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Decision in *Re Harbinger Class PE Holdings (Cayman) Ltd* – a step forward for open-ended funds?

Introduction

The recent decision in *Re Harbinger Class PE Holdings (Cayman) Ltd* confirms that the traditional “impossibility” test for loss of substratum will be applied in the context of a Cayman Islands company which is not an open-ended mutual fund. The decision appears, at first glance, to depart from earlier Cayman Islands authorities which deal with the question of what loss of substratum entails in the context of an open-ended mutual fund. Uncertainty remains, however, about the test for loss of substratum of a Cayman Islands open-ended fund, and this decision could be a step toward the traditional test for loss of substratum also being applied in that context.

The Proceedings

On 14 May 2015, a petition was presented by “NYROY/RBC Acct# 1583 pledged to Royal Bank of Canada” (the **Petitioner**) for the winding up of Harbinger Class PE Holdings (Cayman) Ltd (the **Company**) and the appointment of official liquidators. The Petitioner was a contributory of the Company, holding a 0.2% interest. The winding up was sought pursuant to section 92(e) of the Companies Law (2013 Revision) on the ground that it was “just and equitable” to wind up the Company as there had been a loss of substratum.

The Company was incorporated on 16 December 2008 as a subsidiary of Harbinger Capital Partners Offshore Fund 1 Ltd (the **Offshore Fund**). The Offshore Fund had been incorporated in the Cayman Islands in 2001 and operated as a feeder fund to Harbinger Capital Partners Masters Fund 1 Limited (the **Master Fund**). In 2008, the Offshore Fund was faced with substantial redemption requests from its investors which it, and in turn the Master Fund, lacked the liquidity to meet; the Company was therefore formed in order to restructure the illiquid investments which were valued at US\$2.4 billion. The Master Fund issued a new class of shares, Class PE Shares, to which it allocated certain private equity-type and other illiquid investments called the “Private Portfolio”. The Class PE Shares were issued by the Master Fund to the Offshore Fund and were ultimately contributed to the Company; participating shares in the Company were then issued to redeeming shareholders in the Offshore Fund as partial in-kind redemption proceeds.

The Petitioner filed detailed evidence on the developments in relation to the Private Portfolio, which was central to the Petitioner’s case. It was alleged that there had been a loss of substratum of the Company on the basis that, contrary to the objective set out in the Supplement to the Confidential Offering Memorandum issued to investors in December 2008 that all commercially reasonable efforts would be made to dispose of or otherwise realise the assets of the Private Portfolio by the end of 2010, proceeds of realisation had in fact been reinvested in largely illiquid assets. The Petitioner put forward a catalogue of complaints alleging a misuse of the Private Portfolio, with the result that the Company was allegedly no longer doing what it was formed to do.

The Company defended the petition on the basis that the purpose of the Company was limited to holding the Class PE Shares, receiving through the redemption of those shares the net cash flow from the realisation of the assets in the Private Portfolio or income attributable to those assets, and distributing such monies to the shareholders of the Company: as distinct from the Master Fund, it was not part of the purpose of the Company to manage and realise the underlying assets of the Private Portfolio. The Company maintained that there had been no loss of substratum, as the Company had fulfilled and continued to fulfil its purpose. The Company also

refuted that there had been any mismanagement by the Master Fund and adduced evidence from the Independent Monitor of the Investment Management in support of its position.

The Decision

Dismissing the petition, Justice Clifford, following the traditional approach applied by the English Courts¹, held that the correct test in determining whether there has been a loss of substratum is whether it has become *impossible* for the company to achieve the purpose for which it was formed. Justice Clifford expressly distinguished the Cayman Islands decision of *In the Matter of Belmont Asset Based Lending Limited*², in which Justice Jones held that it is just and equitable to make a winding up of an open-ended corporate mutual fund in circumstances where “*it has become impractical, if not actually impossible, to carry on its investment business in accordance with the reasonable expectations of its participating shareholders, based upon representations contained in its offering document*”³ and the line of Cayman Islands authorities which have followed this decision⁴, on the basis that the Company is not, and has never been, an open-ended corporate mutual fund.

Justice Clifford further held that the question of impossibility must be determined by ascertaining the principal or main objects of the company and then deciding whether it has become impossible for the company to attain those objects; the Court is required to look beyond a wholly general objects clause in the company’s memorandum of association, to ascertain, on the particular evidence, the main object of the company in line with the reasonable expectation of its participating shareholders.

Applying the above to the facts of the case, Justice Clifford held that it was clearly established that the main purpose or object for which the Company was established was limited to holding the Class PE Shares and receiving the net cash flow from the realisation of the assets in the Private Portfolio, for onward payment to the Company’s shareholders, and that the evidence demonstrated that the Company had fulfilled its purpose and continues to do so. The Judge also dismissed the relevance of the complaints in relation to the alleged mismanagement of the Private Portfolio on the basis that there had been a fundamental misconception that it was the Company’s purpose to realise the Private Portfolio, when this was in fact the responsibility of the Master Fund.

Justice Clifford held that there was therefore no jurisdiction to make a winding up order, but commented that, in any event, the factors relevant to whether or not the Court should exercise its discretion pointed against there being a winding up: the petition had very little support from other contributories and it was difficult to see how the appointment of an independent liquidator would have served any useful purpose and would indeed carry the risk of being detrimental to the interests of the shareholders.

Conclusion

The decision of *Re Harbinger* confirms that the traditional “impossibility” test for loss of substratum will be applied in the context of a Cayman Islands company which is not an open-ended mutual fund.

There remains some uncertainty about the test for loss of substratum of a Cayman Islands open-ended fund, however, in the writers’ view, this decision could be a step toward the traditional test for loss of substratum also being applied in that context. Petitions alleging collapse of substratum are continuing to be presented to the Cayman Islands Court in respect of open-ended funds and it should therefore only be a matter of time before further clarification is received on this question.

¹ English authorities referenced in the judgment include *In re Suburban Hotel* (1867) LR 2 Ch App 737, *In re Diamond Fuel Company* (1879) 13 Ch D 400, *In re Haven Gold Mining Company* (1882) 20 Ch D 151, *In re German Date Coffee Company* (1882) 20 Ch D 169 and *Re Kitson & Co Ltd* [1946] 1 All ER 435. The Courts of the BVI have followed the traditional approach of the English Courts: *Aris Multi-Strategy Lending Fund Ltd v Quantek Opportunity Fund Ltd* (Judgment 15 December 2010)

² [2010] 1 CILR 83

³ [2010] 1 CILR 83 at page 89

⁴ *In the Matter of Freerider Limited* [2010] CILR 486; *In the Matter of Wyser-Pratte Eurovalue Fund Ltd* [2010] CILR 194 and *In the Matter of Heriot African Trade Finance Fund Limited* [2011] 1 CILR 1

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