

**IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS
ON APPEAL FROM THE GRAND COURT OF THE CAYMAN ISLANDS,
FINANCIAL SERVICES DIVISION**

**C.I.C.A. NO:24 OF 2014
(GRAND COURT CAUSE NO: FSD 33 OF 2011-ASC)**

BETWEEN:

DD GROWTH PREMIUM 2X FUND (IN OFFICIAL LIQUIDATION)

Appellant

AND

RMF MARKET NEUTRAL STRATEGIES (MASTER) LIMITED

Respondent

BEFORE:

**THE HON JOHN MARTIN, JA
THE HON SIR RICHARD FIELD, JA
THE RT HON SIR ALAN MOSES, JA**

Appearances

Mr Peter McMaster QC and Mr Jeremy Snead of Appleby for the Joint Official Liquidators of the DD Growth Premium 2X Fund (in Liquidation).

Mr Paul Smith and Mr Ben Hobden of Conyers Dill & Pearman (Cayman) for RMF Market Neutral Strategies (Master) Limited

Hearing: 10 & 11 November, 2015
Judgment delivered: 20 November 2015

JUDGMENT

The Hon. Sir Richard Field, JA

1. This appeal raises a difficult question of statutory construction: Is a payment by a company out of share premium to redeem its own redeemable shares a payment out of "capital" for the purposes of s. 37 (6) (a) of the Companies Law (2007 Revision)?

2. This issue came before the Grand Court in an action in which: (i) the respondent (“RMF”) sought a negative declaration that sums it had received from the appellant (“2X Fund”) for the redemption of redeemable shares held in 2X Fund had been lawfully paid and received; and (ii) 2X Fund by its joint official liquidators (“the JOLs”) sought to recover the said sums paid to RMF on the basis, inter alia, that they had been unlawfully paid contrary to s. 37 (6) (a).
3. The action was tried in the Financial Services Division of the Grand Court by the learned Chief Justice (hereinafter “the judge”) on the basis of a set of agreed facts and facts specified by each of the parties that were not agreed.
4. 2X Fund was ordered to be wound up on 20 March 2009 and two official liquidators of the company were appointed on 29 May 2009. The company remains in official liquidation.
5. At all material times 2X Fund was a Cayman Islands exempted limited liability company that operated as an open ended investment feeder fund. The master fund was DD Growth Premium Master Fund (“the Master Fund”) which is also a Cayman Islands exempted company now in official liquidation.
6. As is normal in the case of Cayman Islands open ended investment companies, investors in 2X Fund, including RMF, were issued redeemable shares with a small par value. Under 2X Fund’s Articles of Association, a shareholder could redeem its (his) shares on any redemption day (the first business day of each month) having given at least 30 days’ prior notice. On redemption day, the redeeming shareholder was entitled to be paid a sum based on the NAV per share of the relevant class of share, with payment being made as soon as possible and in any event within 14 days of the redemption day.
7. Under its Articles, the Directors of 2X Fund were authorised to suspend calculation of the NAV in a number of different circumstances including where: (i) the Investment Manager was of the opinion that a disposal of a substantial portion of the investments of the company would not be reasonable or practical; and (ii) in the opinion of the Board there existed a state of affairs where disposal of the Company’s assets or the determination of the NAV of the Shares would not be reasonably practicable or would be seriously prejudicial to the non-redeeming shareholders. The Articles also authorised the Directors to delay payment of the redemption price if they bona fide determine if raising funds would be unduly burdensome for the company.
8. 2X Fund was not issued redeemable shares in respect of the investments it made in the Master Fund. Instead, after deductions to meet due redemption requests and other expenses, subscription monies were transferred to the Master Fund via Société Général so that it was to Société Général that it looked as a creditor for payments out of the Master Fund.

9. RMF served redemption requests on 2X Fund on 29 October 2008 and 31 October 2008 to redeem (respectively) 87,466.106 and 437,330,534 shares with aggregate values of US\$10,397,970.68 and US\$51,989,853.88. Between 22 October and 31 October 2008 six other investors served redemption requests for varying sums for the 1 December 2008 redemption date.
10. Between 12 January and 6 February 2009, 2X Fund paid RMF the following sums on the following dates: (i) US\$10,428,584 and US\$2,085,716 on 12 January 2009; (ii) US\$5,000,000 on 22 January 2009; (iii) US\$2,500,000 on 30 January 2009; and (iv) US\$3,000,000 on 6 February 2009. These sums total US\$23,014,300 which represents 36.89% of the full amount that RMF was entitled to be paid.
11. The judge found that on 12 January 2009 and the subsequent dates on which 2X Fund made redemption payments to RMF, 2X Fund was insolvent. 2X Fund's only asset was its investment in the Master Fund whose net asset position as at 30 November 2008 was minus US\$69 million. This sorry position was due to the collapse of the derivative market triggered by the Lehman Brothers insolvency announced in mid September 2008. The Master Fund's losses were disguised by the purchase of bonds issued by Asseterra Inc at a fraction of the stated cost and which were virtually worthless.
12. 2X Fund had two classes of shares, US dollar shares and Euro shares. The par value of both classes of shares was respectively US\$0.001 and €0.001 per share. Its total authorized share capital was 50,000,000 shares with total par values of US\$25,000 and €25,000. The initial offering prices for the shares were US\$100 and €100 and thereafter the shares were offered at a price based on NAV. It followed, as found by the judge, that almost all of the value of 2X Fund was identifiable as share premium and thus although 2X Fund did not operate a share premium account, the redemption payments made to RMF on and after 12 January 2009 were made out of share premium save only to the *de minimis* extent that the par value of the shares was being returned.¹
13. Section 37 (6) (a) of the Companies Law (2007 Revision) ("the 2007 Law") provides:

"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."

¹ In paragraphs 142 and 211 the judge contemplates the possibility of the proceeds of a fresh issue of shares funding the RMF redemptions but in the first instance he was dealing with a submission to that effect and in the second he was dealing with an undue or fraudulent preference claim. These references therefore do not detract from his finding it was share premium account that funded the redemption payments made to RMF save to a *de minimis* extent.

14. The JOLs' principal case advanced at trial was that the redemption payments made to RMF on and after 12 January were made out of share premium which constituted payments out of capital within s. 37 (6) (a), with the result that since they were made when 2X Fund was insolvent they were unlawful and could be clawed back.

15. Section 37 (5) (a) and (b) of the 2007 Law provides:

(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 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.

16. The JOLs contended that a payment out of share premium for the redemption of redeemable shares was a payment "otherwise than out of profits or the proceeds of a fresh issue of shares" and was therefore a payment of capital by virtue of s. 37 (5) (b) for the purposes of s. 37 (6) (a). The redemption payments made to RMF had therefore been made out of capital and were unlawful under s. 37 (6) (a) because 2X Fund was cash flow insolvent at the time the payments were made.

17. The judge rejected the JOLs' contention. In his view, share premium used by a company for the redemption or purchase of its own shares was not capital for the purposes of s. 37 (6). It is this ruling which is challenged in this appeal.

18. In reaching his decision, the Judge began by considering what he thought would be the consequences if the JOLs' contention were correct. He observed that investors in Cayman open ended investment companies were invariably issued with redeemable shares at a price well in excess of their nominal value and the investors understood from the company's Articles that their shares would be redeemed on the basis of the NAV per share out of share premium in the ordinary course of business. It followed, said the judge, that treating all payments made for the redemption of shares from share premium as payments from capital and unlawful the moment an investment company became cash flow insolvent would carry far-reaching consequences. In particular it would contradict the expectations of investors in such a company. It was precisely for dealing with crises such as cash flow difficulties that the constitutional documents of 2X Fund enabled the directors to suspend the calculation of NAV and redemptions of shares.

19. The judge then turned to s. 34 of the 2007 Law. This section and section 37 are contained within Part III of the 2007 Law which is headed:

PART III - Distribution of Capital And Liability Of Members Of Companies And Associations

Distribution of Capital

20. S. 34 provides in relevant part:

(1) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the value of the premiums on those shares shall be transferred to an account called "the share premium account". Where a company issues shares without nominal or par value, the consideration received shall be paid up share capital of the company.

(2) The share premium account may be applied by the company subject to the provisions, if any, of its memorandum or articles of association in such manner as the company may, from time to time, determine including, but without limitation-

- (a) paying distributions or dividends to members;
- (b) paying up unissued shares of the company to be issued to members as fully paid bonus shares;
- (c) any manner provided in section 37;
- (d) writing off the preliminary expenses of the company; and
- (e) writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; and
- (f) providing for the premium payable on redemption or purchase of any shares or debentures of the company:

Provided that no distribution or dividend may be paid to members out of the share premium account unless, immediately following the date on which the distribution or dividend is proposed to be paid, the company shall be able to pay its debts as they fall due in the ordinary course of business; and the company and any director or manager thereof who knowingly and wilfully authorises or permits any distribution or dividend to be paid in contravention of the foregoing provision commits an offence and is liable on summary conviction to a fine of fifteen thousand dollars and to imprisonment for five years.

(3) ...

(4) ...

(5) ...

(6)...

(7) ...

