

## APPLEBY eALERT

## Strategic Turnaround: Welcome Guidance for the Funds Industry on the Suspension of Redemptions

Among the most debated issues in the funds industry over the last two years are the questions to what extent, and when, can a fund suspend redemptions; and what is the effect on a redeeming investor of a suspension imposed by the fund after the investor's redemption notice has expired?

The recent judgment of the Privy Council in *Culross Global SPC Limited v Strategic Turnaround Master Partnership Limited* provides helpful and authoritative guidance about how provisions in a fund's contractual documentation addressing redemptions and suspensions of redemptions should be interpreted, and how to determine which of the various documents constituting the investment agreement between a fund and its investor should take priority if the documents contain inconsistent provisions.

The Privy Council held that a fund did not have power to suspend the payment of redemption proceeds after a valid redemption notice submitted by the investor had expired, having construed the fund's articles of association and other documents that were incorporated or referred to therein. As a result, the investor was held to be a creditor of the fund following the expiry of its redemption notice and thus had standing to petition to wind up the fund for non-payment of its redemption proceeds.

The Court of Appeal of the Cayman Islands had held that the fund was entitled to suspend not only the calculation of NAV and redemptions but also the payment of redemption proceeds. The Court considered that the process of redemption was not complete until the investor had been paid his redemption proceeds in full; the investor remained a member until that time and so remained bound by the articles which permitted a suspension of redemptions (even though only the offering document referred to suspending the payment of redemption proceeds). In coming to this conclusion, the Court of Appeal had relied on 19th century authority concerning disputes between building societies and their members. Overturning the Court of Appeal's decision, the Privy Council found that as the matter was a contractual one, none of those cases had any particular relevance to the question.

## **The Decision**

Key holdings by the Privy Council were:

- Section 37(3)(c) of the Companies Law provided that the terms on which shares are to be redeemed must be authorised by or pursuant to the articles of association; to the extent that certain articles referred to the offering memorandum, the terms of the latter were expressly relevant, but the offering memorandum itself made clear that the legal relationship between the Fund and its shareholders was defined by the articles and not the offering memorandum.
- The focus of provisions in the articles concerning redemptions was on the Redemption Date by reference to which the redemption price crystallized: the payment obligation was dealt with as a matter subsidiary to the ascertainment of the redemption price. While both stages may be said to be part of a continuing process, it did not follow that “redemption” only occurred at the conclusion of that whole process.
- The existence and extent of any power to suspend the payment of redemption proceeds after the Redemption Date is a subject on which a fund and investors were at liberty to make any contract between themselves which they pleased. However, this would require clear words to that effect in the articles (and those in the instant case read naturally to the opposite effect).
- There should be no a priori view that, until the payment of redemption proceeds an investor should necessarily remain a shareholder of the fund; and the fact that an investor’s name remains on a register of shareholders does not mean that it should have done so under the fund’s articles.
- The provisions of this fund’s articles dealing with suspension of redemptions were not, on their true construction, intended to operate on redemption notices which had already expired (i.e. where the Redemption Date has passed) as at the date of the suspension. The terms of the articles and the offering memorandum were not consistent, but in this case the former prevailed over the latter (contrary to the view expressed by the Court of Appeal).

The Privy Council was fortified in its conclusion by reference to commercial sense. The fund was an investment vehicle to which investors could for a defined period commit funds and which offered investors, for obvious commercial reasons, the relative security of a defined route by reference to which they might recover the value of their investments at a defined date. The fund’s analysis was unattractive for investors in the fund and by extension for the fund itself as an institution seeking investors, in subjecting them to different and much greater insecurity.

## **Helpful guidance for the industry**

The Privy Council’s decision is a welcome decision for funds practitioners and an authoritative development of jurisprudence in this field. Points of general application, which are expressed in or are implicit in the judgment, include:

1. Disputes of this kind are to be resolved almost wholly by reference to the documents constituting the contractual relationship between the parties. The Court will apply a commercial approach to the interpretation of those documents to ensure that the effect of the documents properly reflects what the parties (acting reasonably) intended.

2. Fund documentation may provide for the retrospective suspension of redemptions: such provisions are not contrary to principle. If the contractual documents do properly provide by clear language for such retrospective suspension then this should be enforced by the Court. Whether such provisions should be included in a fund's articles is a commercial, and not a legal, consideration.
3. A commercial construction of a fund's constitutional documents will normally require its articles of association to take precedence over the terms of the offering memorandum, but this is a matter where the parties are free to regulate their relationship: a fund can determine which provisions of which documents will take precedence in any given situation, as long as this is clearly drafted. However, non-contractual provisions in an offering memorandum can still give rise to misrepresentation claims by investors who relied on them in deciding to invest.
4. Redemption is not a process but an event, the contractual documents determining when that event comes about.
5. If an investor has effectively redeemed in accordance with the constitutional documents of the fund, that investor is a creditor of the fund with standing to petition to wind up the fund.

The case is likely to have far-reaching implications outside the Cayman Islands; it will be of interest and no doubt relied upon in other jurisdictions facing fund disputes on similar issues.

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