

IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS
CICA NO 17 OF 2015
FROM THE GRAND COURT OF THE CAYMAN ISLANDS FINANCIAL
SERVICES DIVISION FSD 27 OF 2013– AJJ

IN THE MATTER OF THE COMPANIES LAW (2013 Revision)
AND IN THE MATTER OF THE HERALD FUND SPC (IN OFFICIAL
LIQUIDATION)

BETWEEN:

MICHAEL PEARSON
(In his capacity as Additional Liquidator of Herald Fund SPC [in Official
Liquidation]
APPELLANT

- AND-

PRIMEO FUND (IN OFFICIAL LIQUIDATION)
RESPONDENT

BEFORE:

THE HON JOHN MARTIN QC, JA
THE HON SIR RICHARD FIELD, JA
THE HON (CECIL) DENNIS MORRISON, JA

Appearances

The Right Honourable Lord Peter Goldsmith QC and Francis Tregear QC instructed by Mathew Goucke and Chris Keefe of Walkers appeared for the Appellant.

Michael Crystal QC and Tom Smith QC instructed by Peter Hayden, Rocco Cecere and Christopher Levers of Mourant Ozannes appeared for the Respondent.

Hearing: 18 & 19 April 2016
Judgment: 19 July 2016

JUDGMENT

The Hon Sir Richard Field JA

Introduction

The issue in the appeal

1. The issue raised in this appeal is whether a previous holder of redeemable shares redeemed in accordance with the company's Articles of Association but without payment of the redemption proceeds has a claim for the sum due in the liquidation of the company only by virtue of section 37 (7) (a) of the Companies Law (2003 Revision) and not otherwise.
2. The answer to this question depends on whether the words "... shares which ... are liable to be redeemed have not been redeemed" in s. 37 (7) (a) mean: (1) "shares in respect of which the company's prospective liability to pay redemption proceeds has arisen but has not been discharged", as argued by the Appellant; or (2) "shares which have not been redeemed in accordance with the company's Articles of Association but as to which the shareholder has an accrued right to enforce the terms of redemption," as argued by the Respondent.

The factual background

3. Herald Fund SPC ("Herald") was incorporated as an exempted segregated portfolio company under the Companies Law (2003 Revision") on 24 March 2004 and was registered as a mutual fund under the Mutual Funds Law (2003 Revision). As is common with such open-ended investment funds, investors in the fund received participating non-voting redeemable shares in exchange for the monies they invested in the fund with a right under the Articles of Association to redeem those shares for a sum based on the fund's NAV established at a specified date ("the Valuation Point") close to the date of the applicable Redemption Day.
4. Article 20 (1) provided:

"Subject to the provisions of the Statute and as hereinafter provided and except as otherwise agreed or determined by the Directors, the Company shall on receipt by it or its duly authorized agent of a written request ... from a Shareholder for the redemption of all or any Participating Non-Voting Shares held by him ... redeem or repurchase such [Shares] for an amount equal to the Net Asset Value per Participating Non-Voting Share of the relevant Separate Class ..."
5. Under Article 22 (1), a redeeming shareholder was entitled to receive the redemption proceeds as soon as reasonably practicable subject to any suspension of payment of redemption proceeds decided on by the Directors under Article 19. The Offering Memorandum stated that redemption proceeds

would normally be paid within 20 Business Days of the relevant Redemption Day.

6. Article 23 provided:

“Upon the redemption of a Participating Non-Voting Share being effected the Shareholder shall cease to be entitled to any rights in respect thereof ... and accordingly his name shall be removed from the Register of Shareholders with respect thereto and the Share so redeemed shall be available for re-issue and until re-issue shall form part of the unissued capital of the Company”.

7. From the outset, Herald placed funds for investment with Bernard L Madoff Investment Securities LLC (“BLMIS”), a limited liability company incorporated under the laws of New York.

8. One of the investors in Herald was another open-ended investment fund incorporated under the Companies Law, Primeo Fund (“Primeo”).

9. Prior to 1 December 2008, redemption requests from two different groups of Herald shareholders - “the December Redeemers” and the “KYC Redeemers” - were received on Herald’s behalf by its administrator, HSBC Securities Services (Luxembourg) SA. The relevant Valuation Point for the Redemption Day of 1 December 2008 was 28 November 2008 and Herald accepted these redemption requests providing these redeemers with a NAV per Share for that Valuation Point of US\$1,386.20 per USD class Share and €1,328.74 per EUR Share in respect of their shares (respectively “the December Shares” and “the KYC Shares”). Accordingly, in accordance with Articles, the December Shares and the KYC Shares were redeemed on 1 December 2008 and removed from Herald’s share register notwithstanding that no redemption proceeds had yet been received.

10. On 11 December 2008, Mr Madoff confessed that BMLIS was a fraud and on the following day, 12 December 2008, Herald’s board resolved to suspend the calculation of the NAV per Participating Non-Voting Shares and the issue, redemption and conversion of such shares with immediate effect and until further notice.

