

JERSEY / JUDGMENT

EVIC -v- Greater Europe [2012]

JRC 146 (01 August 2012)

[2012] JRC 146

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judgment

the commissioner: 1. This is an application by the plaintiff ("EVIC") to have the defendant ("the Fund") wound up under Article 155 of the Companies (Jersey) Law 1991 (as amended) ("the Companies Law") or for alternative remedies under Articles 141 and 143 (unfair prejudice) of the Companies Law. The key issue in this case is whether a Redemption in Kind proposal put forward by the Fund and approved by a majority of the shareholders at an EGM held on the 26 th July 2011 is in breach of the terms of the Articles of Association of the Fund ("the Articles") and the Prospectus. 2. The Fund is a Jersey incorporated closed end investment fund regulated by the Jersey Financial Services Commission. It is administered by Kleinwort Benson (Channel Islands) Corporate Services Limited and its directors currently comprise Mr Andrew John Pitter, a director of Kleinwort Benson (Channel Islands) Corporate Services Limited, Mr Allan Andersen, a Danish citizen with extensive experience in real estate investment, Miss Natalie Sullivan, an advocate of the Royal Court of Jersey and sole practitioner at Noirmont Consulting and Mr Andrew Wignall, a chartered accountant with extensive experience in investment funds specifically in real estate. 3. The investment manager is Greater Europe Funds Management Limited ("the Manager") and the investment adviser is Wermuth Asset Management GmbH ("WAM") a company incorporated in Germany, the principal person behind which is Mr Jochen Wermuth, a banker and economist with extensive experience in investment in Russia. 4. Apart from a nominal number of ordinary shares held by the Manager, the share capital of the Fund comprises participating shares of which 27% are held by EVIC and 12.28% by or on behalf of Mr Wermuth and staff at WAM. The participating shares are not redeemable at the option of the holders. We will refer to the holders of the participating shares as "the shareholders". 5. EVIC is a special purpose company formed to enable wealthy clients of the Nomura Group in Japan to invest in the Fund through a structure that it is not necessary to detail. EVIC's investment is monitored by Nomura Funds Research and Technologies America Inc which we will refer to as "Nomura". 6. The Fund was launched on 29 th June, 2007, for the purpose of investing primarily in Russia and the former Soviet Union related countries. It is an "Expert Fund" suitable only for those who are "Expert Investors" as defined by the Jersey Financial Services Commission. 7. The Prospectus provides for a life of the Fund of five years (unless extended) which is divided into two periods, the first, defined as the "Investment Period", meaning the first three years and the

second, defined as the "Wind-Down Period", meaning the two years immediately following. The definitions are as follows:- "Investment Period" means the initial 3 year period following the Initial Offer Date during which assets of the Fund will be invested and reinvested at the discretion of the Manager, or such shorter period as (a) the Manager shall determine on not less than 5 Business Days' notice to Shareholders or (b) Shareholders shall determine by way of Ordinary Resolution in the event of Mr Jochen Wermuth ceasing to be the managing partner of the Investment Adviser. "Wind-Down Period" means the 2 year period (or such other period as the Directors may determine subject to the approval of the holders of Participating Shares representing not less than 75% of all Participating shares in issue at such time) immediately following the Investment Period during which investments will be realised and distributions made to the holders of Participating Shares." 8. When setting out the principal features of the Fund, the Prospectus says this in relation to the Wind-Down Period:- "After the Investment Period during which no Participating Share may be redeemed (save where compulsorily redeemed by the Fund as described below), the Manager shall over the Wind-Down Period look to realise the underlying investments of the Fund on the most favourable terms and effect distributions to Shareholders prior to formally winding up the Fund." "No Participating Shares may be redeemed during the Investment Period, save where compulsorily redeemed by the Fund as described below. Following the Investment Period, the Manager expects to redeem Participating Shares in the Fund on a monthly basis as and when investments are realised during the Wind-Down Period." 9. The Prospectus provides that no income or gains or other distributions by way of dividend were to be expected. Under the heading "Redemptions", the Prospectus provides that:- "Participating shares are not redeemable at the option of Shareholders. During the Investment Period, the Manager intends to reinvest all of the fund's income and gains. During the Wind-Down Period the Manager shall endeavour to realise underlying investments at times and upon terms most favourable to the Fund and shall at the discretion of the Manager effect the redemption of Participating Shares at such times as the Manager considers appropriate so as to effect distributions to Shareholders of the proceeds of the realisation of such investments." "The Fund expects to pay redemption proceeds in cash and not in kind. However, redemptions in kind are permitted with the approval by [sic] an Ordinary resolution". 10. The Articles contain the following relevant provisions in relation to redemption of Participating Shares:- "15.04 Amounts payable to a Redeeming Member in connection with the redemption of Participating Shares will be paid in cash unless the Directors determine to pay the proceeds of redemption (or any amount thereof) by way of delivery of assets in specie as described below. 15.05 Upon the redemption of any Participating Shares being effected pursuant to these articles, the Directors shall have the power to divide in specie the whole or any part of the assets of the Company and appropriate such assets in satisfaction or part satisfaction of the proceeds of redemption to one or more redeeming Member either pro rata or non pro rata." 11. In terms of fees, the Prospectus provides that the Manager is entitled to a management fee at the rate of 2% of the aggregate subscription proceeds received by the Fund on the offer date, payable quarterly in advance, but during the Wind-Down Period, the management fee is the lower of the aggregate subscription proceeds and the net asset value, so that as redemptions are made out of realised investments, the management fee is reduced. Of that management fee, the majority is paid to WAM and to Mr

Wermuth, the latter having, we are told, a sponsorship agreement with the Manager and WAM. 12. The Manager does not feature in the history of this matter and it would seem that the role of the Manager under the Prospectus as set out above was in practice undertaken by the Fund. No issue was taken in relation to this.

Background

13. The Court received detailed affidavits from Mr Masashi Kuwashima, Atsushi Ota and Mr Yosuke Aoyama on behalf of EVIC and Mr Pitter on behalf of the Fund and very extensive copy documentation. There was no application for any of the witnesses to be cross-examined. Much time was taken in dealing with the events that led up to the EGM on 14 July, 2011, but for the purposes of this judgment it suffices to set out the key events, taken in the main from the affidavit of Mr Pitter. 14. The Fund was initially successful, but was hit by what was described as the dramatic sell-off in global markets and the Russian market in 2008. Prior to the commencement of the Wind-Down Period (the 30th June, 2010), some 61% of the Fund was invested in illiquid private equity and real estate assets in Russia, which on the advice of WAM needed longer than the two year Wind-Down Period to realise their fair value. A letter to Shareholders of 22nd April, 2010, calculated that those investments would realise \$21,510,477 if they had to be realised during the Wind-Down Period as against a pessimistic \$80,843,810 or an optimistic \$132,210,477 if sold as a going concern beyond the Wind-Down Period with certain follow-on investments. 15. The strategy of the board, on the advice of WAM, was set out in a letter to shareholders of 12th July, 2010, as follows:- "a) We intend to pursue attractive opportunities to realise the assets of the Fund before the end of the Wind-Down Period. However, in the present market environment, though better than a year ago, it seems highly unlikely that we will be able to realise the entire portfolio at a respectable price, especially given that the majority of the portfolio is currently illiquid. As the fund's Prospectus states that "The Manager shall over the Wind-Down Period look to realise the underlying investments of the fund on the most favourable terms", we decided that while looking to wind-down the Fund and aiming to be a net seller in any one month, the Fund should not just be "liquidating" assets; this would be value destructive given the asset illiquidity. In order to try to maximise returns, we have decided that the Fund may reshuffle the listed portfolio during the Wind-Down Period within the same sectors and it may increase listed positions in order to reach critical mass, improve liquidity in any one position or otherwise improve the terms at which a sale might eventually be achieved. We do not intend to make any new private equity or real estate investments. We may undertake necessary and value creating follow-on investments for existing projects. b) As described above, the fund will seek to realise any assets which have reached a fair or respectable value (in our opinion) and use the receipts firstly to build or maintain the liquidity reserve for operations and follow-on investments and secondly to repay Participating Shares." 16. In the opinion of the Board and as advised by WAM the best solution, in particular in relation to the Fund's real estate assets, was to extend the Wind-Down Period, for which the consent of 75% of the shareholders was required. As EVIC was the largest single shareholder with 27%

