

## BVI ruling on the status of a redeemed shareholder

*Western Union v Reserve International*

March 2010

The BVI Commercial Court, which was established last May, has handed down an important decision on the status of a redeemed shareholder and the application of Section 197 of the Insolvency Act 2003 to the investor's status. In summary, the redeemed shareholder was viewed as an unsecured creditor and, as such, able to petition for the liquidation of the company in which they were previously a shareholder and to rank alongside other, third party, unsecured creditors.

The facts presented to the Court involve a Fund ("**Reserve**") that operated daily redemptions which were ceased following the collapse of Lehman Brothers. Western Union, as one of Reserve's shareholders ("**WU**") had submitted redemption requests for its entire shareholding on 15 September 2008. These requests were received and acknowledged on the same day and Reserve announced an NAV of US\$1 per share for that day. Redemptions were subsequently suspended. The redemption proceeds were not paid and WU petitioned as a creditor to wind up Reserve on just & equitable grounds.

Reserve:

- 1 denied that WU had completed the redemption of its shares;
- 2 denied that WU was a creditor of the Fund by virtue of Section 197 of the Insolvency Act 2003; and
- 3 also argued that, even if Western Union was a creditor, the Court should exercise its discretion against appointing liquidators.

### **Judgment**

#### *Scope of redemption process*

On the first issue raised by Reserve, the Court held that the question of whether or not the redemption process had been completed fell to be determined by an analysis of the Fund's articles, rather than as an independent question of fact. The Court examined the provisions of the Articles that dealt with the redemption of shares and reached the conclusion that the effect of the Articles was that if a redemption request was received by the Fund before 5pm ET on a dealing day, the shares referred to in that request were redeemed on the day of receipt.

The Court also examined the provisions of the Articles when reaching a conclusion as to whether or not the Fund had a power to suspend the payment of redemption monies. The Court concluded that there was no such power, but noted that nor was there a specific date by which the Fund was obliged to remit the redemption proceeds stating:

*“The fact that the redemption proceeds have not been paid does not, in my judgment, mean that the shares have not been redeemed, nor does it mean... that the redemption process is incomplete, except in the sense that WU remains unpaid. **The redemption was complete** when the Company accepted the request on 15 September 2008. The fact that WU has yet to receive the redemption proceeds has no bearing on that fact. [emphasis added]*

Effect upon the status of a redeeming shareholder

In relation to the second issue raised by Reserve, the Court highlighted the difference it saw between:

- a) a case involving a redemption that was still in progress, in which case the redeeming shareholder will continue to be and claim as a member and therefore section 197 of the Insolvency Act 2003 will prevent him from claiming in competition with third party creditors; and
- b) a case involving a redemption that had been completed, save for payment of redemption proceeds, in which case the redeeming shareholder will no longer be a member and will claim as a creditor and therefore section 197 will not apply and he will be able to claim in competition with third party creditors.

In this case, the Court found that, on its interpretation of the Articles, the redemption had been completed and so WU was a creditor of Reserve.

It is important to note that there may be no factual difference between the positions of redeeming shareholder in either of the above situations, other than how that company's Articles define the process of redemption, including when that process ends.

#### **Chapter 15 concerns**

On the third issue raised by it, Reserve suggested (and the Financial Services Commission agreed) that the Fund should not be wound up, so that the parallel proceedings regarding the distribution of the Fund's assets in the US could continue. The foundation of this argument was that in light of the recent decision in *re Bear Stearns High-Grade Structured Credit Strategies Master Fund Limited* 374 B.R. 122 the prospects of Liquidators appointed in the BVI obtaining recognition and assistance from the US Bankruptcy Court were negligible or worse. The Court rejected this argument, stating:

*“It seems to me of the highest importance that those who become creditors of, or who invest in, companies incorporated under the laws of the BVI, as well as those who finance them, should have complete confidence that if the company in question gets into difficulties, their rights will be determined in accordance with the law of this jurisdiction... this confidence will be weakened if the perception is allowed to be gained that the Courts here are prepared to decline or defer jurisdiction in insolvency matters in favour of foreign courts;”*

## Analysis

The statement by the BVI Court that it will not stand idly by and allow foreign Courts to determine insolvency proceedings regarding BVI Companies will be welcomed by those who manage and invest in BVI Companies, as they would expect a BVI company to be liquidated in accordance with BVI law and under the supervision of the BVI Courts. Any contrary indication would have risked undermining the certainty afforded to investors utilising BVI companies.

As an aside, it is noteworthy that the BVI Court's attention does not appear to have been drawn to the successful application before the Delaware Court for Chapter 15 recognition of a Cayman Liquidation in the case of *Saad Investments Finance Company (No.5) Ltd.*, in which judgment was handed down on 4 December 2009 and for which Harneys acted as Cayman attorneys. (See article [here](#))

The analysis regarding the effect of section 197 of the Insolvency Act 2003 will have surprised many BVI practitioners, who had formerly regarded that section (set out below) as subordinating the claims of redeeming shareholders to redemption proceeds in a company's liquidation below any claims of third party creditors. Section 197 is quoted in full below:

*"A member, and a past member, of a company may not claim in the liquidation of the company for a sum due to him in his character as a member, whether by way of dividend, profits, redemption proceeds or otherwise, but such sum is to be taken into account for the purposes of the final adjustment of the rights of members and, if appropriate, past members between themselves."*

Indeed, this was one of the arguments advanced by the Fund, but rejected by the BVI Court, which held that the critical issue was whether or not the redeeming shareholder's claim to the redemption proceeds was made *in his character as a member*. Following its reasoning above, the Court held that because the redeeming shareholder was no longer a member, it could only claim as a creditor and therefore was not caught within the language of section 197. There appears to have been no argument advanced as to whether a redeeming shareholder could have been both a creditor and still a member, in line with the analysis of the Cayman Court in *Strategic Turnaround*.

The Court considered the type of situation that section 197 was in fact designed to catch, stating:

*"The reference in section 197 to past members is intended, in my judgment, to catch, by way of example, transferors of shares who have reserved the right, against their transferees, to dividends, etc, referable to the period during which the transferor held the shares."*

In light of this judgment, it would be prudent for BVI funds to re-consider the drafting and effect of their own Articles and whether they should be amended to better suit their lender's requirements, which are likely to include subordinating redeemed investor's rights to the assets of the company on insolvency behind third party unsecured creditors.

Please note that the judgment in *Western Union* is currently subject to appeal. We will issue a further bulletin on this subject as it develops.

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