11. On 24 December 2008, Herald’s board resolved:

“...to the extent not expressly contemplated by the Suspension, the payment of redemption proceeds to investors in respect of redemption requests in Herald USA for value 26 November 2008 (but in respect of which [Herald] is not ordinarily obliged to pay redemption proceeds until or about 28 December 2008) is hereby suspended with immediate effect and until further notice.”

12. The December Redeemers were not paid their Redemption Proceeds. The KYC Redeemers were also not paid for the additional reason that “Know Your Client” documentation was outstanding.

13. On 23 January 2009, Primeo was voluntarily wound up and on 8 April 2009, the Grand Court ordered that Primeo's winding up should continue under the supervision of the court. On 11 May 2012, the original Joint Official Liquidators, Mr James Cleaver and Mr Richard Fogerty, were replaced by Mr Gordon MacRae and Ms Eleanor Fisher respectively.
14. On 16 July 2013, Herald was ordered to be wound up by the Grand Court and on 23 July 2013, Mr Russell Smith and Mr Niall Goodsir-Cullen were appointed as Joint Official Receivers. Also, Mr Michael Pearson was appointed as Additional Official Liquidator with the functions of settling the list of contributories pursuant to section 112 (1) of the Companies Law and determining related issues.
15. The December Redeemers and the KYC Redeemers claimed that they were entitled to claim in Herald's liquidation as creditors for the Redemption Proceeds they say are due following Herald's acceptance of their Redemption Requests as of 1 December 2008. They also contend that such claims rank *pari passu* with Herald's other creditors and in preference to any claims that Herald's shareholders may have in the liquidation in their capacity as shareholders.
16. The Liquidators of Herald dispute these claims. They contend that the claims are caught by section 37 (7) (a) of the Companies Law and that both provisos to that paragraph apply, with the result that the December Redeemers and the KYC Redeemers have no entitlement to present claims for the Redemption Proceeds.
17. On 24 November 2014, the Grand Court directed that the issue arising out of these competing contentions be determined in an *inter partes* proceeding pursuant to Order 11, rule 3 of the Companies Winding Up Rules, with Primeo acting as representative of both the December Redeemers and the KYC Redeemers (the claims of both groups being legally indistinguishable) and Herald's Additional Liquidator acting as representative of all contributories who did not serve Redemption Notices for the Redemption Day of 1 December 2008.
18. In its Amended Points of Claim, the Respondent sought a declaration not only that subsection 37 (7) (a) did not apply to the shares redeemed by Primeo ("the Primeo Shares") and the shares redeemed by the KYC Redeemers' ("the KYC Shares") but also that Primeo and the KYC Redeemers have claims against Herald for payment of the Redemption Proceeds which are admissible for proof and rank *pari passu* with the claims of other ordinary unsecured creditors of Herald.

Section 37 of the Companies Law

19. It is regrettably necessary to set out most of section 37.

37. (1) Subject to this section, a company limited by shares or limited by guarantee and having a share capital may, if authorised to do so by its articles of association, issue shares which are to be redeemed or are liable to be redeemed at the option of the company or the shareholder and, for the avoidance of doubt, it shall be lawful for the rights attaching to any shares to be varied, subject to the provisions of the company's articles of association, so as to provide that such shares are to be or are liable to be so redeemed.

(2) Subject to this section, a company limited by shares or limited by guarantee and having a share capital may, if authorised to do so by its articles of association, purchase its own shares, including any redeemable shares.

(3) (a) No share may be redeemed or purchased unless it is fully paid.

(b) A company may not redeem or purchase any of its shares if, as a result of the redemption or purchase, there would no longer be any issued shares of the company other than shares held as treasury shares.

(c) Redemption or purchase of shares may be effected in such manner and upon such terms as may be authorised by or pursuant to the company's articles of association.

(d) If the articles of association do not authorise the manner and terms of the purchase, a company shall not purchase any of its own shares unless the manner and terms of purchase have first been authorised by a resolution of the company.

(da) For the avoidance of doubt –

(i) a company's articles of association; or (ii) a resolution of the company,

may authorise the company's directors to determine the manner or any of the terms of, any such redemption or purchase not being inconsistent with such articles of association or resolution and subject to such restrictions (if any) as may be provided therein.

(e) The premium, if any, payable on redemption or purchase must have been provided for -

(i) out of either or both of the profits of the company or the company's share premium account, before or at the time the shares are redeemed or purchased; or

(ii) in the manner provided for in subsection (5).

(f) Shares may be redeemed or purchased out of profits of the company, out of the share premium account or out of the proceeds of a fresh issue of shares made for the purposes of the redemption or purchase or in the manner provided for in subsection (5).

(g) Subject to section 37A, shares redeemed or purchased under this section shall be treated as cancelled on redemption or purchase, and the amount of the company's issued share capital shall be diminished by the nominal value of those shares accordingly; but the redemption or purchase of shares by a company is not to be taken as reducing the amount of the company's authorised share capital.

