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Industry Information

## The Entitlement of Redemption Creditors to Statutory Interest

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A recent judgment of the Grand Court of the Cayman Islands<sup>1</sup> (**Grand Court**) has provided clarity for investors and insolvency practitioners alike with respect to the entitlement of former investors with claims for unpaid redemption proceeds in a solvent winding up of a Cayman Islands investment fund to statutory interest on such claims.

The Grand Court's decision is the most recent in the ongoing liquidation proceedings of Herald Fund SPC (in Official Liquidation) (**Herald**), a segregated portfolio company incorporated in the Cayman Islands which was one of the largest so-called feeder funds into the Madoff Ponzi scheme. This issue involved a novel point of law, the determination of which was not directly illuminated by binding or persuasive authority - as stated by the Honourable Justice Kawaley, at paragraph 1 of the judgment: "'There is nothing new under the sun' is an adage which has only limited resonance for Cayman Islands insolvency law." The relevant issue was whether unpaid redemption creditors, whose claims are deferred by section 49(g) of the Companies Law (as revised) (**Companies Law**), are entitled to statutory interest pursuant to section 149 of the Companies Law, following the commencement of the liquidation.

### Background

As reported in our advisory issued in July 2017 ([click here](#)), the Judicial Committee of the Privy Council (**Privy Council**) determined last year a separate, but related point (again one in respect of which there was no existing authority), that section 37(7)(a) of the Companies Law does not apply to the claims of certain classes of Herald's unpaid redeemers in circumstances where, at the commencement of the winding up, the relevant redeemable shares had been "redeemed" in accordance with the terms of Herald's memorandum and articles of association. The result of this decision is that redeeming shareholders are entitled to prove in respect of their claims to redemption proceeds under section 139(1) of the Companies Law, though they are, as former members, subject to having their claims deferred under section 49(g) of the Companies Law to the claims of ordinary unsecured creditors.

Although section 149(1) of the Companies Law provides that statutory interest is payable "on any debt proved in the winding up", it appears to be accepted, both in the Cayman Islands and other common law jurisdictions, that the claims of deferred creditors (including redemption creditors) rank after statutory interest for payment. As such, a question arises as to whether such deferred creditors are entitled to statutory interest at all in

<sup>1</sup> Herald Fund SPC (in Official Liquidation), unreported, Kawaley J, 27 August 2018.



the absence of express wording to this effect in the legislation and/or any authorities in the Cayman Islands or other common law jurisdictions which directly address the issue.

## Decision

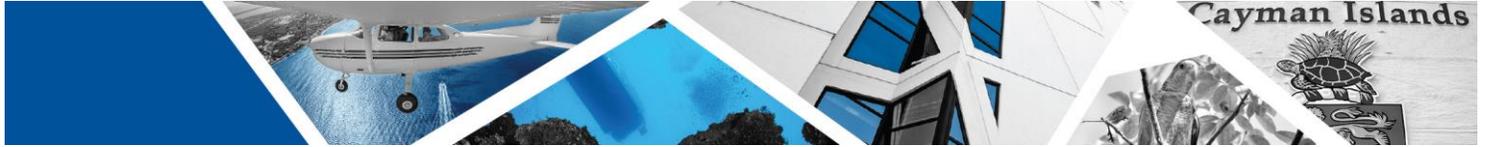
The Grand Court answered this question in the affirmative, finding that, in the absence of express language to the contrary, redemption creditors are entitled to statutory interest pursuant to section 149 of the Companies Law. The Grand Court held that the starting assumption must be that all creditors, including deferred or postponed creditors, qualify for statutory interest and section 49(g) of the Companies Law determines whether or not such claims are actually provable for the purposes of an entitlement to statutory interest:

- » In an insolvent liquidation, section 149 of the Companies Law read with section 49(g) of the Companies Law operates such that, to the extent that ordinary creditors are not able to be paid principal and interest in full, the claims of past or present members (regardless of whether or not they have been admitted or proved) are not in law deemed to be debts upon which statutory interest can be paid.
- » In a solvent liquidation, the general rule that all proved debts qualify for statutory interest is not displaced because in the absence of any actual competition between member debts and ordinary debts, the deeming provisions of section 49(g) of the Companies Law are not engaged.

In addition, the Grand Court found that it did not matter whether the redemption creditors had "proved" their claims by submitting formal proofs of debt to the Liquidators of Herald. The Grand Court held that a debt may be proved, admitted or established in a variety of ways, only one of which is through a formal proof of debt, and that "proved" essentially means established through whatever legally recognised process the liquidator (subject to the Grand Court's supervision in doubtful cases) deems appropriate having regard to the nature and merits of the relevant claim, and the interests of the liquidation as a whole.

## Conclusion

As noted by the Grand Court, the largest creditors in the liquidations of Cayman Islands funds are often former shareholders, and therefore the Grand Court's decision (subject to any potential appeal) provides helpful clarity as to the entitlement of such creditors in a solvent winding up.



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