IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS
CICA Appeal No. 6 of 2012
(CACV006/2012)
FSD0013/2012-ASCJ

BEFORE

Rt Hon Sir John Chadwick, President
Hon Elliott Mottley, Justice of Appeal
Hon Abdulai Conteh, Justice of Appeal

ON APPEAL FROM THE GRAND COURT

BETWEEN

FIA LEVERAGED FUND

Appellant

and

FIREFIGHTERS' RETIREMENT SYSTEM
NEW ORLEANS FIREFIGHTERS' PENSION & RELIEF FUND
MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM OF LOUISIANA

Respondents

Mr. David Chivers QC with Mr Gowrie of Walkers appeared for the Appellant
Mr Michael Crystal QC with Mr Cowan of Campbells appeared for the Respondents

Hearing: 31 July 2012
Judgment: 1 August 2012

JUDGMENT
Revised from transcript and Approved released 18 Feb 2013

Sir John Chadwick, President:

1. This is an appeal from an order for the winding up of the appellant company, FIA Leveraged Fund (hereafter "The Fund" or "The Company"), made on 18 April 2012 by the Chief Justice on the petition of three retirement pension plans or systems, Firefighter's Retirement System, New Orleans Firefighter's Pension and Relief Fund and

Municipal Employees' Retirement System of Louisiana (together "the Petitioners") presented on 31st January 2012. The Petitioners are the respondents to this appeal. They are described in the petition, respectively, as "FRS", "NOFF" and "MERS". Where it's necessary to distinguish between them, I shall adopt those acronyms.

2. The allegations made in the petition, so far as material, may fairly be summarised as follows:

(1) The Company was incorporated in the Cayman Islands on 13 March 1998 as an exempted company under the Companies Law (1998 revision). The Company is the feeder fund in a "master/feeder" structure. The master fund in the structure is Fletcher Income Arbitrage Fund Limited, described as the "Master Fund" or "Arbitrage". Arbitrage is also an exempt company incorporated in the Cayman Islands. Fletcher Asset Management Inc. ("FAM" or "The Investment Manager"), a company incorporated in Bermuda, is the investment manager of the Fund, the Master Fund and other funds within the group structure.

(2) In or about March 2008, the Company offered a new series of shares, designated "the Series N shares", with a par value of US$0.01 at net asset value as at the date of issuance. The offer was made on terms set out in the Company's confidential offering memorandum, read with its articles of association and a supplement to the offering memorandum.

(3) The Petitioners made investments in the Fund, amounting in aggregate to US$100 million, by acquiring 100,000 Series N shares in the Company. More particularly, FRS acquired 45,000 Series N shares, MERS acquired 40,000 Series N shares and NOFF acquired 15,000 Series N shares.

(4) The provisions of the articles, read with the terms of the offering memorandum and the supplement (together described as "the offering documents"), provided that the redemption date applicable to redemption requests for Series N shares of the Company was deemed to be the end of any calendar month, on 60 days' prior written notice to the Company.

(5) The articles provided that, in respect of all redemptions, 90% of the amount estimated by the directors to be due on redemption should be paid by the Company within 35 days of the date that the shares were redeemed; and the remaining amount

should be paid when Company had finally determined the redemption price per participating share. But, in respect of Series N shares, the supplement further provided that the Company was obliged to pay at least 90% of the redeemed amounts in cash or in kind generally within 15 calendar days of the redemption date. A discretionary amount of up to 10% of the redemption monies might be retained by the Company until no later than 30 days after the completion of the audit of the financial statements related to the fiscal year of the Company in which the redemption had occurred.

(6) Redemption requests were submitted by each of the Petitioners. More particularly: (i) an initial redemption request was made by FRS in writing on 14 March 2011 seeking the redemption of shares with an aggregate redemption value of US$17 million; and a further redemption request was made by FRS in writing on 27 June 2011 seeking the redemption of all the remaining shares credited to its account in the books of the Company; (ii) an initial redemption request was made by MERS in writing on 3 March 2011 seeking the redemption of shares with an aggregate redemption value of US$15 million; and a further redemption request was made by MERS in writing on 22 June 2011, again seeking the redemption of all the remaining shares credited to its account; (iii) NOFF submitted a redemption request in writing on 27 June 2011 seeking the redemption of all the shares credited to its account in the books of the Company. Each of those requests was acknowledged by the Company.

(7) Pursuant to the terms of the offering documents, the redemption date in respect of each of the first MRS redemption request and the first FRS redemption request was 31 May 2011. The redemption date in respect of each of the second MERS redemption request, the second FRS redemption request and the NOFF redemption request was 31 August 2011.

(8) On 15 June 2011 the Company purported to discharge its payment obligations under the first MERS redemption request and the first FRS redemption request by sending to MERS and FRS, respectively, promissory notes in the respective sums of US$15 million and US$17 million payable by the Master Fund to the Company; together with assignments of those notes to MERS and FRS as the case might be. Those

notes and the assignments were dated 15 June 2011. The notes themselves were expressed to be payable on 15 June 2013.