(sufficient to block such a proposal), WAM approached Nomura to gauge its reaction. Nomura decided to carry out a due diligence exercise, which included a visit to the office of WAM in Moscow, an inspection of some of the real estate investments and an instruction of Jones, Lang Lasalle to advise independently on the valuations the Fund had obtained from Knight Frank. The process was delayed somewhat by the need for a non-disclosure agreement to be negotiated and completed. It is clear that WAM offered Nomura every cooperation in this due diligence exercise. 17. By letter dated 22 nd October, 2010, the Fund wrote to the shareholders, seeking their consent to the Wind-Down Period being extended for up to three years from 30 th June, 2012:- "Globally, many private equity and real estate funds are currently calling for extensions in order to realize assets at fair value and avoid having to sell at current distressed valuations. The problem the Greater Europe Deep Value Fund II faces is that, as stated in the Prospectus, the "wind-down period" began after 30 June, 2010. There is a two-year timeframe in which to realize assets. The Fund's life cannot be extended in a simple way even if this would be beneficial for all Shareholders. Rather, the Fund requires almost unanimous support from Shareholders: 75% of all Shareholders must vote in favour. Without an extension, the Fund will be less likely to recover the fair value on its private equity and real estate investments, given the limited time available. The fund would also be known in the market as a seller with a firm "sell by date" i.e. a distressed seller in a distressed market. A significant extension would be a clear signal to the market that the Fund is not forced to sell. In fact, the Investment Adviser expects not just to achieve better valuations but possibly even earlier exits if the extension is granted." 18. The letter contained the results of the valuations carried out for the Fund by Knight Frank which showed that if the Fund's assets had to be sold within the Wind-Down Period, then even on an optimistic scenario some two-thirds of the "fair value" of those assets would be destroyed. By "fair value" is meant the value if sufficient time for realisation was made available. The letter confirmed that no new investments would be made during this extended period. 19. Nomura's due diligence exercise comprised two aspects, firstly WAM's investment management and operational capabilities and secondly the Fund as an investment. In its operational report issued in November 2010, Nomura concluded that the survival of WAM was called into serious question due to poor performance, as well as a decline in its assets. It gave the Fund a "C" rating, indicating that improvements were required in certain areas of its investment and operational processes. 20. The investment report was issued on 28 th December, 2010, and concluded that the investor risk would be better mitigated by the completion of the liquidation of the Fund during the Wind-Down Period as originally planned, rather than agreeing with the proposed three year extension. This was communicated to the Fund and had immediate implications in terms of the calculation of the net asset value, which, without an extension, would now have to be written down very substantially. 21. Mr Pitter was informed by Nomura that their main concern related to the valuation of the real estate and in particular, an investment called "Yekaterinburg", in respect of which a land swap proposal was under consideration by the directors. The directors were concerned that Nomura had instructed Jones Lang Lasalle in a rather haphazard and brief fashion and that differences in their valuations compared to those

provided by Knight Frank could be explained. Nomura agreed to reconsider the matter, but ultimately, in late March 2001 it maintained its refusal. This resulted in a 40% mark-down in the net asset value of the Fund to \$63M. 22. Whilst exploring the possibility of EVIC's shareholding being bought out through the creation of a secondary market, WAM put forward for consideration by the board and shareholders a set of proposals which were explained to shareholders in one of the regular investor up-date and conference calls held on 7 th April, 2011. The presentation recorded that the extension proposal had been blocked and that "to avoid distribution of RE [real estate] shares to investors in kind another solution must be agreed upon." Three solutions were presented, namely, an extension of the Wind-Down Period subject to the buy-out of the blocking shareholder, a re-structuring giving shareholders an exit at a fixed price and an auction. 23. A letter from the board of 7 th April, 2011, to shareholders stated that the directors did not recommend the sale of the real estate assets below fair value, but since there was insufficient investor support for an extension, they wished to facilitate a secondary market in the shares of the Fund. The proposal was intended to allow those shareholders who wished to exit to offer their shares to other current shareholders and third party investors who wished to bid for those shares. The Fund ought then to have sufficient approval for an extension following which the assets could be marked up to fair value again. Ultimately, nothing came of the secondary market proposal. 24. At a presentation made by WAM to shareholders on 21 st April, 2010, the second option had been refined to provide a choice for shareholders to either take a redemption by way of cash or in kind by way of shares in a new special purpose vehicle into which the real estate assets would have been transferred plus cash. This was described as "wind-down with choice" and it was indicated that 75% approval by the shareholders was required. Nomura sent a "draft" letter, designed, Mr Pitter understood, to encourage dialogue between shareholders, expressing concern at the proposals made at this presentation, which it said were not set out sufficiently clearly or with enough detail and that none of the options were consistent with the process set out in the Prospectus and that each required "investor approval". 25. WAM drafted a letter to the shareholders, which Bedell Cristin (the Fund's lawyers) transformed into a circular. It was pointed out by Bedell Cristin that the second option comprising a Redemption in Kind of the shares in the SPV required an ordinary resolution of the shareholders as per the Prospectus, and not 75% approval, as previously indicated. At a telephone conference on 1 st June, 2011, Bedell Cristin confirmed that the proposals contained in the draft were in accordance with Jersey law, the Fund's documentation and the relevant regulatory rules. In due course the circular was approved by the Jersey Financial Services Commission. 26. The notice of the EGM was issued to the Shareholders on 6 th July, 2011, and it is necessary to set out its proposals in more detail. EGM 27. At this stage, all of the private equity assets of the Fund had been sold, and WAM had advised that it would be possible to sell all of the listed assets of the Fund at market values (\$30.5m) before the end of the Wind-Down Period, namely 30 th June, 2012, (defined in the notice as "the Deadline"). They have, in fact, now all been sold. That left the Fund with cash of \$30.4m and its three real estate assets the market for which remained weak, and the directors stated their concern that the shareholders would lose substantial value if they had

to be sold at or before the Deadline. The one year realisation value was \$11.4m against a fair value estimated by WAM at some \$64m. 28. The three real estate assets are each held through Cyprus incorporated SPVs. Two involve partnerships with Russian entities and one constitutes a minority holding with other private individuals. Each form real estate development projects which are at an early stage and in none of the cases does the Fund own the whole project. We were told that some \$40m was required to bring these projects to ultimate fruition but that with more limited follow-on investments they should become self-financing. 29. The notice said this in relation to the real estate assets:- "Real Estate Assets The Investment Adviser has put effort into facilitating sales of real estate assets with considerably low interest from the market. In the view of the Investment Adviser, the majority of these projects can probably only be sold at severely distressed prices if they must be sold within the Deadline. Real estate of the kind owned by the Fund is illiquid. Its market largely depends on the economy's overall health and the recovery of bank lending in Russia. At the time of investment, the real estate market was booming; in each case, exit strategies were identifiable. However, due to the global economic crisis in 2008-2009, these assets lost a lot of value: financing disappeared and demand decreased sharply. In many cases, it is impossible to provide valuations of land plots based on comparable transactions, as there has been almost no market evidence of such transactions and therefore, benchmarks are virtually non-existent. Demand remains weak, though residential construction in Moscow and the Moscow region has begun to show some signs of recovery. The Investment Adviser believes the growth trend will continue, though from a low base; fundamental statistics such as the growing economy provide solid support." 30. The first option remained an extension of the Wind-Down Period, which the directors recommended the Shareholders support. It was not necessary for approval to be put to a General Meeting and instead Shareholders were asked to indicate their approval or otherwise by signing and returning an enclosed consent. The extension of the Wind-Down Period was put forward on the following conditions:- "1. All the listed assets are sold before the Deadline with the proceeds returned to Shareholders through the redemption of Participating Shares. These redemptions are expected to make up some 70% of the total assets of the Fund (as at 31 May, 2011). 2. The only assets of the fund remaining at the Deadline are real estate assets plus a reserve of no more than \$10m for follow-on investments ("FOIs") and operational expenses. 3. Any money realized over and above the FOIs and operational expenses reserve amount shall be returned to Shareholders whenever received through the redemption of Participating Shares. 4. Effective from the Deadline the management fee of the fund will be \$750,000 per annum plus a standard brokerage fee of 5% of the cash returned to Shareholders from the sale of all non-listed assets. The purpose of the brokerage fee is to provide an incentive to sell quickly and at as high a price as possible." 31. The second option was now headed "Redemptions in Kind" and as it is succinctly set out in the notice, it is best to quote it in full:- "Redemptions in Kind In the event that there is insufficient investor support for the Extension, Shareholder approval is also sought to a "Redemptions in Kind" proposal. Under this proposal there will be no extension to the wind-Down Period. Instead, a new SPV ("Phoenix SPV") will be established as a wholly-owned subsidiary of the Fund to hold the unsold real estate assets

