

## Court of Appeal rules on dispute over in specie distribution to shareholder in Cayman Islands Fund

The Cayman Islands' Court of Appeal has now delivered its judgment in the case involving the winding up of FIA Leveraged Fund (the "Fund"). In dismissing the appeal, the Court of Appeal held that based on the wording in the offering documents for the Fund, the in specie distribution in question could only be made using assets from the Fund's portfolio (the Fund was fully invested in the ultimate master fund, Fletcher International Ltd. ("The Master Fund")) that were held by the Fund at the time when the investor was entitled to be paid its redemption monies. Further, even if the Fund's documents stated that the directors of the Fund had a complete discretion as to the value of the assets to be distributed to the investor, that discretion is still limited as a matter of necessary implication by concepts of honesty, good faith and genuineness and a need for the absence of arbitrariness, capriciousness, perversity and irrationality.

The Court of Appeal upheld the decision of the Grand Court in ordering the winding up of the Fund and found that there had not been a valid in specie distribution to the investor because the asset purportedly distributed did not exist in the Fund's portfolio at the time the investors were entitled to be paid their redemption monies, was not of a sufficient value and because the directors had not acted rationally when valuing the asset.

In its judgment, the Court of Appeal referred to a number of provisions of the Fund's documents, extracts from which are set out below.

"The directors may, when making payments in respect of the redemption or purchase of shares, if authorised by the terms of issue of the shares being purchased or with the agreement of the holder of such shares, make such payment either in cash or in specie." (Articles of Association)

"Under the forgoing circumstances [illiquidity] and under other circumstances deemed appropriate by the board of directors, investors may receive in kind distributions from the fund's portfolio." (Offering memorandum and subscription agreement)

"If any redemption amount is paid in assets of the fund other than cash, the value of the assets so paid shall be determined by the board of directors in consultation with the investment manager in its sole discretion as of a date reasonably contemporaneously of the date on which the redemption amount is paid to the shareholders." (Supplement to offering memorandum)

In its judgment, the Court of Appeal noted that during the course of the appeal, counsel for the Fund accepted that it would not be open to the Fund, after a redemption request had crystallised, to go out into the market and

purchase some other asset which would then be used for the purposes of making an in-kind distribution to the redeeming investor. It was accepted that it was necessary that the asset distributed by way of an in-kind distribution is an asset comprised in the Fund's portfolio.

As the Court of Appeal explained, that, begs the question: at what date does the asset need to be comprised in the Fund's portfolio? In particular, is it enough that the asset is comprised in the Fund's portfolio at the time of distribution, notwithstanding that it was not comprised in the Fund's portfolio at the date upon which it was contractually required to make payment in accordance with the Fund's constitutional documents. Sir John Chadwick, President of the Court of Appeal stated that in his view, the answer to that question is "No". He explained that the reason appears in the paragraph from the offering memorandum and subscription agreement quoted above. He said that it was plain from that language that the intention was that if an investor sought to redeem at a time when the Fund was illiquid, his request could be satisfied by transferring to him an asset which is held in the Fund and is available for distribution. "To put the point another way, instead of realising an asset which is held in the Fund at the time when payment is due, the Fund can transfer that asset to him. To hold otherwise would have the effect that the Fund could seek to satisfy the redeeming investor by transferring to him an asset which was never comprised in the Fund in which he was an investor: that is to say, by transferring to him an asset acquired after the date on which he was entitled to be paid his redemption monies. His interests could be prejudiced – as this case shows – by the transfer to him of an asset which the Fund did not have while he was an investor in it."

Sir John went on to say that he was satisfied that in this case, the power to make in-kind distributions does not extend to the distribution of an asset which did not exist at the time when the investor was entitled to be paid his redemption monies.

Sir John also addressed the wording in the supplement to the offering memorandum quoted above that stated that the directors of the Fund had a complete discretion as to the value to be attributed to the assets to be distributed to the investor. Referring to two recent decisions of the English Court of Appeal he reiterated that a decision maker's discretion is still limited as a matter of necessary implication by concepts of honesty, good faith and genuineness and a need for the absence of arbitrariness, capriciousness, perversity and irrationality. In this case the directors' discretion was so limited and the court is concerned to see that it is not abused. He held that in this case the directors had not acted rationally when attributing a value to the assets purported distributed.

Although not specifically addressed by the Court of Appeal, in light of this decision, consideration has to be given as to how in a master-feeder structure where the feeder is fully invested in the master fund an in specie distribution will be effected. It would seem that the directors of the feeder fund from which an investor is redeeming would have to ensure that the asset to be distributed to the investor is available to the feeder fund as at the date on which the redemption monies are due. This may mean ensuring that the master fund has transferred or assigned its rights to the assets as of that date.

A more detailed discussion about the issues raised at the hearing of the winding up petition is contained in a separate briefing paper.

*This advisory should not be construed as providing specific legal advice. It is intended only as a general guide to clients or prospective clients. We recommend that, in connection with any particular transaction or circumstance,*

*specific legal advice be obtained.*

Should you have any queries regarding the above, or if we can be of any assistance, please do not hesitate to contact your usual Campbells contact or any of the following:



**Guy Cowan**

Associate

+1 345 914 5876

[gcowan@campbellslegal.com](mailto:gcowan@campbellslegal.com)



**Alistair J. Walters**

Partner

+1 345 914 5861

[awalters@campbellslegal.com](mailto:awalters@campbellslegal.com)