(9) It is alleged in the petition that MERS and FRS each rejected the promissory notes sent to them; that the promissory notes did not discharge fully or at all the Company's obligations in respect of the first redemption requests; and that the sums of US$15 million and US$17 million payable in response to those requests remained due and payable.

(10) Between September and November 2011 extensions of time for the payment of the amounts due in respect of the second MERS redemption request, the second FRS redemption request and the NOFF redemption request (together "the August redemption requests") were granted by the Petitioners; but no extension for payment of those amounts was granted beyond 15 December 2011 or, as the petition alleges, "at the very latest 15th January 2012".

(11) In those circumstances, it is alleged at paragraph 23 of the petition, that as at the date of the petition no payment had been made by the Company in cash or in specie in respect of the August redemption requests; and that, in the light of what had gone before, the Petitioners contended that substantial amounts were due and payable to them as at the date of the petition by the Company in respect of the first redemption requests and the August requests.

(12) On 20 January 2011, the Petitioners, through their local advocates, Campbells, requested that the Company, by 4:00 p.m. on 27 January 2012, provide the Petitioners with confirmation of the value of the Petitioners' shares in the Fund as at the redemption dates of 31 May 2011 and 31 August 2011 and make full payment in respect of the same either in cash or in kind.

(13) It is alleged that, since receiving that letter, the Company has failed to provide confirmation of the amounts due to the Petitioners or to pay any amounts to the Petitioners. It is said that the Company's failure to pay any of the amounts which are presently due and owing to the Petitioners demonstrates that the Company is unable to pay its debts and it should be wound up pursuant to section 92(d) of the Companies Law (2011 revision). Further, or in the alternative, it is alleged at paragraph 29 of the petition that it is just and equitable that the Company be wound

up pursuant to section 92(e) of that Law so that official liquidators may investigate its affairs and take control of its assets. That is said to be appropriate in circumstances in which (i) the Company has failed to file audited accounts since 2008, (ii) the Company appears to have had no directors for the period from 21 November 2011, when its last director resigned, until 24 January 2012 when Mr. Stuart Turner was appointed a director and (iii) the replacement directors are also directors and/or advisors of the Investment Manager which, itself, appears to be the subject of investigation by both the United States Securities Exchange Commission and the United States Federal Bureau of Investigation.

3. The allegations made in the petition were verified by formal affidavits sworn on 30 and 31 January 2012 on behalf of each of the Petitioners. The Company opposed the petition on the grounds set out in an affidavit sworn on 27 February 2012 by Mr Stuart Turner, then its sole director. At paragraphs 11 and 12 of that affidavit, Mr Turner explained how the company had invested its assets. He said this:

> "11. The fund and the affiliated investments funds managed by Fletcher Asset Management Inc. (FAM or the investment manager) invests substantially all their assets in special purpose investments vehicles referred to in this and the next paragraph as 'master funds' structured by FAM exclusively on behalf of the 'Fletcher funds' (the fund, the master funds, FII as defined below and FILB as defined below). The only investors in these master funds are the Fletcher funds known as 'feeder funds' and this is commonly referred to as a 'master/feeder' structure. Each master fund generally makes different kinds of investments than the other master funds. By investing in the common equity, preferred equity or debt instruments of one or more of the master funds each feeder fund including the fund may gain access to investments strategies and risk levels that for a variety of reasons may be best pursued in a particular master fund. . . ."

I observe that the definition in that paragraph of "Master Funds" is wider than the "Master Fund" as defined in the petition: in the petition the term "Master Fund" refers only to Arbitrage. Mr. Turner went on:

> "12 The fund is an open-ended investment company and is registered as a mutual fund under section 4(3) of the Mutual Funds Law as amended. All assets of the fund, including funds obtained through leverage, were invested through a master/feeder fund structure using leverage. In essence, the fund invested most of its assets in Fletcher Income Arbitrage Limited [which he then defines as the master fund]. The master fund in

turn invested most of its assets in Fletcher International Inc. ('FII'), a Delaware incorporated company, which in turn invested most of its assets in Fletcher International Limited (Bermuda) ('FILB") a Bermudian incorporated entity."

4. At paragraphs 13, 14 and 15 of his affidavit Mr. Turner set out particulars of the share capital and company registration details of Arbitrage, FII and FILB. At paragraph 17 he referred to the articles of association of the Company, the offering memorandum in respect of the Series N shares and to the supplement to that offering memorandum ("the supplement"). Those documents were exhibited to his affidavit: it will be necessary to refer to their terms in some detail later in this judgment. At paragraph 19 Mr. Turner confirmed that the investments made by the Petitioners in the Fund on 1 April 2008 were as set out in the petition. At paragraph 20 he set out figures which were intended to demonstrate that "prior to settlement of the obligations due to the petitioners" - a date which, as appears later in the affidavit, he put at 13 February 2012 - the Company was solvent on a net asset basis.

