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Legal Briefings

Shareholder disputes: A comparison between the Cayman Islands and the British Virgin Islands

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In the prevailing economic conditions investors in offshore companies registered in the Cayman Islands or the British Virgin Islands (“BVI”) are increasingly being forced to consider their rights against directors who may have been responsible for mismanagement of the company’s affairs. Minority shareholders, in particular, are keen to understand the availability of remedies which allow them to overcome “wrongdoer control.” That is to say, the common situation where the composition and direction of the board is controlled by majority shareholders. We have set out below a brief summary of the duties owed by directors and the remedies available to shareholders in each of these two jurisdictions.

What is scope of director’s duties?

Cayman Islands

The duties of a director of a Cayman company are found in the common law and include the duty to act *bona fide* in the best interests of the company, a duty not to exercise his or her powers for purposes for which they were not conferred and not to make secret profits.

BVI

The law governing the duties of directors and conflicts is set out in the BVI Business Companies Act (as revised) (the “Act”). These largely mirror the position at common law and include, for example:

- (a) the duty to “act honestly and in good faith and in what the director believes to be in the best interests of the company”;
- (b) the duty to exercise powers “for a proper purpose” and a requirement that a director “shall not act, or agree to the company acting, in a manner which contravenes this Act or the memorandum or articles of the company”; and
- (c) a requirement that a director “shall, forthwith after becoming aware of the fact that he or she is interested in a transaction entered into or to be entered into by the company, disclose the interest to the board of the company.”

It is interesting to note that the Act provides that a director of a company that is a wholly-owned subsidiary, subsidiary or joint venture company may, subject to certain requirements, act in the best interests of the relevant parent, or in the case of the joint venture company, the relevant shareholders even though such act may not be in the best interests of the company of which they are a director.

What are the standard director's duties?

Cayman Islands

While the decisions of English common law cases are not binding in the Cayman Islands, they are persuasive authority. Accordingly, a large body of the English caselaw authority on a director's duties has been followed by the Cayman Islands court and applies to the Cayman Islands such that a director is under a duty to act with reasonable care, skill and diligence in the performance of his or her duties. In the English authority of *Re City Equitable Fire Insurance Co* [1925] Ch. 407 it was held that "a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. This highly subjective test, however, has been met with increasing criticism in more recent years and there is further English caselaw authority to suggest that directors are nevertheless subject to an objective duty to "take such care as an ordinary man might be expected to take on his own behalf" (*Dorchester Finance Co v Stebbing* [1989] BCLC 498 (decided in 1977)). As such, a distinction appears to be drawn between the duty of skill on the one hand and the duty to take care on the other. However, in *Re City Equitable Fire Insurance Co* it was further held that "in respect of all duties that, having regard to the exigencies of business, and the articles of association, may be properly left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting to that official to perform such duties honestly."

BVI

In terms of the standard of care that directors of BVI companies must show, the Act provides that a director "*when exercising powers or performing duties as a director, shall exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation-*

- (a) *the nature of the company;*
- (b) *the nature of the decision; and*
- (c) *the position of the director and the nature of the responsibilities undertaken by him or her."*

This duty is qualified in the Act to the extent that the director of a company is entitled to rely upon the books, records and financial statements of the company in question and/or employees and professional advisers provided that in doing so he or she acts in good faith, undertakes a proper inquiry where this is warranted and has no knowledge of a reason for not placing reliance on the said documents.

What are the key remedies available to a member or shareholder?

Cayman Islands

The following remedies are available to a member of a Cayman company:

- (a) A personal action against the company (where the company has breached a duty which is owed to the member personally);
- (b) A representative action (similar to a personal action such a claim would lie for breach of a duty owed to a group of shareholders);
- (c) A derivative, or multiple derivative claim (this is the most common type of action. See below); or
- (d) A petition to wind up the company on just and equitable grounds. (This is seen as a last resort because it risks placing the company into liquidation although the Cayman Companies Act (As Revised) (the "**Companies Act**") provides the Court with the option of making an alternative order. See below).

BVI

The members of a BVI company may pursue the following remedies:

- (a) A personal action (on the same grounds as at common law in the Cayman Islands);
- (b) A representative action which provides that the Court may appoint a member “to represent all or some of the members having the same interest and may, for that purpose, make such order as it thinks fit”. An order would include an order “as to the control and conduct of the proceedings” and “directing the distribution of any amount ordered to be paid by a defendant in the proceedings among the members represented.”;
- (c) A derivative claim; or
- (d) An unfair prejudice claim.

The most common type of remedies sought by minority shareholders are derivative claims and unfair prejudice claims (see below).

What are derivative claims and what is their legal basis?

Cayman Islands

A derivative action is a claim commenced by one or more minority shareholders on behalf of a company of which they are a member in respect of loss or damage which that company has suffered. Such a claim can only be brought in certain circumstances and amounts to an exception to the rule that a company, as a separate legal person, should sue and be sued in its own name (often referred to as the rule in the English authority of *Foss v Harbottle* (1843) 2 Hare 461; 67 E.R 189). In the Cayman Islands the law governing derivative actions is drawn from the common law rather than statute.

BVI

While the English common law applies in the BVI, members’ remedies have been given a statutory footing in the Act (see below).

What is the procedure for commencing a derivative action?

