

## The Rocky Road to Redemption

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Investors will undoubtedly agree that “the path to redemption is not always smooth” as stated by Lord Mance in the Privy Council’s recent judgment in *Pearson -v- Primeo Fund* [2017] UKPC 19. The judgment brings finality to the dispute between Herald Fund SPC (in Official Liquidation) (“Herald”) and Primeo Fund (in Official Liquidation) (“Primeo”) regarding the redemption of shares. The Privy Council dismissed Herald’s appeal, confirming the earlier decisions of the Cayman Islands Court of Appeal and Grand Court. All three courts found that an investor who had properly redeemed its shares, but had not been paid, will be a creditor of the company in respect of its redemption proceeds. Accordingly, its claim (as a creditor) will rank ahead of the remaining investors in the liquidation of the company, albeit behind those of ‘ordinary’ creditors.

### The Dispute between Herald and Primeo

Herald, an open-ended investment fund, invested the majority of its funds in Bernard L. Madoff Investment Securities LLC. Primeo also carried on business as an open-ended investment fund. From 2004 onwards, Primeo invested in Herald which resulted in Primeo becoming an indirect victim of the Madoff Ponzi scheme.

On 1 December 2008 (or at some earlier redemption date), a number of investors’ redemption requests (represented in the Privy Council by Primeo) were accepted by Herald in accordance with Herald’s articles (the “December Redeemers”).

On 11 December 2008, the Madoff fraud was exposed and Herald took immediate steps to suspend the calculation of its net asset value and the issuance and redemption of shares, doing so at 5:00 pm on 12 December 2008. The December Redeemers had not been paid.

Herald’s position was that all investors who were unpaid on 12 December 2008 rank as ordinary shareholders and should therefore be paid *pari passu*. Primeo’s position was that the December Redeemers were owed simple debts by Herald and so should rank in the liquidation as ordinary creditors (above unredeemed investors).

### The Interveners

In addition to the Privy Council hearing the dispute between Primeo and Herald in relation to the December Redeemers, the Privy Council also heard arguments from two additional parties:

- Reichmuth & Co appeared representing the interests of investors who, before 5pm on 12 December 2008, gave notice to redeem on a subsequent date (the “Late Redeemers”); and

- Natixis SA appeared representing investors who made requests to redeem after 5pm on 12 December 2008 (the “Later Redeemers”).

Neither party had been heard in the courts below.

## The Law

The fundamental question for the court was whether (and to what extent) Section 37(7)(a) of the *Companies Law (2006 Revision)* applied to each group of redeemers. Section 37(7)(a) provides that:

*Where a company is being wound up and, at the commencement of the winding up, any of its shares which are or are liable to be redeemed have not been redeemed or which the company has agreed to purchase have not been purchased, the terms of redemption or purchase may be enforced against the company, and when shares are redeemed or purchased under this subsection they shall be treated as cancelled:*

*Provided that this paragraph shall not apply if-*

- (i) *the terms of redemption or purchase provided for the redemption or purchase to take place at a date later than the date of the commencement of the winding up...*

The Privy Council found that:

*“Section 37(7) is thus addressing situations in which redemption or purchase ought to have been, but was not, effected by the company before the commencement of the winding up, and allows the relevant shareholder to enforce the terms of redemption or purchase notwithstanding the winding up.... [Section 37(7) was not] designed to lower or reverse the status of a shareholder who had by a redemption or sale already become a creditor. Indeed, it is difficult to see any basis in the Companies Law or in Herald’s articles whereby such a redemption or sale could be regarded as reversed, or a former shareholder reconverted to the status of a shareholder.”*

Therefore, so the Privy Council said, Section 37(7) did not apply to the December Redeemers (whose shares had been redeemed pursuant to the articles of Herald but who remained unpaid). Accordingly, the December Redeemers were found to be creditors of Herald and therefore entitled to claim in priority to the unredeemed shareholders in the liquidation of Herald.

The Late Redeemers accepted that Section 37(7) applied to them, but argued that the proviso at Section 37(7)(a)(i) did not apply and that therefore they should be entitled to enforce their redemption requests against Herald. The Late Redeemers argued that the redemption was expected to take place in February 2009, before the winding up of Herald in July 2013 (although it did not occur as a result of the suspension on 12 December 2009). The Privy Council found that the effect of the suspension was that redemption could not occur under the articles of Herald. As the suspension continued until the commencement of the winding up of Herald, the terms of the redemption must be regarded as having provided for redemption to take place at a date later than the date of commencement of the winding up. Accordingly, the Section 37(7)(a)(i) proviso applied to the Late Redeemers and they were unable to enforce the redemption against Herald under Section 37(7)(a). Given the findings in relation to the Late Redeemers, it followed that the Later Redeemers were also unable to enforce under Section 37(7)(a). The Privy Council also noted that the redemption requests by the Later Redeemers after suspension may have been invalid under the articles of Herald (but did not need to decide this point).

## Conclusion

Fund managers and investors will welcome the Privy Council’s judgment which confirms, and is consistent with, the earlier decisions of the Cayman Islands Court of Appeal and Grand Court. The Privy Council’s comments that shareholders and companies have the freedom to shape their relationship as regards redemption or purchase of the company’s shares will also be well received.

While the path to redemption may not always be smooth, the Privy Council decision marks, at least, the end of the road for Primeo.

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