

Potential causes of action in relation to Guernsey funds in financial difficulty

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Introduction

In these uncertain times, investors in investment funds are increasingly looking at options regarding their investment, including ways in which to redeem or recover their investment in such funds. However, if the fund in question is in financial difficulties then it may be much more difficult for those investors to take action against the fund the directors of the fund and/or recover their monies in full. This article looks at some of the ways in which investors in Guernsey funds, which are in financial difficulty may take action in order to assess the extent of that difficulty or recover their investments either from the funds themselves or from third parties connected to the fund.

In Guernsey, a fund may be structured as: (i) a company (including a stand alone company, (ii) a protected cell company ("PCC") (or a cell of a PCC ("PCell")), (iii) an incorporated cell company ("ICC") (or a cell of an ICC ("ICell")), (iv) a unit trust; or (v) a limited partnership.

References in this article to the "Companies Law" are to the Companies (Guernsey) Law, 2008 (as amended), to the "LP Law" are to the Limited Partnerships (Guernsey) Law, 1995 (as amended) and to the "Trusts Law" are to the Trusts (Guernsey) Law, 2007 (as amended).

Potential causes of action

1. Actions against the fund directly

The relationship between the investors of a fund and the fund itself is governed by the constitutive documents of the fund along with the offering documentation and any subscription agreement. In order to establish a claim against the fund directly, an investor would need to show that the fund had breached the terms of those documents in order to give rise to a claim

for breach of contract or misrepresentation, or that the fund had otherwise acted in a manner which was negligent or for which it was otherwise liable in tort. Evidence of the manner in which the fund has acted and which have led to a causative loss will need to be compiled in order to identify whether such causes of action may be able to be brought against a fund.

(A) Information gathering

Prior to considering taking any action against a fund, investors should consider making a request for information. Such information may assist in identifying whether the fund is in financial difficulties or whether there are any issues in respect of operation of the fund. However, an investor's right to such information may be significantly limited as set out below.

Constitutional documents: The rights in the fund's constitutional documents should be carefully reviewed for rights to access information. However, as a general proposition, these are likely to be limited.

Guernsey law: Guernsey law provides investors with limited rights to access fund information and documentation. Pursuant to the Companies Law, the company must send a copy of its accounts, its directors' report and its auditor's report to each member within 12 months after the end of the financial year to which they relate. These, however, are unlikely to provide investors with insight in relation to any current or likely future issues with the fund.

In respect of limited partnerships, a limited partnership is required to keep certain documents, including accounting records at the registered office and these are available for inspection by any partner. In addition, under the LP Law, a limited partner has the right to be given, on demand, true and full information of all things affected the partnership and to be given a formal account of partnership affairs whenever circumstances render it just and reasonable. However, both these rights are subject to the express provisions of the relevant limited partnership agreement.

In respect of trusts, the trust instrument may provide unitholders with rights to access information regarding a fund established as a unit trust and the Trusts Law provides that, subject to the terms of the trust, a beneficiary (which a unitholder would be characterised to be) may make a written request of the trustee to provide full and accurate information as to the state and amount of the trust property.

Guernsey Regulatory Rules: Guernsey regulatory rules apply equally to all fund structures and do not provide any further rights for investors to gain access to information. These rules do however require a fund to state in its information memorandum when and where financial information about the fund will be published and available to investors.

Searches: Although public searches of the company and limited partnership registers will not reveal information as to the balance sheet position of a fund, (as accounts are not available for

inspection at the Guernsey Companies Registry), Royal Court searches and a review of advertisements placed in La Gazette Officielle may provide an indication as to whether insolvency proceedings have been issued against the fund or whether a liquidator or administrator has been appointed.

(B) Unfair Prejudice Claims

A shareholder who can establish that the affairs of a company are being, have been or may be conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself) may apply to the Royal Court of Guernsey (the "Court") for an order. The Court, upon being satisfied that the shareholder has established a claim, has very broad powers to grant relief, including making orders regulating the conduct of the company's affairs in the future, requiring the company to refrain from doing or continuing to do the act complained of by the applicant or to do any act that the applicant has complained that the company has omitted to do or authorising civil proceedings to be brought in the name and on behalf of the company by such persons and on such terms as the Court may direct. In very limited circumstances, a shareholder may be able to ask the court to bring an action on behalf of the company against its directors.

(C) Other Avenues

General meetings may not address the concerns of a single investor but rather they will deal with concerns common to all investors. The terms of the constitutional documentation for a fund may allow its investors (or a certain representation of the investors in the form of a committee) to call a meeting. Further, in relation to a company fund, the Companies Law allows members with greater than 10% of voting rights (either singly or in concert with other members) to requisition a meeting of the Company. At such a meeting investors may request further information about matters concerning them and steps to be taken by the fund.

In addition, where the investors are more confident in respect of potential issues with the management of the fund, they may have rights under the constitutional documents to appoint/dismiss directors, general partners or trustees. In this way, the investors could ensure that they have a person/entity in management that represents their interests.

Finally, if there is a sufficient concern amongst investors and subject to the fund's constitutional documents, investors may seek to amend the terms of those constitutional documents to allow more transparency in the management process and/or change it.

