

# Cayman Islands' Court of Appeal confirms approach to redemption claims

UPDATE

Update prepared by Peter Hayden (Managing Partner, Cayman Islands) and Rocco Cecere (Counsel, Cayman Islands)

---

Cayman Islands' Court of Appeal confirms that redeemed investors rank as creditors, clarifies application of section 37(7) of the Companies Law and the circumstances in which section 49(g) of the Companies Law operates to defer certain creditor claims.

---

In a significant decision that will be welcomed for providing certainty to investors in Cayman Islands' investment funds, the Cayman Islands Court of Appeal (the **CICA**) has unanimously upheld the judgment of the Grand Court that redeemed investors have creditor claims for the redemption price of their shares in a liquidation.

The decision is also notable for clarifying that redemption claims rank behind those of ordinary unsecured creditors, although since investment funds in liquidation tend to have very limited ordinary creditors, the subordination of redemption claims to ordinary creditor claims is unlikely to be a material consideration in most cases.

## Background

The decision is the latest in the ongoing representative proceedings between Primeo Fund (in official liquidation) (**Primeo**) and the Additional Liquidator of Herald Fund SPC (in official liquidation) (**Herald**).

- Primeo was an indirect investor in Bernard L Madoff Investment Securities LLS (**BLMIS**), through its investment in Herald, a BLMIS feeder fund.
- Primeo, along with a number of other Herald investors, (the **December Redeemers**) submitted redemption requests in respect of certain shares (the **Shares**) for a redemption date of 1 December 2008. Those redemptions were accepted by Herald and, on 1 December 2008, the Shares were redeemed pursuant to Herald's articles of association.
- On 11 December 2008, and before Primeo and the December Redeemers were paid, Madoff confessed that BLMIS was a massive fraud. Shortly afterwards, Herald suspended both the determination of NAV and the payment of redemption proceeds.
- On 16 July 2013, on a contested winding up petition brought by Primeo, the Court made an order putting Herald into official liquidation.

## Grand Court Ruling

As discussed in our guide entitled '[Grand Court construes section 37\(7\)\(a\) of the Companies Law - redeemed but unpaid investors to be treated as creditors](#)', in June 2015 the Grand Court accepted Primeo's submission that section 37(7)(a) of the Companies Law (as amended) (the **Law**) did not apply to the Shares. It held that section 37(7)(a) did not apply to shares which had already been redeemed in accordance with the Articles of Association but instead to pending redemptions where the shares had not been redeemed because some step that was required to be taken under the Articles had not been taken. As a result, Primeo and the December Redeemers had valid creditor claims against Herald.

The Additional Liquidator appealed the Grand Court's Ruling.

## **CICA Ruling**

The CICA noted that it was not (and could not have been) disputed that, upon redemption occurring pursuant to the Articles but before payment of the redemption proceeds, an investor was divested of his rights as a shareholder and ceased to be a member of the company. This outcome was expressly provided for by Herald's Articles.

Affirming the Grand Court's decision, the CICA found that section 37(7)(a) does not apply where, as in this case, at the commencement of the winding up the relevant redeemable shares have been redeemed in accordance with the Articles, notwithstanding that the redemption proceeds remain outstanding. In those circumstances, the claims for the redemption proceeds are provable claims falling within section 139(1) of the Law and it is not necessary for the redeemed investor to rely on section 37(7)(a) in order to establish a creditor claim.

The CICA held that section 37(7)(a) 'applies where at the commencement of the company's winding up a holder of redeemable shares has an accrued right to the redemption thereof under the Articles of Association but there has been no redemption because steps required by the Articles for those to occur have not been completed'. It found that section 37(7)(a) was enacted to permit a claim in a liquidation for redemption proceeds where no such claim could be made, for two reasons, under the general winding up provisions. The first reason is that such a claim involves the claimant seeking to change status from that of a member to that of a creditor and this is not generally permissible under section 99 of the Law. The second reason is that a counterparty will not normally be permitted to enforce a contract against a company in liquidation which requires the company to pay out money in order to acquire property. In essence, section 37(7)(a) provides a remedy where redemption has not taken place due to some failing on the part of the company to take the steps necessary to effect redemption pursuant to the Articles.

This construction was found to be supported by the legislative origins of section 37(7) and to be consistent with the reasonable expectations of investors, informed by the Articles. The CICA roundly rejected a number of arguments put forward by the Additional Liquidator, including that the word 'redemption' should have different meanings in different sub-sections of section 37, that redemption was a process which was not completed until payment was made and that the interpretation adopted could increase the risk of a run on the fund.

The CICA also dealt with a point which was not expressly considered by the Grand Court Ruling, namely where the December Redeemers claims should rank. Section 49(g) of the Law provides for sums due to a shareholder in his character as a shareholder to rank as creditor claims but behind ordinary unsecured creditors. However, there had previously been inconsistent authority as to whether a claim for redemption proceeds in a liquidation is founded on the statutory contract between a shareholder and the company. The CICA clarified that it is and that redemption claims fall within section 49(g). Importantly though, the claims rank in priority to the claims of other investors who have not redeemed.

## **Conclusion**

The CICA's decision confirms that an investor who has been redeemed and become a creditor cannot be retrospectively converted back to a shareholder in a liquidation context. It clarifies that their creditor claim will rank behind ordinary unsecured creditors but ahead of the claims of unredeemed investors. It also explains the rationale behind section 37(7) and the circumstances in which it may elevate the claim of a redeeming (but unredeemed) investor into a creditor claim in a liquidation.

All of this clarification is welcome and should provide reassurance to investors in Cayman Islands' investment funds that the contractual terms they agree with the fund will be respected by the Courts and cannot be displaced by a liquidator.

As we have said before, this is a common sense decision which provides certainty to investors and others involved in the Cayman Islands' funds industry.

Peter Hayden, Rocco Cecere and Christopher Levers successfully acted for Primeo on the appeal.

If you wish to discuss further the Cayman Islands' Court of Appeal confirms approach to redemption claims, please call your usual Mourant Ozannes contact.

## Contacts

---



**Peter Hayden**  
Partner, Mourant Ozannes  
Cayman Islands  
+1 345 814 9108  
peter.hayden@mourant.com



**Rocco Cecere**  
Counsel  
Cayman Islands  
+1 345 814 9218  
rocco.cecere@mourant.com

---

This update is only intended to give a summary and general overview of the subject matter. It is not intended to be comprehensive and does not constitute, and should not be taken to be, legal advice. If you would like legal advice or further information on any issue raised by this update, please get in touch with one of your usual contacts. © 2018 MOURANT OZANNES ALL RIGHTS RESERVED