

RULINGS > PRODUCT

Harbour Fund II GP Limited

Issued: 26 January 2021

BR Prd 21/01

The Arrangement is the receipt by Harbour Fund II Limited Partnership (Fund) of proceeds under individual funding agreements that the Fund will enter into with litigation claimants to a class action against James Hardie New Zealand and the other James Hardie entities. Under this Arrangement, the Fund agrees to pay all legal and other costs the claimants incur in respect of their claim, in return for a share of the proceeds.

START DATE – END DATE

24/10/2020 – 23/10/2025

(THIS TITLE PAGE DOES NOT FORM PART OF THE RULING.)

Product Ruling – BR Prd 21/01

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of person who applied for the Ruling (the Applicant)

This Ruling has been applied for by Harbour Fund II GP Limited.

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of ss BD 1(4) and (5) and BG 1, and the definition of “interest” in s YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the receipt by Harbour Fund II Limited Partnership (the Fund) of proceeds (Proceeds) under individual funding agreements that the Fund will enter into with litigation claimants (Claimants) to a class action against James Hardie New Zealand and the other James Hardie entities, under which the Fund agrees to pay all legal and other costs the Claimants incur in respect of their claim (Claim), in return for a share of the Proceeds.

Further details of the Arrangement are set out in the paragraphs below.

Background to the Arrangement

- 1) The Fund is a limited partnership registered in the Cayman Islands and established to make litigation and arbitration funding available for all types of claims other than personal injury, divorce and defamation proceedings. The Fund is not a trustee of a trust.
- 2) Under the law of Cayman Islands, the Fund does not have a legal personality that is separate from that of its partners (Limited Partners). The Fund is not the beneficial owner of its assets, which Harbour Fund II GP Limited (the General Partner) holds in accordance with the terms of the Fund's limited partnership agreement (Partnership Agreement).
- 3) The Fund provides funding for litigation claimants all around the world who have met certain criteria. The criteria include the creditworthiness of the defendant, the legal merits of the case, the expertise of the legal team and the likely legal fees.

- 4) Harbour Advisors Cayman Limited (the Investment Advisor), a company incorporated in the Cayman Islands, advises the Fund. The Investment Advisor has been contracted by the General Partner under an investment advisory agreement (Investment Advisory Agreement) to perform investigation, evaluation and due diligence services in respect of potential claims for which funding is sought.
- 5) The Investment Advisor, in turn, has subcontracted preliminary investigation and due diligence services to Harbour Litigation Funding Limited (the Sub-Advisor), which is a company incorporated in England and Wales under a sub-advisory agreement (Sub-Advisory Agreement). The Sub-Advisor earns fees under the Sub-Advisory Agreement for providing these services to the Investment Advisor.
- 6) Details of the activities the Investment Advisor and Sub-Advisor (together, the Advisors) undertake when investigating and evaluating potential claims are set out in [7] to [14].

Summary of the normal investment procedures

- 7) The Advisors ensure interested parties know about the business of the Fund. However, the Advisors do not actively or routinely seek to identify and locate specific claims for which funding might be provided.
- 8) Generally, once a request for funding is received, a confidentiality agreement is entered into, and the Advisors conduct a preliminary assessment. Information is gathered regarding the claim and an immediate analysis is conducted to assess whether the claim is likely to satisfy the Fund's criteria. If the Advisors think the claim is unlikely to satisfy the criteria, they will generally reject it at this stage.
- 9) If a claim passes the preliminary analysis, the Sub-Advisor, if appropriate, will enter into a letter of intent, usually with the claimant directly, but in the case of a class or group action, with the legal representative seeking funding on behalf of the claimants. This procedure has been adopted because, in the case of a class action, there are too many claimants to execute separate documents with and not all claimants may have been identified yet. The Sub-Advisor will then conduct a more detailed due diligence to ascertain whether the claim would be likely to meet the criteria for funding.
- 10) The Investment Committee established by the Investment Advisor then meets periodically to evaluate the legal merits of the cases for which funding is sought and that satisfy the Fund's criteria. The Investment Committee reviews updates on the progress of existing funded claims.
- 11) At the conclusion of each meeting, the Investment Committee, where appropriate, makes a formal recommendation to the board of the Investment Advisor about

investing in proposed new claims. The Investment Committee also reports to the board on existing funded claims if material developments have occurred with those claims.

