In The Supreme Court of Bermuda

(COMMERCIAL COURT)

CIVIL JURISDICTION 2009: 178
AND
CIVIL JURISDICTION 2009: 374

(Consolidated by Order of the Court dated 26 November 2009)

AND IN THE MATTER OF CLASSES B, C, H, I AND L OF NEW STREAM CAPITAL FUND LIMITED
IN THE MATTER OF SECTION 19 AND 20 OF THE SEGREGATED ACCOUNTS ACT 2000

BETWEEN:

(1) BNY AIS NOMINEES LIMITED (as nominees for each of the 2nd to 6th Plaintiffs)
(2) GOTTEX ABL (CAYMAN) LIMITED
(3) GOTTEX ABI MASTER FUND LIMITED
(4) GOTTEX MATRIX ASSET FOCUSED MASTER FUND LIMITED
(5) HUDSON ABL FUND LIMITED
(6) GVA ABL PORTFOLIO LIMITED

Plaintiffs

-And-

NEW STREAM CAPITAL FUND LIMITED

Defendant

JUDGMENT
(in Court)

Date of Trial: April 19-23, 2010
Date of Judgment: May 27, 2010

Mr. Jan Woloniecki & Mr. Alex Jenkins,
Attride-Stirling & Woloniecki, for the Plaintiffs

Mr. Thomas Lowe QC of Counsel & Mr. Mark Chudleigh
& Mr. Cameron Hill, Sedgwick Chudleigh, for the Defendant

CONTENTS

Topic	**Paragraph(s)**
Introductory	1-5
Pleadings	6-17
Ps' fact evidence	18-24
D's fact evidence	25-47
Expert evidence on US law	48-53
Loan & Security docs pre-Plan	54-67
Loan & Security docs post-Plan	68-73
The Plan	74-77
D's Bye-laws	78-88
Key provisions of SACA	89-100
The issues	101-105
<u>Ps' submissions on legality of Plan</u>	
What assets were segregated pre-Plan	106-112
Impact of illiquidity/insolvency	113-115
Were Bye-law rights impermissibly varied?	116-117
<u>Ds' submissions on legality of Plan</u>	
What assets were segregated pre-Plan	118-122
Impact of illiquidity/insolvency	123-126

Were Bye-law rights impermissibly varied? 127-129

<u>Findings on legality of Plan</u>

What assets were segregated pre-Plan 130-147

Impact of illiquidity/insolvency 148-166

Were Bye-law rights impermissibly varied? 167-172

<u>Ps' submissions on Receivership application</u>

Would appointment be just and equitable? 173-174

Would appointment achieve 19(3) goals? 175

<u>D's submissions on Receivership application</u>

Would appointment be just and equitable? 176-180

Would appointment achieve 19(3) goals? 181

<u>Findings on Receivership application</u>

Would appointment be just and equitable? 182-191

Would appointment achieve 19(3) goals? 192 -198

Conclusion 199-208

Introductory

1. The present action results from the consolidation on November 26, 2009 of a Writ action commenced on June 18, 2009 and an action commenced by an Originating Summons issued on November 16, 2009. The Plaintiffs seek the following relief under paragraph 1 of the prayer to their Generally Indorsed Writ, as reformulated in paragraph 1 of the prayer set out at the end of their Statement of Claim:

"*A declaration or declarations that the purported variation of the rights of each of the Second to Sixth Plaintiffs as members of the Defendants of which notice was purportedly given to the First Plaintiff by letter dated May 22, 2009 ("the Purported Plan") is ultra vires and/or contrary to the Bye-Laws of the Defendant and/or contrary to the provisions of the Segregated Accounts Companies Act 2000 and that, accordingly, the said purported variation of rights is void and without legal effect.*"

2. Paragraphs 2-4 of the Writ and Statement of Claim each seek relief which is consequential upon the granting of the primary relief sought. Paragraph 1 of the Plaintiffs' Originating Summons seeks the following relief:

"*1. A receivership order pursuant to sections 19 and 20 of the Segregated Accounts Companies Act 2000 ("the SAC Act"):*

1.1 Approving a fit and proper person as a receiver of each of the segregated accounts of the defendant titled Class B, Class C, Class H, Class I and Class L (together the "Relevant accounts") with all powers of a receiver under the SAC Act; and

1.2 *Directing that the business and assets linked to each of the Relevant Accounts shall be managed by the receiver of each Relevant Account for the purposes of the distribution of the assets linked to each of the Relevant Accounts to those entitled thereto.*"

3. The First Plaintiff is the nominee and agent of Plaintiffs 2-6 ("the Gottex AB Funds"), which are all mutual fund companies. Plaintiffs 2-5 are incorporated in the Cayman Islands and the Sixth Plaintiff is incorporated in the British Virgin

Islands. The Defendant is incorporated in Bermuda and registered under section 6 of the Segregated Accounts Company Act 2000 (hereinafter either ("the Act" or "SACA"). It issued shares in various classes to the Plaintiffs, who proceeded to trial in their capacity as 100% holders of Class C and I shares. The Defendant's investment activity consisted of advancing funds by way of loan, as far as Classes C and I are concerned, to an onshore affiliate incorporated in Delaware, New Stream Insurance, LLC ("NSI"). NSI is wholly owned by New Stream Secured Capital, L.P ("NSSC"), a Delaware limited partnership, in which other of the Defendant's share classes invested in.

4. The Act creates a unique offshore legal construct under which: (a) account owners, if they are characterised as shareholders, are issued shares of a designated class; and (b) the segregated account company conducts its business on behalf of its investors by reference to the relevant class of shares through transactions linked to the relevant segregated accounts or cells. The legalities of the segregated account company corporate structure have seemingly never been tested by any Court before. However, I refused the application of another of the Defendant's investors to appoint a receiver under the Act in *UBS Fund Services (Cayman) Ltd. and Tensor Endowment Fund Ltd.-v- New Stream Capital Fund Ltd.* [2009] SC (Bda) 63 Civ (18 December 2009) ("the *Tensor* case"). In that case the applicant owned 20% of the shares linked to the relevant segregated account and did not directly challenge the Plan's compliance with SACA.

5. The Plaintiffs ultimately contend that an out of court restructuring approved by the majority of various share classes of the Defendant in May 2009 ("the Plan") ought to be declared unlawful because it contravenes the Defendant's constitution and the Act itself, as well as the Plaintiffs' legal and economic rights in their capacity as 100 % shareholders of Classes C and I[1]. It seeks to appoint a receiver to manage the relevant accounts under the provisions of the Act. In addition to

[1] On November 26, 2009, the Plaintiffs' application to appoint a receiver in respect of classes B, H and L was stayed.

contesting the legal entitlement of the Plaintiffs to the relief they seek, the Defendant crucially contends that unwinding the Plan (which has widespread support from its investors as a whole) will require NSI and NSSC to file for bankruptcy and create: (a) great uncertainty at best; and (b) economic disaster for all concerned, the Plaintiffs included, at worst.

The Pleadings

6. The Plaintiffs allege that the Prospectus and the Defendant's Bye-laws represented to prospective investors that the Defendant would establish segregated accounts in accordance with SACA. The following provisions of Bye-law 4 are relied upon:

> "*(6) Save as otherwise provided in the Bye-laws, the assets held in each Fund shall be applied solely in respect of the Shares of the Class to which such fund appertains. The following provisions shall, subject to SACA, apply to the Funds established and maintained pursuant to this Bye-law:*
>
> *(a) The proceeds from the allotment and issue of each class of Shares shall be applied in the books of the Company to the Fund established for that class of Shares, and the assets and liabilities and income and expenditure attributable thereto shall, subject to this Bye-law, be applied to such fund and linked to its corresponding Segregated Account;*
>
> *(b) ...*
>
> *(c) ....*
>
> *(d) On a redemption of Shares of a class, the redemption proceeds shall be paid to the holder redeeming such shares out of the relevant Fund;*
>
> *(e) ....*

(f) ...

(g) Notwithstanding anything to the contrary in the Bye-laws or in any prospectus, offer document, agreement or other document relating to the Company:

(i)the company shall maintain a Segregated Account in respect of each Fund and the assets of each Fund shall be held by the Company in accordance with and subject to SACA; and

(ii) the holders of the class of Shares in respect of which a Fund is established shall be the only Account Owners of the Segregated account maintained in respect of such Fund."

7. The Plaintiffs also rely on Bye-law 9, which provides an entitlement to payment as soon as practicable after a redemption request, and Bye-law 7(1), which provides that share rights may only be varied with the consent of three-quarters of either (a) the issued shares of the relevant class, or (b) on the resolution of three-quarters of those meeting at a separate class meeting.

8. The Plaintiffs allege that the Plan was proposed by a letter dated April 6, 2009, that they negotiated on the proposal thereafter and that, despite the fact that the Defendant incorporated certain amendments in a revised proposal forwarded to them on May 6, 2009, the Plaintiffs still declined to consent to the Plan. The validity of the Plan, and in particular its implementation through modifications made to the Loan Agreement linked to each segregated account, is essentially challenged on the following grounds. It is alleged that collateralized assets linked to the Plaintiffs' accounts were improperly made available to meet the claims of other investors who did not previously have claims linked to those assets.

9. In its Amended Defence, the Defendant avers that the Prospectus makes it clear that numerous notes would be issued by the same New Stream fund to various

segregated accounts. Reliance is also placed on that portion of the March 2007 Prospectus which discloses that the Manager would have a broad discretionary power to manage the investments. NSI is said to have been formed solely for investing in life settlements and premium finance loans. It was established by NSSC's general partner, New Stream Capital LLC ("NSC" or the "Managers") in 2004 and became a subsidiary of NSSC in 2006. As of June 30, 2009, insurance policy investments constituted 44.4% of the total assets of NSSC. NSI's private placement memorandum ("PPM") made full disclosure about the illiquid nature of NSI's investments.

10. The Defendant avers (paragraph 19) that it was "*established as a Bermuda segregated account mutual fund company on 31 October 2005 primarily for non-US investors and structured to allow offshore investors who wanted to invest in NSSC or NSI (when it existed as a separate fund) without subjecting their investments to U.S. taxation by taking advantage of the Portfolio Interest Exemption ("PIE") under U.S. tax law.*" To qualify for PIE, neither non-US investors nor the Defendant could invest directly in NSSC or NSI; they did so indirectly through segregated accounts with the Defendant, which in turn placed investments in the form of loans under broadly similar Loan and Security Agreements and a common Collateral Agency Agreement. Under these documents, each borrower (NSI or NSSC) pledged all of its assets as collateral for each of the Bermuda loans. It is then averred:

> "*22. Accordingly, the Defendant will say that the Plaintiffs were fully aware of the fact that the Collateral relied on in respect of the Loan and Security Agreements and the Loan Notes issued to each of the segregated accounts of the Defendant and to the Cayman and US Feeder Funds...related to the same pool of assets.*"

11. It is then averred that the Defendant's segregated account assets consisted of the Loan Notes issued by NSI and NSSC. Because those Notes carried fixed interest

and the Gottex AB Funds were among the last investors to redeem their shares in the Defendant, their total initial investment of $156.15 million had increased to a total net asset value ("NAV") of $192.66 million. Redemption was not an absolute right, but one which did not crystallize into a right to payment unless it was "practicable" for the Defendant to make payment (Bye-law 9(1)(c)). The Amended Defence then proceeds to set out the Defendant's case with regard to the Plan.

12. In 2007 the US Feeder Fund was established for US investors, and the first of several Cayman Feeder Funds were established for the non-US investors. All of the US investors exchanged shares in NSSC for shares in the US Feeder Fund (New Stream Secured Capital (U.S.) LLC). Many of the Defendant's shareholders redeemed their shares in the Defendant and invested the redemption proceeds in the Cayman or US Feeders. At this juncture, although this did not affect the status of its Loan Notes, NSI became a subsidiary of NSSC. The Collateral Agency Agreement was amended and restated as of March 26, 2008 to provide that liquidation proceeds would be paid to the Defendant on a *pari passu* basis ahead of the US and Cayman Feeders.

13. It is admitted that redemption requests were made on behalf of the Plaintiffs between September 30, 2008 and November 3, 2008, and averred that the Plaintiffs as a result are no longer shareholders of the Defendant. Their redemptions came at the end of a wave of similar requests which started in the Spring of 2008 and peaked in late September, 2008 following: (a) the liquidity crisis in financial markets, and (b) the discovery of the Petters fraud. The redemption requests represented almost 100% of the Defendant's NAV. The Cayman and US Feeders responded to these crises by (a) rejecting all redemption requests which had not become effective on or before October 1, 2008, and (b) pooling the claims of post-October 1, 2008 investors so that they would be paid out of the liquidation of NSSC's portfolio in the ordinary course. The Defendant had initiated no equivalent response. It became apparent that due to market

conditions, particularly the decline of the life settlements, liquidation in the ordinary course would:

(a) take several years, requiring some form of restructuring process or bankruptcy due to the inability of NSSC and NSI to meet demands on Loan Notes; and

(b) necessitate a substantial cash reserve to fund the premium payments in relation to NSI's life portfolio.

14. US attorneys Reed Smith were engaged to develop the Plan which was described in letters dated April 6 and May 22, 2009, the main components of which are described in paragraph 41 (2) of the Amended Defence as follows:

> "*(2) A comprehensive restructuring plan was formulated as set out in the investor letter dated 6 April 2009 and the subsequent letter of 22 May 2009 ('the Plan'). The Defendant will rely on the letters and amended documents identified below for their full terms and effect. However, in summary, the Plan included the following main components:*
>
> *(i) a two-year forbearance period in which each investor agreed to make no redemptions;*
>
> *(ii) a payment-in-kind program to accommodate investors who wished to take payment-in-kind of insurance-based assets in lieu of cash for their redemptions;*
>
> *(iii) amendment of the Loan Notes to provide, among other things, that demand thereon would be suspended or tolled for the duration of the two-year forbearance period and, at the conclusion*

thereof, subsequent payments of the Loan Notes would be subject to the ability of NSSC to liquidate its investments in the orderly course of business in accordance with the payment allocation described below;

(iv) amendment of the Loan Notes to allow payment of 'available cash' in accordance with the following methodology:

> *(1) firstly, to the Defendant, the Cayman and US Feeder funds where the redemption requests made by the underlying investors had become effective prior to 1 October 2008, in accordance with the sequence established by the date upon which such redemption requests had become effective; and*
>
> *(2) secondly, to the New Stream feeders (distributed based on an adjustable Distribution Percentage (as that term is defined in each demand note) among the investors in the defendant and the Cayman and US Feeder Funds, each an 'Investor Group'), where the underlying redemption requests had become effective on or after 1 October 2008, on a pari passu basis within each Investor Group;*

(v) The order in which the US Feeder Fund and the Cayman Feeder Fund met redemption requests which became effective prior to 1 October 2008 would not be altered by the Plan but that investors whose redemption requests took effect on or after 1 October 2008 would be paid on a pari passu basis; and

(vi) The Distribution Percentage would never net the Defendant's investors in the group referred to at 40(2) (iv) (2) above less than 70% of any such distribution available."

15. The alternatives likely involved a forced Chapter 7 or Chapter 11 bankruptcy which, *inter alia*, could deprive investors in the Defendant of the priority status conferred by the Plan and would likely be a protracted process with a far lower rate of return. Pursuant to a written resolution of the Defendant's directors dated May 12, 2009, the Plan was implemented as of May 1, 2009 with the consent of approximately 60% of the Defendant's investors, 90% of the Cayman Feeder's investors and 100% of the US Feeder's investors. The Amended Defence concludes with the following averments which are central to the issues in dispute:

    (a) nothing in the Plan altered the segregated nature of the accounts which continued to hold separate Loan Notes;

    (b) nothing in the Bye-laws, SACA or the Companies Act precludes the directors renegotiating rights and interests in the Defendant's assets, including amending the terms of the Loan Notes;

    (c) the Loan and Security Agreement did not give the Defendant in respect of Classes C and I (as lender) a proprietary interest in any particular assets of NSI (as borrower);

    (d) the Plaintiffs are not in any event in a worse off position post-Plan because under the un-amended security documentation, the notional ability to enforce the Loan Notes against the collateral would have been practically worthless. Absent the Plan, NSI would have sought bankruptcy protection and enforcement action would create a risk that NSSC would discontinue its vital support for NSI's insurance premium obligations.

16. The Plaintiffs then gave Voluntary Further and Better Particulars of their case as to why it is just and equitable to appoint a receiver. It is asserted that prior to the Plan, Classes C and I could have instructed the Collateral Agent to enforce the security because Class C alone represents 56% of the outstanding principal of all Loan Notes issued by NSI. The requisite majority is 51%. Under the "Purported Plan", the previously separate loan obligations have been combined making "*the timing, process and amount of repayment contingent upon a group scheme, rather than upon a Class's earlier agreement with its particular Borrower...*" (paragraph 19.1). In the Plaintiffs' Response to the Defendant's Request for Further and Better Particulars (paragraph 3), it is clarified that:

> "*The assets that are the property of the segregated accounts at issue here, and that are being pooled in contravention of the Bye-Laws and the SAC Act, are (i) the Loan Notes, or obligations to repay, with all their attendant characteristics and terms specified under each Class's Loan and Security Agreement with the borrower including (ii) the security interests and limitations on the disposal of assets that are part of each Class's Loan Notes under its Loan and Security Agreement.*"

17. Paragraph 51A –to 51C of the Amended Defence provide as follows:

> "*51A. It is denied that Clause 7.2(a) of the un-amended Loan Security Agreements relating to Class C,F, and I means that the assets of the Borrower (NSI) could not be traded or transferred as construed under it governing law and having regard to the context in which the Loan and Security Agreement was concluded. In conferring a lien, Clause 7.1 is in the nature of a floating charge which gave the Borrower the continued right to manage and deal with its assets until the charge was crystallized. The lien in the*

Loan and Security Agreement did not give the Lender a proprietary interest in any particular assets of the Borrower who was free to deal with such assets insofar as the wording of Clause 7.2(a) suggested otherwise the inconsistency would be disregarded. Further, SACA is not contravened by any transaction carried out by the Borrower (NSI).

51B. The Defendant's assets referable to Classes C, F and I are the contractual rights to repayment of principal and interest under the Loan and Security Agreements pertaining to those Classes. The Defendant continues to hold such rights. Nothing under the Bye-Laws of the SACA prevents the Defendant from agreeing variations to the terms of those contractual rights, including giving accommodations to NSI as Borrower. It is denied that any criticism can be made of the Defendant for varying those rights and they were varied in the best interests of the Defendant in general and Classes C, F and I in particular.

51C. It is denied that the Plan places Class C, F or I in a worse or different position than if the Loan and Security Agreements had remained un-amended. It is admitted that, upon a default under the Loan and Security Agreements, Class C could have instructed the Collateral Agent to enforce the security over NSI. It is denied that there was such a default, but if there had been and instructions given to the Collateral Agent, it is further denied that there would have been any enforcement against the collateral or any assets to recover.

(1)NSI and NSSC would have commenced bankruptcy proceedings in United States under Chapter 7 or 11. The Defendant repeats paragraph 44 above.

(2)There would have been automatic stay of execution against NSI's assets by the Defendant or the Collateral Agent under the Federal Bankruptcy Code and no enforcement. The rights of

NSI's creditors would have been subjected to the collective enforcement by all its creditors which have substantially delayed redemptions inter alios for the Plaintiffs.

(3)In the bankruptcy of NSI, NSSC or its shareholders would have been substantial claimants to NSI's estate by virtue of the financial contributions it had made since 2006 to maintain NSI assets. The Defendant's position as creditor of NSI was liable to be subordinated or re-characterised because of payment made to NSI by NSSC.

(4)Any enforce against NSI's collateral would occasion the risk that NSSC would cease providing financial support to NSI. In that event, NSI could no longer have made the premium payments needed to maintain its assets which would have become worthless or nearly worthless.

(5)In the premises, the Defendant would not have recovered payments on the basis of the un-amended Loan and Security Agreements in the bankruptcy."

The Plaintiffs' fact evidence

18. The Plaintiffs' case from the outset was evidence "light" and law "heavy". The action for declarations of invalidity relating to the implementation of the Plan was fundamentally based on the construction of the Act and the Defendant's governing instruments. The key documents were the Bye-laws and the Loan Agreements, with no great reliance being placed on the Prospectus. The approach taken to the Receivership application was to assume that if the plan was struck down, a receivership order would logically follow, without the need to flesh out in any great detail what action a receiver would take and what his likely prospects of success would be. After all, unlike the unsuccessful receivership applicant in the *Tensor* case, these Plaintiffs were 100% owners of the applicant segregated accounts. Much of the evidence set out in the affidavits and canvassed in cross-

examination had background relevance only to the declaratory relief sought, and direct relevance only to the receivership application, depending upon the view the Court took of the evidential threshold required to be met under section 19 of the Act.

19. The Plaintiffs' principal witness as to the background facts was Ms. Amy Lai, Managing Director of Gottex Fund Management Limited. She was cross-examined on her Fourth and Fifth Affidavits, which were sworn in support of the receivership application. According to paragraph 7 of her Fourth Affidavit:

> "*The Gottex AB Funds make this Receivership Application because of the history of the New Stream fund structure and the Purported Plan of reorganization show that it is just and equitable to appoint a receiver and that a receiver would achieve these purposes: (a) to protect and manage the assets of Classes C and I, (b) to assert and act upon the interests of those Classes without the multiple conflicts of interest that currently plague New Stream Capital, LLC (the 'Investment Manager') (which is the general partner of New stream Secured Capital L.P. ('NSSC'), the Onshore Master fund) and the Board of Directors of the Bermuda Fund, and (c) to secure payment of and distribute those assets-loans secured by perfected security interests in the insurance-related collateral owned by New Stream Insurance ("NSI")-to the Class C and I investors.*"

20. The Fourth Lai Affidavit concludes by indicating that John McKenna is the receiver proposed by the Plaintiffs. The potential scope of his duties is described in paragraph 98 as follows:

> "*98.In somewhat more detail, the Receiver could, it the Court makes the appointment after determining Purported Plan to be invalid, consider performing the following tasks which are meant to be illustrative rather than exhaustive:*

98.1 negotiate with NSI or other New Stream entities as appropriate to serve the specific interests of Classes C and I;

98.2. work with others to secure financing to ensure future premium payment obligations are met on the underlying insurance business;

98.3. declare an event of default absent repayment of the Class C and I Loan Notes or upon any improper movement of the NSI collateral;

98.4. direct the Collateral Agent to execute on and sell the Collateral;

98.5. retain counsel in the US and, if necessary, seek judicial intervention if any if the NSI assets were being removed from the collateral pool before full payment of Classes C and I;

98.6. advocate, directly or through US counsel, the Class C and I interests in any bankruptcy proceeding, if indeed any bankruptcy proceeding ever transpired; and

98.7. any other actions that an investment manager or board of directors could accomplish."

21. The Fifth Amy Lai Affidavit is a reply Affidavit, and challenges the way the Gillies Affidavit describes the course of the negotiations between the Managers and the Gottex AB Funds on the contents of the Plan. Under careful cross-examination by Mr. Lowe, Ms. Lai was bound to concede that the grounds on which the Plan is now attacked were not advanced by her at the negotiation phase. At best the documentary record merely demonstrated that the Gottex AB Funds never consented to the Plan. Mr. Lowe also succeeded in establishing that if the Plaintiffs had wished to challenge the Plan on the grounds that the segregation principle would be violated, sufficient information was provided to enable them to raise such an objection earlier than they did. Ms. Lai also produced as a result of

cross-examination a previously non-disclosed document she had prepared for the Gottex AB Funds' bankers in which Gottex Management positively recommended the Plan. This document ought to have been disclosed in the first instance, despite its peripheral significance at the end of the day. Ms. Lai also admitted that John-Paul Bailey, to whom she reported, was angry with her when he learned that she had adopted this stance. She stated that not long before Gottex Management's lawyers sent their May 28, 2009 letter challenging the validity of the Plan, she and Mr. Bailey called Perry Gillies to warn him that the letter was on its way.

22. John-Paul Bailey was the Plaintiffs' second fact witness. He is a founding Partner of Gottex Fund Management Sarl, Senior Managing Director of the Executive Committee and Portfolio Manager for the Gottex AB Funds. His First Affidavit was filed in reply to First Gillies. His Second Affidavit was sworn on the second day of the trial in response to the cross-examination of Amy Lai. Under cross-examination, he explained that he was the principal decision-maker who would advise the Plaintiffs' clients what position to take on the Plan. He insisted that he communicated his opposition to the Plan to Mr. Gillies in strong terms as soon as he was briefed by Amy Lai on it in late April 2009, although he admitted that business etiquette did not warrant bluntly refusing to negotiate any further with the Managers. He also explained that a Chinese wall was belatedly established between that part of his firm which was representing the Gottex MN Funds (who consented to the Plan) and the Gottex AB Funds. This was because he felt that Ms. Lai had been overly influenced in her initial support for the Plan by a senior Gottex executive, Mr. Liebovitch who was committed to serving the inconsistent interests of the Gottex MN Funds.

23. Since Mr. Bailey took no notes of his limited involvement in the negotiation process and there is no indication of any definitive rejection of the Plan prior to May 12, 2009 when it was implemented, it seems quite possible that he was mistaken in his recollection as to precisely what he told Mr. Gillies, how vehemently he spoke and precisely when specific conversations occurred.

However, it does seem clear that when a decision not to assent was taken, this was not based solely on the opposition of Barclays, as Ms. Lai's communications with Mr. Gillies implied; otherwise, as Mr. Bailey pointed out in his oral evidence, the non-Barclays clients would not have also declined to support the Plan. While these details may be significant to the witnesses themselves, they are of marginal relevance to the principal points at issue in the present case.

24. The most important point established by the Defendant's counsel through cross-examination of both Mr. Bailey and Ms. Lai was that they had no concrete plan in place for financing the payment of premiums which would be essential to preserve the value of the life portfolio held by NSI. Neither witness was able to credibly refute the suggestion that NSSC's funding of the premiums did confer a real financial benefit on the Plaintiffs and that the Plan was implemented by the Managers in response to an unprecedented and unexpected liquidity crisis. In addition both witnesses conceded that the characterisations of the Plan as "egregious" in their Affidavits were never communicated to Perry Gillies during the course of their negotiations.

The Defendant's fact evidence

25. The Defendant's factual evidence, particularly the Affidavits of Perry Gillies, was a mixture of helpful background explanations about how the investment business operated in practice, a description of the circumstances that motivated the development of the Plan and the course of the negotiations, rounded off by fulsome arguments as to (a) the fairness of the Plan, and (b) why even the Plaintiffs would be financially worse off if they were granted the relief they sought. From the Defendant's perspective, the complaints about the legality of the Plan were highly technical and inconsistent with the efficient management of mutual funds; the law required proof of the practical benefits the receivership would bring, and the Plaintiffs' case was woefully lacking in this regard.

26. Perry Gillies, President of NSC, the investment manager of the Defendant, swore his First and Second Affidavits on February 29 and March 17, 2010, respectively. His First Affidavit explained the form of debt investments made by the Defendant in respect of various segregated accounts into NSSC and NSI. Classes C, F and I invested in NSI only. A separate Loan and Security Agreement ("LSA") was executed for each account, and the amounts committed were drawn down under Loan Notes. The key features of the relevant documentation were described in paragraphs 31-33 as follows:

> "*30. The form of these agreements and other related documents is typical of US asset based loans ("ABL"). The following is an outline of the structure of these types of arrangement and how they interrelate for commercial and legal enforcement purposes.*
>
> *31. In order for a lender to be secured against the assets of a borrower in the US, the loan agreement will either grant the lender a lien against a specific asset or set assets, or in the case of an ABL, a general pool of assets. The most common form of asset based lending is a loan against commercial receivables. For ordinary course business assets, like receivables and inventory, the lien is against current and future assets, and in this instance the lien does not prevent the borrower from selling the assets, as to release a lien on an asset-by-asset basis would be operationally cumbersome. Therefore the granting of a "blanket lien" does not by itself dictate specific collateral nor an amount of collateral that must be held at any point in time. It merely establishes which classes of asset will be security for a loan from time-to-time should the borrower go into default and the lender elect to foreclose.*
>
> *32. To ensure that sufficient collateral will be available as security, the ABL usually contains a mechanism requiring the*

borrower to maintain a certain ratio of collateral to loan proceeds. These formulas can be quite complex, but are very commonplace in the industry. They allow the borrower to increase and decrease the amount borrowed commensurate with increases and decreases in the collateral. Essentially, as long as a borrower is in compliance with the formula, it can buy and sell assets, and manage its business affairs, without interference from the lender. Should the borrower be out of formula, there is a default under the loan which must be cured. A failure to return to formula within the prescribed period can result in foreclosure by the lender.

33. A third feature of the ABL structure is the relationship with other lenders. It is unusual for a business to obtain all of its borrowings from a single lender, if for no other reason than that the lenders will want to limit their exposure to a single credit. Therefore, the loan agreement will dictate what, if any, other lenders may have a security interest in the same pool of collateral an their relationships (e.g. if they will be senior, subordinate or pari passu). When multiple lenders exist, their relationships are usually defined in a separate, inter-creditor agreement which stipulates how they will interact with respect to the collateral in the even of a default under the loan agreement(s) which results in a foreclose and liquidation. Therefore an inter-creditor agreement only becomes effective in the event of a default and foreclosure."

27. Each Loan Note was repayable by the Borrower: (a) within six months of demand, liquidity permitting; and (b) upon the expiration of 12 months in any event. All of the Borrower's assets were pledged as collateral, without prejudice to the borrower's right to use those assets in the ordinary course of business. The Defendant on behalf of each segregated account entered into Collateral Agency Agreements with NSSC and NSI, which agreements were governed by Delaware

law. Liquidation of the collateral could only be demanded by the holder(s) of 51% of the aggregate debt under each agreement.

28. First Gillies goes on to explain the 2007 restructuring, under which the Cayman Feeders and the US Feeder were established and invested in NSSC through a combination of debt and equity to eliminate concerns about the high level of debt relative to equity. The Defendant remained the sole NSI Feeder Fund lender. As such, the Collateral Agency agreement for NSI remained unchanged while its NSSC equivalent was altered to make reference to the new Cayman and US lenders. First Gillies also emphasises (paragraphs 49-57) that in August 2008, Gottex Management negotiated an amendment to the Bermuda Loans to resolve NSSC's non-compliance with the applicable loan-to-value ratio ("LTV"). The amendments permitted the payment of other loans and the ratio calculation took into account NSI's assets as part of NSSC's assets. Bye-law 9(1) was also amended in August 2008 in response to the Gottex Funds' threatened redemptions to require the Defendant on receipt of a redemption request to make a demand for repayment on a linked loan.

29. Two observations are called for at this stage in relation to the significance of these amendments. Firstly, the need for NSI's assets to be taken into account as part of NSSC's assets to enable NSSC to comply with its LTV requirements under its Loan Agreements suggests: (a) that the so-called mutualisation of the two Borrowers' assets was not part of the original loan structure, but rather evolved as a marriage of commercial convenience; and (b) that far from NSSC's payment of NSI's life settlement premiums being akin to a loan which NSI could be compelled to repay, the financial support provided by parent to subsidiary was a means of sustaining the parent's own asset value. Secondly, the amendment to Bye-law 9(1) confirms that the internal relations between NSSC and NSI and how they treated their assets for accounting purposes in relation to the loans did not weaken the nexus between the segregated accounts and the respective collateralized asset pools. The new version of Bye-law 9 (1) fortified the link

between the redemption rights of account owners under the Defendant's constitution and the pool of assets securing the repayment obligations under the linked Loans.

30. The same Affidavit (paragraph 64) explains that as a "*matter of practice, liquidity generated from NSSC and NSI assets has always been applied to repay Feeder Loans in the order determined by the effective date of the underlying redemption obligation that the loan repayment will ultimately be used (by the Feeder Fund) to discharge. NSC directs the application of liquidity for this purpose.*" NSI loans were generally repaid through cash generated by NSSC because "*NSI was virtually always cash negative*" (paragraph 65). This practice is explained in paragraphs 66 to 75 under the heading "**THE MUTUALIZATION OF NSSC AND NSI**". Although Mr. Gillies under cross-examination volunteered that he regretted using the term "mutualization", he did not seek to recant the assertions made in paragraph 75 of his First Affidavit:

> "*To summarize, NSSC and NSI have for some years formed a single pool of assets, mutually self-funding, and available for the repayment of any and all loans advanced to either NSI or NSSC. Since 2007, no offset has been made between NSI and NSSC in respect of the periodic costs of financing assets. The assets are made available for the benefit of all investors. As such, there is no special connection between the assets of either vehicle and the loans advanced by its lenders. Hundreds of millions of dollars of loan repayments and premiums have been paid out of this mutual pool, without regard to actual legal ownership of assets (that is, whether the assets used to repay the loans or finance premiums are owned by the same vehicle as is liable under the loan or owns the life policy). This has been the position since 2007, and in many ways since 2004.*"

31. Again, it was difficult to understand these assertions as more than an explanation of how the New Stream Group managed its internal financial relations as otherwise the legal relations which the Defendant's investors and their related segregated accounts purportedly entered into with NSI and NSSC respectively would have to be found to be entirely sham transactions. Their primary point was to explain the commercial logic behind the Plan, which was eventually adopted and to suggest that, legal segregation notwithstanding, the Defendant's various investors really had commercial interests in common.

