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Recent Developments in Cayman Arbitration Law

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Cayman arbitration law is in the process of undergoing something of a renaissance. The number of arbitrations taking place in the Cayman Islands has increased over the past few years, particularly in the property and business interruption insurance field as a direct consequence of the impact of major storms such as Hurricane Ivan in September 2004 and Hurricane Paloma in 2008. This trend is continuing as fallout from the worldwide financial crisis and recession has given rise to disputes concerning Cayman domiciled funds and other structured investment vehicles, or where parties have otherwise provided for dispute resolution in 'neutral' jurisdictions like the Cayman Islands. At the same time, Cayman arbitration law is currently the subject of a review aimed at reforming the law and implementing the terms of the UNCITRAL Model Law on International Commercial Arbitration.

Sources of domestic Cayman arbitration law

By way of a brief introduction, the primary sources of Cayman arbitration law are statutory:

- the Arbitration Law (2001 Revision) governs domestic and international arbitration proceedings and the enforcement of local arbitration awards; and
- the Cayman Islands is also a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The Foreign Arbitral Awards Enforcement Law (1997 Revision) gives effect to the provisions of the New York Convention, and governs the recognition of foreign arbitral proceedings and the enforcement of foreign arbitral awards.

Foreign arbitral awards to which the New York Convention is not applicable may also be enforced in the Cayman Islands pursuant to applicable conflict of laws principles as applied by the Grand Court.

Arbitration case law is developed through judicial decisions of the Grand Court of the Cayman Islands, and through appeals therefrom to the Cayman Islands Court of Appeal and thereafter to the Privy Council in London. The Arbitration Law is based on the English Arbitration Act 1950, and as a consequence the Cayman courts will apply common law principles established through relevant English case law in interpreting its provisions.

The Cayman courts have a supervisory jurisdiction over Cayman arbitrations aimed at ensuring both quality and fairness. The courts also exercise a supportive function, including the ability to provide interim relief in support of the arbitral process, particularly in cases of urgency. In general, however, the courts will seek to exercise this jurisdiction sparingly so as to avoid encroaching unnecessarily upon the powers invoked on the arbitrators by the parties to the relevant dispute.

Recent developments

A major factor in the increasing number of arbitrations that have taken place in the Cayman Islands over the last couple of years have been storms such as Hurricane Ivan, which passed close to Grand Cayman on 11 and 12 September 2004, and Hurricane Paloma,

which caused extensive damage on Cayman Brac and Little Cayman in particular as it passed on 8 November 2008.

In particular, Hurricane Ivan caused widespread damage to property and infrastructure and resulted in widespread business interruption, particularly on Grand Cayman, the largest of the three islands that comprise the Cayman Islands and the location of the vast majority of its population. Approximately 83 per cent of the total housing stock on Grand Cayman was estimated to have suffered some degree of damage during the storm at a cost in the region of CI\$1.44 billion.¹ Major damage was also sustained to infrastructure and commercial premises such as hotels and resorts which formed a key part of Cayman's tourism industry. In total, the economic impact of the storm on the Cayman Islands was estimated to be US\$3.43 billion.²

The insured loss associated with Hurricane Ivan was estimated to be in the region of US\$1.5 billion.³ In the weeks and months that followed the storm, numerous insurance claims were made under property and business interruption policies issued by local and overseas insurers. Although the vast majority of these claims were settled without recourse to legal proceedings, inevitably a small proportion of these claims were disputed and resulted in litigation or arbitration proceedings. A large proportion of the Cayman arbitrations that have taken place between 2005 and 2008 have been linked in some way to damage sustained during Hurricane Ivan. This said, very few of these arbitrations have resulted in the production of ancillary judgments of the Grand Court, the Cayman Islands Court of Appeal or the Privy Council on matters associated with the proceedings, a factor that suggests that these arbitrations were concluded to the parties' satisfaction.

