In The Supreme Court of Bermuda

COMMERCIAL COURT

COMPANIES (WINDING-UP)

2010: Nos. 393/395

IN THE MATTER OF CAI MASTER ALLOCATION FUND, LTD

IN THE MATTER OF CAI ALLOCATION FUND, LTD

AND IN THE MATTER OF THE INVESTMENT FUNDS ACT, 2006,

SECTION 36

RULING

(In Chambers)

Date of Hearing: September 19, 2011
Date of Ruling: September 26, 2011

Mr. Narinder Hargun, Conyers Dill & Pearman Ltd.,
for the Joint Provisional Liquidators
Mr. Christopher Basile, a creditor, in person
Mr. Michael E. McMurtrey, sole investor in SAC 7, in person

Introductory

1. The Bermuda Monetary Authority petitioned to wind-up CAI Master Allocation Fund, Ltd. ("the Master Fund") and CAI Allocation Fund, Ltd. ("the Feeder Fund") on November 16, 2010. That same day, Mark Smith and Rachel Frisby of Deloitte were appointed by the Chief Justice as Joint Provisional Liquidators of each company ("the JPLs"). Both the Master Fund and the Feeder Fund were incorporated in Bermuda on November 16, 2005 and registered under the Segregated Account Companies Act 2000 on November 23, 2005.

2. On December 10, 2010, both companies were wound-up by order of the Chief Justice and the JPLs' appointments were continued. The JPLs prepared a Report to Investors and Interested Parties on January 31, 2011, according to which the Investment Manager was also wound-up by this Court on January 14, 2011.

3. By Summons dated June 8, 2011, the JPLs seek directions pursuant to section 176(3) of the Companies Act 1981 on the following issues:

    (1) (a) whether the JPLs are obliged to return the investors' monies which the investors have sent to the Feeder Fund for the issue of shares where no shares were issued prior to the Companies' liquidation, and (b) a like direction in relation to investments made by the Onshore Funds[1] with the Master Fund;
    (2) Whether the JPLs may return the funds to SAC 1, SAC 2 and SAC7 investors without regard to the issue of whether improper payments were extracted by the manager and affiliates from SAC 11;
    (3) Whether the JPLs' remuneration can be paid entirely from SACS 1, 2, 7 and the Onshore Funds.

4. The conduct of the present liquidation of two segregated account fund companies is complicated by the absence of clear precedents and a detailed statutory code for the liquidation of segregated accounts. Nevertheless it seemed fairly clear from the outset that, having regard to the preliminary nature of the guidance which the JPLs were seeking from this Court, it was premature for Mr. Basile (on behalf of Mr. Fridman) and/or Mr. McMurtrey to seek any final determination at this stage on their respective claims. Assuming traditional winding-up procedures were not displaced altogether, it would be for the JPLs to adjudicate such claims in the first instance before this Court would have standing to determine the legality of such adjudication. And this is not a case where one or more segregated accounts in a company which is otherwise fully functional have become insolvent.

[1] CAI Multi-Strategy Growth Funds and CAI Aggressive Growth Fund LP.

5. Furthermore, this is a case where the Companies themselves have been placed into liquidation on the petition of the Bermuda Monetary Authority based on regulatory concerns. In these circumstances it is unrealistic to expect either the JPLs or this Court to authorise the return of monies to specific investors without affording the JPLs a reasonable opportunity to investigate the relevant claims in light of the wider commercial background of the business of the Funds overall.

Were monies remitted to the Bermuda Funds for shares which were never issued held in trust for the relevant investors or did property in the funds pass to the Funds?

6. The question whether monies remitted to the Bermuda Funds for shares which were never issued were held in trust for the relevant investors or whether property in the funds passed to the Funds was raised in relation to the following factual scenarios. How this question is answered will determine, in relation to segregated accounts with a deficiency, whether investors can be made whole or will have to accept a *pari passu* share of the assets available for distribution.

