

## Client Update

### Cayman Islands Court of Appeal strikes out investor petition to wind up segregated portfolio company

**In May 2012 the Court of Appeal gave guidance to promoters, investors and creditors on the circumstances in which a segregated portfolio company would be wound up when there are difficulties affecting investors in some portfolios**

#### Executive summary

A Cayman Islands segregated portfolio company (an "SPC") is a single legal entity that may establish one or more portfolios. The assets and liabilities of each portfolio are ring fenced from one another. The creditors and shareholders in respect of a portfolio normally may only look to the assets of that portfolio to satisfy their claims.

The SPC is a popular vehicle to house ring fenced investment portfolios and associated share classes within a single company. The Court of Appeal decision confirms that a long term suspension of share redemptions in one portfolio will not automatically place the SPC as a whole at risk of liquidation.

The petitioner was a small shareholder in a portfolio of an SPC which gave exposure to the German real estate market. Owing to underlying market and liquidity conditions, the SPC suspended share redemptions in respect of the portfolio for three years in order to implement a long term realisation strategy. The petitioner, wishing to accelerate the realisations, petitioned the Court on the "just and equitable" ground to make an order that the entire SPC be wound up (or a similar order be made in respect of the investor's portfolio).

The Court of Appeal, reversing the decision at first instance, struck out the petition. The Court found the petitioner could not argue that it would be "just and equitable" to wind up the SPC where the offering documents contemplated market disruption and the directors had made a *bona fide* decision to suspend redemptions in respect of some of the portfolios.

#### Facts

J & Co Ltd (the "**Petitioner**") was an investor in a German real estate portfolio of ABC Company (SPC) (the "**Company**"). The Company was organised as an SPC and operated as an investment fund offering exposures to a number of different strategies each within a separate portfolio. In February 2008, owing to underlying market and liquidity conditions, the Company suspended redemptions in respect of 19 real estate related portfolios (representing approximately one third of the Company's assets)

including the Petitioner's portfolio. The Petitioner's holding represented 0.27% of the assets of the entire Company. In the course of 2010 the Company's constitution was amended by shareholder resolutions which refined the suspension powers.

In June 2011 the Petitioner sought the winding up of the Company on the "just and equitable" ground on the basis that the Company, having suspended redemptions and ceased to carry on new investment business in respect of the Petitioner's portfolio, had "lost its substratum". In the alternative, the Petitioner sought that a statutory receiver be appointed to the Petitioner's portfolio or a limited winding up order be made in relation to the Petitioner's portfolio.

#### Decision

The Judge at first instance ruled against striking out the petition. He found, in line with a number of recent decisions, where a fund company had suspended redemptions and was solely realising its investment assets then it would normally follow that the fund can no longer fulfil the reasonable expectations of its investors. Accordingly, in an appropriate situation, an investor is entitled to have the fund wound up by a suitable liquidator rather than by the manager and the directors of the fund.

The Court of Appeal, reversing the decision at first instance, struck out the petition. The Court was of the view that it was "*impossible for the Petitioner to contend*" that the Company should be wound up on the "just and equitable" ground where (i) the Company's offering documents and recent shareholder resolutions contemplated the suspension of redemptions, (ii) the directors of the Company had made a *bona fide* decision to suspend redemptions in respect of some of the portfolios, and (iii) a substantial majority of the portfolios were operating normally.

The Court also noted that:

1. where a petition is brought by a shareholder on the "just and equitable" ground, no alternative winding up order (such as a tailored order to sell a specified portfolio's assets) can be granted, unless the Court has

already concluded that it is ready to grant a winding up order in respect of the entire company.

2. a receivership order in respect of a portfolio of an SPC can only be made where the portfolio is insolvent. It is not available on the "just and equitable" ground.

The Court agreed to the proceedings being conducted on a "no names" basis due to the risk of commercial harm arising if the identity of the SPC had been made public.

### Key practice points

Clients should consider the following:

1. *Use of SPCs* – The decision makes clear that when dealing with an investor's petition to wind up an SPC on the "just and equitable" ground, the Court will consider the condition of all portfolios and the interests of all investors and creditors, and not those of the petitioning investor in isolation. From the fund promoter's perspective, this would seem to be a positive development as it reduces the risk that a difficulty in one portfolio can lead to the winding up of the entire SPC. Creditors and investors may have mixed reactions based on whether they see themselves as likely petitioners or potential victims of an inopportune liquidation.
2. *Importance of constitutional documents* – the question of an investor's reasonable expectations will be determined by reference to the company's offering document and constitution (and the sophistication of the target audience). In this decision these provisions were construed to imply that the fund manager and the directors are to remain in office and retain their powers during periods of disruption, suspension, illiquidity and run off.
3. *Reduce challenge by consulting* – a fund that has entered an extended period of suspension (or similar difficulties) should consider convening a meeting of investors to sanction its proposed strategy. Appropriate resolutions will bind all investors (including dissenting investors) and could significantly reduce the risk of a successful winding up

challenge by an aggrieved investor. Directors may wish to convene pre-emptive approval meetings. Creditors may also be asked to confirm their support of the management's strategy.

4. *Should the "loss of substratum" test be revisited?* – there have been conflicting decisions across common law offshore jurisdictions as to the legal test to apply in deciding whether to wind up a fund company that is unable to discharge its stated investment objective. The Court of Appeal recognised that "*it is anticipated that an appeal will come before this Court in which it will be necessary to choose between [those different tests] ... but this is not that appeal*".
5. *Avoiding negative publicity associated with winding up petitions* – the Court is willing to recognise the potential for oppression when a meritless winding up petition is presented. The Court noted that "*the fact that a petition has been presented, when known to investors and potential investors, will give rise to such a loss of confidence that, in practice, the business of the company will be destroyed*". Here the Court was prepared to keep the identities of the parties out of the public domain by using code names.

7 June 2012

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This Client Update is intended to provide only general information for the clients and professional contacts of Travers Thorp Alberga. It does not purport to be comprehensive or to render legal advice. Please do not hesitate to contact us if you would like more detail on any of the points made in this Client Update.

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