Case study: a Hurricane Ivan arbitration

A good example of an arbitration connected with a Hurricane Ivan insurance claim is the proceedings brought by the operator of a major timeshare resort on Grand Cayman against the underwriters of its material property damage and business interruption insurance.⁴ The resort property sustained major damage during the storm and the owner made a claim under its policy, which was governed by Cayman law and contained an arbitration clause in respect of any disputes that may arise. The resort operator and its underwriters were unable to agree on the quantification of the damage sustained and therefore the extent of the operator's claim under the policy, and as a consequence arbitration proceedings were brought against underwriters. The proceedings were commenced in early 2006 and were determined at an arbitration hearing that took place in Grand Cayman in December 2007.

1 See the World Bank Report 'The Impact of Hurricane Ivan in the Cayman Islands' (ECLAC, 2005).

2 Ibid.

3 Source: The Cayman Islands Monetary Authority.

4 The co-authors acted on behalf of the underwriters in the proceedings.

Although the details of the arbitration proceedings and the award subsequently issued by the arbitrators are confidential to the parties, we are able to comment in general terms on the following procedural aspects of the proceedings.

This was an ad hoc arbitration conducted under rules of the parties' own devising. Until very recently, there were no arbitral institutions established to provide services in connection with arbitrations in the Cayman Islands. However, there is now a Cayman Islands chapter of the North American branch of the Chartered Institute of Arbitrators, which is available to assist parties in the conduct of their arbitrations in the Cayman Islands.⁵ Arbitrations are conducted in Cayman using the rules of various international institutions (such as the American Arbitration Association, the International Chamber of Commerce and the London Court of International Arbitration, as well as the Chartered Institute of Arbitrators). However, more often ad hoc arbitrations are conducted here pursuant to rules of the parties' own devising, usually with very successful results. Underlying Cayman arbitration law is a strong presumption in favour of allowing the parties to resolve their disputes in accordance with a private system of rules agreed between them rather than one imposed externally. In this case, the parties were able to agree a tailored set of rules and procedures as were necessary to manage the particular type of dispute and the issues arising therein.

Given the subject matter of the dispute concerning the quantification of hurricane damage sustained to property, the parties nominated arbitrators in different disciplines appropriate to the determination of a specialist dispute of this nature. The arbitrators were located in Grand Cayman and in London. The parties' experts were also located in Grand Cayman and in a number of overseas jurisdictions, and the parties used specialist Queen's Counsel from the UK at the final arbitration hearing. This geographical diversity presented some logistical challenges, although these were overcome by using video links for all hearings with the exception of the final arbitration hearing and a meeting of the parties' experts. This allowed both of the arbitrators (and in the lead up to trial the parties' Queen's Counsel and the UK-based umpire) to participate in the proceedings without the need for the persons located overseas to travel to Cayman on a regular basis during the interlocutory stage of the arbitration. As a consequence, the parties were able to limit the costs associated with the proceedings while selecting arbitrators and experts with appropriate experience and expertise for a dispute of this scale and nature.

The Cayman Islands does not have any specialist facilities available for the conduct of arbitration proceedings, although again this does not pose any impediment to the efficient and effective conduct of arbitrations in Cayman. The parties in this arbitration were able to utilise the facilities available at the offices of the parties' local counsel and the Cayman-based arbitrator in conducting the interlocutory hearings using video link facilities as stated above. The arbitration hearing took place at the Ritz Carlton Grand Cayman, one of several hotels able to provide excellent facilities for the conduct of an arbitration hearing of this nature. The opening of the Ritz Carlton in December 2005 has led to increase in both the range and quality of facilities available on Grand Cayman for arbitration hearings.

Overall, these arbitration proceedings illustrate the ease with which specialist disputes are being successfully arbitrated in the Cayman Islands using legal and other resources located in both Grand Cayman and overseas. More generally, the case also provides an excellent example of the advantages that the arbitration process

has to offer in comparison with court-based litigation, particularly for more specialist types of dispute of this nature. The parties in this case were able to tailor both the tribunal and the conduct of the proceedings to reflect the particular issues arising in the dispute in a manner that would not have been possible if the claim was conducted through the courts. The parties were also able to conclude the dispute within two years of the issue of the proceedings, notwithstanding that a number of interlocutory hearings were required due to the complexity of the claim. Accordingly, the arbitration process allowed for a reasonably swift conclusion to the dispute.

