

BRITISH VIRGIN ISLANDS SPECIAL SITUATIONS REDEMPTIONS

Jerry D. Samuel - February 2009

Introduction

In summary, this case involved an application made by SV Special Situations Fund Limited (the “**Fund**”) to set aside a statutory demand served by Headstart Class F Holdings Limited (the “**Investor**”). Both parties were professional funds incorporated in the BVI. The case was heard in October 2008 before the Honourable Joseph-Olivetti, J. in the BVI High Court.

Statutory Demand

The Investor issued the statutory demand on the basis that it had validly redeemed its shares in the Fund and was therefore a creditor of the Fund. Although solvent, if the Fund failed to set aside the statutory demand the Investor would have been entitled to make an application to wind up the Fund.

In support of the application to set aside the statutory demand, two issues were raised by the Fund, which the Court was required to determine, namely (i) whether the Investor was a creditor of the Fund within the meaning of the BVI Insolvency Act, 2003 (the “**Insolvency Act**”); and (ii) whether there was a substantial dispute that the debt was owing or due, on the basis of a dispute as to the manner in which the Fund was required to satisfy the Investor’s redemption.

Justice Joseph-Olivetti’s judgment dated 25 November 2008 highlights a number of findings which provide some guidance to funds and investors on the effect of redemptions under BVI law and the Court’s approach in construing ‘side letters’ when determining the form of payment agreed by the parties.

The Redemptions

The Investor served two redemption notices of its shares in the Fund. The first notice for US\$1.5m was given on 25 February 2008 and the second notice, worth approximately US\$7m, was given on 7 May 2008.

The claim under the first notice was paid in full. Following negotiations between the parties, due to the Fund’s reluctance to have the Investor immediately redeem in full, they entered into a compromise agreement in the form of a ‘side letter’ dated 8 May 2008 (the “**Side Letter**”).

The Side Letter provided that US\$4m would be paid to the Investor within 5 days of 30 May 2008; the remainder would be split, such that 95% would be paid within 5 days of the 30 June 2008 dealing date; and the remaining 5% within 2 days of the said dealing date. Interestingly, the Side Letter also provided that the Investor would have the status of a creditor for any amount due and owing.

Under the Articles of Association of the Fund and the Share Subscription Agreement between the parties, the Fund had the power to divide in *specie* the whole or any part of the assets of the Fund and to appropriate such assets in satisfaction or part satisfaction of the redemption price. In exercising this power, the Fund notified the Investor in July 2008 that it intended to make payment of the redemptions ‘in kind’, by delivery of securities selected by the Fund.

The Investor rejected this approach and on 18 July 2008 served a statutory demand for US\$4m plus interest, in connection with the obligation due to be paid within 5 days of 30 May 2008.

Creditor Status

Contrary to the arguments made by the Fund, the Court held that the Investor was a creditor with an admissible claim within the meaning of section 9 of the Insolvency Act, thereby having the requisite *locus standi* to make a statutory demand under section 155 of the Insolvency Act.

In considering whether section 197 of the Insolvency Act (which prevents members and past members from claiming, *inter alia*, redemptions in liquidation of a company in its character as a member) applied in determining the Investor's status as a creditor, the Court found that, as a matter of statutory construction, section 197 only applied after commencement of liquidation.

In relying on *obiter dicta* from the House of Lords in *Soden v British & Commonwealth Holding PLC [1998] AC 298*, to determine whether the Investor's cause of action arose in its "character as a member", the Court found that the Investor's cause of action was founded on the Side Letter.

Justice Joseph-Olivetti's judgment also provides *obiter dicta* that where the parties agree that the redeeming member shall be treated as an unsecured creditor for any amount due and owing, there is no prejudice caused to any of the parties by such an agreement, which accords with section 62 of the BVI Business Companies Act, 2004 (the "**Companies Act**") which stipulates that from the date of redemption, a former shareholder shall rank as an unsecured creditor of the company for the sum payable on redemption.

While the judgment suggests that under BVI law a member becomes a creditor upon redemption of his shares, it was silent on when the redeeming member's status as a shareholder ceases. However, limited guidance on this point as a matter of BVI law may be gleaned from *Claim No. BVIHCV 2007/0227 Brantley Inc. v Antarctica Asset Management Ltd.* dated 9 May 2008, which dealt with the meaning of 'redemption', albeit in connection with the appraisal process connected to redemption of minority shares under Companies Act "arrangements". In *Brantley Inc. v Antarctica Asset Management Ltd.* it was held that the redemption process is not complete until a fair value had been agreed or determined by the appraisal procedure and surrender of the share certificates.

Cash or Kind Factual Matrix

Contrary to the Fund's contention that there was a substantial dispute as to the manner of payment intended by the Side Letter, since there was no reference or express obligation to pay cash, the Court held that the factual matrix obligated the Fund to satisfy the redemptions in cash. The factual matrix upon which the Court relied was evidence that (i) the first redemption obligation was paid in cash; (ii) normally, in the industry, redemption obligations are met in cash; and (iii) the Side Letter made no specific mention of payment in securities.

Given the factors considered, it appears that the BVI Court will likely take a broad view and consider evidence of the parties' prior conduct and industry practice in determining the manner of payment intended. Therefore, funds and investors entering into side agreements must pay close attention to the express terms of such agreements regarding the form of payment, since the absence of an express term to pay 'in kind' may be as fatal to a fund as the absence of an express term to pay in cash may be to an investor.

Conduct of the Parties

In making its determination, the Court accepted that since there was an agreement in writing, subsequent conduct of the parties could not be taken into consideration in construing the Side Letter. However, the Court found that it was entitled in the circumstances to examine the parties' subsequent conduct to determine whether the reasons advanced for not honouring the contract were credible.

The Court also found that the Fund was estopped from reneging on promises to make payments in cash, where evidence of such promises had been made to make redemption payments "in funds" and the Investor had been prejudiced by its reliance on such promises.

With regard to timing, the Court held that the decision as to the manner of payment has to be taken when the redemption notice is accepted and the date for satisfaction of the redemption is settled.

The Court made it clear that by giving up its “not insubstantial right” to receive the whole of the redemption proceeds and agreeing to receive split payments in the form of two installments, the Investor had provided good and valuable consideration, disposing of any doubt as to whether the Side Letter was a binding agreement.

Conclusions

These findings suggest that the subsequent conduct of investors and funds is likely to be a salient consideration in the Court’s determination regarding credibility of the parties. Furthermore, directors of BVI funds would be well advised to notify investors of their intention to exercise any powers to make payments in *specie* when accepting redemption notices and settling the date of redemptions. Finally, since section 42 of the Companies Act stipulates that the entry of the name of a person in the register of members as a holder of shares is *prima facie* evidence of legal title to such shares, in light of the meaning of ‘redemption’ given by the Court in *Brantley Inc. v Antarctica Asset Management Ltd.*, funds and investors alike would welcome guidance from the BVI Court on precisely when a redeeming member’s status as a shareholder ceases and what rights a redeemed member retains prior to removal from the share register.

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