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RISA Cayman

RISA CONFERENCE 2018

IN ASSOCIATION WITH SOUTH SQUARE

Panel A
Fund Redemption Disputes

Jeremy Goldring QC - South Square (Moderator)

Adam Al-Attar - South Square

Sam Dawson - Carey Olsen

Eleanor Fisher - Kalo

Cayman Islands Funds

Has the law struck the right balance between members, former members, creditors, and others?

Cases to consider

- In considering the issues below, it is useful to have in mind a couple of simplified cases.

- Case 1: a Cayman Islands fund that is a Ponzi scheme.

- Case 2: a Cayman Islands fund that invests in a Ponzi scheme, but which is itself innocent of any fraud or wilful default.

Perspectives

There are various competing perspectives to consider. These include:

- Members
- Former members
  - Fully redeemed and paid
  - Partly redeemed and paid
- Creditors:
  - Former members (unpaid redeemers)
  - External creditors (e.g. corporate service providers)
  - Internal creditors (e.g. management)
- Officers
- Advisors

Issue 1: Does the law go too far in favouring redemption creditors over remaining investors in a fund?

- *Pearson v Primeo* [2017] UKPC 19
- *Held*: Primeo's shareholding in Herald had been redeemed, for the purposes of section 37(7) of the Companies Law as well as Herald's articles of association, on 1 December 2008, and the fact that payment remained suspended and outstanding until the commencement of the winding up on 14 February 2013 was irrelevant.
- *Appellant's submission*: "redemption" under section 37 of the Companies Law must be understood "as embracing a whole process including payment of the proceeds".
- *Board's reasoning*: (1) "redemption" is "the surrender of the status of shareholder, with all attendant rights"; and (2) the deferral of payment of the redemption price is "a grant of a short period of credit to the company".
- Should the dividing line be payment, as opposed to a sufficiently communicated intention to surrender the rights of a shareholder?
- Conversely, why should payment matter, especially as its timing can be controlled by the fund?
- How does statutory interest affect the balance between redemption creditors and members?

Issue 2: How important are shareholder rights - should Caymar law allow alternative methods of distribution in the case of fund insolvency?

- *Pearson v Primeo*, CICA (Civil) 5/2017, 9 January 2018
- *Held*: the power of a liquidator, under section 112(2) of the Companies Law, to rectify the register of members is to alter the register to reflect the prior legal rights of those entitled (or not entitled) to be registered as members.
- *Appellant's submission*: the power of a liquidator under section 112(2) of the Companies Law is freestanding power of variation exercisable by the liquidator according to his discretion in order to achieve a "just" scheme of distribution as between members. It is not dependent upon the existence (or not) of a prior legal right to be entered (or removed) from the register of members.
- *CICA' reasoning*: it is inherent in the concept of rectification that the register should only be rectified to reflect prior legal entitlements, which, relevantly, would require circumstances sufficient to avoid the contract of allotment / the validity of the relevant redemptions by reasons of a fraud or default by the fund in connection with the relevant misstated NAVs.
- Should binding statements of NAV be so significant, even in relation to a fund whose underlying investments were wholly fictitious?
- Should the difference between an internal and external fraud be so significant, given all investors have suffered the same common misfortune?

Issue 3: Should there be more or fewer clawback claims?

- *DD Growth Premium 2X Fund v RMF* [2017] UKPC 36.
- *Held*: (1) pursuant to section 37 of the Companies Law (Revision 2007), the payment of a redemption price in respect of redeemable preference shares funded from the fund's share premium account in circumstances in which the fund was unable to pay its debt as they fell due was unlawful; (2) however, there was no restitutionary remedy to reverse any unjust enrichment merely because of that illegality, and there had instead to be the circumstances of an unconscionable receipt for any claw back claim to exist.
- *In re Weavering Macro Fixed Income Fund* [2016 (2) CILR 514]
- *Held*: it is not necessary to demonstrate fraud or dishonesty in relation to a preferential payment contrary to section 145(1) of the Companies Law; however, the company's principal intention must be to prefer the recipient relative to other creditors who would rank in the liquidation of the company.
- Should a strict liability claim exist for the receipt of an unlawful dividend?
- Should an objective test be used to identify a preference?
- Is it sufficient that a fund's officers can be held accountable for any unlawful payments, or for any preferential payments?

