GUIDE

APPLEBY

GUIDE TO PROTECTION OF MINORITY SHAREHOLDERS IN THE CAYMAN ISLANDS

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PREFACE

This Guide outlines the remedies available to minority shareholders in Cayman Islands companies.

We recognise that this Guide will not completely answer detailed questions which clients and their advisers may have; it is not intended to be comprehensive. If any such questions arise in relation to the contents, they may be addressed to any member of the team, using the contact information provided at the end of this Guide.

Appleby
Cayman Islands
January 2015

1. INTRODUCTION

The company law provisions governing minority shareholder protection in the Cayman Islands are derived from the equivalent provisions in English law, although there are some notable differences. In particular, shareholders in Cayman Islands companies will find it much more difficult to obtain access to company information than their English equivalents. Further, there is no ability for a shareholder of a Cayman Islands company to bring a petition on the basis of "unfair prejudice". Under statutory provisions which were introduced in 2009, however, the court hearing a just and equitable winding up petition now has the discretion to grant alternative remedies, which are the same as the remedies which the English court can grant on an "unfair prejudice" petition.

2. RIGHT TO INFORMATION

Unless specifically stated in the articles, or agreed by contract (for example in a shareholders agreement), the shareholder of a Cayman Islands company has no right by virtue of his position as shareholder to be provided with information regarding the company, including the company's accounts. Nor is this information publicly available. The companies' registry can be searched, but the only information a search will reveal is the company's name, number, formation date, type, registered office and status.

On the application of the holders of not less than one-fifth of a company's shares, the court may appoint inspectors to examine the company's affairs and prepare a report thereon to the court.

The court also has discretion to order pre-action discovery of information by an intended defendant, but only if this is required to facilitate the precise formulation of the claim. If a shareholder has a potential claim against the company's directors, he may be able to use this rule to obtain information.

3. RIGHT TO BRING LEGAL ACTION – PERSONAL, REPRESENTATIVE AND DERIVATIVE ACTION

3.1 Personal Actions

A shareholder in a company may be able to bring an action against the company if he can show that a duty owed to him personally (rather than to the company) has been breached. For example, if a shareholder is prevented from exercising a contractual right embedded in the company's articles, they would generally bring a personal action against the company for a declaration/injunction.

3.2 Representative Actions

In Cayman, it is possible for an individual shareholder to bring an action on behalf of himself/herself and their fellow shareholders. This type of action would be appropriate if there is a common interest or right which the representative shareholder seeks to enforce on behalf of all the shareholders. Apart from in certain limited circumstances, a judgment will bind all of the parties named in the proceedings.

3.3 Derivative Actions

It is possible for shareholders to enforce a right belonging to the company rather than to any individual shareholder or shareholders (such as a breach by a director of their fiduciary duties). Since the right belongs to the company, the litigation has to be brought by the company itself. Normally, a company's Articles of Association will state that the right to commence litigation will lie with the Board of Directors. As such, the shareholders will need to persuade the directors to bring an action on behalf of the company.

If the directors decline to take this action, the shareholders will want to consider whether they can replace the directors with a newly constituted Board, who can then initiate the action against the former directors. The procedure for removal and replacement of directors will be set out in the Articles of Association.

Alternatively, it is also possible for the shareholders by ordinary resolution to bring litigation in the name of the company, at least where the directors are alleged to be a party to the wrongdoing.

If the shareholder can bring himself within one of the exceptions to the rule in *Foss v Harbottle*, he may be able to bring a derivative action, whereby he may bring an action in his own name but on behalf of the company. The exceptions are when the act complained of:

- is *ultra vires* (i.e. beyond the capacity of) the company or illegal;
- constitutes a "fraud on the minority", and the wrongdoers are themselves in control of the company, so that they will not cause the company to bring an action;
- is an irregularity in the passing of a resolution which requires a special majority; or
- infringes the personal rights of an individual shareholder.

If the company gives notice of intention to defend the proceedings, the shareholder must at that stage apply to court for permission to continue the action. At that stage he must show a *prima facie* case that the company is entitled to the relief claimed, and that the action falls within one of the exceptions to the rule in *Foss v Harbottle*. This requirement has been described as a "filter" to satisfy the court that the claim is not vexatious or frivolous or has no real prospect of success, or is brought in the shareholder's own interests (rather than those of the company)[1].