plus a reserve of \$10m for follow on investments ("FOIs") and operational costs. During the Wind-Down Period, whenever the Fund proposes a redemption of shares for cash, it will also propose a redemption of shares to be settled in kind by way of a transfer of a number of shares in the SPV. Upon each such redemption, which will occur from time to time during the Wind-Down Period, Shareholders will be invited to submit to the Fund their preferred allocation of cash or shares on the SPV for settlement of their Shares. Subject to availability, the fund will re-allocate cash or shares in the SPV between Shareholders according to (or as close as possible to) their preferred allocation. Under the terms of the Articles and the Prospectus, the Fund is permitted to satisfy redemptions in kind i.e. by way of delivery of assets in satisfaction or part satisfaction of the proceeds of redemption) subject to the approval of an Ordinary Resolution. An Ordinary Resolution may be passed by a simple majority of Shareholders present in person or by a proxy and voting at a general meeting. For this purpose, the Board has convened the Extraordinary General Meeting. For the purposes of redemptions, shares in Phoenix SPV will be valued on the basis of:- 1. 1-year realization values as estimated by an independent appraiser (valuation reports as of 30 June 2011 are to be issued at 1 July 2011) for real estate assets, and 2. the FOI and operational costs reserve will be valued at par. The 1-year realization value of the real estate assets is estimated to be \$11.3m, and one year is needed to realize these assets; the current value of these assets is about \$7.9m (applying a discount of 30% over 1 year). The FOI and operational costs reserve is estimated at \$10m. It is therefore estimated that the total asset value of Phoenix SPV will be \$17.9m. The Board considers the Redemptions in Kind proposal to be advantageous for the reason that it will allow all shares to be redeemed and the Fund to be wound up. The Fund is currently incurring high running costs, approximately US\$950,000 per annum, which are ultimately borne by Shareholders. Phoenix SPV's running costs would be much lower, approximately US\$300,000 per annum. The shares in Phoenix SPV will have the rights and be subject to the terms and conditions set out in Phoenix SPV's memorandum and articles of association (the "SPV M&A"), which will be substantially the same as those attaching to Participating Shares with the major difference being lower fees and an extended life of Phoenix SPV versus the Deadline, subject to the requirements of Jersey law. A copy of the proposed SPV M&A is available for inspection at the registered office of the Company. The Board of directors of Phoenix SPV would be composed of the members of the current board of the Company. Phoenix SPV would provide annual accounts and valuations and make distributions wherever assets are realized, with quarterly valuation estimates and updates provided by the Investment Adviser if and when required. The Investment Adviser would be appointed directly by Phoenix SPV to act as its investment adviser. To best align incentives of the members of Phoenix SPV and the Investment Adviser, the Board proposes, and the Investment Adviser has agreed to, the following fee structure. Phoenix SPV will enjoy reduced operating costs and the Investment Adviser will be incentivised to exit as quickly as possible and at as high a valuation as possible. • fixed management fee of \$750,000 shall be paid; • no performance fees shall be paid prior to investors receiving returns in excess of their original high water mark (that is, the high water mark is not reset); but • a 5% exit fee is paid to the Investment Adviser on the basis of

cash returned to investors, if and when returned, excluding that part of the cash reserve which is not used for follow-on investments or fees. The fee structure shall be applied as of 31 July, 2011, if set up. Phoenix SPV will have a limited life of four years subject to two one-year extensions as (sic) the discretion of the directors. No new investments will be allowed, only follow-on investments to protect, increase and monetize the value of existing assets. The sale of assets at fair value, or close to it, will be the priority for Phoenix SPV and will be achieved as early as possible. The Company is authorised as a collective investment fund in Jersey under the Collective Investment Funds (Jersey) Law 1988 . There is no expectation that Phoenix SPV will be licensed or regulated in Jersey as an investment fund or otherwise. Shareholders should note that structuring investments through an unregulated limited company in Jersey may afford less investor protection than investing through a Jersey investment fund regulated by the JFSC (as is the current position with the Company). The investor rights and obligations shall be subject to the SPV M&A." 32. A number of observations can be made at this stage in relation to the Redemption in Kind proposal:- (i) Phoenix SPV would be little different to the Fund than if the Wind-Down Period had been extended on the conditions put forward by the Fund, namely it would have broadly the same constitution, the same real estate assets, the same cash of \$10m, the same management and investment adviser and the same fee structure. (ii) \$10m would be taken from the assets of the Fund that had been realised during the Wind-Down Period and placed in Phoenix SPV. We were not told exactly how that would be achieved. (iii) Those shareholders who elected for cash only would receive their pro rata share of the cash held by the Fund outside Phoenix SPV and additional cash to compensate for their interest in the cash in Phoenix SPV and the real estate assets but the real estate assets were discounted by 30%. (iv) Depending on how shareholders exercised their options, shareholders who elected for cash only could be forced to accept shares in Phoenix SPV. We were told that the tipping point was two thirds; if more than two thirds elected for cash only then they would be required to accept shares in Phoenix SPV and thus be locked in as investors for up to a further six years. 33. The third option was an auction. We will not set this proposal out in detail, though the process was subject to some criticism on the part of Nomura. It was not recommended by the investment adviser, which described it as a complex process, which on a best case scenario might realise some \$7.9m, (the discounted value of the real estate assets) against a fair value, after follow-on investments of some \$10m, estimated at \$64m. 34. On 15 th July, 2011, EVIC sent a letter to the board expressing a number of concerns in relation to each of the options set out in the notice, and asking for the EGM to be delayed so that it could obtain legal advice and so that the board could respond to those concerns. One of those concerns was that the creation of the Phoenix SPV appeared to be a mechanism for circumventing the closed end nature of the Fund. They asked for the letter to be copied to the other shareholders immediately in order to maintain transparency and to give them the opportunity to consider the issues raised. Although it hoped for a constructive outcome through sensible discussion, EVIC expressly reserved its legal rights and in particular, its rights under Article 141 and 143 of the Companies Law, together with the right to seek immediate interim relief. 35. At a meeting held with Bedell Cristin on 19 th July, 2010, the board was advised to reject the

invitation to circulate the letter to the other shareholders on the grounds that the board was under no legal obligation to do so and it would be counter-productive without being accompanied by a full response and this on the basis that EVIC was entitled to attend at and address the EGM. The board did however respond in full to EVIC's letter, stating in conclusion that it was confident and entirely satisfied that the proposals as presented in the circular presented the best options available in order to achieve an orderly exit for investors having regard to the prevailing market conditions. The invitation to circulate the letter to the shareholders was declined, but EVIC was reminded of its right to attend at and address the EGM. 36. EVIC did attend the EGM but as the other shareholders had all voted through proxies in favour of the chairman and none were present, it was a sterile exercise. Nonetheless, Mr Steven Zoric of Nomura addressed the meeting reiterating EVIC's concerns. 37. Prior to the EGM 62.73% of the Shareholders indicated their consent to the extension of the Wind-Down Period, which being short of the 75% required was not approved. At the EGM shareholders representing 62.74% of the participating Shareholders voted in favour of the Redemption in Kind proposal and 32.87% against; 4.39% abstained. The Redemption in Kind requiring only an ordinary resolution under the terms of the Prospectus, the proposal was therefore approved. 38. The Fund wrote to the shareholders on 2 nd August, 2011, informing them of the results of the EGM and inviting them to complete their "election of redemption proceeds" form. The Fund, at that stage, had some \$20m in cash available for an immediate distribution and would have approximately \$17.9m in shares in the Phoenix SPV (comprising the real estate and the \$10m cash) once that had been established. Given that dissenting views had been expressed by EVIC at the EGM, shareholders were given a month in order to make their choice and to review the comments made by EVIC which had at that stage been circulated. The proceedings 39. Proceedings were issued by EVIC on 5 th September, 2011, when an interim injunction was obtained preventing the Fund from putting the Redemption in Kind proposal into effect. The pleadings were exchanged and the action set down to be heard on 19 th March, 2012. That date had to be vacated as a consequence of the Fund failing to comply with its discovery obligations and the hearing was therefore delayed until the four days commencing 18 th June, 2012. With the benefit of hindsight we think this matter should have been dealt with as a " cause de brièveté". Key issue 40. There was no issue between the parties on the following:- (i) The contract between the Fund and its shareholders is contained in the articles of association and in the Fund's offering document, namely the Prospectus (see In re FIA Leveraged Fund (Grand Court of the Cayman Islands) unreported 18/4/12 Smellie CJ at paragraph 115). (ii) Where words in an offering document are intended to have contractual effect they will be contractually binding on the company, and while a company cannot contract out of its right to amend its articles by special resolution (see Allen-v-Gold Reefs of West Africa