32. The deponent then explained the origins of the Plan. By September 30, 2008, approximately $200 million of redemption requests had matured, $166 million of which related to the Defendant. Repayment demands on 20% of NSSC loans had been made, but NSC felt these could be met. However, fund failures linked to the Petters Fraud triggered a second wave of redemption requests in September 2008, with the total value of requests rising to $545 million. In October NSC decided to reject (in respect of the US and Cayman Feeders) all redemptions which had not matured prior to October 1, 2008 and to pay those investors on a pro rata basis out of available cash generated by NSSC in the ordinary course of business. As far as the Defendant was concerned, redemptions were neither rejected nor suspended as nearly all investors had made redemption requests. However, NSC advised that redemptions not effective on or before September 30, 2008 would be paid on a pro rata basis as in the case of the Cayman and US Feeders. This process was nevertheless problematic because: (a) the Loan Notes could not be paid according to their terms within 12 months, and (b) the NSSC PPM stated that investments would not be sold under forced sale conditions. NSC planned to discuss with the directors extending the term of the Loan Notes.

33. However, "*a second catastrophic event occurred*" on November 28, 2008. AVS, the largest rating agency for life settlements revised its methodology with the effect by late February, 2009, the life settlement market completely dried up. This resulted in a 33% loss of value for NSSC's life portfolio coupled with a

substantial impairment of the ability to monetize life assets at a reasonable or non-distressed value. The Plan was devised to facilitate an orderly liquidation and to avoid a court-supervised process (which would waste time and costs); and Gottex Fund Management was intimately involved in the development of the Plan. As far as the life assets were concerned, there was the stark contrast between a forced sale recovery estimated at US$68 million in respect life policies with an aggregate death benefit of US$2.7 billion, complicated by the fact that the payment of premiums constituted " *a significant drag on liquidity*" (paragraph 99). Giving priority to the Bermuda investors while using NSSC's funds to pay NSI premiums would potentially be challenged as inequitable by the Cayman and US Feeders in the US Bankruptcy Court. A consensual reorganization was likely to beneficial to the Defendant's investors as well as those in the other Funds.

34. The case for the Plan and set out in a webinar presentation included the following key points:

> "*106.1 Chapter 11 bankruptcy creates the potential for a process that would take several years to resolve legal issues precluding any distribution of cash during that period as compared with the Plan which anticipates a return of US $210 million of capital during the forbearance period and a total unwind of assets by 2013;*
>
> *106.2. the "distressed seller" status in Chapter 11 bankruptcy proceedings would impair the value of asset dispositions by NSSC, impact upon the retention of key employees and*
>
> *106.3 constituents with differing interests could present a disorderly process in the unwinding of the collateral whereas the Plan allows a prudent and expeditious monetization of assets by a core team of knowledgeable and experienced managers;*

106.4 Chapter 11 bankruptcy would involve an exorbitant level of legal, liquidation and court related fees and expenses which would be borne by the funds and investors whereas under the Plan expenses are expected to decline significantly as the assets in the portfolio are realised."

35. After explaining how the negotiation process went and how surprised NSC was at the late indication by Amy Lai in May 2009 that the Gottex AB Funds were not going to approve the Plan, First Gillies explains how the Defendant's directors decided nonetheless to proceed to implement the restructuring:

> "*The Gottex MN Funds' approval brought the percentage of the Bermuda fund's investors who had consented to the Plan to 60%. With this information, NSC reverted to the Bermuda Fund's directors who were well apprised of the situation and the ongoing discussions with Gottex and Barclays. The directors affirmed their view that they had a clear majority of investors supportive of the restructuring and that they would place the Plan into effect on this basis. The Plan was therefore implemented through a resolution of the Bermuda Fund's directors effective 1 May 2009.*"

36. After asserting that the alternative to the Plan would have been catastrophic for all concerned, First Gillies concludes by asserting that: (a) the interests of Classes C and I were specifically taken into account; (b) the Plan did not pool the assets of segregated accounts; (c) any change in the identity of the borrower did not alter any share rights (by the time of the Plan there were no longer any shareholders of the segregated accounts); (d) the Collateral Agency Agreements only apply in a default context and have nothing to do with ordinary course of business disposals or redemptions. Moreover, these agreements came into existence after the investment of the Gottex AB Funds; (e) the Plan has caused no harm as no distributions have been made to the Feeder Funds; and (f) a receivership would be futile as (i) a receiver could do no more than NSC is already doing, and (ii) given

the extensions of the Bermuda Loans until May 2011, a receiver could do nothing before then.

37. Second Gillies responds to the main points made in Fourth Lai and restates many of the points made in First Gillies. In reiterating that no conflict of interest existed between various classes of shares, he deposed in paragraph 72 as follows:

> "*72.In any event, absolutely no trace of conflict appears where repayments are made according to ordinary course of business structures. This is because of the mutualized structure, treating assets of all NSSC subsidiaries as available to repay all Feeder Loans regardless of borrower. This structure is plain from the past corporate practice (referred to above), as well as Feeder Loan provisions such as the LTV covenants which treated NSI as an asset of NSSC for the purposes of gauging NSSC's ability to repay its own loans. I have explained how the structure and practices were preserved and perpetuated under the Plan. It is only where an attempt is made to break out of the structure that an apparent conflict could emerge. Fortunately, scenarios of that kind are immaterial. This is because, as I have explained, the hard facts of US litigation would swiftly re-impose a common interest in relation to all Bermuda Loans, given the risks of subordination that would face them all equally. It would serve no segregated account's interest to jeopardize its position in this way, particularly where a consensual means of preserving seniority of negotiated compromise). So the appearance of conflict only arises when contemplating courses of action that no prudent segregated accounts company would pursue.*"

38. The Second Gillies Affidavit then concludes as follows:

"*84.Two factors are particularly striking about Ms. Lai's Fourth Affidavit, and I have tried to highlight these. First, while plainly accepting that negotiation is a normal component of any restructuring, she then goes on to brand any element of compromise of Bermuda rights under the Plan as unacceptable in principle. I have explained how litigation was adverse to all interests of the Bermuda Fund, and that the plan preferred it by assuring recognition of its priority without the risk of challenge in US bankruptcy. But, to achieve that, some compromise was inevitable.*

85.The other factor is this. The Gottex AB Funds' entire case on (a) why the Plan directly harmed the Bermuda Fund in respect of C, F and I to the benefit of everyone else, (b) why the Bermuda Fund is split by a conflict of interest, and (c) the fruitful work that a receiver could accomplish, is premised on a misrepresentation of the New Stream structure as it had stood for several years before the Plan. For years, NSSC, and NSI (in common with all subsidiaries of NSSC) have represented one single fund under single management, with an undifferentiated pool of assets which was centrally paid for, and which was available to repay all Feeder Loans (in order of date of underlying redemption) regardless of the actual identity of the borrower. There have not been (and there was no need for) the rigorously segregated onshore asset bases that Ms. Lai describes. That is the reality. If the Bermuda Fund tried to disturb that by asserting exclusive rights over the assets of NSI, there would be immediate bankruptcy, the separateness of debtors would be challenged based on their historic treatment as one, and the proposition that NSSC

> *had depleted its own asset base to sustain a discrete pool of collateral just for the Bermuda Fund would furnish the other investors with the basis of subordination claims. It is implausible to portray foreclosure on C, F and I Bermuda Loans as a simple, tidy process. It would provoke years of complex expensive litigation leaving the Bermuda Fund with an uncertain future. The Gottex AB Fund's case relies on that simple, tidy process, but it is in error.*"

39. The above evidence appears to ultimately imply that despite the segregated account structure according to which the Plaintiffs invested and according to which their accounts lent to NSI, they were bound to accept a legal reality based on the integrated way in which NSI and NSSC managed their cash-flow demands. Understandably, it fell short of contending that the Plaintiffs were estopped from asserting their present claims because they had waived their right to do so. Presented as part of the deponent's sales pitch for the commercial fairness and logic of the Plan, it reveals what appear to be inherent weaknesses in the global corporate structure which the market liquidity crisis and an avalanche of redemption requests strained to breaking point. Both the Loan Agreements and the Defendant's Prospectus expressly or impliedly represented that NSI and NSSC were viable and self-sustaining entities with separate pools of collateralised assets. These documents did not suggest that the Borrowers were only able to function as an integrated whole; accordingly, this part of Mr. Gillies' evidence has no real impact on how the governing instruments of the Defendant are construed in conjunction with the Act.

40. Under cross-examination, Mr. Gillies denied that the individual equity owners of NSSC stood to benefit from the Plan, explaining that they were at the end of the payment queue. He also voiced his surprise at Mr. Bailey's suggestion that he had made his opposition to the Plan (on behalf of the Gottex AB Funds) clear in late April, 2009. He insisted that as late as May 19, 2009, he still hoped that the

Gottex AB Funds would support the Plan. Mr. Gillies also stood by his central thesis that the Plan represented a fair compromise between the interests of the Plaintiffs and other investors (in both the Defendant and the Cayman and US Feeders). This was principally because investors in NSSC had to be persuaded to support NSI by funding NSI's premium obligations. He agreed that on its face the post-Plan LSA appeared to show that NSSC had assumed NSI's payment obligations, both because of the wording of section 2.2 and the fact NSI had not even signed the May 1, 2009 version of the LSA. However he stated that NSSC had signed NSI's agreement due to a clerical error, and that it was obvious that a mistake had been made in the wording of section 2.2 which was corrected in the February 24, 2010 further amendment. He denied the suggestion that this explanation was concocted in response to the Plaintiffs' present claims. He also made it clear that although consent was sought, it was never considered to be a legal precondition for the efficacy of the Plan. This latter point touched upon an issue of law of considerable importance which does not, of course, ultimately depend on the views of the witnesses.

41. In re-examination, Perry Gillies corrected his assertion under cross-examination that when NSSC paid NSI's premiums this was accounted for as an equity investment, explaining that in fact such payments were booked as an 'investment in subsidiary'. He referred the Court to the relevant accounts which did <u>not</u> make it obvious to me that the relevant payments were not recorded as an equity investment, as opposed to a loan. He fairly conceded that if the Plaintiffs received bankruptcy law advice to the effect that they would benefit more from a bankruptcy than under the Plan, it would be reasonable for the Plaintiffs to pursue such a remedy.

42. Although the Defendant initially relied upon affidavits filed by both of its Bermuda-based Directors, Mr. Clipper and Mr. Price, Mr. Price's affidavit was withdrawn before trial and only Mr. Clipper appeared at trial for cross-examination. Mr. Clipper's Affidavit explained how he first got an in depth

understanding of the Defendant's business, which he previously had a working knowledge of, through a meeting with NSC in March 2009. In paragraphs 13-14 of his Affidavit he deposed:

> "13. *The Bermuda Loans are collateralized by security over the assets of the borrower. As a result, the collateral under all Bermuda Loans with each borrower is identical. Again, the interests of all segregated accounts with Bermuda Loans to the same borrower are all of a piece*
>
> *14. Bermuda Loans attributable to seven of the Bermuda Fund's ten segregated accounts were concluded with NSSC. Bermuda Loans attributable to the remaining three were made to NSI. NSI is a wholly owned subsidiary of NSSC. At the time, my understanding from NSSC, concerning the structure of the group, was that no distinction was drawn between the assets of any of NSSC's subsidiaries.*"

43. By the conclusion of the March 2, 2009 meeting at which NSC made a presentation on the need for an accommodation between all Feeder Funds, Mr. Clipper was convinced that the only alternative of a bankruptcy with the risk of prolonged multi-jurisdictional litigation was not in the best interests of the Defendant. He was reinforced in this view by subsequent meetings and, in particular, NSC's analysis of the comparative returns under the Plan compared with a forced liquidation. He also observed that NSC had excellent relations with shareholders and creditors and developed the Plan on a consultative basis. The only informal Bermuda law advice he obtained was that the Bye-laws should be consulted to determine what level of approval was required for the Plan. He understood from a lawyer (who explained in cross-examination was NSC's US counsel) that the Bye-laws were silent on any voting requirements for a "work-out plan". Mr. Clipper and Mr. Price implemented the Plan by resolution dated May 12, 2009.

44. Under cross-examination, Mr. Clipper confirmed that no formal Bermuda law advice had been obtained about the Plan generally and SACA in particular. He also revealed that the Defendant was the only segregated account company amongst his several directorships. He accepted that the Board resolution approving the Plan was passed "*subject to the Fund receiving the required consents in respect of each of the segregated accounts...of the Fund*". Under re-examination the director indicated that he was told by NSC that Conyers Dill & Pearman, the Defendant's corporate Bermuda attorneys, had drafted the resolution. Although Mr. Clipper stuck to the "party line" that it was not considered that the Plan required shareholder approval, it was difficult to square this ritual incantation with the way the resolution was drafted.

45. Mr. Woloniecki did not to my mind elicit any startling and significant concessions in cross-examination. I accepted Mr. Gillies' assertion that the February 24, 2010 amendments to the recitals of the modified LSA to correct the reference to the NSSC Collateral Agency Agreement were prompted by purely clerical errors. However, counsel's case from the outset was that the relief the Plaintiffs seek turns on a construction of the loan documentation, the Bye-laws and the Act. The Defendant's Investment Manager and directors appear to have consummated the Plan in good faith genuinely believing that it was in the best interests of all of the Defendant's share classes including the Plaintiffs. They rationally believed that an out of court restructuring could not be effectively implemented without near universal support from all investors, even though no such approval was formally required as a matter of law. When one of their largest investor groups in the Defendant surprisingly withheld its consent at the eleventh hour, the Defendant seemingly decided to "tough it out" and take on the legal challenge which eventually emerged in the form of the present proceedings.

46. In hindsight it does seem astonishing that such a complex and substantial restructuring involving a Bermudian company should have taken place without the Defendant obtaining formal Bermuda law advice. The Plaintiffs could not

make much of this apparent lapse because the breaches of SACA of which they now complain were never raised by them, even in the May 28, 2009 reservation of rights letter, as Mr. Lowe pointed out. In the present case, however, it is difficult to avoid the suspicion that rather than ignoring the far from straightforward Bermuda law position, a "don't ask don't tell" policy was adopted. Mr. Woloniecki invited the Court to infer from Mr. Clipper's evidence that Conyers Dill and Pearman must have advised that the Plaintiffs' consent was required for them to be bound by the Plan.

47. In my judgment the most significant findings which inevitably arise from Mr. Clipper's evidence are that (a) the directors approved the transaction having regards to the collective interests of the various segregated accounts as a whole; and (b) that the transaction was viewed by the Defendant's directors as an extraordinary transaction in relation to which it was desirable (if not necessary) to obtain prior shareholder approval.

Expert evidence on US law

48. The Defendants' expert was not required to give oral evidence. Professor Frederick Tung is a Professor of Law and Business at Emory University, with specialties in bankruptcy and corporate law. He practised with the international law firm of Gibson Dunn & Crutcher in Los Angeles and San Francisco for four years before commencing his academic career. He is a non-active member of the California Bar. Although he described the rules of construction applicable to the LSA and Collateral Agreements under Connecticut and Delaware law respectively, both counsel eventually agreed in closing that these documents could be construed by this Court as if they were governed by Bermudian law. The main controversy between the parties centred on the opinions expressed by Professor Tung on the likely course of a bankruptcy proceeding if NSSC and NSI were to file for bankruptcy protection in the wake of foreclosure under the Loan and Security Agreements.

49. Professor Tung opined that the relevant security interests could potentially be varied by the US Bankruptcy Court under the doctrines of substantive consolidation and equitable consolidation. In paragraph 37 of his Opinion, the Professor states:

> "*Substantive consolidation is justified when, as to the entities sought to be consolidated, either (i) they disregarded separateness so significantly that their creditors relied on a breakdown of entity borders and treated them as one legal entity, or (ii) by the time of bankruptcy, their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.*"

50. It is then suggested that the US Bankruptcy Court might pool the secured assets of NSSC and NSI although the novel feature of the Bermuda segregated account structure makes it difficult to predict more than the potential for a protracted bankruptcy proceeding. The Professor next opined that attempts to ring-fence NSI assets might be challenged by other investors under the doctrine of equitable subordination:

> "*58. As for equitable subordination, courts typically require that the claimant* [sic] *have engaged in inequitable conduct that either results in injury to creditors or confers an unfair advantage on the claimant, and a claim will be subordinated only to the extent necessary to redress this harm. In addition, subordination must not be inconsistent with the provisions of the bankruptcy laws.*"

51. The Plaintiffs' expert was Richard Broude, who after working as a full-time law professor for 5 years has practised law in Los Angeles for 20 years and New York City for 20 years, specializing in insolvency, work-outs and bankruptcy reorganizations. He has worked on his own since 2000, and for the previous

decade was a partner with Mayor, Brown, Rowe & Maw. Mr. Broude expressed the following opinions on issues which appeared to me to be of particular significance:

(a) A perfected US security interest, as created by the loan and collateral documents together with the filings under the Delaware Uniform Commercial Code, establishes the priority of the relevant security interest from the time of perfection;

(b) A Chapter 11 filing is the only likely filing the management of NSSC or NSI would consider (unless, he explained in his oral evidence, they no longer wished to manage the companies);

(c) The Plaintiffs' security interests would likely be respected by the US Bankruptcy Court, and they would fare better in a bankruptcy than under the Plan, even if substantive consolidation occurred.

52. Under cross-examination, Mr. Broude conceded that positions contrary to his key assertions could be argued by interested parties, even if they might not prevail. In addition, he was bound to concede (or unable to credibly deny) that the issue of procuring debtor-in possession ("DIP") financing to fund the NSI premiums was not an entirely straightforward matter. Looking at the expert evidence in the round, I was satisfied that the Defendant's desire to avoid the potential delays and costs of a bankruptcy proceeding through the Plan was in general terms reasonable. But, on the other hand, the Plaintiffs' belief that they would fare better in a bankruptcy, to the extent that this view was supported by a US bankruptcy law expert, could not be said to be unreasonable, even though the detail provided of what a receiver would likely actually achieve (in comparison to what is projected under the Plan) was extremely thin indeed. This was attributable in part to the undoubted uncertainties of how any bankruptcy proceeding would unfold, in part due to uncertainties of market conditions in the life settlements market and

in part flowed from uncertainties relating to whether or premium finance could be obtained by a receiver and what compromises might be reached. However, I inferred from the way in which the Plaintiffs advanced their case that they refuted the contention that any such detailed road map had to be adduced in evidence to support their receivership application.

53. How this evidence falls to be interpreted ultimately turns on the legal analysis which will be undertaken after the key legal documents are first described. However, I was able to readily accept the opinion of Professor Tung to the general effect that various attacks could be potentially launched in a bankruptcy proceeding against the NSI asset pool which would complicate any attempt be secured creditors to liquidate their collateral. Mr. Broude I found to be an impressive witness. I accepted his opinion to the effect that the security interests over the collateralised assets ought ultimately to be respected, even if the enforcement of the secured creditor rights under the Collateral Agreement were delayed by unmeritorious equitable subordination and substantive consolidation claims. Although Mr. Gillies' evidence appeared to be compiled with one eye on this Court and another eye on the US Bankruptcy Court, Professor Tung's formulation of the law of substantive consolidation and equitable subordination did not appear to fit neatly with the facts of the present case.

The loan and security agreements pre-Plan

54. The LSA in force prior to the purported implementation of the Plan was the Amended and Restated Loan and Security Agreement dated August 1, 2008 between New Stream Insurance, LLC and New Stream Capital Fund Class C[2], it being agreed that a corresponding agreement existed in relation to Class I in the same terms. This agreement provided for a $250 million revolving line of credit. Sections 2.1-2.3 provide as follows:

[2] Bundle A at 553-576.

"***Article II LOANS***

Section 2.1. Revolving Loans. *Subject to the terms and conditions contained in the Agreement, and so long as no Default or Event of Default shall exist and no demand for payment has been made by Lender, Lender agrees to make loans (each, a "**Revolving Loan**") to Borrower from time to time, provided that the aggregate amount of all Revolving Loans in the aggregate at any time outstanding shall not exceed the Maximum Line Amount.*

Section 2.2 Payment After Demand. ALL OBLIGATIONS OF BORROWER ARISING UNDER THE REVOLVING LOANS SHALL BE PAID BY BORROWER IN FULL ON THE FIRST OF THE MONTH FOLLOWING SIX (6) MONTHS AFTER DEMAND OR AS SOON THERAFTER AS BORROWER IS ABLE TO LIQUIDATE IN THE ORDINARY COURSE OF BUSINESS AND IN AN ORDERLY MANNER (BUT NOT LATER THAN TWELVE (12) MONTHS AFTER DEMAND), A SUFFICIENT AMOUNT OF ITS INVESTMENT PORTFOLIO TO REPAY THE LOANS (THE "PRINCIPAL DUE DATE").

Section 2.3 Procedure For Advances, Advance Request, Revolving Loan Note, Etc. *So long as Borrower is in compliance with all of the terms and conditions of this Agreement, no Default has occurred and no demand for payment has been made by Lender, Borrower may request borrowings of and repay Revolving Loans. Whenever Borrower desires an advance (an "**Advance**"), Borrower shall make a written request (each , a "**Borrowing Request**") to Lender in the form of Exhibit A attached hereto and made a part hereof. Each such Borrowing Request shall recite the Advance requested, the outstanding principal balance on the Loan and the remaining outstanding loan availability after the Advance is made. Lender shall within 30 business days of receipt of such Borrowing Request, provide the-Advance to Borrower. In addition to this Agreement, the Revolving Loans shall be*

evidenced by a revolving loan promissory note payable to Lender in the form of Exhibit B *attached hereto (as amended, restated or supplemented from time to time, together with any notes given for the substitution or replacement thereof, the "**Revolving Loan Note**"). Insofar as Borrower may request and Lender may make Advances hereunder, Lender shall enter any such Advances as debits on a revolving loan account maintained by Borrower with customary accounting practices and procedures, all fees and charges which are properly chargeable to Borrower under this Agreement.*"

55. So the primary payment obligations for NSI were to pay within 6 months after demand or as soon thereafter not later than 12 months after demand as it could liquidate in an orderly manner a sufficient amount of its investment portfolio. Under Section 3.1 of the Agreement the contractual rate of interest is 10.5%, with an additional 2% default rate for any period of default. Mirroring the amended Bye-law 9(1) as of the same date, the repayment obligation under the LSA is not only the obligation of NSI alone but was also explicitly linked independently of default to NSI's own investment portfolio. If the Lenders were at this juncture, (a time of accelerating redemption requests albeit before the first of the two catastrophic events which occurred in September and November 2008), regarding NSI and NSSC as one single entity with a composite pool of assets, this was not reflected in the loan documentation.

56. Article VI ("COVENANTS") provides as follows:

> "**S*ection 6.1 Affirmative Covenants.*** *Borrower covenants and agrees that from the date hereof until payment and performance in full of all Obligations, and until the termination of this Agreement, unless Lender otherwise consents in writing, Borrower shall:*
>
> *(a) keep adequate records and books of account with respect to its business activities in which proper entries are made in*

accordance with GAAP reflecting all its financial transactions; and, cause to be prepared and furnished to Lender the following (all to be kept and prepared in accordance with GAAP, unless such Borrower's certified public accountants concur in any changes therein and such changes are disclosed to Lender and are consistent with then generally accepted accounting principles):

(i) as soon as practicable after the end of each fiscal year of Borrower, and in any event within one hundred eighty (180) days thereafter; of income and cash flow for Borrower, setting forth in comparative form, the financial statement for the immediately preceding fiscal year, all in reasonable detail, prepared in accordance with GAAP, together with an opinion thereon of independent certified public accountant selected by Borrower, which opinion shall, without qualification, state that such financial statements present fairly, in all material respects, the financial position of the companies being reported upon and their results of operations and cash flows and have been prepared in conformity with GAAP, and that the examination of such accountants in connection with such financial statements has been made in accordance with generally accepted auditing standards, and that such audit provides a reasonable basis for such opinion in the circumstances;

(ii) Borrower's monthly balance sheet and such monthly statements as are provided to the members of Borrower concurrent with the distribution of same to such members; and

(iii) such other data and information (financial and otherwise) as Lender, from time to time, may reasonably request, bearing

upon related to the Collateral, Borrower's financial condition and/or results of operations;

*(b) direct the administrator of the Borrower to provide the Lender, in writing, within five (5) Business Days after each close of the monthly financials of the Borrower: (i) the outstanding amount of all loans between every share class of New Stream Capital Fund Ltd. And the Borrower ("**Total Debt Value**"), specifying the principal and interest thereon, as of the end of such month, (ii) the outstanding amount of Senior Indebtedness as of the end of such moth, (iii) the amount of any written redemption requests and any cancellations of redemption requests submitted with respect to the Borrower as of the end of such month calculated in accordance with the Borrower's private placement memorandum and limited partnership agreement, (v) the aggregate value of all assets of the Borrower pledged under an Senior Indebtedness as of the end of such month, (vi) the outstanding amount of Debt Securities (as defined in the Collateral Agency Agreement) as of the end of such month, and (vii) the outstanding amount of any other Debt of the Borrower and any other obligation of the Borrower that is secured by a Lien as of the end of such month.*

(c) preserve and maintain its separate legal existence and all rights, privileges and franchises in connection therewith, and maintain its qualification and legal and valid existence in all states in which such qualification is necessary in order for Borrower to conduct its business in such states;

(d) comply, in all material respects, with all laws, ordinances, governmental rules and regulations to which it is subject; and shall obtain and maintain each license, permit, franchise or other

governmental authorization necessary to the ownership of its Properties or to the conduct of its business, the failure of which to obtain and maintain could reasonably materially and adversely affect the business, prospects, profits, Properties or condition (financial or otherwise) of Borrower;

(e) maintain its chief place of business and chief executive offices at the address set forth in the opening hereof unless Borrower shall have given Lender thirty (30)days' prior written notice of any change in such place of business; and

(f) permit Lender, at its sole discretion, to inspect the books and records of Borrower at such time and from time to time as Lender deems necessary.

Section 6.2 Negative Covenants. *Borrower covenants and agrees that from the date hereof until payment and performance in full of all Obligations, and until the termination of this Agreement, unless Lender otherwise consents in writing, Borrower shall not:*

(a)permit or suffer to exist any Lien, encumbrance, pledge, mortgage or security interest in or upon any of its Property, except:

(i) those security interests granted in favour of Lender pursuant to this Agreement and the other Loan Documents;

(ii)Liens securing taxes, assessments or governmental charges or levies or the claims or demands of materialmen, mechanics, carriers, warehousemen, landlords and other like Persons, provided the payment thereof is not at the time required;

(iii)Liens incurred or deposits made in the ordinary course of business (A) in connection with workmen's compensation, unemployment insurance, social security and other like laws or (B) to secure the performance of leases, statutory obligations, surety, appeal and performance bonds and other similar obligations not incurred in connection with the borrowing of money, the obtaining of advances or the payment of the deferred purchase price of Property;

(iv)Attachment, judgment and other similar non-tax Liens arising in connection with court proceedings, provided the execution or the other enforcement of such Liens for the payment of money in excess of $10,000 is effectively stayed or bonded within thirty (30) days after issuance or filing, and the claims secured thereby are being actively contested in good faith and by appropriate proceedings;

(v) Liens placed upon fixed assets hereafter acquired at the time of, or within then (10) days after, the acquisition thereof to secure a indebtedness incurred to finance all or a portion of the purchase price thereof, provided that (A) any such Lien shall not encumber any other Property of Borrower, or (B) any such Lien shall not exceed the purchase price of such Fixed Assets.

(vi) Liens placed by participants in loans or investments of Borrower which secure the participants' interest in such loans or investments;

(vii) Liens on the assets of Subsidiaries securing Debt which finance the loans or investments of the Subsidiary; and

(viii) those security interests and Liens in favour of : (i) other share classes of New Stream Capital Fund Ltd. pari passu to the rights of the Lender in payment and in priority with respect to access to the Property of the Borrower, (ii) any other Person who specifically subordinates its security interest the Lender and (iii) the Senior Lender to secure the Senior Indebtedness;

(b) beginning as of March 31, 2009 (the "Initial LTV Calculation Date") and at the end of each calendar month thereafter, permit the ratio (the Loan to Value Ratio"), expressed as a percentage, of (i) the Total Debt Value (including any accrued but unpaid interest thereon) outstanding plus the Excess Senior Indebtedness (each as reported for such month pursuant to Section 6.1 (b)) to (ii) the Total Asset Value of Borrower (as reported for such moth pursuant to Section 6.1 (b)) to exceed fifty percent (50%). In the event that the Loan to Value Ratio for any calendar month after the Initial LTV Calculation Date shall be more than fifty percent (50%) within one-hundred and twenty (120) days (each, an "LTV Cure Period) from the last day of such calendar month. During any LTV Cure Period, continue to pay its day-to-day operating expenses incurred in the ordinary course of its business (including, without limitation, any amounts due pursuant to Senior Indebtedness existing prior to the commencement of the LTV Cure Period) and any obligations Borrower or any of its Subsidiaries may have under the Investment Portfolio existing prior to the commencement of the LTV Cure Period (including, without limitation, any obligations under funding commitments issued by the Borrower or any of its Subsidiaries as part of the Investment Portfolio prior to the commencement of the LTV Cure Period). Notwithstanding the foregoing, the Borrower shall not

permit the Loan to Value Ratio (i) for any calendar month during the term of this Agreement prior to the Initial LTV Calculation Date to exceed sixty-five percent (65%) and (ii) for any calendar month during the term of the Agreement from and after the Initial LTV Calculation Date to exceed sixty percent (60%)

*(c) beginning as of the Initial LTV Calculation Date and at the end of each calendar month thereafter, permit the ratio (the "Total Debt Value Ratio"), expressed as a percentage, of (i) the Total Dept Value (including any accrued but unpaid interest thereon) outstanding (as reported for such month pursuant to Section 6.1 (b)) to 9ii) the Total Asset Value of the Borrower less the Excess Encumbered Assets (each as reported for such month pursuant to Section 6.1 (b)) to exceed fifty percent (50%). In the event that the Total Debt Value Ration for any calendar month after the Initial LTV Calculation Date shall be more than fifty percent (50%) but less than sixty percent (60%), the Borrower shall be obligated use its best efforts to cause the Loan to Value Ratio to be less than or equal to fifty percent (50%) within one-hundred and twenty (120) days (each, an "**Debt Value Cure Period")** from the last day of such calendar month. During any Debt Value Cure Period, the Borrower shall be required to operate in accordance with the conditions set forth above for an LTV Cure Period. Notwithstanding the foregoing, the Borrower shall not permit the Total Debt Value Ratio (i) for any calendar month during the term of this Agreement prior to the Initial LTV Calculation Date to exceed sixty-five percent (65%) and (ii) for any calendar month during the term of this Agreement from and after the Initial LTV Calculation Date to exceed sixty perfect (60%);*

(d) permit any redemptions by any member of Borrower if

the Loans have not been repaid in full by the first of the month following six (6) months after demand; or

(e) incur, assume, or otherwise become liable for any Debt senior to the rights of the Lender in payment and in priority with respect to access to the Property of the Borrower, other than Senior Indebtedness."

57. Section 6.1(b) requires NSI to provide the Defendant (in respect of Classes C and I) monthly financials relating to the position in relation to all share classes of the Defendant. Section 6.2 (a) provides that the Borrower shall not "*permit or suffer any Lien, encumbrance, pledge, mortgage or security interest in or upon any of its Property, except*" those liens permitted by (i) to (viii). Section 6.2(a) (viii) permits NSI as borrower to create "*security interests and Liens in favor of: (i) other share classes of New Stream Capital Fund Ltd. pari pasu [sic] to the rights of the Lender in payment and priority with respect to access to the Property of the Borrower, (ii) any other Person who specifically subordinates its security interest to Lender and (iii) the Senior Lender to secure the Senior Indebtedness"*.

58. So the security interests conferred on Classes C and I are not fixed interests in the sense that no charge is created which attaches to all or specified assets which NSI is not free to deal with in the ordinary course of business. Not only are various types of liens permitted to be created by the Borrower over its "Property" ("*all property or assets, whether real, personal or mixed, or tangible or intangible*"- Section 1.1), it is expressly contemplated that other classes of the Defendant's shareholders will have similar security interests over the same asset pool, and that each class is entitled to receive financial data relating to such overlapping loan relationships. It is agreed that all share classes of the Defendant which have lent to NSI will have security interests which rank pari passu. It is not contemplated that similar security interests may be created in favour of the other Feeder Funds or their shareholders.

59. Article VII ("COLLATERAL") provides as follows:

"***Section 7.1 Grant.*** *To secure the prompt payment and performance of each and all of the Obligations, Borrower pledges, assigns, transfers and grants to Lender a continuing, lien and security interest in the following Property of Borrower, whether now owned or hereafter acquired (herein called the "**Collateral":***

*(a)All accounts receivable related to or arising from the sale of inventory, rendition of services by Borrower or Borrower's Investment Portfolio and all other accounts, bank accounts, contracts, contract rights, notes, documents, chattel paper, instruments, acceptances, drafts or other forms of obligations (collectively with Accounts Receivable, the "**Accounts**"), whether or not the same are listed on any schedules, assignments or reports furnished to Lender to from time to time, and whether such Accounts are now existing or are created or arise at any time hereafter, and all guaranties, securities, and liens which Borrower may hold for the payment of any such Accounts;*

*(b)all interests of Borrower in any financial transaction in which it has invested including, but not limited to, loan agreements, promissory notes, guarantees, mortgages, insurance, assignment of leases, participation agreements and intercreditor agreements (the "**Investment Portfolio**");*

(c)all general intangibles, including but not limited to all licenses, permits, authorizations, deposit accounts, investment property, contract rights, tax refunds and other payments, credits or rights in respect of Accounts, unearned insurance premium refund, insurance proceeds (whether or not representing proceeds of other Collateral described in the Section 7.1), choses and rights-in action, including without limitation, all rights of

stoppage in transit, replevin and reclamation and all other rights and remedies of an unpaid vendor or lienor, and any liens held by Borrower as a mechanic, contractor, subcontractor, processor, materialman, machinist, manufacturer, artisan, or otherwise, and all warranty rights, (collectively, the ***"General Intangibles")****;*

(d)all accessions to, substitutions for and all replacements, products and proceeds of the Property described in clauses (a), (b), and (c), above, including without limitation, proceeds of insurance polices insuring the Collateral;

(e)all books and records (including, without limitation, customer lists, credit files, computer programs, printouts, and other computer materials and records) of Borrower pertaining to any of the Property described in clauses (a), (b), (c) and (d) above, including all customer list, billing information, supplier lists, ledgers, evidences of shipping, invoices, purchase orders, sales orders and all other evidences of shipping, invoices, purchase orders, sales orders and all other evidences of Borrower's business records, including all cabinets, drawers etc. that may hold the same; wherever located, all whether now existing or hereafter arising or acquired; and

(f) all renewals, substitutions, replacements, additions, accessions, proceeds, and products of any and all of the foregoing.