K Coast Development Limited v Proprietors of Strata Plan #55

One recently reported decision of the Grand Court in the field of arbitration law is the case *K Coast Development Limited v Proprietors of Strata Plan #55* [2007] CILR N. 17, which illustrates the influence of English case law on Cayman jurisprudence. The case concerned a dispute over the payment of fees by the defendant to the plaintiff for work undertaken in restoration of the defendant's property following Hurricane Ivan.

The plaintiff had retained subcontractors to undertake restoration work on the defendant's property, which had been certified under the construction contract by an independent quantity surveyor. On receipt of the certification, the defendant paid to the plaintiff the contractually agreed sum by cheque in respect of the work undertaken. In reliance on the deposit of the cheque into its bank account, the plaintiff paid this sum to the subcontractors. However, the quantity surveyor then purportedly changed his mind about the work certified and as a consequence the defendant stopped the cheque. The plaintiff sued the defendant on the cheque and sought summary judgment in respect of its claim.

The defendant asserted that there had been a total failure of consideration for the payment given the change in the quantity surveyor's mind about the work, and sought a stay of the proceedings and an order that the plaintiff's claim be referred to arbitration pursuant to the terms of the construction contract. However, the Grand Court held that the claim could not be submitted to arbitration given that the defendant's claim was in effect a claim for unliquidated damages based on an alleged overpayment, which could not be raised as a defence, set-off or counterclaim to the plaintiff's action on the cheque. There was, therefore, no 'dispute' between the parties that could be referred to arbitration.

In so finding, the Grand Court applied the decision of the English House of Lords in *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 2 All ER 464, and approved the following quote taken from the headnote:

Even if the claim on the [cheque] were liable to be submitted to arbitration, there was not any dispute between the parties with regard to the claim within [section 6 of the Arbitration Law], since a claim for unliquidated damages [ie the claim for total failure of consideration based on an overpayment pending quantification through an arbitral award] could not be raised by way of defence, set-off or counterclaim to an action on a [cheque] and therefore could not be used to create a 'dispute' on the [cheque] within the meaning of [section 6]. It followed that no admissible defence to the appellants' claim on the [cheque] had been put forward by the respondents.'

The Grand Court therefore followed the stated principle of English law established in the context of the English Arbitration Act 1975, and refused to grant a stay of the proceedings pending arbitration in these circumstances. However, the Grand Court left it open for the defendant to pursue separate arbitration proceedings based on the allegation that the work for which payment had been given had not been done and had been erroneously certified.

⁵ One of the co-authors, Jeremy Walton, is the chairman of the Cayman Islands Chapter.

The case is a good example of the wide variety of disputes that have arisen from damage sustained to property during Hurricane Ivan. It also illustrates the manner in which the Cayman courts will follow and apply relevant common law principles established by the English courts in the arbitration field, in this case in respect of the circumstances in which the court will stay proceedings brought before it in favour of arbitration.

Unilever Plc v ABC International; Molson Coors Brewing Company v ABC International

Unilever Plc v ABC International [2008] CILR 87 provides an illustration of the extent of the Cayman court's jurisdiction to supervise parties, and grant relief, in connection with an improper threat to commence arbitration proceedings. The decision also provides a further example of the fact that the Cayman courts will follow the English common law principles on this topic.

In *Unilever*, the defendant had made several attempts to initiate arbitration proceedings against the plaintiffs in relation to various disputes that had arisen concerning the performance of obligations under a contract which contained an arbitration clause. The plaintiffs then commenced proceedings seeking declaratory relief to the effect that they were not bound by the agreement and were not bound to engage in arbitration in respect of the disputes, and injunctive relief restraining the defendant from further attempts to compel them to arbitrate.