- (h) Without prejudice to paragraph (g), where a company is about to redeem or purchase shares, it has power to issue shares up to the nominal value of the shares to be redeemed or purchased as if those shares had never been issued: Provided that where new shares are issued before the redemption or purchase of the old shares the new shares shall not, so far as relates to fees payable on or accompanying the filing of any return or list, be deemed to have been issued in pursuance of this subsection if the old shares are redeemed or purchased within one month after the issue of the new shares.
- (4) (a) Where, under this section, shares of a company are redeemed or purchased wholly out of either or both of the company's profits or share premium account, the amount by which the company's issued share capital is diminished in accordance with paragraph (g) of subsection (3) on cancellation of the shares redeemed or purchased shall be transferred to a reserve called the "capital redemption reserve" and the share premium account or company's profits, as the case may be, shall be adjusted accordingly.
- (b) If the shares are redeemed or purchased wholly or partly out of the proceeds of a fresh issue and the aggregate amount of those proceeds is less than the aggregate nominal value of the shares redeemed or purchased, the amount of the difference shall be transferred to the capital redemption reserve.
- (c) Paragraph (b) does not apply if the proceeds of the fresh issue are applied by the company in making a redemption or purchase of its own shares in addition to a payment out of capital under subsection (5).
- (d) The provisions of this Law relating to the reduction of a company's share capital apply as if the capital redemption reserve were paid-up share capital of the company, except that the reserve may be applied by the company in paying up its unissued shares to be allotted to members of the company as fully paid bonus shares.
- (5) (a) Subject to this section, a company limited by shares or limited by guarantee and having a share capital may, if so authorised by its articles of association, make a payment in respect of the redemption or purchase of its own shares otherwise than out of its profits, share premium account, or the proceeds of a fresh issue of shares.
- (b) References in subsections (6) to (9) to payment out of capital are, subject to paragraph (f), references to any payment so made, whether or not it would be regarded apart from this subsection as a payment out of capital.
- (c) The amount of any payment which may be made by a company out of capital in respect of the redemption or purchase of its own shares is such an amount as, taken together with - (i) any profits and share premium of the company being applied for purposes of the redemption or purchase; and (ii) the proceeds of any fresh issue of shares made for the purpose of the redemption or purchase, is equal to the price of redemption or purchase, and the payment out of capital permitted under this paragraph is referred to in subsections (6) to (9) as the capital payment for the shares. Nothing in this paragraph shall be taken to imply that a company shall be obliged to exhaust any profits and share premium before making any capital payment.
- (d) Subject to paragraph (f), if the capital payment for shares redeemed or

purchased and cancelled is less than their nominal amount, the amount of the difference shall be transferred to the company's capital redemption reserve.

- (e) Subject to paragraph (f), if the capital payment is greater than the nominal amount of the shares redeemed or purchased the amount of any capital redemption reserve or fully paid share capital of the company may be reduced by a sum not exceeding, or by sums not in the aggregate exceeding, the amount by which the capital payment exceeds the nominal amount of the shares.
 - (f) Where the proceeds of a fresh issue are applied by a company in making any redemption or purchase of its own shares in addition to a payment out of capital under this subsection, the references in paragraphs (d) and (e) to the capital payment are to be read as referring to the aggregate of that payment and those proceeds.
- (6) (a) A payment out of capital by a company for the redemption or purchase 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.
- (b) The company and any director or manager thereof who knowingly and wilfully authorises or permits any payment out of capital to effect any redemption or purchase of any share in contravention of paragraph (a) commits an offence and is liable on summary conviction to a fine of fifteen thousand dollars and to imprisonment for five years.
- (7) (a) 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 or which the company has agreed to purchase have not been purchased, the terms of redemption or purchase may be enforced against the company, and when shares are redeemed or purchased under this subsection they shall be treated as cancelled: Provided that this paragraph shall not apply if-
- (i) the terms of redemption or purchase provided for the redemption or purchase to take place at a date later than the date of the commencement of the winding up; or
 - (ii) during the period beginning with the date on which the redemption or purchase was to have taken place and ending with the commencement of the winding up the company could not, at any time, have lawfully made a distribution equal in value to the price at which the shares were to have been redeemed or purchased.
- (b) There shall be paid in priority to any amount which the company is liable by virtue of paragraph (a) to pay in respect of any shares-
- (i) all other debts and liabilities of the company (other than any due to members in their character as such); and
 - (ii) if other shares carry rights whether as to capital or as to income which are preferred to the rights as to capital attaching to the first mentioned shares, any amount due in satisfaction of those preferred rights, but subject to that, any such amount shall be paid in priority to any amounts due to members in

satisfaction of their rights (whether as to capital or income) as members.

