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Offshore courts

Graeme Halkerston of Appleby highlights the important aspects of the Cayman system

The western Caribbean islands of Grand Cayman, Cayman Brac and Little Cayman make up the British Overseas Territory of the Cayman Islands. The islands are located about 480 miles south of Miami, Florida and have a population of about 50,000. Although the United Kingdom remains responsible for defence and foreign affairs and retains residuary legislative powers over the islands, the Cayman Islands are otherwise self-governing.

The fiscal system is based solely on indirect taxation: there are no income, corporate, capital gains or inheritance taxes, but the government raises its revenue through indirect taxes such as import duty, stamp duty on land transfers and various permit and registration fees. With no direct taxation or exchange controls, a pool of experienced professionals, stable political and economic environment, and excellent communications technology, the Cayman Islands is renowned as one of the most sophisticated offshore financial centres in the world.

The financial services sector benefits from a well-established legal regime. Fund administration and litigation in particular have been enhanced by recent developments with respect to judicial administration. The legislative framework for financial services generally provides contracting and investing parties wide discretion in arranging their affairs. This allows Cayman-focussed transaction parties to respond quickly to varying market conditions. At the same time recent legislation, particularly in respect of company and insolvency law, has responded to specific issues raised by practitioners in the offshore industries.

Legal framework

The legal system of the Cayman Islands is based upon English common law, complemented by locally enacted statutes, Orders-in-Council, and domestic case law.

Legislation

As a British Overseas Territory, the United Kingdom retains the rights to extend certain provisions of UK Parliamentary Acts to the Cayman Islands by way of an express provision in the Act itself or by Order in Council. While the UK has power to legislate over certain affairs of the Cayman Islands, local principal statutes are approved by the Legislative Assembly of the Cayman Islands and assented to by the Governor, the representative of the Sovereign. A draft constitution is in the process of being negotiated, and it is anticipated that

this will define and increase the scope of local legislative authority.

The Court System

Significant commercial litigation takes place in the Grand Court. The Grand Court judiciary consists of the Chief Justice and three other full-time judges (supplemented from time to time by acting judges brought in from overseas or drawn from the ranks of senior Cayman Islands practitioners) who exercise the same jurisdiction as that of the English High Court and Divisional Courts. The Grand Court judges have considerable experience of disputes involving complex offshore structures, particularly in the context of hedge fund and commercial trust litigation.

Civil actions brought before the Grand Court in the Cayman Islands are governed by the Grand Court Rules 1995 Revision (GCR). These rules lay down procedural requirements which have to be complied with at each stage of litigation. Save for some exceptions, the GCR closely follows the English Rules of the Supreme Court as they stood before the coming into force of the Civil Procedure Rules. There are limited but significant differences between the GCR and the previous English regime.

Appeals

Appeals from the Grand Court to the Cayman Islands Court of Appeal are governed by rules set out in the Court of Appeal Law (2006 Revision) and the Court of Appeal Rules (2004 Revision). The Cayman Islands' Court of Appeal is widely regarded as one of the strongest appellate courts in the Caribbean and the offshore world generally.

In certain circumstances a decision from the Cayman Islands Court of Appeal can be made to Her Majesty's Judicial Committee of the Privy Council. The process is governed by the Cayman Islands (Appeals to Privy Council) Order 1984 (a UK statutory instrument), which came into operation on 1 September 1984. The procedures governing appeals to the Privy Council are in the process of a review, although the changes are anticipated to be largely technical and procedural.

Decisions of the Grand Court, the Court of Appeal and the Privy Council on appeals from the Cayman Islands are reported in the jurisdiction's own series of law reports, the Cayman Islands Law Reports (cited as CILR), which are published by Law Reports International.

Since 2006, a right of petition to the

European Court of Human Rights following the exhaustion of traditional domestic legal remedies has existed. The first case from Cayman using this procedure is pending before the Court.

Status of English and Commonwealth authorities

Only decisions of the Grand Court, the Cayman Islands Court of Appeal and the Privy Council on appeals from the Cayman Islands are technically binding precedent. However, English authorities have strong persuasive force and English jurisprudence is commonly cited and adopted, especially on matters of common law or equity, or on the interpretation of similarly worded legislation. Decisions of other Commonwealth courts are occasionally cited and may be accepted as persuasive by the Grand Court and Court of Appeal. For example, recent developments in the enforcement of judgments have been heavily influenced by Canadian Supreme Court jurisprudence. There is also developing a significant body of offshore case law and decisions of similar jurisdictions are becoming increasingly influential in the Grand Court most notably, decisions from Bermuda, the British Virgin Islands, Jersey and the Isle of Man.

