

HONORABLE RICHARD A. JONES

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

SEATTLE CITY EMPLOYEES'
RETIREMENT SYSTEM,

Plaintiff,

v.

EPSILON GLOBAL ACTIVE VALUE
FUND II, L.P., et al.,

Defendants.

CASE NO. C10-555RAJ

ORDER

I. INTRODUCTION

This matter comes before the court on the motion (Dkt. # 12) of Plaintiff Seattle City Employees' Retirement System ("SCERS") for a preliminary injunction. The court has twice heard oral argument from the parties: once on April 2, 2010 and again on April 29. For the reasons stated below, the court DENIES the motion. Because this order "grant[s] or den[ies] an interlocutory injunction," findings and fact and conclusions of law are required. Fed. R. Civ. P. 52(a)(2). The court's findings and conclusions are included in this order, which serves as a memorandum of the court's decision. Fed. R. Civ. P. 52(a)(1) (permitting findings and conclusions to be contained within "an opinion or a memorandum of decision filed by the court"); *see also* *FTC v. H. N. Singer, Inc.*, 668 F.2d 1107, 1109 (9th Cir. 1982) (noting that explicit factual findings are unnecessary).

1 **II. BACKGROUND**

2 SCERS is a pension fund for employees of the City of Seattle. In 2003 and 2004,
3 it made two separate investments of \$10 million dollars in a fund controlled by
4 Defendants.

5 SCERS invested in Epsilon II, a fund controlled by Defendant Epsilon Global
6 Active Value Fund II, Ltd. a British Virgin Islands corporation. A Confidential Offering
7 Memorandum (the “Offering Memo”) stated the terms of SCERS’ investment.¹ Epsilon
8 II was a “feeder” fund that was expected, but not required, to invest all of its resources in
9 a “master” fund, Defendant Epsilon Global Master Fund II, L.P., a Cayman Islands
10 limited partnership. Offering Memo at 1 (“[T]he [Epsilon II] Fund is authorized to invest
11 outside of the Master Fund, although it does not currently anticipate that it will do so.”).
12 The master fund’s general partner was Defendant Epsilon Global Asset Management
13 Ltd., another Cayman Islands entity. The “investment manager” for Epsilon II was
14 Defendant Epsilon Investment Management, LLC, a Delaware entity. Defendant Steven
15 Stevanovich was a director, officer, or otherwise held a controlling interest in each of
16 these entities. The court will refer to the Defendants collectively as Epsilon II, except
17 where clarity demands otherwise.

18 Epsilon II’s use of SCERS \$20 million was, by design, shrouded in relative
19 secrecy. Epsilon II had broad investment objectives, could invest its resources wherever
20 management chose, and investors had no opportunity to review those investments.
21 Offering Memo at 11 (“The Memorandum and Articles of Association of the Fund do not
22 restrict the type of investments the Fund may make.”), at 13 (“The Directors have broad
23 discretion to expand, revise or contract the Fund’s business. The investment strategies of
24 the Fund may be altered without prior approval by, or notice to, the investors . . .”). Its
25 investment manager was authorized to operate under numerous undisclosed conflicts of

26 ¹ Epsilon II periodically updated the Offering Memo. No one disputes that the January 1, 2009
27 version controls in this dispute. It is found at Exhibit C to the declaration of Cecelia Carter (Dkt.
8-6) and at Exhibit F to the declaration of Joseph McMillan (Dkt. # 30).

1 interest. Offering Memo at 13-14. Investors were given only limited access to
2 information on Epsilon II's activities. Epsilon II's only disclosure obligations were to
3 provide an annual report containing an "audited financial statement," as well as quarterly
4 reports "describing the Fund's activities in such detail, as the Fund, in its sole discretion,
5 shall determine." Offering Memo at 2.

6 It was Epsilon II's failure to provide a 2008 annual report and audited financial
7 statement that precipitated this litigation. Those documents should have come within 120
8 days of the end of 2008 (Offering Memo at 2), although in prior years they had arrived as
9 late as July. Eventually, SCERS began to inquire about the late documents. It received
10 no satisfactory answer, and by January 2010, it decided to redeem its investment in
11 Epsilon II. Carter Decl. (Dkt. # 8-6), Ex. F (Jan. 28, 2010 redemption request).

