H&J FOCUS

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ICON - A New Structure Custom Designed for the Latin American Investor

Christel Sands-Feaste

The Bahamas has long been recognised as a leader in the financial services industry. From relatively humble beginnings and well before the widespread use of automobiles, the first commercial bank was established on Bay Street, Nassau in 1908; and the industry has since developed into a sophisticated, well regulated and globally renowned one. Today, the jurisdiction offers a full range of banking, trusts, insurance and investment funds products employing over 7,000 professionals.

Following the introduction of the SMART Fund in 2003, one of the most significant growth areas in the securities sector has been in the number of investment funds licensed or registered in The Bahamas. Every two to three years since then, and most recently in 2012 when the SMART Fund Model 007 was introduced, The Bahamas has unveiled a new SMART Fund model to respond to the constantly evolving global environment and client base.

With an increasing jurisdictional focus on Latin America and Brazil, the Investment Condominium ("ICON") was introduced in September, 2014 by the coming into force of the *Investment Condominium Act, 2014* (the "Act") to facilitate the structuring of Bahamian investment funds using a vehicle which is familiar to clients in Brazil and other countries with similar concepts.

In general terms, a Brazilian "condominium" involves the joint ownership of property. It is not a separate legal entity and the administrator acts on its behalf. A Brazilian investment fund condominium is a communion of assets, incorporated in the form of a condominium and aimed at investing in financial assets. Similarly, an ICON is a contractual relationship between one or more participants, pooling assets for the purpose of operating as an investment fund. The ICON possesses no legal personality. For the purpose of enabling the ICON to operate as an investment fund, when represented by its administrator, the ICON is able to (i) hold assets in its own name, (ii) enter into agreements in its own name and (iii) sue or be sued.

The ICON is not a new category of investment fund licence. Instead, it provides a fourth vehicular option for the structuring of a Bahamian investment fund (in addition to the corporate, unit trust and exempted limited partnership structures). An investment fund can be established as an ICON, (i) from inception, (ii) by converting an existing Bahamian company, unit trust or exempted limited partnership to an ICON or (iii) by re-domiciling a foreign company or exempted limited partnership to The Bahamas and converting the re-domiciled entity to an ICON. In the case of options

(ii) and (iii), the converted entity can be licensed as an investment fund following conversion. There is no restriction on the category of investment fund license that may be selected in connection with an ICON; subject to compliance with the prescribed requirements, an ICON can be licensed as a SMART Fund, professional fund or standard fund.

The Bahamas continues to augment the wide range of financial service products available to clients and to refine the strong legislative framework within which these products are provided.

The process of establishing an ICON is similar in some respects to that for the registration of an exempted limited partnership; the ICON is established once its governing regulations are signed by the initial participants. The establishment is evidenced by a Certificate of Establishment signed by the administrator which is submitted to the Registrar General's Department. There is no requirement for the governing regulations to be publicly filed.

The ICON is administered by its administrator, which executes all documents on behalf of the ICON and has the power to perform all actions and engage in all activities necessary to conduct and attain the objects of the ICON. An ICON is required to appoint (i) a governing administrator who is responsible for the governance functions of the operator of an investment fund imposed by the *Investment Funds Act, 2003*, as amended (the "IFA") and *the Investment Funds Regulations, 2003*, as amended; and (ii) a general administrator who is responsible for the general administration functions imposed upon an administrator by the IFA, or a single administrator to perform both functions. Both the governing administrator and the general administrator must be regulated entities which fall within one of the categories set out in the Act.

The Bahamas continues to augment the wide range of financial service products available to clients and to refine the strong legislative framework within which these products are provided. Like the Foundation, the ICON adapts a civil law concept to a common law environment and is the most recent example of Bahamian innovation at work.

Christel Sands-Feaste is the Chair of the Securities & Investment Funds group. She has extensive legal experience in corporate and commercial law and has acted in all aspects of commercial transactions including asset financing, private placements of offshore securities and investment fund structuring. As a member of the ICON Working Group, she received the 2014 Financial Services Development & Promotion award given by the Bahamas Financial Services Board.