7. The First Affidavit of Mark W.R. Smith explains that monies received from investors were initially deposited with JP Morgan, and once it was decided to accept the investments the monies would then be forwarded to Goldman Sachs "*for active investment*" (paragraph 10). Having regard to the Bye-Laws and related documents and the relevant legal principles[2], Mr. Hargun submitted that directions in general terms along the following lines were appropriate for the treatment of monies received from investors to whom share certificates were never issued. In other words, the JPLs should be at liberty to adopt the following general approach (subject to the resolution of any factual disputes as to which category a particular case falls into) :

    (1) where monies were received, no shares were issued and the monies were not actively invested, the funds may be regarded as held on trust for the investors in question;
    (2) where monies were received, shares issued and the monies invested, no dispute properly arises that the title to the invested monies passed to the Companies in respect of the relevant segregated account;

[2] *Kingate Global Fund Ltd-v-The Bank of Bermuda et al* [2009] Bda L.R. 44; *Kingate Global Fund Ltd.-v-Knightsbridge (USD) Fund Limited et al* [2009] Bda L.R. 59.

(3) where subscriptions were accepted and the monies were invested with Goldman Sachs, title to the monies should be regarded as having passed to the Bermuda Funds.

8. I find the suggested approach to be entirely reasonable and consistent with the existing law on this issue as recently established by the Court of Appeal for Bermuda in *Kingate Global Fund Ltd.-v-Knightsbridge (USD) Fund Limited et al* [2009] Bda L.R. 59.

9. As regards Mr. McMurtrey and SAC 7, I agree with the JPLs that it seems wholly academic whether or not his subscription was accepted as he is apparently the sole investor and *prima facie* entitled to the return of his $100,000 investment in full, net of any applicable expenses. But I decline to entertain Mr. McMurtrey's request for a direction that the JPLs should repay the monies at the present time.

10. Mr. Basile contended in respect of the Fridman SAC 1 investment that the condition precedent for the investment of these funds never occurred; they were accordingly held in trust and should be repaid forthwith. I decline to consider the merits of this claim at the present time.

11. Whether or not liquidators have been appointed in respect of a segregated account which is insolvent, the following subsection of section 17 of the 2000 Act applies:

> "*(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.*"

12. The governing distribution principle for winding-up the business of an insolvent segregated account is the same rule which applies upon corporate insolvency under

section 225 of the Companies Act 1981[3]. Where liquidators have been appointed and the segregated account company is being wound-up, section 24(1) of the 2000 Act will also apply:

> "*24 (1) Subject to this section, a segregated accounts company shall be wound up in accordance with the provisions of this Act, the Companies Act 1981 and any other Act which applies to the winding up of a company, save that in the event of any conflict, the provisions of this Act shall prevail.*"

13. So the Companies Act winding-up regime appears to apply, save that (principally) each segregated account must be wound-up on an individual basis. The liquidators will, until a coherent body of practice evolves, be free to decide to what extent (if at all) the general winding-up regime should be followed in relation to each insolvent segregated account. But the starting assumption will generally be that the umbrella principles which inform the *modus operandi* of a traditional winding-up will apply in the Segregated Account Companies Act context. Accordingly in the present case, the JPLs have quite logically carried out preliminary investigations, identified important problematic issues, and sought general guidance from the Court which appointed them as to how to handle the investors' claims. They will no doubt in early course move on to the process of adjudication of claims, following a procedure which is efficient and consistent with the *sui generis* nature of most claims; which are in one sense strictly "shareholder" claims, but in another sense creditor claims.

14. It is, in light of this statutory background, clearly premature at the present juncture for this Court to consider directing the JPLs as to how they should treat individual investor claims. This is particularly the case because the Funds were wound-up on the Bermuda Monetary Authority's Petitions and the JPLs may well have a public duty to investigate regulatory concerns.

Are SACs 1, 2 and 7 potentially liable for the costs of recovering the allegedly improper payments made to the manager and affiliates from the now depleted SAC11?