12 On February 4, 2010, Mr. Stevanovich issued a letter to Epsilon II investors.
13 Bergan Decl. (Dkt. # 29), Ex. A. The letter stated that "we are temporarily suspending
14 the redemption of shares" in Epsilon II and two other funds. *Id.* Mr. Stevanovich noted
15 that the funds had not yet received audited financial statements for 2008 from
16 PriceWaterhouseCoopers ("PWC"), its designated auditor. *Id.* The stated reason for the
17 delay was that the Westford fund, another fund managed by interests controlled by Mr.
18 Stevanovich, was under investigation by the SEC. *Id.*

19 After receiving the memorandum, SCERS officials attempted to negotiate at least
20 a partial redemption of their shares. They were unsuccessful.

21 On March 15, SCERS sued the Defendants in King County Superior Court. Their
22 complaint was entitled "COMPLAINT FOR INJUNCTIVE RELIEF." True to its billing,
23 the complaint sought no damages. Instead, it contended that Epsilon II had breached its
24 contract to provide a 2008 annual report and audited financial statement. It also claimed
25 that the same omission violated the British Virgin Islands Business Companies Act of
26 2004. These were the only substantive causes of action in the complaint. The other
27 claims merely requested injunctive relief without reference to substantive law.

1 Upon filing its complaint, SCERS sought an ex parte temporary restraining order.
2 On March 16, the state court issued an amended ex parte temporary restraining order (the
3 “TRO”) with five terms. It required Defendants to produce a 2008 report and audited
4 financial statement and to produce the 2009 report and statement when they came due on
5 May 1, 2010; if audited statements did not exist, it mandated the production of “all
6 underlying documents provided to Epsilon II’s auditor,” PWC; it ordered third parties
7 (including PWC and several of Epsilon II’s brokers and administrators) to produce
8 financial information; it ordered Epsilon II to “cease from taking any action harmful to
9 Plaintiff’s position as an investor in Epsilon II and/or its investment in Epsilon II; and it
10 ordered Epsilon II to “cease from paying any management fee to Epsilon Management, or
11 any other entity, while redemptions are not being permitted from Epsilon II.” TRO (Dkt.
12 # 8-10). The court also set a hearing on an order to show cause why a preliminary
13 injunction should not issue. Before that hearing occurred, Defendants removed the action
14 to this court, invoking diversity jurisdiction.

15 Defendants filed their notice of removal March 31; this court held its first hearing
16 on April 2. SCERS took the position that the court should issue a preliminary injunction
17 essentially identical to the TRO. After the court heard argument from SCERS’ counsel,
18 counsel for Defendants took the podium and began making a series of proposals
19 regarding information Defendants would provide to SCERS. The court took a recess so
20 that the parties could discuss the proposals. When the court resumed the hearing, the
21 parties announced that they had reached a series of agreements. They agreed to adjourn
22 the hearing until later in April, with the hope that Defendants’ disclosures might resolve
23 or at least narrow their disputes. The court issued an order (Dkt. # 15) acknowledging
24 their agreements, and declaring that the “TRO has no further effect,” while “specifically
25 declin[ing] to dissolve or vacate The TRO at this time.”

26 In the days following the first hearing, Defendants made a series of disclosures to
27 the court indicating that they were disclosing documents to SCERS. At this point, no one

1 disputes that Defendants have produced *unaudited* 2008 and 2009 financial statements, a
2 financial statement as of the end of January 2010, 2006 and 2007 statements for the
3 Epsilon II master fund, information about Epsilon II's investors, and a statement of
4 Epsilon II's investments in various financial sectors.

5 In response to a court order for supplemental briefing, SCERS asked for a new
6 preliminary injunction. It asked the court to bar "Defendants from paying themselves any
7 sort of management fee in connection with the management" of either the Epsilon II
8 feeder fund or the master fund. Pltf.'s Supp. Br. (Dkt. # 25) at 2. It also asked the court
9 to require Defendants to disclose names and contact information for all undisclosed
10 investors in Epsilon II², the names and contact information for Epsilon II's directors and
11 officers, and "documents memorializing [Epsilon II's] investment in [the Epsilon II
12 master fund] and/or Westford Special Situations fund." *Id.*

13 III. ANALYSIS

14 To win an injunction, SCERS must "establish that [it] is likely to succeed on the
15 merits, that [it] is likely to suffer irreparable harm in the absence of preliminary relief,
16 that the balance of equities tips in [its] favor, and that an injunction is in the public
17 interest." *Winter v. Natural Resources Defense Council, Inc.*, 129 S.Ct. 365, 374 (2008).