5. At paragraphs 22 to 52 of his affidavit, under the heading "The petitioners' debts have been paid", Mr. Turner set out the substance of the Company's opposition to the petition. As there set out, that comprised two elements: first, that the promissory notes and corresponding assignments dated 15 June 2011 were valid and sufficient to discharge, and did discharge, the liabilities created by the first MERS redemption request and the first FRS redemption request (paragraph 31 of the affidavit); second, that, on 16 February 2012, the Petitioners were informed that a further redemption in kind had been initiated by the directors of the Fund.

6. That further redemption in kind was said to be in the form of the issue, and allocation to the Petitioners, of shares in a limited liability company that held assets formerly held by affiliates of the Master Fund. It is convenient to set out the terms of the email sent to the Petitioners which is said to communicate that information. It was addressed to Mr. Stockstil, who was general counsel at FRS, and sent by Alphonse Fletcher, of Fletcher Asset Management Inc (not, as might have been expected, by the Fund itself. It reads:

> "A redemption in kind structured by the investment manager has been executed by the directors of FIA Leveraged Fund this week with shares of a limited liability company holding assets formerly held by the master fund. Further, Fletcher Income Arbitrage Fund prepaid its notes held by the systems [meaning the petitioners] with shares of that limited liability company. Additional information will be provided tomorrow and next week."

That was how the Petitioners were told that they had been paid in kind.

7. At paragraph 35 of his affidavit, Mr. Turner refers to copies of resolutions of the Fund and the Master Fund with respect to the in kind redemption payments. He exhibits, first, minutes of a meeting of the directors of the Master Fund (Arbitrage) held by telephone at 11.53 p.m. on 13 February 2012. Paragraph 3.1 of those minutes records - at subparagraphs (i), (j), (k), (l) and (m) - that the following steps had been, or were to be, taken:

   (1) "In order to resolve beyond doubt any issues with respect to the May redemptions, and in order to satisfy and resolve the August redemptions, the investment manager, FILB and the company had determined to transfer certain underlying assets of FILB [the ultimate master fund] to a newly incorporated Delaware LLC, FILB Co Investments LLC ('FILBCI', and the shares of FILBCI, 'the FILBCI shares')". In that context, of course, the company is not the FIA Leverage Fund: it is Fletcher Income Arbitrage Fund Limited.

   (2) "In order for the company to obtain FILBCI shares so as to be able to distribute FILBCI shares to the feeder funds and to the underlying investors currently holding the promissory notes, the company has determined first to redeem the shares of FII, having an aggregate value of USD136,135,806 that the company holds directly". In that paragraph "the feeder funds" is a reference to FIA Leverage Fund and "the underlying investors" is a reference to the Petitioners.

   (3) In satisfaction of the company's redemption of such FII shares, FII has determined to pay the company in kind by transferring non-voting common shares of FILB, having an aggregate value of $136,135,806 and the company has determined to accept such FILB shares".

   (4) "Immediately upon the company becoming a direct shareholder of FILB, FILB

and the company have agreed to a transaction whereby FILB would re-purchase the FILB shares held by the company having an aggregate value of $136,135,806 by paying the company in kind with FILBCI shares having an aggregate value of 136,135,806 shares (*sic*)".

(5) "The investment manager has recommended to the directors that they exercise their powers noted above and prepay the promissory notes with a transfer of FILBCI shares from the company to the holders of those promissory notes corresponding to the May redemptions at the feeder fund level (the 'note of prepayment'). And second, can partially redeem an amount of the feeder fund shares held in the company and satisfy the same with an in kind payment of FILBCI shares corresponding to the value of the outstanding August redemptions at the feeder fund level (the 'compulsory redemption')".

By those steps, the Master Fund (Arbitrage) was to become the owner of FILBCI shares: FILBCI having become the owner of "certain underlying assets" formerly owned by FILB.

8. The relevant resolutions are set out at paragraph 3.2. Resolutions A and B are intended to give effect to the steps just described. Resolutions C, D and E are in these terms:

> "(C) In order to pay all principal and interest due on the promissory notes, the company make prepayment by way of a transfer of a corresponding number of FILBCI shares to the current holders of the notes, and in so doing all principal and interest due on the promissory notes be deemed paid by and upon the distribution of FILBCI shares to the current holders of the notes.

Again, in that context "the company" is Arbitrage.

> "(D) Pursuant to the articles, the compulsory redemption be and hereby is approved with immediate effect."

Compulsory redemption was, as I have indicated, defined at paragraph 3.1(n). It meant the compulsory redemption of FIA Leverage Fund's shares in Arbitrage by an in-kind payment of FILBCI shares.

> "(E) In order to satisfy the compulsory redemption, the company effect a distribution of FILBCI shares to the feeder fund as an in kind redemption payment."