- 12) The board of the Investment Advisor at its next following meeting considers the recommendations made by the Investment Committee. Where the board considers that a proposed claim is likely to meet the Fund's criteria for funding, the board makes a recommendation to the board of the General Partner, which has the authority to invest in claims on behalf of the Fund.
- 13) The board of the General Partner meets periodically to consider the recommendations the board of the Investment Advisor made.
- 14) Where the board of the General Partner (on behalf of the Fund) considers that a recommended claim is meritorious, the Fund will make funds directly available for the claim by entering into a funding agreement or agreements with the claimants.

How the decision to fund this Claim was made

- 15) The Sub-Advisor was contacted by email in November 2014 by a barrister working with Adina Thorn Lawyers in relation to the possible funding of a representative action in relation to cladding supplied and fitted in buildings throughout New Zealand. The claim would be based in negligence and breach of statutory duties and was expected to involve over 500 Claimants with a claim for damages in excess of NZD \$100m (the Claim).
- 16) In accordance with standard procedure, as summarised in [7] to [14], this approach for funding was subjected to a preliminary assessment. The Advisors concluded that the Claim could potentially satisfy the Fund's criteria.
- 17) The Advisors then undertook due diligence and, ultimately, a recommendation was made to the board of the General Partner that the Claim be approved for funding.
- 18) At its March 2015 meeting in the Cayman Islands, the board of the General Partner approved the Claim for funding.
- 19) The Sub-Advisor was then instructed to attend to the finalisation of expected timetables and funding amounts and to prepare appropriate documentation for the Fund to record the terms on which funding would be provided to the Claimants.
- 20) The Sub-Advisor then prepared a draft of the Funding Agreement (the Funding Agreement) that records the terms on which the Fund will make funding available to Claimants for their legal and other costs incurred in relation to the Claim. The Sub-Advisor prepared a draft relationship agreement (Relationship Agreement) to record

the various invoicing and reporting requirements that would apply to the legal representative (the Legal Representative) acting for the funded Claimants throughout the proceedings. On entering into the Funding Agreement, the Claimants agree to give the Legal Representative such instructions and authorisations as are contemplated in the Relationship Agreement, to ensure the Fund is kept fully informed as to the legal costs the Claimants are incurring, the work the Legal Representative is doing, and the conduct of the proceedings (Proceedings).

- 21) The board of the General Partner and Adina Thorn Lawyers as the Legal Representative finalised and entered into the Relationship Agreement on 19 May 2015. At the date of this Ruling, Adina Thorn Lawyers is still the Legal Representative, but the Claimants can appoint a replacement Legal Representative.
- 22) The Funding Agreement was finalised in late 2015, and the Claimants progressively entered into the Funding Agreement from that time.

Funding Agreement

- 23) The Funding Agreement records the terms on which the Fund agrees to make funds available to the Claimants (that is, the individuals or groups who have suffered damage within the scope of the Claim) for Claimants Legal Costs. The phrase "Claimants Legal Costs" is defined in cl 20.1 of the Funding Agreement. These costs include legal fees incurred in relation to the Claim and any costs the Claimants incur (subject to certain exclusions) should the Claimants be ordered to pay the legal costs of the defendant or any other party involved in the Claim. Under cl 9 of the Funding Agreement, the Claimants agree that if they are successful, the Fund will receive a proportion of the Proceeds.
- 24) The Claimants are individuals, groups of individuals and companies (or their respective representatives such as liquidators or administrators) that are home and building owners affected by defects in cladding used in the construction of their homes and buildings. Some of these Claimants are unable to bring a claim under the Weathertight Homes Resolution Services Act 2006 because their buildings were constructed outside the 10-year limitation period imposed by that Act.
- 25) While members of the Claimant group are in New Zealand and other countries, including Australia and the United Kingdom, it is the Applicant's understanding that all the properties to which the Claim relates are in New Zealand.

Funding process

- 26) Under the Funding Agreement, funding for Claimants Legal Costs is made available in two stages.
- 27) The first stage of funding runs from the time the Claim was accepted to the point at which all preconditions for full funding were satisfied and a statement of claim was filed. The second stage runs from that point until the Fund terminates its obligations under the Funding Agreements or the Proceedings are concluded (whether by settlement or court judgment).
- 28) During the first stage, as the process of confirming claimants for a representative action takes some time, Claimants were confirmed as being part of the Claimant group on a progressive basis. Claimants continued to be confirmed after the statement of claim was filed, so some Claimants entered into the Funding Agreement after the second stage of funding commenced.
- 29) Claimants were confirmed on a progressive basis. During that period, legal fees were incurred for work for the benefit of all Claimants. Claimants agreed, on entering into the Funding Agreement, that Claimants Legal Costs (as defined in cl 20.1 of the Funding Agreement)(for which each Claimant will receive funding under the Funding Agreement) include each Claimant's proportionate share (by reference to the value of their claim) of such legal fees relating to the Claim as have been incurred during the first stage, regardless of when each Claimant entered into the Funding Agreement.
- 30) The Claim has satisfied the preconditions for full funding, so the Fund is now funding the second stage of the Claim. Funding will be provided during the second stage of the Claim until the Fund terminates its obligations under the Funding Agreements or the Proceedings are concluded (whether by settlement or court judgment).