Developments in litigation

The landscape of the funds industry in the Cayman Islands has undoubtedly been affected by the recent changes in the global economic climate. That impact can however be matched by the introduction of new legislation and procedural developments. Although some of the most significant legislative changes are in the context of insolvency procedures, these procedures often form an integral part of general commercial litigation strategy in the offshore context.

There have also been case law developments in the context of enforcement of foreign judgments, rights of redeeming hedge fund investors and the ability of companies involved in fraud to bring claims against professional service providers.

Courts – Financial Services Division

This year will see the creation of the Financial Services Division (FSD) of the Grand Court. The FSD will be responsible for the handling of more complex civil cases in the Grand Court with the emphasis being more dedicated and robust case management. This has followed a period of detailed consultation and review of the litigation requirements of the financial services industry.

Cases in the FSD will be assigned to specific judges with financial services industry experience that will conduct more effective case management strategies to dispute resolution. Dedicated FSD registry staff and electronic filing is also intended to aid and assist resolution efficiency.

Legislation

A broad suite of company and insolvency

Author biography



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Graeme Halkerston is a partner in the litigation and insolvency practice group and is a member of the fund disputes team. He practices across a wide area of commercial and banking law. Graeme is a specialist commercial advocate, with particular expertise in cases involving international elements.

He joined the group in April 2007 and became Partner in April 2009. Prior to that, he practised for 11 years as a barrister at the Chambers of Lord Grabiner QC at One Essex Court, one of the 'magic circle' London commercial sets. He has also worked at the

European Commission and the UK Financial Services Authority.

He has advised in many leading corporate collapses in recent years including litigation involving Parmalat, Canada Trust, Lloyds, Manhattan Investment Fund and Barings. He has acted in numerous freezing order applications and jurisdiction disputes, particularly in cases involving fraud claims. These matters have included disputes in all the leading offshore jurisdictions. His work has covered a wide range of international banking disputes including hedge fund failures, derivatives litigation and M&A disputes. He was consistently rated in Legal 500 and Chambers and Partners as a leading sports law specialist.

Graeme studied law at Lady Margaret Hall, Oxford University, where he won the Martin Wronker Prize in Tort, was a College Scholar and President of the Oxford Union. He graduated with an LL.M from University of Pennsylvania as a Thouron Scholar and was admitted to Middle Temple, where he was awarded a Queen Mother Scholarship. He also obtained a post-graduate diploma in sports law from King's College, London.

legislation came into force on March 1 2009 including:

- The Companies (Amendment) Law 2007;
- The Companies Winding-up Rules 2008;
- The Insolvency Practitioners' Regulations 2008;
- The Foreign Bankruptcy Proceedings (International Co-operation) Rules 2008; and,
- The Grand Court (Amendment No. 2) Rules 2008.

The Companies (Amendment) Law 2007

The Companies (Amendment) Law 2007 repeals and replaces Part V of the Companies Law (2007 Revision). These reforms provide significant new protections to shareholders and investors in Cayman companies.

For example, for the first time Cayman law has introduced the concept of shadow directors, which is broadly consistent with the provisions relating to shadow directors in the English Companies Act 1985.

Perhaps the most significant reform given the current market is that the Court will be given power, on the presentation of a petition by a contributory on the "just and equitable" ground, to make alternative orders regulating the conduct of the company's affairs beyond ordering the winding-up of the company in question. This will greatly increase the availability of remedies for minority shareholders that allege oppressive conduct by the management of the company or the majority shareholders. Previously minority shareholders had more limited remedies essentially being limited to derivative litigation or seeking the full winding-up of companies which may have significant negative impact on returns to interested parties.

A new Part XVI of the Companies Law codifies the Grand Court's power to make orders in aid of foreign insolvency proceedings. On the application of a foreign trustee, liquidator or other representative, the court may make orders recognising that person's right to take actions on behalf of the debtor in the Cayman Islands, staying proceedings against the debtor, requiring the production of information or ordering the turnover of assets to the foreign representative.

Specific provision is made as to the matters that the court must take into account in exercising its discretion under these sections. These include the just treatment of all creditors, wherever domiciled, which preserves the approach traditionally followed in the Cayman Islands. However, as to procedure rather than substantive rights, the court is directed to consider the protection of claim holders in the Islands against the prejudice and inconvenience in the processing of claims in the foreign proceeding. This of course corresponds with similar provisions found in the cross-border co-operation provisions of many other countries. Other factors to be taken into account include the recognition of security interests created by the debtor, and the distribution of assets substantially in accordance with the order prescribed by Cayman Law.

Recent case law developments

Enforcement of foreign judgments

Two recent judgments of the Grand Court have widened the ability of the Court to enforce judgments of foreign courts where the foreign court ruled on issues argued between those parties properly before it. Cayman law had imposed traditional common law

restrictions on enforcement of foreign judgment, the most significant of which was the judgments had to be for a specific sum of money.

