

UPDATE

Grand Court construes section 37(7)(a) of the Companies Law – redeemed but unpaid investors are to be treated as creditors

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On 4 June 2015 the Cayman Islands Grand Court ruled in favour of Primeo Fund (**Primeo**), in the ongoing Representative Proceedings between Primeo and Herald Fund SPC (**Herald**). The Court had to construe section 37(7)(a) of the Companies Law. Although the Court's detailed reasons are still awaited, it is clear from the Court's decision that section 37(7)(a) does not apply to redeeming investors whose shares have been redeemed prior to the commencement of the liquidation and provides for the circumstances in which they can enforce their redemption in the liquidation.

The Court's detailed reasons are discussed in our legal update [Cayman Court gives guidance on the status of redeeming investors and approach to distributions](#). The decision was appealed to the Court of Appeal and our legal update following the Court of Appeal's decision can be found [here](#).

It follows that those investors are to be treated as creditors for the redemption price of the shares. It appears that section 37(7) deals with redeeming investors whose shares have not been redeemed prior to the commencement of the liquidation and provides for the circumstances in which they can enforce their redemption in the liquidation.

The Facts

Primeo invested in Herald, which in turn invested in Bernard L Madoff Investment Securities LLC (**BLMIS**), the massive Ponzi scheme run by Bernard Madoff.

Primeo, along with a number of other Herald shareholders (the **December Redeemers**), submitted requests for the redemption of certain of their shares in Herald (the **Shares**) for a redemption date of 1 December 2008. It was common ground between the parties that:

- Herald had accepted the redemption requests;
- the Shares were, as a matter of law, redeemed on 1 December 2008 (the **Redemption Day**) pursuant to Herald's articles of association (the **Articles**); and
- the Shares were subsequently removed from Herald's register.

However on 11 December 2008 and before Herald paid the redemption moneys, Madoff confessed that BLMIS was an elaborate fraud. As a result, Herald passed resolutions suspending the determination of NAV and payment of unpaid redemption moneys (the **Suspension**). On 14 February 2013, Primeo petitioned for the winding up of Herald. On 23 July 2013, the Grand Court ordered that Herald be wound up.

Section 37(7)(a) of the Companies Law provides that:

- (a) Where a company is being wound up and, at the commencement of the winding up, any of its shares which are or are liable to be redeemed have not been redeemed or which the company has agreed to purchase have not been purchased, the terms of redemption or purchase may be enforced against the company, and when shares are redeemed or purchased under this subsection they shall be treated as cancelled.

Provided that this paragraph shall not apply if:

- (i) The terms of redemption or purchase provided for the redemption or purchase to take place at a date later than the date of the commencement of the winding up...

Primeo's position was that, on a plain reading, the first paragraph of section 37(7)(a) does not apply to shares which have been redeemed. Primeo maintained that, in accordance with the Articles and the Privy Council's reasoning in *Culross Global SPC Limited v Strategic Turnaround Master Partnership Limited* [2010] UKPC 33, Primeo and the other December Redeemers had been redeemed on the Redemption Day.

Herald's position was that redemption in the context of section 37(7) was something different from redemption under the Articles. Herald argued that redemption, for the purposes of section 37(7), meant a process that was only completed at the time of payment of the redemption proceeds. This view of the process of redemption was specifically rejected by the Privy Council in *Strategic Turnaround*, but Herald argued that that authority did not apply in these circumstances.

The Decision

Mr Justice Jones found in favour of Primeo, although his detailed reasons are awaited. Those reasons will provide welcome guidance on the construction of section 37(7) and the status of redeeming investors. In any event, the outcome should be welcomed by fund managers and investors alike. It now appears clear that the position is governed by the fund's constitutional documentation, and not by some other set of undefined criteria.

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