Fund's entitlement to Proceeds

- 31) If the Claim is successful, the Fund is entitled to receive a proportion of the Proceeds. The amount of the Proceeds will be calculated on the basis set out in the Funding Agreement.
- 32) Clause 9.1(a)(i) to (vi) of the Funding Agreement outlines how the Proceeds will be allocated between the Fund and the Claimants.
- 33) In accordance with the Funding Agreement, the Legal Representative will receive and hold any damages, costs and settlement sums received in respect of the Claim on bare trust for the Fund and the Claimants in the proportions agreed until the relevant amounts are paid to the Fund and the Claimants. All amounts received from the

defendant must first be paid to the Fund, which will be paid in priority to the Claimants, who will each receive such sum as is equal to their share of the remaining damages, costs or settlement sum.

- 34) Any interest the Fund and the Claimants derive while the Legal Representative holds the Proceeds on bare trust does not form part of the Proceeds for the purposes of this Ruling. This Ruling does not rule on the tax consequences for the Fund of any interest derived while the Legal Representative holds the Proceeds on bare trust.

Control of the Claim

- 35) Control of the Claim rests with the Claimants. The Fund has no ability to instruct the Legal Representative or dictate how the Proceedings are conducted, subject to the right of the Fund to make decisions which affect any applications or negotiations relating to security for costs, in relation to any financial or other commitments or undertakings proposed to be proffered by the Fund to the defendant or to a court. Clause 5 of the Funding Agreement expressly acknowledges that the Fund has no control over or right to make decisions in the Proceedings. Only the Claimants, through a representative claimant (the Representative Claimant) may instruct the Legal Representative and determine, for example, the claims that will be pursued, actions that will be taken or decisions made on a day-to-day basis in respect of the conduct of the Proceedings.
- 36) Clause 6.1(f) of the Funding Agreement provides that Claimants are entitled to change the Legal Representative at any time. While the prior written agreement of the Fund is required, this clause provides that the Fund's consent to such a change is not to be unreasonably withheld. However, to continue to receive funding under the Funding Agreement, the Claimants are required to ensure the new Legal Representative executes a deed in favour of the Fund under which the new Legal Representative agrees to be bound by the terms of the Relationship Agreement as if they were the prior Legal Representative.
- 37) Clauses 5, 6 and 13 of the Funding Agreement outline the Claimants' obligations under the Funding Agreement. Obligations include taking certain actions and providing certain instructions to the Legal Representative in relation to certain expected future events. For example, obligations exist in relation to pursuing an appeal should the Fund wish to provide funding for an appeal and in relation to settlement decisions should the Legal Representative recommend or not recommend (as the case may be) settlement.
- 38) The Applicant states that because this is a class action, Claimants also agreed on entering into the Funding Agreement the way the Proceedings would be conducted

and the Representative Claimant would instruct the Legal Representative. This was to ensure the funded Claimants agreed at the outset how the Proceedings would be conducted, so the Fund could be confident that the Proceedings would be conducted in an optimal manner.

Termination

- 39) Clause 1 of the Funding Agreement contains an initial cooling off period of 20 days.
- 40) Clause 12 of the Funding Agreement provides that a Claimant cannot unilaterally terminate their obligations under the Funding Agreement. Claimants are entitled to actively terminate their obligations if a material breach by the Fund has adversely affected the Claimant's interests and the Fund has not remedied that breach within 30 days.
- 41) Clause 12 of the Funding Agreement enables a Claimant to opt out of the class action if the Claimant gives instructions to the Legal Representative or otherwise exercises a right to opt out of the proceedings. However, if the Claim is subsequently successful, the Fund is still entitled to recover its share of the Proceeds as if the Claimant had not opted out of the class action.
- 42) Clause 11 of the Funding Agreement provides that the Fund has the right at any time to terminate its obligation to contribute to future legal costs in respect of the Claim.