15. The JPLs reported to investors that the now inactive SAC 11 had no funds. They advised the Court that SACs 1 and 2 hold the majority of the funds, in excess of $3 million. The First Mark W.R. Smith Affidavit suggests that, in addition to what has already been

[3] Section 225 provides: "*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.*"

identified as allegedly improper payments made from SAC 11, "*there is evidence that those in control of SACS 1 and 2 have also used those accounts for improper purposes*" (paragraph 26).

16. Mr. Basile, a former attorney for the Funds and current creditor of the Master Fund, filed evidence refuting the allegations made in respect of the expenses paid by SAC 11; the merits of these allegations are not (or not properly) before this Court for determination.

17. Mr. Hargun submitted that a question arose as to whether, if the Funds had been used as vehicles of fraud, the separate legal status of the segregated accounts might be pierced so that the liability for liquidation costs incurred in respect of one account might fall across the entire range of accounts. He referred the Court to *Kensington International Ltd.-v-Republic of the Congo* [2006] 2 BCLC 296 on piercing the corporate veil. In my judgment, there is nothing in the material presently before me that would support even an arguable case for veil-piercing in the special legal context of a segregated account company. Absent agreement on the part of investors, or a binding variation of their share rights, it seems to me that the separate status of segregated accounts in companies registered under the 2000 Act is sacrosanct, particularly in the event of insolvency. Section 25 of the Segregated Accounts Companies Act provides in material regard as follows (emphasis added):

> "***Application of assets***
> *25 (1) Notwithstanding any statutory provision or rule of law to the contrary, in the winding up of a segregated accounts company the liquidator shall deal with the assets and liabilities which are linked to each segregated account* ***only in accordance with this Act*** *and accordingly the liquidator shall ensure that the assets linked to one segregated account are not applied to the liabilities linked to any other segregated account or to the general account, unless an asset or liability is linked to more than one segregated account, in which case the liquidator shall deal with the asset or liability in accordance with the terms of any relevant governing instrument or contract.*"

18. Any attempt to get behind what is not merely a corporate veil but a statutory "Iron Curtain" separating the various segregated accounts would, it seems to me, have to be justified by reference to the provisions of the Act itself. The sort of provision which might in appropriate factual circumstances be deployed towards this end would include section 18(16) of the Act:

"*(16) Subject to section 17B(1)(c) and (2), the provisions of this section and section 11 operate to the exclusion of any rule of law relating to trusts treating with the same subject matter, and no rule of law relating to trusts may be pleaded by any person to augment or modify the operation of this Act, but nothing in this section shall be construed so as to deny—*

(a) the remedy of tracing in law and in equity the assets or the proceeds of the assets of any segregated account where such assets or proceeds have been commingled with the assets of any other segregated account or the general account; or

(b) any remedies available under the doctrine of constructive trusts or similar equitable remedies where those remedies would otherwise be available."

19. The scheme of the Act is inconsistent with departing from the segregated account scheme in the absence of investor agreement or compelling equitable grounds for so doing.

Apportionment of costs

20. The following direction is sought as regards the apportionment of costs in First Mark W.R. Smith:

"*30. The Court is respectfully asked to consider whether the JPLs should charge the costs and expenses of the liquidation expressly related to this account or whether they should allocate the costs of the liquidation generally on the basis of account value.*"

21. It seems obvious to me that apportioning the liquidation costs to the various accounts based on account value is at the very least arguably reasonable. This does not preclude reconsideration of this issue on an *inter partes* basis should any investors challenge the JPLs' decision to adopt this approach.

Conclusion

22. Unless an application is made within 21 days by letter to the Registrar to be heard as to costs, the JPLs' shall be entitled to their costs of the present application out of the assets of the Companies on an indemnity basis, and in default, out of the assets of the segregated accounts on a *pro rata* basis based on the value of assets attributable to each relevant account.

Dated this 26th day of September, 2011

KAWALEY J