In The Supreme Court of Bermuda

(COMMERCIAL COURT)

CIVIL JURISDICTION

2011: No. 179

IN THE MATTER OF HIGHLAND CRUSADER FUND II, LTD.

AND IN THE MATTER OF THE COMPANIES ACT 1981

REASONS FOR RULING

(In Court)

Date of Ruling: July 15, 2011
Date of Reasons: August 12, 2011

Mr. Rod Attride-Stirling and Ms. Kehinde George,
Attride-Stirling & Woloniecki, for the Petitioner

Mr. Delroy Duncan and Ms. Nicole Tovey, Trott & Duncan, for UBS Securities LLC and UBS AG, London Branch ("UBS")[1]

[1] Over 25 Notices of Intention to Appear were filed in the winding-up proceedings on behalf of Compulsory and Prior Redeemers who were represented by counsel at the sanction hearing. Firms appearing included Cox Hallett Wilkinson for Muirfield Offshore Fund SPC, Ltd, the Petitioner in the winding-up proceedings which were dismissed on the date of the present hearing of the application to sanction the Scheme, Marshall Diel & Myers, Sedgwick Chudleigh, Smith & Co. and Williams.

Introductory

1. On May 31, 2011, the Company issued an Ex Parte Originating Summons on notice to Scheme Creditors seeking leave pursuant to section 99 of the Companies Act 1981 to summon Scheme Meetings in respect of two classes of creditor: (1) Company Prior Redeemers; and (2) Company Compulsory Redeemers.

2. The Company was one of three affiliated "Crusader" feeder funds which invested into a master fund before the 2008 financial crisis made their winding down inevitable. The commercial purpose of the Scheme (as part of a broader Plan embracing all of the Crusader Funds) was to determine how the assets available for distribution were to be apportioned as between the two classes of Scheme Creditor. On May 2, 2011 when the winding-up petition presented in Civil Jurisdiction 2010: No. 352 was heard, that petition was adjourned to July 15, 2011, to afford the Company an opportunity to seek approval for a Scheme of Arrangement.

3. On June 9, 2011, the Company's Originating Summons for leave to convene Scheme Meetings was heard, with various Scheme Creditors from each proposed class represented by counsel. Directions were given for the convening of the meetings on July 7, 2011, including a requirement for advertisement in a local paper and a posting of the relevant materials in an online Data Room. The Meetings duly took place and on July 13, 2011 the Company presented the Petition in these proceedings seeking this Court's sanction of the Scheme, pursuant to which all Prior Redeemers were to receive 60% and all Compulsory Redeemers 40% of the Company's stake in the Master Fund's assets, which were valued at $1.6 billion overall.

4. The Scheme Meetings Report disclosed that 89 Prior Redeemers (with claims totalling $824,609,521) voted in favour of and 2 (with claims totalling $5,085,575) voted against the Scheme[2]. This represented over 97% in number of Prior Redeemers who voted and some 99% in value. As far as Compulsory Redeemers were concerned, some 67 (with claims totalling $159,634,890) voted

[2] Those who actually voted represented almost 80% of all eligible investors by way of number and nearly 99% in value of all eligible to vote.

in favour while only 2 (with claims totalling only $404, 448) voted against[3]. In terms of votes cast by Compulsory Redeemers, nearly 97% in Number and over 99% in value supported the Scheme. All of the Company's Redeemer's who appeared through counsel at the sanction hearing supported the Company's application and no investor who had voted against the Scheme appeared in opposition.

5. The opposition that was raised to the sanction sought came from an unlikely source, albeit one with eminent legal representation. UBS Securities LLC and UBS AG London Branch ("UBS"), represented in New York by Cadwalader Wickersham & Taft and in London by Freshfields Bruckhaus Deringer LLP, instructed Mr. Delroy Duncan to oppose the sanctioning of the Scheme on various grounds. In essence UBS contended that it was adversely impacted by the Scheme which entailed the dissipation of assets to which it was potentially entitled in litigation pending in New York against other Highland entities; accordingly, it possessed the standing to raise legal objections to the proposed sanctioning of the Scheme.

6. Having heard argument from Mr. Duncan for UBS (whose standing to oppose I accepted) and Mr. Attride-Stirling, whose submissions were warmly endorsed by all other counsel present, for the Company, I granted the sanction order, reserved costs and indicated that I would give the present Reasons which I now deliver.

UBS' standing to object to the Scheme

7. In addition to countering the Objections advanced by Mr. Duncan on their merits, the Company's counsel pointed out that UBS was not a Scheme Creditor and its interests were not impacted by the Scheme. UBS accordingly lacked the standing to oppose the sanction order the Company (and its Scheme Creditors) sought.

8. It did not seem possible to me to fairly decide the standing issue against UBS without hearing the objection in full. Accordingly, I applied a liberal approach to the Objectors' right to be heard on the basis that, if their connections with the Scheme turned out to be tenuous, their objections could be rejected on "merits" grounds. In any event Mr. Duncan referred the Court to highly persuasive authority which suggested that the Court has a flexible discretionary jurisdiction to entertain objections at a sanction hearing from third parties to a scheme of arrangement. In *Re B.A.T. Industries PLC*, 3rd September 1998 (unreported), the

[3] Those who actually voted represented almost 79% in number of all potential voters and nearly 88% in value of the entire investor class.

