

Redemption of shares in BVI investment funds

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This guide examines a number of issues which arise on the redemption of shares by an investor in a BVI investment fund which may lead to disputes between the investor, the fund, and other investors. This note also includes an examination of an investor's status in the investment fund once a redemption request has been submitted, the right to enforce payment of the redemption proceeds, standing to seek the liquidation of the fund on the grounds of non-payment, and the distribution of a fund's assets upon its liquidation.

Introduction

Companies domiciled in the BVI are often the vehicles of choice used by investment managers and the promoters of investment funds, as part of their investment structure, and are often the corporate entity in which investors directly invest and hold shares.

Central to any investment fund is an investor's right to the return of capital, by way of a redemption of his shares. Principally, those rights are set out within the fund's constitutional documents, most relevantly the fund's memorandum and articles of association, and offering memorandum; however, those documents must be read in conjunction with a number of statutory and common law principles which are particular to the BVI. These principles can catch an ill-advised investor off-guard, particularly in circumstances where the redemption process is interrupted by the fund's insolvency and/or liquidation.

The redemption

A fund's constitutional documents represent the contract between the fund and its investors, and will set out the terms on which an investor may request the redemption, either in part or in full, of his shares. Some funds require minimum periods of time in which shares must be held before they can be redeemed, others provide penalties for early redemption; most prescribe minimum periods in which notice must be given before a redemption may be effected, and all will prescribe the day or days on which redemptions may be made (**Redemption Day**). Whatever is contained in the constitutional documents of any particular fund, those terms are of a contractual nature, and are capable of being enforced as such.

Assuming that the redemption terms within a fund's constitutional documents have been followed, an investor who has requested the redemption of his shares will cease to be a member of the company upon the passing of the relevant Redemption Day, and will be a creditor in an amount equal to the redemption proceeds owed to him, which is generally calculated in accordance with the fund's net asset value (**NAV**). When those redemption proceeds become due and payable will be a term of the contract between the fund and the investor, again set out in the fund's constitutional documents; for example, the constitutional documents of many funds contain provisions to the effect that redemption proceeds will be paid within 30 days of the relevant Redemption Day.

Status of the redeeming investor

As set out above, upon the passing of the relevant Redemption Day, an investor seeking the redemption of his shares ceases to be a member of the company and, in turn, becomes a creditor with respect to the unpaid redemption proceeds. However, the rights conferred on him in his status as a creditor are limited,

particularly within any liquidation of the fund, and do not resemble those that would vest in a third party creditor, such as a trade creditor.

Redeemed investors cannot seek the liquidation of the fund

A redeemed investor cannot seek the liquidation of the fund, even if the time for payment of his redemption proceeds has passed – any recovery action will need to be by way of ordinary court proceedings, for the recovery of a debt. This is the effect of section 197 of the Insolvency Act 2003 (the **Act**), which provides:

A member, and a past member, of a company may not claim in the liquidation of the company for a sum due to him in his character as a member, whether by way of dividend, profits, redemption proceeds or otherwise, but such sum is to be taken into account for the purposes of the final adjustment of the rights of members and, if appropriate, past members between themselves.

Redemption proceeds constitute a debt due from a company to a member in his character as such, and are thus caught by section 197. The provision operates to exclude members who have claims for outstanding redemption proceeds from being creditors for the purposes of the company's liquidation – at least in their capacity as former members (and subject to what follows below). Given that no claim will exist in any liquidation, such members are thus precluded from seeking the liquidation of the company on the basis that they do not fall within the definition of 'creditor' contained in section 9.1(a) of the Act, and thus lack standing to do so under section 162, on the basis that, although being a creditor in the literal sense, they would not have an admissible claim within any liquidation.¹

Claims for outstanding redemption proceeds: priorities in a liquidation

Given that redeemed investors are creditors, but with no 'admissible claim' within a liquidation of the fund, it necessarily falls for consideration what rights, if any, do those who fall within this class have to share in the surplus assets of the fund once creditors with admissible claims have been paid in full. There are three possible answers:

1. as creditors, although ranking behind third party creditors of the fund, claims for unpaid redemption proceeds will rank ahead of the claims of members;
2. surplus assets should be distributed rateably between redeemed investors and members; or
3. having no admissible claim, and no longer being members, those with claims for outstanding redemption proceeds have no right to share in any surplus assets.

This issue recently fell for consideration by the courts; at first instance the court held that the answer was (2) – a rateable distribution; however, on appeal, the court of appeal held that the answer was (1) – subordinated priority.

In *Somers Dublin Ltd A/C KBCS and Others v Monarch Pointe Fund Limited*², Bannister J rejected the notion that those with claims for redemption proceeds, being former members of the fund, would be precluded from sharing in any distribution on the basis that they were not members within the meaning of section 207 of the Act, holding that section 207(3) must be read as covering past members, and the sums due to them in their character as members. In dealing with (1) above, the Learned Judge rejected any notion that the relevant statutory provisions within the Act envisaged any system of priorities as between redeemed and continuing members and, in the absence of any statutory provisions to the contrary, held that equity required the application of the *pari passu* principle, thus directing that the surplus assets be divided equally between (i) the debts owed by the company to the redeemed members, and (ii) the capital contributions of the remaining members.

The Court of Appeal, however, took a different view, holding that the purpose of section 197 was to subordinate the claims of redeemed investors, as former members of the company, to those of ordinary third party creditors, but otherwise did not operate to preclude such claims from being made within the

¹ See generally *Westford Special Situations Fund Ltd. v Barfield Nominees Limited and Ors*, unreported, Eastern Caribbean Supreme Court, Virgin Islands, Court of Appeal, March 2011

² Unreported, November 2012, Eastern Caribbean Supreme Court, Virgin Islands, Bannister J

liquidation.³ The effect of the Court of Appeal's decision is that, although redeemed investors are precluded from claiming within the liquidation as an ordinary unsecured creditor, claims for unpaid redemption proceeds are able to be made, but will rank behind those of ordinary unsecured creditors. Although subordinated in this way, as a creditor claim, redeemed investors will still enjoy priority over continuing members.

Clawbacks of redemption proceeds

Some funds, as part of their constitutional documents, will include provisions by which an investor who receives an overpayment of redemption proceeds (by mistake or otherwise) must repay the excess amount to the fund. Where those provisions exist, they will form part of the contract between the investor and the fund, and the obligation to repay will be enforceable as a matter of contract. Alternatively, and if the investor retains an investment in the fund, the fund will generally have the power to adjust the investor's interest, and make the necessary changes to the number of shares he holds based on the overpayment.

But what if a contractual obligation to repay is not included within the constitutional documents or if the investor has fully redeemed his interest? These questions fell for consideration in the *Fairfield Sentry* litigation. For a detailed discussion of this litigation, please click [here](#). In short, the redemption by an investor of his shares gives rise to a debt obligation on the part of the fund, whatever the value of the shares may be, and the surrender of the shares by the investor, and the rights that attach thereto, is good consideration for the redemption proceeds which the fund pays. In the event the fund seeks restitution based on a mistaken overpayment, such a claim is capable of being defeated by a good consideration defence. There are obvious limits to this, for example, knowledge of the overpayment by the investor at the time the redemption proceeds are received and, ultimately, clawback claims will always turn on their own facts, together with an examination of the constitutional documents of the particular fund.

Contacts

To find out more, please get in touch with your usual Mourant contact, or alternatively, a full list of contacts specialising in BVI law can be found [here](#).

³ Unreported, February and March 2013, Eastern Caribbean Supreme Court, Court of Appeal, Pereira CJ, Blenman JA and Mitchell JA [Ag.]