- (8) (a) Any redeemable preference shares issued by a company before the 18th day of January, 1988, are subject to redemption in accordance with this section.
- (b) Any capital redemption reserve fund established by a company before the 18th day of January, 1988, is to be known as the company's capital redemption reserve and to be treated as if it had been established for the purposes of subsection (4), and accordingly, a reference in any law, the articles of association of any company or any other instrument to a company's capital redemption reserve fund is to be construed as a reference to the company's capital redemption reserve.
- (9)

The judgment below

20. The issue was determined below in the Financial Services Division of the Grand Court by Justice Andrew Jones QC ("the judge"). Applying the well-known decision of the Privy Council in *Culross Global SPC Limited v Strategic Turnaround Partnership Limited* [2000] 2 CILR 364, the judge held: (i) (as was not disputed by the Defendant) that the December Redeemer Shares had been redeemed in accordance with the company's Articles before the commencement of Herald's winding up, notwithstanding that the Redemption Proceeds had not been paid; (ii) section 37 (7) (a) only applies where shares are liable to be redeemed but have not been redeemed in accordance with the company's Articles; (iii) accordingly, the claims of the December Shareholders and the KYC Shareholders were not caught by s.37 (7) (a).
21. Noting that the word "redemption" appears repeatedly throughout section 37 and that s. 37 (3) (c) "expressly provides that redemption occurs 'in such manner and upon such terms as may be authorized by or pursuant to the company's articles of association'", the judge concluded that "redemption" was intended to have the same meaning throughout section 37 and that therefore if "redemption" had taken place in accordance with subsection (3) it had also taken place for the purposes of s. 37 (7) (a). The subsection was therefore intended to apply where shares "were liable to be redeemed" (for instance because a valid redemption notice had been served) but further steps remained to be completed before there was redemption under the Articles.
22. Consequent on the handing down of his decision, the judge made an order declaring that section 37 (7) (a) does not apply to the December Shares and the KYC Shares. His order was silent, however, as to whether the December Redeemers and the KYC redeemers were entitled to prove in the Herald liquidation ranking *pari passu* with Herald's other ordinary outside creditors as claimed by the Respondent in its Amended Points of Claim.

A summary of the parties' contentions on appeal

The Appellant's case

23. As heralded in paragraph 2 above, the Appellant argued that the words "... shares which ... are liable to be redeemed have not been redeemed" in s. 37 (7) (a) meant "shares in respect of which the company's prospective liability to pay redemption proceeds has arisen but has not been discharged". The Appellant submitted that this interpretation was to be preferred to the Respondent's interpretation both on textual construction grounds and because the Respondent's interpretation leads to a result that: (a) denudes the subsection of any substantial effect; and (b) is fundamentally at odds with well-established company law principles.
24. The argument that the Respondent's proposed interpretation leads to results fundamentally at odds with well-established corporate law principles proceeded on the basis that under this interpretation the December Redeemers and the KYC Redeemers would be entitled to prove for their redemption proceeds in Herald's liquidation outside s 37 (7), ranking not only ahead of other shareholders but *pari passu* with Herald's ordinary creditors. This, it was submitted, offended against: (a) the Capital Maintenance rule established in *Trevor v Whitworth* [1878] LR 12 App. Cas. 609; and (b) the principle enshrined in section 49 (g) of the Companies Law whereby "outside creditors" have priority over "inside creditors".
25. Section 49 (g) provides:
- In the event of a company being wound up every present and past member of such company shall be liable to contribute to the assets of the company to an amount sufficient for payment of the debts and liabilities of the company, and the costs, charges and expenses of the winding up and for the payment of such sums as may be required for the adjustment of the rights of the contributories amongst themselves:
- Provided that –
- (a) – (f)
- (g) no sum due to any member of a company in his character of a member by way of dividends, profits or otherwise, shall be deemed to be a debt of the company, payable to such member in a case of competition between himself and any other creditor not being a member of the company; but any such sum may be taken into account for the purposes of the final adjustment of the rights of the contributories amongst themselves.
26. The Appellant also relied on: (i) *In the Matter of Belmont Asset Based Lending Limited* [2011] (2) CILR 316 where it appears that the judge (Justice Jones) and the parties all proceeded on the assumption that the unpaid redeemed

shareholders would rank after ordinary creditors; and (iii) *Somers Dublin Ltd. A/C KCBS et al v Monarch Pointe Fund Limited* [2013] ECSC JO 311-10 where the Eastern Caribbean Court of Appeal held that: (a) an unpaid redeemed shareholder in a company in liquidation could claim for redemption proceeds as a creditor; and (b) pursuant to s. 197 of the BVI Insolvency Act 2003, such a shareholder ranked after creditors but in priority to continuing members. (Section 197 is the equivalent of s.49 (g) of the Cayman Companies Law, save that “redemption proceeds” are expressly included in section 197 along side “dividend” and “profits”).