[1900] 1 Ch 656) the company has no power by a subsequent amendment of its articles to justify or excuse what would otherwise be a breach of contract (see British Equitable Assurance-v-Baily

- [1904] 1 Ch 374 (CA) and
- [1906] AC 35 (HL) and *Jacobs-v Batavia Trust*
- [1924] 2 Ch 329). (iii) A company cannot by mis-describing its articles in its offering document either enlarge its powers against its members or cut down their rights (see *Culross Global SPC Limited-v-Strategic Turnaround Master Partnership Limited*
- [2010] UKPC 33 at paragraph 32). 41. Because the fundamental nature of the investment was that it was a closed end fund and the provisions to this effect were contained in the Prospectus, the parties must in our view have intended the provisions of the Prospectus to have contractual effect, and Mr Taylor did not seek to argue to the contrary. If the Prospectus was not binding then it was not a closed end fund at all. 42. The key issue in the case, therefore, is whether the Redemption in Kind proposal is in breach of the Articles and the Prospectus on their true construction. Plaintiff's submissions in summary 43. Mr Sanders submitted that on a proper construction of the Articles and the Prospectus:- (i) the Fund was contractually bound not to make investments during the Wind-Down Period; if money was received from investments the Fund was obliged to retain it for distribution and not to reinvest it; (ii) there was an absolute duty to endeavour to sell, that is actively to market, the Fund's underlying investments during the Wind-Down period, such duty being unaffected by any purported decision to make redemptions in specie or in kind; (iii) a redemption in specie or in kind would be lawful, that is to say not a breach of contract, only if an attempt had been made to sell the relevant underlying investments, and that attempt had failed; (iv) in order to be a valid redemption in specie or in kind the assets to be distributed must be existing assets of the Fund and not assets artificially created for the purposes of the redemption; (v) the following were express or implied terms of the contract between the Fund and the shareholders:- (a) that the Fund would not take any step with the object or effect of prolonging the winding down of the Fund's affairs beyond the expiry of the Wind-Down Period unless with the approval of holders of the participating shares representing not less than 75% of all participating shares then in issue; (b) that the Fund by its Manager would seek to realise its underlying assets within the Wind-Down Period; (c) that the Fund would not make new investments during the Wind-Down Period; and (d) that the Fund would not take any step which would make the realisation of any one or more of its underlying assets within the Wind-Down period impossible or substantially more difficult. 44. So far as the implication of terms is concerned, the parties agreed that the leading authority in Jersey is *Grove-v-Baker*
- [2005] JLR 348 . At page 355, paragraph 16 et seq *Bailhache, Bailiff*, referred to the earlier Jersey Court of Appeal decision in *Sibley (née Pavey)-v-Berry (née du Feu)* 1992 JLR N-4, which itself had cited and applied the English House of Lords case of *Liverpool C. C-v-Irwin*
- (1977) AC 239 . He noted that in *Sibley* it had been held by *Le Quesne JA* that:- "In other cases, where there is an apparently complete bargain, the courts are willing to add a term on the ground that without it the contract will not work - this is the case, if not of *The Moorcock*

(1889) 14 PD 64 itself on the facts, at least of the doctrine of *The Moorcock* as usually applied ... it remains to consider whether the case can be brought within the second of Lord Wilberforce's categories [set out in *The Moorcock*], that is, the category of cases in which something must be implied because without it the contract 'will not work'. Lord Wilberforce himself remarked further about this category of case on page 254: 'In my opinion such obligation should be read into the contract as the nature of the contract itself implicitly requires, no more, no less: a test, in other words of necessity'. He went on, on page 255, to refer to the judgment of Bowen LJ in the earlier case of *Miller-v-Hancock*. In that judgment, referring to the term which, in that case, it was sought to imply, which in fact he held should be implied, Bowen LJ said that the term to be implied was something without which the whole transaction would be futile, something the absence of which would render the whole transaction inefficacious and absurd". 45. *Bailhache, Bailiff*, in *Grove-v-Baker* concluded by saying that:- "This then is the hurdle to be overcome by a contracting party who seeks to persuade the court that a term should be implied into a contract. It must be shown either that the term is customarily included in contracts of the kind in question, or that it is necessary to imply the term in order to ensure that the contract is not futile, inefficacious or absurd." The Fund's submissions in summary 46. Mr Taylor submitted that the Redemption in Kind proposal was developed along with the auction proposal as an alternative to the extension option, which EVIC had opposed. It provides for more efficient and effective means of achieving the more orderly realisation of the investments. It would enable those who wished to exit to exit and those who do not wish to be forced to accept oppressed realisation values to retain their interest in specie. 47. Phoenix SPV was, he said, an asset of the Fund, a collection of the real estate investments bundled together in order to preserve value as much as possible for the purposes of redemption in specie. A very small minority holding in a separate holding company would be more vulnerable and less valuable than a restructured shareholding in a Jersey holding company. The proposal was permitted and contemplated by the Articles and the Prospectus on their proper construction. It consists of a Redemption in Kind of shares in a holding company held within the structure of the Fund. It would be possible for the Fund to simply redeem shares in a holding company (holding the investment) in specie. The holding company would (subject to the duties of its directors) be capable of appointing advisers as it saw fit at levels of fee as it regarded as appropriate without any fixed life span and without regulation. Under the proposal, the Fund had sought to provide more protection and certainty with respect to the future conduct of the company in which the shares redeemed in specie are held, its corporate governance, management and the quality of advice given to it. 48. Mr Taylor argued that the proposal was not an artificial way of extending the life of the Fund. The Fund ends. Shares in Phoenix SPV are distributed in specie. Such a distribution is contemplated by and provided for in the Articles and in the Prospectus and it is not abusive. It preserves the homogeneity of the illiquid real estate investments while ensuring continued good corporate governance, with a view to the earlier realisation of the assets at as close to fair value as reasonably possible. It is not the same as an extension of the Fund, as for one thing it provides for a potential

exit. The \$10m reserve fund is for follow-on investments and costs only (no new investments are to be made). The follow-on investments would be to protect increase and monetise the value of the existing investments. The project required urgent financing even in 2011 and the reserved fund offered a limited fund for that purpose and was a compromise figure following discussions with shareholders. It was considered to be the minimum required. Discussion and decision on key issue 49. This is a closed end investment fund and those who invested in it had no right to redeem their shares. The provisions of the Prospectus setting out how and when shares would be redeemed by the Fund therefore take on particular importance. Under the terms of the Prospectus the Fund has a life of five years divided into the three year Investment Period and the two year Wind-Down Period. It is during the Investment Period that the assets of the Fund will be "invested and reinvested" at the discretion of the Manager. During the Wind-Down Period "investments will be realised and distributions made" to the Shareholders. To "invest" as a matter of ordinary English means to put money into something offering potential profitable returns. To "realise" as a matter of ordinary English means to sell and convert into money. 50. There is no reference anywhere in the Prospectus to investment or reinvestment during the Wind-Down Period and Mr Sanders pointed out if there had been it would make the two periods pointless. 51. The Prospectus goes on to provide that over the Wind-Down Period the Manager "shall look to realise the underlying investments of the Fund on the most favourable terms and effect distributions to Shareholders prior to formally winding up the Fund". Furthermore, it states that during the Wind-Down Period the Manager expects to redeem shares "on a monthly basis as and when investments are realised". Redemptions were expected to be "in cash and not in kind". The total amount of redemption proceeds "depends upon the amount of investments realised up to and/or on the applicable redemption date". 52. Mr Sanders referred us to the House of Lords' decision of *Chartbrook-v-Persimmon Homes*