English Companies Court was asked to approve a shareholder scheme which was objected to by a third party contingent creditor. The third party was suing the company in the US and objected to a dividend contemplated by the scheme. Although UBS has not joined the Company in the present case in the US litigation out of which its objection to distributions which may be made pursuant to the Scheme arises, the facts relevant to *locus* in *Re B.A.T. Industries PLC* were clearly quite analogous to the facts of the present case. UBS' counsel also referred to two other cases where third party objectors who were not scheme creditors had their views taken into account: *Re RAC Motoring Services Ltd.* [2000] 1 BCLC 307; *Re MyTravel Group plc* [2005] 2 BCLC 123.

9. Section 99 of the Companies Act 1981, without elucidating the question of who may object to the making of an order sanctioning a scheme, provides in salient part as follows:

> "*99 (1) Where a compromise or arrangement is proposed between a company and its creditors or any class of them or between a company and its members or any class of them, the Court may, on the application of the company or of any creditor or member of the company, or, in the case of a company being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members of the company or class of members, as the case may be, to be summoned in such manner as the Court directs.*
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> *(2) If a majority in number representing three-fourths in value of the creditors or class of creditors or members or class of members, as the case may be, present and voting either in person or by proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall if sanctioned by the Court, be binding on all the creditors or the class of creditors, or on the members or class of members, as the case may be, and also on the company or, in the case of a company in the course of being wound up, on the liquidator and contributories of the company.*"

10. In *Re B.A.T. Industries PLC,* Neuberger J, considering the English statutory provision from which section 99(2) of our own Companies Act is derived, opined (at pages 8-9 of the transcript) as follows:

> "*There is nothing in s.425(2) which indicates that the power of the court is to be fettered as to whom it can hear and what it must take into account. Given that the circumstances in which a company and its members may wish to come up with a scheme are multifarious, it seems to me scarcely surprising that the legislature did not consider it appropriate to lay down any limitations as to the procedure which the court should adopt or the factors it should take into account, when considering whether or not to sanction a scheme. The general approach of the court when considering a scheme is summarised in a passage in* ***Buckley on the Companies Acts****, 14th edition, vol. 1, at pp.473-4(cited with approval by Plowman J. In Re National Bank Ltd. [1966] 1 W.L.R. 819, at 829) in these terms:*
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> > '***Function of the Court*** *In exercising its powers of sanction the court will see, first, that the provisions of the statute have been complied with, second, that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interests, might reasonably approve.*
> >
> > *'The court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting, but, at the same time, the court will be slow to differ from the meeting, unless either the class has not been properly consulted , or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, <u>or some blot is found in the scheme</u>" (Emphasis added)'*
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> *While the precise ambit of the closing eight words of that passage is not entirely clear, they suggest to me that, while it may require*

exceptional circumstances, it is open to the court to take into account the legitimate concerns of third parties in relation to the proposed scheme, even if they are not members of the Company."

11. I accepted the above analysis and accordingly decided that I should hear argument from UBS, a third party to the Scheme, to see whether the concerns they wished to raise were sufficiently legitimate to the exercise of the Court's discretion to sanction the Scheme to justify the exceptional course of either: (a) declining to sanction the Scheme altogether, or (b) adjourning the sanction hearing to facilitate a fuller investigation of the UBS objection.

Principles applicable to sanctioning schemes of arrangement

12. As I indicated in the course of the hearing, the dominant rule for dealing with applications under section 99(2) of the Companies Act 1981 is that the relevant stakeholders are ordinarily the best judges as to where their best commercial interests lie: *Re APP China Ltd.* [2003] Bda LR 50. Even where a sanction order has been obtained by fraudulent non-disclosure, this Court will not subsequently set the sanction aside where the objectors are unable to suggest any more commercially credible bargain than the scheme the creditors have approved: *Fidelity Advisors Series VIII et al-v-APP China Group Ltd* [2007] Bda LR 35.

First objection: Defective Explanatory Statement

13. The initial impression that it was extremely odd for a third party such as UBS to complain about inadequate disclosures in the Explanatory Statement did not fade after closer scrutiny. The raw fuel typically required to lift a non-disclosure argument off the ground is the ability of an objector, sharing similar commercial interests with those who voted in favour of a scheme, to suggest that if fuller disclosure had been made, a different resolution might have been passed. Where a party which asserts an adverse interest to those who have voted in favour of the Scheme seeks at the same time to advocate their disclosure interests, their objections lack the inherent credulity which normally accompanies arguments advanced by parties unambiguously pursuing their own commercial interests.