27. It was submitted that the example the judge gave of the application of s.37 (7) (a) to a situation where, at the commencement of the winding up, the steps required by the Articles for redemption to occur had not all been completed, was self-defeating because: where a redemption request has been submitted but the redemption day has not arrived before the commencement of the winding up, the enforceability provided for in the body of s. 37 (7) (a) would immediately be disapplied by the first proviso, leaving no scope for the application of the second proviso in any circumstances.
28. Turning to the Appellant’s textual submissions, it was argued that, as a matter of ordinary parlance, it was only once redemption proceeds had been received that the shares in question would be regarded as “redeemed”. Redemption is not a *scintilla temporis* but is a process culminating in payment and it is that concept that informs s. 37 (7) (a) which is all about enforcing an entitlement to redemption proceeds which has accrued before the commencement of the winding up.
29. The Appellant submitted that there were many examples in the wording of section 37 as a whole that demonstrate that the statute is focused on the entire redemption process; see eg s. 37 (3) (e), s. 37 (3) (f); s.37 (4) (b); s. 37 (5) (a); s.37 (5) (d); s. 37 (5) (f); and s.37 (6).
30. The judge was wrong to find that the wording of s.37 (3) (c) constituted a definition of “redemption”. Section 37 (3) (c) does no more than state that the manner in which redemption or purchase may be effected must be authorized by or pursuant to the Articles of Association.
31. The Appellant also relied on *Re Founding Partners Global Partners Limited (in Liquidation)* (Unreported, Foster J, 21 September 2010) where the parties (and by implication, the judge) were in agreement that “*the wording of subparagraph (a) [of s.37 (7)] is not as clear as it might be but that the words ‘... have not been redeemed’ must mean ‘the redemption proceeds due have not been paid’*”.
32. Finally, it was submitted that section 37 is the only statutory authorization for the return of capital to fund the redemption of shares by a company in liquidation. Thus, if the December Redeemers and the KYC Redeemers are not within section 37 (7), they have no enforceable claim for redemption proceeds at all.

The Respondent's Case

33. It was submitted on behalf of the Respondent that, when construed in light of the whole of section 37 and against the background of the statutory scheme for the winding up of companies, section 37 (7) (a) can be seen as intended to deal with those situations where, before the commencement of the winding up, a shareholder has acquired a right to be paid redemption proceeds but there remain outstanding steps required under the Articles before his shares are redeemed and thereby he ceases to be a member of the company. An example of such an outstanding step would be the calculation of NAV. In such a situation, absent s. 37 (7) (a), the shareholder would generally have no provable claim under the statutory winding up provisions.
34. On the other hand, where before the commencement of the winding up the shares in question have been redeemed in accordance with the Articles so that the shareholder has divested himself of his rights as a shareholder and ceased to be a member, the unpaid former shareholder has a provable claim for the redemption proceeds under section 139 (1) of the Companies Law without the need of a specific enactment in the nature of section 37 (7) (a).
35. Such a claim under section 139 (1) of the Companies Law would rank *pari passu* with the company's creditors and ahead of the remaining shareholders pursuant to section 140 (1) of the Companies Act: "*Subject to subsection (2), the property of the company shall be applied in satisfaction of its liabilities pari passu and subject thereto shall be distributed amongst the members according to their rights and interests in the company*").
36. Section 49 (g) of the Companies Law does not operate in this situation to postpone the claim behind the claims of the creditors because, as held by Bannister J in *Western Union International Limited v Reserve International Liquidity Fund Limited* [2010] ECSJ No 26 in reference to section 197 of the BVI Insolvency Act, a claim to redemption proceeds is not a claim founded on the statutory contract between a member and the company but arises after the claimant has ceased to be a member.
37. Even if the claim for redemption proceeds under section 139 (1) were subordinated to the claims of the creditors, it would still rank ahead of the members in respect of distributions on their shares.
38. The ordinary meaning of "redeemed" in the context of shares is synonymous with the shareholder ceasing to be a shareholder in the company. Further, the words "have not been redeemed" in s. 37 (7) (a) must have the same meaning throughout the whole of s. 37 and in the other subsections, especially s. 37 (3) (c) and (g) redemption means that the shareholder has ceased to be a member of the company in accordance with the Articles.
39. Section 37 (7) (a) applies where a shareholder has served a redemption notice prior to the commencement of the winding up which under the Articles gives him an accrued right for the redemption of his shares but at the

commencement of the winding up some further step needs to be done for redemption to occur, such as the calculation of the NAV.