Section 7.2 Representations, Warranties and Covenants – Collateral. *Borrower represents, warrants, and covenants to Lender:*

(a) The Collateral is now and so long as Borrower is obligated to Lender,

will be owned solely by Borrower. No Person has or will have any right, title, interest, claim, or Lien therein, thereon, or thereto other than Liens permitted by Section 6.2(a) hereof;

(b) Except as specifically consented to in writing by Lender or as permitted by Section 6.2(a), the Liens granted to Lender shall be first and prior to all other Liens on the Collateral and as to the Accounts and proceeds, including insurance proceeds, resulting from the sale, disposition, or loss thereof; no further action need be taken to perfect said Lien, other than filing of continuation statements under the Code and continued possession by Lender of that portion of Collateral constituting Instructions or Documents (as such terms are defined in the Code); and

(c)All goods evidenced by the Collateral constituting Chattel Paper, Documents, or Instruments (as such terms are defined in the Code), the possession of which has been given to Lender, are owned by Borrower; the same are free and clear of any prior Lien other than Liens permitted herein or in writing by Lender. Borrower shall pay and discharge when due all taxes, levies, and other charges upon said Collateral and upon the goods evidenced by any Documents constituting Collateral, except to the extent being contested in good faith and for which adequate provisions have been made, and shall indemnify and defend Lender against and save it harmless from all claims of any Person except Persons holding Liens permitted by Section 6.2(a). This indemnity shall include reasonable attorneys' fees and legal expenses.

Section 7.3 Financing Statements. *If necessary, Borrower agrees to execute the financing statements provided for by the Code together with any and all other instruments interest in the Collateral; unless prohibited by law, Borrower hereby authorized Lender to execute and file any such financing statement on Borrower's behalf.*

Section 7.4 Perfection of Lender's Security interest in other Collateral. *Borrower shall, at its sole cost and expense, take any steps reasonably requested by Lender to evidence, perfect and record Lender's security interest in any form of Collateral not specifically covered by Section 7.3 above.*

Section 7.5 Location of Collateral. *Borrower warrants and covenants that tangible Collateral will remain, at all times, on the premises in which it is now located.*"

60. The security interest created by section 7.1 must be understood in light of Article 6. The security interest is created over accounts receivables, the Investment Portfolio, General Intangibles, etc., but it is not an exclusive interest. Indeed, the Borrower expressly warrants in 7.2 (a):"*...No person has or will have any right, title, interest, claim or Lien therein, thereon or thereto other than the liens permitted by Section 6.2(a) hereof*". Article 8 deals with acts of default, which are defined under section 8.1 to include: (a) failure to make a payment of principal or interest when due under any Note; (b) failure to comply with any other covenant which cannot be cured within 60 days; (c), dissolution, insolvency, bankruptcy (etc.); and (d) the issue of a qualified audit opinion. The remedies of the Lender where an act of default occurs include, subject to the terms of the Collateral Agreement: (a) all the rights of a secured party under the Uniform Commercial Code; and (b) the right to take immediate possession of the Collateral (section 8.2). Section 10.2 provides that any amendments or waivers must be in writing. Clause 10.5 provides that the Agreement is governed by Connecticut law.

61. The final clause of the LSA provides as follows:

"**Section 10.7 Segregated Accounts Company**. *The Borrower acknowledges that the Lender is registered as a segregated account company under The Segregated Accounts Company Act 2000 of Bermuda, being a company which has segregated its assets and liabilities among each of its classes of shares (each such class, a "Fund") and, accordingly, any liability owed or indemnity payable to the Borrower pursuant to this Agreement shall be limited to the assets and liabilities of Segregated Account of the Lender (being the segregated account Class indicated in the preamble to this Agreement).*"

62. This clause appears to be intended to emphasise the fact that the LSA is entered into by and with the Defendant in respect of the relevant segregated account and not its general account nor indeed the various segregated accounts which like Class C have entered into similar contractual arrangements with NSI giving rise to overlapping security interests and enforcement rights. Indeed, it is by way of compliance with SACA which permits segregated accounts to enter into transactions with each other that the overlapping security interests of other segregated accounts are expressly spelt out in the LSA. However, this clause makes it more difficult to contend with respect to the NSI pool of collateralised assets which is created by this instrument, that despite these elaborate terms the parties tacitly understood that NSI's assets and NSSC's assets were effectively part of a single collateral pool out of which all Lenders' redemption requests were to be paid.

63. An example of a note issued by NSI to the Defendant in respect of Class C was also in evidence. This is described as an Amended and Restated Revolving Loan Note in the amount of $2 million effective as of August 1, 2008[3] and cross-references the terms of the LSA. The Note is payable in full without any demand upon the occurrence of an act of default (paragraph 6); the time for payment can

[3] A 503-507.

be extended that the lender's sole discretion, without in any way releasing liability to pay or releasing any of the collateral (paragraph 7); and the Note is registered, can only be transferred for registration and interest and principal "*shall be paid solely to the registered holder of this note*" (paragraph 15).

64. The Second Amended and Restated Collateral Agency Agreement dated July 31, 2008[4] is the third of the connected loan documents reflecting the status of the loan and security arrangements prior to the Plan. The parties are NSI (defined in the Agreement as the 'Fund'), the Lenders and the Collateral Agent (Wilmington Trust Company). Paragraph A of the recitals provides as follows:

> "*Each of the Lenders has entered into a Loan and Security Agreement (the 'Loan Agreement'; the form of which is attached hereto as Exhibit B) with the Fund, pursuant to which each Lender, under substantially identical terms and conditions, has extended to the Fund a senior subordinated commercial revolving loan facility (each a 'Loan', and collectively, the 'Loans'), evidenced by a Loan agreement, and in the amount set forth in, a Senior Subordinated line of Credit Note (each a 'Note', and collectively, the 'Notes'; each Loan Agreement and the related Note, as the same may be amended, supplemented or modified from time to time, shall collectively be referred to as the 'Security Documents'.)*"

65. So while each of the Defendant's shareholder classes has separate loan agreements with NSI and has received separate Notes from NSI, they have all signed the same Collateral Agency Agreement with the same Collateral Agent. So, as the terms of each LSA suggest, the separate security interests are protected by a common pool of collateral rights. There is, nevertheless, a legal distinction between the NSI collateral and the NSSC collateral under the pre-Plan

[4] A 455-474. This was in fact the NSSC 2008 Collateral Agency Agreement but it was common ground that its terms were materially the same as the NSI counterpart, the 2006 version of which appeared at A 437-A 452.

documentation. Only the "Required Lenders" are competent to instruct the Collateral Agent to take enforcement action; and clause 1 states that: "*'Required Lenders' means, at any time, the Lenders having or holding at least 51% in aggregate principal amount of the Loans at the time outstanding.*"

66. Not only are the Plaintiffs as investors in Classes C and I are 100 % holders of those shares (or were holders, if the effect of their redemption requests is to terminate their status as shareholders), those classes also admittedly held at least 51% of all of the NSI Notes prior to the Plan. As Required Lenders, the Plaintiffs and/or their accounts in addition to possessing the security interests other Lenders to NSI possessed sufficient combined commercial interest to enforce the rights created by the Collateral Agreement. Other Lenders would not have been able to do so without the Plaintiffs' support. In addition, the Defendant in respect of Classes C and I lent to NSI on terms that only contemplated overlapping similar security interests being created in favour other share classes of the Defendant.

67. It is difficult to think of any species of commercial contract more sacrosanct in the common law world, particularly in insolvency contexts, than agreements designed to create security interests. Credit is the oxygen of the free enterprise system, which why the interruption of credit flows in 2008 caused economic seizure. A common battleground in insolvency proceedings centres on attempts by unsecured creditors to challenge the status of secured creditors. But where parties have apparently entered into genuine express security agreements in relation to a commercial loan, the Courts should be slow (in the absence of cogent reasons for doing so) to find that the relevant agreement was not intended to take effect according to its terms.

The loan and security agreements post-Plan

68. The Second Amended and Restated Loan and Security Agreement dated as of May 1, 2009 between NSI and the Defendant in respect of Class C was the

modified LSA referred to at trial[5]. The references in this document to the July 31, 2008 NSSC Collateral Agency agreement were corrected in the February 24, 2010 Amendment No. 1 to refer to the Second Amended and Restated Loan and Security Agreement of October 5, 2006[6]. More substantively, Section 2.2 was changed in a way, which was responsive to the present claim by replacing the May 1, 2009 version's curious repayment obligation on the part of NSSC out of available cash with an obligation on the part of NSI to pay out of available cash. Section 3.1 (c) was amended on April 9, 2010 but these changes did not appear to be significant.

69. The post-Plan LSA has five key elements to it: (a) a modified timing mechanism according to which the Lenders' right to make demand for payment is postponed for two years and the loan term is capped at 10 years, combined with a modified payment obligation limited to paying out of available cash (section 2.2); (b) a modified payment mechanism, according to which payment is to be made by NSI out of available cash generated NSSC and its subsidiaries (sections 2.2 and 3.1); (c) a waiver of any defaults under the pre-Plan documentation (section 2A1-2A2); and (d) a "*Payment Split*" provision under which the Defendant's investors in NSSC and the Feeder Funds are to be paid in addition to NSI's original Lenders (section 3.1 (c)) with priority being given to pre-October 1, 2008 redeemers; and (v) a clause permitting the transfer or sale of the Collateral at the election of NSI in accordance with the Plan (and, by implication, its Payment in Kind provisions) (section 7.6).

70. Section 3.1 (c) (as amended[7]) provides as follows:

> "***(c) Payment Split.*** *So long as no default exists under any of the Senior Indebtedness, payments from Available Cash to Lender, and all other share classes of New Stream Capital Limited (together*

[5] A 587-608.
[6] A 615-617.
[7] Amendment No.2, April 9, 2010, A 691 (Class I).

*with Lender, the "**Bermuda Fund**"), to New Stream Secured Capital Fund (US), LLC (the "**US FUND**"), or to certain Cayman entities who have purchased notes substantially identical to those purchased by the US Fund (the "**Cayman Funds**"; the Bermuda Fund, the US Fund and the Cayman Funds shall collectively be referred to as the "**New Stream Funds**") shall be paid as follows: (i) firstly, to the New Stream Funds, where the redemption requests made by the underlying investors had become effective prior to October 1, 2008, in accordance with the sequence established by the date upon which such redemption requests had become effective; and (ii) secondly, to the New Stream Funds (distributed based on the applicable Distribution Percentage to (a) the Bermuda Fund and (b) the US Fund the Cayman Funds), where the underlying investor's redemption requests had become effective on or after October 1, 2008. With respect to the Bermuda Fund, distributions of Available Cash made with respect to Loan Notes which are subject to (ii) above, shall be applied to the Loan Notes held by the Lender pari passu in respect in subject of the outstanding balance of such Loan Notes against the total outstanding balances of the loan notes which are subject to (ii) above held by the Bermuda Fund. Notwithstanding the foregoing, if a distribution of Available Cash causes the Bermuda LTV Ratio, if calculated as of such Distribution Date (the "**Revised Bermuda LTV Ratio")**, to trigger a change in the Distribution Percentage, the Distribution Percentage used on such Distribution Date be the initial Bermuda LTV Ratio for the amount of Available Cash Distributed to the point that the Revised Bermuda LTV Ratio would indicate a change in the Distribution Percentage and the remainder of the Available Cash shall be distributed based upon the Distribution Percentage computed using the Revised Bermuda LTV Ratio.*"

71. Section 3.1(c) firstly modifies the original loan documentation by: (a) permitting the US and Cayman Feeders to be paid by NSI when, previously, NSI was only obliged to the Defendant and its NSI-lending segregated accounts; and (b) according priority to those investors in the Defendant or the Feeder Funds who filed redemption requests prior to October 1, 2008, irrespective of any contrary priority rights enjoyed under perfected security interests acquired under the pre-Plan arrangements (the Plaintiffs were not early redeemers). Section 7.6 further permits NSI in accordance with the Plan to release or sell the Collateral to "third party" investors in the New Stream Funds who previously had no interest in the Collateral. Section 7.6 provides as follows[8]:

> "***Restructuring Plan.*** *Notwithstanding any other provisions of this Agreement, Borrower shall have the right to transfer or sell the Collateral and distribute the proceeds in accordance with the restructuring plan set forth in the letters to investors in the New Stream Funds dated April 6, 2009 and Lender shall release such Collateral from its security interest at the request of Borrower upon such transfer or sale. For avoidance of doubt, the Collateral may be exchanged in full settlement of outstanding redemption requests to the New stream Funds and Collateral may be sold and the proceeds distributed according to such plan*."

72. The Loan Note dated as of May 1, 2009 mirrors the post-Plan LSA. Section 2 states: "*Payment under this note shall be subject to Section 3.1 (c) of the Loan Agreement.*" So the broad effect of the Plan on the pre-existing security interests of the Plaintiffs has on the face of the documents been to dilute those interests by providing that the secured assets previously available solely for the Plaintiffs' segregated accounts and other segregated accounts of the Defendant are now payable: (a) under a new payment and timing mechanism which varied the redemption rights under Bye-law 9(1) to payment within 12 months out of NSI's

[8] A 602.

investment portfolio; (b) under new priorities; (c) to third parties who previously had no security interest in NSI's assets; and (d) in circumstances where previous defaults have been waived and the repayment obligations redefined so as defaults are unlikely to occur, such that the previous secured creditor rights of NSI Lenders were all but extinguished.

73. The loan documentation pre-Plan purportedly created separate collateralized asset pools for the benefit of Lenders to NSI and NSSC respectively; the effect of the Plan appears to have been to merge those two separate asset pools into one single pool for all practical purposes. It is true that the liens and the Collateral Agreements theoretically remain in force, but the available cash payment mechanism strips the repayment obligation of most of its substance until the Loan becomes payable in full on May 1, 2019. It is possible to imagine a variety of amendments and waivers in relation to the Loan Agreements which could be regarded as falling within the scope of the directors' or Managers' ordinary course of business investment powers. Yet while the Defendant sought to contend that these radical changes did fall within such powers at trial, the steps which were adopted prior to implementing those changes were inconsistent with this argument.

The Plan

74. Shareholders of the Defendant of all classes were sent two April 6, 2009 documents. The first was a letter which explained the need for the Plan and described its key terms:

"***NEW STREAM CAPITAL, LLC***

April 6, 2009

Dear Investors,

This communication provides an important update on developments affection your investment in New Stream Capital Fund Limited (the "Bermuda Fund").

As you know, we strive to generate consistent positive performance results for our investors. For a substantial period following the inception of the Bermuda Fund, we successfully achieved that goal. As a result of the recent financial turmoil, certain portions of our portfolio have been adversely affected while others have continued to perform favorably. The financial uncertainties have presented new market dynamics. Additionally, we have received substantial redemption requests by many of our investors. It is against this backdrop that we were to you now with a proposed plan to address this situation.

The discussion below is intended to present a plan (the "Plan"), which has been endorsed by the directors of the Bermuda Fund and the Investment Manager, New Stream Capital, LLC ("NSC"), for addressing these new market dynamics. The Plan is intended to maximize value of the investment portfolio available to redeem the interests of all the investors in the New Stream Funds (as the term is defined below). We are attempting to achieve maximum value in an expeditious manner so that all our investors are treated in a fair and equitable manner. We hope that you will agree that by working together, we can achieve our objectives.

The majority of investors in the Bermuda Fund have indicated their intention to redeem part or whole of their investments. As you know, pursuant to the Prospectus of the Bermuda Fund, the

assets of each segregated account of the Bermuda Fund (each, a "Segregated Account") were invested in notes (each a "Bermuda Note", collectively, "Bermuda Notes") issued to the Segregated Account by either New Stream Secured Capital, L.P (the "Secured Capital Fund") or its wholly owned subsidiary New Stream Insurance, LLC. ("New Stream Insurance"). Accordingly, the directors of the Bermuda Fund have sought repayment of the Bermuda Notes from the relevant issuers. Concurrently, a significant number of investors in New Stream Capital Fund (U.S), LLC (the "US Feeder") and various Cayman Island feeder funds (the "Offshore Feeders") which also invest in the Secured Capital Fund (through a combination of equity and purchase of notes (each a "Feeder Note", collectively the "Feeder Notes") have requested redemptions of their respective investment in the U.S Feeder and the Offshore Feeders (as the case may be). The Offshore Feeders, together with the U.S. Feeder, shall collectively be referred to as the "Feeder Funds" and together with the Bermuda Fund shall be collectively be referred to as the "New Stream Funds". The Bermuda Notes, together with the Feeder Notes shall collectively be referred to as the "Secured Capital Notes". Given the foregoing, NSC, the general partner of the Secured Capital Fund, has been assessing the Secured Capital Fund's portfolio investments.

NSC has notified the directors of the Bermuda Fund that it intends to meet over time all redemptions from available cash. However, NSC has indicated that due to: (i) the redemption requests from all the New Stream Funds constituting a substantial portion of the Secured Capital Fund's assets; and (ii) the continued volatility and dislocation in the global financial markets, it will not be able to liquidate its investments in the near term in a manner which would

best serve all the investors in the New Stream funds (collectively, the "New Stream Investors").

As you know, the Secured Capital Fund's investment portfolio consists of investments generally in the form of loans to private companies (i.e., non-traded debt) in the following asset classes: life insurance, real estate, commercial finance and energy. These asset classes, by their very nature, are long-lived and illiquid. The on going credit crises has caused significant dislocation in the global capital markets which has severely impacted the assets in an illiquid market. While all of the assets in the investment portfolio have been impacted, the real estate and life insurance assets have been impacted the most. In particular, with respect to the life insurance sector, this dislocation, along with an adverse shift in industry valuation standards, has brought the secondary market for life settlements to a near standstill. Life insurance related assets comprise the majority of the Secured Capital Fund's insurance portfolio. As a result, the Secured Capital Fund's investment strategy has shifted, by necessity, from expecting pay-offs on premium finance loans to foreclosing on such loans and holding life settlements until the markets normalize. This, in turn, requires substantial capital for ongoing premium payments to ensure that the life polices underlying each life settlement does not lapse. With respect to the real estate portfolio, the illiquidity of underlying investments has caused the Secured Capital Fund to adopt a strategy to hold such assets until the markets recover. Notwithstanding the Secured Capital Fund's inability to liquidate its investment portfolio, other than the insurance portfolio, the other portfolios have continued to perform favorably relative to the markets.

Each of the Bermuda Notes is issued pursuant to a Loan and Security Agreement between the Secured Capital Fund or New Stream Insurance (as the case may be) and the respective Segregated Account. Additionally, each of the Segregated Accounts, along with all the Feeder Funds which have purchased notes from the Secured Capital Fund, are lender parties to a Collateral Agency Agreement which coordinates the sharing of the collateral of the Secured Capital Fund in the event of a liquidation. Pursuant to the terms of those Loan and Security Agreements, as amended, and Collateral Agency Agreement, as amended, the Bermuda Fund holds a priority position over the Feeder Notes and consequently would receive payment before the Feeder Notes in the event of the liquidation of the Secured Capital Fund. Northstar Financial Services Ltd. ("Northstar") is also a direct lender to the Secured Capital Fund. Northstar is a Bermuda insurance company and a wholly-owned indirect subsidiary of the Secured Capital Fund. The Secured Capital Fund currently has a debt obligation to Northstar in the principal amount of US $35 million. Northstar is also a lender party to the Collateral Agency Agreement and its debt is subordinated to the Bermuda Notes, but senior to the Feeder Notes.

NSC believes that a forced liquidation of the Secured Capital Fund's assets at this time would likely cause the Secured Capital Fund to incur significant losses and prejudice New Stream Investors by liquidating assets at inopportune times and thereby destroying investor value. Such a forced liquidation would wipe out the remaining equity and impair the Feeder Notes. In light of these adverse consequences to the investors in the Feeder Funds, NSC believes that it is likely that certain investors in these funds would take legal action against NSC, the Collateral Agent and

possibly the Bermuda Fund or its investors to stay the liquidation of the Secured Capital Fund's investments and the distribution of the proceeds. Such legal action would likely the [sic] delay the ultimate distribution for an extended period of time and have a materially adverse effect on the investment portfolio of the Secured Capital Fund through the incurrence of substantial ongoing legal expenses.

NSC is committed to meeting the redemption request of all New Stream Investors in a fair and equitable manner. In consideration of the above, NSC has proposed the following plan to restructure the New Stream Fund and provide for an orderly and equitable liquidation and distribution of the assets for the Secured Capital Fund.

PROPOSED RESTRUCTURING PLAN

It is proposed that with respect to all New Stream Funds, New Stream Investors agree to a two-year forbearance period (the "Forbearance Period"). As discussed below, such Forbearance Period will provide NSC sufficient time to address the Secured Capital Fund's liquidity issues with respect to its investment portfolio. With regard to investors in the Bermuda Fund, a forbearance would require the Bermuda Fund investors to agree to a stay on prosecuting their claims in connection with their redemption requests during the Forbearance Period.

In order to help provide more immediate liquidity to new Stream Investors who seek to exit their investment positions during the Forbearance Period, NSC will endeavour to establish a matching service which would pair New Stream Investors who desire to sell

their interests in the New Stream Funds with other New Stream Investors or third-party investors who may wish to purchase those interest during the Forbearance Period (the Matching Service"). New Stream Investors who wish to participate in the Matching Service will be able to indicate to an independent broker contracted by NSC to provide the Marching Service (the "Matching Broker") a discount amount at which they would be willing to consider a sale and the Matching Broker will communicate such offers to other New Stream Investors and third-party investors who have indicated an interest to purchase additional interests in the new Stream Funds. The Matching Broker will notify the interested buyer and seller of the match and the parties will the independently negotiate a final sale price.

During the Forbearance Period, NSC will endeavour to make available a payment-in-kind option the New Stream Investors whereby NSC would make available selected life settlement assets of New Stream Insurance to New Stream Investors as settlement-in-full of any outstanding redemption requests of such investors in order of the sequence established by the original timing of each such investor's redemption requests in each of the New Stream Funds.

During and subsequent to the Forbearance Period:

1. The Secured Capital Fund would accrue interest on all Bermuda Notes held by the Bermuda Fund at an adjustable rate equal to the 90-day LIBOR; provided, however, that such rate shall not exceed 3% per annum.

2. NSC will continue to manage and will seek to orderly liquidate the investment portfolio of the Secured Capital Fund and pay the normal day-to-day operating expenses of the Secured Capital Fund out of the proceeds of such liquidations including, without limitation the payment of life premiums on the life settlement and premium finance portfolios which continue to meet the investment criteria of the Secured Capital Fund and expenditures to which it is legally obligated to make under the remainder of its portfolio. Periodically, NSC, on behalf of the Secured Capital Fund, shall determine the amount of unrestricted cash (e.g., cash which is not needed to pay present and near future obligations of the Secured Capital Fund) which is available for distribution to the New Stream Investors ("Available Cash"), provided however, that with respect to cash reserves being held for the express paying life premiums, any such cash reserve shall not exceed $60 million at the end of any calendar quarter. Such Available Case shall be distributed to all New Stream Funds in repayment of their respective outstanding Secured Capital Notes as follows: (i) firstly, to the New Stream Funds, where the redemption requests made by the underlying investors had become effective prior to October 1, 2008, in accordance with the sequence established by the date upon which such redemption requests had become effective; and (ii) secondly, to the New Stream Funds (distributed based on the applicable Distribution Percentage (as that term is defined below) amount the investors in the Bermuda Fund and the Feeder Funds, each an "Investor Group"), where the underlying investor's redemption requests had become effective on or after October 1, 2008, on a pari passu basis to each Investor Group in respect of the balance of the Secured Capital Notes held by each new Stream Fund in an Investor Group against the total outstanding amount of the Secured Capital Notes held by all the

New Stream Funds in such Available Cast (each, a "Distribution Date") as follows: (i) if the Bermuda LTV Ratio (as that term is defined below) is more than 85%, then the Distribution Percentage shall be 100% to the Bermuda Fund and 0% to the Feeder Funds; (ii) if the Bermuda LTV Ratio is less than or equal to 85%, but more than or equal to 70%, then the Distribution Percentage shall be 85% to the Bermuda Fund and 15%to the Feeder Funds; and (iii) if the Bermuda LTV Ratio is less than or equal to 70%, then the Distribution Percentage shall be 70% to the Bermuda Fund and 30% to the Feeder Funds. The Bermuda LTV Ratio shall be equal to the ratio, expressed as a percentage, of the outstanding amount of Secured Capital Notes held by the Bermuda Fund as of the end of the calendar quarter prior to the any Distribution Date to the total asset value of the Secured Capital Fund and its subsidiaries as of the end of such calendar quarter calculated in accordance with the Secured Capital Fund's private placement memorandum and limited partnership agreement. Notwithstanding the foregoing, to the extent that, on any Distribution Date, distribution of Available Case shall change the Bermuda LTV Ratio such that it triggers a change in the Distribution Percentage, the Distribution Percentage used on such Distribution Date shall be based on the initial Bermuda LTV Ratio for the amount of Available Cash distributed to the point that the Bermuda LTV Ratio changes the Distribution Percentage, and the remainder of such distribution of Available Cash shall be distributed based on the changed Distribution Percentage.

3. In order to assure the continued capital base of Northstar, NSC will be authorized to renegotiate and make payment with respect to this intercompany loan in a manner so as to maintain the value of the Secured Capital Fund's investment in Northstar.

4. NSC will endeavour to liquidate a sufficient amount of the Secured Capital Fund's investments to meet all redemption requests and will seek to liquidate or restructure the insurance portfolio in a manner to optimize its value to all New Stream Investors. It should be noted that because of the uncertainty in the capital markets, NSC cannot guaranty that it will be able successfully meet the aforementioned objective. In particular, NSC will address the insurance portfolio and consider all possible transactions to secure the best value for the insurance assets. During the Forbearance Period, the Secured Capital Fund and its affiliates can continue to raise capital in a manner not adverse to current investors.

5. The operating expenses of The Secured Capital Fund and the management fee will be shared among all the New Stream Fund in a manner intended to be in proportion to their aggregate interest in the Secured Capital Fund. The Secured Fund intends on continuing to manage down the operating expenses being charged to the New Stream Funds commensurate with the liquidation of its investment portfolio.

NECESSARY ACTION

Execution of the attached consent agreeing to (and directing the directors to effect as required):

- *the Forbearance Period with regard to the forbearance on collection activities in connection with your redemption request;*

- *the suspension of the demand payment request on the Secured Capital Notes held by the segregated Bermuda cell company in which you invested; and*

- *the amendment of the Secured Capital Notes held by the Bermuda Fund to, among other things, provide that demand thereon will be tolled for a two-year period, indicate that subsequent payments will be subject to the ability of the Secured Capital Fund to liquidate its investments in the orderly course of business, and provide for the payment allocation among the noteholders. The priority position of the Bermuda Fund over the Feeder Funds in the event of liquidation will be maintained.*

We and the directors firmly believe that this Plan will maximize the value of the Bermuda Funds' shares over time and create sufficient amounts available for redemption distributions. While it is difficult to craft a plan that will fully address all the views of the various investors, we have attempted in good faith to craft this Plain in a manner that addresses many of these concerns.

We remain committed to maximizing the value of the interests for the benefit of all New Stream Investors and we hope that most investors are committed to finding a fair, equitable and economically viable solution. We believe that the proposed Plan accomplishes this goal and that by working together, we can weather this unforeseen economic storm. We note that this situation is not unique and would as that you consider the Secured Capital Funds' current financial condition and the Plan propose above to address it in context.

Yours sincerely,

NEW STREAM CAPITAL, LLC

*By:*_________________

Managing Partner"

75. The second document was a "REQUEST FOR FORBEARANCE AND WRITTEN CONSENT", which (in addition to attaching a Consent Form) provided as follows:

"***REQUEST FOR FORBEARANCE AND WRITTEN CONSENT***

For Immediate Distribution

April 6, 2009

NEW STREAM CAPITAL FUND LIMITED

(THE "FUND")

Re: Proposed Restructuring Plan

The Directors of the Fund hereby request that the investors forbear from exercising certain rights and remedies in connection with their redemption requests and seek the written consent of the investors in order to implement the proposed restructuring plan set forth in the investor letter dated April 6, 2009 (the "Plan").

Specifically, the Directors request consent to the following actions:

1. Institution of a two-year Forbearance period (the "Forbearance Period") during which no requests for redemption by any of the investors in (a) New Stream Secured Capital Fund (U.S.), LLC, (the "U.S. Feeder"), (b) various Cayman Island Feeder Funds (collectively, the "Offshore Feeders") and (c) the Fund may be made, no redemption requests will be accepted and no existing or new redemption requests will be effective or will be paid. The U.S. Feeder and the Offshore Feeders shall hereinafter be collectively referred to as the "Feeder Funds" and together with the Fund shall collectively be referred to as the "New Stream Funds". The investors in the New Stream Funds shall hereinafter be collectively referred to as the "New Stream Investors".

2. A two-year stay on prosecuting any claims in connection with requests for redemption by any of the investors in the Fund.

3. A two-year suspension of the demand payment request on the all notes (collectively, the "Secured Capital Notes") issued by New Stream Secured Capital, L.P. (the "Secured Capital Fund") and New Stream Insurance, LLC ("NSI"), a wholly-owned subsidiary of the Secured Capital Fund, and held by; (i) the Fund's segregated cells in which you invested (the "Bermuda Notes"); (ii) the U.S. Feeder; and (iii) the Offshore Feeders.

4. During the Forbearance period, NSC will endeavor to make available a payment-in-kind option to New Stream Insurance Investors as settlement-in-full of any outstanding redemption requests of such investors in order of the sequence established by the original timing of each such investor's redemption requests in each of the New Stream Funds.

5. During the Forbearance Period, NSC will endeavor to establish a matching service which would pair New Stream Investors who desire to

sell their interest in the New Stream Funds with other New Stream Investors or third-party investors who may wish to purchase those interest during the Forbearance Period (the "Matching Service"). New Stream Investors who wish to participate in the Matching Service will be able to indicate to an independent broker contracted by NSC to provide the Matching Service (the "Matching Broker") a discount amount at which they would be willing to consider a sale and the Matching Broker will communicate such offers to other New Stream Investors and third-party investors who have indicated an interest to purchase additional interests in the New Stream Funds. The Matching Broker will notify the interested buyer and seller of the match and the parties will then independently negotiate a finale sale price.

6. During and subsequent to the Forbearance Period:

A. The Secured Capital Fund will accrue interest on all the Bermuda Notes at an adjustable rate equal to the 90-day LIBOR; provided, however that such rate shall not exceed 3% per annum.

B. New Stream Capital, LLC ("NSC"), the investment manager to the Fund and the general partner of the Secured Capital Fund, will continue to manage and will seek to orderly liquidate the investment portfolio of the Secured Capital Fund and pay the normal day-to-day operating expenses of the Secured Capital Fund and expenditures to which it is legally obligated to make under the remainder of its portfolio.

C. NSC shall periodically determine the amount of unrestricted cash (e.g., cash which is not needed to pay present and near future obligations of the Secured Capital Fund) which is available for distribution to the New Stream Investors ("Available

Cash"), provided however, that with respect to cash reserves being held for the express purpose of paying life premiums, any such cash reserve shall not exceed $60 million at the end of any calendar quarter. Such Available Cash shall be distributed to all New Stream Funds in repayment of their respective outstanding Secured Capital Notes as follows: (i) firstly, to the New Stream Funds, where the redemption requests made by the underlying investors had become effective prior to October 1, 2008, in accordance with the sequence established by the upon which such redemption request had become effective; and (ii) secondly, to the New Stream Funds (distributed based on the applicable Distribution Percentage (as that term is defined below) among the investors in the Bermuda Fund and the Feeder Funds each an "Investors Group"), where the underlying investor's redemption requests had become effective on or after October 1, 2008, on a pari passu basis to each Investor Group in respect of the balance of the Secured Capital Notes held by each New Stream Fund in an Investor Group against the total outstanding amount of the Secured Capital Notes held by all the New Stream Funds in such Investor Group. The "Distribution Percentage" shall be determined as of the date of any distribution of Available Cash (each, a "Distribution Date") as follows: (i) if the Bermuda LTV Ratio is more than 85%, then the Distribution Percentage shall be 100% to the Bermuda Fund and 0% to the Feeder Funds; (ii) if the Bermuda LTV Ratio (as that term is defined below) is less than or equal to 85%, but more than or equal to 70%, then the Distribution Percentage shall be 85% to the Bermuda Fund and 15% to the Feeder Funds; and (iii) if the Bermuda LTV Ratio is less than 70%, then the Distribution Percentage shall be 70% to the Bermuda Fund and 30% to the Feeder Funds. The Bermuda LTV Ratio shall be equal to ratio, as expressed as a percentage, of the

outstanding Secured Capital Notes held by Bermuda fund as of the end of the calendar quarter ratio to and Distribution Date to the total asset value of the Secured Capital Fund and its subsidiaries as of the end of such calendar quarter calculated in accordance with the Secured Capital Fund's private placement memorandum and limited partnership agreement. Notwithstanding the forgoing, to the extent that, on any Distribution Date, distributions of Available Cash Shall change the Bermuda LTV Ratio such that it triggers a change in the Distribution Percentage, the Distribution Percentage used on such Distribution Date shall be based on the initial Bermuda LTV Ratio for the amount of Available Cash distributed to the point the Bermuda LTV Ratio changes the Distribution Percentage, and the remainder of such distribution of Available Cash shall be distributed based on the changes Distribution Percentage.

