24/8/10

IN THE GRAND COURT OF THE CAYMAN ISLANDS
CAUSE NO. 551 AND OF 2007
CAUSE NO. 552 OF 2007

IN THE MATTER OF THE COMPANIES LAW (2007 REVISION)

AND IN THE MATTER OF BEAR STEARNS HIGH GRADE STRUCTURED CREDIT STRATEGIES (OVERSEAS) LTD. (IN VOLUNTARY LIQUIDATION)

IN CHAMBERS
BEFORE THE HON. ANTHONY SMELLIE, C.J.
THE 22ND FEBRUARY 2008

APPEARANCES: Mr. Francis Treagear QC instructed by Mr. Jeremy Walton of Appleby for the investors of Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage (Overseas) Ltd. and Bear Stearns High Grade Structured Credit Strategies (Overseas) Ltd.

Mr. Barrie of Nelson & Co. for Walkers SPV with

RULING

1. I have before me Ordinary Applications brought in these Causes by the Investors in Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage (Overseas) Ltd ("HGEL") and Bear Stearns High Grade Structured Credit Strategies (Overseas) Ltd. ("High Grade") respectively.

2. HGEL and High Grade are both exempted limited liability companies organized and incorporated under the Companies Law of the Cayman Islands (hereinafter together referred to as "the Companies"). Both have been placed into voluntary liquidation by resolutions of the members holding their ordinary voting shares. Both were promoted and managed by Bear Stearns Asset Management Inc. ("BSAM") as their investment manager.

3. These ordinary applications are based on petitions now before the Court seeking directions that the voluntary liquidations shall continue under the supervision of the Court.

4. The relief sought by the Investors are of varying and alternative kinds.

5. In both the HGEL and High Grade applications, the first relief sought are orders setting aside the resolutions purportedly passed by the ordinary shareholders of the Companies respectively in General Meetings on 1st November 2007 to appoint Simon Whicker and Kris Beighton of KPMG as Joint Voluntary Liquidators ("JVLs")of the Companies. These are the resolutions aforementioned by which the Companies were placed into voluntary winding up.

6. This first head of relief required a trial of factual allegations of a very serious and troubling nature going to the central issue of whether or not the powers to pass the resolutions by which the Companies were placed into voluntary liquidation were exercised for an improper purpose and if so, whether those powers were exercised in breach of the fiduciary duties and obligations owed to those persons having the real financial interests in the Companies. These persons are the Investors who are the participating shareholders and now the respective Applicants in this matter.

7. The "improper purpose" specifically alleged is to the effect that the ordinary voting shareholders (Walkers SPV as trustees of the STAR Trust that holds the ordinary voting shares) resolved to place the Companies into liquidation in order to stymie a removal petition notified by the participating shareholders to be voted on by them for the removal of the directors of HGEL (who are certain officers of BSAM and Walkers Fund Services) and to replace them with directors of their

own choosing and whom the participating shareholders intended to require to investigate the massive losses which they had been told had been suffered by the Funds of the Companies.

8. In short therefore, that the resolutions for voluntary liquidation were steps taken by the Walkers directors and by the Trustee (Walkers SPV) at BSAM's behest and for BSAM's benefit and not in the interests of the only persons whose interests at that stage mattered; that is: the Investors.

9. The relevant background to these allegations has been canvassed in some detail over the past three days and there has been extensive cross-examination of an officer respectively of Walkers Fund Services (Mr. Scott Lennon) and of Walkers SPV (Mr. David Egglisham).

10. For reasons which I need not elaborate now (but will be prepared to elaborate if asked) one is led to the an irresistible impression that the manner of the conduct of the directors, trustee and the lawyers advising them over the ordinary shareholders' resolutions for winding up, was clandestine and suspicious and was certainly in breach of the strict prohibition in the STAR Trust, against such resolutions being taken during the pendency of the participating shareholders' petitions for the removal of the directors.

11. The only issue that separates this impression that I have formed from an outright and firm conclusion that the resolutions were "not taken bona fide in the interests of the Companies" is the further requirement of a positive finding of actual knowledge of the improper purpose on the part the Walkers SPV trustee; in this instance, in the person of Mr. David Egglisham. This is although I have formed

the view that even in his case, there are also highly suspicious circumstances from which the necessary *scienter* might well be inferred, if one were obliged to put that issue to the test.