Discussion

40. It is not uncommon pursuant to the Articles of Association of Cayman Islands open-ended investment funds for the redemption of redeemable shares to occur prior to the payment of redemption proceeds. Herald's Articles were to this effect (see Articles 20, 22 and 23) as were the Articles construed by the Privy Council in *Culross Global SPC Limited v Strategic Turnaround Master Partnership Ltd*, where Lord Mance observed that the interpretation of the Articles "*is 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 which is (as the Respondent was) due to make such payment upon a certain date ...*"
41. It was not disputed (nor could it have been) that upon redemption occurring pursuant to the Articles before payment of the redemption proceeds, the shareholder is divested of his rights as a shareholder and ceases to be a member of the company. This outcome is sometimes expressly provided for in the Articles of Association of open-ended funds, as it was in Article 23 of Herald's Articles and Article 40 of Strategic Turnaround's Articles.
42. Justice Foster decided *Re Founding Partners Global Partners Ltd (In Liquidation)* (above) on the basis that s. 37 (7) (a) had the meaning contended for by the Appellant. However, that was an interpretation agreed by the parties and although of course I take account of the fact that Justice Foster seems to have agreed with the adopted interpretation, his judgment cannot be determinative of the issue in this appeal since the point was not argued and the judgment contains no reasoning in support of the agreed meaning.
43. For my part, for the reasons that follow, I am of the view that section 37 (7) (a) applies where at the commencement of the company's winding up a holder of redeemable shares has an accrued right to the redemption thereof under the Articles of Association but there has been no redemption because the steps required by the Articles for this to occur have not been completed and no redemption proceeds have been paid.
44. Section 37 (7) (a) does not apply where, as in the instant case, at the commencement of the winding up the redeemable shares in question have been redeemed in accordance with the Articles, notwithstanding that the redemption proceeds are yet to be received.
45. In the case of redeemable shares, the right conferred by the section 37 (7) (a) is the right to "enforce the terms of redemption" and those terms will be as set out in the Articles of Association, see: (i) s. 37 (1) ("... a company ... may if authorized to do so by its articles of association, issue shares which are to be redeemed or are liable to be redeemed ..."); and (ii) s. 37 (3) (c) ("Redemption ... may be effected in such manner and upon such terms as may be authorized by or pursuant to the company's articles of association"). In my view, these

provisions strongly suggest that the words “have not been redeemed’ in s. 37 (7) (a) mean, “have not been redeemed in accordance with articles” and do not mean, “have not been redeemed because the redemption proceeds remain unpaid.”

46. The wording of section 37 (3) (g) (“*Subject to section 37A, shares redeemed ... shall be treated as cancelled on redemption ...*”) also suggests that for the purposes of section 37, redemption occurs when the redeemer ceases to be a shareholder and not only upon receipt of the redemption proceeds.
47. Section 37A further supports this interpretation. This provision deals with the situation where a company is authorized to hold treasury shares (as was Herald by Article 23). In such a case, when redeemable shares are redeemed, they are not cancelled but go into the treasury and become available for re-issue to a new shareholder, which is a clear pointer to the conclusion that it is when the redeemer ceases to be a shareholder that there is redemption for the purposes of the whole of s. 37, including subsection (7) (a), and not only when the redemption proceeds are paid.
48. The words “and when shares are redeemed ... under this subsection they shall be cancelled” in s. 37 (7) (a) itself are also a strong indication that the intention behind that subsection is that it only applies to shares which have not already been cancelled, which they will have been under s. 37 (3) (g) if they have been redeemed under the Articles, notwithstanding that redemption proceeds have not been paid.
49. If, following their redemption pursuant to the Articles, shares were to become treasury shares and be reissued to third parties as permitted by the Articles, on the Appellant’s interpretation of s. 37 (7) (a) a claim for the redemption proceeds against the company now in liquidation would have to be brought under the subsection, with the result that the shares would be cancelled notwithstanding their re-issue to third parties. In my judgment, such a nonsensical outcome is another clear indication that s. 37 (7) (a) is not to be interpreted in the manner contended for by the Appellant but in the manner advanced by the Respondent.
50. As argued by the Respondent, I am of the view that an unpaid former shareholder whose shares pursuant to the Articles were redeemed before the commencement of the winding up would have a provable claim for the redemption proceeds under section 139 (1) of the Companies Law, quite apart from section 37 (7) (a). Accordingly, it is difficult to see why s. 37 (7) (a) should have been intended to apply to such a case.
51. Take the facts of this case. The claims by the December Redeemers and the KYC Redeemers (“the Claimants”) for redemption proceeds would be contingent claims but such claims fall within s. 139 (1) of the Companies Law that provides:

All debts payable on a contingency and all claims against the company whether present or future, certain or contingent, ascertained or

sounding only in damages, shall be admissible to proof against the company and the official liquidator shall make a just estimate so far as is possible of the value of all such debts or claims as may be subject to any contingency or sound only in damages or which for some other reason do not bear a certain value.

