



## In the Matter of Ardon Maroon Asia Master Fund

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Cayman Grand Court rules on the natural and ordinary meaning of fund constitutional documents in preference to following common practice in the funds industry.

In the unreported judgment delivered 17 July 2018, *In the matter of Ardon Maroon Asia Master Fund (in official liquidation)* Cause no. FSD 18 of 2015, the Hon Justice Robin McMillan found that, in a master-feeder fund structure, a feeder fund redemption was ineffective on the basis that there was a failure by the feeder fund to serve a further redemption notice on the master fund in accordance with the procedures set out in the master fund constitutional documents.

### Background

Ardon Maroon Asia Dragon Feeder Fund (the “Feeder Fund”) was a feeder fund into Ardon Maroon Asia Master Fund Limited (the “Master Fund”) (together, “the Funds”), a structure by which investors would subscribe for shares in the Feeder Fund and the Feeder Fund would use this capital to subscribe for shares in the Master Fund. The Feeder Fund did not retain any liquidity or own any assets other than its Master Fund shareholding and (as is common in such structures) both the Feeder Fund and Master Fund appointed the same service providers including the Investment Manager, Administrator and directors. This structure is one which is common in the Cayman Islands.

On 11 August 2014, an investor in the Feeder Fund (the “Investor”) submitted an electronic copy redemption notice for a US\$15 million redemption for the 3 October 2014 redemption day (the “Redemption Request”) to the Transfer Agent. The Transfer Agent acknowledged receipt on 12 August 2014 and notified the Investment Manager of the Funds that it had received the same on 19 August 2014.

The Master Fund’s assets were illiquid and could not be readily realised to meet the Redemption Request. Consequently, on 30 October 2014, the directors of the Funds resolved to suspend redemptions and the payment of redemption proceeds from both Funds. In December 2014, the directors of the Feeder Fund resolved by written resolution that the Administrator should be instructed to record the redemption as a debt due to the investor and adjust the net asset value of the Feeder Fund accordingly.

On 30 December 2014, the Funds passed special resolutions that the Funds should be wound up voluntarily and that joint voluntary liquidators (the “Master Fund JOLs”) should be appointed. In 2015, the Investor lodged a proof of debt in the liquidation of the Feeder Fund which was ultimately admitted by the joint official liquidators of the Feeder Fund (the “Feeder Fund JOLs”) by consent on 23 March 2016. However, the Master Fund JOLs rejected the Feeder Fund’s ‘back-to-back’ proof of debt. The rejection was on the basis that the Feeder Fund had not completed the redemption process to redeem its shares

in the Master Fund as it had not submitted a written notice to do so (as required by the constitutional documents of the Master Fund). An appeal against the rejection of the Feeder fund proof of debt was filed on 1 April 2016.

## Matters for Consideration

The key issues in dispute were:

- (a) What were the requirements for a valid redemption of the Feeder Fund's shares in the Master Fund? In particular, did the Master Fund constitutional documents permit the redemption of shares without a redemption notice and if so, did the directors of the Master Fund make a determination as to the terms and/ or manner in which shares issued by the Master Fund could be redeemed (i.e. without the need for a separate written redemption request by the Feeder Fund)?
- (b) Were the requirements for a valid redemption of the Feeder Fund's shares in the Master Fund met or (if possible) waived by the Master Fund or persons on its behalf?

It was contended by the directors of the Funds and other highly qualified figures in the Cayman Islands hedge fund industry that an automatic or 'back-to-back' redemption at the Master Fund level is a normal and/ or universal practice utilised to avoid the risk of misalignment of the liquidity profiles between the Master Fund and Feeder Fund. The Court found the expert opinions to be "*largely irrelevant and unhelpful*" in terms of the legal task identified for resolution.

In determining whether the directors of the Master Fund had the power to issue shares on terms that they were capable of being redeemed without a written notice being served, the Court considered the decision of the Privy Council in *Innimore Fund Management Limited -v- Fenris Consulting Ltd.* [2016] UKPC 9, and the English law principles set out in *Arnold -v- Britton* [2015] AC 1619.

It was accepted by the Court that when interpreting the meaning of the relevant words in a written contract that meaning has to be assessed in light of: (i) the natural and ordinary meaning of the clause; (ii) any other relevant provisions of the document; (iii) the overall purpose of the clause and the document; (iv) the facts and circumstances known or assumed by the parties at the time that the document was executed; and (v) commercial common sense; but, (vi) disregarding subjective evidence of any party's intentions.

## Master Fund Amended and Restated Articles

The following Articles were considered relevant to the analysis:

Article 1 defines "Redeeming Shareholder" as "a Shareholder who has requested the redemption of part or all of his Shares in accordance with these Articles".

"Redemption Notice" is defined as "a notice in writing in such form as the Directors may from time to time determine from a Shareholder requesting the redemption of part or all of his Shares."

Article 9 provides: "Subject to these Articles, all Shares for the time being unissued shall be under the control of the Directors who may:

- (a) Issue, allot and dispose of the same to Persons, in such manner, on such terms, and having such rights and being subject to such restrictions as they may from time to time determine;..."