In *Miller v Gianne* (2007) CILR 18 and *Bandone v Sol Properties* (unreported, June 5 2008) the Grand Court confirmed that it will no longer be bound by the specific sum restriction. This follows the reversal of the similar restrictions in Canada in *Pro Swing Inc v Elta Golf* (2007) 3 LRC 338 and by the Privy Council on an Isle of Man appeal in *Ali v Pattni* (2006) UKPC 51. It is worth noting that unlike other jurisdictions which have largely applied *Pattni*, Cayman has referred specifically to the developments in Canadian law and in that context decisions of Canadian Courts may be influential on future Cayman jurisprudence.

These recent decisions show how important the wider enforcement powers may be in offshore jurisdictions. Orders for rectification of share registers and declarations in respect of ownership of assets located in Cayman will now be capable of enforcement in the Grand Court. This is a developing area of law and further judgments on the extent of the Court's willingness to enforce judgments are anticipated.

Redemption of shares

Many issues have arisen in the last two years on the ability of investors in funds to redeem their investments. Increasingly imaginative strategies have been adopted by fund managers to restrict such redemptions or to limit the medium or long-term impact of redemptions on fund value. Some of these strategies are of questionable validity and are unlikely to survive a legal challenge.

The most important recent Cayman decision on redemption process is the judgment of the Court of Appeal in *In The Matter Of Strategic Turnaround Master Partnership Limited* (unreported, December 12 2008). An investor submitted a timely request for redemption, but was prevented from receiving redemption proceeds as a result of the directors' blanket decision to suspend redemptions.

The Court considered the rights of redeeming investors in the event of a suspension of redemptions in the context of a winding-up petition brought by the investor.

On the facts of the case the Court held that the suspension prior to the payment date was indeed valid. In coming to its decision the Court looked to the specific powers to suspend redemption payment in the offering document together with that same power as contained within the articles of association.

The Court analysed the legal mechanics of the redemption process in some detail, and held that upon a suspension a redeeming investor could not petition to wind up the company on the ground that the fund was unable to pay its debts as the debt in question, namely the payment of the redemption funds,

was a future debt.

The Court did not strike out the investors petition based on “just and equitable” grounds. This, coupled with the new widening of the Court’s powers to order appropriate remedies in such petitions, means that the negative impact of Strategic Turnaround for investors is unlikely to be as significant as initial industry reports of the case suggested. There may be a further appeal to the Privy Council.

Corporate fraud and recovery from service professionals

Courts across the common law world have been grappling with the rights of a company whose management has been involved in a fraud, to bring claims for the recovery of losses caused by that fraud from professional service providers through claims for professional negligence.

The Grand Court considered this issue in *Trade and Commerce Bank v Arthur Andersen* (unreported, November 7 2008). The case arose out of the collapse of a South American conglomerate following the apparent diversion of monies from the group’s retail banking operations to trading companies in the group as uncollateralized loans. A Cayman bank, (TCB) which was part of the banking group was allegedly used as a conduit to the funds. On the case as pleaded, the management of the Cayman bank, which was co-extensive with the senior management of the retail banks, were on notice of and complicit in the fraud.

TCB went into insolvent liquidation and the losses on the bad loans, totalling some \$900 million, were claimed against the auditors of the bank, Arthur Andersen, on the basis that had the audit been performed properly, the fraud would have been discovered and stopped.

The Grand Court struck out TCB’s claim. In doing so, it relied heavily upon the decision of the English Court of Appeal in *Moore Stephens v Stone & Rolls* (2008) EWCA Civ 664. The fraudulent conduct of TCB’s management was attributed to TCB. TCB was not a victim of the fraud but was a conduit for it. As a result of this finding TCB would have to rely upon its own illegal conduct in order to establish a claim against its auditors. As such the claim was contrary to public policy on the basis of illegality.

An appeal is pending in TCB. The *Moore Stephens* case is itself on appeal to the House of Lords. The final result of the English litigation is likely to be heavily influential on the Cayman action.

While in *Moore Stephens* the Court had come to specific findings of fraud and knowledge at a previous trial, the TCB matter was disposed of on an exclusively interlocutory basis. This is consistent with other recent Cayman cases where it has been held that a party having alleged fraud in its pleadings or in other litigation in Cayman or

abroad cannot seek to resile from that allegation in order to obtain a litigation advantage in the Grand Court.

As in most jurisdictions there has been a noted upturn in the volume of commercial litigation in the last year. There will continue to be a stream of questions of law coming before the Grand Court for determination in the coming months. It is hoped that the new company law and insolvency regime, coupled with the establishment of the FSD will put Cayman in a good position to deal with these difficult times.