4. JUST AND EQUITABLE WINDING UP

A last resort for a shareholder who has been unfairly treated is to petition the court to wind up the company on the basis that it is "just and equitable" to do so. If a winding up order is made, liquidators will be appointed who can then investigate the company's affairs and pursue claims against the former directors (and any others who have caused loss to the company).

A shareholder bringing a petition on this ground will have to show that he has a "tangible interest" in the winding up, i.e. that there is likely to be a surplus of assets available for distribution to shareholders. If the company is hopelessly insolvent and there is no prospect of a return to shareholders, a shareholder will not have standing to issue a petition on this ground: if such a petition is issued, it is liable to be struck out.

The categories of cases in which a winding up has been ordered on the just and equitable ground are not closed. However, winding up on this ground has been ordered where:

- The "substratum" of the company is gone. In 2010, the Grand Court reformulated the test for loss of substratum as follows: if it has become impractical, if not impossible, to carry on the company's business in accordance with the reasonable expectations of its participating shareholders, it will be just and equitable for the company to be wound up[2].

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[1] *Renova Resources Private Equity Limited v Gilbertson and four others* [2009] CILR 268.

[2] *In re Belmont Asset Based Lending Ltd* [2010(1)] CILR 83. The decision in Belmont has been followed in a line of cases including *Heriot-African Trade Finance* [2011(1)] CILR 1. The Commercial Court in the British Virgin Islands has expressly declined to follow the approach taken by the Cayman court in this regard: see *Aris Multi-Strategy Lending Fund Ltd* and *Quantek Opportunity Fund Ltd*, Claim No BVIHCOM 2010/0129. See also *In re FIA Leveraged Fund*, Judgment of 23 April 2012 and *In re ABC Company (SPC)*, Judgment of 25 May 2012 (both unreported), in which the Chief Justice and the Court of Appeal respectively note the alternative approaches without endorsing one over the other, on the basis that the issue is likely to fall for judicial determination in the near future.

In 2010, we successfully petitioned for the winding up of a company which was incorporated in the Cayman Islands for tax purposes: since those purposes could not in the end be achieved due to a ruling of an overseas tax authority, the company was held to have lost its substratum[3].

- There is deadlock in management.
- There has been loss of confidence in management, due to a lack of probity in their conduct of the company's affairs.
- There is a need for investigation into the affairs of the company.
- The company is a "quasi-partnership" and the petitioner's legitimate expectations have been breached. A "quasi-partnership" is a company in which features are present which make it appropriate to subject the strict legal rights of the members to equitable considerations. These features include the following:
    - the company is formed on the basis of a personal relationship involving mutual confidence;
    - there is an agreement that all or some of the members will participate in the company's business;
    - there is a restriction on the transfer of the members' interest in the company.

Under revisions to the Companies Law which were introduced in 2009, if the court hearing a shareholder's petition for the winding up of the company on the just and equitable ground is of the opinion that it is just and equitable that the company be wound up, the court also has jurisdiction to make the following orders as an alternative to winding up:

- an order regulating the conduct of the company's affairs in the future;
- an order requiring the company to refrain from doing an act which the petitioner has complained of, or to do an act which the petitioner has complained that it has omitted to do;
- an order authorising civil proceedings to be brought in the name and on behalf of the company by the petitioner; or
- an order providing for the purchase of the shares of any member of the company by the company or by other members of the company.

A winding up petition has to be brought in the Financial Services Division of the Grand Court. Upon filing the Petition, a filing fee of CID5,000 (USD6,097.56) must be paid. At the same time as filing the Petition, the petitioner must issue a summons for directions. There will then be a directions hearing at which the Court will give directions in relation to:

- whether the proceedings are to be treated as proceedings against the company or *inter partes* proceedings between the shareholders (in the latter case, the company should not bear any of the costs);
- service and advertisement of the petition;
- service of a defence; and
- service of evidence, discovery and inspection of documents.

[3] *In re Freerider Limited* [2010(1)] CILR 486

For more specific advice on minority shareholder protection in the Cayman Islands, we invite you to contact:

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For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found here.