Issue 4: In relation to fund redemptions, what should matter more: the terms of the fund document, or market practice?

- *In re Ardon Maroon Asia Master Fund*, FSD 18/2015, 17 July 2018
- *Held*: the master fund's liquidators had validly rejected the feeder fund's proof of debt, which has been asserted on the basis of a conforming redemption request. The redemption request did not conform to the requirements of the master fund's articles of association. The fact of redemption at the feeder fund level, or of any market practice of "automatic" and "back-to-back" redemptions in a master-feeder structure was irrelevant.
- Should the precise requirements for a redemption matter in circumstances in which the same officers and administrators administer the master fund and the feeder fund, whose investor made the redemption request, which the feeder fund had accepted?
- Should a market practice relating to redemptions, if genuinely notorious, have a greater role to play in the construction of the Companies Law?
- Should such a practice be irrelevant because, if it really was followed in a given case, there will be a good factual argument as to the waiver of any otherwise unsatisfied procedural requirements?

Panel B

Cayman valuation issues - One year on
An update from last year

Barry Isaacs QC - South Square (Moderator)
Marcus Haywood - South Square
Fiona MacAdam- Walkers
Gemma Freeman- Maples

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Dissenter Discovery

Gemma Freeman

Maples and Calder

MAPLES

Recap

- ***Homeinns*** (Mangatal J, August 2016), ***Qunar*** (Parker J, July 2017), ***Trina Solar***, (Segal J, July 2017)
  - Mutual exchange of documents under GCR O.24 not appropriate.
  - Dissenter discovery not ruled out - "*very clear grounds*" required
  - Section 238 cases should not be treated like ordinary civil litigation

Disconnected reasoning?

- Court not interested in Dissenting Shareholders' subjective motivations / views
- Public information - only half of the picture

Versus

- Consider all factors and elements known or ascertainable as at the date of the merger or consolidation
- One true rule

Dole/ Delaware

- Valuation is not an esoteric specialty
- Rise of the investor class - stock holders presumed to be competent to express views in valuation
- Lay witnesses?
  - Should be competent to explain why they made the decisions they did including the views they held about the value of the subject company
- Professional investors?
  - Hardly unqualified to express views about valuation. If they believe otherwise, they should disclose to their investors "*that the financial professionals who manage their funds are not qualified to do their jobs*."

Qunar CICA

- CICA on *Dole*: "*sophisticated, well-reasoned decision”* containing "*much wisdom”* on discovery
- Usual relevance based principles of discovery apply to documents of company and dissenter alike
- One sided disclosure - "*anomalous*", "*unprecedented outside of s.238 cases*" and "*counter-intuitive*"
- No-one is more concerned with getting the research, analysis and insight right than those who invest in a company
- Court should be exposed to all material and all the arguments

Proprietary Rights Carve Out?

- **Nord Anglia** (Kawaley J, June 2018)
  - Grand Court is bound by CICA
  - Internal / external valuations reviewed including supporting materials?
  - Dissenters' own models – a bridge too far?
  - Exclusion for documents where Dissenters assert **proprietary rights**
- *"Dissenters' only legitimate objection is being required to disclose proprietary material which is not directly relevant to the fair value question*" [?]
- Point considered before Parker J in Qunar directions hearing, June 2018
- Exclusion of documents? Workarounds ?

Dissenter Discovery since CICA

Qunar

- Consent Orders agreed in:
  - Trina (Segal J): "Qunar " categories
  - Zhaopin (Kawaley J): " Qunar " categories with proprietary rights tweak

Beyond *Qunar* categories?

- What would a PE Firm or Hedge Fund be expected to have with regard to its investments?

  - Internal valuation committees / investment committee documents?

  - Auditor-related communications?

  - Audited financial statements?

