REPRINT

CD corporate disputes

INVESTMENT FUNDS & TRUST DISPUTES

REPRINTED FROM:
CORPORATE DISPUTES MAGAZINE
OCT-DEC 2016 ISSUE

www.corporatedisputesmagazine.com

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Published by Financier Worldwide Ltd
corporatedisputes@financierworldwide.com

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SCA ONTIER LLP is the London office of international global law firm ONTIER. Along with its associated firm SCA Creque in the British Virgin Islands, SCA ONTIER LLP specialises in international disputes and transactions, with its work focused on complex, high value litigation, insolvency matters and dispute resolution, usually with an international element, in a wide range of financial and industry sectors. Staffed by high-calibre, experienced solicitors and barristers, the firm provides a bespoke, case-specific service of the highest quality in order to get the best possible result for clients in the most cost effective and efficient way.

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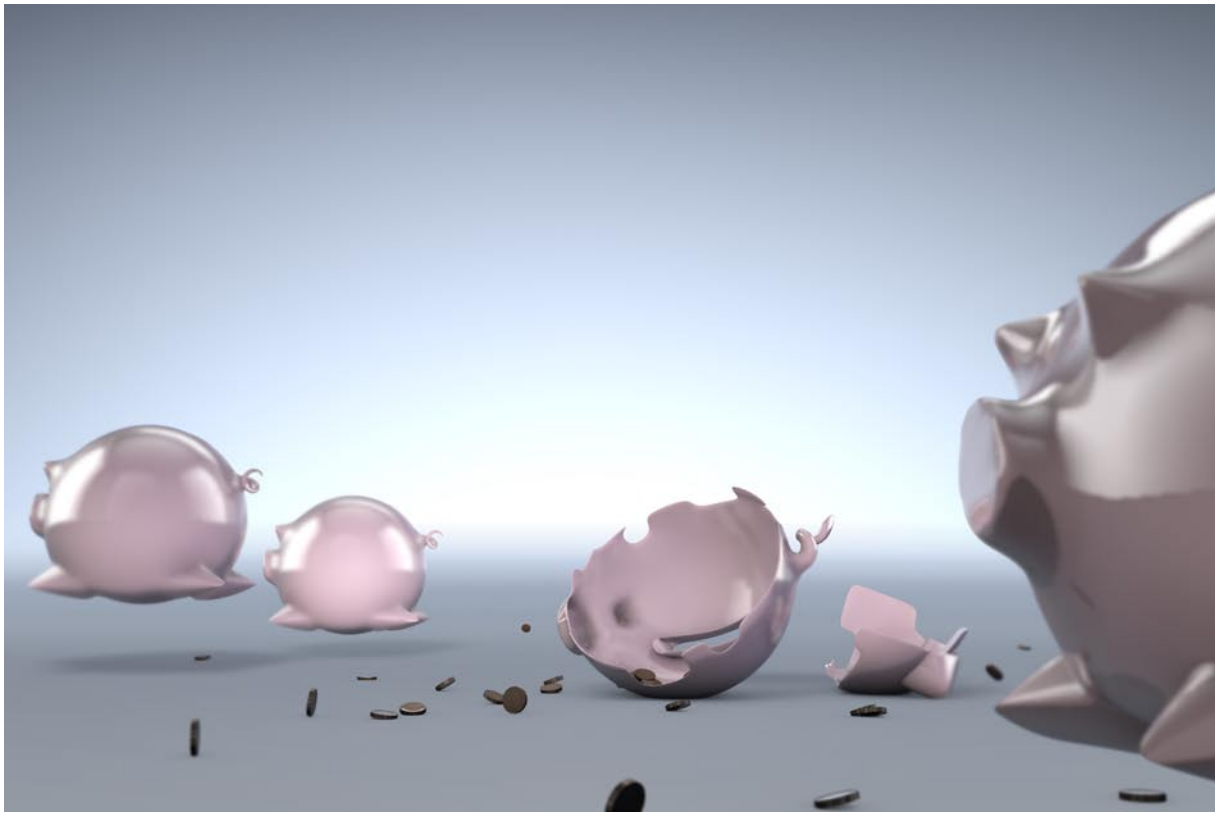
INVESTMENT FUNDS & TRUST DISPUTES



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Mark Goodman is a partner in Campbells' Litigation, Insolvency & Restructuring Group where he specialises in insolvency, restructuring and investment fund litigation. He joined Campbells in 2013 having previously worked at two respected London law firms before relocating to the Cayman Islands with another law firm in 2008.

