

CAYMAN ISLANDS

GRAND COURT

Primeo Fund (in official liquidation) -v- Herald Fund SPC (in official liquidation), FSD 27/2013, per Jones J (12 June 2015)

REDEMPTION OF SHARES - RECTIFICATION OF THE REGISTER OF MEMBERS - SECTION 37(7) OF THE COMPANIES LAW - UNDER SECTION 112 OF THE COMPANIES LAW

This case concerned Herald Fund SPC (In Official Liquidation) (“Herald”), which was an open-ended investment fund, which was incorporated on 24 March 2004. Herald invested the majority of its funds in the Bernard L. Madoff Investment Securities LLC (“BLMIS”). The Primeo Fund (In Official Liquidation) (“Primeo”) was incorporated on 18 November 1993 and also carried on business as an open-ended investment fund. Primeo initially placed funds for investment directly with BLMIS in 1993 but, from 2004 onwards, it invested in Herald which resulted in it becoming an indirect victim of the Madoff Ponzi scheme.

The above proceedings concerned an application that certain issues involved the liquidation of Herald (which included an additional liquidator (the “Additional Liquidator”) acting as Herald’s representative) and Primeo be resolved through the direction of the Court. Primeo was placed into voluntary liquidation on 23 January 2009 and its liquidation was brought under the supervision of the Court on 8 April 2009. Herald had suspended the calculation of its net asset value (the “NAV”) and the issue and redemption of shares on 12 December 2008 (the day after the revelation of the Madoff fraud) but remained under the control of its Directors until 23 July 2013 when a winding up order was made on the petition of Primeo.

The first issue in question was whether Section 37(7)(a) of the *Companies Law* applies in relation to the Participating Non-Voting Shares, which form the subject of redemption requests submitted to Herald by various shareholders in December 2008 (the “December Redeemers”). HSBC Securities Services (Luxembourg) SA (“HSSL”), acting on behalf of Herald in its capacity as administrator, received requests from the December

Redeemers requesting the redemption of Participating Non-Voting Shares (the “December Redeemer Shares”) for a redemption day of 1 December 2008. On or about June 2011, HSSL acting for, and on behalf of, Herald sent the December Redeemers confirmation that their shares had in fact been redeemed. One of the December Redeemers ultimately was paid prior to the suspension of trading on 12 December 2008 (as a result of Madoff’s confession of his fraud on 11 December 2008) whilst the others were not.

The Court considered Section 37(7) of the *Companies Law* issue regarding the redemption of shares. In *Culross Global SPC Limited -v- Strategic Turnaround Partnership Limited* (2000) 23 CILR 364, it was indicated that the question of when shares are redeemed is a question not only for the *Companies Law*, but also for the relevant company’s articles of association. On the basis of the facts, this was non-contentious and it was clear that the December Redeemers had redeemed their shares in accordance with the Company’s articles of association. In that case, it was determined that the Plaintiff Shareholder had in fact served a valid redemption request before the suspension of trading. The Privy Council held that the power to suspend the redemption process did not apply to the Plaintiff in question as the redemption had already taken place. Similarly in *RMF Market Neutral Strategies (Master) Limited -v- DD Growth Premium 2X Fund* (Unreported, 17 November 2014), the Chief Justice concluded that the effect of the articles was that upon service of a valid redemption notice, the shares in question ceased to be outstanding on the relevant valuation day, whereupon the shareholder became a creditor in respect of the redemption proceeds. Jones J held in favour of Primeo.

In addition to the issue of redemption, the Court also considered the matter of rectification of the register of members. In particular, the Courts considered whether: (a) the NAVs determined pursuant to the articles of association during the period from 24 March 2004 (being the date of its incorporation) to 10 December 2008 (being the date immediately before the revelation of the Madoff fraud) in respect of each class of Participating Non-Voting Shares issued by Herald were not binding on Herald by reason of 'fraud or default' within the meaning of Section 112 of the *Companies Law* and Order 12, Rule 2 of the *Companies Winding Up Rules* and (b) Section 112 of the *Companies Law* and Order 12, Rule 2 of the *Companies Winding Up Rules* applied so as to empower the Additional Liquidator of Herald to rectify its register of members. Section 112(2) of the *Companies Law* empowers an official liquidator to rectify the register of members in the case of a solvent liquidation of a company, which has issued redeemable shares at prices based upon its NAV from time to time. Jones J reasoned that for the NAVs not to be binding between the company and its members, there must be some conduct on the part of the company or its agent, which has the effect of vitiating the company/member contract. Further, he reasoned that the mere fact that Herald's NAVs were negatively affected by the BLMIS scandal would not be sufficient to vitiate the contract (see *Fairfield Sentry Ltd -v- Migani* [2014] UKPC 9). Furthermore, Jones J held:

"I think that it is highly improbable that Rule 2 was intended to operate in a way which would make the determination of a company's NAV open to challenge whenever it could be said, with the benefit of hindsight, that it had been mis-stated by reason of the fraud or default in some way which would not have the effect of vitiating the contract".

The key issue is when the Additional Liquidator should use this power under Section 112 of the *Companies Law* and what methodology should be used by the Additional Liquidator to determine how the rectification of the register of members should take place. Jones J ultimately adjourned this question until the next hearing.

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