D. NSC will be authorized to renegotiate and pay (as required by contact) the debt obligations of: the Secured Capital Fund currently held by Northstar Financial Services Ltd. ("Northstar"), a Bermuda insurance company and a wholly-owned indirect subsidiary of the Secured Capital Fund, in a manner so as to maintain the value of the Secured Capital Fund's investment in Northstar.

E. The Secured Capital Fund and its affiliates can continue to raise capital in a manner not adverse to the current New Stream Investors.

7. In order to implement the foregoing, the Bermuda Notes shall be amended to provide, among things, that demand thereon will be tolled for the duration of the Forbearance Period, and at

the conclusion therefore, subsequent payments of the Bermuda Notes will be subject to the ability of the Secured Capital Fund to liquidate its investments in the orderly course of business, and provided for the payment allocation set forth above among the New Stream Investors. The priority position of the Fund over the Feeder Funds in the event of liquidation will be maintained.

8. During and subsequent to the Forbearance Period, the operating expenses of the Secured Capital Fund and the management fee will be shared among all the New Stream Funds in a manner intended to be in proportion to their aggregate interest in the Secured Capital Fund.

In order to implement this proposed change in respect of the Fund's existing investors and shareholders as of the date hereof, we request your written consent. For this purpose, we would request that written consent. For this purpose, we would request that you sign the attached consent form and return the same to the Fund's administrator, Butterfield Fulcrum Group (Bermuda) Limited at facsimile number (441) 295-6759 (with the original to follow by mail), within 14 days from the date of this Circular and Request for Written Consent."

76. The Defendant's approval of the Plan was embodied in a resolution of the directors which provided as follows:

"***NEW STREAM CAPITAL FUND LIMITED***

Written Resolutions of the Directors

Pursuant to Bye-law 59(3) of the Bye-Laws

WHEREAS the Request for Forbearance and Written Consent (the ("Request") had been approved by the board for circulation to investors (being comprised of both shareholders and redeemed shareholders) pursuant to written resolutions adopted on April 8, 2009;

WHEREAS the Investment Manager of the Fund, New Stream Capital, LLC had advised that they had currently received an affirmative written response for over 59% of the investors in favour of the proposed restructuring.

WHEREAS on this basis, the directors felt it was prudent to being to take steps to implement various matters described in the Request. In particular, (i) wished to authorize the manager to being to negotiate the amendments to the Secured Capital Notes (as defined in the request) on behalf of each segregated account, (ii) make available a payment in kind option to New Stream Investors (as defined in the Request) as described in item 4 the Request and (iii) to agree that the operating expenses and management fee be shared among all New Stream Funds (as defined in the Request) in proportion to their aggregate interest in the Secured Capital Fund (as defined in the Request).

***RESOLVED** that, subject to the Fund receiving the required consents in respect of each of the segregated accounts and the relevant creditors of the Fund:*

(i)any Director of officer of the fund be and is hereby authorized to renegotiate and execute on behalf of each applicable segregated account, Bermuda Notes (as defined in the Request) with the Secured Capital Fund, pursuant to the terms as further described in the Request;

(ii)the Fund be and is hereby authorized to implement a payment-in-kind option to New Stream Investors pursuant to the terms contained in item 4 of the Request;

(iii)the Fund agrees to the reallocation of operating expenses of the Secured Capital Fund and the management fee to the shared amongst all the New Stream Funds (as defined in the Request) in a manner intended to be in proportion to their aggregated interest in the Secured Capital Fund as further described in item 8 of the Request; and

(iv) any Director be and is hereby authorized to take any steps or actions consistent with the terms outlined in the Request."

77. It is self-evident on the face of the above documents, under which Defendant's shareholders (or redemption creditors) were asked to consent to a restructuring "Plan" which directors approved subject to the obtaining of such consent, that the relevant transactions were not regarded by the Defendant's key agents as occurring within the ordinary course of business.

The Defendant's Bye-laws

78. The central controversy between the parties to the present proceedings turns on the Plaintiffs' complaint that the effect of the Plan was to vary the rights attached to their shares (a) contrary to the Bye-laws, and/or (b) contrary to SACA. The Defendant contends that the Plan was validly executed within the directors' managerial powers and entailed no variation of share rights. One of the key Bye-law provisions alleged to have been contravened was Bye-law 4 (6)(d):

> "*On a redemption of Shares of a class, the redemption proceeds shall be paid to the holder redeeming such shares out of the relevant Fund.*"

79. This provision is important because the whole purpose of the Plan is to provide a framework for the payment of redemption proceeds to the Defendant's redeeming shareholders in circumstances where such payments could not be made in the ordinary course of business as a result of liquidity and solvency concerns. The Bye-law appears to prescribe the source from which redemption proceeds should be paid. The "*relevant Fund*" can only be ascertained by reference to the definition provisions of Bye-law 1, which defines "Fund" as follows:

> "*a separate and distinct fund established and maintained by the Company in accordance with SACA and in connection with each class of Shares created for issue and within which all assets and liabilities attributable to the relevant class of Shares shall be held and segregated from the assets and liabilities attributable to each other class of Shares and from the general assets and liabilities of the Company.*"

80. Stepping back from this narrow perspective, Bye-law 4 as a whole provides as follows:

> "***SHARE CAPITAL***
>
> *4. (1) The capital of the Company shall be divided into shares with the rights*
> *and restrictions contained in the Bye-Laws as follows:*
>
> *(a)Manager Shares the holders of which shall, subject to the Bye-laws:*
> *(i) be entitled to one vote per Manager Share;*

(ii) not be entitled to any dividends in respect of the Manager Shares;

(iii) in the event of a winding-up or dissolution of the Company, whether voluntary or involuntary or for the purposes of a reorganization or otherwise or upon any distribution of capital, be entitled, subject to the Bye-laws, to be repaid out of the general account of the Company (but not, for greater certainty, out of assets linked to any Segregated Account) the capital paid up on the Manager Shares and to share pro rata in any surplus in such general account; and

(iv) not be subject to redemption or repurchase of the Manager Shares, whether at the option of the Company or the holder; and

(b)Shares the holders of which shall, subject to the Bye-laws:

(i)be entitled to one vote per Share in respect of (i) the appointment or change of the Auditor or the administrator of the Company and (ii) any amendment to these Bye-laws. In all other cases, save as otherwise provided by the Act, the holders of the Shares shall not be entitled to receive notice of, nor attend or vote, at general meetings of the Company;

(ii)be entitled to such dividends as the Directions may from time to time declare;

(iii)in the event of a winding-up or dissolution of the company, whether voluntary or involuntary or for the purposes of a reorganization or otherwise or upon any distribution of capital, be entitled, subject to the Bye-laws, pari passu with the holders of Shares of the same class, to be repaid out of the assets linked to the Segregated Account maintained in respect of such class of Shares, the capital paid upon such Shares and to share pro rata in any surplus in such Segregated Account; and

(iv)be entitled, and subject, to redemption or repurchase of such Shares as provided in the Bye-laws.

(2)Each of the classes of Shares, together with the relative Funds established and maintained in respect thereof and detailed of any series into which it may be divided, shall be listed in the Appendix to the Bye-laws (such Appendix not forming part of the Bye-laws).

(3)The directors shall be entitled from time to time in their absolute discretion to create and constitute such further class or classes of Shares with such name or names as the Directors my determine provided that, except with respect to the Fund attributable to such new class or classes of Shares. On the creation of a new class or classes of Shares. The Directors shall also be entitled in their absolute discretion to issue any class of Shares in series with such name or names as the Directors my determine. Where there are no longer Shares of a class in issue, the Directors may cancel such class of Shares and wind up in or terminate the Fund attributable to such class of Shares.

(4)Except where the context otherwise requires, the Bye-laws shall apply, mutatis mutandis, separately and independently to each class of Shares and to each Fund as if any such class of Shares and Fund were the sole class of Shares and Fund created and established pursuant to the Bye-laws.

(5)Subject to the Bye-laws, unissued Shares shall be available for issue as Shares of any class and shall be at the disposal of the Directors who may offer, allot, grant options over or otherwise dispose of them to such persons, at such times and for such consideration and upon such terms as they may determine.

(6)Save as otherwise provided in the Bye-laws, the assets held in each Fund shall be applied solely in respect of the Shares of the class to which such Fund appertains. The following provisions shall, subject to SACA, apply to the Funds established and maintained pursuant to this Bye-law:

(a) the proceeds from the allotment and issue of each class of Shares shall be applied in the books of the Company to the Fund established for that class of Shares, and the assets and liabilities and income and expenditure attributable thereto shall, subject to this Bye-law, be applied to such Fund and linked to its corresponding Segregated Account;

(b) where any asset is derived from another asset (whether cash or otherwise), such derivative asset shall be applied in the books of the Company to the same Fund as the asset from which it was derived and on each revaluation of an investment the increase or diminution in value shall be applied to the relevant Fund;

(c) subject to the Act and the Bye-laws, any dividends as and when declared by the Directors shall be paid to the holders of Shares out of the relevant Fund;

(d) on a redemption of Shares of a class, the redemption proceeds shall be paid to the holder redeeming such Shares out of the relevant Fund;

(e) the Directors shall (for the avoidance of doubt, without further requirement to obtain the consent of the Account Owners) have power and discretion (and where applicable, in accordance with sub-sections 11(4) and 17(5) of SACA) to allocate among the funds and to determine the basis of such allocation, any asset of the Company

which the Directors do not consider as belonging to the general account of the Company or attributable to a particular Fund or Funds and to vary any such allocation and basis of allocation at any time and from time to time;

(f) the Directors shall (for the avoidance of doubt, without further requirement to obtain the consent of the Account Owners) have power and discretion (and where applicable, in accordance with sub-sections 11(4) and 17(5) of SACA) (i) to allocate any liability among the Funds and the general account of the Company and to determine the basis of such allocation (including the terms of any subsequent reallocation thereof if circumstances so permit) and to vary any such allocation and basis of allocation at any time and from time to time and (ii) to transfer any assets to and from Funds and the general account of the Company if, as a result of a creditor proceeding against certain of the assets of the general account of the Company or attributable to a particular Fund or Funds or otherwise, a liability would be borne in a different manner from that in which it would have been borne under clause (i) aforesaid, or in any similar circumstances; and

(g) notwithstanding anything to the contrary in the Bye-laws or in any prospectus, offer document, agreement or other document relating to the Company:

(i) the Company shall maintain a Segregated Account in respect of each Fund and the assets of each Fund shall be held by the Company in accordance with and subject to SACA; and

(ii) the holders of the class of Shares in respect of which a Fund is established shall be the only Account Owners

of the Segregated Account maintained in respect of such Fund."

81. Bye-law 4(1) provides for "Manager Shares", and what might be described as investor shares. Investor shareholders are only entitled to vote on (a) appointing or changing the Auditor or administrator, and (b) amending the Bye-laws. Although it is made explicit that investors have no right to vote on restructuring or winding-up the company, this is unsurprising as their only interest is in their own company within the company, or segregated account. It is true that Bye-law 4 confers a right to be paid out of the Fund that is linked to the relevant class of shares, but it is obvious that what this Fund consists of will be subject to change depending on how the relevant segregated business is carried out.

82. Bye-law 7, also alleged to have been infringed by the Plaintiffs, provides as follows:

> "*7. (1) Whenever the capital of the Company is divided into different classes of shares all or any of the special rights for the time being attached to any class of share for the time being issued may only (unless otherwise provided by the terms of issues of the shares of that class) be altered of abrogated, either whilst the Company is a going concern or during or in contemplation of a winding up, with the consent in writing of the holders of not less than three-fourths of the issued shares of the class, or with the sanction of a resolution passed at a separate meeting the provisions of the Bye-Laws relating to general meetings of the Company or to the proceedings threat shall, mutatis mutandis, apply, except that the necessary quorum shall be two persons at least holding or representing by proxy not less than one-third in nominal amount of the issued shares of the class (but so that if at any adjourned meeting of such holders a quorum), and that the*

> *holders of shares of the class shall, on a poll, have one vote in respect of every share of the class held by them respectively and that any holder of shares of that class present in person or by proxy may demand a pool. For such purposes the Directions may treat all the classes of shares as forming one class if they consider that all such classes would be affected in the same way by the proposals under consideration but in any other case shall treat them as separate classes.*
>
> *(2)The special rights conferred upon the holders of any shares or class of shares issued with preferred or other special rights shall not (unless otherwise expressly provided by the terms of issue of such shares) be deemed to be varied by the creation, allotment or issue of further shares ranking pari passu therewith or subsequent thereto.*"

83. The last sentence of Bye-law 7(1) permits the directors to treat different classes of shares "*as forming one class if they consider that all such classes would be affected in the same way by the proposals under consideration*". Bye-law 12 gives the directors broad investment and borrowing powers:

> "*(1) In carrying on the business of the Company or any Fund, the Directors shall be entitled to acquire, hold, deal in and dispose of any Investment in such manner at such times and in such amounts as the Directors shall think fit.*
>
> *(2) The directors may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property and uncalled capital, or any part thereof, and may issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the Company, any Fund or third party.*"

84. It is in dispute whether this provision empowered the directors to approve and implement the Plan so as to bind the Plaintiffs' segregated accounts without the consent of the Plaintiffs or whether this broad power only applies to transactions in the ordinary course of business which do not alter redemption-related rights. Bye-law 9 provides as follows:

> "***REDEMPTION OF SHARES***
>
> *9. (1) Subject to the Act and SACA and subject as hereinafter provided, the Company shall, on receipt by it or its authorized agent of a Redemption Request from a Member (the "Applicant"), make a demand for repayment (on or before the last day of the calendar month in which the Redemption Request has been made) on any investment held by the Company in respect of the Segregated Account linked to the class of Shares referenced in such Redemption Requests in an amount sufficient to redeem or purchase all of the Shares requested in the Redemption Request provided that:*
>
> *(a)subject as hereinafter provided, the redemption or purchase of Shares pursuant to this Bye-law shall be made on the Dealing Day immediately following the day on which the redemption Request is received provided that such Redemption Request is received in compliance with notice and other applicable requirements set out in the latest offer document for the time being for the class of shares concerned;*
>
> *(b)the redemption or purchase of Shares pursuant to this Bye-law shall be effected at the Redemption Price;*

(c)subject as hereinafter provided, payment shall be made to the Applicant in the Dealing Currency in respect of the redemption or purchase of Shares. Any amount payable as aforesaid to the Applicant shall be payable as soon as practicable after the relevant Dealing Day plus (i) the duration of any Suspension Period falling after the receipt of the Redemption Request and before such payment and (ii) any period during which the relevant share certificate, if any, has not been lodged as provided in this Bye-law. Payment for Shares redeemed or purchased hereunder shall be made to the Applicant by a cheque, draft, electronic funds transfer or other means of payment posted (at the risk of the Applicant) or otherwise paid to the Applicant in the manner determined by the Directors from time to time. If an Applicant shall require payment in a currency other than the Dealing Currency, the Directors may, subject to receipt of any necessary exchange control to other governmental consent and at the risk of the Applicant and on his paying any costs thereby involved, arrange for the conversion of the amount to which the Applicant is entitled into such currency as the Applicant may require at such exchange rate as the Directors shall consider appropriate;

(d)on any redemption or purchase the Directors may in their absolute discretion divided in specie the whole or any part of the assets of the Company and appropriate such assets in satisfaction or part satisfaction of the Redemption Price and any other amounts payable on redemption as is herein provided;

(e)during any Suspension Period no Shares may be redeemed or purchased, and the right of the Applicant to have his Shares redeemed or purchased, shall be similarly suspended, notwithstanding the foregoing, the existence of a Suspension Period shall not impact the Company's obligation to submit a

demand for repayment upon receipt of a Redemption Request pursuant to the Bye-Law 9(1);

(f)the Applicant shall not be entitled to withdraw a Redemption Request without the consent of the Directors except during any Suspension Period. Any such withdrawal of a Redemption Request must be made in writing. Any withdrawal of a Redemption Request during a Suspension Period shall only be effective if actually received by the Company or its duly authorized agent during the Suspension Period concerned. If a Redemption Request is not a withdrawn, the redemption or purchase of the applicable Shares shall be made on the Dealing Day next following the end of such Suspension Period;

(g)instead of redeeming or purchasing the Applicant Shares, the Directors may procure the purchase thereof at not less than such Redemption Price and at the same time and under the same terms as apply to redemption under the Bye-laws; and

(h)if as a result of a redemption or purchase of part of holding of any Member, such Member would hold less than the minimum number of Shares of the class and, if applicable, series, concerned as specified from time to time by the Directions, then the Directors may refuse to allow such partial redemption, or alternatively, may require full redemption of all such Member's Shares of the class or series concerned or only allow such partial redemption that would still result in the Member holding the requisite minimum.

(2) Where a certificate has been issued in respect of any Shares to be redeemed or purchased:

(a) the Applicant shall lodge with the Company or its duly authorized agent such certified and subject as hereinafter mentioned no payment shall be made under this Bye-law until such certified shall have been received;

(b) the Directors may at their option dispense with the production of any certificate which shall have become lost or destroyed upon compliance by the Applicant with the like requirements to those applying in the case of an application by him for replacement of a lost or destroyed certificate under the Bye-laws;

(c) on redemption or purchase of part only of the Shares of the same class or series registered in the Applicant's name the Applicant shall be entitled by a request in writing without payment to a balance certified for the balance of such Shares.

(3) Upon the redemption or purchase of a Share being effected pursuant to this Bye-law, the holder thereof shall cease to be entitled to any rights in respect of that Share (excepting always the right to receive a dividend which has been declared in respect thereof prior to such redemption or repurchase being effected) and accordingly his name shall be removed from the Register with respect thereto.

(4) If the Company shall at any time be prevented from redeeming or purchasing Shares by virtue of a limitation contained in the Act or the Memorandum (such limitation prohibiting a redemption or purchase if as a result thereof the issued share capital of the Company would be below the minimum amount specified in the Memorandum), the Directors shall forthwith convene a special

meeting of the company and recommend the passing of an appropriate resolution to wind up the Company.

(5) Notwithstanding any other provision of the Memorandum or the Bye-laws, the Directors shall have the power to withhold the payment of the proceeds payable on the redemption or purchase of any Shares of any Member for such period of time as the Directors may determine, including permanently, but only if the Directors determine that it is appropriate or necessary to do so in order to comply with the Proceeds of Crime Act, 1997, or any regulation, code of practice, or guidance note promulgated thereunder, or any similar legislation applicable to the Company, directly or indirectly, in any other jurisdiction. In the event the Directors withhold the payment of any redemption or purchase proceeds with or to the order of the Custodian in the name of the Company for the payment to the Member upon approval by the Directors. Upon the deposit of such redemption or purchase moneys as aforesaid, the Member shall have no further interest in such Shares or any of them or any claim against the Company in respect thereof except the right to receive the money so deposited (without interest) from the Company but only when, if ever, the payment is approved by the Directors. Provided the Directors acted honestly and in good faith, the Company and the Directors shall not be liable to any Member for loss or damages arising as a result of the Directors exercising their power pursuant to this paragraph

(6) To the extent that a Member determines that there has been a default under an investment held by the Company in respect of a Segregated Account which said Member's class of Shares is linked, then that Member may direct the Directors, in writing, to effect its

rights and remedies with respect to that investment, including without limitation, a liquidation of any collateral secured by such investment. Any proceeds received by the Company from such action shall be used to redeem the Shares held by such Member which are linked to such Segregated Account, pari passu to any other Redemption Requests pending in respect of the same Share class linked to such Segregated Account at such time.

(7) Subject to the Memorandum, the Bye-laws and the Act and subject as hereinafter provided, the Directors shall have the power exercisable by resolution to redeem or purchase all or any portion of the Shares registered in the name of any Member and the provisions of this Bye-law shall apply to any such redemption or purchase exempt that:

(a) the Company shall give written notice to the relevant Member of its intention to redeem or purchase such Member's Shares specifying the number, class and, if applicable, series of such Shares;

(b)subject as hereinafter provided, the redemption or purchase of Shares pursuant to this Bye-law shall be made on the dealing Day immediately following the day on which such notice is received or deemed by virtue of the Bye-laws;

(c)if a certificate in respect of any Shares the subject of redemption or purchase under this paragraph of this Bye-law is outstanding then, upon receipt of the notice as aforesaid, such Member shall be bound forthwith to deliver to the Company or its duly authorized agent the certificate for such Shares. Payment of the redemption or purchase proceeds shall be deposited by the Company with or to

the order of the Custodian in the name of the Company for payment to such Shares previously held by such Member. Upon the deposit of such redemption or purchase proceeds as aforesaid, such Member shall have no further interest in such Shares or any of them or any claim against the Company in respect thereof except the right to receive the proceeds so deposited (without interest) from the Company upon surrender of such certificate;

(d)no Shares shall be redeemed or purchased under this Bye-law during any Suspension Period."

85. The main body of 9 (1) imports into the constitution of the Company and the share rights of the various share classes a linkage between payment of redemption proceeds and investments made by a segregated account, echoing the provisions of the LSA. Moreover, redemption rights are explicitly made subject to the Companies Act and SACA. It is also implicitly envisaged that a redemption request will be funded by the proceeds of a demand for repayment made by the Defendant under an applicable Loan Note. In one important context, however, the shareholders and not the directors are given the operative decision-making power: when an investment (e.g. a loan) is in default. Paragraph 6 of Bye-law 9 merits consideration in its own right:

> "6.*To the extent that <u>a Member determines</u> that there has been a default under an investment held by the Company in respect of a Segregated Account which said Member's class of Shares is linked, then <u>that Member may direct the Directors , in writing, to effect its rights and remedies with respect to that investment, including, without limitation, a liquidation of any collateral secured by such investment.</u> Any proceeds received by the Company from such action shall be used to redeem the Shares held by such Member which are linked to such segregated account, pari passu to any other Redemption Requests pending in respect*

of the same Share class linked to such segregated Account at such time." [emphasis added]

86. So although investment powers are vested solely with the directors for the purposes of ordinary business operations, in the default context the shareholders are entitled to both (a) determine that an investment linked to their share class is in default; and (b) direct the directors to take remedial action including liquidating collateral. One may perhaps imply a requirement that the shareholder must act reasonably in determining under Bye-law 9(6) that a default exists which warrants remedial action, with the terms of the relevant investment (i.e. the LSA and the Loan Notes) governing the issue of whether a default situation exists. Equally, although the directors are given the power to determine whether or not all share classes have the same interests for the purposes of Bye-law 7(1), this discretionary power must be exercised in a rational manner and is not wholly unfettered. It may well be to avoid the consequences of this crucial shareholder power that the Defendant is keen to contend that the Plaintiffs (and other redeemers) are no longer able to exercise share rights. But assuming the Defendant is right, does Bye-law 9(6) not have residual effect to deprive the directors of the ability to modify default collateral rights pertaining to a segregated account without the investors' consent?

87. These redemption rights are not absolute, and can be suspended. Bye-law 9 (7)(d) provides: "*no Shares shall be redeemed or purchased under this Bye-law during any Suspension Period.*" It is undisputed that the Defendant's directors elected not to suspend the determination of Net Asset Value under Bye-law 11. Had they triggered a suspension period and acted in accordance with any applicable rules and regulations, the directors' determination that a suspension was justified would have been "*conclusive*" (Bye-law 11(1)).

88. Accordingly, prior to the implementation of the Plan on May 1, 2009, the position appears clearly to have been as follows. The Plaintiffs' redemption requests had matured so they were creditors entitled to be paid (in accordance with the Bye-laws) their redemption proceeds "*as soon as practicable*" out of monies payable by NSI under the investment linked to their segregated accounts. Whether their rights under Bye-laws 4 and 9 to be paid out of assets linked to those accounts were varied by the Plan essentially turns not just on whether the Plan altered the composition of assets linked to their accounts (which in my judgment was always potentially subject to change). The variation question also crucially depends on whether the impugned modifications to the Loan Agreement were effected in a way which was contemplated by the Bye-laws. As the Bye-laws incorporate by reference the provisions of SACA, the relevant statutory provisions must also be considered.

Key provisions of SACA

89. The Act provides a statutory framework for companies to which the Companies Act 1981 applies to be registered as and to operate as segregated account companies. The traditional corporate concepts are altered both as regards the internal relations between the SACA company and its shareholders ("account holders"), and as regards the external relations between the company and third parties with which the company deals on behalf of a segregated account ("counterparties"). Irrespective of what commercial context drafters of similar legislation elsewhere had in mind, the Bermuda legislation certainly contemplates insurance and reinsurance companies and mutual funds registering under the Act.

90. That insurance companies are contemplated is clear from section 3, which permits companies engaged in insurance business apply for registration under section 6 by filing a notice under section 5. However, in the case of non-insurers, an applicant must additionally obtain the consent of the Minister. Although this might suggest an assumption that most companies registering will be insurers, it is equally

plausible that this provision simply reflects the fact that registered insurers will have already been subjected to heightened regulatory scrutiny, while non-insurers may not.

91. Be that as it may the Act also explicitly contemplates its application to mutual fund companies as well. Section 12, for example, provides that in the case of mutual fund companies, assets and liabilities of the company may only be attributed to two or more segregated accounts and the general account if the relevant contract or governing instrument expressly refers to sections 11(4) and 17(5) (as the Bye-laws do, arguably permitting the overlapping security interests under the LSA for the Defendant's various NSI Lenders *ab initio*). This provision has no obvious relevance to the present case where the controversy centres on whether assets of a segregated account can be made available to meet the liabilities of both (a) other segregated accounts of the Defendant which did not invest in NSI *ab initio* and (b) third parties altogether (the Cayman and US Feeders). It was not suggested that assets already linked to the Plaintiffs' accounts could be reassigned to other NSSC-investing accounts under the Plan; the relevant documents made no express reference to section 11(4) and 17(5) in any event.

92. Section 15 of the Act also makes specific provisions for share redemptions in the case of mutual fund companies out of assets linked to the segregated account. The Act also requires the Company to keep separate accounting records for each segregated account, and to maintain a separate fund for such accounts distinct from its general account. Where a SACA company enters into transactions with third parties on behalf of segregated accounts, the transactions must be linked to the relevant segregated account. The internal and external relations of a SACA company in relation to a segregated account are primarily governed by the "governing instrument", which will be (depending on the relationship at issue) the bye-laws and any prospectus or offering document or the contract or other document evidencing a transaction with third parties linked to a segregated

account. However, it is not possible to contract out of the statutory requirements for the assets and liabilities of a segregated account to be segregated.

93. The immunization of segregated accounts from the risk of insolvency flowing from commercial risks the account has not assumed is one the most important commercial and legal objects of the legal framework created by SACA. Thus a SACA company can only be wound-up if its general account is insolvent and the assets and liabilities of a segregated account may not be taken into account in determining whether the company in this sense is insolvent. Moreover, if the company is placed into liquidation, the liquidator must ensure that assets of a segregated account are only applied to meet the liabilities of that account, unless one segregated account has an actual liability to another account. The notion of the segregated account as a "company within a company" is reflected in the receivership regime which is created for winding-up the business of a segregated account. The Act permits segregated accounts to enter into transactions with one another and provides that counterparties (creditors) are entitled to be paid ahead of account owners (shareholders). The company may sue and be sued in respect of a segregated account.

94. In summary, the Act does contemplate segregated accounts entering into transactions under which their assets may be applied to meet the liabilities of other segregated accounts or third parties. But in an insolvency situation, the Act envisages that the assets of each segregated account will be applied in accordance with whatever contractual arrangements are linked to the relevant accounts. What is not clear, on the face of the relevant statutory provisions, is whether the broad management powers given to the directors to conduct the business of a segregated account continue undiluted when insolvency occurs. Were that to be the case, this would be inconsistent with general principles of corporate and personal insolvency, as well as the manner in which the Defendant itself sought to implement the Plan.

95. Before considering the principal issues requiring determination and the submissions made by Counsel at trial, the most important statutory provisions require more detailed consideration. Firstly, the main focus of SACA is to immunize the assets of segregated accounts from the non-linked claims of either the company's general creditors or creditors or account owners of other segregated accounts. However, section 17B (on which the Plaintiffs rely) affords similar protections against third part claimants as well:

> "**Creditor enforcement rights limited to account assets**
>
> *17B (1) There shall be implied (except in so far as the same is expressly excluded in writing) in every contract and governing instrument entered into by a segregated accounts company the following terms:-*
>
> *(a) that no party shall seek, whether in any proceedings or by any other means whatsoever or wheresoever, to establish any interest in or recourse against any asset linked to any segregated account to satisfy a claim or liability not linked to that segregated account;*
>
> *(b) that if any party succeeds by any means whatsoever or wheresoever in establishing any interest in or recourse against any asset linked to any segregated account of the company in respect of a liability not linked to that segregated account, that party shall be liable to the company to pay a sum equal to the value of the benefit thereby obtained by him; and*
>
> *(c) that if any party shall succeed in seizing or attaching by any means or otherwise levying execution against any assets linked to any segregated account of the company in respect of a liability not linked to that segregated account, that party shall hold those assets or their proceeds on trust for the company and shall keep those assets or proceeds separate and identifiable as such trust property.* "

96. Although this provision may be contracted out of expressly, the Bye-laws of the Defendant (and perhaps the loan documentation as well) must seemingly be read

as containing an implied term that the assets of the Plaintiffs' segregated accounts should not be available to meet the claims of other segregated accounts or other creditors as well. Did the Plan validly contract out section 17B if it had the effect of making NSI assets available to NSSC investors? Section 17B is complemented by the following provisions of section 18:

> "*(10) Except to the extent it may be agreed otherwise by virtue of the governing instrument or contract, as the case may be, an account owner of a segregated account and any counterparty who is a creditor in respect of a transaction linked to that segregated account shall have an undivided beneficial interest in the assets linked to a segregated account, and, after satisfying in full the claims of creditors of the segregated account, account owners shall share in the profits and losses of the segregated account in such proportions of the residual undivided beneficial interest in the segregated account owned by that account owner as may be specified in any governing instrument relating to such segregated account.*"

97. An important concept embedded in section 18(10) is the notion of "*counterparty who is a creditor in respect of a transaction linked to that segregated account*". *Section 2(1)* defines "*transaction*" in a way which suggests that the only way a third party creditor can acquire an interest in assets linked to a segregated account is if they enter into a contract with the relevant account:

> " *'transaction' means any dealing of whatever nature, which may be evidenced by a governing instrument (in the case of a transaction with an account owner) or contract (in the case of a transaction with a counterparty), including the issue of any security, by which assets or liabilities become linked to a segregated account or by which the assets or liabilities linked to a segregated account are otherwise affected, or, in the case of assets*

linked to a segregated account which are intended by the parties to be applied to a risk of any nature, any dealing which exposes such assets to liability or loss."

98. This confirms that who may assert claims against a segregated account is not static; it may change depending on the identity of the parties to transactions entered into from time to time by the relevant account. Section 17 (7) and (10) makes the following related provision for what happens when the life of an account comes to an end:

> "*(7) In the event that a segregated account has insufficient assets to pay all of its obligations in full, the order and priority of the rights in relation to assets linked to a segregated account shall (without prejudice to the rights of any parties holding valid security interests against assets linked to that segregated account and any valid preferential claims in respect of that segregated account) be determined by the terms of the governing instrument and any contracts pertaining to that account, and any ambiguity in respect of the order and priority rights shall be resolved as follows:*
>
> *(a) the claims of creditors shall rank ahead of the claims of account owners;*
>
> *(b) the claims of creditors inter se shall rank pari passu; and*
>
> *(c) the claims of account owners inter se shall rank pari passu…*
>
> *(10) Subject to the terms of the governing instrument relating to a given segregated account, on dissolution of the segregated accounts company or termination of the segregated account and after paying creditors of the segregated account, any property linked to that segregated account shall be paid pro rata to the account owners of such segregated account or, if there are no account owners, shall be deemed to fall into the general account.* "

99. Section 11(2)(d) of the Act provides as follows:

> "*(d) unless otherwise provided in the governing instrument, the segregated accounts company may take any action, including—*
>
> > *(i) the amendment of the governing instrument;*
> >
> > *(ii) the appointment of one or more managers;*
> >
> > *(iii) for the benefit of the segregated account only, the sale, lease, exchange, transfer, pledge or other disposition of all or any part of the assets of the segregated account, or the orderly winding-up of the affairs and termination of the segregated account, or may provide for the taking of any action to create under the provisions of the governing instrument a class, group or series of account holdings that was not previously outstanding, without the vote or approval of any particular manager or account owner, or class, group or series of managers or account owners…*"

100. These broad powers which the Act says are conferred on a SACA company's management (unless otherwise provided by its governing instrument) to act without account owner consent appear not to have been excluded by the Defendant's Bye-laws and are broadly reflective of the Bye-law 12 powers on which the Defendant relies. But can these powers be used otherwise than in the context of transactions carried out: (a) "*for the benefit of the segregated account only?*"; and (b) in the ordinary course of business in the sense that there is no question that all stakeholders will be paid in full?

