LEGAL ALERT

2016

Shareholder disputes in the Cayman Islands: Petitions to wind up a company on "just and equitable" grounds for loss of substratum following the recent case of *In Re Harbinger Class PE Holdings (Cayman) Ltd*

Loss of substratum (or reason for existence)

Shareholders of a Cayman Islands company may petition the Grand Court for an order that a company is wound up pursuant to section 92(e) of the Companies Law (As Revised) on the basis that it is "*just and equitable*" for it to do so. One ground which is often relied on by shareholders for this purpose is that the company has lost its "*substratum*" or, in other words, its reason for being in existence. The seminal dicta in this area is that of Lord Cairns in *In re Suburban Hotel* (1867) LR 2 Ch App 737, where he held that:

"It is not necessary for me to decide it; but if it were shown to the Court that the whole substratum of the partnership, the whole of the business which the company was incorporated to carry on, has become impossible, I apprehend that the Court might, either under the Act of Parliament, or on general principles, order the company to be wound up."

In the recent case of *In Re Harbinger Class PE Holdings (Cayman) Ltd* (unreported, 10 November 2015) Justice Clifford, noted that subsequent English authorities have followed the approach adopted by Lord Cairns. He quoted the decision of Lord Justice Baggallay in the English case *In re German Date Coffee Company* (1882) 20 Ch D 169 that:

"It appears to me that the principle involved in the decision of In re Suburban Hotel Company by Lord Cairns amounts to this, that if you have proof of the impossibility of carrying on the business contemplated by the company at the time of its formation, that is sufficient ground for winding up the company. Therefore the question arises in the present case, is there an impossibility of carrying out the objects of the company."

However, Justice Clifford also noted the confines of the principle of the loss of substratum as set out in *Re Kitson & Co Ltd* [1946] 1 All ER 435 in which the English Court of Appeal held that there had been no failure of substratum where a company had sold its business, but at the same time was carrying on a similar type of business through a subsidiary. Provided that the company could carry on that type of business, then prima facie at least, it would be impossible to hold that the substratum had gone.

Divergence between the approach taken in the Cayman Islands and the British Virgin Islands in respect of open-ended corporate mutual funds.

In *In Re Belmont Asset Based Lending Limited* [2010] 1 CILR 83, Jones, J sitting in the Financial Services Division of the Grand Court held:

"*To translate these statements into a modern context, it can be said that it just and equitable to make a winding-up order in respect of an open-ended corporate mutual fund if the circumstances are such that it has become impractical, if not actually impossible, to carry on its investment business in accordance with the reasonable expectations of its participating shareholders, based upon representations contained in its offering document. If such a company, organised as an open-ended mutual fund, has ceased to be viable for whatever reason, the court will draw the inference that it is just and equitable for a winding-up order to be made*."

In *Harbinger*, Clifford, J., noted that whilst this test had been applied in other Cayman Islands cases, the approach had not been followed in other jurisdictions, most notably, the British Virgin Islands, where Bannister, J., in *Aris Multi-Strategy Lending Fund Ltd V Quantek Opportunity Fund Ltd* (15 December 2010) held that:

"It seems to me that the underlying principle to be extracted from these cases, with the exception of In re Bristol Joint Stock [where Kekewich, J referred to the impossibility of a business being carried on with any hope of success] is that a minority seeking a winding up on the grounds that the business life of a company has come to an end will only be permitted to overcome the will of the majority if they can show that further conduct of the company's business is impossible."

Bannister, J., held that the reasoning of Jones, J in *Belmont* was confined to open-ended investment funds. Indeed, in that case, Jones, J., had referred to *"sound policy reasons for making a winding-up order in respect of non-viable mutual funds."* As a consequence, Bannister, J., interpreted the ratio of the English case law authorities to the effect that there will only be a failure of substratum if it is impossible, as opposed to no longer viable, for the business of the company to be carried on.

The approach followed in *Harbinger*.

In *Harbinger*, Clifford, J., was faced with the task of determining which of the two divergent approaches should be followed. That case concerned the question of the substratum of a subsidiary which had been incorporated as part of a restructuring of a closed-end fund which had suffered significant difficulties as a result of the financial crisis in 2008. The company was intended amongst other matters to hold a special class of shares in the parent fund company which related to largely illiquid assets held by the parent and "ear marked" for disposal so that the special shares would receive the benefit of the allocated assets after the discharge of all prior ranking liabilities of the fund. Clifford J., held that because company in question was not, and never had been, an open-ended corporate mutual fund the test to be applied was:

"*founded upon the established underlying principle of the line of authorities referred to which requires the Court to determine whether it has become impossible for the company to achieve the purpose for which it was formed*."

Harbinger would therefore appear to confine the ruling of Jones, J., in *Belmont* to closed ended mutual funds, or at least to companies within structures where similar policy arguments may apply.

Interpretation of the objects of a company

In Harbinger significant argument was also lead about the interpretation of the objects of the subsidiary company which contained a modern form unrestricted objects clause. Clifford J., held that on the basis of previous authorities, including the BVI authority of *Aris* cited above, that the Court is required to look beyond a wholly general objects clause to ascertain on the particular evidence in a case the principal or main object of a company in line with the reasonable expectation of its participating shareholders. This is a useful reconfirmation of these principles as they apply to Cayman Islands companies.

For more information on shareholder disputes in Cayman Islands' companies- please contact:

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