



Cayman Islands Law Changes Prompt Reviews of Fund Documents

Taken together, the 2007 and 2009 revisions to the Companies Law of the Cayman Islands have the unintended consequence of allowing unpaid redeeming investors and redeeming investors whose redemption of shares are suspended, to petition to wind up a Cayman fund.

This is a significant departure from the law as it stood following the *Strategic Turnaround* case. In that Cayman Islands case, it was relevantly held that (pursuant to the particular articles under consideration) the investor did not have standing to petition to wind up the fund on the basis that the fund was unable to pay its debts because an investor had a future debt that was not presently due and payable. Given that ruling, it was only open to unpaid and suspended investors to petition to wind up the fund on the grounds of some alleged impropriety or mismanagement of the fund, by filing a petition to wind up on just and equitable grounds.

While the submission is yet to be made to the Grand Court, it is now arguably the case that investors with unpaid redemption entitlements or subject to a suspension can petition to wind up a fund on the basis of their contingent or prospective debt claim and the inability of the fund to pay its debts, notwithstanding the *Strategic Turnaround* decision. The reasons for this are as follows:

1. The 2009 revision of the Companies Law enabled contingent or prospective creditors to petition to wind up a Cayman company.
2. The 2007 amendments did not include the mooted balance sheet test for insolvency.
3. In order to avoid a fundamental conceptual contradiction between consideration of contingent and prospective debt on the one hand and the test for insolvency being solely debts due and owing on the other, the cash flow test will need to take account of some futurity of debt.
4. Future cases in the Cayman Islands are therefore likely to require an assessment of the ability of the fund concerned to meet future debt from future cash flow.

A redeeming investor will fall into the category of a contingent and prospective creditor on submitting a valid redemption notice despite being a 'creditor qua member' and will remain a contingent and prospective creditor notwithstanding a fund's suspension of redemptions and redemption payments.

Such a process will clearly place shareholders in a far stronger position in negotiating with the fund. Funds are very rarely insolvent on a balance sheet test, as the assets within the fund are ordinarily very substantial when compared with their liabilities. Problems arise on redemptions when assets may not be sufficiently liquid to meet redemption requests. Historically, this was addressed by the use of gates or suspension of redemptions to limit the amount that had to be paid out on any given redemption day. However, under Cayman law, an investor who is subject to a gate or suspension (or indeed who remains unpaid without any formal suspension process having been deployed by the fund) is likely to be able to petition to wind up the fund as the investors will immediately become a contingent or prospective creditor and the cashflow insolvency test will need to take account of unpaid redeemers' contingent and prospective claims.

At Appleby, we are advising managers setting up new funds on this potentially very damaging scenario for a fund and its manager, and are preparing fund documents which protect the fund in such circumstances. Consideration should also be given to the position by existing funds. Whilst it is not as straightforward for existing funds to amend their constitutional documents and offering memoranda, managers should still be aware of their options, and take action before we see the next round of illiquidity strike. Existing investors in troubled funds may also find it useful to consider the implications of the changes to their position.

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