CD: How would you characterise the current landscape for fund-related disputes? What do you consider to be the key underlying reasons behind the rise in investment fund disputes seen in recent years?

Andrew: There are a lot of fund disputes about – perhaps more than ever before. We believe that the 2008 financial crisis is still a significant driver. There is an inevitable time lag between economic events and the litigation that follows. The continuing development of the litigation capacity of the offshore jurisdictions and in particular the Cayman Islands and the British Virgin Islands has expanded the field. The law has also developed, in particular in areas such as the treatment of unpaid but redeemed shareholders, the suspension of redemptions and the duties of directors of offshore funds. The Privy Council continues to play a significant role in these developments, as seen in *Fairfield Sentry v Migani*. Litigation funding is also increasingly relevant. The number of funders is growing fast and the awareness of the availability of litigation funding is rising among key sectors, such as insolvency practitioners.

Le Tissier: The predominant characteristic of fund-related disputes at present, and for some time, is relatively uncomplicated in nature: they tend to be a product of a failing or failed investment fund. It is not particularly surprising that when investors are in a position where they are unable to redeem all or part of their investment in the manner they intended, or where they have lost or look likely to lose some or all of their investment they will frequently look to see if they are any forms of recourse. That is not to say that disputes do not happen to well performing funds, particular where fee issues may arise, but they tend to be much less normal. While the major motivating factor behind the dispute may well arise because of performance issues, it is inevitable that the precise basis of the claim will be complex in nature and will frequently involve multiple parties and jurisdictions.

> **"There is an inevitable time lag between economic events and the litigation that follows."**
>
> *Seamus Andrew, SCA ONTIER LLP*

Goodman: After several years of intense activity, it would appear to us that the number of fund related disputes in the Cayman Islands courts is stabilising at a level below its peak. A wide variety of fund-related disputes arose after the 2008 financial crisis, mainly as a result of weaknesses in fund governance exposed by liquidity issues caused by a flood of redemption requests. The *Weavering* litigation, brought by the liquidators of a fund against its former non-executive directors, was a prime example. Additionally, many claims arose out of the competing interests of redeemers – particularly between those whose rights to payment had crystallised prior to the date of winding up, but who had not been paid, and those whose redemption requests were submitted too late. The ongoing *Herald v Primeo* litigation is such a dispute. A number of claims against service providers such as auditors and administrators are still ongoing.

CD: What about trust-related disputes? What factors are leading to an increase in these cases?

Goodman: We have not noticed an increase in trust-related disputes, although there is a fairly stable number of cases in the courts. Typically, the cases relate to disputes concerning the appointment of new trustees, and the consequent terms for the release of the outgoing trustee, disputes between family members concerning inheritance or the appropriate distribution of benefits, and onshore tax-driven litigation, with attempts to rectify trust deeds to permit more favourable tax treatment in the home jurisdiction, although in light of the trend away from the Hastings Bass principles, this strand of dispute may lessen.

Le Tissier: For trust-related disputes we are seeing that the majority of disputes centre, in one way or another, on concerns over a trustee's actions, though not necessarily the manner in which the trustee has managed the trust's investments. We are seeing challenges to what a trustee has done or intends to do and criticism over the trustee's approach to its decision. In addition, we are now seeing more instances where a trust's liabilities exceed its assets and the difficult issues that can bring up where the interests of creditors, beneficiaries and the trustee itself are in serious conflict. This is an issue which, until relatively recently, had rarely been explored by the courts.

Andrew: The old fashioned family trust disputes are not as commonly encountered as in days gone by. This may well be due to reluctance on the part of private clients to be caught up in a repeat of the 'Jarndyce vs. Jarndyce' style of trust dispute that has been seen in the past few decades. What we are seeing is a marked increase in institutional trust disputes for instance involving debenture trustees. The private client trust disputes we do see

are increasingly cross-border in nature, typically involving a trust in one jurisdiction said to be affected by the laws of another. We expect litigation funding to have a major impact in this sector going forward.

CD: Is the ongoing fallout from the financial crisis still considered to be one of the overriding reasons for the extent and types of dispute being observed? What other sources of conflict are evident?

Le Tissier: There certainly are some disputes which can still identify the financial crisis as being a major contributing factor to the dispute. However, the fact that worldwide economies remain challenging is also contributing to the number and type of both investment fund and trust-related disputes being observed. We are also seeing the spectre of fraud and criminal activity having an influence on the type of disputes taking place. Where assets are perceived as being the proceeds of criminal activity or may represent the proceeds of such activity, this can often cause a number of particularly difficult problems not only concerning the usual parties one would expect to see, but also regulators and law enforcement agencies playing a role.

