BRITISH VIRGIN ISLANDS
EASTERN CARIBBEAN SUPREME COURT
IN THE HIGH COURT OF JUSTICE
(CIVIL)

CLAIM NO: BVIHCV 2009/0020A

IN THE MATTER OF THE INSOLVENCY ACT 2003 AND THE INSOLVENCY RULES 2005

AND IN THE MATTER OF Y2K FINANCE INC.

BETWEEN:

CITCO GLOBAL CUSTODY NV

Applicant

and

Y2K FINANCE INC

Respondent

Appearances: Mr Simon Browne-Wilkinson QC; Mr Jeffrey Chapman and Ms Arabella di Iorio and Ms Aisling Dwyer of Maples & Calder for the Applicant Citco Global Custody NV
Ms Barbara Dohmann QC; Mr Jack Husbands of Walkers; and Mr Robert Weekes for the Respondent Y2K Finance Inc

JUDGMENT

[2009: 9, 25 November]

(Member's application for the appointment of liquidators on just and equitable grounds – substratum lost – respondent company undertaking to go into voluntary liquidation – application opposed by majority of other investors – whether any investors had become creditors – section 62(2)(c) Business Companies Act, 2004 – exercise of Court's discretion)

[1] Bannister J [ag]: This is an application for the appointment of a liquidator over the respondent, Y2K Finance Inc ('Y2K'). The application has a chequered history and I must set some of it out in order for this judgment to be intelligible.

[2] Y2K is a BVI incorporated company and operated as a Professional Fund within the meaning of the British Virgin Islands Mutual Funds Act, 1996, as amended. It used a

typical hedge fund corporate structure, with investors subscribing for shares and being entitled to redeem those shares in accordance with the provisions of Y2K's Articles of Association. Redemptions were paid out on the familiar Net Asset Value ('NAV') basis and there were provisions in the Articles permitting the directors to suspend the calculation of NAV in certain specified circumstances. Such suspensions, if validly made, would prevent the making of applications to redeem or the further processing of such applications if not completed before the suspension was declared. The applicant, Citco Global Custody NV ('Citco') is a nominee shareholder for various different beneficial owners of shares in Y2K.

[3] Between 25 and 27 July 2007 Y2K received six redemption notices. Five were from the holders of Class A shares and one was from a holder of Class X shares. There is no dispute between the parties that the Articles of Association provide (somewhat ungrammatically) for A shares to be redeemed on the basis of a calculation of NAV made at the end of the calendar month which first occurs after the expiry of 30 days from the giving of the redemption notice. In the case of the A shares the subject of these late July redemption notices, there is again no dispute that Y2K, instead of redeeming them on the basis of NAV calculated at the end of August 2007, as envisaged by the terms of the Articles which I have summarised above, paid them out between 10 and 16 August 2007 on the basis of NAV calculated as at 31 July 2007. I shall refer to these redemptions as ('the early redemptions'). The amounts so paid out to the A shareholders amounted in aggregate to some US$41 million. The amount paid out in respect of the X shares referred to above was some US$9.8 million – making a total paid out between 10 and 16 August 2007 of some US$51 million. I pause to mention that there is a dispute between the parties whether the X shares are redeemable at all. For reasons which will become obvious, it is not necessary for me to resolve that question for the purposes of this decision.

[4] The early redemptions were made out of cash available to Y2K at the relevant time. Subsequently, Y2K realised assets and unwound its positions. On 10 September 2007 NAV was suspended. That remains the position.

[5] On 22 November 2007 a company called Headstart Class F Holdings Limited ('Headstart') commenced proceedings in the High Court claiming that the conduct of the directors of Y2K in authorizing or permitting the early redemptions very shortly summarised above amounted to conduct of the affairs of Y2K in a manner unfairly prejudicial to Headstart ('the unfair prejudice proceedings'). Following the realization that Headstart was not a member of Y2K, the claim was amended to join Citco as a claimant. Citco undoubtedly is a member of Y2K and holds the 8,000 A shares in the capital of Y2K which are in issue in these proceedings for Headstart beneficially. When referring to Citco as applicant I shall refer to it as Citco/Headstart.

[6] On 4 November 2008 Hariprashad-Charles J struck out the unfair prejudice proceedings. Citco/Headstart appealed.

[7] Meanwhile, on 21 May 2008, three days after the argument in the unfair prejudice proceedings had taken place, Citco/Headstart issued an originating application for the appointment of a liquidator to Y2K. The application relied (a) upon the early redemptions and (b) upon alleged loss of substratum as entitling Citco/Headstart to a winding up order. In other words, the liquidator application relied upon substantially the same grounds as were relied upon to support the unfair prejudice proceedings, but in addition relied upon alleged loss of substratum. On 11 November 2008 Y2K applied to strike out Citco/Headstart's liquidator application.

