

Hedge fund side letters and in specie payments of redemption proceeds

A recent decision of the British Virgin Islands High Court in *SV Special Situations Fund Limited (SV) v Headstart Class F Holdings Limited (Headstart)* should be treated by investors and hedge fund managers as a cautionary tale to consider carefully the terms of any side letters.

The facts of the case are that Headstart had invested in SV (a mutual fund in the British Virgin Islands) and subsequently sought to redeem the balance of its shares worth approximately US\$7m. Although the offering documents entitled Headstart to redeem in full, the parties signed a side letter that SV would pay the redemption monies in two instalments. SV, relying on its Articles of Association, endeavoured to persuade Headstart to accept payment of redemption proceeds *in specie*. Headstart rejected the suggestion, and argued that the communications between the parties demonstrated that the side letter represented an agreement to pay cash.

The High Court found that the agreement had been to pay the redemption proceeds in cash, on the basis that (1) Headstart's first redemption requests had been paid in cash; (2) there was no mention of payment in securities in the side letter; and (3) the possibility of Headstart being paid *in specie* had been raised by SV after a long period of delay when Headstart had expressed its extreme dissatisfaction in the delay in payment.

The judgment serves as a reminder to ensure that any agreements or decisions with potential impact on a fund's liquidity be reviewed by legal counsel prior to entry. In this instance easily avoidable errors had been made, which ultimately required costly litigation proceedings to resolve.

Cayman Insolvency Law Changes

The provisions of the Companies (Amendment) Law 2007 of the Cayman Islands came into full force on 1st March 2009, following the formulation of the new Companies Winding Up Rules 2008, and Insolvency Practitioners Regulations 2008. That law repeals the entirety of the current Part V of the Companies Law (2007 Revision), which covers winding up by the Court, voluntary winding up, winding up subject to the supervision of the Court, and various ancillary provisions, and substitutes new provisions implementing wide ranging and detailed changes, and much needed clarification of the current law.

The Foreign Bankruptcy Proceedings (Internationals Cooperation) Rules 2008 and the Grand Court

(Amendment No. 2) Rules 2008 came into force on 1 March 2009.

The aggregate effect of these new provisions is to provide the Cayman Islands with a comprehensive, flexible, self-contained, creditor friendly regime for corporate liquidation and cross-border co-operation. Until now, resort to the UK Insolvency Rules, although workable, was proving increasingly unsatisfactory.

In the Matter of Strategic Turnaround Master Fund Partnership, Limited

In this judgment handed down by the Cayman Islands Court of Appeal on 12 December 2008, guidance was provided on the exercise by a corporate mutual fund of a power to suspend redemptions. The Court found, among other things, that the construction of a fund's constitutional documents and offering memorandum determine whether it has the power to suspend redemption payments and that upon the redemption date, the redeeming shareholder becomes a creditor of the fund. Notwithstanding that it has become creditor the shareholder remains a member (and is therefore subject to the power of fund to exercise its right to suspend the payment of redemption proceeds) until such time as the fund's register of members has been amended to reflect the redemption. In the instance that there has been such an amendment, the member would have standing to bring an action against the fund as a creditor for winding up on the ground that the fund is unable to pay its debts as and when they fall due.

This judgement is one of which funds and investors alike should be cognisant and is particularly relevant given the current climate of the global hedge fund industry, which, it has been reported, sustained redemptions amounting to US\$152 billion, or 9 percent, in the fourth quarter alone of last year.

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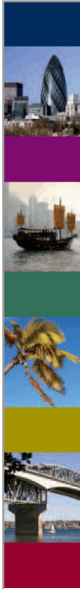


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