POTCAKEMAN TRIATHLON SPONSOR

H&J team (l - r) Narendra Ekanayake (IT); Antonia Burrows (Marketing); Brett Higgs (Attorney)

Higgs & Johnson was a sponsor of the 2015 Potcakeman Triathlon, a major fundraiser for 'Baark!', which is a completely volunteer run organization whose mission is to carry out spay/neuter and education projects to reduce the homeless animal population and end the suffering of dogs and cats in The Bahamas.

Stephen Melvin, Partner with responsibility for Charitable Donations for the firm, noted, "It is important to support local organizations such as this and it feels good to know that we were able to assist in helping them raise over $25,000 from this event alone."

JUDGMENT HANDED DOWN IN THE APPEAL OF THE WEAVERING CASE

John Harris

Earlier this year the Cayman Islands Court of Appeal finally gave its judgment in the long-running case of *Weavering Macro & Fixed Income Fund (in liquidation) v. Stefan Peterson & Hans Ekstrom.*

Essentially, the directors' evidence had been that they honestly believed they were complying with their duties, and it was never put to them in cross-examination that this was untrue.

This case concerned two non-executive directors of a fund which collapsed in the wake of the financial crisis. The liquidators of the fund sued the directors on the ground that they failed to act when they should have realised that the fund's assets were at risk. The directors relied in their defence on the fund's articles of association which, as is standard in most Cayman Islands investment funds, gave the directors an indemnity against any liability other than for "wilful default".

At first instance Justice Jones found that the directors had completely failed to carry out any of the functions expected of them, and that they had simply gone along with the wishes of the fund's manager. He found that they had simply signed whatever the investment manager asked them to, and had not made any enquiry at all into the fund's business.

The Justice held that they could not rely on the indemnity since they were recklessly careless of their obligations to supervise the fund's affairs. The Justice held that, by doing nothing at all to perform a duty which they knew they were under, the directors' inaction could amount to "wilful default" and he held them liable for the fund's losses amounting to $111 million.

This decision led to a great deal of comment at the time and formed the basis of a substantial review by the Cayman funds industry of its governance issues. Justice Jones included in his judgment some guidance as to practical steps which funds should take, which have since been widely adopted.

The Court of Appeal has now found for the directors and set aside the Justice's decision. Essentially, the appeal court found that while the directors were negligent, indeed grossly negligent, the liquidators had not proved "wilful default".

Crucially however, the Court of Appeal did not disagree with Justice Jones on his interpretation of the law as to whether the directors' default was wilful. That is, that a person will be found to have been wilfully negligent if he either knows that he is committing a breach of duty, or is recklessly careless in that he does not care whether or not his act or omission is a breach of duty.

The appeal judges held that there was insufficient evidence in the case for the Justice to decide that test was met. Essentially, the directors' evidence had been that they honestly believed they were complying with their duties, and it was never put to them in cross-examination that this was untrue. The Justice disbelieved them but the Court of Appeal held that there was no evidence for him to do so.

On one level therefore, this decision could be seen as resting on the failures at the original trial on the part of the liquidators' counsel, and arguably the Justice himself, to ensure that such a crucial issue was dealt with in cross-examination. It also

leaves open the question of whether, in light of the Court of Appeal's findings, it will ever be possible to establish the level of 'wilful' conduct on the part of directors without a 'smoking gun' in the form of an admission or contemporaneous evidence that they were acting deliberately wrongfully.

Looking forward, the guidance given by Justice Jones at first instance as to what constitutes best practice remains valuable and should be followed. Liquidators however will need to think carefully before embarking on claims against delinquent officers and service providers, and ensure that they have sufficient evidence of misconduct that goes beyond the circumstantial.

The Court accepted this analysis in Primeo v. Herald, and confirmed that it makes no difference to the rights of a redeemed investor whether the redemption proceeds have been paid or indeed fallen due for payment before the commencement of the winding up.

Another recent decision of Justice Jones has given some helpful guidance on the position of fund investors who are in the process of redeeming their investment at the time the fund goes into liquidation. In *Primeo Fund (in liquidation) v. Herald Fund SPC (in official liquidation)* the Court was concerned with the liquidation of Herald Fund which was a feeder fund for Bernard Madoff's notorious Ponzi scheme.