[2009] 1 AC 1101, where at paragraph 17, Lord Hoffmann stated that the label given to a defined term is an aid to the construction of the definition because parties generally choose terms which are a distillation of the meaning which they intend to set out in more detail in the definition. We accept this authority as being persuasive in this jurisdiction and that the defined expressions "Investment Period" and "Wind-Down Period" themselves indicate that the time when the Fund can make investments and thus place shareholders' funds at risk is during the Investment Period. 53. We conclude, therefore, that the Wind-Down Period was established in order to be a time when risk would be reduced by realisation and distribution and that the Fund was contractually bound not to make new investments during the Wind-Down Period. Monies received from the realisation of investments during the Wind-Down Period were, subject to the requirements of the Fund, to be made available for distribution pro rata to the shareholders. 54. This position is accepted by the Fund, in that in its various communications with the shareholders it has always maintained that during the Wind-Down Period or any extension of it no new investments would be made, but Mr Taylor argues that what the directors describe as follow-on

investments are permitted and that in any event, the Redemption in Kind proposal does not constitute a new investment. 55. Follow-on investments are described in paragraph 25 of Mr Pitter's third affidavit as follows:- "25. The first topic is one that I have already referred to, namely follow-on investments. These are basically further sums of money invested into a pre-existing investment in order to protect and/or enhance its value. Generally in the context of the current fund this has meant an additional loan of monies to a company which is involved in private equity or real estate project in which the Fund has invested. Examples of follow-on investment for "protecting the asset value" may be protection from direct threats to the assets (hostile takeover), investments related to resolving conflict situations with project partners (when escalation of such conflicts may harm future profits or extend realisation time), or managing reputational, legal and other issues that may potentially affect marketability of the project. Examples of follow-on investment for "enhancing the asset value" in the case of follow-on investments are all related to performing the actions required for moving the assets towards the point when they can be successfully sold/exited. For example, it became impossible to sell the early stage real estate development project located outside of Moscow at nearly any price after the 2008 crisis (due to all demand shifting towards less risky assets), so the only reasonable exit strategy seen for those projects after the crisis was to invest some additional funds in further development in order to achieve a stage when those could be exited. Further, a project may not have any available cash, but may simply have need of cash in order to pay audit fees or legal fees." 56. Mr Sanders accepted that during the Wind-Down Period running costs of existing investments and the cost of marketing existing investments would clearly be permitted but that the other transactions described by Mr Pitter were properly to be regarded as investments and were therefore prohibited. In our view the terms of the Prospectus do not advocate such an inflexible approach to existing investments during the Wind-Down Period which would be contrary to the interests of the shareholders. 57. The directors are required to act in the interests of the Fund (Article 74(1) of the Companies Law) i.e. in the interests of the general body of shareholders and as Bedell Cristin advised on the 16 th December, 2009, (albeit in relation to the re-shuffling of listed shares), the directors do have flexibility during the Wind-Down Period to act in the interests of shareholders in order to preserve, protect and enhance (for the purposes of realisation) the value of existing investments. However as Bedell Cristin point out this must be done with a view to realising those investments on the best available terms within the allotted timescale, in other words during the Wind-Down Period. 58. The circumstances in which the directors may need to act during the Wind-Down Period in relation to existing investments for these purposes will vary enormously and we do not think it is helpful for us to comment any further. We are certainly not in a position to comment on individual follow-on investments that have been made by the Fund, the detailed facts of which are not before us. We think the Court should be slow however to criticise the directors for seeking to protect, preserve and enhance existing investments with a view to realising those investments during the Wind-Down Period honestly and in good faith for the benefit of the shareholders. 59. We accept Mr Sander's assertion that

there is an unqualified duty upon the Manager (in effect the Fund) to endeavour to realise underlying investments during the Wind-Down Period - "The Manager shall endeavour to realise underlying investments" (our emphasis). "Shall" is the language of obligation. That must mean taking active steps such as marketing or offering the underlying investments for sale. There is flexibility as to when the sale will take place during the Wind-Down Period and the Wind-Down Period itself can be extended with the approval of 75% of the Shareholders. Without that consent, then as the Prospectus clearly states at the end of the Wind-Down Period the Fund will be formally wound up. 60. The emphasis on the returning of cash to Shareholders means that the Fund must try to realise underlying investments during the Wind-Down Period so as to return cash to the Shareholders. The expectation would be that only if assets cannot be realised into cash that a Redemption in Kind would arise. 61. Mr Sanders submitted that there had been no attempt by the Fund to realise the real estate investments, rather a decision to postpone that realisation to a date beyond the Wind-Down Period when a better return might be expected. We do not think the evidence supports the first part of this contention. In our view the Fund had taken active steps to realise the real estate assets, including having them valued and through WAM testing the market at a real estate trade fair (see the Notice for the EGM under the "Auction" section), but the directors had reached the perfectly reasonable conclusion that it was in the best interests of the shareholders to avoid the distressed prices that a sale during the Wind-Down Period would have generated, as opposed to the apparently greatly enhanced prices that might be achieved with an extension. It was necessary however for 75% of the shareholders to agree to an extension. 62. Having failed to obtain the consent of 75% of the Shareholders to an extension of the Wind-Down Period for this purpose, Mr Sanders argued that the Fund should have accepted the decision and set about realising the real estate assets but instead it set about achieving the same end as an extension by means of an artificially created asset. 63. The potential for abuse by funds through the use of artificially created assets is illustrated by the case of *Re Stewardship Credit Arbitrage Fund Limited*

[2008] 73 WIR 136, where the company, an open-ended fund, created non-transferable or negotiable participation notes in loans that had been pooled into a trust and purported to redeem the notes in kind. Bail J was highly doubtful that these notes could be described as assets of the company, describing them as nothing more than derivative instruments created by the company whose value could not possibly equate to the redemption price. 64. In this case, the Fund has underlying investments in real estate in Russia, as well as direct investments in Cyprus SPVs, both of which would be included in the phrase "assets of the company" within the meaning of Article 15.05 of the Articles. The Fund has however created a new asset holding structure during the Wind-Down Period, effectively a further fund whose constitution is very similar to that of the Fund, but even if that were permissible for the purpose, as Mr Taylor put it, of bundling together the real estate assets, investing \$10m in it must in our view constitute a new investment. It cannot be a follow-on investment as it is not being made with a view to realisation during the Wind-

Down Period. It is putting money realised during the Wind-Down Period and which should be held for the purpose of making redemptions in cash to the shareholders pro rata , into a new fund with a view to a profitable return many years beyond the Wind-Down Period. It is a new investment which is not permissible under the Prospectus. 65. To test the argument that the creation of Phoenix SPV and the distribution of its shares would amount to a valid redemption in kind it is necessary, Mr Sanders argued, that the fact that the fund chose to propose a procedure whereby some investors could elect to receive cash must be disregarded. The following points, he said, arose:- (i) If there is a right to make redemptions in kind by means of Phoenix SPV, then the Fund would be entitled to make redemptions in that manner with no cash alternative. (ii) It would follow, if the Fund's argument is correct, that the entire assets of the Fund could have been transferred to Phoenix SPV with an extended life, and then with the approval of an ordinary resolution, the Fund could have been redeemed in kind by distributing the shares of the SPV. (iii) In effect, the whole of the Fund could be rolled over into a new fund with an extended life with the approval of an ordinary resolution, when the extension of the life of the existing Fund would require the approval of 75% of the participating Shareholders. (iv) Such a construction of the Articles and Prospectus makes no commercial sense. 66. We find these arguments persuasive. 67. Under the first proposal put to the Shareholders in the notice for the EGM, the Wind-Down Period was to be extended for the sole purpose of allowing a recovery of "fair value " of the real estate assets. The only assets in the Fund would be the real estate assets and \$10m. That proposal was not approved by the requisite majority of the shareholders. The Redemption in Kind proposal seeks to achieve precisely the same end. We agree that it must of necessity be an implied term of the Prospectus that the Fund would not take any step with the object or effect of prolonging the Wind-Down Period, save with the approval of 75% of the Shareholders. As Mr Sanders said what is the point of that provision if the Fund is free to achieve the same end by different means. 68. We also agree that it is an implied term of the Prospectus that the Fund would not take any steps which would make the realisation of one or more of its underlying assets within the Wind-Down Period impossible or substantially more difficult. The Manager is obliged to endeavour to realise the underlying investments during the Wind-Down Period. Therefore, there must of necessity be an implied term that the Fund will not take action which prevents this or makes it substantially more difficult. The transfer of the real estate assets in to Phoenix SPV has both as its object and effect the deferment of any realisation of the underlying assets. 69. However as Mr Taylor pointed out there is a difference between the proposal to extend the Wind-Down Period and the Redemption in Kind proposal and that is that the latter offers shareholders such as EVIC the potential of an exit. Those shareholders who wish to exit could potentially do so by electing to receive cash only. This works if less than two-thirds of the shareholders elect to receive cash only. At the moment, 54% have indicated that they wish to receive cash only, but as is made clear in the form of election of redemption proceeds sent to the shareholders, that can be changed by notice given three days before the redemption date which is yet to be announced. Thus, the proposal has built into it the possibility that shareholders who did