The effect of those steps was to distribute FILBCI shares to the Fund (the FIA

Leverage Fund) in an amount corresponding to the value of the August redemptions.

9. Mr Turner exhibits, also, minutes of a meeting of the directors of the Company (FIA Leverage Fund) held by telephone conference call on 13 February 2012 at 11:55 pm; which suggests that the directors of Arbitrage managed to get through the business of the earlier meeting, just described, with remarkable expedition. At paragraph 3 of those minutes the background which led to the determination to make redemption payments in kind is set out. In particular, it is noted, at paragraph 3.1(h):

> "That in order to resolve beyond any doubt any issues with respect to the May redemptions and in order to satisfy in full the August redemptions, the investment manager, the master fund and FILB -- the ultimate master fund -- have determined to transfer certain underlying assets of FILB to a newly incorporated Delaware LLC, FILB Co. Investments LLC (FILBCI), and FILBCI has issued to the master fund FILBCI shares having an aggregate value of 136,135,806 United States dollars."

The reader of that paragraph might be led to think that the purpose was to satisfy the August redemptions in full; but later material shows that, in fact, that was not the intention. The August redemptions were only to be satisfied to the extent of 90.1%.

10. The relevant resolutions adopted at that meeting are at paragraphs 3.2(a) and (b). Paragraph 3.2(a) recorded that, in order to satisfy the August redemptions and pursuant to the articles and the rights and restrictions attaching to the shares, the Company accepted the in-kind redemption payment by the transfer of FILBCI shares with respect to the compulsory redemption and waived the notice requirements. Paragraph 3.2(b) was in these terms:

> "The company distribute the FILBCI shares to the investors in full settlement of the initial payment to the investors of the redemption proceeds to which they are entitled as a consequence of the August redemptions by making three redemption payments (the 'in kind redemption payments') as follows: (1) FRS, FILBCI shares having an aggregate value of $43,958,372.15. (2) MERS, FILBCI shares having an aggregate value of $39,177,092.92 and (3) NOFF, FILBCI shares having an aggregate value of $19,909,992.79, the aggregate value of those redemption payments taken together is $103,048,457.96."

The initial payment referred to in that paragraph may be taken to be the 90.1% of the redemption proceeds payable in respect of the August redemptions. The effect of the

steps taken by the master funds was to distribute FILBCI shares to the FIA Leveraged Fund in an amount corresponding to the value of the August redemptions to which I have referred.

11. At paragraph 37 of his affidavit, Mr. Turner states that:

> "The assets contributed to FILBCI had an aggregate value of $136,135,806 as at the date of redemption in kind according to an external valuation expert firm Quantal."

What Mr. Turner does not state in that paragraph is that - as can be seen by the external valuation to which he refers and exhibits - although a valuation was made by Quantal "as at 13 February 2012", it was not, in fact, made until 27 February 2012: that is to say some 14 days after the date on which the board minutes record that the relevant meetings of the Fund and the Master Fund had been held.

12. Mr. Turner goes on, at paragraph 37 of his affidavit, to say this:

> "Each share of the FILBCI has a net asset value of $1000. The fund and the master fund have distributed FILBCI shares to each of the petitioners in the following manner so as to pay all principal and interest due on outstanding promissory notes held by FRS and MERS and to provide approximately 90.1% of the amounts required to satisfy the petitioners' later redemption requests in accordance with the fund's governing documents."

He then describes, with particularity, what is said to have been distributed to the petitioners. In relation to MERS, it is said that the Master Fund distributed 15,513.44444 FILBCI shares having a net asset value of $1000 a share and an aggregate value of $15,513,444.44 as payment in respect of all principal and outstanding interests on the promissory note held by MERS and similarly discharged in full the liability created by the first MERS request. The fund then distributed 39,177.09292 FILBCI shares having a net asset value of $1000 per share and an aggregate value of $39,177,092.92 in satisfaction of approximately 90.10% of the second MERS request. He sets out comparable particulars in relation to FRS and NOFF. In relation to FRS the FILBCI shares distributed in satisfaction of the promissory notes were said to have an aggregate value of $17,581,903.17 and the amount distributed to FRS in satisfaction of the second FRS redemption request for shares is said to have an aggregate value of $43,958,372.15. In relation to NOFF, the amount distributed in satisfaction of its request or 90.1% of its

request is $19,909,902.79. Doing the best that I can with the arithmetic, the aggregate of those sums comes to $136,135,716.86; which seems to leave outstanding some $90. But nothing turns on that; and Mr. Turner's arithmetic may be more accurate than mine.

13. At paragraph 40 of his affidavit, Mr. Turner states that the fund will pay the remainder - approximately 9.90% - of what was due in respect of the August redemptions, to each investor once the fiscal year audit has been completed.

14. At paragraphs 54 to 70 of his affidavit, Mr. Turner addresses the just and equitable ground. It is unnecessary to refer to those paragraphs in detail.

