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Primeo v Herald – More Certainty for Unpaid Redeemers

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The recent decision of the Grand Court of the Cayman Islands in the case of *Primeo Fund (in Official Liquidation) v Michael Pearson as an Additional Liquidator of Herald Fund SPC (in Official Liquidation)* has brought some welcome clarity as to how liquidators will treat the claims of redeemed, but unpaid former shareholders of Cayman companies (Unpaid Redeemers).

Until now, it had not been clear whether Unpaid Redeemers would rank as creditors and therefore be paid in full before any monies are distributed to unredeemed shareholders, or whether, in certain circumstances, they would fall to be paid *pari passu* with unredeemed shareholders.

Other offshore jurisdictions have grappled with the same question in the relatively recent past. For example, in the 2013 BVI case of *Somers v Monarch Pointe*, the BVI High Court analysed the operative sections of the Insolvency Act 2003 and held that the claims of Unpaid Redeemers should rank alongside the claims of unredeemed shareholders. The Eastern Caribbean Court of Appeal disagreed, holding that Unpaid Redeemers were, in fact, deferred creditors and as such entitled to have their claims against the company satisfied in priority to any claims by unredeemed shareholders.

In the Cayman Islands, the question is also governed by statue, namely section 37(7) of the Companies Law. The operative parts of this statute (which are very different from their BVI counterparts) are:

- section 37(7)(a), which states:

  where a company is being wound up and, at the commencement of the winding up, any of its shares which are or are liable to be redeemed have not been redeemed… the terms of redemption… may be enforced against the company.; and

- subjections (i) and (ii) which contain carve-outs from this enforceable right, including if the company was insolvent between the period on which the redemption was to have taken place and the date of winding up; and

These sections were first enacted in 1987 and have not changed materially since then. They were based on (now repealed) equivalent sections of the English Companies Acts 1981 and 1985. As a consequence, they were drafted well before the Privy Council clarified precisely at what stage a redemption would be completed, which it did in the 2010 case of *Culross v Strategic Turnaround*.

In *Strategic Turnaround*, both the Cayman Grand Court and Court of Appeal had held that a redeeming shareholder remains a member of a company until he has received payment for his shares and his name has been removed from the company's register of members.

The Privy Council disagreed, concluding that the issue depended entirely upon the construction of the individual company's Articles, and that it was *not to be approached on the basis of any a priori view that, until payment of the redemption proceeds, a shareholder must or should necessarily remain a member of a company…* For the company in question, the Privy Council determined that the redemption had taken place on the Redemption Date, with the remittance of redemption proceeds being treated as a matter of supplementary procedure.

Similarly, in *Herald* it was common ground between the parties that the relevant redemptions had taken place before the commencement of the company's winding up. On that basis, the Grand Court held that because the shares in question had been redeemed, the claims fell outside section 37(7), which only applied to shares *which have not been redeemed*.

As a result of this decision, it is now clear that the claims of Unpaid Redeemers fall outside section 37(7). Therefore, they will always be paid in priority to any claims by unredeemed shareholders, even if the company was insolvent when the redemptions took place and, therefore, the claims could not have lawfully been paid prior to the company's liquidation.

Unredeemed shareholders may well feel that such an approach is harsh and that it unfairly relegates their interest behind that of any Unpaid Redeemers. However, the rationale for the approach is investor certainty, and the benefit all investors have from knowing in advance that their contractual bargain will be given effect by the Courts. In that respect, the decision in *Herald* builds on the previous decisions of the Privy Council in *Strategic Turnaround and Fairfield*, which have stressed the desirability of certainty and giving effect to a fund's constitutional documentations.

The decision also considered the circumstances in which liquidators can rectify a company's register of members in the event of fraud. This is an issue that the Grand Court will consider in more detail on a subsequent occasion. However, one noteworthy part of this decision was that the Grand Court stated that the power to rectify would only apply to *those recorded as shareholders as at the commencement of the liquidation*. Therefore, unless they still held other shares, the power would not affect Unpaid Redeemers, as by the commencement of the liquidation they had already become creditors and were no longer shareholders.

This decision is subject to appeal.