Their question whether an investor is to be treated as a shareholder or creditor can be of the utmost importance when determining what, if any, of their investment they will recover from the liquidation. Creditors rank ahead of shareholders in priority for payment and so stand a far better chance of making a recovery.

It is already well established (see for example the Privy Council's decision in *Culross Global SPC Limited v. Strategic Turnaround Partnership Limited [2010] UKPC313*) that an investor becomes a creditor, rather than a shareholder, at the date on which their shareholding is redeemed, which date will be determined in accordance with the company's articles of association.

The Court accepted this analysis in *Primeo v. Herald*, and confirmed that it makes no difference to the rights of a redeemed investor whether the redemption proceeds have been paid or indeed fallen due for payment before the commencement of the winding up.

The Court then went on to consider section 112 of the Companies Law, which provides a mechanism by which the liquidator of a fund may rectify the register of shareholders. The liquidators of Herald argued that this mechanism should be used to adjust the rights of redeemed shareholders to reflect the true value of their holding, rather than the incorrect NAV applied at the date of redemption.

Justice Jones held that although the rectification mechanism of section 112 could be used to adjust the holdings of shareholders so as to do justice among them in respect of previous fraud, that mechanism applies only as between the existing shareholders of the fund. A redeemed investor is no longer a shareholder but is instead a creditor, and so cannot have its rights adjusted in this way.

John Harris is an Associate in the Firm's Litigation practice group in the Cayman Islands. He has significant experience in commercial litigation with an emphasis on insolvency, primarily acting for financial institutions and insolvency practitioners.

UNDER WHOSE INFLUENCE? ENHANCING CENTRAL BANK OVERSIGHT OF CONTROLLING PERSONS

Portia J. Nicholson

On an application for a bank or trust licence being made, the Central Bank will consider not just the fitness and propriety of the directors and officers of the applicant but also of its controllers.

Although directors are charged by law with managing the affairs of a company, quite often the persons with actual control are not those formally appointed to be directors or officers but others who may exert significant influence over the board by virtue of their voting power, contractual rights or economic relationships.

In 2010, amendments to the Companies Act ("CA") and the International Business Companies Act ("IBCA") introduced liabilities for shadow directors, defined therein as persons (not including professional advisors) in accordance with whose directions or instructions the directors of a company are accustomed to act.

Effective June 1, 2015, by virtue of the Banks and Trust Companies Regulation (Amendment) Act, 2015 (the "Act") the regulatory powers of the Central Bank of The Bahamas ("Central Bank") have been extended to shadow directors and other "controllers" of banks and trust companies ("licensees"). A person (including a company) who fits into any of the following categories is a "controller":

- If the directors or officers of a licensee or its parent are accustomed to act, or are under a formal or informal obligation to act, in accordance with his directions, instructions or wishes. This category clearly includes persons who are "shadow directors" as defined in the CA and IBCA. However, it goes beyond that definition as it also includes the shadow directors of the parent company and catches not only persons whom the directors or officers of a licensee or its parent are *accustomed* to obey, but also persons to whom they owe a contractual or other *obligation* of obedience.
- If he is able to exercise significant influence over the management of a licensee or its parent company by virtue of his shareholding or other securities, his voting power, or his ability to control the exercise of voting power at general meetings.
- If he is in a position to determine the policy of a licensee but is neither an approved director or officer nor a shadow director.

On an application for a bank or trust licence being made, the Central Bank will consider not just the fitness and propriety of the directors and officers of the applicant but also of its controllers.

Similar considerations will be applied when the Central Bank receives applications for the transfer of shares or other securities in a licensee which would cause someone to become a controller of the licensee or increase the influence of an existing controller. Before granting such applications, the Central Bank must satisfy itself that the proposed transferee is fit and proper, that the licensee will continue to conduct its business prudently and comply with the statutory provisions, and that approving the transaction is in the best interests of the Bahamas financial system. In approving a transfer of shares or securities, the Central Bank may impose such conditions as it sees fit, including restricting the controller's ability to dispose of or acquire further shares, securities or voting power, or restricting the controller's exercise of its voting power. The Central Bank may add to, vary or revoke any condition that it imposes.