14. UBS asserted that if it succeeded in their pending suit against the Master Fund and HCM Capital Management, LP ("HCM") in the United States, monies to be distributed to the Company by the Master Fund and paid out by the Company to Scheme Creditors may be liable to be clawed back. The Explanatory Statement failed to disclose this risk, despite the fact that a condition precedent for the

Scheme taking effect was a payment by HCM on behalf the Master Fund of more than $6 million into the Redeemer Trust Account. It was also complained that no disclosure was made of the fact that allegations of fraud are made in the US against HCM, who are to continue in a key management role. The alternative of a liquidator playing this role ought to have been discussed, and the explanation as to why a liquidation of the Company was not a more favourable option was criticised. These matters were set out in the First Markel Affidavit and Trott and Duncan's July 12, 2011 letter to Attride-Stirling & Woloniecki.

15. Mr. Attride-Stirling countered these concerns with three compelling arguments. Firstly he pointed out that UBS'$160 million claim (initially filed in 2009) was being asserted against a $1.6 billion company in circumstances where there were no grounds for suggesting that insufficient assets would be available if the claim succeeded. The distribution process was likely to take some two years and would take place in any event irrespective of the Scheme, which served the primary purpose of apportioning the distributions amongst the Company's investors. Secondly, UBS' claim against the Master Fund and HCM had been widely reported and the view had been taken that no disclosure was required under US GAAP principles. In any event, a large percentage of Scheme Creditors were before the Court and still supporting the Scheme despite being fully apprised of UBS' criticisms of the Explanatory Memorandum. And, thirdly, UBS' intervention in the present proceedings was an attempt to get a back-door injunction in Bermuda in circumstances where they must believe it was not possible to get a temporary restraining in order from the New York Court to prevent the Master Fund transferring funds to the Company.

16. I found that the main function of the Scheme was to decide how the Company's assets were to be distributed and that UBS had failed to seek the most obvious relief in respect of their indirect commercial interests in relation to the Company. I was unable to attach any or any significant weight to what appeared to me on the whole to be wholly abstract criticisms about the Explanatory Memorandum in relation to the Scheme.

17. The most superficially meritorious non-disclosure complaint related to the failure to discuss the alternative merits of having an independent liquidator in charge of the Group's assets rather than HCM against whom fraud allegations were being made. The force of this criticism was significantly weakened by the fact that the winding-up proceedings were specifically adjourned to enable the Petitioner and other investors to consider the Scheme as an alternative to a winding-up; and all

investors present in Court supported the Scheme. It was a matter of record that the winding-up proceedings before this Court were in part based on the premise that independent management was required. It was obvious at the Scheme sanction hearing that all creditors appearing (including the Petitioner represented by Ms. Hurrion) had made a conscious choice to approve the Scheme as a preferred alternative to a traditional liquidation, despite being aware of the UBS allegations against HCM.

18. Complaint was also made, in a draft unsworn Affidavit by Neil Golding, that the Scheme ought to have disclosed, or the Court ought to have been informed about, an agreement for certain redeemers to assist in soliciting support for the Scheme. The relevant agreement was, fairly read[4], wholly innocuous and broadly consistent with what the Court was explicitly made aware was taking place: as a continuation of a failed mediation and the filing of winding-up proceedings, the Company was attempting to "do a deal" with its investors within a tight timetable, which "deal" necessitated achieving both a consensus as to how court applications would be dealt with and procuring support for the Scheme.

19. Accordingly, I found no good reason not to sanction the Scheme as prayed forthwith, notwithstanding the non-disclosure criticisms advanced by UBS.

Releases

20. Mr. Duncan also complained that the Scheme contained releases which appeared to be drafted so broadly as to defeat any future UBS claw-back claims. Mr. Attride-Stirling confirmed that this was not the intention of the relevant clauses, and this issue was not further pursued.

Classes

21. UBS also queried the differential treatment of those who consented to the Scheme and those who did not, suggesting this gave rise to the need for separate classes. Ms. George for the Company explained that the related Plan provided for such differential treatment, but not the Scheme. Section 1.01 of the Plan's definition of "Consenting Redeemers" expressly provides that "*all Offshore Fund II Redeemers are deemed to be Consenting Redeemers for the purposes of the Scheme*". This disposed of this complaint to my satisfaction.

[4] This complaint appears to have originated from an investor who did not give the agreement a fair construction.

Conclusion

22. The objections to the Scheme, which was overwhelmingly approved by Scheme Creditors, were advanced by third parties who are suing affiliates of the Company in New York. If they succeed in obtaining a judgment against these affiliates, it appears to be theoretically possible that they would be entitled to claw back payments made to the company by the Master Fund, assuming insufficient assets were held by that entity to satisfy such a claim. UBS' proper remedy for its articulated concerns of asset dissipation is to seek injunctive relief against the defendants in the New York proceedings in which it hopes to obtain a judgment.

23. The objections raised to the Scheme were sufficiently unmeritorious to reject the plea to adjourn the sanction hearing pending the fuller investigation the objectors sought. No "blot on the Scheme" was arguably made out; nor was any other potential defect which might credibly, if cured, lead to a different voting result identified.

24. For the above reasons, on July 15, 2011 I rejected UBS' objections and sanctioned the Scheme.

Dated this 12th day of August, 2011 _____
KAWALEY J