Granting the relief sought by the plaintiffs, the Cayman court held that the contract (and the arbitration agreement relied upon by the defendant) had been terminated previously, such that there was no basis for alleging any contractual relationship between the parties. Accordingly, the court granted an injunction restraining the defendant from attempting to force arbitration upon the plaintiffs.

The Cayman court held that it had jurisdiction to grant the relief sought notwithstanding the defendant's contention that the court had no jurisdiction to adjudicate in the dispute between the parties. The court noted that having acknowledged service of the proceedings, the defendant had not applied to strike out or stay the proceedings as it would have had standing to do under section 4 of the Foreign Arbitral Awards Enforcement Law. Accordingly, and following the decision of the English Court of Appeal in *Liberia (Republic) v Gulf Oceanic Inc* [1985] 1 Lloyd's Rep 544 (which was approved by the House of Lords in *Metal Scrap Trade Corp Ltd v Kate Shipping Co Ltd (The 'Gladys')* [1990] 1 WLR 115), the court held that it had a general jurisdiction to grant declaratory relief in such circumstances.

The court also held that it had an inherent jurisdiction to grant an injunction restraining a defendant amenable to the jurisdiction from proceeding to arbitration where appropriate and necessary to avoid injustice, including where (as here) an action had been brought by a party contending that it was not bound by a supposed arbitration agreement. The court followed and approved the English decision in *Kitts v Moor & Co* [1985] 1 QB 253 in this regard.

Finally, the court held that in the circumstances there was no reason why it could not grant declaratory and injunctive relief of this nature on an application for summary judgment, following the English decisions in *Leco Instruments (UK) Ltd v Lan Pyrometers Ltd* [1982] RPC 133 and *Shell-Mex & BP Ltd v Manchester Garages Ltd* [1971] 1 WLR 612.

The case is a good example of the Cayman court exercising its supervisory jurisdiction by granting relief to a plaintiff at an early stage of proceedings in circumstances where it considered the conduct of a defendant in attempting to compel the plaintiff to submit to arbitration to be vexatious and oppressive.

Reform of Cayman arbitration law

Arbitration law in the Cayman Islands is currently the subject of a collaborative effort by private and public sectors to reform the law. The main purpose of the proposed reform is to stimulate Cayman's growth as an international arbitration centre. Although increasing numbers of domestic Cayman arbitrations have taken place over recent years as discussed above, the Cayman Islands have historically been infrequently used as a seat for international arbitrations. As stated, the Cayman Arbitration Law is based on the English Arbitration Act 1950, which in England has since been replaced with the Arbitration Act 1996. The implementation of new legislation in the near future will serve to correct any perception that Cayman arbitration law is outdated and in need of modernisation and bring Cayman arbitration law into the modern era.

In particular, it is proposed to introduce into Cayman law the principles enshrined in the UNCITRAL Model Law on International Commercial Arbitration.⁶ The UNCITRAL Model Law sets out desired international standards aimed at achieving the harmonisation and improvement of domestic law as it pertains to international commercial arbitration practice, and covers all aspects of the arbitral process from the arbitration agreement to the recognition and enforcement of the arbitral award. Given the nature of the jurisdiction, much of the business conducted in the Cayman Islands originates onshore and is of an international nature: companies and funds are formed in Cayman with the primary object of conducting their business overseas. Accordingly, the implementation of the harmonised rules and principles for the conduct of international commercial arbitration as set out in the UNCITRAL Model Law will have direct relevance and applicability to much of the business transacted through the Cayman Islands when disputes arise.