In addition to its power to approve the acquisition of interests in a licensee by controllers and impose conditions to such acquisition, the Central Bank may serve written notice of objection on a controller where it is satisfied of any of the following:

- the controller has ceased to be a fit and proper person;
- under the controller's influence the licensee is no longer likely to conduct its business prudently or comply with the law;
- a condition of approval imposed on the controller has not been complied with;
- the controller supplied false or misleading information to the Central Bank in connection with its application to acquire interests in a licensee;
- the Central Bank would not have granted the approval had it been aware of circumstances relevant to the application for approval; or
- it is no longer in the best interests of the Bahamian financial system for the controller to continue as a controller of a licensee.

In addition to its power to approve the acquisition of interests in a licensee by controllers and impose conditions to such acquisition, the Central Bank may serve written notice of objection on a controller...

In its notice of objection, the Central Bank must specify a reasonable period for the controller to either comply with its directions or cease to be a controller. A controller who has been served with a notice of objection by the Central Bank has fourteen days within which to respond with written representations. In determining whether to vary or revoke its notice the Central Bank must take such representations into account. If the Central Bank is satisfied that a person on whom a condition was imposed has failed to comply with it or if the Central Bank has served a notice of objection, it may proceed to:

- direct any person or the person's associate to transfer or dispose of any shares or securities;
- restrict the transfer or disposal of shares or other securities; or
- make such other direction as it considers appropriate.

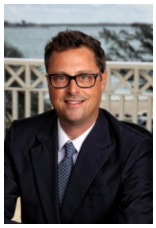
The Central Bank's power to order the transfer or disposal of shares or securities is not limited to the shares or securities held by a controller but may be exercised in relation to any shareholder or securityholder of a licensee including certain family members, controllers of the affected person, other related parties and a person with whom the affected person has an agreement or arrangement to act together in relation to the acquisition, holding or disposal of shares or other interests in the licensee or the exercise of their voting power in relation to the licensee.

Once the Central Bank has issued a direction or restriction, then unless the Central Bank expressly permits it:

- no voting rights may be exercised in respect of the affected shares or securities;
- no shares or other securities of the licensee may be issued or offered to the affected person/s by way of rights, bonus or otherwise; and
- no dividend may be paid or other payment made by the licensee in respect of the affected shares or securities.

The above provisions represent a fairly significant enlargement of the Central Bank's regulatory powers. They have the potential to force shadow directors and other hitherto unseen controllers out of the shadows, thereby ensuring better corporate governance, greater transparency, and more effective regulatory control.

Portia J. Nicholson is a Partner in the Ocean Centre office. She has over 25 years of experience in the areas of Corporate and Commercial law and has acted as lead counsel to or been involved in many domestic commercial projects and cross border commercial transactions.



FOCUS on Influential Figures of the Firm

Higgs & Johnson has a decidedly rich history of providing high quality legal services both locally and internationally. Its success has been accentuated by past and present accomplishments of individual attorneys within the Firm who have distinguished themselves among their peers. FOCUS is pleased to provide its readers with insight into the personalities who formed the traditions, established the culture, and who are the current custodians of the ongoing legacy of providing the finest in legal professional services. We trust that you will enjoy reading a record of the informal interviews and direct quotes designed to focus on the life and times, the character and experiences of influential Higgs & Johnson attorneys. This issue features Stephen J. Melvin, Partner in the Ocean Centre office of The Bahamas.

What made you decide to specialize in Real Estate & Development law?

The worldwide real estate market in 1999/2000 was booming and foreign direct investment work in The Bahamas was at its highest level through to 2005/2006. This resulted in a very busy area within the firm and I ventured over into this area of practice.

How did you become involved in acting for high profile real estate transactions?

Luckily, I entered the practice at the right time and with the right mentor. I worked as a junior attorney under the supervision of Ronnie Lowe who was one of the best real estate attorneys in the country at the time. Due to his significant expertise in the area he dealt with the most high-end clients in the country and was a very sought after development attorney. From the start, I happily fell into serving the offshore real estate investment clientele. Because I came in at the ground level I had to deal with the more mundane and routine aspects of the transactions, including frequent and direct communications with the clients. This enabled me to develop relationships with principals, local and foreign attorneys, corporate management, real estate agents and family offices. After five years, I was thrust into a more senior role, taking on Mr. Lowe's clients after his retirement.

Which aspects of practice do you enjoy most?