21. The judge noted that under s. 34 (1), when a company issues shares without nominal or par value, the consideration received is treated as part of the paid up share capital of the company, not as share premium, which suggested that share premium was not regarded by s. 34 as paid up capital of the company. He noted too that this difference is maintained in s. 34 (2) which permits share premium but not paid up share capital to be used in such manner as the company may, from time to time, determine, including providing out of share premium for the premium payable on redemption or purchase of shares or debentures owned by the company. The judge also attached great importance to the fact that under the proviso in s. 34 (2) the only listed uses of share premium that are subject to the solvency requirement imposed by the proviso are payments of dividends or distributions, leaving the use of share premium on redemption or purchase of shares or debentures (paragraph (f) free from the proviso solvency requirement.
22. With these considerations in mind, it must follow, said the judge, that where the Articles allowed, share premiums were not to be regarded under the 2007 Law as having become part of paid up capital of the company for the purposes of the capital preservation rule as expressed in the prohibition on the use of capital for the redemption of shares in s. 37 (6) (a). In his view, there was no scope for widening the prohibition in that provision simply by implication by virtue of s. 37 (5) (a).
23. Proceeding on the basis that to do so was a permissible aid to construing s. 37 of the 2007 Law, the Judge then went on to consider the amendments made to ss. 34 and 37 in the 2011 Revision that expressly excluded payments from share premium for the redemption or purchase of own shares from what would otherwise be payments from capital subject to the solvency requirement in s. 37 (6). In carrying out this exercise, the Judge went so far as to consult Hansard's report of the second reading of the Bill amending the 2007 Law in the Cayman Islands' Legislative Assembly.
24. I agree with the submission of Mr McMaster QC for 2X Fund that the judge erred in having regard to the 2011 amendments and in consulting Hansard. Reference to the amending legislation was not a permissible aid to construction because the exercise on foot was the interpretation of the relevant unamended provisions in the previous legislation. The judge also should not have consulted Hansard, not only because the report concerned the amending legislation and not the 2007 Law but also because in doing so the Judge was acting on his own initiative after the

close of submissions and he thereby deprived counsel of the opportunity to address him on the appropriateness of the course he took.

25. Mr McMaster argued that the judge's interpretation of s. 37 (6) (a), even without reliance on the 2011 amendments and Hansard, was erroneous. He submitted that: (i) the words "so made" in s. 37 (5) (b) referred to payments by a company, "in respect of the redemption or purchase of its own shares otherwise than out of its profits or the proceeds of a fresh issue of shares" in s. 37 (5) (a); and (ii) since a payment out of share premium was otherwise than out of profits or the proceeds of a fresh issue of shares, it was a payment out of capital for the purposes of s. 37 (6) (a).

26. Mr McMaster contended that this construction of s. 37 (5) (b) was supported by s. 37 (5) (c) which provides:

"(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 available profits 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. "

27. The submission was that if a payment out of share premium for the redemption or purchase of shares were not "capital" by virtue of s. 37 (5) (b), this formula would not be workable in such a case because there would be nothing to subtract from the total of available profits and the proceeds of any fresh issue of shares.

28. Attractively though Mr McMaster's contentions were advanced, I am not persuaded that the meaning and effect of s. 37 (5) (a) and (b) is that a payment out of share premium for the redemption or purchase of its own shares is a payment out of capital for the purposes of s. 37 (6) (a).

29. Subsections (5) (a) & (b) and (6) (a) of section 37 must be construed in light of s. 34 and the whole of s. 37. I agree with the judge that standing alone, s. 34 proceeds on the basis 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. I say this having in mind the conferment by s. 34 (2) of the very wide power to use share premium in such manner as the company may determine if such use is permitted by its memorandum or articles. I

also have in mind the concluding sentence of s. 34 (1): “ Where a company issues shares without nominal or par value, the consideration received shall be paid up share capital of the company,” from which it is to be inferred that share premium is not to be regarded as being paid up capital.

30. In addition, I attach great importance (as the judge did) to s. 34 (2) (f) which refers to the use of share premium “for providing for” the premium payable on redemption or purchase of any shares or debentures of the company. In my opinion, “providing for” in paragraph (f) does not mean simply making a provision in the share premium account in advance of the payment of premium in an accountancy sense (which would demonstrate the capacity of that account to sustain the sum provisioned if payment is to be made in the near future); it also covers the making of the subsequent payment out of the provisioned share premium account for the premium due.
31. As is plain from the proviso in s.34 (2), the only listed uses of share premium in paragraphs (a) to (f) that are caught by the solvency requirement imposed by the proviso is the paying of distributions or dividends to members. Thus, s. 34 (2) strongly suggests that it was not the legislative intention that payments by a company out of share premium in respect of the redemption or purchase of its own shares were to be swept into the extended definition of capital contained in s. 37 (5) (b) and thereby made subject to the solvency requirement in s. 37 (6) (a).
32. It follows, in my opinion, that it would only be if s. 37, construed as a whole, very clearly provided that a payment out of share premium for the redemption or purchase shares is to be treated as a payment out of capital, that the strong indication to the contrary resulting from the wording of s. 34 would be neutralised.
33. I turn to consider the following potentially relevant subsections of s. 37, including subsections (5) (a), (b) and (c) to which reference has already been made.