not agree to an extension of the Wind-Down Period may be forced to receive shares in Phoenix SPV which will lock them in as investors in another very similar fund for up to six years. That outcome, or the possibility of it, is not in our view permissible under the Prospectus. 70. It needs to be remembered that the Fund is not proposing to distribute real estate assets in kind which it has been unable to realise. The evidence is clear that the Fund's decision on the advice of WAM was to postpone such a sale beyond the Wind-Down Period in order to avoid the distressed prices that according to the valuations would be achieved on a realisation. Postponing a sale beyond the Wind-Down Period can only be done by an extension which requires the consent of 75% of the Shareholders. Having failed to achieve that consent, we agree that the Fund must now endeavour to realise the real estate assets, presumably through an auction (or some other means of realisation), and ultimately and only if necessary redeem in kind those real estate assets that cannot be realised. 71. Thus for all these reasons we conclude that the Redemption in Kind proposal is in breach of the terms of the Articles and the Prospectus. The fact that 62% of the shareholders have approved the Redemption in Kind proposal cannot cure the breach (see paragraph 40(ii) above). Just and equitable winding up 72. The Plaintiff seeks an order for the just and equitable winding up of the Fund under Article 155 of the Companies Law. It put its case principally on the basis of loss of substratum. Loss of substratum is recognised in Jersey law as a ground for the granting of a winding up order under the just and equitable ground (see *Leveraged Income Fund Limited*

[2002] JRC 209). 73. The traditional basis for a loss of substratum winding up is that where it is impossible for a company to carry on the business for which it was established, then it will be wound up, even if the directors or a majority of the shareholders wish the company to continue in business. For these purposes the identification of the business for which the company was established will include not only the sector of commerce but also particular features of the manner in which the business was to be carried on. For example:- (i) In *Re German Date Coffee Company*

[1882] 20 Ch D 169 at 186-8 the company was established to exploit a German patent for making synthetic coffee. The German patent could not be obtained, but the company proposed to continue manufacturing in Germany under a Swedish patent. The company was wound up on the grounds that it was impossible for it to carry out its intended business, that is to say exploiting a German patent. It still intended to manufacture date coffee, but the nature of the patent to be exploited was crucial; (ii) In *Re Haven Gold Mining Company* [1881] 20 Ch D 151 at 163-5 and 167-8 the intended business was the operation of a gold mine in New Zealand, but the company had not acquired title to it. A large majority of the shareholders voted to continue, but the company was wound up. Since there was no title, the majority could not compel the minority to continue on the basis of hope; (iii) In *Re Amalgamated Syndicate*

- [1897] 2 Ch 600 a company was formed for the purpose of selling seats to watch Queen Victoria's Diamond Jubilee. After the Jubilee was over the directors proposed to enter upon other business. Of those appearing on the Petition, a majority opposed a winding up, but a winding up order was made. The Jubilee was over, and all that remained was to distribute the assets. 74. It should be noted that the above cases were cases of public companies, i.e. no question of quasi-partnership arose. In *Amalgamated Syndicate* the business was in part time-limited, as it is here. In the case before us there is no prospect of an extension to the time limit, since EVIC, which brings the claim for a winding up, has sufficient shares to prevent an extension. 75. Mr Sanders submits that the reason why loss of substratum became a ground for winding-up under the just and equitable ground was that it was unfair for members who had invested for a specific commercial purpose to find their money used for wholly different purposes, even though the memorandum and articles of association might be widely drawn. In *O'Neill-v-Phillips*
- [1999] 1 WLR 1092 AT 1101H-1102B Lord Hoffmann said:- "I do not suggest that exercising rights in breach of some promise or undertaking is the only form of conduct which will be regarded as unfair for the purposes of section 459. For example, there may be some event which puts an end to the basis upon which the parties entered into association with each other, making it unfair that one shareholder should insist upon the continuance of the association. The analogy of contractual frustration suggests itself. The unfairness may arise not from what the parties have positively agreed but from a majority using its legal powers to maintain the association in circumstances to which the minority can reasonably say it did not agree: *non haec in foedera veni*. It is well recognised that in such a case there would be power to wind up the company on the just and equitable ground (see *Virdi-v-Abbey Leisure Ltd*
- [1990] BCLC 342) and it seems to me that, in the absence of a winding up, it could equally be said to come within section 459. But this form of unfairness is also based upon established equitable principles and it does not arise in this case." (emphasis added). 76. The fact is, said Mr Sanders, that it is not possible for the Fund to carry on the business for which it was established, that of a five year fund. There is not sufficient approval for an extension. Therefore the Fund should be wound up. 77. A line of authorities in the Cayman Islands has reformulated the loss of substratum as follows:- "...it can be said that it is just and equitable to make a winding up order in respect of an open ended corporate mutual fund if the circumstances are such that it is impractical, if not actually impossible, for the company to carry on its business in accordance with the reasonable expectation of its participating shareholders, based upon representations contained in its offering document. If such a company, organized as an open ended mutual fund, has ceased to be viable for whatever reason, the Court will draw the inference that it is just and equitable for a winding up order to be made". See *Re Belmont Asset Based Lending Ltd* (FSD 15/2009, unreported, 21 January 2010, Andrew Jones J, QC) at paragraph 13. 78. Other decisions in this line of authorities include *In re Freerider Limited* (FSD 48/2009, unreported, 13 May 2010, Foster J) at paragraphs 58 and 59, and *Re Wyser-Pratte Eurovalue Fund Ltd* (FSD

167/2010, unreported, 26 October 2010, Andrew Jones J, QC) at paragraphs 18 to 26. 79. The Courts of the British Virgin Islands have taken a different view: see *Citco Global Custody NV-v-Y2K Finance Inc BVIHCV 2009/0020A* (25 November 2009) and *Aris Multi-Strategy Lending Fund Ltd-v-Quantek Opportunity Fund Ltd BVIHCOM 2010/0129* (15 December 2010) where Bannister J concluded at paragraph 28 that the underlying principle which is to be extracted from English authority is that a minority seeking a winding-up on the grounds that the business life of the company has come to an end will only be permitted to overcome the will of the majority if they can show that further conduct of the company's business is impossible. In his judgment, the only purpose for which liquidators are appointed by the Court is in order for them to manage the final moments of companies which the Court has decided, according to established principles, ought to be put out of existence. 80. It is not necessary for us to decide which line of authority we should prefer as a matter of Jersey law because it is clear that whatever the position when these proceedings were issued, the substratum of the Fund has now been lost save to the extent that its formal winding up forms part of the Fund's business. Due to the passage of time the Wind-Down Period expired on 29 th June, 2012, and under the terms of the Prospectus, the Fund must now be wound up formally. Under the Companies Law, the formal winding-up of the company can be undertaken by the directors of the Fund, or, following a special resolution, by a liquidator appointed by the shareholders or, under Article 155, a liquidator appointed by the Court. The Prospectus anticipated that the Manager (in practice in this case the directors of the Fund) would formally wind up the Fund. 81. EVIC seeks the appointment of a liquidator by the Court because it says the Fund has reinvested during the Wind-Down Period, has failed to endeavour to realise the real estate assets and has put forward the Redemption in Kind proposal, all of which are in breach of the Prospectus. 82. For the reasons set out above, we make no findings that any follow-on investments have been made in breach of the terms of the Prospectus. Furthermore we have found that active steps were taken to realise the real estate assets but that a perfectly reasonable decision was taken to seek the consent of the shareholders to an extension of the Wind-Down Period. Indeed on the basis of the advice the directors had received from WAM they were duty bound to seek such an extension. 83. The EGM was held just over a year into the Wind-Down Period and there was still time for the Fund either to be extended or the real estate assets sold for their one year realisation value. Proceedings were then issued and the directors were advised, we think quite properly, to await the outcome of the proceedings. After all the directors had been advised that the redemption in Kind proposal was lawful and could reasonably have anticipated that it would be upheld. 84. The Court has now found that contrary to the advice given to the Fund, the Redemption in Kind Proposal was not lawful, but it does not follow from that finding that the directors are not still best placed to proceed with the formal winding-up of the Fund. In *Re Heriot African Trade Finance Fund Limited* (FSD Nos 87 and 219 of 2010, unreported, 4 th January 2011) Andrew Jones J QC sitting in the Grand Court of the Cayman Islands said this:- "Counsel referred me to *Re Perfectair Holdings Ltd*