52. In proving their claims under s. 139 (1), the Claimants would be acting in the capacity of creditors. They ceased to be members of Herald once their shares were redeemed under the Articles; see *Somers Dublin Ltd AC KBCS v Monarch Pointe Fund Ltd (In Liquidation)* (above) which is considered in paragraph 54 below.
53. Pursuant to s. 49 (g) of the Companies Law, the claims would rank, in my opinion, behind the claims of Herald's ordinary creditors. As recorded above, the Respondent submitted to the contrary, relying on the reasoning in *Western Union International Limited v Reserve International Liquidity Fund Limited* [2010] ECSJ No 26 where, in reference to section 197 of the BVI Insolvency Act, Bannister J held that a claim for redemption proceeds in a liquidation is not a claim founded on the statutory contract between a member and the company but arises after the claimant has ceased to be a member. With respect, I decline to accept this reasoning. Although the Claimants ceased to be members of Herald upon redemption of their shares, their claims for redemption proceeds would be founded on the statutory contract between them as members and Herald and as such would be claims for sums "due to any member of a company in his character of a member" within s. 49 (g).
54. However, the Claimants' claims would rank ahead of the entitlement of other Herald shareholders to be paid sums due to them in their capacity of members. As Mitchell JA said in reference to s. 197 of the BVI Insolvency Act in the *Somers Dublin Ltd* decision, any adjustment within s. 197 must give higher priority to former members who have become creditors as a result of a redemption than to mere continuing members.
55. In terms of ranking, the outcome of the postulated claims would therefore be the same as the outcome of a successful claim under s. 37 (7) (a), which puts paid to the Appellant's contention that it cannot have been intended that shareholders of shares redeemed under the Articles without payment of the redemption proceeds could claim in the company's liquidation otherwise than under s.37 (7) (a) because the outcome of such a claim would see the claimants ranking *pari passu* with the outside creditors.
56. I reject the submission advanced on behalf of the Appellant that unless the Respondent's claim falls within s.37 (7) there can be no claim at all because a statutory sanction for a return of capital is necessary and the subsection is the only available sanction. Herald was authorized by s. 37 (1) to issue the December and KYC shares and was authorized to provide in its Articles for the redemption of those shares as it did in Articles 20 -23. Further, since the Claimants' claims for redemption proceeds rank after the claims of Herald's

unsecured creditors, the payment of those claims will involve no breach of the Capital Maintenance rule.

57. I accept the Respondent's persuasively advanced submission that s. 37 (7) (a) was enacted to permit a claim in a liquidation for redemption proceeds where, for two reasons, no such claim could be made under the general winding up provisions. The first reason is that in such a claim, the claimant would be seeking to change his status from that of member to that of creditor and this is generally impermissible; see s.99 of the Companies Law: "*When a winding up order has been made, any disposition of the company's property and any transfer of shares or alteration in the status of the company's members made after the commencement of the winding up is, unless the Court otherwise orders, void*". The second reason is that a counterparty will not normally be permitted to enforce a contract against a company in liquidation which requires the company to pay out money in order to acquire property. As Oliver J explained in *In re Dynamics Corpn* 1976] 1 WLR 757 at 774 C-D:

In the ordinary way the court does not, I think, decree specific performance against a trustee in bankruptcy or a liquidator where the obligation is simply to pay money, as for instance, in the case of the insolvent purchaser of land; see Holloway v York (1877) 25 WR 627. The reason is not, I think, far to seek. The effect would be in fact that the other party to the contract would be receiving payment otherwise than pari passu with the other creditors.

58. On this approach, s. 37 (7) (a) would apply where at the commencement of the winding up a shareholder has acquired an enforceable right under the Articles of Association for the redemption of his shares (for instance by serving a conformant redemption notice) but redemption has not occurred because some further step required by the Articles has not been completed, such as the NAV calculation. I accept the Respondent's submission that there is nothing contrived or far fetched in this scenario. It is entirely possible in my view to conceive of Articles of Association that give a redeeming shareholder an accrued right to redemption on serving a conformant notice but require some further steps to be taken before redemption occurs and he ceases to be a shareholder under the Articles.

59. As was submitted by the Respondent, this construction of s. 37 (7) (a) is supported by the legislative origins of section 37(7). The genesis of the subsection is sections 59(4)-(6) of the English Companies Act 1981, now section 735 of the English Companies Act 2006. Sections 59(1)-(6) of the 1981 Act provided as follows:

“(1) Where on or after the appointed day a company –
(a) issues shares on terms that they are or are liable to be redeemed; or

(b) agrees to purchase any of its own shares;

the following provisions of this section shall apply in relation thereto.

- (2) A company shall not be liable in damages in respect of any failure on its part to redeem or purchase any of the shares.*
- (3) Subsection (2) above is without prejudice to any right of the holder of any of the shares other than his right to sue the company for damages in respect of its failure; but the court shall not grant an order for specific performance of the terms of the redemption or purchase if the company shows that it is unable to meet the cost of redeeming or purchasing the shares in question out of distributable profits.*
- (4) Where the company is wound up and at the commencement of the winding up any of the shares have not been redeemed or purchased then subject to the following provisions of this section the terms of the redemption or purchase may be enforced against the company; and when shares are redeemed or purchased under this subsection they shall be treated as cancelled.*
- (5) Subsection (4) above shall not apply if -*

 - (a) the terms of the redemption or purchase provided for the redemption or purchase to take place at a date later than the date of the commencement of the winding up;*
 - or*
 - (b) during the period beginning with the date on which the redemption or purchase was to have taken place and ending with the commencement of the winding up the company could not at any time have lawfully made a distribution equal in value to the price at which the shares were to be have been redeemed or purchased.*
- (6) There shall be paid in priority to any amount which the company is liable by virtue of subsection (4) above to pay in respect of any shares -*

 - (a) all other debts and liabilities of the company (other than any due to members in their character as such);*
 - (b) if other shares carry rights whether as to capital or as to income which are preferred to the rights as to capital attaching to the first mentioned shares, any amount due in satisfaction of those preferred rights;*

but, subject to that, any such amount shall be paid in priority to any amounts due to members in satisfaction of their rights (whether as to capital or income) as members.

