CAYMAN ISLANDS

GRAND COURT

DD Growth Premium 2X Fund (in official liquidation) -v- RMF Market Neutral Strategies (Master) Limited (Unreported 20 November 2015)

SECTION 37 OF THE COMPANIES LAW (2007 REVISION) - STATUTORY CONSTRUCTION - SHARE CAPITAL - CLAW-BACK CLAIMS

In this case, the Cayman Islands Grand Court clarified that redemption proceeds paid to investors by insolvent companies out of share premium cannot be clawed back by a liquidator under Section 37(6) of the Companies Law (2007 Revision) (the "Law").

The liquidators of DD Growth Premium 2X Fund (the "Fund") sought an appeal to claw-back redemption payments to RMF Market Neutral Strategies (Master) Limited ("RMF") made at a time when the Fund was insolvent.

The Fund was a feeder fund incorporated in the Cayman Islands, which fell into difficulties in late 2008 and early 2009 and faced a large number of redemption requests. One such investor was RMF whose request gave rise to a liability of more than US$62 million, which was paid in part at a time when the Fund was cash flow insolvent.

When the Fund was subsequently wound up it transpired that it had, in effect, become a Ponzi scheme. There was no suggestion that any of the redeeming investors knew about the fraud. The Fund's liquidators instigated proceedings seeking to recover redemption payments in the amount of US$22 million paid to RMF at the end of 2008.

Due to the timing of the redemption payments, it was the construction of the Law that fell to be considered.

The Liquidators' argument was based upon Section 37(6)(a) of the Law which provides that:

"*A payment out of capital by a company for the redemption or purchase out of its own shares is not lawful unless immediately following the date on which the payment out of capital is proposed to be made the company shall be able to pay its debts as they fall due in the ordinary course of business*".

The liquidators sought to argue that the payments made to RMF were payments made out of capital at a time that the Fund was insolvent and that, in effect, payments out of either share capital or share premium were impermissible.

At first instance, the Chief Justice dismissed this argument and found that the provisions of Section 37(6)(a) had not been breached as only a, *de minimis*, amount of US$1/1000 per share represented share capital, with the remainder representing share premium, the use of which was permissible pursuant to the Law. This is the position that is found in the current version of the Law.

On appeal, the Court of Appeal held that Section 37 of the Law must be read in conjunction with Section 34 of the Law, which provides that: payments by a company out of share premium for the redemption or purchase of its own shares are not payments out of capital and as such are not subject to any solvency requirement. The Court of Appeal attached particular importance to Section 34(2)(f), which refers to the use of share premium "for providing for" the premium payable on redemption which is held to cover payment for the premium due.

It is now clear that for the purposes of Section 37(6), share capital is given its natural meaning and represents only the par value of shares.

The Judgment of the Court of Appeal makes sound commercial common sense and comes as a relief to many investors, as well as a disappointment to many liquidators.

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