12. I do not do so now for two reasons:

13. First, among the various alternative kinds of relief sought by the Investors, it seems to me that a finding that the winding up resolutions are invalid – to which a finding of improper purpose would lead – would be the outcome least advantageous to them.

14. This is because, whatever may have been the true financial position of the Companies on 1st November 2007 when the impugned resolutions to wind up were taken, the Companies have now lost their substratum and so, on the just and equitable basis, are liable to being wound up in any event.

15. Thus, the real question now is not whether the Companies must be wound up but rather how best, in the context of their winding up, to secure the interests of those having the real financial stake in the outcome; that is again: the interests of the Investors.

16. My second reason is that however improbable it may seem from all the circumstances that Mr Egglisham did not have actual knowledge of the petition for removal of the directors; a conclusion that he in fact had that knowledge is one which I could now arrive at only as a matter of inference. While I would be entitled to consider all the evidence in that regard if compelled to decide the question of the invalidity of the winding up resolution, I am not so bound to do if,

as a matter of discretion, I consider as I do, that another form of relief would be in the best interest of the Investors.

17. The attribution of the directors' knowledge to the trustee is perhaps another route by which the conclusion of invalidity could have been reached, but as a legal concept the principles are not free from difficulty if, as here, attribution of knowledge would have to be made by disregarding the separate legal corporate identities of the entities within which the trustee and directors operated.

18. The conclusion at which I have arrived is that the resolutions should remain but the JVLs should be required to step aside in deference to other liquidators of the Investors' choosing and who will enjoy the confidence of the Investors.

19. By this conclusion, I wish to emphasise that no suggestion of impropriety, collusion or incompetence on the part of the JVLs themselves is intended. On the contrary, all parties have been keen to acknowledge the high reputation of KPMG and of its nominated officers who are involved here.

20. The problem as I see it is primarily the potential conflict of interest facing the JVLs in their dual capacity as liquidators of these feeder funds (HGEL and High Grade) and of the insolvent Master Funds as well.

21. In that latter capacity, their primary obligations must be regarded as being owed to the creditors of the Master Fund.

22. Already some $600 million in creditor claims have been anticipated in the Master Fund liquidation as against assets in hand of only some $50 million.

23. To the extent that the Investors in the HGEL and High Grade Feeder Funds will have claims against the Master Fund, its promoters and investment managers –

here BSAM – it is clear that the primary obligation of the JVLs of the Master Fund would not be to the Investors but to the creditors.

24. A clear implication of all this is that the costs of the investigation and prosecution of claims arising from the losses suffered by the Feeder Funds will have to be borne at least in the first instance by the Investors of the Feeder Funds (HGEL and High Grade).

25. Better then, from their point of view, that if they must fund the liquidation with the hope to recovery of any of their huge losses of equity (in the order of $600 million) they should be able to do so through liquidators in whom they have full confidence will be committed to securing their own interests.

26. While BSAM has provided initial funding of $1.25 million to the JVLs as a pre-condition to the JVLs' acceptance of their initial appointment, I am told that less than half that amount remains in the estate of HGEL and High Grade. And it is to be expected that the Master Fund's cash-in-hand will be available to fund the winding up of HGEL or High Grade. Any of its recoveries, as already mentioned, would be first pledged to the creditors of the Master Fund which is hugely insolvent. There is, moreover, no basis for expecting that BSAM, which sought the appointment of the JVLs, will be prepared to fund the JVLs' efforts to any further extent, especially because BSAM will itself likely be a target of the investigations to be undertaken.

27. The allegations to be investigated on behalf of the Investors include – as manifestations of fraudulent breach of duty – that BSAM generated and relied upon erroneous NAV calculations and that BSAM "warehoused", or

"dumped" unrealisable ungraded investments (so-called sub-prima debt) in HGEL and High Grade.

28. If such allegations are to be investigated, it is understandable that those having the real economic interests would wish to be assured that they will be undertaken in an entirely independent, impartial and unfettered manner. And, in this regard, the perceptions are as important as the realities.

29. I consider that in all the circumstances of this case there are proper grounds (within the meaning of the case law – see ***In Re Parmalat 2004-05 CILR 22***) for the removal and replacement of the JVLs.

30. That, for the reasons explained, is the aspect of the relief sought by the Investors in their ordinary applications which I now grant.

GRAND COURT CAYMAN ISLANDS

Hon. Anthony Smellie
Chief Justice

22nd February 2008

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