18 A. Success on the Merits

19 The court begins by assessing SCERS' likelihood of success on the merits. In
20 doing so, the court must remain focused on the claims SCERS raised in its complaint.
21 Those claims are not claims of mismanagement or fraud, they are claims for failure to
22 produce an annual report and audited financial statement. Both in oral argument and in
23 its briefs, SCERS has suggested that Defendants mislead at best, and defrauded at worst.
24 The court need not take a position on those allegations, whatever their merits, because

25 ² Defendants have already disclosed that SCERS' investment constitutes the vast majority of
26 Epsilon II's assets. They have also disclosed that there are only four other investors in the fund,
27 one of whom is an entity that Mr. Stevanovich controls. Defendants have declined to disclose
the other three investors, but represent to the court that they are attempting to obtain those
investors' consent to disclose their identities to SCERS.

1 SCERS has not sued based on those allegations. It has sued based on breach of an
2 obligation to provide an annual report and financial statement.

3 **1. Request for Injunction Requiring Additional Disclosures**

4 SCERS is quite likely to succeed on the merits of its claim that Defendants
5 breached their agreement to provide a 2008 annual report and audited financial statement.
6 There is no dispute that Defendants have not met that obligation. Their only defense is
7 that they cannot provide an audited financial statement because PWC will not complete
8 the audit. SCERS counsel repeatedly noted at oral argument that there is no evidence
9 from PWC on this subject, but the court would expect nothing less. PWC is not a party to
10 this litigation. The Offering Memo discloses that PWC will serve as Epsilon II's auditor.
11 Defendants apparently employ a PWC office in the Netherlands, which is apparently a
12 Dutch entity over which PWC's United States offices have no control. The court uses the
13 term "apparently" because there is nothing in the record to reflect SCERS efforts to
14 obtain discovery from PWC. The court relies solely on SCERS' counsel's statement at
15 oral argument that he had attempted to subpoena PWC's United States and Netherlands
16 offices without success. Similarly, SCERS could have served discovery on Defendants
17 seeking information about their communication with PWC. It has not done so, despite
18 the April 2 order's authorization to "commence discovery in this action immediately."

19 Thus, on the record before the court, Defendants have breached their agreement to
20 provide an audited financial statement, but no order of the court can cure that breach.
21 Defendants cannot be compelled to produce documents that do not exist, and the entity
22 with the power to create the documents is not a party to this litigation.

23 In lieu of disclosure of the unaudited financial statement, SCERS seeks disclosure
24 of documents identifying investors in Epsilon II, Epsilon II's directors and officers³, and
25 information about Epsilon II's investment in the Westford fund. Yet SCERS fails to

26 ³ Defendants made a binding promise at oral argument to provide SCERS with the names and
27 contact information of Epsilon II's officers and directors. This promise moots SCERS request
for an injunction requiring these disclosures.

1 explain how this request relates to the claims it raises in its complaint. Even if it
2 succeeds on those claims, it is not entitled to these documents. Neither the Offering
3 Memo nor British Virgin Islands law, the sole sources of substantive law to which
4 SCERS points, gives rise to any right to these documents. SCERS fails to explain why
5 the court should use its equitable power to force Defendants to provide documents that
6 they need not provide even if SCERS prevails in this suit.

7 SCERS suggests that in lieu of the audited financial statement to which it is
8 entitled, it should receive a reasonable equivalent. Even if the court agrees with SCERS,
9 however, it is apparent that SCERS has already received a reasonable equivalent.
10 Defendants have voluntarily produced unaudited financial statements as well as a variety
11 of supporting information. SCERS does not explain why these documents are
12 inadequate, or explain why disclosure of investor names and information on the Westford
13 investment are necessary.