[8] There then followed a series of events which it is unnecessary to go into in any detail for present purposes. They culminated in the issue of a second liquidator application, in substantially the same terms as the first. It is this second liquidator application which is before me for decision.

[9] On 16 January 2009 a consent order was made by Hariprashad-Charles J in the second liquidator application. Its effect was that the second liquidator application was treated as a 'continuation' of the first; that Y2K's application to strike out the first liquidator application was to be treated as an application to strike out the second; that the strike out application

was to be heard after the decision of the Court of Appeal in Citco/Headstart's appeal against the dismissal by Hariprashad-Charles J of its unfair prejudice claim; and that the substantive hearing of the originating application (if still on foot) be heard over 5 days beginning not before 1 June 2009. Importantly, the consent order contained an undertaking by Y2K not to resume the calculation of NAV or permit redemptions. That undertaking remains on foot.

[10] As a result of two subsequent orders of mine Y2K's strike out application was heard on 18 September 2009, despite the fact that the decision of the Court of Appeal in Citco/Headstart's appeal in the unfair prejudice proceedings had yet to be handed down.

[11] I had better now set out the material grounds relied upon in the second liquidator application:

> 'The grounds upon which [Citco/Headstart] seek[s] the order are summarized below and are further set out in the first affidavit of Helen Mulcahy sworn on 21 May 2008:
>
> 1. [not material]
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> 2. Y2K is a BVI company operating as a Professional Fund within the meaning of the British Virgin Islands Mutual Fund Act 1996, as amended. The Applicant is, in its capacity as custodian for Headstart Class F Holdings Limited, an investor in, and member of, Y2K.
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> 3. Y2K was incorporated as a fixed income performance mutual fund, however, Y2K has itself expressed that its life has come to an end and it no longer has any reasonable expectation of meeting its objects as a mutual fund. It is Y2K's intention to realize the last of its assets and to distribute those assets between the remaining members.
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> 4. In July and August 2007, Y2K purported to accept and pay out substantial redemptions in excess of US$50 million notwithstanding Y2K's own admission the redemptions failed to comply with the notice requirement contained in Article 10 of Y2K's Articles of Association.

5. Y2K has indicated that it will distribute its remaining assets to its members and no longer has any prospect of meeting its objectives. Should Y2K be put into voluntary liquidation, it is likely that Y2K's claims in respect of 27 July 2007 redemption will never be investigated or pursued to the detriment of Y2K and accordingly, its members.

6. In all the circumstances, it is just and equitable that a liquidator be appointed over the Company.

[12] My decision on Y2K's strike out application, for which I gave reasons in writing on 24 September 2009, was that the grounds relied upon in paragraph 4 and in the second sentence of paragraph 5 of the second liquidator application be struck out as disclosing no reasonable prospect of success and as being bound to fail. The reasons are set out more fully in the written judgment which I gave on 24 September 2009, but I can summarise them by saying that I took the view that to permit minority shareholders to wind up a company on the basis simply that it had, or might have, claims against its directors and others and which the incumbent board was unlikely to prosecute was something unsupported by authority and inconsistent with the principle of majority rule established in Foss v Harbottle[1].

[13] I refused, however, to strike out paragraph 3 and the first sentence of paragraph 5 (the 'loss of substratum' grounds). The result was that on the substantive hearing of the liquidator application, which took place on 9 November 2009, argument (and evidence) was restricted to that issue.

[14] The only other procedural matter to which I need to refer before turning to consider the arguments of the parties on this issue is that on 19 October 2009 the Court of Appeal reversed the decision of Hariprashad-Charles J striking out the unfair prejudice proceedings. Citco/Headstart is therefore free to prosecute them.

[1] (1843) 2 Hare 461

Factual matters

[15] There is no dispute that the commercial life of Y2K is at an end, in the sense that it does not intend to and will never resume operation as a mutual fund. It appears that Y2K has some 23 investors who have yet to receive redemption payments. There is undisputed evidence that the fund is fully encashed and that it has no creditors. I think that the most up to date evidence before the Court as to Y2K's cash position is that contained in an affidavit sworn on 11 November 2008 by Stephen Dobson, a partner in Speechly Bircham LLP. Relying on information received, he says that as at that date Y2K had cash of some US$6.2 million after the costs of striking out the unfair prejudice claim, but it is likely that this figure will have been substantially eaten into by subsequent litigation costs.