A committee appointed by the Law Society of the Cayman Islands⁷ produced recommendations and draft new legislation modelled on the UNCITRAL Model Law for the consideration of the Cayman Islands' government. The proposed reforms will closely follow the provisions of the Model Law save that some changes may reflect the experiences of other offshore jurisdictions, such as Bermuda, Singapore and Hong Kong, which have adopted the Model Law. In addition, revisions have been proposed to reflect the nature of the offshore financial business conducted in Cayman, and in particular the types of business where participants may require access to sophisticated dispute resolution mechanisms. For example, in recognition of the multitude of parties often involved in hedge fund disputes, specific provisions have been proposed that deal with multi-party arbitrations and related issues concerning the consolidation of arbitral proceedings. Another proposal addresses the fact that Cayman is a major centre for offshore banking: to the extent that ancillary asset-preservation relief may be required in support of arbitration proceedings, the proposed reforms seek to augment the asset-preservation powers of arbitral tribunals.

The Law Reform Commission has now produced a draft Bill, which is currently undergoing a further round of review. It is expected that the proposed reforms will be implemented in early 2010.

Arbitration and the Cayman funds industry

The timing of the reforms is certainly apposite given the growing number of disputes concerning Cayman registered funds and other structured investment vehicles. Cayman currently boasts over 10,000 registered funds with a total net asset value in excess of

⁶ As adopted by the United Nations Commission on International Trade Law on 21 June 1985, and as amended on 7 July 2006

⁷ One of the co-authors, Jeremy Walton, was the chairman of that committee.

US\$1.3 trillion.⁸ Cayman has a greater number of domiciled hedge funds than any other offshore jurisdiction.

The recent financial crisis and recessions in a number of countries led to a loss of confidence on the part of investors. Funds struggled to meet consequential redemption requests submitted by investors and at the same time struggled to meet margin calls on their leveraged investments. In addition, deterioration in financial performance led investors and creditors to take a harder look at and harder line with the funds' service providers. Declining financial performance generally has a tendency to give rise to heightened suspicions of malfeasance by investment managers and other service providers, while some managers were making increasingly risky plays to cover below-par returns and short positions.

All of this has led to an increasing number of disputes concerning Cayman domiciled funds, including claims brought by disgruntled investors, creditors and also liquidators in cases where a fund has had a winding-up order made against it. Claims of this nature have been brought in the courts of various jurisdictions, including in particular Cayman, New York and Delaware. However, given the specialised nature of disputes concerning funds, many of these claims are likely to be amenable to resolution through arbitration rather than court-based litigation. For example:

- The flexibility offered by the arbitration process allows the parties to tailor any arbitration, including the tribunal and the procedure to be followed, to the particular matters in dispute. This makes arbitration particularly useful and well-suited to the complex and technical commercial disputes that can arise in connection with hedge funds, for example disputes concerning the valuation of a fund's assets: the parties to such a dispute would be able to nominate specialist arbitrators with expertise in the funds industry. While the judges in the Cayman courts have an increasingly wide range of experience in dealing with fund disputes, the ability to nominate a particular arbitrator with specific expertise in the funds industry is a significant factor that can make arbitration extremely attractive for disputes of this nature in comparison to court-based proceedings.

- Arbitration is usually much quicker than litigation, not least because the arbitrators' decision is final and binding and only subject to appeal on limited grounds. In addition, arbitration proceedings are not subject to the challenges of court schedules that can arise in a small jurisdiction, and parties can avoid the conventional pre-trial timetables usually imposed by the court on litigants. Accordingly, arbitration usually results in the final determination of disputes in a much shorter time frame than court-based litigation. As with many commercial disputes, this factor may be of critical importance in the funds arena. With the asset values of many troubled funds declining at alarming rates, and with the distinct possibility that there may be nothing left to argue about by the time parties get to trial as a consequence, the speed of dispute resolution afforded by the arbitration process is likely to be particularly advantageous in fund disputes. This factor can also result in considerable costs savings in determining such claims.
- Arbitration is private and results in the production of an award which is confidential to the parties. Accordingly, the process does not result in the production of a public judgment and avoids any disclosure of confidential information into the public domain. Again, this can represent a considerable advantage in fund disputes, for example where there are issues concerning the identity of investors, investment strategies adopted, portfolio make-up and other commercial secrets relating to a fund's operations.