14 The court concludes that it must deny SCERS' request for an injunction requiring
15 additional disclosures for the simple reason that even if SCERS prevails in this suit, it is
16 not entitled to those disclosures. At oral argument, SCERS counsel frequently insisted
17 that SCERS had a right to more transparency. While Epsilon II's conduct certainly
18 suggests a need for transparency, the court cannot overlook that SCERS did not contract
19 for transparency. Instead, it invested \$20 million in a foreign investment vehicle that by
20 its own terms provided for only minimal transparency. The court's equitable powers do
21 not permit it to transform SCERS' investment into the investment it perhaps now wishes
22 it had made.

23 **2. Request for Injunction Prohibiting Payment of Management Fees**

24 The only remaining portion of SCERS' requested injunction is a provision barring
25 Defendants from paying themselves "any sort of management fee" in connection with the
26 management of either the Epsilon II feeder fund or the master fund. Unlike SCERS'
27 other requests, this one has an arguable basis in the Offering Memo. The Offering Memo

1 twice provides that Epsilon II “will not charge management fees” in the event that it fails
2 to promptly satisfy a redemption request. Offering Memo at 4, 19. This provision is
3 found in two sections of the Offering Memo, both entitled “Redemption Procedure.” *Id.*
4 The earlier “Redemption Procedure” provision is repeated almost verbatim in the later
5 “Redemption Procedure” provision. The earlier provision, however, notes that the “Fund
6 has the power to suspend the redemption of shares,” and directs readers to the later
7 provision for more information on the suspension process. Offering Memo at 4. The
8 court thus relies on the later “Redemption Procedure” provision, as it fully discloses the
9 intricacies of the redemption process. Offering Memo at 19-20. An investor must make
10 a redemption request at least 45 days before the end of a calendar quarter. *Id.* If the
11 investor does so, the final day of the calendar quarter becomes the “Redemption Date,”
12 and payments are typically made within 30 days after the Redemption Date. *Id.* SCERS
13 made its redemption request on January 28, 2010; its Redemption Date was thus March
14 31, 2010. On February 4, however, Epsilon II notified investors that it was “temporarily
15 suspending the redemption of shares” Bergan Decl. (Dkt. # 29), Ex. A. It explained
16 that the decision was motivated, among other things, by a “concern . . . regarding the
17 persistence and possible intensification of credit market dislocation and volatility.” *Id.* It
18 noted that the decision was “reached after painstaking consideration on the part . . . of
19 each [fund’s] Board of Directors . . .” in a reflection of their “dedication to the best
20 interests of the Funds and their investors,” and a “conviction that these decisions will best
21 serve those interests.” *Id.*

22 The authority to suspend redemption of shares is found in the Offering Memo.
23 Among other things, Epsilon II can suspend redemption “[d]uring any state of affairs
24 which, in the judgment of the Directors, would render disposition of the Fund’s assets
25 impracticable or be seriously prejudicial to the Fund’s Shareholders.” Offering Memo at
26 19-20. Epsilon II has a separate power to delay, rather than suspend, share redemption:
27

1 [U]nder conditions of market turmoil in which, in the judgment of the
2 Investment Manager, the Fund is unable to liquidate portfolio positions in
3 an orderly manner to meet redemptions, the Fund may in its sole discretion
4 delay, in whole or in part, payment of the Redemption Price for longer than
5 thirty (30) days and/or pay the Redemption price in two or more stages.
6 With respect to assets representing any part of the Redemption Price not
7 paid within thirty (30) days of the redemption date, the Fund will not
8 charge management fees and will pay interest at the rate paid by the Fund's
9 prime broker on the Fund's cash balances.

7 Offering Memo at 4, 19. The portion of the Offering Memo that permits suspension of
8 share redemption comes after this provision, and includes no similar language with
9 regard to the payment of management fees. The court thus concludes that the plain
10 language of the contract dictates that management fees are impermissible only in a delay
11 of share redemptions, rather than a suspension.⁴

12 In these circumstances, the court can only conclude that Epsilon II "suspended,"
13 rather than "delayed" the redemption of shares. This is in part because Epsilon II
14 explicitly declared that it was suspending redemption in Mr. Stevanovich's February 4
15 letter. Epsilon II's choice of words is not necessarily dispositive. The court also
16 considers, however, that Epsilon II's declaration that suspension was in the best interests
17 of shareholders more resembles the Offering Memo conditions that permit a suspension
18 rather than a delay of redemption. In addition, Epsilon had no need to announce a delay
19 of share redemptions until 30 days after the March 31 redemption date, further
20 reinforcing that its decision on February 4 was a suspension of redemptions, not a delay.