[16] It appears that of the investors who have yet to receive redemption payments, only Citco/Headstart and two other investors have not submitted redemption requests.

[17] It is common ground that Y2K must be wound up. The difference is over the manner by which that is to be done. Citco/Headstart wants a liquidator to be appointed by the Court under section 162 of the Insolvency Act, 2003 ('the 2003 Act'). Y2K says that it wants what it calls a voluntary liquidation. At the same time, Y2K says that the holders of its voting shares propose to pass a qualifying resolution under section 159(2) of the 2003 Act. If they do that, the result will be a liquidation governed by the provisions of sections 175 to 232 of the 2003 Act and the liquidator appointed will be an officer of the Court (see section 184(1) of the 2003 Act). The result would be no different from that which obtains when the Court appoints a liquidator under section 162 of the 2003 Act – in other words, both parties would be contending for an identical outcome. I suspect that Y2K may have formed the erroneous view that simply because section 159(2) permits the appointment of a liquidator to be made by the members, it results, as would a liquidation commenced by a similar route in England, in a voluntary liquidation. A voluntary liquidation of broadly similar effect to one commenced under Chapters II and III of the UK Insolvency Act 1986 can be carried out in the BVI only by making use of Division 1 of Part XII of the Business Companies Act, 2004 ('the 2004 Act').

[18] The more fundamental distinction between what Y2K proposes and what Citco/Headstart seeks to achieve is that under the Y2K proposals its directors will, if Citco/Headstart's application is dismissed (which would release Y2K from its undertaking of 16 January 2009), proceed to distribute the company's cash to investors who have submitted redemption requests by way of redemptions carried out in accordance with Y2K's Articles of Association. Only once that has been done would any liquidation (under whichever regime) be commenced. Given the preponderance of investors who have submitted requests, the obvious outcome of that process would be that there would be little funds left for any liquidator of Y2K, however appointed, to pursue claims against the directors and others whom Citco/Headstart has in its sights.

The Law

[19] There are a number of cases deciding that a member may apply for the liquidation of a company where it has lost its 'substratum.' This is not a term of art and the expression is used to cover a number of different factual situations. First, there must be mentioned those cases where upon an examination of the objects clause in a company's memorandum of association it turns out that the company has no prospect of commencing, or continuing, the business which the objects clause defines. Of the cases cited to me In re Haven Gold Mining Company[2], In re German Date Coffee Company[3] In re the Varieties, Limited[4] and Re Baku Consolidated Oilfields Ltd[5] fall within this category. Other cases which appear superficially similar are not loss of substratum cases in this sense, but applications of specific statutory grounds for winding up which have appeared in United Kingdom Companies and Insolvency Acts from the outset but which do not find express mention in the 2003 Act. In re Middlesborough Assembly Rooms Company[6] was such a case, being founded upon section 79(2) of the Companies Act 1862 on the grounds that the company had suspended its business for more than 12 months. The one year suspension cases are not directly in point, since there is no equivalent legislation in the BVI.

[2] (1881-1882) LR 20 ChD 151,
[3] (1882) 20 Ch D 169
[4] [1893] 2 Ch 235
[5] [1944] 1 All ER 24
[6] (1880) LR 14 Ch D 151

[20] The true loss of substratum cases can have no direct application here, since the objects clause in Y2K's memorandum of association permits it to do anything in the world it wishes, provided that that does not involve a breach of any law of the British Virgin Islands. On one view, at least, it has no object at all[7]. Recent legislation in the United Kingdom has moved in the same general direction as that already in place in the BVI and specific objects clauses are now optional in that jurisdiction[8].

[21] I do not consider that these trends mean that a company without a specific objects clause cannot be wound up on the grounds that its substratum has been lost, simply because it is impossible in such cases for the Court to say, *as a matter of construction of a company's objects clause,* that it is unable to prosecute the business for the purpose of which it was incorporated. In Re Suburban Hotel Co[9] Lord Cairns said, *obiter*:

> ' . . .if it were shown to the Court that the whole substratum of the partnership, the whole of the business which the company was incorporated to carry on, has become impossible, I apprehend that the Court might, either under the Act of Parliament or on more general principles, order the company to be wound up.'

Although *obiter*, that is a powerful statement of general principle of the highest authority. In my judgment where, under modern conditions, it becomes necessary to inquire whether a company's substratum has been lost and where the question cannot be answered by reference to a specific objects clause, the information upon which the decision is to be made must simply be collected from elsewhere.