Article 36 provides, so far as is material: "Subject to the Law, the Company may:

- (a) Issue shares on terms that they are to be redeemed or liable to be redeemed at the option of the Company or the Shareholder on such terms and in such manner as the Directors may determine, or as may otherwise be determined from time to time;"

Article 37 provides: "Subject to the law, these Articles and any rights and restrictions for the time being attached to any Class or Series:

- (a) On receipt by the Company or its authorized agent of a Redemption Notice upon at least such number of days' prior notice as the Directors, in consultation with the Investment Manager, may from time to time determine (subject to the discretion of the Directors, in consultation with the Investment Manager, to waive or reduce such period of notice) the

Company shall redeem all or any portion of such Redeeming Shareholders Shares on a Redemption Day at the Redemption Price for the relevant Class and Series..."

Given the comprehensive nature of the redemption procedure set out in the Articles, the Court was unable to accept that the procedure could be disregarded entirely by the directors unless such power to so disregard is expressly permitted.

## Determination of the Directors

The Court then turned to whether, if there was an authority to dispense with the Redemption Notice procedure, they did indeed make any determination to that effect.

It was contended by the Appellants that there was a clear and express statement in the Feeder Fund Private Placement Memorandum (the "Dragon PPM") that the redemption procedure for the Master Fund was to be identical to the Feeder Fund procedure, such that it was clearly intended that the same redemption procedure should apply for the purposes of redeeming shares in both of the Funds. Given that the directors were common to both the Feeder Fund and Master Fund it was contended that there was "*clear concurrence by the Directors of the Master Fund to the terms of the Dragon PPM*".

The Court was not persuaded by this noting that "...*there appears to be underlying the argument a conscious infringement of the doctrine of corporate responsibility. In other words, if two companies have the same Directors that surely does not make them one company or enable them to function as one company.*"

The Appellants submitted that there was clear, unequivocal, credible and independent evidence from the directors as to what their understanding and intentions were as regards the redemption process; namely that there would be an automatic back-to-back redemption of the Master Fund's shares upon the Feeder Fund receiving a valid redemption request from an investor. Adding this to the broad discretion in the Master Fund Articles to determine the applicable redemption procedure it was submitted that the directors made their subjective intentions and understanding sufficiently manifest in order to amount to a "determination". Again, the Court was not persuaded and described the reasoning as "*tortuous, speculative and unpersuasive.*"

In principle, the Court agreed that a redemption at the Feeder Fund level can lead to an automatic corresponding redemption at the Master Fund level without the need for a separate redemption notice to be served if constitutionally authorised, and a determination is made to that effect.

Based on the constitutional documents of the Master Fund and the resolutions passed by the Feeder Fund and Master Fund it was, in the opinion of the Court, the natural and ordinary meaning of the language used that the redemption procedure required two separate identical redemption procedures as between an investor and the Feeder Fund and, subsequently, the Feeder Fund and the Master Fund, and not simply one procedure that served automatically for two purposes.

The Appellants further submitted that if there was a requirement for a separate redemption notice to be served on the Master Fund, then this requirement was waived. Evidence was adduced to indicate that the directors of the Master Fund considered the redemption to be effective at the Master Fund level and it was for this reason that the Master Fund resolved to suspend the payment of redemption proceeds and any further redemptions and thereafter to resolve to wind up the Master Fund. The register of the Master Fund was updated to record the redemption and the Transfer Agent was permitted to proceed on the basis that the redemption in relation to the Master Fund was effective.

As a matter of construction, the Court preferred the view that the requirement for written notice was not capable of being waived (unlike the period of notice) and even if this view was incorrect, found the argument of the Master Fund JOLs compelling that there had not been any unequivocal representation of the Master Fund directors to indicate that there had been an effective redemption.

The Feeder Fund was held to be unsuccessful in its appeal in all respects.

## Potential Effects for Cayman Funds

While the judgment touches on a number of themes, the main issue to emerge will likely be that unless the relevant constitutional and offering documents of Cayman master-feeder fund structures are drafted in such a way that a formal

process is not required between a feeder fund and a master fund to effect a redemption, then the process, as set out in the constitutional documents, must be followed in order for an effective and valid redemption to take place. While this is not a controversial point from a legal perspective, investors will now be aware that master-feeder redemption processes set out in legal documents are not always being followed to the letter of the agreement by fund administrators.

The second (and perhaps less surprising) theme will be that industry practice is not a defence to non-compliance with constitutional documents and, while it is operationally helpful for the directors of a master and feeder fund to be the same, sufficient and clear corporate records should be maintained by separate legal entities documenting any actions and resolutions of the directors. This is particularly important in the case of master-feeder funds which, while they may share the same board, must still act as distinct legal entities.

For clients operating such master-feeder structures, it would be advisable to:

- (i) check with their Administrator and/or fund directors as to what process is being followed upon a redemption and whether written notices are being sent from the feeder to the master if that is what the constitutional documents call for (i.e. are they following the terms of the fund documents specifically or relying on industry practice); and
- (ii) if necessary, update the fund documents so that the redemption process and documents for the feeder and master are consistent with what is occurring in practice.

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