



## How to obtain creditor status in offshore funds: redeem early and often

By Morgan Nighan and Jonathan Sablone

The Judicial Committee of the Privy Council recently confirmed in *Pearson v. Primeo Fund* that investors in distressed offshore funds that redeem their shares prior to a fund's suspension of redemption will be treated as creditors of the fund in liquidation. These creditors will receive priority over investors that did not redeem prior to the suspension date.

The key takeaway from *Pearson* is that, in order to be considered a creditor in a fund litigation, an investor needs to notice redemption and have that redemption take place under the applicable notice period in the Articles of Association (or have the notice period waived) prior to a suspension of redemption. Merely providing notice of redemption immediately prior to a suspension of redemption is not sufficient.

In *Pearson*, a Cayman Islands registered hedge fund, Herald Fund SPC ("Herald"), issued participating non-voting shares of stock that were redeemable on certain terms, and heavily invested the funds raised with Bernard L. Madoff Investment Securities LLC ("BLMIS"). On December 11, 2008, Bernard Madoff revealed that BLMIS was a Ponzi scheme. The next day, on December 12, 2008, at 5:00 p.m. (the "Suspension Date"), Herald suspended all further payments to investors in its redeemable shares. Three categories of investors sought creditor status in Herald's liquidation, which would entitle them to substantial distributions:

- Primeo Fund investors: provided notice of redemption under Herald's Articles of Association with the necessary 35 days' notice, or had the notice period waived, such that redemption of Primeo Fund shares occurred prior to the Suspension Date, either on or before December 1, 2008. Due to the suspension, the Primeo Fund investors never received their funds, despite the fact that redemption was made.
- Reichmuth & Co. investors: provided notice of redemption prior to the Suspension Date, but under the notice provisions, redemption would occur at a later date (in this case, February 2, 2009).
- Natixis SA investors: Provided notice of redemption after the Suspension Date.

The case centered on when redemption is effective in the context of a wind-up. The Privy Council upheld the decision of the Court of Appeal of the Cayman Islands, finding that pursuant to section

37(7)(a) of the Companies Law, the Primeo Fund investors had redeemed prior to the Suspension Date, notwithstanding the fact that payment on the redemption was deferred. Thus, Primeo Fund investors were entitled to be treated as creditors. On the other hand, Reichmuth and Natixis investors failed to effect redemption prior to the Suspension Date, and therefore they should be treated as members of Herald in the liquidation. The Privy Council concluded that “the critical moment is when an investor has redeemed and so ceased to be a member of the fund, becoming instead a creditor owed the redemption proceeds.” Redemption is effective on “the surrender of the status of shareholder, with all attendant rights, just as the essence of purchase is the transfer of property.”

The decision from the Privy Council provides final clarity related to creditor designation upon redemption in offshore funds. Institutional, and other, investors in such funds should consult the fund documents and remain vigilant as to the redemption application and effective dates. Such investors should consider redeeming their interest, with the advice of counsel, when a fund appears in distress or upon the appearance of red flags. In a subsequent liquidation, such investors will be treated much more favorably as creditors than if they remained investors in the fund.

For more information on the content of this alert, please contact your regular Nixon Peabody attorney or:

- Morgan Nighan at [mnighan@nixonpeabody.com](mailto:mnighan@nixonpeabody.com) or (617) 345-1031
  - Jonathan Sablone at [jsablone@nixonpeabody.com](mailto:jsablone@nixonpeabody.com) or (212) 224-6395
-