  - Anything else?

Need more law!

- Directions Orders are not "precedents"
- There may be some orders that are "standard" in the "usual type of case" (*Homeinns*)
- Orders made by consent are of limited assistance to the Court

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Interim Payments

Fiona MacAdam
Walkers

WALKERS

Interim Payments - What is the issue?

- Statutory effect of commencing s.238 proceedings: s.238(7)
- Company has use of money pending outcome of s.238 proceedings

"It can be said that the [dissenting shareholders] have been kept out of the money since 2 July 2014, the date on which Integra made its written offer to pay fair value of US$10 per share pursuant to section 238(8). For whatever reason, it did not offer to pay this amount (or any lesser amount) on account pending the outcome of the proceedings. It follows that Integra has had the use of the [dissenting shareholders'] money for more than a year."

In the matter of Integra Group, (Jones J, unreported, 28 August 2015)

Interim Payments – Grand Court Rules

- Order 29, rules 9 to 18 of the Grand Court Rules (1995 Revised Edition)

"***Interim payments***" *in relation to a defendant, means a payment on account of any damages, debt or* ***other sum****…which* ***he may be held liable to pay*** *to or for the benefit of the plaintiff*…" (GCR O.29, r.9)

- Court has power to make an order for interim payment of such amount as it thinks **just** if satisfied:

"…*that if the action proceeded to trial the plaintiff would obtain* ***judgment*** *against the defendant for a* ***substantial sum of money*** *apart from any damages or costs…*" (GCR O.29, r.12 (c))

Interim Payments – Key Cases

- *In the matter of Qihoo 360 Technology Co. Ltd*
  (Quin J, unreported 26 January 2017)

- *In the matter of Qunar Cayman Islands Limited*
  (Mangatal J, unreported 8 August 2017)

- *In the matter of Qunar Cayman Islands Limited*
  (Cayman Islands Court of Appeal, 20 June 2018)

Interim Payments – *Re Qunar Cayman Islands Limited* (1)

1. Does the Grand Court have jurisdiction to award interim payments in fair value proceedings?

- Money judgment or declaratory relief?
- Stand-alone statutory code
- No carve out in the GCR
- Substantial sum of money

2. If the Grand Court does have that jurisdiction, should it exercise its discretion to do so?

3. If so, what is a "just sum"?

Interim Payments – *Re Qunar Cayman Islands Limited* (2)

2. Should the Grand Court exercise its discretion?

3. If so, what is a "just sum"?

"*The purpose of the jurisdiction to order an interim payment is to* ***mitigate the hardship or prejudice*** *that may be occasioned to the Applicants by being kept out of money, during the interval between the commencement of the proceedings and the ultimate outcome*."

"*…a* ***just amount*** *…should be* ***predicated*** *on the basis of* ***what the Company has maintained is the fair value***…"

- Ability to order repayment of any overpayment following trial

Interim Payments – Does the Court have jurisdiction? (CICA)

In the matter of Qunar Cayman Islands Limited (Cayman Islands Court of Appeal, 20 June 2018)

- Court has jurisdiction to order interim payments in s. 238 proceedings
- S.238 does not preclude an order for interim payment notwithstanding there is no express reference
- Not a self-contained code
- Liability to pay is expressly the subject of s. 238

Interim Payments – Impact of minority discounts

In the matter of Zhaopin Limited (McMillan J, unreported, 22 June 2018)

- Minority discount applied to interim payment (15%) as fair value offer made pre *Shanda Games* but in the absence of expert evidence on the amount of the minority discount

Interim Payments – Practical Points

- The principle that interim payments are available in s.238 cases has been settled and more recently interim payments have been the subject of consent orders
- Dissenting shareholders have standing to present a winding up petition against the Company on the basis of a debt owed by way of interim payment reflected in a consent order

In the matter of Trina Solar Limited (Segal J, 25 August 2017)

Re Shanda Games Limited

Should a minority discount be applied by the court in its assessment of the fair v
dissenter's shares?

