

# When is a Redemption Effective?: Reserve International Liquidity Fund Ltd

The British Virgin Island's Commercial Court has recently delivered a decision in *Western Union International Limited v Reserve International Liquidity Fund Ltd* which addresses the issue of when during the redemption process a redeeming investor becomes a creditor of the fund and is therefore entitled to apply for the appointment of a liquidator.

The BVI Court's decision is significant when considered with the 2009 Cayman Islands decision in *Re Strategic Turnaround Master Partnership Limited*. While each case turns on its facts, these two decisions seem to adopt different approaches as to when a redeeming investor ceases to have rights as a member of a fund.

## Background

Reserve International Liquidity Fund Ltd (the "**Fund**") was a money market daily liquidity fund, which aimed through its investments to maintain a stable net asset value ("**NAV**") of US\$1.00 per share. Following the bankruptcy of Lehman Brothers on 15 September 2008, the Fund "broke the buck" and was forced to suspend redemptions and the calculation of NAV on 16 September 2008. Among those investors submitting redemption requests on 15 September 2008 was Western Union International Limited ("**Western Union**"), who submitted two redemption requests, in aggregate for its entire holding of 298 million shares in the Fund (the "**Shares**") for a value of US\$298 million based upon the NAV at the close of business on 15 September 2008 of US\$1.00 per share.

Western Union subsequently claimed that it was a creditor of the Fund for the full amount of the redemption proceeds owing to it, based upon NAV struck in relation to the Shares at the close of business on 15 September 2008 (US\$298 million).

## When Does an Investor Become a Creditor?

The fact that Western Union submitted its redemption request on 15 September 2008 was not disputed. However, the Fund argued that Western Union was not a creditor because, despite submitting a redemption request on the "Dealing Day" (15 September 2008), the redemption process was incomplete. The Fund sought to rely upon a provision in the Articles of Association (the "**Articles**") which stated that requests for redemption "...will generally be honoured within seven days of receipt..." and that because the redemption proceeds had not been paid, the redemption process was incomplete and Western Union was not a creditor. The BVI Court rejected the Fund's arguments, holding that the

meaning of "...will generally be honoured within seven days of receipt..." referred to honouring by way of payment and could be contrasted with the use of the word "*processing*" redemptions used elsewhere in the Articles, such that the Shares were redeemed on the Dealing Day (15 September 2008) and that Western Union was therefore a creditor of the Fund from that point.

In reaching this determination, the BVI Court distinguished between the event of redemption and the subsequent payment of the redemption proceeds, such that the fact that Western Union had not received its redemption proceeds had no bearing on its status as a creditor of the Fund.

The Articles also contained the standard wording in relation to redeeming investors ceasing to have any rights, except the right to receive the redemption proceeds and the right to receive any dividend declared but unpaid prior to the redemption. In the BVI Court's view it followed that Western Union ceased to have any rights with respect to the Shares other than the right to the redemption proceeds (as a creditor of the Fund).

## Construction of Section 197 of the Insolvency Act, 2003

The Fund sought to also argue that even if the redemption was complete on 15 September 2008, Western Union could not claim in a liquidation as a consequence of Section 197 of the Insolvency Act, 2003 which provided that "...a member and a past member of a company may not claim in the liquidation of the company a sum due to him in his character as a member, whether by way of dividend, profits, redemption proceeds or otherwise...". A past member is defined in the Insolvency Act, 2003 as "...a person who ceased to be a member of the company at any time during the period of one year before the commencement of the liquidation of the company...".

The BVI Court held that Western Union's claim to its redemption proceeds was not being made in its character as a member of the Fund, which it ceased to be on 15 September 2008 (and that therefore Section 197 of the Insolvency Act, 2003 did not apply). In reaching this decision, the BVI Court relied upon Section 62 (1) (c) of the BVI Business Companies Act, 2004 which provides that "...from the date of redemption, the former shareholder ranks as an unsecured creditor of the company for the sum payable on redemption...", such that its claim to its redemption proceeds was being made in its character as a creditor of the Fund because the redemption process had been completed.



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In the BVI Court's view, in interpreting Section 197 of the Insolvency Act, 2003, the critical question was the nature of the claim made by a member or a past member, not whether the person claiming can be described as a member or past member and that therefore Western Union was claiming not in its capacity as a member of the Fund but as a creditor.

## **How Does This Decision Contrast With the Cayman Islands Decision in *Re Strategic Turnaround Master Partnership Limited*?**

In reaching its decision, the BVI Court did not refer to the Cayman decision in *Re Strategic Turnaround Master Partnership Limited*, which is interesting as these two decisions adopt very different approaches as to when a redeeming investor ceases to have rights as a member. On the facts, in *Western Union International Limited v Reserve International Liquidity Fund Ltd*, the BVI Court determined that a redeeming investor ceased to be a member on the redemption day. In contrast, in *Re Strategic Turnaround Master Partnership Limited*, the Cayman Court interpreted redemption as being a longer process, with redeeming investors continuing to have rights as a member until they had received the redemption proceeds and had their name removed from the register of members, which enabled them to have a dual capacity as both a member of the Fund on the one hand and a creditor on the other.

The principal question considered by the BVI Court in *Western Union International Limited v Reserve International Liquidity Fund Ltd*, was when does Western Union become a creditor? Significantly, the answer to this question, when applying *Re Strategic Turnaround Master Partnership Limited* would not differ, rather the question as to the point at which Western Union would cease to have rights as a member of the Fund would differ.

The decision in *Western Union International Limited v Reserve International Liquidity Fund Ltd* has been appealed. It will be interesting to see the approach that the Court of Appeal adopts to the issues considered in this judgment.

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