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UPDATE

The views of participating shareholders prevail in solvent liquidations

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The decision of *Re Adamas Asia Strategic Opportunity Fund Limited (in Voluntary Liquidation)*[1] reinforces the need for the wishes of investors in Cayman Islands investment funds to be taken into account when the fund's investment manager (or the holder of the fund's voting shares) takes steps to place the fund into liquidation. As those who hold the economic interest in any liquidation, the wishes of investors cannot be ignored simply because they have no involvement in the management of the fund.

Background

Like many Cayman Islands investment funds, Adamas Asia Strategic Opportunity Fund Limited (the **Company**) offered redeemable Participating Shares to investors; however, those shares did not include the right to vote at general meetings of the Company. The right to vote at general meetings attached only to the Company's Founding Shares, which were held by the Company's Manager and which were not offered to investors. Thus the Manager retained sole control over the management of the Company.

In January 2019, the Manager, as the holder of the Founding Shares, resolved to place the Company into voluntary liquidation and appointed nominees from accountancy firm Grant Thornton as its voluntary liquidators. The appointment of these individuals was against the wishes of the Company's sole remaining investor (and sole holder of the Company's Participating Shares) (the **Participating Shareholder**). Rather than partners from Grant Thornton, the Participating Shareholder wished for nominees from the accountancy firm FTI to be appointed as the Company's voluntary liquidators.

In April 2019, the Participating Shareholder applied for orders pursuant to s.131(b) of the Companies Law (2018 Revision) (the **Law**). That section provides that the voluntary liquidator or any contributory or creditor may apply to the court for an order for the voluntary liquidation to be continued subject to the supervision of the court, on the grounds that the supervision of the court will facilitate a more *effective*, *economic* or *expeditious* liquidation of the company in the interests of the contributories and creditors. As part of its application, the Participating Shareholder sought the appointment of its preferred individuals from FTI as the Company's official liquidators.

While the application primarily gave rise to a determination of the scope of s.131(b) of the Law and the discretion afforded to the court, in disposing of those matters the court dealt with the wider question of whose views should be given more weight as to the identity of the liquidator: the Manager as the holder of the shares entitled to vote and who was responsible for commencing the voluntary liquidation; or the Participating Shareholder who, although was not entitled to commence the voluntary liquidation, held the economic interest in the voluntary liquidation as the holder of the Participating Shares?

[1] Unreported, 23 July 2019.

Judgment

The court held that while it was the Manager who had the power to resolve to place the Company into liquidation, that power was not conferred for its own benefit but for the benefit of the Participating Shareholder[s]. Thus, in a fund where a majority of investors nominate a suitably qualified voluntary liquidator, their wishes should be acceded to by the holder of the voting shares, given it is the investors who have the economic interest in the voluntary liquidation.

Notwithstanding, in order for the court to accede to the Participating Shareholder's application, it was necessary for the court to accept that, based on the evidence before it, the application fell within the ambit of s.131(b) of the Law, which is to say that the court needed to first be satisfied that the order would facilitate:

(a) a more effective, economic or expeditious liquidation of the Company, and

(b) was in the interests of contributories and creditors.

As a matter of general principle, the court accepted that in the context of an investment fund, the views of the management shareholders will seldom outweigh those of the equity or participating shareholders in terms of identifying where '*the interests of the contributories*' lie. An exception to this may be where a shareholder is seeking to achieve a collateral purpose or is not seeking a remedy for the benefit of the entire class.

The circumstances which will constitute a more *effective, economic, or expeditious* liquidation are broad and flexible, although the court needs to form its own independent view as to whether one or more of these preconditions have been met: there is no broad brush discretion to be applied given the section mandates that at least one of these preconditions is met.

The court was ultimately satisfied that its jurisdiction under s.131(b) of the Law was enlivened based on the particular facts of the case and the steps the official liquidators would need to take in order to conclude the liquidation. The court ordered the voluntary liquidation to continue subject to its supervision and that the Participating Shareholder's preferred nominees from FTI be appointed as official liquidators.

Comment

While it is common for the voting shares in a Cayman Islands investment fund to be held by its manager, the decision is a helpful reminder that this does not give the manager an unfettered ability to vote those shares in the way it chooses. It is the fund's investors who have the economic interest in the fund. The liquidation of the fund will result in that economic interest being realised. It is thus inherently sensible that the wishes of investors as to how that process ought to be managed, and by who, ought to carry more weight than the wishes of the entity who, although has the power to bring about the liquidation, has no economic interest in it.

While in these circumstances, more often than not there is no dispute between a manager and the investors – given it is far more common for a voluntary liquidation to be brought about after investors (or a majority of them) have already left the fund via their shareholding being redeemed (compulsorily or voluntarily) - the decision does highlight that this is not always the case and where a dispute does arise between the manager and investors, a manager cannot sit blindly behind its contractual right to vote its shares.

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