[1990] BCLC 423 in which Scott J. (as he then was) said (at page 437) 'The directors were not put into office and cannot claim to be maintained in office for the purpose of liquidating the company. That is not the function of managers. That is the function of a liquidator'. This must be right as a general statement of principle. However, I do recognize that there may be circumstances in which it can be said that a liquidation is being carried out in the ordinary course of a company's business, as contemplated by its articles of association and offering documents. A fund may be set up for the very purpose of liquidating distressed assets. A fund may be set up as a limited duration company, in which case its articles of association will set out when, how and by whom the company is to be liquidated at the end of its pre-determined life. In these circumstances, it may be said that the liquidation is itself part of the company's business, in which case it would not be appropriate for the Court to interfere in the process by making a compulsory winding up order, at least in the absence of serious breach of duty or serious mismanagement on the part of those responsible for the company's liquidation." 85. In our view the Prospectus does set out by whom the Fund is to be formally wound up namely by the directors. We have to accept that putting forward a proposal in breach of the terms of the Prospectus is serious but we are not currently persuaded that on the facts of this case there is a loss of confidence in the directors of the Fund which justifies their removal from the task which under the terms of the Prospectus they would be expected to perform. The Redemption in Kind proposal came from WAM which as investment advisor and as a substantial shareholder (whose interests it would say coincided with the interests of the other shareholders) was adamant that a sale of the real estate assets during the Wind-Down Period would be destructive of value. It was therefore pressing very hard to find a solution to EVIC's blocking vote. The proposal was approved by the Fund's lawyers and the circular to the shareholders approved by the Jersey Financial Services Commission. It was then approved by 62% of the shareholders all of whom are expert investors with access, one presumes, to legal advice. 86. It is arguable that the directors, who are very experienced, assisted if they thought fit by WAM, would be able to realise the real estate assets in a more cost effective manner than liquidators appointed by the Court. We can, we think, take judicial notice of the very substantial costs likely to be incurred by the appointment of professional liquidators in Jersey for a fund of this kind. 87. Whilst the other shareholders are aware of the injunction and the hearing that has taken place before us, they have not been convened and it is not clear to us that they fully appreciate the possibility of liquidators being appointed by the Court in place of the directors. The fact that 62% of them have approved the Redemption in Kind proposal would suggest to us that there is no loss of confidence in the directors on the part of a substantial majority of the shareholders. 88. We think it important that the views of the shareholders on whether the winding-up should be completed by the directors or by liquidators appointed by the Court should be ascertained. 89. For this purpose we are going to adjourn the application for the winding up of the Fund under Article 155. Unfair prejudice 90. Mr Sanders submitted that the conditions for an unfair prejudice remedy are satisfied in two respects:- (i) The Fund's affairs are being conducted in a manner which is unfairly prejudicial to the interests of

some part of its members, namely those including EVIC who did not support the ordinary resolution carried at the EGM. (ii) The proposed restructure involves both a proposed act namely the transfer of the real property assets and \$10m to the Phoenix SPV and a proposed omission, namely the omission to realise the underlying real property assets, which would be unfairly prejudicial to EVIC and others. 91. Some considerable part of Mr Taylor's address to us on the case as a whole was devoted to a detailed examination of the conduct of Nomura and what the Fund regarded as inconsistencies and failings on its part on this matter. He argued that personal animosity had allowed the judgement of those involved in Nomura to be clouded and it was these personal issues that had motivated its decision. We do not regard it as relevant to go into these matters because it is clear that the voting and other rights of a shareholder are property rights which the shareholder is entitled to exercise upon the basis of his own perception of his own interests

- see Astec (BSR) plc

[1998] 2 BCLC 556 at 584. 92. By virtue of its shareholding, EVIC had the right to withhold approval to an extension and it did so. WAM and the Fund may disagree with its decision but under the terms of the Prospectus they are not entitled to extend the Wind-Down Period without EVIC's approval and it was for EVIC and EVIC alone to decide whether or not to give that approval. No other investor was in the same position as EVIC because no other investor had made such a large investment in the Fund as EVIC. EVIC had paid for its rights. EVIC had concluded that the interests of its investors were better served by a liquidation than by an extension. The Fund's actions and omissions, both actual and proposed, sought, in effect, to overrule EVIC's decision to withhold approval and to extend the life of the Fund without approval. What the Fund should have done following its failure to achieve the 75% necessary for the extension of the Wind-Down Period was to accept the decision and to proceed to endeavour to realise the underlying real estate investments during the Wind-Down Period. 93. Our finding that the Redemption in Kind proposal was in breach of the terms of the Articles and Prospectus is sufficient, in our view, for us to be satisfied that EVIC's application under Article 141 is well founded. 94. In *Prestigic-v-JTC and Others*

[2012] JRC 097 it was observed that the Jersey courts have developed a body of case law in relation to Articles 141 and 143 of the Companies Law which draws heavily on English case law in this sphere and that it was clear that the approach of both jurisdictions under these statutes is broadly similar. 95. The principles underlying the unfair prejudice remedy were summarised in the decision of the English Court of Appeal in *Grace-v-Biagioli, Titanium Electrode Products Ltd. Re*

[2006] BCC 85 following the speech of Lord Hoffman in the House of Lords decision of *O'Neill-v-Philips*

[1999] 1 WLR 1092 :- "One can deduce the following principles:- (1). The concept of unfairness, although objective in its focus, is not to be considered in a vacuum. An assessment that conduct is unfair has to be made against the legal background of the corporate structure under consideration. This will usually take the form of the articles of association and any collateral agreements between shareholders, which identify their rights and obligations as members of the company. Both are subject to established equitable principles which may moderate the exercise of strict legal rights when insistence on the enforcement of such rights would be unconscionable; (2). It follows that it will not ordinarily be unfair for the affairs of a company to be conducted in accordance with the provisions of its articles or any other relevant and legally enforceable agreement, unless it would be inequitable for those agreements to be enforced in the particular circumstances under consideration. Unfairness may, to use Lord Hoffmann's words, 'consist in a breach of the rules or in using rules in a manner which equity would regard as contrary to good faith'; see p. 1099A; the conduct need not therefore be unlawful, but it must be inequitable. (3). Although it is impossible to provide an exhaustive definition of the circumstances in which the application of equitable principles would render it unjust for a party to insist on his strict legal rights, those principles are to be applied according to settled and established equitable rules and not by reference to some indefinite notion of fairness; (4). To be unfair, the conduct complained of need not be such as would have justified the making of a winding-up order on just and equitable grounds as formerly required under s.210 of the Companies Act 1948; (5). A useful test is always to ask whether the exercise of the power or rights in question would involve a breach of an agreement or understanding between the parties which it would be unfair to allow a member to ignore. Such agreements do not have to be contractually binding in order to found the equity; (6). It is not enough merely to show that the relationship between the parties has irretrievably broken down. There is no right of unilateral withdrawal for a shareholder when trust and confidence between shareholders no longer exist. It is, however, different if that breakdown in relations then causes the majority to exclude the petitioner from the management of the company or otherwise to cause him prejudice in his capacity as a shareholder." 96. In our judgement the affairs of the Fund have not been conducted in accordance with the terms of the Prospectus in this respect and it would not be unjust for the terms of the Prospectus to be enforced. 97. Mr Sanders went on, however, to raise the following further matters. 98. The first was the Fund's refusal to circulate its letter to the shareholders as requested. We agree (in the absence of any authority on the point) that there is no legal duty upon a company to circulate letters received from shareholders to the other shareholders but in the circumstances of this case, we do question the legal advice given to the directors that they should not do so. They were, after all, dealing with expert investors. The letter raised perfectly proper, and as it transpires correct (in part at least), concerns as to the proposals and it came from Nomura, representing a shareholding of 27%. The Fund's advisers were perfectly capable of preparing and did, in fact, prepare a response to it, which we feel should have gone out to the other shareholders, so that they could at least be informed of Nomura's concerns and the Fund's response. It was not practicable for Nomura to be