Andrew: This is still a major factor – it does take time for the fallout from a financial crisis to work themselves through to litigation and arbitration. It was the same in 1998. Brexit has already started to feed into the disputes arena and will play a major part for some time to come. Rapid changes in commodities prices have driven many of our recent disputes affected the outcome in others. We expect the depressed oil price to feed through into more disputes as it begins to affect the viability of some projects and then cause different types of dispute when the price rebounds.

Goodman: In the Cayman Islands, the effect of the fallout from the financial crisis is reducing quite markedly as the Financial Services Division of the Grand Court and the Cayman Islands Court of Appeal have been able to deal with the litigation and winding up proceedings which flowed from the financial crisis fairly efficiently. We are, however, seeing an upswing in the number of petitions to wind up funds on just and equitable grounds, in the absence of an express power to grant remedies to 'oppressed' minority shareholders, particularly where the fund's shareholding is structured so as to leave the voting and management power entirely in the hands of the fund manager, leaving the economic interest with non-voting preference shares only, and also of petitions pursuant to section 238 of the Companies Law, which gives shareholders who dissent from a merger or consolidation the right

to payment of a fair value for their shares. Many of these cases involve businesses in Far-East Asia which are structured through the Cayman Islands.

CD: To what extent have increased regulatory and legislative enhancements impacted fund, and in turn fuelled disputes? What general strategies can fund managers and trustees deploy to manage the process of handling a dispute with regulatory authorities?

Andrew: The unprecedented surge of new regulations affecting hedge funds has not yet worked its way through the system. AIFMD presents a significant – and expensive – change to the regulatory landscape. Many hedge funds have had to overhaul their compliance functions and time will tell whether the industry has adapted successfully to the new environment. Key to handling a fallout with the regulatory authorities is to take early advice.

Goodman: The Cayman Islands' Monetary Authority (CIMA) is not, in general, the 'operational'

regulator for fund managers and trustees of Cayman Islands' funds and trusts, most of whom are based in other jurisdictions and are regulated in their place of business. CIMA has a range of regulatory strategies, including the ability to declare directors or controllers of such entities to be unfit to hold those positions. We have noted an increase in the exercise of these powers by the regulator in recent months but the powers have tended to be exercised in a 'reactive' rather than proactive manner, in the sense that CIMA will often make a declaration of unfitness if an individual has been convicted of a crime or been subject to regulatory discipline in his home jurisdiction.

Le Tissier: Ongoing regulatory and legislative developments are expected in the area of investment funds and changes, while they will affect the basis on which funds operate and are administered, have not thus far appeared to have fuelled disputes to any great extent. However, breaches of regulatory and legislative requirements are often likely to form part of a dispute concerning investment funds. We have seen regulators become increasingly assertive over past years and therefore it is important for both funds and trustees alike to ensure that they take compliance with the regulatory environment very seriously and make it a leading priority. Management also needs to ensure that this perspective is held by all areas of the organisation at

all levels. It is also helpful to ensure you have a good working relationship with your regulators.

CD: Could you outline the key challenges and issues that regularly surface in complex fund-related disputes? What dispute resolution options should be considered by parties if a dispute involves multi-jurisdictional and multi-party considerations?

Le Tissier: Often an important and potentially difficult challenge in fund related disputes is the interplay between the dispute itself and regulatory considerations as well as potential regulator involvement. This can mean that considerations beyond, the dispute alone, need to be factored into any resolution. As far as options for dispute resolution are concerned, arbitration is an important avenue for dispute resolution if the parties do not want, for any number of reasons, the dispute to be resolved through the court process. One of the important advantages of arbitration is that the process will generally remain confidential. However, where there are multiple parties to a dispute it may be difficult for the dispute to be resolved by arbitration if all parties do not agree to this form of resolution, or have not already agreed to it, such as through agreements contained within the fund documentation.

Goodman: In purely practical terms, complex fund-related litigation can raise serious logistical issues such as the availability of witnesses of fact, who may be in other jurisdictions, and not compellable, or – in some cases – incarcerated, and identifying and retaining expert witnesses with relevant experience in appropriate disciplines and appropriate jurisdictions. Complex legal issues can also arise, including the interplay of contractual indemnities and insurance, the standards to be applied to the conduct of the individuals concerned, quantum of damages, and reflective loss – for example, in a derivative action brought by shareholders against service providers or directors,

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>
> *Jeremy Le Tissier, Ashton Barnes Tee*

the shareholders bring an action in the name of the company, but can only recover losses suffered by the company, not by themselves.