15. The petitioners responded to Mr. Turner's affidavit in a second affidavit sworn by Mr. Stockstil (the general counsel of FRS) on 20 March 2012. Mr. Turner responded to that affidavit by a second affidavit of his own, sworn on 28 March 2012. It was on the basis of that evidence that the petition came before the Chief Justice on the 4 and 5 April 2012. He gave judgment on 18 April 2012.

16. After setting out the factual background, the Chief Justice identified (at paragraph 24 of his judgment) what he described as "the battle lines around the petition". He said those battle lines were clearly drawn. There was no dispute that the petitioners were entitled to exercise - and had effectively exercised - their rights to redeem their investments in the company. The first issue was whether the company had effectively redeemed the liabilities owed to the petitioners by its payment in kind of the indebtedness created by the exercise of the redemption rights. Second, if there were a genuine dispute about that, whether the petitioners were entitled to wind up the company, a solvent entity.

17. At paragraph 50 of his judgment, the Chief Justice again identified what he described as the primary issue underlying the petition; whether the distribution of the FILBCI shares constituted a valid in specie distribution. At paragraphs 51 to 85 he examined, carefully and in detail, the nature and value of the assets held by FILBCI. Those assets, as he explained in paragraph 51, comprised a right (which, I think, had been acquired by FILB on 1 April 2010), to invest $65 million in what was described as series C convertible preferred stock in United Community Banks Inc. ("UCBI"), a public traded company on

the NASDAQ, having a market capitalisation of some $503 million. He went on to explain that the investment in preferred stock – or, more precisely, the right to make the investment in preferred stock – carried a potential further right to a perpetual preferred income stream; but that that might be called under certain circumstances by UCBI after five years from the date of the investment. In that case the right to a preferred income would be converted to a right to common stock of UCBI. And that, assuming that the full amount of $65 million was invested pursuant to that right, an additional $35 million of common stock warrants on different terms would be issued by UCBI to the investor.

18. The Chief Justice referred, at paragraph 61 of his judgment, to a press release issued by UCBI on 17 June 2011 announcing that its shareholders had approved a reclassification of its stock pursuant to which each five shares of UCBI stock would be reclassified into one share. That consolidation or "reverse stock split" was to be effective as at 5:00 p.m. on 17 June 2011. The effect of that announcement was to give rise to some dispute as to just what it was that could be acquired under the right which had become an asset of FILBCI.

19. The Chief Justice concluded, at paragraph 85 of his judgment, that if the petitioners were to be treated as having had the debts due to them discharged by the in-kind distribution, they would have suffered massive losses. He went on to say this:

> "Is there nonetheless a genuine dispute about whether the debt has been validly discharged by the company. That is the first question that arises from the foregoing examination of the circumstances of the case. A genuine dispute over whether or not the petitioners have been given an in specie distribution that realistically represents the value of their investment would not be one suitable for resolution by winding up the company. Such a dispute would be suitable for trial by way of writ."

He reminded himself of the authorities which pointed to that conclusion; including a decision of my own some 15 years ago in the High Court in England and Wales in *In re a Company No. 0066885* [1997] 1 BCLC 639 at 645, and two decisions in this Court, *Parmalat Capital Finance Ltd v Food Holdings Ltd* [2009] 1 BCLC 274 and *In re GFN Corporation Limited* [2009] CILR 650. The principles are not in doubt; and it is unnecessary to refer to passages in those authorities to support them.

20. At paragraph 102 of his judgment, the Chief Justice expressed his conclusion that there could be no genuine dispute that the Company owed a very substantial debt to the petitioners which had not been satisfied. He then went on to explain why he had reached that conclusion; and, in particular, why he had reached the conclusion that the purported distribution in kind did not provide value sufficient to discharge the debt. He said this, at paragraphs 108 and 109:

> "108. First, the distribution in specie of the FILBCI shares could have been of no real consequence unless those shares had real underlying value, but such value, even that purported by the company itself, can lay no existing claim back to a substantial proprietary interest in UCBI. What the company can claim - treating the company for these purposes as the master fund - is only the right to exercise a stock option within the time allowed by UCBI; that is, until 26th of May 2012.
>
> 109. The 'right' the company has, seen in that light, could in no circumstance will be regarded as itself being worth anything resembling the very substantial debt owed to the petitioner."

And so he reached the conclusion that this was a case in which the company should be wound up on the ground that it was unable to pay its debts. up.

21. The Chief Justice went on to hold, also, that it was just and equitable that the company should be wound

22. It is, I think, common ground that the first question to be determined on this appeal is whether, in the events which happened, it was - in principle and, for the moment ignoring valuation - open to the Company to satisfy the obligations which arose out of the August redemption requests by a transfer to the petitioners of FILBCI shares: that is to say, whether that transfer was a "payment in kind" within the meaning of the articles of association and the offering documents. If that question is answered in the affirmative, the second question to be determined is whether it was open to the directors of the Company to rely on their own valuation of the FILBCI shares as providing sufficient value to discharge the obligations which arose out of the August redemptions.