Application

[22] It seems to me beyond doubt that in the broad sense, the substratum of Y2K has been lost. It cannot resume the business of an active mutual fund, seeking investors and running a fund on their behalf. It accepts that it must go into liquidation.

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[7] Per Harman LJ in **Re Introductions Ltd** [1970] Ch 199 at 201.
[8] Companies Act 2006, s 31
[9] (1867) 2 Ch App 737 at 750

[23] In light of that unarguable fact, the two questions which must be answered are (1) whether grounds are shown why it should be wound up under the supervision of the Court under the Insolvency Act, 2003, rather than voluntarily under the Business Companies Act, 2004 and (2) whether, if the answer to (1) is yes, the opposition of other members or creditors to that course requires that it should not be followed.

[24] In the present case, Y2K's proposal is, as I have said, not merely that it should be wound up, but that before that is put in train suspension of NAV should end and the shares of all requesting investors be redeemed out of the remaining available funds. Mr Browne-Wilkinson QC and Mr Jeffrey Chapman, who appeared together with Ms Arabella di Iorio and Ms Aisling Dwyer for Citco/Headstart characterised the proposed resumption of redemptions as 'a distribution of assets to be carried out by the directors', as if they were proposing some sort of informal and extra-statutory liquidation of their own devising. Although he put the point very persuasively I do not think that that is right. A redemption of the shares of those investors who wish to redeem is not a distribution by way of *ad hoc* liquidation, of the sort which Scott J (as he then was) so deplored in re Perfectair Holdings Ltd [10]. It is wholly different from liquidation both in law and in fact. It is a carrying on, albeit for the last time, of the business of Y2K in accordance with the contractual rights of members under Y2K's Articles of Association. If, after that has been done, there remain investors who do not wish to be redeemed, then liquidation must follow, since the surplus cannot lawfully be distributed in those circumstances except in accordance with the statutory scheme. But while Y2K is solvent (that fact is not challenged), it seems to me that there is nothing in the authorities which suggests that it would be a proper exercise of discretion for the Court to step in and shut the company down while it remains in a position to carry out the last of its commercial functions for the benefit of those of its investors who have requested that it should do exactly that.

[25] Perfectair is not authority to the contrary. The realisations being made and proceedings being prosecuted in that case were not being made and prosecuted in accordance with a procedure laid down in that company's articles of association. Members of Y2K who wish Y2K to be permitted to redeem their shares are not initiating any sort of informal

[10] [1990] BCLC 423

liquidation. Where redemption requests are made directors who comply with them are not informally carrying out a preliminary, or any, process of liquidation. They are giving effect to Y2K's obligation to meet redemption requests. If the directors were to ignore existing requests and instead arrange for Y2K to be placed into liquidation, they would, in my judgment, be in breach of duty. Equally, it seems to me that it would be wrong for the Court to appoint a liquidator until after that duty had been performed.

[26] It seems to me that there is a further consideration which should be taken into account. All of the substratum cases have underlying them the fact that if the company is not wound up, shareholders either cannot recover whatever money of theirs might be left in the company or, worse, risk having it squandered on ventures to which they never assented. In the case of a mutual fund such as the present there exists machinery whereby investors can redeem their shares without the need for the company to be placed into liquidation first. I appreciate that in the present case Citco/Headstart wishes to remain a member for the purposes of its unfair prejudice proceedings, but that does not affect the point of principle, which is that liquidation is not the only avenue by which Citco/Headstart can retrieve the current value of its shareholding. Its unfair prejudice proceedings meanwhile, are the proper setting in which its complaints about the early redemptions can be advanced.

[27] In my judgment, therefore, Citco/Headstart has not established that it is just and equitable for the Court to appoint a liquidator to Y2K.

[28] That makes it unnecessary for me to consider the expressions of wishes which have been made by investors in relation to this application. But careful submissions were made to me on this issue and I think that I should at least indicate my views, even if they are necessarily *obiter*. A substantial number of investors have informally expressed their views on this application. It is true that none of them has appeared to support or oppose the application and I have been troubled, in those circumstances, about the weight which should be given to any of their views. In the end, however, I have come to the conclusion that I should take the investors views into account.

[29] Although In re JD Swain Limited[11] and other cases were cited to me, I do not think that the authorities on the approach to be taken where a creditor seeks a compulsory winding up when a voluntary winding up is already in progress have any relevance to this case. The creditors winding up cases are not in point because they start from the position that an unpaid creditor is entitled *ex debito justitiae* to an order unless other circumstances persuade the court that some alternative (such as the continuation of an existing voluntary winding up) is to be preferred. There is no similar presumption where members petition on just and equitable grounds.