Andrew: These disputes are usually multijurisdictional and this is the first layer of complexity, requiring among other things that a jurisdiction be chosen to determine the dispute. An arbitration clause very often adds a second layer of complexity, requiring a choice between a national court and the arbitration tribunal. If the arbitration clause bites, then there will usually be no choice because arbitration is a binding process enforceable by way of a stay of court proceedings. However, this is unlikely to be the end of the argument in a fund dispute involving several participants, not all of whom are parties to arbitration clause.

CD: What final piece of advice can you offer to parties on dealing with investment fund and trust disputes?

Goodman: The most important thing to do, once a dispute has arisen, is to take legal advice in the relevant jurisdiction promptly. Even if the aim is to seek to resolve the dispute between the parties without the intervention of lawyers, it is usually more than helpful, particularly where fiduciary concerns may arise, to have your attorney in the background.

Andrew: First, go to a law firm that is habitually involved in this type of dispute, or at least a law firm that is used to dealing with international commercial disputes generally. Secondly, take a pragmatic view based upon a sober cost benefit analysis and avoid the temptation to be drawn into a heated dispute which is more likely to devour the remaining assets rather than restore the fund.

Le Tissier: It is absolutely essential to do as much investigatory and preparatory work as possible before taking a position in any dispute, and to take advice from experienced practitioners when so doing. The disputes are frequently very complex and high value. Parties will often be very well funded.

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The last position anyone wants to get into is to be embroiled in a dispute which incurs a great deal of cost only to realise that the approach being taken is in some way flawed because of factors which may not have been considered properly or there have been unrealistic expectations of what may be able to be achieved. Careful preparation and consideration are absolutely key.

CD: What broad steps can fund managers and trustees take to mitigate the possibility of disputes arising in the future?

Andrew: A hugely underutilised function of the dispute resolution department of a modern law firm is its ability to provide a 'dispute' audit. Many of the most likely causes of future disputes will be apparent from a thorough review of the entire fund or trust documentation typically in use. Such an audit can also lend itself to other forms of dispute resolution planning, such as the insertion of arbitration clauses into standard form contracts and consideration of the types and functions of internal documents generated within a fund management or a trust business.

Le Tissier: The importance of maintaining effective communication with all parties cannot be underestimated. It is always far better to be able to discuss dissatisfaction at an early stage so that there is the opportunity to address it rather than allowing it to progress until some form of litigation becomes inevitable. In addition, maintaining appropriate levels of professional advice are also important as it will be far more difficult for a manager or trustee to be properly criticised for taking and following professional advice. Plus, this permits the potential to claim a contribution from professional advisers if the advice has been incorrect.

Goodman: One of the most common traits which we see in this kind of dispute is an allegation that managers and trustees are concealing important information from stakeholders. Thus, many disputes could be avoided or mitigated by prompt provision of accurate information to stakeholders, even if subject to non-disclosure agreements. In the fund context, a significant source of complaint is that investments have been made outside the parameters of the offering documents. Again, contemporary provision of information, such as an updated or amended offering document, or a circular to stakeholders, can help to avoid such allegations. Record keeping is key, and concise but accurate records of the rationale for decisions should be kept.

CD: How do you envisage the investment fund and trust disputes landscape evolving in the months ahead? Are there any particular trends and

developments you expect to see emerge in this space?

Goodman: We expect the continued slowdown in the growth of the Chinese economy, unprecedented debt ratios in China and other emerging economies and the overall weakening commodities markets to continue to drive the current trend of shareholder disputes, restructurings and contested mergers of companies structured through the Cayman Islands for the medium to long term. The volume of trust disputes is expected to stay fairly constant as this seems to be less susceptible to market trends.

Le Tissier: We expect that economic problems arising, or not, are most likely to have a significant effect on potential disputes in the future. Poor economic performance or severe economic shocks may well be a stimulus for disputes to arise as a result of causing poorly performing or distressed assets to fail. We expect to see litigation funding continuing to play an important role and potentially increasing.

Andrew: We expect that the first Brexit cases will start to emerge over the next few months. More fundamental changes such as to the UCITS regime will cause issues in the longer term. Developing areas of funds law include the role of custodians and the extent of their liability in a modern cross-border fund structure. CD