23. Although the petitioners maintained their position that it was not open to the Company to satisfy the obligations which arose out of the May redemptions - that is to say, the MERS first redemption request and the FRS first redemption request - by the

assignment of promissory notes on 15 June 2011, that issue was not developed in argument on this appeal. That may be because the Chief Justice had concluded (at paragraph 33) in his judgment that for the purpose of trying this petition, the question of redemption by distribution in specie by way of valid promissory notes had been overtaken by events. My own view, with respect to the Chief Justice, is that, on a proper analysis, that question had not been overtaken by events: given what the Fund sought to do in conjunction with the Master Fund on 13 February 2012. But the Chief Justice did not address that question - because he did not think it arose - and it was not addressed in any detail in this Court. I say no more about it.

24. If the assignment of the promissory notes were a proper method of satisfying the obligations which arose on 31 May 2011, then a future issue - but not an issue for determination on this appeal - is whether the Master Fund was entitled to satisfy its obligations under the promissory notes by transferring FILBCI shares to the petitioners as the holders by assignment of those notes.

25. I return, therefore, to what I have described as the first question to be determined on this appeal: whether, as a matter of principle, it was open to the company to satisfy the obligations which arose out of the August redemptions by a transfer to the petitioners of the FILBCI shares. The question turns on the construction of the articles and the offering documents. It is necessary, therefore, to set out the relevant provisions in those documents.

26. Article 11D of the articles of association of the Company (FIA Leverage Fund) gives to the holder of any class of participating shares the right to be redeemed on delivery of a redemption request to the Company. The Company's obligation was to redeem at the value fixed on the last business day of each month or on such other day as the directors might determine: that being described as the redemption date. Article 11F sets out provisions applicable to all redemptions. It is in these terms:

> "Subject to the next paragraph of this article, amounts due on redemption for participating shares redeemed will be sent at the option of the company by wire transfer to the bank account designated by the holder whose participating shares are being redeemed either in the relevant redemption form, or in the case of redemption by the company by notice in writing to

the company, in each case in dollars at the risk and cost of that holder as follows: At least 90% of the amount estimated by the directors to be due on redemption shall be paid by the company generally within 35 days of the date that the shares were redeemed and the remaining amount shall be paid when the company has finally determined the redemption price for the participating share. If the initial payment made by the company exceeds the finally determined redemption amount, that holder shall repay to the company on demand the amount of any such excess.

With respect to series N shares, the company will pay at least 90% of the redeemed amounts in cash or in kind without interest within 15 days of the date that the shares were redeemed and the company, subject to the discretion of the directors, will retain up to 10% of such redemption until no later than 30 days after the completion of the audit of the financial statements relating to the fiscal year of the company in which the redemption occurred.

The directors may, when making payments in respect of the redemption or purchase of shares, if authorised by the terms of issue of the shares being purchased or with the agreement of the holder of such shares, make such payment either in cash or in specie."

The phrases "payment in kind" and "payment in specie" appear to be used in that article interchangeably and without distinction.

27. Article 21 provides for the determination of the directors of the net asset value as at the close of business on each valuation day. In that context "valuation day" means the last business day of each month or such other days as the directors may in good faith determine, provided that there shall be at least one valuation day in each month: (Article 2). Reading article 21 with article 11D, the redemption date under article 11D should, in the ordinary away, coincide with a valuation day at which a net asset value is determined by the directors. And it is that, of course, which leads to the conclusion that in the present case the relevant redemption days were 31 May and 31 August 2011.

28. Article 223, which appears between articles 23 and 24, provides for the method in which the company and its directors determine the value of an investment in kind. In the present case the value fell to be determined in accordance with the terms of any applicable offering memorandum. We were taken to the confidential offering memorandum of the fund dated 9 October 1998, as amended on 21 February 2007. It is necessary, I think, to refer only to the description of the fund in the summary of terms

which appears in that document. The fund is said to be "An open-ended investment company incorporated in the Cayman Islands on 13th March 1998". All assets of the fund, including funds obtained through leverages, will be invested through a "master/ feeder fund structure" in the Fletcher Income Arbitrage Fund Limited (the master fund). The fund and the master fund are sometimes collectively referred to as "the fund". There is no suggestion there that there is some underlying master fund at the end of a chain; such as FILB in Bermuda. The structure offered to investors is that of the fund and the master fund (Arbitrage): it does not extend to other funds.