I enjoy the clientele I deal with and the hotel development side of my work. I also enjoy working with the cruise ship industry and their development of private islands as port stops. It is extremely rewarding to bring in a project that you can see develop and hopefully become iconic.

Having acted as attorney in relation to many high value real estate transactions, what would you say is the future for such major deals?

From 2013, the real estate market in The Bahamas went wild again and the very high end investments in resort development went off the charts. Now in 2015 there is a leveling off. Inventory levels for the perfect, client-desired property have declined and prices have increased tremendously, so many clients are now in a holding pattern, watching and waiting to see if prices will decrease in the near future.

How has the Real Estate group changed during your time at Higgs & Johnson?

Over the last ten years we have made significant further inroads into the

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development resort work. The overall increase in such work may have been a result of the economy but I think our share of it has also been increasing. I estimate that I have been personally involved in more than 50% of the resort development work in The Bahamas in recent times.

What in your view has contributed to the success of the Real Estate group at Higgs & Johnson?

I believe training and education are vital to the continued improvement of this area, as well as international exposure.

The excellent work and reputations of our predecessors, Sir Geoffrey Johnstone, Ronnie Lowe, Leon Potier and Peter Higgs have greatly contributed to the success of the group. We also have the largest search archive deed history in the country, which is very beneficial to our clients.

From your vantage point, what are the issues that The Bahamas as a jurisdiction should focus on to ensure that the quality of legal services is progressively improving?

I believe training and education are vital to the continued improvement of this area, as well as international exposure. Unfortunately, due to the oversaturation of the market, there are not enough firms providing young attorneys and pupils with proper tutelage and mentoring. This can negatively impact the jurisdiction. Higgs & Johnson is very proud of our tradition in this respect.

Under the umbrella of Real Estate, what type of work do you particularly enjoy and why?

My practice is primarily in commercial real estate and spans corporate, commercial and conveyancing law. I particularly enjoy the development side and negotiating with the government.

What advice would you give to young attorneys wishing to excel in law?

Always smile when you are on the telephone with your client. Young attorneys should focus on the basics, thereby creating a solid foundation. Mastering the most basic, mundane and simple aspects of the profession allows one to create this foundation. Resist jumping into complex matters before you are ready; and become well-rounded in as many fields as you can.

FIRM WELCOMES NEWEST PARTNER

Oscar N. Johnson, Jr., Managing Partner of Higgs & Johnson, is pleased to announce that Paul Davis has joined the firm's partnership. Based in our Ocean Centre office, Paul's areas of practice include trusts, private trust companies, purpose trusts, foundations, executive entities, financial services law and regulation and corporate law.

He started his legal career with Higgs & Johnson in 2008 and has spent five years working for a prominent international trust and fiduciary services group of companies with offices in The Bahamas, Switzerland and Singapore, ultimately holding the position of General Counsel and Chief Compliance Officer for the international group.

This practical experience gives Paul an excellent insight into the progressive demands of the trust and fiduciary services industry and will enable him to provide considerable advice and counsel to our clientele taking into consideration the legal and regulatory environment as well as the risk management strategy of each client. Paul is a member of the Bahamas Financial Services Board Trusts Working Group which serves to ensure that the trust legislation in The Bahamas is regularly reviewed.

PURSUIT OF EXCELLENCE SCHOLARSHIP 2015

Higgs & Johnson awarded its 'Pursuit of Excellence', scholarship in the Cayman Islands this year to Mr. Jaron Leslie. Mr. Leslie, who is the holder of a LLB (Hons) degree, will be undertaking the Professional Practice Course (PPC) offered by the Truman Bodden Law School in the Cayman Islands.

Gina M. Berry, Cayman Islands Country Managing Partner noted, "We took note of Jaron's achievements to date, which are truly laudable; and trust that our vote of confidence will provide added encouragement, enabling him to complete this important step in his professional development."

The Pursuit of Excellence award was started in 2011 and is, among other things, based on academic achievement, community involvement and commitment to all-round excellence. Previous scholarship recipient, Ms. Ridhiima Kapoor, is a respected member of the legal profession and Caymanian community.

Pictured from left to right: Philip Boni, Partner, Mr. Leslie and Gina Berry.