

Turning around Strategic Turnaround: Privy Council reverses decision of Cayman Islands Court of Appeal

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On 13 December 2010 the Privy Council delivered its judgment in *Re Strategic Turnaround Master Partnership Ltd*. The case concerned the ability of a fund to suspend the redemption of shares and the payment of redemption proceeds. Their Lordships reversed the controversial decision of the Cayman Islands Court of Appeal ("CICA") and in so doing brought the law of the Cayman Islands into line with other jurisdictions. The judgment provides helpful guidance on this complicated issue and will be of interest not only to practitioners, but also to investors and professional service providers.

Background

Strategic Turnaround Master Partnership Ltd (the "Company") was a regulated mutual fund. On 31 October 2007, Culross Global SPC Ltd (the "Investor") served the Company with a notice to redeem its shares for a Redemption Date of 31 March 2008. According to the Company's Confidential Explanatory Memorandum ("CEM"), 90 per cent of redemption proceeds were to be paid within 30 days of the redemption date, with the balance due after the completion of the annual audit.

On 17 April 2008, prior to paying the redemption moneys, the company's directors resolved to suspend all redemptions. On 22 April 2008, the directors passed a further resolution suspending the calculation of the Net Asset Value. On 30 April 2008, the NAV applicable to the shares for the 31 March 2008 redemption date was calculated at US\$980,508 and communicated to the investor.

The investor brought a petition seeking to wind up the company either on the basis that

it was unable to pay its debts, or that it was just and equitable that the company should be wound up. The company then applied to strike out the petition, on the grounds that it was an abuse of the Court's process. It argued that it had acted in accordance with its articles of association and CEM and that the investor was not owed money and therefore had no standing to present a petition. That application was dismissed at first instance.

Court of Appeal decision

The CICA held that the extent of a company's powers to suspend redemptions of its shares or to suspend the payment of any redemption proceeds, is determined in each case, by careful reference to that company's articles and other associated documentation.

The CICA held that, on the true construction of the company's articles and CEM, the investor became a creditor of the fund at the redemption date. The CICA also held that, as a matter of general principle, a redeeming shareholder remains a member of a company (bound by the company's articles and CEM) until he has received payment and his name has been removed from the register of members.

The CICA further held that the company's articles and CEM gave it the power to suspend the payment of redemption proceeds after the redemption date. The power in the articles to suspend "redemption" was found to apply to the entire process of redemption from the notice through to the payment and the removal of the member from the register.

Accordingly it could be exercised at any time prior to the completion of the process and was not retrospective in effect, because the resolutions only took effect at the date at which they were passed.

The effect of this ruling was that if the Company had properly and validly exercised

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its power to suspend redemptions, then the investor was, at the date of the issue of the petition, a prospective creditor of the company and therefore lacking the standing to petition for its winding up on the basis that the company was unable to pay its debts. The debt was not one which was presently due and payable but rather a prospective liability (which would fall due on the lifting of the suspension)¹.

Privy Council

The Privy Council (the "Board"), in a decision delivered by Lord Mance, considered whether the CICA were correct to conclude:

- i. that the company had the power to suspend the payment of redemption proceeds after the redemption date but before the payment of the redemption proceeds; and
- ii. that a redeeming shareholder remains a member of the company until he has received payment and his name has been removed from the register of members and that the process of redemption continued until this point.

Their Lordships found that the existence and extent of any power to suspend redemptions, or the payment of redemptions, was a subject upon which a company's members were at liberty to make "any contract inter se which they pleased". Therefore the appeal could only be decided upon the construction of the company's articles read with such other documents as may be incorporated.

Having accepted that the redemption date was the date upon which the redemption price crystallised and was deemed to be a liability of the company, the Board did not agree that the company possessed the power to suspend its liability to pay redemption proceeds to the investor, once the redemption date had passed. Both stages may have been said to have been part of a continuing process, but it did not follow that redemption only occurred at the conclusion of that whole process. On the construction of the articles, the power to suspend "redemption" was only effective up to

the redemption date. The remittance of the redemption proceeds was found to be simply a matter of supplementary procedure.

In reaching this conclusion, the Board held that in order for the company to have power to suspend payment of redemption proceeds after the redemption date, its articles would have to contain clear provisions entitling it to do so and that there were no clear words to that effect contained within the articles.

The Board found that the CICA, in reaching the opposite conclusion, relied largely, if not exclusively, upon the terms of the CEM which, unlike the articles, afforded the directors the power to suspend the payment of redemption proceeds. The Board did not agree that the articles incorporated the CEM provisions relating to redemptions. The Board also found that even if the CEM provisions had been incorporated into the articles, the CEM expressly stated that the legal relationship between the company and its shareholder was to be defined by the articles and not the CEM, with the effect that where they were inconsistent, the terms in the articles would prevail.

The Board further concluded that given the articles and CEM were inconsistent in relation to the redemptions provisions, the company was seeking to take advantage of a discrepancy between its own description of its articles in the CEM and the actual contents of those articles themselves. In this situation, the Board could see no basis for allowing the company to rely upon its own [mis] description of its articles.

However, the Board expressed the (obiter) view that in the opposite case, where an investor might wish to claim the benefit of the effect of a company's [mis] description of its articles within its CEM, such an investor may have an arguable case for being entitled to do so.

Having construed the articles in this way, the Board drew comfort both from its own view that this outcome was more likely to be the intended effect of the articles when drafted,

¹Since the Petition was filed, the law has been changed by section 94(b) of the Companies Law, which now permits contingent and prospective creditors to present winding up petitions

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on the grounds that it made good commercial sense and provided investors with a measure of certainty and security. The Board also noted several recent first instance decisions, in which it has been held or contemplated that redemption of redeemable shares issued in various investment vehicles took place at the expiry of the relevant notice to withdraw, converting the member into a simple creditor as from that date, even though payment had not yet been received.

The Board also considered, but did not express a concluded view, as to whether the CICA had been correct to decide that, as a point of general principle, a redeeming shareholder remains a member of the company until he has received payment and his name has been removed from the register of members. The Board noted that the CICA had relied upon "Victorian authority" for this conclusion and then later went on to distinguish each of these authorities in turn, before noting:

"On the [company's] analysis, [the investor] was both a creditor whose debt fell... to be regarded as a liability of the [company] from the Redemption Date and would fall to be taken into account in any balance sheet, and at the same time a shareholder whose shareholding would continue to be included in the company's capital until payment of the debt. The result of this double-counting would be to dilute the company's NAV, to the potential detriment of present shareholders and benefit of prospective shareholders. No satisfactory response to this point was, to the Board's mind, forthcoming from the [company's] side, but, since the point was not explored in detail in the light of relevant statutory and accounting principles, the Board need not rely upon it to decide the issue before the Board."

This issue is likely to be the subject of further examination in future cases.

The Privy Council's decision is perhaps a timely reminder of a point that has been obscured by the weight of commentary. The central issue that was decided in this case was not one of overarching legal principle, but one that turned upon the construction of the company's articles. In the final analysis, the company would have been able to suspend the payment of redemptions proceeds, had

the constitutional documents empowered it to take that course. The judgment underscores the importance of the need for careful drafting of a company's constitutional documents. However, as investors increasingly react against long periods of suspension, we can be sure that we have not seen the last of arguments as to the correct construction of funds' constitutional documents.

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