29. A supplement to that confidential memorandum, dated March 2008, contains, in its summary of terms, the same description of the fund. A section headed "redemption of shares" is in substantially the same terms as article 11H of the articles; but it has particular reference to the redemption of series N shares. It reads as follows:

> "No shareholder will be permitted to redeem any series N shares until after the second anniversary of their date of purchase. Thereafter series N shares may be redeemed at the end of any calendar month on 60 days' prior notice to the fund, subject to the discretion of the board of directors to waive such notice. Each date as of which series N shares may be redeemed is hereinafter referred to as 'a redemption date'. All series of shares will be redeemed at a per share price based on net asset value of such series determined in accordance with the amended articles of association, the memorandum and this supplement. With respect to series N shares, the fund will pay at least 90% of redeemed amounts in cash or in kind without interest generally within 15 calendar days after the applicable redemption date and the fund, subject to the discretion of the directors, will retain up to 10% of such redemption until no later than 30 calendar days after the completion of the audit of the financial statements related to the fiscal year of the fund in which the redemption occurred. Notwithstanding anything to the contrary herein contained, series N shares must be redeemed no later than the business day prior to the shares of series 4, 5 and 6 of the funds being redeemed.
>
> If any redemption amount is paid in assets of the fund other than cash, the value of the assets so paid shall be determined by the board of directors in consultation with the investment manager in its sole discretion as of a date reasonably contemporaneously of the date on which the redemption amount is paid to the shareholders."

30. The subscription agreement under which investors subscribed for series N shares is also before the Court. It takes the form of a letter addressed to potential investors. The letter

begins with a paragraph in these terms:

> "Reference is made to the confidential memorandum dated March 2008 with respect to the offering of series N shares ('the shares) of the FIA Leveraged Fund ('the fund'). Such confidential memorandum, together with the offering memorandum of the master fund and any supplements thereto delivered to the undersigned being herein called 'the memorandum'. By executing this subscription agreement, the undersigned investor ('the investor') (a) agrees to be and upon acceptance of this subscription agreement shall be bound in respect of its investment in the fund by the terms, provisions and requirements applicable to investors as set forth herein and in the memorandum (b) acknowledges that it has read and understands the terms, provisions and requirements set forth herein and in the memorandum."

31. Attached to that letter is the confidential memorandum of the master fund; which, pursuant to the paragraph just set out, is incorporated in the terms upon which investors subscribe for series N shares. The confidential memorandum is dated 31 January 2004 as amended on 16 August 2007. It includes a paragraph relating to "a liquid portfolio securities and valuation"; which requires that, if valuation by marking to market is not practical, an investment will be carried at a fair value as reasonably determined by the investment manager. There is no guarantee that a fair value will represent the value that will be realised by the Fund on the disposition of the investment.

32. The next paragraph of the confidential memorandum is headed "limited liquidity in kind distributions". It is in these terms:

> "An investment in the fund provides limited liquidity since the shares are not freely transferable and investors generally may redeem their shares only at the end of a calendar week. There can be no insurance that the fund will have sufficient cash to satisfy redemption requests or that it will be open to liquidate investments at the time of such redemption request at favourable prices. Under the foregoing circumstances and under other circumstances deemed appropriate by the board of directors, investors may receive in kind distributions from the fund's portfolio. Such investments so distributed will not be readily marketable or saleable and may have to be held by such investors for an indefinite period of time. As a result, the investment is suitable only for sophisticated investors."

33. Reading that paragraph, which forms parts of the subscription agreement, together with the earlier provisions which enable the fund to redeem in kind or in specie (and, in

particular, the provisions in article 11F), it is reasonably clear that what is meant by payment in kind or in specie is payment by way of an in-kind distribution from the Fund's portfolio. Counsel for the fund did not dissent from that proposition. He accepted that it would not be open to the Fund, after a redemption request had crystallized, to go out into the market and purchase some other asset which would then be used for the purposes of making an in-kind distribution to the redeeming investor. He accepted that it was necessary that the asset distributed by way of an in-kind distribution is an asset comprised in the Fund's portfolio.

34. That, of course, begs the question: at what date does the asset need to be comprised in the Fund's portfolio? In particular, is it enough that the assets is comprised in the Fund's portfolio at the time of distribution, notwithstanding that it was not comprised in the Fund's portfolio at the date upon which it was contractually required to make payment in accordance with article 11F and the equivalent provision in the supplement to the confidential memorandum. In my view, the answer to that question is "No". The reason appears in the paragraph "limited liquidity in kind distributions" to which I have referred. It is plain that the intention is that, if an investor seeks to redeem at a time when the Fund is illiquid, his request can be satisfied by transferring to him an asset which is held in the Fund and is available for distribution. To put the point another way, instead of realising an asset which is held in the Fund at the time when payment is due, the Company can transfer that asset to him. To hold otherwise would have the effect that the Company could seek to satisfy the redeeming investor by transferring to him an asset which was never comprised in the Fund in which he was an investor: that is to say, by transferring to him an asset acquired after the date on which he was entitled to be paid his redemption monies. His interests could be prejudiced - as this case shows - by the transfer to him of an asset which the fund did not have while he was an investor in it.