Cayman Islands

As with the majority of actions commenced in the Cayman Islands, derivative claims are normally begun by serving a writ and statement of claim on the relevant defendant or defendants. Grand Court Rules O.15, r. 12A provides that where the defendant gives notice of an intention to defend the claim then the plaintiff must apply to the court for leave to continue the action. Such an application should be supported by affidavit evidence verifying the facts on which the claim and entitlement to sue on behalf of the company are based. Pursuant to Grand Court Rules O.15 r.12A(8) on the hearing of the application, the court may grant leave to continue the action for such period and upon such terms as it thinks fit, dismiss the action, or adjourn the application and give such direction as to joinder of parties, the filing of further evidence, discovery, cross-examination of deponents and otherwise as it considers expedient. *In Renova Resources Private Equity Limited v Gilbertson and Others* [2009] CILR 268, Foster., J affirmed the application in the Cayman Islands of the test to be applied in determining whether to grant leave to continue the action put forward by the English Court of Appeal in *Prudential Assurance Co Ltd v Newman Industries Ltd (No.2)* [1981] Ch 257. Foster, J., held that: “(...) there are two elements to this: first the plaintiff [is] required to show prima facie that there [is] a viable cause of action vested in the company and, secondly, that the alleged wrongdoers [have] control of the company (or could block any resolution of the company or the board) and thereby prevent the company bringing an action against themselves.”

BVI

The Act provides that subject to certain exceptions, “the Court may, on the application of a member of a company, grant leave to that member to-

- (a) bring proceedings in the name and on behalf of that company; or

- (b) *intervene in proceedings to which the company is a party for the purpose of continuing, defending or discontinuing the proceedings on behalf of the company.*"

Without limiting the above, in determining whether to grant leave, *"the Court must take the following matters into account-*

- (a) *whether the member is acting in good faith;*
- (b) *whether the derivative action is in the interests of the company taking account of the views of the company's directors on commercial matters;*
- (c) *whether the proceedings are likely to succeed;*
- (d) *the costs of the proceedings in relation to the relief likely to be obtained; and*
- (e) *whether an alternative remedy to the derivative claim is available."*

It should be noted that leave to bring or intervene in proceedings may be granted *"only if the Court is satisfied that-*

- (a) *the company does not intend to bring, diligently continue or defend, or discontinue the proceedings, as the case may be; or*
- (b) *it is in the interests of the company that the conduct of the proceedings should not be left to the directors or to the determination of the shareholders or members as a whole."*

Is it possible to bring multiple derivative claims ("MDCs")?

Cayman Islands

In Renova the Grand Court held that in appropriate circumstances MDCs would be permitted. In that case, the plaintiff had brought an action in respect of loss incurred by a wholly-owned subsidiary of the company in which it was a shareholder and therefore loss to the subsidiary caused indirect loss to its parent company and shareholders. However, the rule against the recovery of reflexive loss applied such that a shareholder or parent company would not be permitted to claim for indirect losses which mirrored those losses suffered directly by the relevant subsidiary or indeed sub-subsidary on whose behalf action was being brought.

BVI

In Microsoft Corporation v Vadem Ltd¹ the Court of Appeal of the Eastern Caribbean Supreme Court held that BVI law which has been codified in this area *"does not permit double derivative proceedings."* That said, English caselaw authority such as Universal Project Management Services Ltd v Fort Gilkicker Ltd² may open up arguments that such actions are nevertheless available in the jurisdiction at common law.

What remedies are available for unfair prejudice and what is their legal basis?

Cayman Islands

Pursuant to the Companies Act the court may wind up a company if it is of the opinion that it would be just and equitable for it to do so. The Companies Act provides that where such a petition is presented by members of the company as contributories on the ground that it is just and equitable that the company should be wound up, the Court shall have jurisdiction to make the following orders, as an alternative to a winding-up order, namely:

- (a) an order regulating the conduct of the company's affairs in the future;
- (b) an order requiring the company to refrain from doing or continuing an act complained of by the petitioner or to do an act which the petitioner has complained it has omitted to do;
- (c) an order authorising civil proceedings to be brought in the name of and on behalf of the company by the petitioner on such terms as the Court may direct; or

¹ BVIHCVAP2013/0007

² [2013] 3 WLR

- (d) an order providing for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, a reduction of the company's capital accordingly.

BVI

The Act provides that a member *"who considers that the affairs of the company have been, are being or are likely to be, conducted in a manner that is, or any act or acts of the company have been, or are, likely to be oppressive, unfairly discriminatory, or unfairly prejudicial to him or her in that capacity, may apply to the Court for an order"*. If on an application *"the Court considers it just and equitable to do so, it may make such order as it thinks fit, including, without limiting the generality of this subsection, one or more of the following orders:*

- (a) *in the case of a shareholder, requiring the company or any other person to acquire the shareholder's shares;*
- (b) *requiring the company or any other person to pay compensation to the member;*
- (c) *regulating the future conduct of the company's affairs;*
- (d) *amending the memorandum and articles of the company;*
- (e) *appointing a receiver of the company;*
- (f) *appointing a liquidator of the company;*
- (g) *directing the rectification of the records of the company; and*
- (h) *setting aside any decision made or action taken by the company or its directors in breach of this Act or the memorandum or articles of the company."*

Further Assistance

This publication is not intended to be a substitute for specific legal advice or a legal opinion. For specific advice on the matters covered in this Legal Briefing, please contact your usual Loeb Smith attorney or any of the following:

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