21 Because Epsilon II suspended, rather than delayed, redemption of shares, the
22 Offering Memo does not prohibit the payment of management fees. The court therefore

23
24 ⁴ In this order, the court relies on the plain and unambiguous language of the Offering Memo to
25 interpret it. In doing so, the court acknowledges that on the record before it, it seems most likely
26 that British Virgin Islands law governs interpretation of the Offering Memo. SCERS devotes no
27 attention at all to this choice-of-law question; Defendants appear to simply assume that British
28 Virgin Islands law applies, and offer the declaration of Andrew Thorp, a solicitor licensed in the
British Virgin Islands, as to the substance of that law. For purposes of this order, the court has
interpreted the Offering Memo in accordance with its plain meaning, assuming that the same
interpretation would obtain under any potentially applicable body of law.

1 concludes that SCERS is not likely to succeed on the merits of its claim regarding
2 payment of the management fee.

3 **B. Irreparable Harm**

4 In the court's view, the findings of the previous subsection mean that it need not
5 consider the remaining requirements for injunctive relief. The court remarks, however,
6 that SCERS has not demonstrated irreparable harm. As to the payment of the
7 management fee, this would appear to be a harm that money damages can remedy.
8 SCERS offers no argument to the contrary. As to the failure to disclose investor names
9 and information on the Westford investment, SCERS has not described what irreparable
10 harm will befall it if it does not receive those documents.

11 It appears to the court that the harm SCERS seeks to prevent is the further
12 dissipation of its investment in Epsilon II. Defendants' actions have given SCERS reason
13 for concern in this regard. This harm, however, even if were irreparable, does not arise
14 from Epsilon II's failure to disclose annual reports and audited financial statements. It
15 arises from Defendants' alleged mismanagement of SCERS investment, a wrong for
16 which SCERS has not sued. Without a nexus between the harm claimed and the claims
17 raised in the suit, the court cannot award injunctive relief. *See Stanley v. U. of S. Cal.*, 13
18 F.3d 1313, 1324 (9th Cir. 1994).

19 **C. Vacating the TRO**

20 Defendants ask the court to vacate the TRO, at least to the extent that it prohibited
21 Defendants from engaging in "any action harmful to Plaintiff's position as an investor in
22 Epsilon II" As noted, the TRO ceased to have effect as of this court's April 2 order.
23 Whatever the merits of Defendants' claim that the TRO's prohibition on "harmful"
24 conduct was unlawfully vague, Defendants have failed to identify any live controversy
25 over the TRO. There is no suggestion that Defendants violated the TRO while it was in
26 effect. Absent evidence of a dispute over Defendants' compliance with the TRO, the
27 court declines to issue a purely advisory opinion as to its validity.

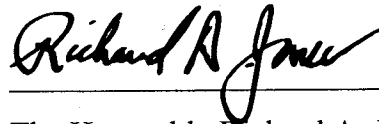
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IV. CONCLUSION

For the reasons stated above, the court DENIES SCERS' motion for a preliminary injunction (Dkt. # 12).

It is not certain what remains of this lawsuit in the wake of this order. SCERS' complaint seeks only injunctive relief. SCERS' effort to obtain preliminary injunctive relief has been unsuccessful. Given the court's ruling today, it seems unlikely that a trial or other disposition of the merits of this suit would give rise to a right to permanent injunctive relief. The court thus directs the parties to meet and confer and, no later than May 28, 2010, provide a joint statement regarding the future course of this action. Among other things, they should inform the court whether discovery or a trial are appropriate. To the extent the parties disagree, they shall explain their disagreements in the joint statement.

DATED this 11th day of May, 2010.



The Honorable Richard A. Jones
United States District Judge

Ditlevson, Roxann (Perkins Coie)

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United States District Court for the Western District of Washington

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