35. Relating that proposition to the facts of this case, it is necessary to ask what assets were transferred, or purportedly transferred, to the investors. The assets transferred to the investors were shares in FILBCI. Those assets were not assets of the FIA Leverage Fund on 15 September 2011 when these investors were entitled to be paid out. Not only

were they not assets of the fund on the 15 September 2011, they were not assets of anyone on that date, because FILBCI had not been incorporated at that date: the shares did not exist. So what the fund sought to transfer to the investor was an asset which did not exist at the date when the investor was entitled to be paid out under the articles of the company. I am satisfied that the power to make an in-kind distribution does not extend to the distribution of an asset which did not exist at the time when the investor was entitled to be paid his redemption monies.

36. It may be said that is a very narrow view: what was really being transferred to the investor were the underlying rights in relation to UCBI; and the underlying rights in relation to UCBI were held by FILB on 15 September 2011. But rights held by FILB cannot properly be described as rights within the Fund's portfolio. They were rights within the file portfolio of FILB. As I have indicated there is nothing in the documentation which shows that investors in the Fund are to be treated as investors in a portfolio which is held by FILB. The asset in their portfolio is the Fund's investment in the Master Fund.

37. For those reasons it seems to me that it was not open, as a matter of principle, for the fund to seek to satisfy its obligations in relation to the August redemptions by transferring to the investors shares in FILBCI which had not existed at the time when the contractual obligation to make the redemption payments crystallised.

38. If I were wrong to reach that conclusion, then it would be necessary to ask whether it was open to the Fund to transfer the shares in FILBCI at the valuation which the directors purported to adopt on 13 February 2012. In my view there are at least three reasons why the answer to that question must be "No".

39. First, there is no evidence that the directors of the Fund ever applied their minds to what the proper valuation of the FILBCI shares should be. On the evidence to which I have already referred, it is clear that the directors simply adopted a valuation which had been put on those shares by the Investment Manager or, perhaps, by the Master Fund or, perhaps, by FILB.

40. Second, the only formal valuation that has been put before the Court to support to the value at which the FILBCI shares were transferred is a valuation which was made 14 days after the date of the transfer (13 February 2012). So that is not a valuation which the directors of the Fund, or the directors of the Master Fund, or (as it appears to me) anyone else, could have had in mind at the date of the transfer. It did not exist on that date.

41. Third, the flaw inherent in the valuation of 27 February 2012 is exposed by the second valuation made by Quantal; which, as I have said, was exhibited to Mr. Turner's second affidavit. That is a valuation dated 27 March 2012. That valuation recognises the difficulty which arises from the UCBI one to five reverse split, which took place on 17 June 2011. Mr. Marsh, the author of that, later, valuation report, reaches the conclusion that, on one scenario, the value of the UCBI rights is $136,135,806 but that on the alternative scenario - that is to say, a scenario which gives effect to the split -, the valuation is $42,372,058. So his conclusion in that later report is that the UCBI asset has a significant value and cannot be considered as a liability. But he makes no choice between the two values that he has identified. Anyone acquiring the asset in those circumstances - quite apart from the need to lay out $65 million in order to do so (although Mr. Marsh has taken that outlay into account) - would be buying a lawsuit because of the uncertainty arising from the one to five reverse split. For the directors to adopt one value rather than the other (if that is what they did) without giving any thought to the difficulties that would arise in relation to the UCBI reverse split cannot be presented as a rational exercise of discretion.

42. It is no answer to say that the directors have a complete discretion to value the Fund as they see fit. As Lord Justice Rix pointed out in *Zuckerman International Bank v Standard Bank (London) Limited* [2008] EWCA Civ 116, a decision maker's discretion in circumstances of this nature is limited as a matter of necessary implication by concepts of honesty, good faith and genuineness and a need for the absence of arbitrariness, capriciousness, perversity and irrationality. The court is concerned to see that the discretion is not abused. Lord Justice Rix reaffirmed that principle, in much the same terms in *Westel AG v Ameuro Bank International* [2012] EWCA Civ 495, [13];

holding, after reference to *Zuckerman*, that there remains an implicit requirement that such a valuation should be carried out rationally. There is simply no evidence in this case that the valuation adopted by the directors at their near-to-midnight meeting on 13 February 2012 was the product of rational thought. To be the product of rational thought, the valuation would have had to take account of the fact that there was a real dispute as to what the value of this right was; arising from the UCBI reverse stock split in June 2011.

43. So if I were wrong on the principal point on which I would decide this appeal – that, in principle, it was not open to the fund to satisfy its obligations to redeem by transferring FILBCI shares to the petitioners - I would, nevertheless, hold that there was no sufficient evidence of any rational decision by the directors of the fund as to the value at which the FILBCI shares should be transferred to the investors.

44. For those reasons I would dismiss this appeal. It has not been shown that the Chief Justice was wrong to conclude that the Company was unable to pay its debts and so should be wound up. In my view it is unnecessary to address consider the just and equitable ground.

Justice Mottley JA:

45. I am in agreement.

Justice Conteh JA:

46. I also agree.