It is anticipated that the forthcoming reform of Cayman arbitration law will, once implemented, see the Cayman Islands well placed as a modern and sophisticated jurisdiction in which to conduct international arbitrations, including disputes concerning Cayman-domiciled funds.

⁸ Source: The Cayman Islands Monetary Authority. Cayman is reputed to have a similar number of unregistered funds.

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Appleby is a leading provider of offshore legal, fiduciary and administration services. Uniquely positioned in the key offshore jurisdictions of Bermuda, the British Virgin Islands, the Cayman Islands, the Isle of Man, Jersey, Mauritius, and the Seychelles, as well as the international financial centres of Bahrain, London, Hong Kong and Zurich, the group offers objective jurisdictional business solutions. Over 800 lawyers and professional specialists deliver sophisticated, specialised services in the areas of corporate and commercial, litigation and insolvency, trusts and property.

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Jeremy Walton Appleby

Jeremy Walton is a partner in the litigation practice group, the local team leader for commercial dispute resolution, and is global head of the firm's fund disputes team. He specialises in inter-

national commercial litigation and arbitration, including: directors' and shareholders' disputes; insolvency work, including the dissolution of commercial joint ventures and the dismantling of corporate structures; asset-tracing and recovery work, often as part of cross-border and multi-jurisdictional litigation and arbitration.

Jeremy is an experienced advocate, with a large number of reported cases in the Grand Court, the Court of Appeal and the Privy Council in London. He has conducted cases of considerable commercial and financial significance for an array of international clients. Examples include: representing the Indonesian state-owned energy company (PT Pertamina) in relation to a US\$316 million ICC award arising out of a JV project to develop and operate a geothermal power plant in Java; representing insurers in litigation and arbitration over contested insurance claims totalling more than US\$150 million arising out of Hurricane Ivan; enforcing a multi-million dollar arbitral award against the Republic of Congo by attacking a structured finance facility secured on its oil assets; acting for the Turkish Savings Deposit Insurance Fund (TMSF) in successful banking fraud proceedings against Murat Demirel, arising out of the collapse of two prominent Turkish banks; representing Prince Jefri Bolkiah in high-profile litigation with the Sultan of Brunei to recover assets arising out of alleged misappropriation of US\$15 billion from the Brunei Investment Agency; acting for Grant Thornton International in litigation arising out of the collapse of the Parmalat group; advising investors and creditors in relation to the liquidation of the Bear Stearns High Grade Structured Credit Strategies Master Fund/Enhanced Leverage Master Fund.

Jeremy is chairman of the Cayman Islands chapter of the North American branch of the Chartered Institute of Arbitrators.



Chris Easdon Appleby

Chris Easdon is an associate in the litigation and insolvency practice group. He specialises in general commercial litigation and has experience of acting in connection with a wide range of com-

mmercial disputes, including insurance and reinsurance, professional negligence, property and fund litigation. Chris joined Appleby in 2005, prior to which he was an associate with Herbert Smith in London.

Recent disputes on which Chris has acted include: acting for life assurance and annuity companies in connection with their exposure to the Bernard Madoff fraud, including advising on related policyholder claims and in connection with the winding up of the Rye Select Funds; advising investors on redemption issues arising in connection with investments in Cayman hedge funds, including advising on gating issues and issues arising from the use of synthetic side pockets; advising insurers in connection with property damage and business interruption claims arising from damage sustained during Hurricane Ivan and Hurricane Paloma, including acting on claims relating to the Hyatt Regency Grand Cayman and Morritt's Tortuga Club; advising insurers on coverage issues and claims under professional indemnity insurance policies; acting for the Indonesian state-owned energy company (PT Pertamina) on a US\$316 million fraud claim arising out of a JV project to develop and operate a geothermal power plant in Java; advising on insolvency issues arising in connection with Cayman structured investment vehicles, including advising on security and enforcement issues and the appointment of receivers; advising on shareholder disputes arising in connection with Cayman hedge funds and captive insurance companies.