Marcus Haywood

South Square

Section 238 of the Companies Law

(1): “A member of a constituent company incorporated under this Law shall be entitled to payment of the fair value of his shares upon dissenting from a merger or consolidation.”

(9): “If the company and a dissenting member fail…to agree on the price to be paid for the shares owned by the member…. the company shall (and any dissenting member may) file a petition with the Court for a determination of the fair value of the shares of all dissenting members.”

(11): “At the hearing of a petition, the Court shall determine the fair value of the shares of such dissenting members as it finds are involved…”

Shanda Games: The Facts

- Shanda Games incorporated in the Cayman Islands
- One of China's largest video games companies
- On 18 November 2015, Shanda Games merged with Capitalcorp Ltd
- 99.3% of Shanda's shareholders vote in favour of the merger
- The shares held by the dissenters amounted to 1.64% of the issued share capital of the company

The First Instance Decision

- In Delaware and Canada, each of which had regimes similar to section 238 of the Companies Law, it was clear no minority discount was to be given

- The purpose of the fair value standard was to ensure that the dissenting minority was fully protected. That meant that they should be compensated for the full value of their interest in the company, which was their proportionate share in the capital and value of the company

The Decision of the Court of Appeal

The Approach in England:

a) The provisions of the English Companies Act 2006 regarding schemes of arrangements and squeeze outs are broadly replicated in sections 86, 87 and 88 of the Cayman Islands' Companies Law

b) Under English law, these two mechanisms ordinarily require a minority discount to be applied

c) So too in the context of an unfair prejudice petition, the general rule is that the court will direct that the minority's shares be purchased at a discount unless the case is one of quasi partnership

d) Section 238 is to be construed consistently with this approach

The Decision of the Court of Appeal

- The Delaware authorities were underpinned by policy considerations that do not apply in the Cayman Islands

- In the Cayman Islands the following policy prevails: It is not unfair to offer a minority shareholder the value of what he possesses, which is a minority shareholding

- What's next?

Panel C

Debate on Common law directors' duties litigation

Richard Fisher- South Square (Moderator)

David Alexander QC- South Square

Mark Arnold QC – South Square

John Royle – Grant Thornton

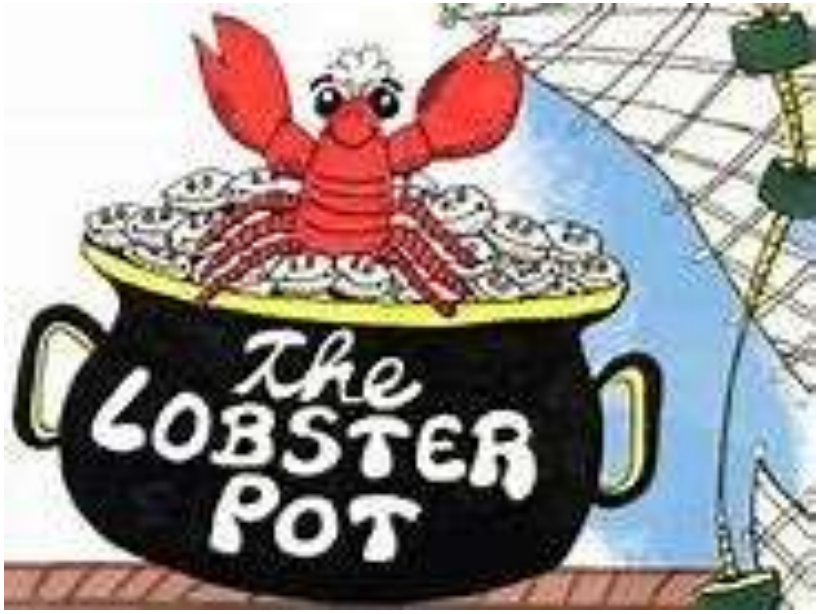
Declan Magennis - BDO

CON Limited: how much can you get away with?

BTI v Sequana; Weavering; Carlyle Capital; Madoff v Raven

CON Limited: Issue 1

CON Limited: Issue 2



CON Limited: Issue 3

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Thank You