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.

(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 member of the company holding 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.

(e) The premium, if any, payable on redemption or purchase must have been provided for out 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) 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 the company's profits, 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".

(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 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 available profits 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 and cancelled, the amount of any capital redemption reserve, share premium account 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) is guilty of an offence and liable on summary conviction to a fine of fifteen thousand dollars and to imprisonment for five years.

34. S. 37 (1), (2), (3) (a) – (d) provide for the power to issue redeemable shares and prescribe a number of requirements relating to the redemption of such shares that do not touch on how the redemption and purchase of own shares may be financed. S. 37 (3) (e) and (f), on the other hand, do deal with this topic and are important. Paragraph (e) deals with the premium payable on the redemption or purchase of a company's shares and stipulates that such premium can be provided for out of profits, or out of share premium, or in the manner provided for in subsection (5). The word "shall" is to be noted; otherwise, to the extent that it provides that premium payable on redemption can be provided for out of the share premium account, paragraph (e) is repeating paragraph (f) of s. 34 (2). Further, and more significantly, the disjunctive "or" before "in the manner provided for in subsection (5)" strongly indicates, in my view, that share premium used in this way is not to be treated as a payment out of capital by virtue of s. 37 (5) (a) and (b).

35. Given that paragraph (e) deals with premium payable on the redemption of shares, paragraph (f) is to be taken to deal with that part of the overall price payable on redemption or purchase that is not referable to premium, namely, in the case of redeemable shares, the par or nominal value of the shares in question. Under paragraph (f), shares may be redeemed or purchased out of profits of the company, **or** 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). Again, the disjunctive "**or**" before "in the manner provided for in subsection (5)" strongly indicates that share premium used in this way is not to be treated as a payment out of capital by virtue of s. 37 (5) (a) and (b).

36. Then we come to s. 37 (5) (b) which, in light of what is provided in s. 34, one would have expected to provide expressly that the use by a company of share premium in respect of the redemption or purchase of its shares was to be regarded as a payment out of capital if this had been legislative intention. But instead, the subsection contains no mention of such payments out of share premium.

37. Mr McMaster drew attention to s.34 (2) (c) arguing that this paragraph contemplated the use of share premium for the redemption or purchase of shares amounting to a payment out of capital under s. 37 (5) (b). Mr McMaster had a point, but I regard it as a weak one since paragraph (c) is contained within the very provision that stipulates that the only use of

share premium that is subject to a solvency requirement is payment of distributions or dividends.

38. I am also unpersuaded by Mr McMaster's point founded on s. 37 (5) (c) because in my opinion it begs the question whether the legislative scheme is to exclude payments by a company out of share premium from the definition of capital in s. 37 (5) (b) or not. Thus, if such payments are not capital, s. 37 (5) (c) will not apply and if they are capital they will be governed by that provision.
39. My conclusion therefore is that s. 37 of the 2007 Law, particularly subsections (5) (b), (6), (7), (8) and (9) thereof, is not to be construed as providing that payments by a company out of share premium in respect of the redemption or purchase of its own shares are payments out of capital for the purposes of those subsections.
40. In construing sections 34 and 37 of the 2007 Law I have had in mind some of the background matters identified in paragraph 18 above to which the judge had regard, namely, that investors in Cayman Islands open ended investment companies are invariably issued with redeemable shares at a price well in excess of their nominal value and understand from the company's articles that their shares will be redeemed on the basis of the NAV per share. I have not, however, proceeded on the basis, as the judge did, that a prohibition against payment out of share premium for the redemption of shares as soon as the company is cash flow insolvent would contradict the expectations of investors. What the expectations of investors in open ended investment companies would be where the company is facing cash flow insolvency (possibly in the short term) I do not know. Articles of association that permit directors to delay payment of the redemption price if they bona fide determine the raising of funds would be unduly burdensome, do not suggest, as the judge thought, that the investors would expect redemption payments still to be made in those circumstances. On the contrary, they suggest that the investors would expect redemptions to be suspended until any substantial cash flow difficulties had been resolved.
41. It follows that it is unnecessary to consider Mr McMaster's interesting submissions as to 2X Fund's entitlement to claw back the redemption payments made to RMF on and after 12 January 2009 on the basis that the payments were unlawfully made under s. 37 (6) (a).

CONCLUSION

42. For the reasons given above, I would uphold the decision of the judge on the meaning and effect of s. 37 (6) (a) of the 2007 Law and dismiss this appeal.

The Hon John Martin QC, JA

I agree.

The Rt Hon Sir Alan Moses, JA

I also agree.