[30] Nevertheless, it seems clear from the old 'substratum' cases which were cited to me that, regardless whether a winding up is already in progress, the views of the majority as to whether or not the company should remain alive carry very considerable weight: see In re City and County Bank[12] and In re Middlesborough Assembly Rooms Company[13]. In the present case there are some 23 investors remaining in the fund. Of these, eighteen have submitted redemption requests; one has submitted a redemption request in respect of some only of its shares; and the remaining four, including Citco/Headstart, have submitted no redemption request.

[31] Bearing in mind that two of the outstanding redemption requests were submitted by Class A shareholders in time for their shares to be redeemed as at 31 August 2007 and bearing in mind also that calculation of NAV was not suspended until 10 September 2007, it seemed to me that those who did submit timely requests might have acquired status as creditors, rather than members of the fund. If that was so, it might be the case that any accrued entitlement which they might have against the fund meant that the assumption on which the application has proceeded, that all remaining investors have an equal interest in the assets available for redemptions, would not be valid.

[32] Since the hearing I have received helpful written submissions on this point. For the purposes only of attempting to assess the relative strengths of the opinions of investors in deciding this matter, and bearing in mind that (apart from Citco/Headstart) no investor has

[11] [1965] 1 WLR 909
[12] (1874-75) LR 10 Ch App 470
[13] (1880) LR 14 ChD 104

had the opportunity to make any representations on this point, I have provisionally formed the view that those who gave sufficient notice for the dealing day falling at the beginning of September 2007 acquired creditor status on that day.

[33] It seems clear to me on the language of Y2K's Articles of Association, that in ordinary circumstances an investor which submits a valid redemption request will have redeemed (and therefore changed its status to that of creditor – see section 62(2)(c) of the 2004 Act) on the dealing day next following the expiration of the applicable notice period: see Articles 10(a) and 10(g), which make clear that the redemption is "effected" or "made" on the next available dealing day. The price will ordinarily be determined by reference to NAV calculated as at close of business on the valuation day next preceding the relevant dealing day: see Article 10(2).

[34] In the present case, calculation of NAV was suspended on 10 September 2007, before NAV for the valuation day at the end of August had been determined. Article 11(1) provides that NAV shall be calculated as at the close of business on each valuation day, unless determination of NAV has been suspended. Article 11(6) provides that where determination of NAV has been suspended, there shall be no determination of 'the Net Asset Value per share of the Fund' until the directors shall declare the suspension to be at an end. It seems to me that these provisions, taken together, mean that where determination of NAV has been suspended but no calculation of NAV has been made in respect of an outstanding valuation day, calculation of NAV for any outstanding valuation day falls away, to be replaced by the first calculation made after the end of the suspension. In other words, the determination of the Net Asset Value of the fund envisaged by Article 11(6) is of the fund as it stands at the end of the period of suspension, not at some earlier date. If it were not so, where calculation of NAV had been suspended on the grounds of impossibility or because a relevant market was closed, the directors would be obliged to go through a charade. It is true that this construction does some violence to the language of Article 10(2), but it seems to me that that Article must be read as subject to the suspension provisions of Article 11.

[35] If therefore it had become necessary for me to assess the value of support for and opposition to this application, I would have concluded that those investors who submitted requests in time to catch the early September redemption day are creditors of the fund, but that their interests in it are identical to those of the other investors who subsequently submitted redemption requests. In the case of the latter, the clear provisions of Article 10(1)(g) require their interests to be valued after suspension has ended.

[36] On that basis, members entitled in respect of around 50% of the funds available for distribution, together with a creditor interested in a further 14.5%, have indicated their opposition to this application; members interested in some 19% of the fund, together with one creditor with an interest in some 3.5% have indicated their support. These figures show that a substantial majority of those interested in the fund oppose the application.

[37] If I had not been satisfied that there are no sufficient grounds for winding up in this case, I would have concluded that the weight of opposition to the application was enough to persuade the Court not to make the order sought. However, I refuse this application on the grounds that no sufficient case has been made out for winding up.

[38] The voting shareholders of Y2K have offered an undertaking to the Court that once the existing redemption requests have been complied with, Y2K will be put into liquidation (although, as I have said, there appears to be some confusion as to the precise route envisaged). I am not prepared to accept an undertaking in that form, since it is not for the Court to police matters of this sort and it does not seem to me that proceedings for contempt are appropriate methods of enforcement in situations of this type. I shall merely give an indication that if it turns out that Y2K is not wound up timeously after the redemption requests have been dealt with, an application to have it wound up by a remaining member would be granted as a matter of course.

Commercial Court Judge

25 November 2009