The issues to be determined

101. The Plaintiffs' Skeleton Argument defines the issues to be tried as follows:

> "*(1) Whether upon a true construction and interpretation of (a) the Segregated Accounts Act 2000 (as amended) (the "SAC Act") and, (b) the documents identified at the Schedule set out below, the purported Plan is illegal, invalid, or ultra vires and therefore must be set aside, with the effect that all loan documentation and relationships are restored to their status on April 31, 2009, immediately before the Plan was purportedly adopted In particular, Plaintiffs contend that the Plan is illegal, invalid or ultra vires because it:*
>
> *(i) eliminates the segregation of the rights and obligations under the Loan and Security Agreements dated 1 August 2008 and the relevant Loan Notes (together the "Loan Documents") which are the assets of each Class of the Defendant by pooling the repayment obligations to make them joint obligations of NSSC and of NSI with a payment schedule which is especially detrimental to the interests of Classes C and I;*
>
> *(ii) gives away economic interests arising from the Class C and I loans to NSI, which, prior to the Purported Plan were in the form of an obligation of NSI to repay the loans in accordance with the terms set forth in the relevant Loan Document(s) (the obligation of which was secured by all of the assets of NSI), by commingling the repayment obligations and security interests of the Class C and I loans with those of the loans of all other Classes of the Defendant and of the US and Cayman Feeder Funds;*
>
> *(iii) takes action based upon the collective economic picture, not only of the Defendant but also of the US and*

Cayman Feeder Funds, while failing to maintain the segregation of each Class's assets and economic position and ceasing to consider the interests of each Class individually to determine and maximize each Class's economic position;

(iv) harms the Gottex AB Fund account holders / redeeming shareholders in the affected classes of the Bermuda Fund without their consent, and binds them involuntarily to drastically different repayment obligations and rights;

(v) relinquishes Classes C and I's senior priority position in terms of rights to repayment of its loans to NSI, the timing of that repayment obligation, and the security provisions that protect that repayment obligation; and likewise relinquishes all of the affected Bermuda Fund share classes' advantageous position by reducing their payment priority over the Cayman and US Feeder Funds; and

(vi) removes Classes C and I's ability to obtain repayment of their loans through the proceeds from liquidation of NSI's assets before NSI transfers those assets, or cash from the liquidation of those assets, to others.

(2) Assuming that the Court finds the purported Plan is illegal, invalid, or ultra vires and sets it aside, whether it is just and equitable to appoint a receiver, pursuant to section 19(1) of the SAC Act, over the C and I accounts for the purposes included in Section 19(3)(a) and 19(3)(b).

(i) In particular, the Plaintiffs contend that it is just and equitable to appoint a receiver because the current manager and Directors allowed the Plan to be adopted with the effects outlined above in issue 1, have an apparent and continuing conflict of interest with regard to different classes of the Bermuda Fund (and, as to the manager, with regard to the Bermuda, Cayman and U.S. funds), and failed to take appropriate steps to identify and protect the specific interests of the different classes of the Bermuda Fund, particularly Classes C and I.

(ii) The Plaintiffs further contend that a receiver can accomplish the purposes included in Section 19(3)(a) and 19(3)(b) by taking steps to protect the assets (the loans and security interests) owned by Classes C and I, seeking repayment and if necessary executing on the collateral in order to secure repayment of those loans, and distributing assets to the redeeming shareholders."

102. The Defendant's Skeleton Argument summarizes the response to those issues believed to be in controversy as follows:

"(1) *The "asset linked to a segregated account" for the purposes of Section 17(2) is a chose in action, the loan notes. The loan notes confer on the lender a basket of rights, including a lien or security right which resembles a floating charge. These rights are by their very nature protean and can be amended, commuted and varied as between lender and borrower. Moreover breaches of the Loan and Security Agreements by the borrower do not entail contraventions of Section 17 of SACA or the Bye-laws;*

(2)The Defendant, as lender, concluded the Loan and Security Agreements when the Borrower, NSI, had an established history of financial dependence on its parent, NSSC. There was a substantial degree of consolidation or "mutualisation" between the two entities. Cash proceeds of NSI's assets were paid to NSSC's bank account, into which proceeds from other subsidiaries were also paid, and from which NSSC made transfers to pay for NSI's assets. NSI was heavily subsidised by NSSC and could not have survived without NSSC's support at any stage of its existence.

(3)Because the assets of NSI were paid for with money belonging to NSSC the assets which were subject to the liens granted by the Loan and Security Agreements and which were linked to the Plaintiffs' Segregated Accounts were always compromised by this co-mingling of assets. At least the investors of NSSC would have been able to require NSSC to trace these funds, if not assert an equitable charge.

(4)The "Plan" is not "invalid" or ultra vires. The various elements of the Plan are designed to protect the assets of the Segregated Accounts by maximising what is to be repaid under the Loan and Security Agreements and averting a tangible risk that such repayments would have been impaired in litigation. Indeed the Plan seeks to improve the position of those classes of the Defendant invested in NSI.

(5)The Plaintiff was fully aware of the way in which NSSC and NSI operated, approved of the relationship between these two companies and cannot now be heard to complain that it did not understand the implications of this. Moreover, the Plaintiffs can hardly be said to have been treated unfairly. It is not just and

equitable for the Plaintiffs to have any relief and nor should the Court grant declaratory relief to the Plaintiffs.

(6)It is fanciful to suggest that a Receiver could enforce the collateral under the Loan and Security Agreements. Indeed the result would be catastrophic not just for the Plaintiffs but for all the Defendant's share classes with an interest in NSI. Quite apart from the fact that NSI and NSSC would have to be immediately placed into bankruptcy, either: the premiums on the assets of NSI could no longer be maintained and the collateral would become immediately worthless; alternatively, foreclosure would be stayed and the collateral would become subject to litigation which could result in its consolidation with that of lenders to NSSC and subordination of the security interests of the Defendant."

103. There are, it is common ground, two main areas of enquiry: (1) is the Plan unlawful, and (2) should a receiver be appointed if it is? The first issue has the following key elements to it, re-framing the questions somewhat from the way in which they were articulated by either counsel:

(a) what constituted assets in relation to the Plaintiffs' segregated accounts with the Defendant prior to the Plan?

(b) how (if at all) do the liquidity or solvency concerns which prompted the Plan impact on the Defendant's directors' ordinary investment powers?

(c) did the directors' approval of the Plan and execution of the modified loan documents vary the Plaintiffs' rights under the

Bye-laws and SACA in a manner which was beyond the scope of their broad investment management powers?

104. The second issue has following key elements to it:

(a) is it just and equitable to appoint a receiver within the context of section 19 (1) (a) of SACA; and
(b) (if the answer to (a) is affirmative) would the objects of subsection 3 of section 19 be achieved by the making of such an order, as mandated by section 19(1)(b).

105. Under these two main umbrellas and within the respective key points, a number of other significant subsidiary points fall to be considered. But it is important to be clear from the outset what principal matters fall to be determined. The respective submissions on the principal points will now be considered before this Court's findings are then set out.

The Plaintiffs' submissions on issue (1): is the Plan unlawful?

<u>What assets were required to be segregated prior to the Plan</u>

106. The Trial Skeleton Argument of Mr. Woloniecki and Mr. Jenkins described the structure of the Defendant Fund and the relevant segregation requirements as follows:

> "*25.It may be, at first blush, difficult to fit the structure of the Bermuda Fund, at least as it was portrayed in evidence during the Tensor trial, into the legislative scheme of the SAC Act. The following aspects of the structure adopted by the Bermuda Fund are worthy of note:*

(1) Applying the statutory definition of "segregated account", it is unexpected to see only a single loan note (with its attendant contractual protections and security interests) as the "assets" held by a "segregated account." A loan note is a chose in action, however, and may therefore reasonably be described as an "asset". On the liabilities side, each of these segregated accounts owes its account owners / redemption creditors the moneys they paid in as investors for shares, and that were then lent to the respective Borrower on the note. Thus, it appears that each class can be "... <u>a separate and distinct account</u> ... <u>pertaining to an identified or identifiable pool of assets and liabilities</u> ..."

(2) The SAC Act further contemplates that the assets "linked" to a "segregated account" are to be held as a "separate fund" (sections 17(2), 18(1)). This is a fundamental requirement. The statutory purpose for the existence of (and indeed necessity for) a "separate fund" is that it should be, "available <u>only</u> to meet liabilities to the account owners and creditors of that segregated account ..." (section 17(2)(a)(ii).) Because the notes here are backed by security interests in two different pools of Collateral, either NSI's assets or NSSC's assets, and thus the structure contemplated shared Collateral across some clearly-identified classes, the separateness of each "separate fund" may appear muddied. Nonetheless, as the New Stream structure was established prior to the Purported Plan, each account and "fund" held a repayment obligation of a loaned amount from a particular Borrower, with various contractual protections and security interests, and could expect that the repayment

amount would come back to that class, pursuant to the note and the applicable Loan and Security Agreement, to satisfy that class's share redemption liabilities – and that it would not be used to satisfy any other liabilities of some other class or altogether separate mutual fund.

(3) If the note obligations are not repaid upon demand or default, the segregated account may have to move to enforce its security interest, and the shared NSI or NSSC Collateral across a few different Bermuda Fund classes make the process of execution more cumbersome. This may tend to complicate the very purpose of Section 19(3)(b), which allows an investor "to get his money out" of a segregated account, by means of appointing a receiver, provided the Court considers it is just and equitable to do so. But it is clear here that Classes C and I have the majority holdings to control execution upon the relevant Collateral under the NSI Collateral Agency Agreement, and thus that in this particular case the purpose of Section 19(3)(b) can be served in a relatively straightforward way if a receiver is appointed."

107. The Plaintiffs' Skeleton Argument takes issue with the Defendant's characterisation of the security interests obtained by Classes C and I under the loan agreements as akin to a floating charge, an analogy which I accepted in UBS Fund Services (Cayman) Ltd. and Tensor Endowment Ltd.-v-New Stream Capital Fund Ltd. [2009] Sc (Bda) 63 Civ (18 December 2009)9. The true nature of those security interests, it was submitted, was as follows:

[9] At paragraph 14.

"*52.Each Share Class of the Bermuda Fund made loans to either NSSC or NSI and, in order to secure its obligation to repay the amounts it borrowed, NSSC or NSI, as the case may be, granted to each Share Class from which it borrowed money a security interest in the Collateral as defined in that class's Loan and Security Agreement (essentially, all of the Borrower's assets). The grant of the security interest is set out in the Loan and Security Agreements, which are governed by Connecticut law, and various enforcement procedures are also set forth in the respective Collateral Agency Agreement, which is governed by Delaware law; however, to the extent that the loan and security documents address segregation of assets, they are subject to and governed by Bermuda law. The Collateral Agent (Wilmington Trust Company) is located in Delaware and has possession of Collateral there. The security interests are typical, US security interests under the Uniform Commercial Code ("UCC") rubric.*

53.Taking security under the UCC requires two elements: attachment and perfection. Attachment is the creation of the interest in writing between the grantor and the secured party and it must identify the collateral. The Loan and Security Agreements satisfy the attachment element through explicit granting language in writing, with a description of Collateral that is typical and sufficient. Under the UCC, there are several methods of perfection, but here the analysis is simple because NSI and NSSC each filed a UCC-1 financing statement in favour of the Collateral Agent in Delaware. The filing of the UCC-1 financing statement is effective to perfect the security interest. Thus, under the Delaware UCC, the lending classes of the Bermuda Funds have a perfected security interest in the Collateral of their respective Borrower, NSI or NSSC. These perfected security interests existed before any lending by the Cayman or US Feeder Funds to NSSC occurred.

54.These security interests are different in nature to a "floating charge," which is not a term generally used in the US. The two types of interests, the perfected UCC security interest and the floating charge, are similar in so far as the borrower may be free to deal in the assets that constitute the collateral prior to enforcement, subject of course to any limitations on the use or disposal of the assets in the particular security documents at issue (and such limitations are present here). However, there is an important difference between the two with respect to priority. Under English law, parties secured by a floating charge are always subordinate to those secured with a fixed charge, even if such fixed charge is created after the floating charge was created. Under the UCC, however, once the security interest has been perfected, its priority has been established forever. Following perfection of a security interest, the UCC will not recognize any subsequent security interest as senior to that of the perfected security interest, but instead will steadfastly protect that earlier-perfected and continuing priority interest (unless, and to the extent that, the creation of a subsequent senior security interests is explicitly permitted under the documents governing the perfected security interest).

55.As Mr. Broude explained in his Expert's Reply Report at paragraph 35, Article 9 of the Delaware Uniform Commercial Code, 6 Del. Code § 9-101 et. seq., provides in § 9-322(a)(1) that any "[c]onflicting perfected security interests … rank according to priority in time of filing or perfection." From the date of filing forward, no lender can usurp the perfected security interest.

56.Thus, a party secured with an English law floating charge is subject to subordination by unknown parties at future dates, while a party secured with a security interest perfected under the UCC is not. A party secured by way of a perfected UCC security interest will always know the extent to which it can rely on the collateral (and the proceeds thereof) as security for the grantor's obligations, whereas a party secured by way of a floating

charge will not know for certain the extent to which it can rely on the collateral (and the proceeds thereof) as security for the chargor's obligations until crystallization occurs and all fixed charges are known."

108. These submissions did not address the issue of what constituted an asset for the purposes of SACA directly. However, in his oral closing submissions, Mr. Woloniecki argued that the assets of the Plaintiffs' segregated account included not simply the Loan Notes, but the related rights under the LSA as well. These rights included perfected security interests over NSI's assets, as supported by the unchallenged expert evidence of Mr. Broude. However, the Plaintiffs' Skeleton did address what the statutory segregation requirements were:

"*19.Keeping the above-mentioned provisions*[10] *in mind, one must then consider section 17 ("nature of segregated accounts, application of assets and liabilities") and section 18 ("rights and obligations with respect to segregated accounts"), which define the legal parameters of "segregated accounts". The following provisions should be noted (emphasis added):*

> *(i)* <u>*Section 17(2)*</u>*: 'Notwithstanding any enactment or rule of law to the contrary, but subject to this Act, any liability linked to a segregated account shall be a liability only of that account and not the liability of any other account and the rights of creditors in respect of such liabilities shall be the rights only in respect of the relevant account and not of any other account, and, for the avoidance of doubt, any asset which is linked by a segregated accounts company to a segregated account -*
>
> > *(a)* *shall be held by the segregated accounts company as a* <u>*separate fund*</u> *which is -*

[10] Various definitions in section 2(1).

(i)not part of the general account and shall be held exclusively for the benefit of the account owners of the segregated account and any counterparty to a transaction linked to that segregated account, and

(ii)available only to meet liabilities to the account owners and creditors of that segregated account; and

(b) shall not be available or used to meet liabilities to, and shall be absolutely and for all purposes protected from, the general shareholders and from the creditors of the company, who are not creditors with claims linked to segregated accounts.'

(ii) Section 17(8): 'A segregated accounts company may, with the consent in writing of all account owners of, or counterparties who are creditors with claims linked to, a given segregated account, transfer to the general account or another segregated account an asset from the segregated account to which it is linked, if the segregated account to which such assets is linked, taking into account the proposed transfer, remains solvent, and, in the event a transfer is made to the general account in breach of the subsection, on an application by an affected party, the court may declare that the transfer is void, without prejudice to the rights of bona fide purchasers for value without notice.'

(iii) Section 17B(1)(a): 'There shall be implied (except in so far as the same is expressly excluded in writing) in every contract and governing instrument entered into by a segregated accounts company the following terms ... (a) that no party shall seek, whether in any proceedings or by any other means whatsoever or wheresoever, to establish any interest in or recourse against any asset linked to any segregated account to satisfy a claim or liability not linked to that segregated account'

(iv) <u>Section 18(1)</u>: 'Notwithstanding any enactment or rule of law to the contrary, any asset of a segregated accounts company which is linked to a particular segregated account is deemed to be owned by the company as a separate fund which does not form part of the general account.'

(v) <u>Section 18(10)</u>: 'Except to the extent it may be agreed otherwise by `virtue of the governing instrument or contract, as the case may be, an account owner of a segregated account and any counterparty who is a creditor in respect of a transaction linked to that segregated account shall have an undivided beneficial interest in the assets linked to a segregated account, and, after satisfying in full the claims of creditors of the segregated account, account owners shall share in the profits and losses of the segregated account in such proportions of the residual undivided beneficial interest in the segregated account owned by the account owner as may be specified in any governing instrument relating to such segregated account.'

(vi) <u>Section 18(11)</u>: 'An account owner's or counterparty's beneficial interest in a segregated account is in the nature of personal property notwithstanding the nature of the property of the segregated account.'"

109. The Plaintiffs' counsel did not effectively refute the argument that the statutory segregation requirements which cannot be contracted out of are primarily directed at protecting each segregated account from claims by creditors or account holders of other segregated accounts, or general creditors of the company. However, reliance was placed on section 17B(1)(a) which does by its terms imply a term into all governing instruments that unconnected third parties may not assert claims against the assets of segregated accounts. This provision, unlike many of the other segregation requirements, can by its express terms be

contracted out of, however. So the broad-brush assertion that the statutory segregation requirements cannot be contracted out of, as provided by section 11(5) oversimplifies the true statutory position.

110. The Act appears to give more latitude to segregated accounts to deal with their assets when conducting their business with counterparties than it does in regulating the internal separation between separate accounts inter se and as regards the general account. However, the Plaintiffs' Skeleton Argument does make the important point that even these broad business management powers can only be exercised for the benefit of the relevant segregated account:

> "*Section 11(d)(iii) of the SAC Act states that any 'sale, lease, exchange, transfer, pledge or other disposition of all or any part of the assets of the segregated account,' if even allowed under the applicable governing instruments and contracts (see discussion, below, of limits created by loan agreements and security interests in this case), is to be 'for the benefit of the segregated account <u>only</u>' (emphasis added), which clearly does not apply to these arrangements, given for example the early payouts to the Cayman and US feeder funds, the mixing of NSSC and NSI obligations despite the distinct segregated accounts that loaned to those entities, and the new disadvantages imposed on Classes C and I.*"

111. So it is implicit in the Plaintiffs' own legal analysis of the relevant statutory provisions, that the statutory requirements of segregation include some elements which clearly cannot be contracted out of and others which can, in the interests of the segregated account, be contracted out of.

112. Much of the Defendant's case in response to the segregation arguments turned on the factual assertion that the Plaintiffs knew or ought to have known that the theoretically separate pools of NSSC and NSI assets were "mutualised" and that (a) as of 2007 NSI cash was used to fund NSSC redemptions, and (b) as of 2008, NSSC cash was used to fund NSI's investment in the life settlement

business, paying premiums vital for preserving the value of those assets. The breach of segregation case was a purely technical argument. The loan documentation had to be read in light of this longstanding practice. Courts of law are required to apply the law, the Plaintiffs countered. Courts could not, as it were, turn a blind eye to formal contractual arrangements in the interests of nebulous notions of commercial justice.

The impact of illiquidity or insolvency on the directors' ordinary management powers

113. The implications of liquidity and solvency concerns for the usual segregation requirements under SACA (and the power of the directors to depart from them) is an issue which I have considered significant but which was not framed in quite this way by either counsel. Argument centred on the narrower issue of whether or not the transaction fell within or without the directors' ordinary management powers. Nevertheless, in his oral submissions, Mr. Woloniecki rightly asserted that no matter what powers the Defendant's directors had in the ordinary course of business, the Plan was not a transaction carried out in the ordinary course of the business of the segregated accounts. And the Plaintiffs' Trial Skeleton made a passing reference to the fact that the transaction interfered with the Plaintiffs' property rights without their consent.

114. The Plaintiffs main case was, in effect, that the LSA contemplated what should happen in the event of liquidity or solvency problems triggering defaults by NSI in response to payments requests under the loan, and gave the Classes C and I the ability to enforce their security rights:

> "*15. NSI was the Borrower only for Classes C, F and I, and not for any other Classes of the Defendant or for the US or Cayman Feeder Funds. Thus, under the terms of the original, segregated Loan Notes, which Loan Notes, in each case, were executed in favour of, and delivered to, the relevant Class pursuant to the terms of the specific Loan and Security Agreement between NSI and such particular class, only Classes C, F and I were entitled to seek repayment from NSI, by liquidation of its assets, and could*

force liquidation of NSI's assets for the benefit of Classes C, F and I at the time permitted under the Loan Documents.

16. Classes C and I could have taken steps to enforce the security. Under clause 3 of the NSI Collateral Agency Agreement ... the Collateral Agent is required to enforce the security for the Loan and Security Agreements upon the instruction of the "Required Lenders" defined in clause 1 of the NSI Collateral Agency Agreement as the Lenders holding at least 51% of the aggregate obligations of the Borrower to the Lenders under the Collateral Agency Agreement (i.e., Classes C, F and I). The outstanding principal amount of the Class C Loan Notes constitutes 56% of the outstanding principal amount of all Loan Notes issued by NSI. Therefore, Class C alone constitutes the Required Lenders under the NSI Collateral Agency Agreement. Therefore, if the Purported Plan had not been purportedly implemented, in November of 2009 Class C could have instructed the collateral agent to enforce the security under the Loan and Security Agreements by liquidating the Collateral of NSI upon the default in payment of the demand on the Class C Loan Notes.

...

18. Prior to the Purported Plan, the Classes C and I, or an appointed Receiver, would have been able to:

> *18.1 expect repayment of NSI's obligations to them according to Clause 2.2 of the Loan and Security Agreements, or in the event of default (as defined), immediately;*

18.2 receive all amounts owed in respect of their Loan Notes from NSI prior to any NSI assets or cash from its assets going to pay non-NSI lenders; and, if necessary,

18.3 enforce their security interest over the Collateral of NSI and apply the monies towards the repayment of their Loan Notes."

115. In his oral closing submissions, however, Mr. Woloniecki submitted that the only way the restructuring could have been implemented was through a scheme of arrangement, which would not have been approved because:

> "*…it's a property right that class has. It is not whether the class is acting fairly or reasonably. Once you identify a class of people with a certain economic right then they're entitled to exercise that economic right.*"[11]

Did the directors' approval of the Plan and execution of the modified loan documents vary the Plaintiffs' rights under the Bye-laws and SACA in a manner which was beyond the scope of their broad investment management powers?

116. The practical effect of the modified loan documentation adopted as part of the Plan is characterised in the Plaintiff's Skeleton in the following way:

> "8. *After the Purported Plan, the NSI Senior Notes, NSSC Senior Notes, and NSSC Subordinated Notes held by the US Feeder and Cayman Feeder have all been collapsed into what is essentially one general obligation note payable from a combined pool of liquidation proceeds, regardless of the source of the assets that generated those liquidation proceeds. In addition, the payment schedules of all the notes have been combined. Now Classes C and I, for example, can no longer effectively look to their Borrower, NSI, for repayment, but instead have been forced to look to this general liquidation pool. Likewise, all the classes*

[11] T 2 page 205 lines 21-25.

of the Bermuda Fund no longer enjoy payment and security priority, but instead are supposed to settle for concurrent payment with creditors – the Cayman and US Feeder Funds – that held security interests subordinate to the earlier-established, perfected interests of the Bermuda Fund and that, according to the security terms of the Loan and Security Agreements that governed the Bermuda class notes, should not have been paid until the assets were first used to pay the Bermuda Fund classes."

117. The Plaintiffs submitted that their payment rights and security interests have, in effect, been diluted through being made available to meet the claims of both: (a) other segregated accounts which did not previously enjoy any payment rights or security priority in the NSI collateral pool; and (b) the Cayman and US Feeder Funds which did not previously enjoy any such payment or priority rights in the relevant pool of assets. It was argued, to my mind too broadly, that this constituted in both cases (a) and (b) an infringement of segregation rules contained in the Defendant's constitution and SACA which could not be contracted out of. However, the Defendant adopted an equally generic response to the breach of segregation complaint by contending that (1) as regards the Plan as a whole, the modifications to the loan arrangements were clearly within the directors' management and investment powers; and/or (2) the modifications did not involve impermissible dealings with qualifying "assets" of the Plaintiffs' segregated accounts in any event.

The Defendant's submissions on issue (1): is the Plan unlawful?

<u>What assets were required to be segregated prior to the Plan</u>

118. The Defendant's 'Submissions at Trial' described the assets which were required to be segregated as follows:

"*30.Subscriptions to a class of participating Share were used to purchase "assets". Such assets were owned by the*

Bermuda Fund and held in the Fund referable to the share class to which the subscription related. The Bermuda Fund was to maintain a Segregated Account in respect of each Fund. Participating shareholders in relation to a specific Fund were Account Owners in respect of the Segregated Account maintained in respect of that Fund…

31.Upon redemption, shares in a class of Participating shares were to be paid out of the relevant Fund (Bye-law 4(6)(c) (A/000402)).

32.Importantly for present purposes, where the Directors of the Bermuda Fund considered there was doubt about whether an asset or liability was attributable to a Fund, they had "power and discretion (and where applicable, in accordance with sub-sections 11(4) and 17(5) of SACA) to allocate among the Funds and to determine the basis of such allocation, . . . and to vary any such allocation and basis of allocation at any time and from time to time" (Bye-laws 4(6)(d) and (e) (A/000402)). Such power and discretion were exercisable without the need to obtain consent of account owners.

33.The assets so purchased by the Bermuda Fund and held in such Funds were Bermuda Loans. Three of the Bermuda Loans purchased in respect of the share classes invested in by the Gottex AB Funds were issued by NSSC (for Classes B, H and L) and two by NSI (for Classes C and I)...

37.While assets purchased using share subscriptions were to be held in Funds and applied to share classes, these

> *assets were nevertheless assets of the Bermuda Fund and as such could be renegotiated or disposed of as the directors of the Bermuda Fund saw fit. The fact that an asset was to be held in a Fund for a share class did not preclude powers of the Bermuda Fund to deal with and renegotiate such assets. The Bermuda Fund was not a mere custodian.*"

119. In the Defendant's Closing Submissions, the need to identify what constitutes "assets" for the purpose of SACA and a breach of the statutory segregation requirements for the first main limb of the Plaintiffs' case to succeed was articulated as follows:

> "*8.In relation to the writ action the Plaintiffs seek declarations setting aside the amendments in the Loan and Security Agreements ("LSAs") of May 2009 for Classes C and I as being contrary to Section 17(2) of SACA and therefore ultra vires. What must the Plaintiffs establish to succeed?*
>
> > *(1)The Plaintiffs must identify the relevant 'asset which is linked to the segregated account' for the purposes of Section 17(2) of SACA.*
> >
> > *(2)The Plaintiff must establish that the asset has been made 'available to meet liabilities' of persons other than the account owner or creditors of the segregated account within Section 17(2)(a)(ii).*
> >
> > *(3)Alternatively, the Plaintiffs must explain in what sense the amendments to the LSAs made the relevant segregated*

account asset "available" or "used it" to the proscribed class of persons within the meaning of Section 17(2)(b).

9.These issues are somewhat intertwined because identification of the 'assets linked to a segregated account' is to some extent informed by what SACA prohibits in relations to dealings with the asset. Nevertheless the expression is used on a number of occasions in the Statute."

120. Mr. Lowe then set out his stall as to the interpretative approach the Court should bring to bear in construing the statute. The legislation should not be construed in a restrictive manner as it was designed for sophisticated businessmen, not consumers. Segregated accounts were intended to enjoy the same commercial freedom as an ordinary company. The arguments advanced in the Defendant's Closing Submissions on the substantive question what constitutes assets warrants reproduction in full:

"*11.Any allegation of a contravention of Section 17(2) involves at a minimum that the Plaintiff identifies "the asset linked to the segregated account" and therefore an inquiry into what is capable of constituting an asset. That is of course nowhere near the end of the matter because the Plaintiff must also demonstrate that dealing with that asset is unacceptable.*

(i) Construction

12.In this case the 'asset linked to the account' for the purposes of Section 17(2) is obviously embedded in the rights created by the LSA. The LSA however represents a complex bundle or rights and obligations. However, apart from the right of repayment, it is not clear

to the Defendant what 'asset' is alleged to have been linked to the C and I Classes.

Ancillary Rights are not Property

13.SACA does not define 'assets linked to a segregated account'. Section 2(1) only gives a little help when it defines "linked" as 'referable' by means of an instrument or entry in the records in respect of a transaction" which 'identifies an asset, right, contribution, liability or obligation as belonging or pertaining to a segregated account'.

14.Intangibles such as choses in action are obviously the main type of asset held within a Segregated Accounts Company. However, unless there is something capable of being owned as property then there is nothing which could be described as an 'asset' in ordinary parlance. It is therefore axiomatic that the Plaintiffs should be required to identify an "asset" which corresponds to accepted notions of property.

15.A contractual or similar right is not per se a 'thing' or a 'chose' so as to represent property or fit within the meaning of 'asset'. Rights may represent property if they allow money or some other property to be recovered by action. Other rights which either fall short of that description or which are merely ancillary machinery to enforce such rights are not property. Indeed Section 2(1) SACA recognizes this distinction: it does not consider 'assets' and 'rights' as being necessarily synonymous.

` *16.In that context it is important to appreciate that an agreement such as the LSA as a collection of disparate rights is not as such 'a chose in action'. The only rights in the LSAs which are capable of being characterized as property and constituting the chose or thing that can be*

recovered by action are the rights to payment of principal and the right to interest.

17.Although personal property rights only exist if there is a thing in action recoverable by action, the enforcement mechanism is not itself property. It is well established under the general law that a chose in action that does not include ancillary rights which are part of the remedy or process of enforcement. The remedy is not property in itself (see Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 WLR 896 at 915, HL) per Lord Hoffman:

> *'My Lords, I agree that a chose in action is property, something capable of being turned into money. Snell's Equity, 29th ed. (1990), p. 71 defines choses in action as 'all personal rights of property which can only be claimed or enforced by action, and not by taking physical possession.' At common law, for reasons into which it is unnecessary to discuss, choses in action could not be assigned. In equity, they could. Assignment of a 'debt or other legal thing in action' was made possible at law by section 136 of the Law of Property Act 1925. In each case, however, what is assignable is the debt or other personal right of property. It is recoverable by action, but what is assigned is the chose, the thing, the debt or damages to which the assignor is entitled. The existence of a remedy or remedies is an essential condition for the existence of the chose in action but that does not mean that the remedies are property in themselves, capable of assignment separately from the chose. So, for example, there may be joint and several liability; a remedy for the recovery of a debt or damages may be available against*

more than one person. But this does not mean that there is more than one chose in action. The assignee either acquires the right to the money (or part of the money) or he does not. If he does, he necessarily acquires whatever remedies are available to recover the money or the part which has been assigned to him.'

18.It is not the entire catalogue of enforceable provisions or rights in the LSA which constitute the chose or thing which can be described as property. Those rights have no existence as property on their own and the fact that they are ancillary to a chose in action does not convert them into property even if it affects the attractiveness or value of the chose in action to which those ancillary rights relate.

19.This has important ramifications for understanding precisely what in the LSA might constitute the relevant asset for the purposes of Sections 17(2). The Defendant submits that the right of repayment in the LSA is the principal relevant 'asset' for the purposes of SACA Section 17.

20.The "security interest" in Section 7.1 is not strictly a chose in action at all because it is ancillary to the right of repayment. Even if it is in some circles treated as a species of property it is only in a limited sense that this can be viewed as an 'asset': until a default has crystallized the Borrower has complete freedom complete freedom to deal with all of its assets and none of them can be recovered.

The Right of Repayment

21. Section 2.2 of the LSA states that the Borrower must repay the Loan on the Principal Due Date. Section 3.1 and 3.2 relate to the obligation by the Borrower to pay principal and interest. Those obligations are enforceable

by action and would result in payment of money if such enforcement action were to be successful.

22.It is therefore clear that these are paradigm choses in action. However other rights within the LSA fall short of this or are no more than machinery for protecting or facilitating the enforcement of the chose in action. As such these rights are not property or assets. To the extent that they are regarded as forming "part and parcel" of the real asset in a generalized sense those rights are nevertheless not the principal focus of the inquiry under Section 17(2) because they could never represent assets on their own.

Section 2.2 of the LSA creates no further property other than the right to repayment

23.The Plaintiffs argued that Section 2.2 of the LSA requires the Borrower to meet its repayment obligation from the investment portfolio. Whilst Section 2.2 gives a right to repayment and it is acknowledged that this constitutes itself a chose in action, it is incorrect to seek to spell out any further property interest. If the Borrower had appropriated the investment portfolio to repayment then it might be arguable that Section 2.2 gave rise to a proprietary interest in NSI's portfolio.

24.A right to repayment from a particular source confers a proprietary interest on the Lender when it operates by way of equitable charge or mortgage over property (such as a particular fund) which is specifically appropriated to the discharge of a debt. If the property is not subject to a legal transfer (a legal assignment in the case of an intangible) then a binding promise to make specific property available which is specifically enforceable will create a proprietary interest in the subject matter in equity.

25.Whether property has been so appropriated is a matter of intention to be inferred from the facts if not express (see Palmer v. Carey [1926] AC 703, Swiss Bank Corp v. Lloyds Bank 1982 AC 684 at 594-6). A comparison between the rights being considered in those cases and Section 2.2 of the LSA is instructive.

26.Here there was no such appropriation of the Borrower's assets to repayment. The LSA clearly allows the borrower full control of its assets and does not require the Loan to be repaid from any particular source.