Key contractual terms relating to process

- 43) Claimants agreed to take certain actions and provide certain instructions to the Legal Representative in relation to the way the Proceedings would be conducted and in relation to certain potential future events. These obligations are in:
 - cl 5 – conduct of Proceedings
 - cl 6 – Claimant's obligations
 - cl 9 – application of Proceeds.
 - cl 13 – settlement decisions
 - cl 19 – general provisions.
- 44) Under clauses 5, 6 and 13 of the Funding Agreement, each Claimant agreed the following:
 - The Representative Claimant will determine in consultation with the Legal Representative what claims will be pursued (cl 5.1(a)).

- The Representative Claimant will give day-to-day instructions to the Legal Representative and will make binding decisions on behalf of the Claimants (cl 5.1(b)).
 - The Claimant will provide all information and documents the Legal Representative requires, will deal promptly with all requests the Legal Representative makes and will cooperate generally with the Legal Representative (cl 6.1(n)).
 - The Claimant will act reasonably and commercially in the prosecution of the Proceedings and in accordance with the Legal Representative's advice (cl 6.1(d)).
 - The Claimant will accept and follow the Legal Representative's reasonable legal advice, including in relation to settlement (cl 6.1 (j)).
 - The Representative Claimant is authorised to make or take any action constituting a settlement decision provided the Legal Representative has advised such action is reasonable (cl 13.1).
 - The Legal Representative is authorised and instructed to accept on the Claimant's behalf any settlement proposed where the Claimant has not initially wanted to act in accordance with the advice of the Legal Representative and the matter has been referred to independent counsel for opinion, with the independent counsel having recommended that the Legal Representative's advice is reasonable in all the circumstances (cl 13.3 and 13.4).
- 45) In addition, each Claimant agreed under the Funding Agreement that the Fund is entitled to communicate directly with the Legal Representative (cl 5.1.(c)) and is entitled to receive any information that has or may have a material impact on the Claim or the Proceedings (cl 6.1(c)).

Relationship Agreement between the Legal Representative and the Fund

- 46) The terms and conditions in the Relationship Agreement are consistent with the above provisions in the Funding Agreement. The Relationship Agreement provides that the Legal Representative must:
- act consistently with all authorisations and instructions the Claimant gives and as contemplated in the Funding Agreement subject to having received such instructions or authorisations (cl 2.4);

- enter into a retainer with a Claimant only if the Claimant gives the Legal Representative all the authorisations and instructions contemplated and referred to in the Funding Agreement (cl 2.5);
- ensure the Claimant is given all necessary information to facilitate informed instructions (cl 8.2);
- keep the Fund fully informed by providing a monthly report in the form set out in the Relationship Agreement (cl 8.1(a));
- give the Fund access to and, when requested, provide the Fund with copies of all material documents produced by or for the Claimants in relation to the proceedings (cl 8.1(b));
- inform the Claimant immediately, and in accordance with the Claimant's instructions as contemplated in the retainer and the Funding Agreement, notify the Fund if the Legal Representative becomes aware of any information that has or may have a material impact on the Claim (cl 8.2(b));
- notify the Fund immediately if the Claimant receives a settlement offer, prepare for the Claimant a written recommendation on whether to accept such an offer and provide a copy of that recommendation to the Fund (cl 8.1(e)).

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

- (a) None of the General Partner, the Limited Partners of the Fund, the Investment Advisor or the Sub-Advisor is resident in New Zealand for income tax purposes.
- (b) None of the General Partner (whether on its own account or on behalf of the Fund), the Investment Advisor or the Sub-Advisor owns or leases any property in New Zealand.
- (c) None of the General Partner (whether on its own account or on behalf of the Fund), the Investment Advisor or the Sub-Advisor has any employees based in New Zealand.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any conditions stated above, the Taxation Laws apply to the Arrangement as follows:

- (a) Any share of the Proceeds received by the Fund and the Limited Partners under the Arrangement is "non-residents' foreign-sourced income" under s BD 1(4).

- (b) Any share of the Proceeds received by the Fund and the Limited Partners under the Arrangement is not assessable income under s BD 1(5).
- (c) Any share of the Proceeds received by the Fund and the Limited Partners under the Arrangement is not "interest" as defined in s YA 1.
- (d) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling applies for the period beginning on 24 October 2020 and ending on 23 October 2025.

This Ruling is signed by me on the 26th day of January 2021.

Dinesh Gupta

Tax Counsel Lead, Tax Counsel Office

About this document

Product rulings are binding rulings on how the tax law applies to a particular "product", which is an arrangement that is likely to be entered into with several people on identical terms.