



January 2009 Updater

Current developments in Cayman's legal and regulatory environment

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Feedback welcome.

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Fund redemptions and suspensions - important new case law

On 12 December 2008 the Cayman Islands Court of Appeal gave judgement in *In the Matter of Strategic Turnaround Master Fund Partnership, Limited*.

Background

In summary, the facts giving rise to the appeal, were these: a shareholder gave the required notice to redeem all of his shares in the fund on 31 March 2008, 90% of the redemption price being payable no later than 30 days after that date. After the redemption date, but before payment of any of the redemption price, the directors of the fund exercised, or purported to exercise, a power within its articles of association to suspend redemptions, which included a power to suspend the payment of redemption proceeds, and gave notice to its shareholders of that suspension. Subsequently, the shareholder petitioned the Grand Court for the winding up of the fund on two grounds, namely that the fund was unable to pay its debts, and that it was just and equitable that the fund should be wound up. The fund's application to the Grand Court to strike out the winding up petition was dismissed, and the fund appealed to the Cayman Islands Court of Appeal.

In its judgement, the Court of Appeal analysed the procedure and effect of redemption of shares in a corporate mutual fund and the exercise of a power to suspend redemptions. The Court confirmed, in a number of important respects, the prevailing views among practitioners as to the status and rights of investors in such circumstances but there are issues arising from the judgement which remain to be clarified.

Important points

Significant points made in the judgement, which was confined to matters of law and construction (of the relevant contractual documents of the fund), include the following:

1. Redemption is not a single event but a process, beginning with submission of the redemption request and ending with payment in full of the redemption price;
2. Upon the redemption date, the redeeming shareholder becomes a creditor of the fund in respect of the redemption price, notwithstanding that that price has not yet been calculated;
3. As a creditor, on a winding up of the fund, a redeeming shareholder ranks behind unsecured third party creditors (i.e. those whose debts do not represent payments in respect of their shares) but ahead of shareholders who have not redeemed their shares;
4. Notwithstanding that it has become such a creditor, the redeeming shareholder remains a member of the fund at least until its name has been removed from the register of members;
5. Whether a fund has power to suspend redemption payments after the relevant redemption date is a matter of construction of the relevant contractual documents (the fund's offering memorandum, articles of association and the subscription agreement), but such a power may lawfully be conferred;
6. If a power to suspend payment of the redemption price is validly exercised, the redeeming shareholder will, during that suspension, have no standing to petition as a creditor for the winding up of the fund on the ground that the fund is unable to pay its debts, because there is no debt presently due and payable to the redeeming shareholder;

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7. However, since it is still a member of the fund, the redeeming shareholder has standing to petition for the winding up of the fund on the just and equitable ground providing it can be shown that it will have a tangible interest in the winding up;

8. The test for whether a fund is unable to pay its debts, for the purposes of a winding up petition on that ground, is a cash flow test, not a balance sheet test. However, insolvency on a balance sheet test may be the basis of a petition to wind up the fund on the just and equitable ground.

Points that require clarification

The court's view of when a redeeming shareholder ceases to be a member of the fund is not altogether clear. The court appeared to contemplate that a shareholder could continue to be a shareholder until the redemption price had been paid in full, notwithstanding that his name had previously been removed from the register of members. This would not be consistent with the provisions of the Companies Law, and it may be that the court was suggesting that the name of a shareholder could not properly be removed from the register of members until the redemption price had been paid in full. This determination was based on the court's interpretation of the contractual documents of that particular fund. It is not clear whether, if the contractual documents had expressly provided that a redeeming member would cease to be a member on the relevant redemption day and required the removal of its name from the register of members on that day, the court would have found differently on this point.

The point at which a redeeming shareholder ceases to be a member is important because, as a member, the shareholder continues to be bound by the provisions of the fund's articles of association including any provisions

empowering the fund to suspend payment of the redemption price. The anomaly of a redeemed member remaining as a shareholder as well as a creditor has the following results:

- a shareholder who had redeemed all its shares could continue to be locked into the fund for up to 18 months where the fund's contractual documents provided for a partial hold back of the redemption price until completion of the audit. During this period, the redeemed shareholder would remain entitled to exercise its rights as a shareholder, and those rights would need to be taken into account in any proposed shareholder actions, including voting at any general meetings of the company;
- a redeemed shareholder could petition to wind up the company as a shareholder although its tangible interest in the fund was as a creditor;
- the interests of shareholders in a fund are continuing and unquantifiable. The interests of creditors are more limited. Their concern is that the fund should be able to pay its debts when they are due. For this reason, the interests of the fund, in which its directors have a duty to act, take account of the interests of creditors only if the fund is in, or near, insolvency. Affording a redeemed investor status as both shareholder and creditor is not easy to reconcile with these traditional views; and
- redeemed shares are required to be cancelled and become available for re-issue when the redeeming shareholder has been removed from the register. If the Court did contemplate that an investor could remain a member of a fund after its name had been removed from the register, the consequence, if the redeemed shares were issued to a new investor would be two members of the fund in respect of the same shares;



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Ogier suggested actions

Until these points are resolved, it would be sensible to ensure that the fund's contractual documents expressly provide that a redeemed member ceases have all the rights of a shareholder, and that its name be removed from the register, on the relevant redemption day. We would also suggest that funds liaise with their administrators to ensure that they are removing the names of redeeming investors on the relevant redemption day.

Cayman Islands passes Tax Information Authority (Amendment) Law 2008

The Cayman Islands Government passed the Tax Information Authority (Amendment) Law 2008 (the "Amendment Law") on 22 December 2008. The Amendment Law amends the Tax information Authority Law 2005 which provides a parallel mechanism to existing bilateral agreements in place on tax cooperation matters. The Amendment Law will enhance the ability of Cayman to provide taxation-related information to other jurisdictions in accordance with international cooperation protocols.

Similar legislation already exists in the jurisdiction, for example the Criminal Justice (International Cooperation) Law, but the amendments put in place is a mechanism that is recognised within the Organisation for Economic Cooperation and Development's (OECD) latest 'green list' initiative designed to categorise cooperative and non-

cooperative jurisdictions by member countries. The new legislation has been written to reflect the OECD technical standards for transparency and information provision and can be used alongside Cayman's existing bilateral agreements.

The new legislation specifically states that any requests for information must be made by the recognised regulating authority of a Schedule 3 country and that the request conforms to the law and administrative practice of the requesting country. It also states that the requesting country must have similar laws that would make the information obtainable in similar circumstances in their own jurisdiction.

Cayman has had an existing tax information agreement with the United States since 2001, which already complies with OECD technical standards and this latest amendment gives Cayman flexibility in dealing with tax cooperation matters without sacrificing the necessary controls. The Cayman Islands Government is currently engaged in a number of bilateral negotiations on tax cooperation matters and the Amendment Law should further assist Cayman in relation to international developments in the tax cooperation arena.

Note: This Updater has been prepared for clients and professional associates of Ogier. The information and expressions of opinion which it contains are not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific advice concerning individual situations.