60. Sections 59 (2) and (3) dealt with the enforcement of the terms of redemption or purchase outside of liquidation. As the Respondent contended, these provisions would make little sense if the intended meaning of “*redemption*” was such that it would not occur until the redemption proceeds had been paid. In particular, it would be puzzling to refer to a damages claim for a failure to redeem where the relevant shares had been removed from the register and the redemption price had accrued due. Similarly, it would make little sense to speak of the specific performance of such a contract i.e. where all that remained to be done was payment of the redemption price. These provisions were clearly concerned with the remedies for enforcement of an executory contract where the redeemer/seller remained the shareholder in respect of the relevant shares. The relevant provisions of the Cayman Companies Law were intended to follow the English legislation. The First Official Member responsible for Finance and Development said when introducing the applicable clause of the Companies (Amendment) Bill 1987 on 16 November 1987: “*By clause 7, it is sought to re-enact a new section 34 [now s.37] which is more in line with the companies legislation in other offshore jurisdictions and which follows the recent changes in the United Kingdom’s companies legislation.*”

61. Further, in my judgment, the reasonable expectation of an investor in a fund with Articles such as Herald’s would be that, having served a conformant notice, he would be redeemed on the Redemption Day and from that moment he would have a claim for redemption proceeds. In my judgment, the interpretation of s. 37 (7) (a) advanced by Respondent would chime with this expectation, but the interpretation advanced by the Appellant would not. On the Appellant’s interpretation the shareholder’s position would be uncertain: redemption would not take effect in accordance with the Articles but would be conditional on the company not going into liquidation before the redemption proceeds are paid. The situation is similar to that in *Strategic Turnaround* where Lord Mance said:

“As far as commercial sense is concerned, the Respondent’s analysis [that the Directors had power to suspend the payment of redemption proceeds after the Redemption Date] appears unattractive for investors in the Fund, and so for the Fund as an institution seeking investors. The Fund is on its face an investment vehicle to which investors can for a defined period commit funds, and which at the same time offers investors, for obvious commercial reasons, the relative security of a defined route by reference to which they may recover the value of their investments as at a defined date. Until the defined date, investors are subject to the risk of a full Suspension or a temporary suspension. The Respondent’s analysis subjects them to different and much greater insecurity.”

62. I am also unpersuaded by the Appellant’s submission that the Respondent’s proposed interpretation of s. 37 (7) (a) is unlikely to be the correct interpretation because it could lead to a run on the fund with investors lodging redemption requests at the first sign of trouble. I say this because in my view the Appellant’s interpretation could equally encourage investors to submit

redemption requests as early as possible in the hope of being paid before any suspension of redemption payments. In any event, as was submitted by the Respondent, it will always be open to investment funds like Herald to include in the Articles of Association provisions to make redemption conditional on some further step taking place, for instance approval of the directors.

63. I also reject the Appellant's submission that since it is plain that s.37 (7) (a) relates to the payment of redemption proceeds, his interpretation is to be preferred over that of the Respondent. Whilst it is undoubtedly true that the subsection relates to the payment of redemption proceeds, this does not advance the Appellant's interpretation argument since the question remains whether s.37 (7) applies: (1) where the shares have been redeemed under the Articles of Association giving rise to a creditor's claim for the redemption proceeds under s. 139 (1) of the Companies Law; or (2) only where the shares have not been redeemed under the Articles so that the shareholder remains a member with no entitlement to enforce the terms of redemption otherwise than by specific legislative enactment.
64. I also do not accept the Appellant's submission that in other subsections of s.37 the word "redemption" is used to signify the whole process of redemption including payment. In my opinion, the use of "redemption" in those other subsections is equally consistent with the obligation to pay the redemption proceeds being something that arises on redemption rather than being an intrinsic part of redemption itself.

Conclusions

- (1) Section 37 (7) (a) of the Companies Law does not apply where, at the commencement of the winding up, the redeemable shares in question have been redeemed in accordance with the Articles, notwithstanding that the redemption proceeds are yet to be received.
- (2) Section 37 (7) (a) applies where at the commencement of the company's winding up a holder of redeemable shares has an accrued right to the redemption thereof under the Articles of Association but there has been no redemption because the steps required by the Articles for this to occur have not been completed.
- (3) The judge was correct in holding that s.37 (7) (a) did not apply to the December Shares or the KYC Shares.
- (4) The December Redeemers and the KYC Redeemers have provable contingent claims in Herald's liquidation, those claims ranking behind Herald's unsecured creditors but ahead of the entitlement of other Herald shareholders to be paid sums due to them in their capacity of members.
- (5) For the reasons given above, I would dismiss the appeal.

The Hon John Martin JA

I agree.

The Hon Denis Morrison JA

I agree.