> *(1)As a matter of construction it is difficult to see why Section 2.2 would be seen as impliedly creating a fixed interest, when the parties had already expressly agreed on a floating security under Section 7.1 ....*
>
> *(2)Section 2.2 leaves the Borrower to repay the loan from any source in the first 6 months. Although the Borrower has the benefit of an indulgence of an additional 6 months to pay in the event that the Borrower's "Investment Portfolio" cannot be liquidated, he has to pay from whatever source he can after 12 months. The parties cannot be taken to have agreed to give the Lender a fixed charge just during the second 6 month period. Even if they had it would expire after 12 months.*
>
> *(3)It is obvious that the Investment Portfolio is not appropriated to repayment. It represents only one of the categories of property subject of the Blanket Lien (see definition of 'Investment Portfolio' at A/556 and Section 7.1(b)). The 'Investment Portfolio' does not include cash at bank (which would be a receivable within Section 7.1(a)) and which could obviously be used to make repayment under Section 2.2.*

Blanket Lien

27.In opening it was suggested that all the rights including, especially the 'security right' under the LSAs, represent 'assets'. That was so, it was said, even if the security right did not create property interests in the underlying entities. However then it is impossible to understand why, NSI or NSSC, as the Borrowers under their respective LSAs could not do as they pleased with their 'cash'.

28.The 'blanket lien' in Clause 7.1 of the LSAs creates only a limited species of property right which is similar in nature to the statutory "floating charge" (despite what is suggested in the Plaintiffs' opening).

> *(1)This is an appropriate analogy because general law concepts are reflected in the statutory scheme, so that the Courts defined a 'fixed charge' as a charge 'that without more fastens on ascertained and definite property or property capable of being ascertained and defined': <u>Illingworth v Houldsworth</u> [1904] AC 355 at 358 per Lord Macnaghten.*
>
> *(2)Whilst a floating security is a recognized species of security, it is well established that, unlike a fixed or specific charge, it confers no proprietary rights against any specific property of the debtor before crystallization or enforcement. The essential feature of a floating charge was explained by Lord Walker at [138] and [139]:*
>
> *'... <u>Under a fixed charge the assets charged as security are permanently appropriated to the payment of the sum charged, in such a way as to give the chargee a proprietary interest in the assets</u>. So long as the charge remains unredeemed, the assets can be released from the charge only with the active concurrence of the chargee. The chargee may*

have good commercial reasons for agreeing to a partial release. If for instance a bank has a fixed charge over a large area of land which is being developed in phases as a housing estate (another example of a fixed charge on what might be regarded as trading stock) it might be short-sighted of the bank not to agree to take only a fraction of the proceeds of sale of houses in the first phase, so enabling the remainder of the development to be funded. But under a fixed charge that will be a matter for the chargee to decide for itself. Under a floating charge, by contrast, the chargee does not have the same power to control the security for its own benefit. The chargee has a proprietary interest, but its interest is in a fund of circulating capital, and unless and until the chargee intervenes (on crystallisation of the charge) it is for the trader, and not the bank, to decide how to run its business.'

29.If on its true construction a security interest is expressed to allow the debtor control over the assets and the application of proceeds then the particular assets have not been specifically appropriated to that purpose (<u>Agnew v. Cssr of Inland Revenue</u> [2001] 2 AC 710 and <u>Re Spectrum Plus</u> [2005] 2 AC 680). There is no attachment to any particular assets of NSI.

30.The Plaintiffs Opening contains a curious assertion on the difference between a floating charge under the law of Bermuda and the lien in the US (see Plaintiffs' Opening Pages 35 and 36 Paragraph 52 to 55 especially paragraph 54) which is stated with great confidence and is nowhere pleaded let alone established in any of the evidence.

(1)This is all the more surprising given the stance the Plaintiffs have taken in the course of these proceedings on pleading. At the very least the assertion cannot be made without evidence.

(2)Broude gave evidence only in relation to perfection by the equivalent to registration – i.e. filing of the UCC form (see A/281-2 and paragraph 34 and 35). That is not the same as attachment which occurs when the floating charge/lien fixes over specific property which then becomes appropriated to the discharge of the debt.

(3)It is in any event wrong. If US lawyers genuinely speak of 'attachment' at the time when the security is granted as the Plaintiffs' opening suggests, it is not self-evident that they could mean it in this same sense as the non-US common lawyers. The security is a floating/non-fixed security which by definition does not attach so as to create rights to specific property.

31.It is therefore submitted that the Blanket lien is not itself a chose or thing recoverable by action and therefore not an "asset". No SAC would generally have a floating charge in its segregated accounts unless that was ancillary to something else. It does not represent a free standing species of property that one would expect to be treated as an "asset". If it is an "asset" at all it is one of subsidiary significance to the primary and principal property held by the Segregated Accounts Company.

Warranties and Covenants: Section 7.2 of the LSA

32.The Plaintiffs referred in opening to Section 7.2(a) of the LSA whereby the Borrower agreed that the Collateral was and would continue to be owned by the Borrower and that no person should have any right, title, interest, claim to the Collateral. This covenant is not a chose in action. It

clearly does not mean that the Lender has any type of property in the Collateral.

Conclusion on 'Asset' for the Purposes of Section 17(2)

33.It is therefore submitted that the only property interest which could clearly fit within the description of "asset linked to a segregated account" is the right to payment of the principal and interest agreed in Sections 2 and 3 of the LSA. The "collateral" in Section 7 does not constitute a species of property recognisable under Bermuda Law.

34.Even if the blanket lien in 7.1 represented a species of property that proprietary interest is an extremely weak one which confers no enforceable rights to the Borrower's property prior to default. The consequence is that no amount of dealing by NSI or NSSC with its assets is capable of representing a diminution in or dealing with the Bermuda Fund's property/assets.

35.Nobody has suggested that the rights to payment of principal or interest have been assigned. Nobody can suggest that the security interest has been "given" to anybody else. Once it is accepted that rights are not assets and that the LSA conferred no proprietary interest in any of NSI's assets then no allegation under Section 17(2) would be sustainable."

121. It is contended that the Loan Notes themselves are clearly assets but that not all rights acquired by the Lenders to NSI under each applicable LSA constitute "assets" for statutory purposes. It is common ground between the parties that the collateralized NSI assets are not themselves assets which belong to the segregated accounts. The Defendant concedes that the right to sue for payment is a chose in action, but contends that the ancillary enforcement rights do not constitute a separate chose in action, default apart. It is denied that the "blanket

lien" created by the LSA and supported by the Collateral Agreement creates any proprietary interest at all. If it does, no relevant interest is created until a default occurs.

122. The crucial controversy appeared to turn on whether the blanket lien created a proprietary interest which (a) could not be "given away" under the Act; and (b) which subsisted at the time when the new loan documents were executed by the Defendant pursuant to the Plan. However, after a careful review of the crucial statutory provisions, it is clear that it is not just assets which <u>belong</u> to a segregated account which qualify as "linked" to an account. Assets "pertaining" to a segregated account qualify as "linked" as well.

<u>The impact of illiquidity or insolvency on the directors' ordinary management powers</u>

123. The Defendant advanced a positive evidential and legal answer to the implicit question of why the illiquidity and insolvency which prompted the adoption of the Plan did not restrict the directors' ability to deal with the assets of the segregated accounts in the ordinary course of business. It was submitted that the business was structured from the outset on the understanding that NSSC and/or NSI would have liquidity problems and that redemption requests would have to be funded out of available cash generated by either entity, without regard to the formal legal distinctions between the various groups of investors. This point was made in the Defendant's Submissions at Trial as follows:

> *"Illiquidity and practice of repaying Feeder Loans from available cash*
>
> *49.Mr Gillies refers to illiquidity as a "constitutive feature" of NSSC (paragraph 16 of the First Affidavit of Mr Gillies... and indeed it was reflected in the way its obligations, including Feeder Loans, were to be repaid. This was, if anything, a much more obvious feature of NSI's ability to repay its lending obligations.*

50.NSSC's Feeder Loans were to be repaid out of available cash generated through the disposal of assets in ordinary course of business sales and loan maturations. Such assets would specifically not be disposed of where market or illiquidity constraints made it unpropitious to do so. The general partner of NSSC was to avoid "forced" asset sales. The Private Placement Memorandum of NSSC dated November 2007 (C/00692) also clearly states that NSSC would be investing in highly illiquid investments and that, at the General Partner's discretion, the payment of redemption proceeds may be deferred pending the emergence of suitable market conditions in which assets may be liquidated in an orderly manner:

> *'It is contemplated that substantially all of the Fund's assets (including amounts borrowed by the Fund) will be fully invested. As a result, the satisfaction of any withdrawal request may require the liquidation of Fund investments. Under certain circumstances, the Fund may be unable to liquidate sufficient investments to satisfy the withdrawal requests of all Withdrawing Limited Partners as of a given date, or the General Partner, in its discretion, may determine that liquidation of such investments would not be in the best interests of the Fund. If, for example, the General Partner believes that it would be necessary to liquidate an investment at a loss in order to honor a withdrawal request, it may, in its discretion, determine not to liquidate such investment. Similarly, even if the General Partner believes it could liquidate an investment without a loss, or at a profit, it may decline to liquidate the investment if it believes that the liquidation might adversely affect the Fund's overall investment portfolio and strategy. ACCORDINGLY, NO ASSURANCE CAN BE GIVEN THAT THE FUND WILL BE ABLE OR WILLING TO LIQUIDATE INVESTMENTS SUFFICIENT TO SATISFY ANY OR ALL*

WITHDRAWAL REQUESTS MADE IN RESPECT OF ANY WITHDRAWAL DATE'.

The constitutive status of illiquidity was reflected in the 120 notice period applying to Redemption Requests in the Bermuda Fund's Prospectus.

51.As a matter of practice, Feeder Loans were repaid in chronological sequence, determined by the date on which the underlying Redemption Request took effect, and out of cash generated through ordinary course of business underlying loan repayments. NSSC would take whatever available cash was generated through its subsidiaries and repay Feeder Loans according to that methodology. It made no difference whether the Feeder Loan was a Bermuda Loan or US or Cayman Loan. There could be no criticism of a debtor repaying creditors in this way in the ordinary course. Nobody applies a pari passu reduction to the debts of a company which is not yet in liquidation.

52.Notably, as a subsidiary of NSSC, cash generated through NSI's assets was treated as available to repay Feeder Loans generally. As Mr Gillies states at paragraph 73 of this First Affidavit, upon consolidation into the NSSC group in 2007, "no cash was held in NSI's separate bank accounts, any cash being swept to NSSC." ... Available cash was accumulated in a pool and used to pay any and all Feeder Loans according to the chronological methodology. It did not matter whether the Feeder Loan in question was issued by NSI or NSSC. The converse was also true: where a NSI Feeder Loan was to be repaid in order to finance redemption of a Bermuda Fund share, NSSC would repay it out of whatever funds happened to be available at the time regardless of their source. This was the procedure used in July 2008 to repay a Redemption Request served by the Gottex AB Funds in November 2007 (paragraph 72 of Mr Gillies'

First Affidavit ... and paragraph 13 of Amy Lai's Fifth Affidavit ... Given the onerous premium obligations, as a matter of probability, cash was more likely to move from other NSSC subsidiaries to NSI, in order to sustain the life assets, than to move in the opposite direction."

124. At first blush, the argument that the internal cash management practices utilized by NSSC and NSI shapes the interpretation to be given to the security obligations these entities assumed to their lenders and the scope of the segregation obligations imposed on the Defendant under the Act is an unappealing one. It is also inherently inconsistent in that it seeks to blur the lines which clearly distinguish ordinary cash-flow management in circumstances where there is no question that redemption requests can be paid in full from the situation which led to the Plan: a liquidity crisis so extreme that it eliminated the ability of NSSC and NSI (in particular, for present purposes) to meet redemption requests and payment obligations arising under the Loan Notes as they fell due.

125. The Defendant seeks at the same time to (a) justify the commercial reasonableness of the Plan by asserting that it would have been disastrous to enforce the Class C and I security rights; and (b) to contend that the liquidity crisis which required significant changes to the loan documentation and the related security rights arose in the ordinary course of business and were contemplated by all concerned as forming part of the directors ordinary management powers. The argument seems designed to sidestep an obvious and inconvenient truth; that security arrangements are invariably put into place specifically to respond to a borrower's chronic liquidity or solvency state. The mere fact that NSI was known by its lenders to be investing in highly illiquid assets is not inconsistent with such lenders seeking real and substantial security which could be called upon in the event of a liquidity crisis on a scale which was not contemplated as falling within a range of payment problems on the ordinary course of business side of the line.

126. To summarise, Defendant concedes that in circumstances of default the segregated accounts would acquire proprietary security rights, but denies that the liquidity crisis which occurred in the second half of 2008 gave rise to any crystallizing event in relation to what it contends amounted to floating charges.

Did the directors' approval of the Plan and execution of the modified loan documents vary the Plaintiffs' rights under the Bye-laws and SACA in a manner which was beyond the scope of their broad investment management powers?

127. The effect of the changes to the loan arrangements is described as follows in the Defendant's Submissions at Trial:

> "*Summary of changes to Loan and Security agreements in May 2009*
>
> *92.It may be seen therefore that the most notable changes to the Loan and Security Agreements involved a postponement of repayment obligation, waiver of defaults, and withdrawal of obsolete covenants.*
>
>> *(1)Determining by how long repayment of a Feeder Loan was to be deferred requires you now to look at the position of that Feeder Loan in the payment allocation. Nevertheless, individual Borrowers remained sole obligors under the contracts.*
>>
>> *(2)The timing of repayment of NSI Bermuda Loans is linked to the extent of Available Cash held by NSSC, and Available Cash accumulated by NSSC comprises cash from all its subsidiaries, including NSI. Nevertheless, the amendments do not in any way oblige NSI to transfer cash to NSSC.*

(3)A for-the-avoidance-of-doubt provision was added in anticipation of PIK. It does not require PIK, nor does it specify in what circumstances PIK may be applied.

(4)The waivers, revocations, modification of covenants and postponement all meant that in practice the Bermuda Fund gave up opportunities that could otherwise have arisen at the time to foreclose on Collateral for breach of Bermuda Loans. That was of course the point of the reorganization under the Plan, and the compromise was made because the alternatives were quite reasonably regarded as adverse to the Bermuda Fund (see below, in relation to Prejudice / Receivership).

(5)Nevertheless, the Liens granted under the Collateral provision remained unchanged and the Plan did not occasion any changes to the CAAs (the NSSC CAA remaining in its form as at July 2008, and the NSI CAA remaining as it was in October 2006)."

128. The most significant and controversial submission is the assertion that "*the Liens granted under the Collateral provision remained unchanged and the Plan did not occasion any changes to the CAAs*". It is true that many of the changes to the loan arrangements involved postponing time and waivers of defaults, and that no formal changes were made to the Collateral Agency Agreements. But the latter agreements interlocked with the LSAs which previously contemplated that NSI assets were secured to meet the payment obligations to the Defendant's investors alone. Can the security interests be said to remain unchanged if the primary payment obligations have been altered? The Defendant submits in its Submissions for Trial that the repayment obligations have not been altered at all and that no breach of the segregation requirements is properly made out:

"106. *The Bermuda Fund responds as follows:*

(i) Section 3.1(c) of the 2009 Loan and Security Agreements with NSI has already been elaborated above. It merely serves to fix a sequence in which Feeder Loans are to be repaid which Section 2.2 then employs in determining the repayment obligation. Insofar as the NSI Bermuda Loans are concerned, Section 2.2 triggers an obligation on NSI to repay its Bermuda Loans: (a) provided there are no pre-October Feeder Loans unsettled; and (b) as soon as, and to the extent that (subject to the Distribution Percentage), NSSC has accumulated Available Cash. Section 3.1(c) per se merely defines a formula which Section 2.2 uses in dictating when the payment obligation under the NSI Bermuda Loans accrues. It does not impose the repayment obligation.

(ii) Thus the Gottex AB Funds' case that Section 3.1(c) imposes a new obligation on NSI to pay not just the Bermuda Fund (in respect of its C, F and I Bermuda Loans) but all Feeder Funds generally overlooks the fact that the provision is concerned merely with the timing of the obligation to pay.

(iii) The Gottex AB Funds' case is premised on a misreading of a clerical error in the NSI 2009 Loan and Agreement which has now been rectified. Section 3.1(c) of the May 2009 NSI Loan and Security Agreements used refer to '<u>payments by Borrower from Available Cash to Lender and all other share classes of New Stream Capital Fund Limited . . .</u> to New Stream Secured Capital Fund (US), LLC (the "US Fund"), or to certain Cayman entities . . ." It now reads "payments from Available Cash . . . .', consistently with the fact that Section 3.1(c) merely explains that all Feeder Loans are now only payable (subject to the payment allocation) to the extent that there is Available Cash held by NSSC. However, it was always obvious that the apparent reference to payments by

NSI was erroneous and unintentional. As explained above, NSI does not have "Available Cash". "Available Cash" denotes sums generated and held by NSSC (not NSI) from ordinary course of business disposals through its subsidiaries, excess of funds necessary to pay costs such as life settlements premiums, as in Section 2.2:

OBLIGATIONS SHALL BE PAID (SUBJECT TO SECTION 3.1(c)) ON THE FIRST DATE ON WHICH THE PARENT OF THE BORROWER, NEW STREAM SECURED CAPITAL, L.P. ("NSSC"), SHALL HAVE UNRESTRICTED CASH AVAILABLE FOR DISTRIBUTION . . . ("AVAILABLE CASH") (emphasis added).

The express reference to "the parent of the Borrower" clarifies this intent, namely that NSSC is to continue accumulating cash from its subsidiaries (according to the established process described above), the first $40m of which will be held to pay life asset and other expenses. NSSC will then distribute any cash excess of that margin ("Available Cash") according to the payment allocation. Any other way of reading Section 3.1(c) as it appears in the unamended the NSI Loan and Security Agreements requires violence to the language of Section 3.1(c). This is apparent from the way the Gottex AB Funds paraphrase the provision: "[NSI] is required to use its Available Cash (as defined) to pay the notes of" all other Feeder Funds (emphasis added). The possessive "its" (applied by the Gottex AB Funds in relation to Available Cash) does not appear in the contractual language and of course is wholly inconsistent with the clear statement in Section 2.2 that Available Cash is cash held by NSSC.

(iv) The amendments to the Bermuda Loans do not make NSI and NSSC joint obligors, they merely postpone repayments and impose a repayment structure by reference to underlying redemption date. The contractual structure, involving separate distinct Bermuda Loans to different Borrowers, and the security arrangements, remains wholly unchanged. The Bermuda Fund in respect of Segregated Accounts with NSSC Bermuda Loans cannot enforce rights or provisions under the Bermuda Loans as against NSI. Other Feeder Funds with Feeder Loans issued by NSSC cannot enforce their Feeder Loans against NSI.

(v) It is true that the intention is, during the demand forbearance period and the further deferment of any Bermuda Loans under the payment allocation, that cash gathered by NSSC to pay asset expenses and – where there is Available Cash – Feeder Loans, will come from any and all of its subsidiaries, including NSI. But that is not a result of the amendments in May 2009. It is a continuation of the process that has applied for several years and which is part of the fabric of the economic model of the New Stream Group.

(vi) The process of accumulating Available Cash by NSSC from its various subsidiaries including NSI is perfectly consistent with the terms of the Loan and Security Agreements both before and after the Plan. The Gottex AB Funds' case turns on their construction of 2.2, 3.1(b), 7.2(a) and the "over-arching lending relationship" referred to above as obliging the Borrower under Bermuda Loans to (a) repay Bermuda Loans out of its own assets and (b) retain those assets pending settlement in full. For the reasons set out above, the Bermuda Fund disputes this construction.

(vii) Even if they were correct on their construction of Section 3.1(c) under the May 2009 Loan and Security Agreements and on the true construction of the August 2008 Loan and Security Agreements (see above), the Gottex AB Funds must show that the alleged rights: (a) to be repaid out of assets of one's Borrower; and (b) to require that Borrower to retain its assets until repayment; have been commingled.

(a) For example, they must show that Segregated Account B, to which is linked a Bermuda Loan to NSSC, now has, since the Plan, a right to compel NSI: (a) to repay its Bermuda Loan (that is, the Bermuda Loan of Segregated Account B) out of NSI's assets; and (b) to retain its (NSI's) assets until it has done so.

(b) Quite plainly, there is no such right conferred through the Bermuda Loan linked to that Segregated Account. Apart from anything else, there is no privity between: (a) the Bermuda Fund in respect of Segregated Account B; and (b) NSI. Equally, NSSC is not now a joint obligor under the Bermuda Loans linked to C and I; the Bermuda Fund in respect of C and I could not sue NSSC for failure to repay NSI Bermuda Loans. It is pure hyperbole for the Gottex AB Funds to assert that the two Borrowers are now joint obligors under the documents (paragraph 5.2 of the Second Further and Better Particulars (B/000172) and paragraph 6.1 of the Voluntary Further Particulars (B/000149)).

(viii) In fact the reality, would the Gottex AB funds correct about clause 7.2(a) before the Plan, we [sic] *be as stated by the Gottex AB Funds themselves in their Second Further and Better Particulars. In that document, it is first argued that Section 7.2(a) under NSI Loan and Security Agreements imposes the constraint*

on NSI's discretion to dispose of assets summarized above. But it continue in not [sic] *by asserting that this right to constrain asset disposals by NSSI has been made available to Segregated Accounts with Bermuda Loans to NSSC, but that such right has been rendered "ineffective":*

'Clause 7.2(a) of the pre –Purported Loan and Security Agreements provides that so long as the Borrower is obliged to Lender, the Collateral (as defined) will be owned solely by the Borrower. The Borrower is required to keep its assets available to meet its obligations under the Loan and Security Agreements until the Loan Notes are paid in full. Although this provision also appears in the post-Purported Plan Loan and Security Agreements, it is rendered ineffective by the new clause 7.6 which provides that the Borrower has the right to transfer or sell the Collateral and distribute the proceeds in accordance with the Purported Plan.'

The point that this drafting plainly illustrates is that the Gottex AB Funds' real objection is not about desegregation, but about compromise of opportunities to foreclose on NSI collateral and on NSSC collateral in accordance with priorities under the NSSC CAA. The attempt to cast the complaint in terms of segregation issues is purely tactical given the aim of reversing the May 2009 amendments. But the facts do not sustain this formulation. The evidence from the Bermuda Fund amply explains why compromise was warranted, and this is discussed later on.*" *Nevertheless, in the present context, compromise per se is irrelevant." *[emphasis added]*

129. The Defendant rightly identifies the crucial area of analysis: have the modifications to the loan agreement amounted to no more than a commercial

compromise or did they impair security rights in a way which offended the segregation requirements? Mr. Lowe was also justified in pouring scorn on his opponent's suggestion that the Plaintiffs' claims were ultimately simple ones. In Mr. Lowe's Submissions at Trial, it is forcefully denied that the post-Plan loan arrangements altered the principle of pari passu distribution across the Defendant's various share classes. It is also contended that the Plaintiffs' rights under Bye-law 9 (6) to direct the company to enforce its security rights under the NSI Loans expired (pursuant to Bye-law 9(3)) when the redemptions took effect in February 1, March 1 and April 1, respectively, 2009. But this raises a further key question: why, if the Plaintiffs had such a significant power before the redemptions took effect, the Bye-laws should be construed as empowering the directors to modify the LSA without the Plaintiffs' consent in the context of a wider restructuring?

FINDINGS ON ISSUE (1): IS THE PLAN UNLAWFUL?

<u>What assets were required to be segregated prior to the Plan</u>

130. The Act requires those managing segregated account companies to firewall the assets belonging to a segregated account from claims asserted by the company's general creditors and claims asserted by other segregated accounts and (subject to any contrary express agreement) third parties who have not transacted business with the relevant segregated account. Since the dominant purpose of the Act is to facilitate the use of segregated accounts for business purposes, the Court ought not to lightly construe the Act in a manner which would restrict the economic freedom of segregated accounts to enter into whatever lawful transactions they wish to enter into. But equally, the Court must be astute not to lightly withhold the protections which SACA is designed to confer in the context of financial failure.

131. Section 17 contains the umbrella provision which requires each segregated account to have a separate fund of assets and liabilities, which assets are only available to the account owners and counterparties to transactions with such account:

> "*(2) Notwithstanding any enactment or rule of law to the contrary, but subject to this Act, any liability linked to a segregated account shall be a liability only of that account and not the liability of any other account and the rights of creditors in respect of such liabilities shall be rights only in respect of the relevant account and not of any other account, and, for the avoidance of doubt, any asset which is linked by a segregated accounts company to a segregated account—*
>
> *(a) shall be held by the segregated accounts company as a separate fund which is—*
>
> > *(i) not part of the general account and shall be held exclusively for the benefit of the account owners of the segregated account and any counterparty to a transaction linked to that segregated account, and*
> >
> > *(ii) available only to meet liabilities to the account owners and creditors of that segregated account; and*
>
> *(b)shall not be available or used to meet liabilities to, and shall be absolutely and for all purposes protected from, the general shareholders and from the creditors of the company who are not creditors with claims linked to segregated accounts.*"

132. I accept Mr. Lowe's submission that section 17 is primarily concerned with immunizing segregated accounts from claims by the company's general creditors. But if section 17 must be read with section 17A which permits

internal transactions between segregated accounts, then it must also be read with section 17B, which provides in salient part as follows:

> "*17B (1) There shall be implied (except in so far as the same is expressly excluded in writing) in every contract and governing instrument entered into by a segregated accounts company the following terms:-*
>
> > *(a) that no party shall seek, whether in any proceedings or by any other means whatsoever or wheresoever, to establish any interest in or recourse against any asset linked to any segregated account to satisfy a claim or liability not linked to that segregated account;*
> >
> > *(b) that if any party succeeds by any means whatsoever or wheresoever in establishing any interest in or recourse against any asset linked to any segregated account of the company in respect of a liability not linked to that segregated account, that party shall be liable to the company to pay a sum equal to the value of the benefit thereby obtained by him; and*
> >
> > *(c) that if any party shall succeed in seizing or attaching by any means or otherwise levying execution against any assets linked to any segregated account of the company in respect of a liability not linked to that segregated account, that party shall hold those assets or their proceeds on trust for the company and shall keep those assets or proceeds separate and identifiable as such trust property."*

133. The term "*asset linked to any segregated account*" appears throughout these provisions. The term asset is not defined by the Act, but section 2(1) does provide:

> "*'linked' means referable by means of—*

> *(a) an instrument in writing including a governing instrument or contract;*
>
> *(b) an entry or other notation made in respect of a transaction in the records of a segregated accounts company; or*
>
> *(c) an unwritten but conclusive indication,*
>
> *which identifies an asset, right, contribution, liability or obligation as* <u>*belonging or pertaining*</u> *to a segregated account...*" [emphasis added]

134. Mr. Lowe was also right to argue that section 2(1) distinguishes the term "asset" from "right" so that the term "asset" ought to be given its ordinary common law meaning. But I reject any suggestion that the term "asset" in the present statutory context should be defined narrowly as that would be inconsistent with the manifest policy of the Act. The Act seeks to encourage investors to use the segregation structure instead of the traditional corporate model and minimize their exposure to liabilities they have not consciously assumed. Moreover, section 2(1) of the Act further provides that an asset may be linked not just by contracts, but also "governing instruments", which include bye-laws and prospectuses according to the same definition subsection. More importantly still, an asset is linked to a segregated account if it is not just identified as "*belonging to*" a segregated account but also as "*pertaining to*" it. This distinction was not highlighted in Mr. Lowe's otherwise careful analysis.

135. So while it is clear that the principal assets are the loans advanced by the Plaintiffs' segregated accounts to NSI, the loan documentation must in my judgment be analysed against the wider backdrop of the Bye-laws and (to the extent relevant) the Prospectus as well. Be that as it may, it is not disputed that the right to repayment (as distinct from the ancillary remedies afforded by the loan agreement) is a chose in action and accordingly an asset for the purposes of

SACA. The passage relied upon by the Defendant's counsel from the judgment of Lord Hoffman in *Investors Compensation Scheme-v-West Bromich Building Society* [1998] 1 WLR 896 at 915 is authority for the proposition that a right to payment is a single chose in action and that any ancillary rights of action cannot be separately assigned. The operative part of the decision was that a claimant with a single cause of action cannot assign part of that cause and retain another part. In the context of the present case, the collateral enforcement rights created under the LSA and the Collateral Agreements are undoubtedly inextricably intertwined.

136. The terms of the LSA make it clear that the assets of NSI as the Borrower remain the property of NSI. What is acquired by the Lender is described in Section 7.1 as follows:

> "*To secure the prompt payment and performance of each and all of the Obligations, Borrower pledges, assigns, transfers and grants to lender a continuing lien and security interest in the following property of Borrower, whether now owned or hereafter acquired...*"

137. If one is concerned with the question of whether this security interest which has admittedly been registered under the Uniform Commercial Code in Delaware creates a charge attaching to NSI's assets from the date of creation or registration, the answer must be negative. Under section 55 of the Companies Act 1981, it is generally accepted that a floating charge can be registered for priority purposes even though the secured party's rights do not attach until a crystallizing event occurs. The position under applicable US law may be different, but there was no evidence in this regard. The LSA provides (by analogy with a floating charge) that perfection of the security interest can take place immediately; but section 8.2 (a) provides that "*upon and after*" an Event of Default the Lender acquires "*all of the rights and remedies of a secured party*

under the Code". This suggests that the security interest created only attaches and becomes a fully embodied proprietary interest when an Event of Default occurs. But before that happens, why should the lien not be regarded as an asset for SACA purposes? More fundamentally still, Mr. Gillies described the loan and collateral agreements as an example of a species of loans known in the United States as "asset-backed loans". Why should the pool of NSI assets which were (a) provided as security for the Bermuda Loans, and (b) in relation to which the Bermuda lenders also had specific payment rights under the Bye-laws, not themselves be regarded as "pertaining to" and in this sense "linked" to the relevant segregated accounts?

138. Mr. Lowe (implicitly assuming that an asset had to belong to an account so as to be linked to it) described the lien as at best a very weak asset. The '*Cambridge Advanced Learners Dictionary*' defines "asset" as follows: "*something valuable belonging to a person or organization which can be used for the payment of debts...A company's assets can consist of cash, investments, buildings, machinery, specialist knowledge or copyright material such as music or computer software.*"[12]So the term asset embraces chattels (tangible personal property), real property and various intangible property rights including intellectual property and various forms of investments, such as loans and shares. A loan obligation consists primarily of the borrower's obligation to repay and the lender's right to demand payment. If it is supported by security rights, such rights do not become freestanding assets in their own right until they can be enforced against specific property giving the secured party a free standing ownership interest in the secured property, albeit an interest born in the cradle of the loan agreement. It may now be helpful to revisit the passage from the speech of Lord Hoffman in the House of Lords case of *Investors Compensation Scheme-v-West Bromich Building Society* [1998] 1 WLR 896 at 915 upon which counsel relied:

[12] www.Dictionary.cambridge.org/

> "*My Lords, I agree that a chose in action is property, something capable of being turned into money. Snell's Equity, 29th ed. (1990), p. 71 defines choses in action as 'all personal rights of property which can only be claimed or enforced by action, and not by taking physical possession.' At common law, for reasons into which it is unnecessary to discuss, choses in action could not be assigned. In equity, they could. Assignment of a 'debt or other legal thing in action' was made possible at law by section 136 of the Law of Property Act 1925. In each case, however, what is assignable is the debt or other personal right of property. It is recoverable by action, but what is assigned is the chose, the thing, the debt or damages to which the assignor is entitled.* ***The existence of a remedy or remedies is an essential condition for the existence of the chose in action but that does not mean that the remedies are property in themselves, capable of assignment separately from the chose.*** *So, for example, there may be joint and several liability; a remedy for the recovery of a debt or damages may be available against more than one person. But this does not mean that there is more than one chose in action. The assignee either acquires the right to the money (or part of the money) or he does not. If he does, he necessarily acquires whatever remedies are available to recover the money or the part which has been assigned to him.*" [emphasis added]

139. In my judgment the relevant question (assuming no events of default) is not whether the security rights created in favour of the Plaintiffs' segregated accounts are assets in their own right, but whether the right to enforce the collateral was an essential and integral part of the loan asset which admittedly formed part of the segregated fund. I find that it is clear, on a fair reading of the Defendant's Prospectus, Bye-Laws and the loan and security documents that the security rights constituted "*an essential condition for the existence of the loan.*"

Further and in any event, the NSI pool of collateralised assets, by virtue of the collateral enforcement rights prospectively conferred on the NSI Lenders under the LSA (and which would become actual enforceable rights in the event of default), were in my judgment assets "*pertaining to*" the Plaintiffs' segregated accounts.

140. The crucial document was called a "Loan and Security Agreement" which is consistent with the fact that the loan obligations and the security obligations were inextricably intertwined. Articles and VII and VIII of the LSA make it clear that the primary remedy granted to the Lender in the event of any default by the Borrower is the security over the collateral and related enforcement rights. The Lender is not an unsecured creditor whose primary remedy is intended to be either arbitration or civil action. The Loan Notes expressly incorporated by reference the security provisions of the LSA and the Collateral Agreement.

