

UPDATE

No automatic redemptions in a master-feeder structure

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In *Ardon Maroon Asia Fund*, the Cayman Islands Court of Appeal found that a notice to redeem served on a feeder fund did not automatically trigger an equivalent redemption in the master fund. This decision provides clarity as to the court's construction of a fund's redemption regime.

In July 2018, McMillan J dismissed an application to set aside a rejection of proof of debt (**POD**). The POD was lodged by the feeder fund in the liquidation of the master fund. The judgment provided guidance on construction when considering a fund's redemption regime in its articles of association. The feeder fund appealed and, on 20 May 2020, the Court of Appeal (the **CICA**) dismissed the appeal, upholding McMillan J's first instance decision and confirming that the redemption process must be made strictly in accordance with the contractual provisions of the fund.

Background

Ardon Maroon Asia Master Fund (the **Master Fund**) and its two feeder funds, Ardon Maroon Asia Dragon Feeder Fund (**Dragon**) and Ardon Maroon Asia Eagle Feeder Fund LP (**Eagle**), formed a traditional master/feeder structure.

In August 2014, one of Dragon's investors (**UBS**) redeemed shares to the value of US\$15 million. Dragon did not give a corresponding notice to redeem shares of equivalent value in the Master Fund. In any event, the Master Fund did not have sufficient liquidity to meet a US\$15 million redemption. Shortly thereafter Dragon and the Master Fund were wound up.

UBS lodged a POD in the liquidation of Dragon, and Dragon lodged a corresponding POD with the Master Fund. The Master Fund rejected the POD on the grounds that Dragon had failed to lodge a redemption notice.

Dragon appealed against the rejection of the POD.

Dragon's application was dismissed on three principle grounds that: (i) the procedure for redemption of shares was set out in the Master Fund's articles and required a notice of redemption; (ii) even if it were open to the directors of the Master Fund to decide on some other procedure, they had not done so; and (iii) the directors had not waived the requirement of a notice.¹

Dragon appealed on all three grounds submitting that the Master Fund's articles authorised the directors of the Master Fund to make a determination that redemption could be effected without service of a notice (the **construction issue**); and that the directors did in fact make such a determination (the **determination issue**). Alternatively, Dragon contended that the directors of the Master Fund were entitled to and did waive any requirement for a separate redemption notice from Dragon (the **waiver issue**).

¹ If you would like to read more on the first instance decision see our legal update 'Ardon Maroon Asia Master Fund – the narrow test for appealing a rejection of a proof of debt in the Cayman Islands' linked [here](#).

Construction Issue

Dragon submitted that, despite the mechanism for redemption as set out in the Master Fund's articles which required a written notice of redemption, the Master Fund's articles gave a general discretion to the directors as to the terms on which shares may be redeemed. As such the directors were authorised to issue redeemable shares on terms that no written notice was required to effect redemption. Dragon submitted that McMillan J had failed to accurately address the language of these provisions and had wrongly disregarded commercial realities by which the service on a feeder fund of a redemption notice would automatically trigger a corresponding redemption in the Master Fund without the need for a second notice.

The CICA rejected Dragon's submissions, finding that it was clear that the regime set out in the articles was the only mechanism by which shares in the Master Fund could be redeemed.

Determination Issue

Due to the CICA's finding on the construction issue, the determination issue did not strictly arise however the CICA chose to deal with it nonetheless.

Dragon submitted that the relevant determination was contained in the Master Fund Launch Resolution (the **Launch Resolution**) which approved the Dragon Private Placement Memorandum (**PPM**). The PPM stated that the Master Fund redemption procedure was identical to Dragon's procedure. Dragon argued that this should be interpreted as meaning that the set of steps required to perform the redemption procedure were only required to be performed once in order to effect redemption of shares both in Dragon and in the Master Fund.

The CICA rejected this argument, finding that the language clearly contemplated two separate identical procedures and not one that would automatically serve both purposes.

Waiver Issue

As an alternative argument, Dragon alleged that the requirement to give written notice had been waived by the Master Fund on the basis that the Master Fund's conduct had indicated that an effective redemption of shares had occurred and Dragon had acted in reliance on that representation by not submitting a redemption notice of its own.

The CICA rejected this argument, reaffirming that the Master Fund's articles provided the only mechanism for redemption and did not authorise the waiver of the requirement to file a notice of redemption.

Conclusion

This decision by the CICA reaffirms McMillan J's first instance decision, that in considering a fund's redemption procedure, the court will look to the mechanism provided by a fund's articles. This is consistent with section 37 of the Companies Law (2020 Revision) which provides that the *redemption of shares may be effected in such manner as may be authorised by or pursuant to the company's articles of association*. What is considered to be 'market-practice' will carry little to no weight if it not permissible under the fund's articles. Directors wishing to vary procedures, within their authority, should do so explicitly by formal resolutions and ensure to avoid relying on informal arrangements or representations.

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