(D) Complaints to the Guernsey Financial Services Commission ("GFSC") and the Channel Islands Financial Ombudsman ("CIFO")

The GFSC is not able to adjudicate in disputes between investors and regulated entities. The GFSC does, however, ensure regulated entities have satisfactory regulatory systems and controls in place to deal with complaints in a thorough and prompt manner. They seek to ensure

that the regulated entity handles a complaint properly.

Whilst a complaint may not result in redress for a complainant, complaints may indicate a pattern of behaviour which the GFSC may examine further to see if it raises any regulatory or prudential concerns. The GFSC cannot however, share the outcome of their investigation with the complainant.

In certain limited instance a complaint may be made to the CIFO in relation to investment dealers, investment intermediaries and managers and other functionaries of recognized class A funds in Guernsey

2. Actions against directors of a company fund

The actions below may also be relevant in respect of corporate general partners and corporate trustees.

(A) The Directors' Liability in Tort

A director may be jointly and severally liable with the company where the director is complicit in the Commission of a tort by the company, even though the company committed the tort. Provided the directors owe the relevant person a duty of care, a person who suffers financial or other loss as a result of acting in reliance upon a misstatement (whether negligently or fraudulently made) contained in an offering memorandum may be able to bring an action for rescission or damages in lieu of rescission against the directors of the fund. In addition to statutory obligations regarding the accuracy and completeness of offering documentation, the directors also owe a duty of reasonable care and skill to the company to ensure that the offering memorandum is accurate and does not omit any material information. If they fail in this duty and the company suffers loss, the directors may be liable to compensate the company.

(B) Fiduciary duties

A director owes both fiduciary and other Common Law duties to the company of which he is a director. These duties include (i) acting in good faith and in the best interests of the company (ii) a duty not to act for a collateral or improper purpose (iii) a duty to exercise independent judgment (iv) a duty to avoid conflicts of interest and (v) a duty to exercise reasonable skill and care. Ordinarily, it would be for the company to bring an action against a director who has failed to comply with their duties. However, if the company is unwilling or otherwise fails to bring a claim, a member may with the permission of the Court bring an action by way of a derivative action or an unfair prejudice application. For example, if a director carries out their responsibilities negligently and causes loss to shareholders they may be liable to pay damages to the relevant shareholders as a result of such derivative action.

(C) Companies Law

The Companies Law provides that where an offence by a company is proved to have been

committed with the consent or connivance of, or to be attributable to any neglect on the part of, any officer of the company (which includes a director, shadow director or any person purporting to act in that capacity), they, as well as the company, are guilty of an offence and may be prosecuted and punished accordingly.

(D) Restraint of Excess Powers

Further, under the provisions of the Companies Law in favour of a person dealing with a company in good faith, the powers of the directors to bind the company, or authorise others to do so, is deemed free from any limitations contained within the company's memorandum or articles, resolutions of the company or any agreement between the company's members. However, if a shareholder believes the directors are acting in a manner which is beyond their powers by virtue of such limitations, they may apply to the Court for an order restraining the doing of such an act.

3. Actions against a general partner of a limited partnership fund

Under the LP Law, subject to limited exceptions, a general partner has the same duties as a partner in a partnership which is not a limited partnership. These duties include to act in utmost good faith to every member of a partnership. If the investors (as limited partners in the limited partnership) are able to establish that the general partner has breached this duty they may be able to make a claim against it.

4. Actions against a trustee of a unit trust fund

Under the common law and the Trust Law, a trustee owes duties to the beneficiaries of the trust. These duties include to act in utmost good faith, to get in and preserve the trust property and not to profit from the trusteeship. If the investors are able to establish that the trustee has breached any of these duties, they may be able to make a claim against it.

5. Actions against a Fund's Third Party Service Providers

The fund itself will have contractual arrangements with third party service providers such as auditors, accountants, administrators, custodians, and investment managers or advisers. Investors are unlikely to be a party to those contracts, so are generally unable to claim directly against the third party service providers if they have acted in a manner which is in breach of the terms and conditions imposed under the contracts between them and the fund. Ordinarily investors would need to rely upon the fund itself to bring such actions for breach of contract.

However, subject to the terms of the contractual arrangements between the fund and its service providers, investors may be able to establish that the service providers owed them a duty of care and that the manner in which they acted in carrying out their responsibilities under the contracts with the fund was such as to give rise to a claim of negligence or other liability in tort (such as fraud or wilful misconduct) for failing to act in accordance with that duty. Again the

specific terms of the arrangements between the fund and third party service providers and the actions of the service providers will need to be scrutinised to determine whether such actions could potentially be brought.

6. Under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 ("POI Law")

Pursuant to section 34 of the POI Law, where there has been a breach of the POI Law or any rules or regulations made under the POI Law, any investor who has suffered loss, or been otherwise adversely affected, may bring a claim in the appropriate Court. It is suggested that this provision is limited to an investor who has suffered a loss as a result of statutory breach and that this is a personal claim by the investor against the fund, or those who have purportedly breached the statutory provisions.

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