141. The importance of the security rights as an essential and integral part of the primary right of repayment is also reflected in the fact that the Defendant's sole business activity consisted of its segregated accounts investing in asset-backed loans to both NSI and NSSC. The security obtained for these loans would likely be of considerable commercial interest to those choosing to invest in the Defendant Fund. It is unsurprising that the Defendant's Prospectus did not omit to make mention of the secured character of the proposed lending activity. For instance:

> "*...the Company intends to focus its investment activities primarily on the acquisition, holding, and sale, exchange, distribution or other disposition of Notes issued by and secured by the Porter Funds...**<u>Description of Assets Securing the Notes</u>** ..each Class of Shares will be linked to one Segregated Account holding one or more of the Notes. Each Note will be secured by the assets of one of the Porter funds, and will be held in a Segregated Account, along with other assets as permitted by the Bye-laws at the discretion*

of the Manager...The rights of each Class of Shareholders are limited to the assets attributable to the relevant Segregated Account. In the event the assets attributable to any Segregated account are insufficient to meet the obligations of the Company to pay money to the relevant Shareholders, such Shareholders shall be limited to proceeding against the relevant Segregated Account and shall not be entitled to exercise any rights against and shall not have further recourse to the assets attributable to the other Segregated Account (s), or any other assets of the Company."[13]

142. However, more substantively still, the security interest created by each LSA was acknowledged (both implicitly and explicitly) as an integral part of the relevant investments by the Bye-laws themselves. Firstly, Bye-law 9 (1) (as amended in 2008) links the redemption right to a demand being made by the Defendant on the related investment:

> "*Subject to the Act and SACA and subject as hereinafter provided,* ***the Company shall, on receipt by it or its authorised agent of a Redemption Request from a Member*** *(the "Applicant"),* ***make a demand for repayment*** *(on or before the last day of the calendar month in which the Redemption Request has been made)* ***on any investment held by the Company in respect of the Segregated Account linked to the class of Shares referenced in such Redemption Request in an amount sufficient to redeem or purchase all of the Shares requested to be redeemed in the Redemption Request*** ..." [emphasis added]

[13] Prospectus, page 6, 14, E/282, E/290.

143. A demand for repayment necessarily gives rise to the possibility of default and the need to have recourse to whatever remedies are available under the terms of the relevant investment. However, even before the 2008 amendment to Bye-law 9(1), Bye-law 4(6) had expressly provided that "*the assets held in each Fund shall be applied solely in respect of the Shares of the Class to which such Fund appertains*" and that "*(d) on a redemption of Shares of a class, the redemption proceeds shall be paid to the holder redeeming such Shares out of the relevant Fund.*" So according to the Defendant's constitution, investors purchased shares with money that was placed into a segregated account, invested in loans made by the segregated account, and on redeeming received payment by the same segregated account out of the proceeds of a demand made on the relevant loan. However, the security was linked to the loan most significantly by Bye-law 9 (6) (referred to both above and below), which conferred on account owners the right to both (a) determine the existence of a default under the loans; and (b) direct the directors to enforce the related collateral rights.

144. Bye-law 9(6) is perhaps the most notable exception to the generally broad management and investment powers which the directors can ordinarily exercise. It allows the shareholder to: (a) determine that there has been a default (presumably when a redemption request has not been honoured within the prescribed time); and (b) direct the directors to enforce the relevant segregated account's security rights under the Collateral Agreement under a loan. So the Bye-laws explicitly recognise that the security rights created by the LSA are an important element of the loan agreement itself, specifically in the redemption context. Irrespective of the fact that these rights may only be available when a default is adjudged by a shareholder to have occurred, they demonstrate how legally strong the interconnection is between the bare right to repayment of the loan and the ancillary security rights. The strength of this connection is not simply made manifest by the loan documentation itself, but also by the Defendant's other governing instruments.

145. For these reasons I find that the security interests created under the LSA are an essential element of the obligation to repay under the LSA and the Loan Notes

constituted assets linked to the Plaintiffs' segregated accounts which were required to be kept as a separate fund in accordance with the requirements of SACA.

146. Further and in any event, I find that the pool of NSI assets which were subject to both (a) a blanket lien equivalent to a floating charge under the LSA and Loan Note, and (b) the redemption rights under Bye-law 9 (1),(6), were (subject to the terms of the Loan Documents) assets "*pertaining to*" Classes C and I and accordingly "*linked*" to these accounts for SACA purposes. I accept the submissions of the Plaintiffs in paragraph 18 (iii) of their Trial Skeleton Argument as to the significance of the following definitions in section 2(1) of the Act:

> " *'segregated account': '... a separate and distinct account (comprising or including entries recording data, assets, rights, contribution, liabilities and obligations linked to such account) of a segregated accounts company pertaining to an identified or identifiable pool of assets and liabilities of such segregated accounts company which are segregated or distinguished from other assets and liabilities of the segregated accounts company for the purposes of this Act;' ...*
> *'linked': '... referable by means of:*
>
> *(a) an instrument in writing including a governing instrument or contract;*
> *(b) an entry or other notation made in respect of a transaction in the records of a segregated accounts company; or*
> *(c) an unwritten but conclusive indication, which identifies an asset, right, contribution or obligation as belonging or pertaining to a segregated account.'* "

147. In my judgment this finding is not undermined by the *ad hoc* practice which the Managers apparently adopted prior to the Plan and the 2008 Credit Crunch of paying redemptions (a) out of available cash generated by NSSC and its

subsidiaries including NSI, with NSSC paying NSI premiums out of available cash, and (b) without regard to the strict terms of the loan documentation with its clear distinctions between loans to NSI and loans to NSSC. The statutory segregation requirements are not designed to place the management of a segregated account company in a straight-jacket and to deprive them of the ability to informally manage cash-flow within a corporate group in a flexible manner when no questions exist about the ability of account holders and creditors having their obligations met in full. Rather, the segregation requirements are specifically designed to come into play in circumstances such as those which confronted the Defendant in the late summer/early autumn of 2008. If parties managing a segregated account company wish to modify the application of the Act in transactions its accounts enter into, this should (as the Act requires) be expressly reflected in the relevant transaction documents. Statutory provisions cannot be contracted out of on the basis of *ad hoc* payment mechanisms which account owners may or may not have notice of.

The impact of illiquidity or insolvency on the directors' ordinary management powers

148. In liquidity and solvency crises, it becomes more commercially significant than ever for those managing segregated account companies to deliver on SACA's primary promise: that the fortunes of account owners will stand or fall with the fortunes of their segregated account and account owners will not unwittingly have their potential recoveries subjected to the vagaries of risks which they have not elected to assume. Section 18(10) provides as follows:

> "*(10)* ***Except to the extent it may be agreed otherwise by virtue of the governing instrument or contract****, as the case may be, an account owner of a segregated account and any counterparty who is a creditor in respect of a transaction linked to that segregated account shall have an undivided beneficial interest in the assets linked to a segregated account, and,* ***after satisfying in full the claims of creditors of the segregated account, account owners shall share in the profits and losses of the segregated account*** *in*

such proportions of the residual undivided beneficial interest in the segregated account owned by that account owner as may be specified in any governing instrument relating to such segregated account." [emphasis added]

149. So it is possible for an account owner to contract out of (a) a beneficial interest[14] in the assets of a segregated account, or (b) the right to share in the profits or losses of the account in such proportions as may be specified in the Bye-laws. Absent such an express agreement, account owners are entitled to expect that subject to satisfying the claims of creditors of the account, they are beneficially interested in all of the assets in the account. The legal connection between the account owner and the assets of the segregated account is therefore ordinarily far closer than the nexus between a shareholder and the assets of an ordinary company. Under the famous principle in *Saloman-v-Saloman* [1897] AC 22, a shareholder has no beneficial interest in the assets of a limited company. There is no suggestion that section 18(10) of SACA has been contracted out of by the Plaintiffs in the present case.

150. Again, under the traditional company law regime, the onset of insolvency requires the directors to manage a company having primary regard to the interests of creditors. This is because under section 225, the shareholders are only entitled to receive a distribution after liabilities to creditors have been paid in full:

> "*Subject to this Act as to preferential payment the property of a company shall, on its winding up, be applied in satisfaction of its liabilities pari passu, and, subject to such application, shall, unless the bye-laws otherwise provide, be distributed among the members according to their rights and interests in the company.*"

[14] The term "beneficial" is used in the Act in a *sui generis* sense as the account owner acquires no interest in any specific property unless such interest is conferred by the governing instrument or contract : section 18 (10), (12).

151. This principle is replicated in SACA, although the rights of creditors are likely in practice to be somewhat muted in the mutual fund context where the liabilities of a segregated account are likely to be limited to the claims of managers and other service providers, while the majority of claims will be based on redemption requests made by account owners, as in the present case. Section 18 provides as follows:

> "*(7) In the event that a segregated account has insufficient assets to pay all of its obligations in full, the order and priority of the rights in relation to assets linked to a segregated account shall (without prejudice to the rights of any parties holding valid security interests against assets linked to that segregated account and any valid preferential claims in respect of that segregated account) be determined by the terms of the governing instrument and any contracts pertaining to that account, and any ambiguity in respect of the order and priority rights shall be resolved as follows:*
>
> > *(a) the claims of creditors shall rank ahead of the claims of account owners;*
> >
> > *(b) the claims of creditors inter se shall rank pari passu; and*
> >
> > *(c) the claims of account owners inter se shall rank pari passu.*"

152. Accordingly, and more specifically relevant to the present redemption scenario, Section 15 provides:

> "*(7) A segregated accounts company which is a mutual fund may redeem or repurchase for cancellation shares using the assets linked to the relevant segregated account provided that, on the date of redemption or repurchase, there are reasonable grounds for believing that the relevant*

segregated account is solvent and would remain so after the redemption or repurchase.

(8) A segregated accounts company which is a mutual fund on the redemption or repurchase of shares linked to a segregated account may—

> *(a) repay the capital paid on such shares out of paid in capital, additional paid in capital or other reserves of the company linked to the relevant segregated account;*
>
> *(b) pay the premium, if any, out of realised or unrealised profits, additional paid in capital or other reserves of the company linked to the relevant segregated account, on such terms and in such manner and at such price as may be determined having regard to the asset value of such shares as ascertained in accordance with the governing instrument.*

(9) A segregated accounts company which is a mutual fund on the redemption or repurchase of shares linked to a segregated account may effect the redemption or repurchase out of the assets of the company linked to the relevant segregated account, on such terms and in such manner and at such price as may be determined having regard to the asset value of such shares as ascertained in accordance with the governing instrument."

153. In the context of an ordinary company which becomes insolvent, it is clear that the assets of the company are regarded as effectively held on trust for the benefit of its creditors and that the directors right to continue the ordinary operations of the company is supplanted by the need to consider appointing independent

management (whether liquidators or otherwise) and to decide whether the company's business should continue or must be brought to an end. The primary duties of a director under section 97 of the Companies Act 1981 are as follows:

> "*(1) Every officer of a company in exercising his powers and discharging his duties shall —*
>
> > *(a) act honestly and in good faith with a view to the best interests of the company; and*
> >
> > *(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.*
>
> *(2) Every officer of a company shall comply with this Act, the regulations, and the bye-laws of the company.*"

154. Counsel did not refer to any statutory provisions which shed light on how the directors' duties are modified in relation to a SACA company. Indeed, Mr. Clipper's formulation of his approach to approving the Plan appeared very much to have his duty to the company as a whole in mind. One apparent modification of these general duties in the case of companies registered under both the 1981 Act and SACA are the following provisions of section 18 (5) which suggest that the inherent challenge of being a director of company established with separate classes of shareholders with potentially conflicting rights is to be resolved by honouring the rights under governing instruments and contracts linked to each account:

> "*(15) To the extent that, at law or in equity, a segregated accounts company or manager has duties (including fiduciary duties) and liabilities relating to a segregated account or to an account owner or to a counterparty—*

> *(a) that company or manager acting under a governing instrument or contract is not liable to the segregated account or to any account owner or counterparty for the company's good faith reliance on the provisions of that governing instrument or contract to which that account owner or counterparty is a party; and*
>
> *(b) the company's or manager's duties and liabilities may be expanded or restricted by provisions in a governing instrument to which the person is a party.*"

155. Section 18(5) permits an expansion of duties and liabilities, for instance by the Bye-laws, but sheds no meaningful light on the scope of management authority in an insolvency context. If anything of relevance to the present controversy can be extracted form this statutory provision, it is that directors can only confidently exercise powers expressly or impliedly conferred by the Bye-laws of a SACA company, and related contracts and prospectuses. The power to modify the provisions of a governing instrument without a shareholder's consent must be found within the governing instruments themselves. SACA does create a mechanism for winding-up the business of a segregated account. That mechanism is a receivership, which may be instituted either by the company itself, a creditor or an account owner. Bye-law 9(6), in conferring on a shareholder the right to direct the company to liquidate any investment in default, is an additional strong pointer to the conclusion in the present case[15] that the interests of account holders are paramount if the Lender to a particular segregated account is unable to meet a demand for payment made pursuant to a redemption request, when due. However, the seemingly generic wording of Bye-law 9(6) must be viewed as modified by the terms of the Loan Agreement

[15] It may well be that Bye-law 9(6) is a standard provision for Bermuda segregated account companies, but this issue was not addressed in argument and the Defendant's Bye-laws are the first segregated account bye-laws to be considered by this (and possibly any) Court.

in the present case under which only 51% of the account holders whose accounts invested in NSI can direct the collateral agent to liquidate the collateral. Since the Plaintiffs (through their 100% ownership of Classes C and I) possessed a 56% interest in the Loan Notes and the ancillary security rights, it seems logical to conclude that any post-insolvency dealings with those assets should at least be carried out with their interests in mind, if not with their express consent. The Defendant of course sought the Plaintiffs' consent for the controversial loan changes which were made. This would mirror the approach in the ordinary insolvency context where the views of the majority of unsecured creditors would ordinarily be given effect to by a liquidator absent contrary Court approval. Bearing in mind that the ultimate remedy absent any out of court restructuring is the appointment of a receiver, it is helpful to remember what the function of a receivership is in the SACA context. Section 19 of the Act provides as follows:

> "*(3) A receivership order shall direct that the business and assets linked to a segregated account shall be managed by a receiver specified in the order for the purposes of—*
>
> > *(a) the orderly management, sale, rehabilitation, run-off or termination of the business of, or attributable to, the segregated account; or*
> >
> > *(b) the distribution of the assets linked to the segregated account to those entitled thereto.*"

156. Since the receiver is responsible solely for a particular segregated account while the directors are responsible for each account and the company as a whole, it is not surprising that a receiver is conferred all of the powers of the directors and additionally is empowered to do whatever is necessary for the purposes of section 19(3). Section 21 provides:

> "*(1) The receiver of a segregated account—*

> *(a) may do all such things as may be necessary for the purposes set out in section 19(3); and*
>
> *(b) shall have all the functions and powers of the directors and managers of the segregated accounts company in respect of the business and assets linked to the segregated account.*"

157. The primary statutory provision conferring broad management powers on the directors in relation to the assets of a segregated account is section 11 (2)(d)(iii). However, as Mr. Woloniecki rightly pointed out, the broad powers of the directors to deal with the assets of a segregated account, under section 11(2)(d)(iii), must explicitly be carried out "*for the benefit of the segregated account only*". In the late summer and early autumn of 2008, all of the Defendant's segregated accounts which had invested in NSI (and NSSC) were facing redemption requests which could not be met in the ordinary course and that the Loan Notes were in default. The directors and/or the Managers were confronted with a situation whereby: (a) redemptions could not be honoured in accordance with the Bye-laws; and (b) the Plaintiffs' segregated accounts and those other accounts which had co-invested on an overlapping basis had crystallized rights as secured creditors of NSI. These security rights included both the right to sell the collateralised assets and the benefit of the priorities obtained through registration. This challenging situation was compounded by the fact that NSI had for some time been, by the Defendant's own admission, unable to meet its loan obligations as they fell due and was dependent upon NSSC for financial support, which as a result of the Credit Crunch was in a similar (if less extreme) condition. Nevertheless, this commercial conundrum brought the various elements of segregation into sharper focus and diminished rather than amplified the ability of the directors to deal with the assets of the various segregated accounts in the same way as they might in the context of ordinary business operations.

158. Section 11 (2) provides as follows:

> *"*(d) unless otherwise provided in the governing instrument, the segregated accounts company may take any action, including—
>
> *(i) the amendment of the governing instrument;*
>
> *(ii) the appointment of one or more managers;*
>
> *(iii) for the benefit of the segregated account only, the sale, lease, exchange, transfer, pledge or other disposition of all or any part of the assets of the segregated account, or the orderly winding-up of the affairs and termination of the segregated account,*
>
> *or may provide for the taking of any action to create under the provisions of the governing instrument a class, group or series of account holdings that was not previously outstanding, without the vote or approval of any particular manager or account owner, or class, group or series of managers or account owners…" [emphasis added]*

159. These powers can by their terms be utilised both in the context of transactions in the ordinary course and in the context of winding-up and terminating the business of an account. But these powers are subject to any contrary (and implicitly more restrictive) provisions in the governing instrument (which means the Bye-laws, the Prospectus and the loan and security documents). They also seem designed for situations where there is no question of the account owners being paid in full nor any question that the company is acting "*for the benefit of the segregated account only*", as opposed situations where the directors are acting at the same time on behalf of other segregated accounts (or, in the case of the Managers, other companies) with conflicting commercial interests. Section 17A(3) does provide immunity against claims for conflict of interest where either (a) the governing instrument permits officers or managers to act in the same transaction for more than one segregated account, or (b) the majority of account owners give their written consent. The Plaintiffs complained about the fact that those who designed and implemented the Plan on

behalf of the Defendant were tainted with conflicts of interest; it was not suggested by way of response that the immunity conferred by section 17A(3) applied. Rather, the existence of any conflicts was denied with the sweeping assertion that all accounts have common commercial interests being made, a submission which I accepted in the *Tensor* case, on materially different facts.

160. In addition, by the Defendant's own account, it is doubtful whether the Plaintiffs (and all other redeemers) were at all material times account owners as opposed to unpaid redemption creditors. Perhaps for this latter reason, the Defendant sought to justify the re-negotiation of the loan arrangements by reference to Bye-law 12 (1), which liberally provides:

> "*In carrying on the business of the company or any Fund, the Directors shall be entitled to acquire, hold, deal in and dispose of any Investment in such manner at such times and in such amounts as the Directors shall think fit.*"

161. In my judgment, the liquidity and solvency crisis which the Defendant was confronted with in 2008 to 2009, and attempted to deal with through the Plan, did not engage the unfettered discretion purportedly conferred by Article 12(1). Literally read in isolation from the related provisions of the Bye-laws and the Act, this power could be used by the directors to abandon the repayment and security interests under the LSA altogether for a song, without regard to the rights of account owners, not to mention counterparty creditors. Obviously these powers upon the onset of illiquidity or insolvency, if not before, could only validly be exercised in such a manner which would not diminish the value of the assets linked to any segregated account. In my judgment, Article 12 (1) cannot validly expand the investment powers conferred by section 11(2)(d); rather, the Bye-law powers are limited by the statutory powers, although the Bye-laws could potentially adopt a more restrictive approach than the statute.

162. The most important significance of the liquidity and solvency crisis which prompted the renegotiation of the LSA and the Loan Notes, apart from its

diminution of the ordinary management powers and its enhancement of the need for account owner consent for significant management decisions, is its impact on the characterisation of those contractual changes. In circumstances where loan arrangements are restructured in such a way as to diminish (if not eliminate altogether) the value of the relevant asset in an arms length transaction between Borrower and Lender, no question of breach of the Act's segregation scheme arises. The commercial reality which prompted the controversial changes in loan terms did not occur within this narrow relationship.

163. The situation which presented was one of two insolvent borrowers. On the one hand, there was NSSC, with its mixed category asset-backed loan business and three classes of creditors: (1) Bermuda Fund investors; (2) Cayman Feeder Fund investors; and (3) US Feeder Fund investors. On the other hand there was NSI with its life insurance focussed asset-backed loan business and with its Bermuda Lenders, which included the Plaintiffs with their segregated accounts' controlling stake in the secured NSI assets, with Class C alone holding 56%[16] of the relevant loans. The renegotiation of the loan arrangements as regards Classes C and I was not a commercial bargain entered into for the benefit these accounts alone (nor indeed all the Defendant's NSI investors collectively). It was a creative and well meaning response to a situation where:

   (a) redemption claims by Bermuda, Cayman and US investors could not be paid in full by NSI or NSSC within the foreseeable future;

   (b) the investment business carried out by the Managers had since in or about 2007 been carried out in cash management terms without strict regard to the separate corporate identities of NSI and its parent NSSC (upon which NSI is now heavily dependent for financial support);

   (c) the amended LSA contained:

[16] It appears that the combined interest of Classes C and I in the NSI Loans is $73.33%.

(i)payment-split provisions which permitted redemption claims of Bermuda, Cayman and US investors potentially to be paid (to some extent at least) out of assets which were previously secured exclusively in favour of those Bermuda investors who lent to NSI on a different priority basis;

(ii)a waiver of defaults which effectively extinguished the crystallized security rights; and

(iii)implied references to the payment in kind of NSI assets (which were immediately before the amendments subject to a security interest in favour of the Plaintiff and other Bermuda NSI investors) to non-NSI investors.

164. The May 1, 2009 LSA was not a transaction between the Plaintiffs' segregated accounts and new counterparties (i.e. non-NSI investors) yet it purports to make assets available to meet their redemption claims which assets were previously subject to security interests forming part of the assets linked to the Plaintiffs' accounts with no consideration in return. The onset of insolvency both:

(a) gave rise to defaults which converted Classes C and I into secured creditors (as opposed to holders of a perfected security interest which could potentially fasten onto NSI's assets); and

(b) created a situation where the various investors in NSI and NSSC had competing redemption claims.

165. The commercial case that the Defendant advanced in support of the Plan, the need to avoid NSSC and NSI filing for bankruptcy protection and the attempt to balance the competing needs of various investor groups, helps to demonstrate that the impugned modifications to the terms on which the segregated assets were held did not take place within the ordinary course of business. Indeed, the very characterisation of the coordinated modification of the existing loan

obligations across various shareholder classes as forming part of a "restructuring plan", the terms of which were the subject of negotiations with shareholders who were finally asked to consent thereto, makes it obvious that the relevant transaction was not regarded by the Defendant's key agents at the time as an ordinary commercial transaction.

166. The right under Bye-law 9(1) and the Act to have redemption requests met through the proceeds of demands for payments on a Loan Note (as opposed to out of available cash) combined with the right of account owners to compel the sale of collateral under Bye-law 9(6) may well have seemed somewhat academic and ethereal when there was no question that the Defendant's investors would be paid both in time and in full. But strict legal rights are always more likely to be insisted upon and accordingly acquire more vitality when investments are distressed. And the power vested in directors to manage investments in the ordinary course without the intrusion of account holders cannot sensibly be construed as extending to a restructuring approved by the directors having regard to the various interests of different segregated accounts.

Did the directors' approval of the Plan and execution of the modified loan documents vary the Plaintiffs' rights under the Bye-laws and SACA in a manner which was beyond the scope of their broad investment management powers?

167. I find that the modification of the NSI loan arrangements with Classes C and I contravened the Defendant's constitutional and statutory segregation obligations and fell beyond the scope of the Defendant's lawful investment management powers. The crucial factual and legal findings upon which this conclusion is based may be summarised as follows:

(a) the Plaintiffs were issued shares on terms that "*the assets held in each Fund shall be applied solely in respect of Shares of the class to which such Fund appertains*" (Bye-law 4 (6));

(b) the directors had the power in accordance with section 11(4) and 17(5) of SACA to allocate assets and liabilities among its various segregate accounts (Bye-law 4(6) (e),(f)). This power was validly exercised through *initially* contracting with NSI on behalf of all segregated accounts which lent to NSI that each account would have similar security rights in respect of NSI's assets. In other words, when the loans were initially assigned to the various NSI-lending segregated accounts, their repayment rights and security rights overlapped with each other, even though priorities might differ in the event of default depending upon when perfection occurred;

(c) the Directors' power to allocate assets among the Defendant's accounts without the consent of account owners only applies to "*any asset of the Company which the Directors do not consider as belonging to the general account of the Company or attributable to a particular Fund*" (Bye-law 4(6)(e)). They had no power to re-allocate "*assets attributable to a particular Fund*" from the accounts of the Defendant's NSI investors and make them available to the Defendant's NSSC's investors, *without the relevant account holders consent*;

(d) on or before May 1, 2009, NSI was in default under its Loan Notes and all its Lenders, including Classes C and I, were secured creditors with vested security rights in respect of the collateralised assets which were linked to the relevant segregated accounts. The assets linked to the accounts immediately prior to the modification of the loan documents consisted of the obligation to repay owed to a single class of lenders under the Loan Notes and the ancillary security rights over NSI's pool of assets;

(e) assuming the Plaintiffs' redemptions had been effected for the purposes of Bye-law 9 (3)[17] (as the Defendant submits), their only subsisting right was to receive payment. But this right to payment was a specific right to receive payment out of the assets linked to their accounts, as provided by the Bye-laws, and various provisions of the Act, notably section 15(3). As regards their right to payment, the following provisions of section 18(14) would apply: "*at the time an account owner or counterparty becomes entitled to receive a payment, distribution, allocation or dividend pursuant to any governing instrument, he has the status of, and is entitled to all remedies available to, a creditor of the segregated account with respect to the payment*";

(f) the modified 2009 LSA is an agreement between Classes C and I and NSI to which neither NSSC[18] nor the Defendant's investors in NSSC, the Cayman and the US Feeder Funds are parties. The modification substitutes an "exclusive"[19] right to payment by NSI backed by vested security rights of its collateralized assets for: (1) a right to payment by NSI out "available cash" generated by the orderly liquidation of both NSSC's and NSI's portfolios; (2) a right to payment that is not legally but in practical effect shared jointly with three additional classes of lender who previously had no interest in NSI's loan obligations to the Plaintiffs: (i) NSSC-investing share classes of the Defendant, (ii) The Cayman Feeder, and (iii) the US Feeder. This constituted commingling of segregated assets; (3) the extinguishment of Class C and I's vested security rights, through the waiver of prior defaults, even though the Collateral Agreement was not formally amended; (4) NSI's right to transfer or sell the Collateral in accordance with the Plan to make payment-in-kind payments using its

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[17] Section 15(7) of the Act states that shares in a mutual fund may only be redeemed if there are reasonable grounds for believing that the relevant segregated account is solvent. An account is deemed to be solvent under section 2(2) if it is able to pay its liabilities (excluding those owed to account holders in their capacity as such).

[18] The version of the modified LSA initially produced was not even signed by NSI and it appeared that NSSC had assumed NSI's primary payment obligation.

[19] Exclusive to all of those of the Defendant's segregated accounts which were NSI Lenders.

assets in satisfaction of the claims of these additional "creditors"; and (5) through the "available cash" formula, the Plaintiffs' accounts became liable for a portion of NSSC's operating expenses, a liability which was not previously linked to their accounts. This was contrary to section 17 (2)(a) (i) of the Act, which provides that "*any asset which is linked* [i.e. which belongs or pertains to] *...to a segregated account...shall be held exclusively for the benefit of the account owners of the segregated account and any party to a transaction linked to that segregated account*", and in breach of the overlapping provisions of sections 17 (2) (b) and 17B(1) as well. To the extent that Bye-law 4 (6)(g)(i) required the accounts' assets to be held in accordance with SACA, the relevant transaction was also an impermissible variation of the special rights attaching to Class C and I shares;

(g) the effect of the May 1, 2009 modifications was clearly to make assets linked to Classes C and I available to meet the claims of persons and/or entities who did not previously have any interest in those assets. How the assets were made available might perhaps be characterised in various technical ways. Most practically, however, Classes C and I purportedly waived all prior defaults thus foregoing their "crystallized" security interests over NSI's assets in return for NSI's promise that those and similar accounts together with investors in NSSC would be paid by NSI out of available assets generated on a consolidated basis by NSSC and NSI as its subsidiary. These new "creditors" purportedly acquired a right to payment out of assets which were previously subject to, *inter alia*, the Plaintiffs' accounts' repayment rights and vested security interests, rights which the new creditors previously did not enjoy;

(h) the net effect of the NSI Lenders purporting to (i) grant the NSSC investors a share of their previously exclusive right to repayment from NSI and to (ii) relinquish their vested security interest in the collateralized NSI

assets was that assets linked to the Plaintiffs segregated accounts — repayment rights, security rights (made available through abandonment or postponement) and collateralised assets were made available to meet the claims of creditors who previously had no rights to those assets;

(i) of course, the post-Plan dispensation purportedly conferred benefits for the Plaintiffs' segregated account as well and could perhaps have been validly achieved with or without solvency concerns in an appropriately authorised transaction. However, modifying the loan obligations in the manner which occurred was not the sort transaction in the ordinary course of business carried out for the benefit of Class C and I alone which the directors were empowered by section 11(2)(iii) and/or Bye-law 12(1) to carry out without account owner approval. Section 11(2) (iii) limits the power of the directors to act in this way because the draftsman no doubt appreciated that directors would owe their primary duties to the company as a whole and would be hopelessly conflicted if they were required to act in transactions for the benefit of more than one party they owed conflicting duties to. Section 17(8), for example, permits an asset to be transferred from one segregated account (to which it is linked) to another account to which it is not linked; but all of the former's account holders must consent. The Bye-laws do not expressly empower the directors to act for multiple segregated accounts in the same transaction and merely require the directors to act in accordance with SACA. Mr. Clipper admitted in his evidence that when he approved the Plan on behalf of Classes C and I, he was taking into account the interests of the Defendant as a whole and all its segregated accounts. No doubt because the drafter of the Resolution considered it was impossible for the directors to act independently in respect of the various accounts, the approval of the Plan was expressed to be "*subject to the Fund receiving the required consents in respect of each of the segregated accounts...*" In the Plaintiffs' case, the anticipated consents were never forthcoming;

(j) the Plaintiffs' right as shareholders to direct the Defendant to liquidate collateral under Bye-law 9(6) cannot sensibly be viewed as having evaporated altogether once the redemption requests matured, giving the directors *carte blanche* to deal with assets out of which the Plaintiffs were entitled to be paid as the directors saw fit, without the Plaintiffs' consent;

(k) it is true, as Mr. Lowe submitted, that the modified LSA does not by its terms create legally enforceable payment obligations in favour of parties who did not previously have claims linked to the Plaintiffs' accounts. This fact only serves to emphasise that the relevant modifications to the Loan Agreement did not form part of an ordinary "transaction" with third parties creating valid claims in their favour linked to the Plaintiffs' segregated accounts. On the face of the modified LSA, Classes C and I have agreed with their delinquent Borrower to give up their vested security rights and to permit the Borrower to pay third parties with no contractual payment rights (in some cases at least) ahead of the secured Lenders. It is this which the Plaintiffs rightly contend is an unlawful interference with their property rights, being done without their consent.

168. It appears to me that the new loan terms are commercially reasonable in a general sense and were negotiated in good faith (the decisions to proceed without obtaining the Plaintiffs' consent and any Bermuda law advice on SACA apart), having regard to (a) the global interests of all concerned (including the Plaintiffs) and (b) taking into account NSI's dependence on NSSC for financial support, as Mr. Clipper and Mr. Gillies both passionately contended. But these arguments have greater potential relevance to the receivership application (or, perhaps, any application which may be made in the US Bankruptcy Court for substantive consolidation of any NSI and NSSC proceedings) than they have to the application for declaratory relief before this Court.

169. Fairness and legality do not always run hand in hand. But in the present segregated account company/mutual fund insolvency context, in which the Plaintiffs have a statutory beneficial interest in the assets they invested in their segregated accounts, it is hardly inconsistent with traditional notions of commercial justice to find that their property rights cannot validly be altered in a manner not contemplated by SACA and/or the Bye-laws without their consent. Mr. Woloniecki somewhat melodramatically decried the "socialistic" assumption by the Defendant's directors and Managers that they (not the Plaintiffs) had the right to decide what the Plaintiffs' best commercial interests were. But in fairness to the Defendant, this apparently paternalistic position was merely a litigation stance. After all, the Resolution was in terms expressed to be conditional upon the consent of all of the segregated accounts being obtained. The Plan was implemented in the hope that the consents would be obtained, with litigation brinksmanship serving as the first phase of the Defendant's fall-back plan.

170. Both counsel agreed that the statutory segregation provisions could probably be modified by way of a scheme of arrangement. In my judgment a scheme of arrangement would only have been required to vary statutory rights which could not have been contracted out of. The Bye-law variations which occurred in the present case could be (and in some cases doubtless were) validly approved by an affirmative vote of 75% of the shareholders of each class. To the extent that a majority in number representing three quarters in value of other of the Defendant's share classes have approved the out-of-court Plan, it is possible that no substantive question of invalidity arises. Most other redeemers have expressly consented and waived any right to challenge the Plan.

171. The only declaratory relief to which the Plaintiffs are entitled is a declaratory relief designed to invalidate the purported modifications of the LSA *to the extent that these changes affect the Plaintiffs' rights*. However, I entirely accept that Classes C and I appear to have the right to liquidate (if necessary) the entire

NSI pool of collateralised assets. An order declaring the Plan as a whole to be unlawful and invalid is beyond the scope of the present application, which is seeking private law relief in respect of an impermissible interference with private law rights. Subject to hearing counsel as to the terms of the Order to be drawn up to give effect to the present Judgment, the Plaintiffs appear to me to be entitled to declarations that :

(1) the Resolution is void and without effect insofar as it affects or purports to affect the assets of Classes C and I;

(2) the purported amendments on May 1, 2009 and thereafter to the LSA on behalf of Classes C and I (including the withdrawal of payment demands and waiver of defaults and the issue by NSI of May 1, 2009 Loan Notes) were void and without effect; and

(3) the LSA dated August 1, 2008 and related Loan Note for Classes C and I remain in force and have full legal effect.

172. The position of the other Gottex AB Fund segregated accounts, whose applications I have understood to be stayed and were not addressed at trial, requires separate consideration.

Plaintiffs' submissions on issue (2): should a receiver be appointed?