expected to write directly to all of the shareholders, working through the share register, and it was unfortunate for EVIC to be held to its bare, and in this context empty, legal right to speak to the meeting; empty, because none of the other shareholders were there to hear what Nomura had to say. 99. Secondly, Mr Sanders maintains that the terms of the Redemption in Kind proposal were unfair because they manifestly favoured those who wished to hold on to the real estate assets and who wished to remain in association with the directors of the Fund and WAM as against those who wished to have the assets realised and the Fund brought to an end in accordance with the terms of the Prospectus. 100. That unfairness was illustrated he said by the discounting of the real estate assets by some 30% below their forced sale value. The Fund had obtained professional advice as to the forced sale value. The effect of that advice was that it should be possible to obtain the figures advised on a forced sale. The forced sale value was discounted from fair value to reflect the reduced time scale for a sale. To make a further reduction was illogical, Mr Sanders argued. A third party purchaser would have paid the forced sale figure without a further deduction. 101. Mr Sanders accepted that the directors had a discretion as to the value to be attributed to an asset that was being redeemed in specie non pro rata and that if they had reached that valuation in accordance with their fiduciary duties as directors, the Shareholders were bound by it. He said that the directors had no advice before them upon which they could properly have decided upon a discount of 30%. 102. We found the issue of the discount difficult. The proposal came from WAM and in the investor conference call of 14 th July, 2011, it was explained by Mr Wermuth as being a discount to reflect the fact that shareholders electing cash would be receiving cash now, whilst those electing for the Phoenix SPV would only get cash later. The slide presented to the shareholders gave this explanation:- "One year realisation values (\$11.3m) are discounted @ 30% to derive value of assets for investors exiting one year before July 2012". It was a discount to reflect the fact that they were receiving cash before the end of the Wind-Down Period. 103. There would not appear to be a record of the board discussing the discount and the reasons for it. There is certainly no reference to such a discussion in the board minute of 5 th July, 2011, in which the circular to the shareholders was approved. At paragraph 242 of his third affidavit, Mr Pitter explains that those shareholders electing for cash would be receiving a distribution early:- "...because it would be constituted by the portion of the cash distribution that would have been distributed to other Shareholders if they had not opted to take a greater level of interest in the bundle [of real estate assets]". 104. At paragraph 247 of his third affidavit, he explains that those exiting under the proposal were going to receive cash earlier in respect of their exit of the real estate assets and that those who opted to take an interest in the real estate assets were taking on all the risk of the depression of liquidation values or even an inability to realise the assets and a deferral of any exit. The discount was decided in the exercise of the directors' discretion and with the benefit of WAM's advice, which had been informed by WAM's experience of the secondary market, particularly in relation to a sister fund known as Greater Europe Deep Value Fund Limited where a number of bids had involved discounts of between 25% and 50% or even 60% in one case. 105. The circular to the shareholders contained no explanation for the

discount, but the form for the election of the redemption proceeds sent out by the Fund after the EGM contained this explanation:- "In particular, please note that the value of the assets in the SPV have been discounted by 30% from \$11.3m in "one year liquidation value" to \$7.9m. This represents a risk and time discount for receiving cash now rather than in a year's time. The \$10m in the SPV has not been discounted." 106. Having made that statement, the document then goes on to say this:- "The investment adviser expects some 350% upside on listed assets through 2015 and therefore recommends electing for SPV shares only as long as available and cash thereafter." 107. It is true to say that if the real estate assets were liquidated, then it might be a year before all of the shareholders received their pro rata share of the sale proceeds, presumably but not necessarily the \$11.9m advised in the valuation. We can see, therefore, that some discount for receiving cash in advance of such a sale, free of the risks of such a sale, would be justifiable. We have some misgivings as to whether the 30% put forward by WAM was fully justified, but there was no attack upon the bona fides of the directors in approving this figure (there was no application to cross-examine Mr Pitter), for which, through Mr Pitter, the directors have given an explanation. Furthermore they did indeed give their approval to this discount on advice, namely on the advice of the investment adviser WAM. On balance, therefore, we do not regard the discount as unfair. 108. The second respect in which Mr Sanders argued that the terms favoured those seeking to retain the real estate assets was the proposal to endow the Phoenix SPV with \$10m raised by the realisation of other investments. Those who wish to retain the real estate assets and to benefit from the increase in value ought to provide any sums required to protect their investment. The use of that sum constitutes a new investment made during the Wind-Down Period in breach of the Prospectus. We have already accepted that this is the case. 109. The third respect in which Mr Sanders said the terms favoured those seeking to retain the real estate assets was the fees proposal, which includes a proposal to pay WAM a fee of 5% of all cash distributed from the real estate assets; a new fee, which is not justified under the existing fee structure. 110. In his oral submission, Mr Sanders said that the real driver behind the proposed fee base was the need to incentivise and sustain WAM's business, a matter that had been discussed by the directors on 29 th January, 2010. He described the proposed fee base as offensive. Mr Taylor took us to Mr Pitter's detailed explanation of the fee base in his email of 31 st August, 2011, which we found plausible. In any event, some 62% of the shareholders, all expert investors, have approved the Redemption in Kind proposal on the basis of the circular, in which the proposed fee base was clearly set out. 111. There is inevitably some overlap in respect of the applications under Article 155 and 141. Under the Article 155 application, we found that the Redemption in Kind proposal was not permissible under the terms of the Articles and Prospectus and it is on that same ground (but no other) that we find unfair prejudice under Article 141. 112. It follows that we should make an order under Article 143 requiring the Fund to refrain from proceeding with the Redemption in Kind proposal, although such an order would be justified on purely contractual grounds. Mr Sanders accepted that in the absence of any shareholders it was not open to the Court to make an order requiring another shareholder to acquire

EVIC's shares, but he sought two further orders as follows:- (i) In the interest of clarity and in order to avoid further proceedings, he invited the Court to specify the basis upon which such a sale would be made. He referred the Court to *Re Bird Precision Bellows Limited*

[1986] Ch 658 where it was held that the Court had a wide discretion which extended to the terms of an order for the purchase of the petitioner's shares. However, in that case both the petitioner and respondent shareholders were before the Court. We do not have any of the other shareholders before the Court and as a matter of principle it cannot be right for this Court to seek to lay down now the terms upon which such a sale might take place in the absence of the relevant counter party. What we can say is that we have not found the 30% discount of the real estate assets to be unfair in the context of the Redemption in Kind proposal. (ii) EVIC had been unfairly prejudiced by the failure of the Fund to endeavour to realise the real estate assets and accordingly it would, Mr Sanders said, be appropriate to direct the Fund to endeavour to realise the same within a time fixed by the Court. He submitted that a maximum period of twelve months from the date of the order would be fair. 113. Mr Taylor has not been able to address us in any detail on what, if any, orders should be made under Article 143 and we do not think it right for us to impose any kind of time period on the realisation of the real estate assets without giving the directors and the investment adviser time to consider how that is to be undertaken and over what time period. We are therefore going to adjourn the making of any other orders under Article 143 for the same period as the winding up application. 114. Whilst we have found that the Redemption in Kind proposal was not permitted under the Articles and Prospectus, we are conscious that 62% of the shareholders consented to an extension of the Wind-Down Period. The solution may still be for EVIC's blocking shareholding to be purchased, so that the Wind-Down Period can be extended, assuming that is still possible bearing in mind that it has now expired. 115. In conclusion:- (i) The Fund is ordered to refrain from proceeding with the Redemption in Kind proposal. (ii) The application by EVIC for the winding up of the Fund under Article 155 and for further orders under Article 143 are adjourned to a date to be fixed by the parties. (iii) The views of the remaining shareholders on whether the Fund should be wound up by the directors or by liquidators appointed by the Court under Article 155 should be ascertained. We will invite the assistance of counsel as to how this can be best achieved. *Authorities Companies (Jersey) Law 1991* (as amended). In *re FIA Leveraged Fund* (Grand Court of the Cayman Islands) unreported 18/4/12. *Allen-v-Gold Reefs of West Africa*

[1900] 1 Ch 656 . *British Equitable Assurance-v-Baily*

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