<u>Is it just and equitable to appoint a receiver?</u>

173. Mr. Woloniecki rightly took the view that the case for the appointment of a receiver could be dealt with more shortly on the basis that the application's primary platform was the attack on the validity of the Plan. In his oral opening submissions, counsel argued that the threshold his clients had to meet as 100% owners of Classes C and I was far lower than that which Tensor as a minority

shareholder had to meet in the *Tensor* receivership application. It was submitted in the Plaintiff's trial Skeleton that:

> "*88.Section 19(a) provides for the appointment of a receiver over one or more segregated accounts if the Court is satisfied that "for other reasons [beyond insolvency of the segregated or the general account, or liquidation of the company] it appears to the court just and equitable that a receiver should be appointed" and that the appointment will achieve one or more of the purposes set out in Section 19(3)(a) or (b). The "just and equitable" requirement of Section 19 is not further defined, and on its face the statute confers upon the Court discretion in determining whether, in all the circumstances of the case, the appointment of a receiver is appropriate.*
>
> *89.The Plaintiffs submit that where the managers of a company have not been managing and protecting certain classes as required by the SAC Act, and where new management is necessary to secure and ultimately distribute those classes' assets to their redeeming investors, it is clear that a receiver is just and equitable. Moreover, the just and equitable nature of this application is underscored by the fact that Class C and I simply seek to be placed in the same position they were in before the Plan, and to enforce the rights they possessed then, while other classes and funds are similarly restored to the positions that they occupied pre-Plan.*
>
> *90.In Tensor (Judgment, paragraphs, 44-45), the Court referred (in obiter dicta) to an Australian case (International Hospitality Concepts Pty Ltd v. National Marketing Inc. (1994) 13 A.C.S.R. 368)) as one source of guidance in applying the "just and equitable" standard (cite to page of opinion). That case included circumstances "[w]here there has been serious fraud, misconduct or oppression in regards to the affairs of the company" as one*

> *grounds for satisfying a "just and equitable" standard for a more severe remedy: the forced involuntary winding up of a (non-SAC Act) company in its entirety. The Plaintiffs submit that while serious misconduct has undoubtedly occurred in this case, and that indeed the misconduct could hardly be more serious under the SAC Act scheme, the Court is not bound to apply the "just and equitable" test, formulated in the winding-up context to section 19(3). The SAC Act receivership provisions are not limited, to insolvency and contemplate receivers stepping in for example for "orderly management," for "rehabilitation," for the sale of the business of an account (not the entire SAC Act company), and for the distribution of the account assets.*

174. It was submitted that it was plain and obvious that a receiver should be appointed having regard to the way the Plaintiffs' rights had been trampled on. If misconduct needed to be made out, it was amply demonstrated by, *inter alia*, the directors' failure to ensure that the Plan was approved before it was implemented, their failure to consider the implications of the Act and their failure to obtain Bermuda law advice. These submissions had considerable force although the Plaintiffs' counsel had earlier fairly conceded that, according to First Gillies (paragraphs 174-175, explaining the effect of certain undertakings given after the commencement of the present proceedings):

> "*...things have remained in a state of suspended animation since 1 May 2009....and as a result the difference between the pre- and post-Plan positions of the parties is a matter of formalities only, and the position before 1 May 2009 could quite easily be restored.*"

<u>Would the appointment achieve the objectives of section 19(3)?</u>

175. In his oral submissions, Mr. Woloniecki placed primary reliance on the evidence of his clients' US Bankruptcy law expert who opined that the Plaintiffs

could potentially do better if they enforced their collateral rights through a receiver, even if NSI filed for bankruptcy. The Plaintiffs' Trial Skeleton concluded with the following submissions on this limb of the application:

> "*93.A receiver will satisfy the multiple statutory purposes of sections 19(3) (a) and (b) of the SAC Act. The Court is referred again to the 4th Affidavit of Amy Lai (in particular paragraphs, 98, 99, 101 and 102), in which she explains what a receiver of Classes C and I can reasonably be expected to achieve. The receiver will step in to manage the classes and their assets by, for example, undertaking the following tasks:*
>
> *(1) negotiating with NSI or other New Stream entities as appropriate to serve the specific interests of Classes C and I;*
>
> *(2) working with others to secure financing to ensure future premium payment obligations are met on the underlying insurance business;*
>
> *(3)declaring an event of default absent repayment of the Class C and I Loan Notes or upon any improper movement of the NSI collateral;*
>
> *(4) directing the Collateral Agent to execute on and sell the collateral;*
>
> *(5) retaining counsel in the US and, if necessary, seek judicial intervention if any of the NSI assets were being removed from the collateral pool before full payment of Classes C and I;*
>
> *(6) advocating, directly or through US counsel, the Class C and I interests in any bankruptcy proceeding, if indeed any bankruptcy proceeding ever transpired; and*

(7) performing any other actions that an investment manager or board of directors could accomplish.

94. The Court will note that Mr. John McKenna, a highly experienced insolvency practitioner, has expressed his willingness to accept an appointment as receiver. It is not disputed that Mr. Gillies knows more about the technical aspects of the management of life insurance assets than Mr. McKenna. That is beside the point. The Plaintiffs want to take the management of the assets linked to the C and I accounts out of the hands of Mr. Gillies and his associates, in whom they have lost all trust and confidence. A receiver (whose fees will be paid by those classes, and thus indirectly by the Gottex AB Funds) can retain whatever expert advisers he thinks necessary to assist him in protecting, managing and realising the proceeds of the loans secured by the life insurance assets."

Defendant's submissions on issue (2): should a receiver be appointed?

Is it just and equitable to appoint a receiver?

176. Mr. Lowe challenged the submission that the just and equitable requirements of section 19 were more easily met when all the owners of a class wished a winding-up. He contended that the views of creditors/shareholders were never dispositive. In this regard counsel relied in part upon the following *dictum* of Lord Hoffman in *O'Neill-v-Phillips* [1999]1 W.L.R. 1092 at 1099, 1104:

"*This approach to the concept of unfairness in section 459 runs parallel to that which your Lordships' House, in In re Westbourne Galleries Ltd. [1973] A.C. 360, adopted in giving content to the concept of "just and equitable" as a ground for winding up. After referring to cases on the equitable jurisdiction to require partners*

to exercise their powers in good faith, Lord Wilberforce said, at p. 379:

> *'The words ['just and equitable'] are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure. That structure is defined by the Companies Act [1948] and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The 'just and equitable' provision does not, as the respondents [the company] suggest, entitle one party to disregard the obligation he assumes by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way'…*
>
> *… 8. No-fault divorce?*
>
> *Mr. Hollington, who appeared for Mr. O'Neill, said that it did not matter whether Mr. Phillips had done anything unfair. The fact was that trust and confidence between the parties had broken down. In those circumstances it was*

obvious that there ought to be a parting of the ways and the unfairness lay in Mr. Phillips, who accepted this to be the case, not being willing to allow Mr. O'Neill to recover his stake in the company. Even if Mr. Phillips was not at fault in causing the breakdown, it would be unfair to leave Mr. O'Neill locked into the company as a minority shareholder.

Mr. Hollington's submission comes to saying that, in a 'quasi-partnership' company, one partner ought to be entitled at will to require the other partner or partners to buy his shares at a fair value. All he need do is to declare that trust and confidence has broken down. In the present case, trust and confidence broke down, first, because Mr. Phillips failed to do certain things which, on the judge's findings, he had never promised to do; secondly, because Mr. O'Neill wrongly thought that Mr. Phillips had committed various improprieties; and finally because, as the judge said, he was 'inclined to see base motives in everything that Mr. Phillips did.' Nevertheless it is submitted that fairness requires that Mr. Phillips or the company ought to raise the necessary liquid capital to pay Mr. O'Neill a fair price for his shares.

I do not think that there is any support in the authorities for such a stark right of unilateral withdrawal..."

177. Counsel also relied upon the views expressed in paragraphs 44-55 of my Judgment in *Tensor Endowment Ltd.-v- New Stream Capital Fund* [2009] SC (Bda) 63 Civ (18 December 2009):

"*44. Mr. Lowe relied on wider expositions on the just and equitable concept, in particular the following extract from the judgment of*

Young J New South Wales Supreme Court Equity Division in International Hospitality Concepts Pty Ltd.-v- National Marketing Inc. (1994) 13 A.C.S.R 368:

> *'A good analysis of the just and equitable ground for winding-up is to be found in the article by McPherson JA when at the bar in 'Winding Up on the 'Just and Equitable Ground (1964) 27 MLR 282. His Honour then said and what he said remains true to today, that 'The situations in which orders will be made on the ground that it is just and equitable may be reduced fundamentally to three in all. They are as follows: (1) where initially it is , or later becomes, impossible to achieve the objects for which the company was formed; (2) Where it has become impossible to carry on the business of the company; and (3) Where there has been serious fraud, misconduct or oppression in regards to the affairs of the company.' The reason for restricting the remedy to these three broad heads is that the basic purpose of forming a limited liability company is that the quasi partners contribute their money to a venture and commit their funds to the venture without power of withdrawal unless and until the venture comes to a frustrating event. The third of McPherson JA's heads was dealt with in Loch v John Blackwood Ltd. at 788, where Lord Shaw, giving the judgment of the Privy Council said: ' It is undoubtedly true that at the foundation of applications for winding up, on the " just and equitable" rule, there must lie a justifiable lack of confidence in the conduct and management of the company's affairs. But this lack of confidence must be grounded on conduct of the directors, not in regard to their private life or affairs, but in regard to the company's business. Furthermore the lack of*

confidence must spring not from dissatisfaction at being outvoted on the business affairs or on what is called the domestic policy of the company. On the other hand, wherever the lack of confidence is rested on a lack of probity in the conduct of the company's affairs, then the former is justified by the latter, and it is under the statutes just and equitable that the company be wound up.'

45. These principles may usefully be adapted and applied in determining when it is just and equitable to appoint a receiver on respect of a segregated account, particularly in cases to which the other two grounds (account insolvent/ company in liquidation) are not engaged by the applicable facts."

178. These principles were clearly drawn from the context of winding-up petitions presented either by minority shareholders or by one of two "partners" in a quasi-partnership context. The Defendant's Closing Submissions advanced the following points specifically directed at the unique context of the present receivership application:

> "73..*In hedge funds investors in practice never have the right to insist on a voluntary liquidation of the company in which they own shares. It is in fact essential to most hedge funds that shareholders are never in a position to force a liquidation of the whole or any part of the structure when they cannot show it is "just and equitable" to do so. They are invariably issued with participating non-voting shares. The method for liquidation of their investment lies in the redemption structure they have agreed. If that does not provide their exit for them then that too follows a balance which must be taken to have been agreed between them. The Companies Act 1981 and SACA contain no*

provisions which prevent hedge funds from extending this practice to segregated account companies.

74.The Bye-Laws make it absolutely clear that Gottex AB Funds had shares which were not entitled to any decision-making votes but which had their exit through redemption rights. The Defendant's share capital was divided into (a) Manager shares which were entitled to vote but not to participate in any dividends and were not redeemable and (b) redeemable shares which participated in dividends and had defined rights to their segregated account in the event of a winding up but only limited voting rights. Those limited voting rights were restricted to votes on appointment of auditor and administrator. They have no right even to be notified of general meetings (see A/400-401). They have no right to vote for a winding up (see A/429).

75.It is therefore wrong in principle as well as in fact to allow the Gottex AB Funds to draw an analogy with voluntary winding up and transpose that into just and equitable liquidation of the segregated account. An application for a just and equitable winding up requires the Petitioner to establish objectively why the trust and confidence in those in charge of the Company has broken down. Such a winding up is not achieved by a vote or desire of investors. That is all the more so when they have agreed with the Company that they shall not have any such voting right."

179. In summary, Mr. Lowe submitted that some want of probity had to be established to make out the just and equitable ground, and that the Plaintiffs had failed to do so. He relied in this regard on the good faith and flexible negotiations carried out by the Managers and the commercial fairness and reasonableness of the Plan. In addition the Defendant invited the Court to reject the evidence of Mr. Bailey to the effect that he had made it plain before May 1, 2009 that the Plaintiffs would not be supporting the Plan.

180. As far as the second limb of the receivership application, it was submitted, *inter alia*, in the Closing Submissions of the Defendant that:

> "*141.The application to appoint a receiver requires the Court to be satisfied that 'the making of the order would achieve the purposes set out in Section 19(3) such as (a) ''the orderly management or ... run-off or termination of the segregated account' or (b) 'the distribution of the assets linked to the segregated account to those entitled thereto'.*
>
> *142.The Plaintiffs submission is that the Court does not need to investigate the risks because this is a matter for them 'as consenting adults'. This is misconceived. The requirement that the Court satisfies itself that the order would achieve the purposes set out in Section 19(3) is mandatory and goes to the jurisdiction to make an order. The Court cannot make an order when the applicant does not present a coherent plan for the receivership which is likely to be successful in fulfilling the Sub-section 3 purposes.*
>
> *143.It is submitted that far from having any plan, the Plaintiffs; evidence showed that little thought had been given to the monetisation of any of NSI's assets and the Plaintiffs appeared to be wholly unconcerned about the danger to NSI's assets if premiums were not immediately financed. Remarkably, they had not taken any steps to obtain DIP finance and had no more than expressions of interest from Barclays. Even worse the Plaintiffs had dangerously underestimated the risk of US Chapter 11 and obtaining finance from NSSC for the NSI policies.*

144.In her affidavit Lai set out a number of steps that she contended the Plaintiffs or a Receive could take to realise assets (see A/53 at paragraph 98). As she began to explain what these steps involved in cross-examination (see Day 2/89-100 it became self-evident that no or only superficial thought had been given to any of them. Her evidence for this period is worth reading in full because it demonstrates just how ill-thought out the idea of a receivership really is."

Would the appointment achieve the objectives of section 19(3)?

181. The Defendant's counsel argued with considerable force that the Plaintiffs' evidence is very thin as to what the appointment of a receiver would achieve having regard to the requirements of section 19(3). It was submitted that unravelling the Plan would compel NSI and NSSC to file for bankruptcy protection in the US, and that this would unleash a wave of litigation and possibly result in the consolidation of the two bankruptcies based on the historical practice of the way in which the two entities were managed as one. Accordingly, there was no or no credible evidence that the objects of section 19(3) would be achieved.

FINDINGS ON ISSUE (2): SHOULD A RECEIVER BE APPOINTED?

Is it just and equitable to appoint a receiver?

182. I find that the Plaintiffs have established that it would be just and equitable to appoint a receiver in the context of the unique statutory framework of SACA. The pivotal factors are that:

(a) the Plaintiffs own 100% of the shares in Classes C and I;

(b) although their unpaid redemption rights flow from their former status of account holders, they are now by the Defendant's own partial[20] admission unpaid creditors seeking relief as such;

(c) under the Act, the Plaintiffs have a beneficial interest in the assets linked to their segregated accounts and their shares were issued on terms that they (and not the Defendant's management) would have the right to decide on:

(i)whether or not NSI had defaulted on a demand for repayment linked to a Redemption Request;

(ii) whether or not their segregated accounts should exercise their secured creditor remedies under the Collateral Agency Agreement; and

(d)the Plaintiffs' investments in respect of Class C alone represent more than the minimum 51% of the indebtedness under the NSI Loans which stake all connected investors contracted would be empowered to exercise the collateral enforcement rights if a default occurred. The appointment of a receiver to do just that, in circumstances where the Defendant's management is unwilling to act, is wholly consistent with the parties' original contractual bargain.

183. My primary finding is to accept the Plaintiffs' case that no need arises to establish want of probity. However, if I were required to find want of probity as an element of the just and equitable ground for appointing a receiver, I would find that this element has also been made out. Firstly it is implicit in a finding that the Defendant has entered transactions which are unlawful that some

[20] To the extent that the Defendant's case is that the Plaintiffs have lost the status of account owner but not yet acquired the status of actual creditor, a position which is not accepted by this Court.

impropriety has occurred. However, this implied misconduct was accompanied by a "don't ask, don't tell" approach to Bermuda law advice, in circumstances where it is difficult to imagine that an appropriately experienced Bermudian lawyer would have opined that the Plan could be implemented without infringing SACA without shareholder consent. However, this is a case of want of probity at the margins, in which (as Mr. Lowe pointed out) even the Plaintiffs' May 28, 2009 reservation of rights letter did not reflect Bermuda law advice supporting the impropriety of the Plan in SACA terms.

184. I reject the suggestion that the Defendant proceeded full steam ahead with the Plan once the Plaintiffs' opposition was known. Although warning flags were raised by Amy Lai in the days leading up to May 1, 2009, I accept that the Defendant and its agents (a) did not definitively know that the Plaintiffs' consent would be withheld until they received the in-house counsel's letter of May 28, 2009 letter; and (b) in response to the filing the Writ seeking declarations as to the invalidity of the Plan, undertook to take no further steps to implement the same. The Plan may be legally "egregious" in the absence of the Plaintiffs' consent, but the fact that the Plaintiffs came within a whisker of approving it is proof that it did, to some extent at least, seek to cater to their commercial needs, as the negotiating process demonstrates. Moreover, it received widespread support from other investors, albeit only a minority of those whose interests truly overlapped with the Plaintiffs' own.

185. Having had the benefit of Mr. Woloniecki's full-blooded assault on the legality of the Plan, it is necessary to revisit some of the conclusions on the receivership scheme I reached in the *Tensor* case. First, it is helpful to remember what the crucial statutory enactments provide:

> "*19 (1) Subject to the provisions of this section, if, in relation to a segregated accounts company, the court is satisfied that—*

> *(a)a particular segregated account is not solvent, the general account is not solvent, a liquidation has been commenced in relation to the company, or for other reasons it appears to the court just and equitable that a receiver should be appointed;*
>
> *(b)the making of a receivership order under this section would achieve the purposes set out in subsection (3),*
>
> *the court may make a receivership order in respect of that segregated account.*"

186. Section 19(1) provides two alternative gateways for an applicant to establish standing to seek a receivership order. In *Tensor*, where Mr. Lowe also ably represented the Defendant, I found that the insolvency gateway did not apply to a redeemer because section 2(2) (b) of the Act provides a *sui generis* definition of insolvency which excludes claims arising by persons in the capacity of account holders:

> "*a segregated account shall be deemed to be solvent if it is able to pay its liabilities (excluding obligations to account owners in that capacity) as they become due.*"

187. The Plaintiffs did not challenge this legal finding and so did not rely upon the insolvency ground. Accordingly the following statutory provision, which I did not consider in *Tensor*, did not receive the benefit of argument in the present case either. Section 18 provides as follows:

> "*(14) Subject to the segregated accounts company complying with section 15, and except to the extent it may be agreed otherwise by virtue of the governing instrument or contract, as the case may be, at the time an account owner or counterparty becomes entitled to receive a payment, distribution, allocation or dividend pursuant to*

any governing instrument, he has the status of, and is entitled to all remedies available to, a creditor of the segregated account with respect to the payment, distribution, allocation or dividend, and the governing instrument or contract may provide for the establishment of record dates with respect to such payment, distribution, allocation or dividend."

188. Without deciding this point, it seems strongly arguable in the context of the present case where the Defendant contends that all redeemers (including the Plaintiffs) are no longer shareholders that such redeemers possess the status of creditors for the purposes of the solvency test under section 2(2)(b) of the Act. It is difficult to sensibly construe section 18(14) as according to unpaid redeemers all the rights of creditors <u>except</u> those under section 19 of the Act. Section 2(2) would make sense if it excluded from the solvency test amounts owing to account holders by way of dividend because such sums would only be payable after all debts owed to creditors were paid in full.

189. On any view, however, it makes no sense to view the Plaintiffs' application under the just and equitable ground through the lens of a disgruntled minority shareholder or as one quasi-partner in a quasi-partnership, even if their substantial status as unpaid creditors is not taken into account. In *Tensor*, the applicant's stake in its segregated account was too small to (a) block a 75% variation in share rights; or (b) if the segregated account were an ordinary company, pass a resolution for voluntary winding-up. In the present case, the Plaintiffs' 100% ownership of their relevant accounts makes the present receivership application more analogous to either a petition presented by all of a company's creditors or all of its shareholders. The cases relied upon by the Defendant clearly do not apply. They are based on the premise that the petitioning shareholder has been unable to pass a resolution for the company's winding-up. Here, all of the beneficial owners of the relevant accounts (who by statute have a beneficial interest in the assets of the account) seek the

appointment of a receiver and it is difficult to see who else has better standing to determine where justice and equity lies. The submissions advanced by the Defendant's counsel about the usual hedge fund or mutual fund context have no meaningful application in the receivership context in relation to a segregated account. The Plaintiffs are not seeking and have no right to seek to wind-up the entire company.

190. The concept of just and equitable upheld by this Court in *Tensor* (incorporating the requirement of proof of want of probity) was also inextricably intertwined with the applicant's status as a dissenting minority asking the Court to extricate it from its contractual bargain of democratic majority rule under the company's constitution. In the SACA context, the relevant contractual bargain is to found both in the statute, the Bye-laws and the Loan arrangements. Bye-law 9(6), as read with the Loan and Collateral Agreements, authorised account owners who cumulatively hold 51% of NSI's indebtedness under the Loans to instruct the directors to enforce collateral rights when the requisite majority of account owners determine that a Loan is in default. If the account owners were able to exercise that power before their right to payment matured, they must surely have the standing to invite the Court to find (without more than showing that the relevant investment is in default and that the directors are unwilling to do their bidding) that it is just and equitable to appoint a receiver. In so doing they are not seeking to extricate themselves from the bargain they entered into when they became shareholders of Class C and I. They are simply seeking to exercise the rights they acquired under that bargain.

191. In summary, it is difficult to discern what standing the Defendant's directors or the Managers have to assert a better judgment as to where justice or equity lies with respect to the distribution of the assets linked to the Plaintiffs' account, particularly in circumstances where the right to redeem has not been suspended. In the case of a company defending a minority shareholder's petition, the directors' opposition to the petition is legitimized by their representation of the

majority shareholder constituency. In the present case, the Defendant has no such constituency and is, in effect, seeking to serve as a self-appointed guardian of the Plaintiffs' commercial rights, proclaiming Robespierre-like: "*Je suis le peuple moi-meme!*"

Would the appointment achieve the objectives of section 19(3)?

192. It follows from the above findings that the application of section 19(3) in the present case must also be approached in a distinctive manner from that taken in the *Tensor* case. The crucial differences appear to me to be that: (a) as noted above, the Plaintiffs are the sole "beneficiaries" of the assets linked to their share classes, although a minority of all NSI Lenders have overlapping but subservient security interests in the same collateral pool; and (b) additionally, the Plaintiffs have proved that the proposed application of their assets pursuant to the Plan is not just in breach of their private rights but is also contrary to their statutory rights. In characterising them as the sole parties beneficially interested in the assets of Classes C and I, I do not ignore the possibility that cross-claims may potentially exist if what Mr. Woloniecki satirised as the "scare" scenario painted by Mr. Lowe actually comes to pass.

193. Again, in *Tensor* the Defendant could legitimately claim to be opposing the application in the interests of the majority of the applicant's share class which had consented to the Plan. In my judgment the present application can only properly relate to the Plaintiffs' accounts linked assets and not to the assets of all other parties (save perhaps those of the other Bermuda lenders to NSI). The Defendant's only proper standing to suggest that the ends of section 19(3) will not be achieved is to seek to protect those segregated accounts which supported the Plan from economic injury. But does it lie in the Defendant's mouth to contend that such other parties should be permitted to benefit from an unlawful interference with the Plaintiffs' rights? The dissenting minority shareholder in *Tensor* was ultimately required to submit to the judgment of the majority of its

share class as to what the best approach to managing the business of the account or liquidating its assets was. Should not what was sauce for the *Tensor* goose be sauce for the *Gottex AB Funds* gander?

194. I see no reason why the same principle should not apply by analogy to the present case so that the Plaintiffs are regarded as the best judges of their own commercial interests.

195. Section 19 (3) provides as follows:

> "*(3) A receivership order shall direct that the business and assets linked to a segregated account shall be managed by a receiver specified in the order for the purposes of—*
>
> > *(a)the orderly management, sale, rehabilitation, run-off or termination of the business of, or attributable to, the segregated account; or*
> >
> > *(b)the distribution of the assets linked to the segregated account to those entitled thereto."*

196. Section 19(3) contains two alternative purposes to be achieved by making a receivership order, and only one needs to be made out. As Mr. Woloniecki rightly submitted, the possible filing of Chapter 11 petitions by NSI and NSSC and the commencement of bankruptcy proceedings cannot fairly be characterised by this Court as a disorderly process, albeit that it may be both costly and contentious. I accept the evidence of Professor Tung to the effect that the way NSI and NSSC operated may give rise to many uncertainties and potential delay and expense if they file for bankruptcy. But I also accept the evidence of Mr. Broude, a lawyer with extensive US Bankruptcy Court experience, that the Plaintiffs are not acting unreasonably in seeking to enforce the collateral rights linked to their segregated accounts. Moreover the main reason why the Plaintiffs have not spelt out with any specificity what the Receiver would likely achieve is because it is conceded that this (a) is

somewhat uncertain, (b) would in the first instance involve negotiations, and (c) would not involve any dramatic steps of any nature without the Receiver seeking appropriate directions from this Court.

197. The most important reasons why I consider that collateral damage to "innocent" third parties is not as inevitable as the Defendant sought to suggest are the following: (a) NSI and NSSC are admittedly under common management, and the Managers have a vested interest in avoiding any "meltdown"; (b) the Plaintiffs, with their more than 51% stake in the NSI Loans, are hard-nosed commercial actors, not social activists, and they have a compelling self-interest in preserving the value of the NSI asset pool as whole in common with the Defendant and the Managers; and (c) the proposed Receiver, John McKenna, is an experienced Bermudian liquidator with many years experience of parallel insolvency proceedings between Bermuda and the US Bankruptcy Court and is a skilled professional also well known for diplomacy, moderation and common sense.

198. I am bound also to have regard to the declarations of invalidity the Plaintiffs are entitled to and the admissions made by the Defendant's sole director witness that he has regard to the interests of the company as a whole and all its segregated accounts. In these circumstances, as the Plaintiffs submit, it is obvious that the management and/or distribution of the assets linked to the Plaintiffs' segregated accounts to satisfy their unpaid redemption claims cannot be fairly conducted by the Defendant without the Plaintiffs' consent. It is sufficiently clear in all the circumstances that the appointment of a receiver will achieve the objects of section 19(3)(a) and/or (b). In other words, the Receiver will be able to take over management of the Plaintiffs' segregated accounts in circumstances where it is impracticable for the directors and the Managers to do so, with a view to achieving the objects of section 19(3), even though the outcome of his endeavours is presently uncertain. The Plaintiffs would have had to justify what the Receiver could achieve with greater specificity if, as in the

Tensor case, they were seeking to persuade this Court to override the commercial judgment of the majority of their share class.

Conclusion

199. The impugned Plan appears to me to have been a creative out-of-court restructuring solution which was approved by the Defendant's directors on the basis that the Plaintiffs would consent to it. It was developed in a fair manner and for some weeks it appeared likely that the Plaintiffs would consent to it; when they eventually did not assent, the Managers' brinksmanship in proceeding without their support prompted the present litigation. However, at no point did they formally seek or obtain Bermuda law advice on the untested SACA framework, with the Defendant's directors and their local attorneys seemingly adopting a "don't ask, don't tell" stance to the implications of the knotty issues considered above in relation to the Plan.

200. The approach I have adopted to interpreting the Act generally has involved implicitly rejecting Mr. Lowe's contention that the integrity of SACA would be disturbed by upholding the Plaintiffs' claims and depriving the Defendant's management of appropriate freedom to manage the assets of a mutual fund. I have preferred the submission of Mr. Woloniecki that the stability of companies registered under SACA would be seriously undermined were this Court to adopt a cavalier attitude towards compliance with the requirements of the Act. To permit the managers of a segregated account company to sidestep an elaborate legal structure, where the statutory segregation concept is reflected in carefully drawn financial documents giving rise to registered security interests, merely to accommodate an *ad hoc* internal cash-management system would be unconscionable-*absent the relevant account holders' consent*.

201. The Bye-laws in the present case, read with the Act, are somewhat elliptic in articulating where management authority lies when insolvency or conflict of interest intervenes in relation to segregated accounts. It may be that the form of Bye-laws in relation to the comparatively modern corporate vehicle of segregated accounts will in the future benefit from further refinement in this regard. I reject the suggestion that, come what may, a segregated account's ordinary managers can insist on retaining management control of their investors' assets over their objections in furtherance of an insolvent restructuring in relation to which (a) the account owners' consent has been withheld, and (b) real differences of interest between various accounts have been brought into play. The flexibility which exists for the management of solvent mutual fund companies in the ordinary course of business should in no way be questioned or undermined by this conclusion.

202. I also do not accept that in construing the Act in the insolvency context that the Court should adopt an approach which seeks to weaken rather than strengthen the manifest statutory policy in favour of protecting assets linked (i.e. owned by or pertaining to) to segregated accounts being made available to parties who have not expressly contracted with the relevant account. In the present case the crucial interference with the concept of segregation occurred not because the segregated accounts could not legally transact with NSI and other interested parties to change the content of pre- May 1, 2009 fund of assets linked to the Class C and I accounts. The purported modifications to the asset pool linked to the Plaintiffs' accounts which the directors sought to carry out was invalid because it was (a) an out of court restructuring designed to deal with solvency problems affecting other segregated accounts and other investors connected with the Managers, and (b) sought to radically change the terms upon which the Plaintiffs invested in the Defendant without their consent. The Bye-laws as read with the Prospectus explicitly contemplated that the segregated accounts' initial funds would be invested in loans which were both (1) linked to a specific pool of collateralized assets, and (2) that in the event of the investment falling into

default, the account holders could assume operational authority for liquidating the collateral .

203. The Plan, in response to chronic liquidity-related defaults, sought in practical terms to merge the two separate underlying asset pools into one, fundamentally altering the basis on which the Plaintiffs had made their initial investment; this could not be done without their consent. Not only did the Plaintiffs own 100% of the shares issued in respect of two segregated accounts; those two accounts held more than a 51% stake in the collateralized NSI assets, which empowered them to enforce secured creditor rights against the entire collateral[21] prior to the implementation of the Plan. In my judgment the segregation provisions of the Act are primarily designed to have greatest force and vitality in the insolvency context. This is to avoid what happens in a traditional corporate insolvency: creditors who conducted profitable business with a company which fails get dragged into the pit of unsecured creditors by those creditors whose dealings with the insolvent company were disastrous. Accordingly, where directors seek to restructure the business of a segregated account under insolvent conditions in a manner which makes assets linked to a segregated account available to persons who are not already counterparties of the said account, they must either do so (a) with the relevant account owner's consent, or (b) under a governing instrument which clearly empowers the directors to act (in such circumstances) without account owner consent.

204. In the present case the Loan and Security Agreement linked to the Plaintiffs' segregated accounts was purportedly modified by the Defendant without account owner consent as part of a wider restructuring which made assets linked to those accounts available to meet the claims of persons who had no pre-existing rights to the relevant assets. This was in breach of provisions of the Segregated Accounts Company Act incorporated into the Defendant's Bye-laws

[21] I make no finding in this regard, the relevant rights being governed by Delaware law.

which neither the Act nor the Bye-laws authorised the directors to contract out of in the manner which occurred, without the Plaintiffs' consent.

205. Accordingly, the Plaintiffs are entitled to declarations that the purported modification of the Loan Agreement linked to Classes C and I segregated accounts are unlawful and are of no legal effect, to the extent that the relevant modifications affect assets linked to those two specific segregated accounts. I see no reason why this Court should invalidate the implementation of the Plan to any greater extent, particularly since it seems likely that the Plan was, as regards some at least of the Defendant's other segregated accounts validly (in substantive terms, if not technically) approved, either unanimously or by the 75% majority required to vary special share rights.

206. It follows logically from the invalidity finding that the Plaintiffs are entitled to apply for the appointment of a receiver to enforce their repayment rights, either as 100% (former) account owners or as 100% creditors (subject to whatever counterparty claims there be in respect of management fees or other cross-claims which may arise out of any US Bankruptcy Court proceedings which may be filed). The Defendant's management through purporting to implement the Plan without the Plaintiffs' consent and through committing themselves to representing the collective interests of all segregated accounts are clearly unable to represent what have been since May 28, 2009 the manifestly different[22] interests of Classes C and I.

207. In these circumstances, it is plainly just and equitable for the purposes of section 19(1) of the Act that a Receiver be appointed to manage their accounts, and self-evident that the objectives of section 19(3) of the Act will be achieved, even if a contentious US Bankruptcy proceeding results and the ultimate return the Plaintiffs will obtain is (a) both uncertain, and (b) not clearly more than they would obtain under the Plan. The Defendant, the Cayman and US Feeders, NSI

[22] Different primarily due to the distinctive way in which the Plaintiffs frame what their best interests are.

and NSSC are all under common ownership and the Plan has been on hold since the present proceedings commenced in June last year. The Plaintiffs have a huge financial incentive in common with the Defendant and other parties involved in the Plan to maximize the value of NSI's underlying assets[23]. The primary object of the Plaintiffs' Receivership application, a negotiated solution, accordingly seems to have realistic prospects of success.

208. I will hear counsel as to the terms of the formal order to be drawn up to give effect to this Judgment. Unless either party applies by letter to the Registrar within 21 days to be heard as to costs, I would award the costs of the consolidated action to the Plaintiffs to be taxed if not agreed on the standard basis.

Dated this 27th day of May, 2010

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KAWALEY J

[23] While in theory the Plaintiffs would be happy to liquidate all the NSI Collateral for a price that resulted in all NSI Lenders being paid in full, its commercial interests would equally be met if such claims could be met leaving intact some collateralized assets to meet other claims.