Cayman Litigation & Dispute Resolution Q4 2016 Review

Welcome to the Q4 2016 Stuarts litigation and dispute resolution review. Stuarts' litigation and dispute resolution team acts in a wide range of company, commercial and insolvency related disputes arising under Cayman Islands law. The Q4 2016 Quarterly Review addresses Limited Partners and Shareholders contracting out of the right to present a Winding-Up Petition.

Limited Partners and Shareholders contracting out of the right to present a Winding-Up Petition

The ability to commence winding-up proceedings is one of the most important rights that either a shareholder or a partner may have in order to seek relief from the Court[1]. However, Section 95(2) of the Companies Law (2016 Revision) (the "**Companies Law**"), which was first introduced in 2009, provides:-

> *"The Court shall dismiss a winding-up petition or adjourn the hearing of a winding-up petition on the ground that the petitioner is contractually bound not to present a petition against the company".*

In this respect, the Exempted Limited Partnership Law, 2014 (the "**ELPL**") is clear in that, save where there are inconsistent provisions therein, the provisions of Part V of the Companies Law relating to the winding-up of companies apply equally to exempted limited partnerships.

This Quarterly Review considers the common law on contracting out, the effect of Section 95(2) of the Companies Law and recent Cayman Islands case law.

Background

The common law context in which Section 95(2) of the Companies Law was first introduced in the Cayman Islands was firmly established in the English Court of Appeal decision In Re Peveril Gold Mines, Ltd. [1898] Ch. 122 where it was held that a shareholder's right to present a winding-up Petition could not be excluded by a provision in a company's Articles of Association. The ability to present a winding-up Petition conferred:-

> *"... a right of which a contributory cannot be deprived, either entirely or in a limited way, by the terms of the articles of association".*

At first instance, the Court emphasised that the Articles of Association "must not conflict with the provisions of the Acts regulating the incorporation of ... companies". The Court's conclusion was based in part on the fact that in certain instances the companies legislation expressly provided that statutory provisions applied "*in default of* any regulations" to the contrary and that was not the case in respect of the power of shareholders to petition. In addition, the Court of Appeal focused on the fact that a company is a creation of statute. Lindley MR held:-

> *"Anyone who is familiar with the Companies Acts knows perfectly well that these registered limited companies are incorporated on certain conditions; they continue to exist on certain conditions; and they are liable to be dissolved on certain conditions ... to say that a company is formed on the condition that its existence shall not be terminated under the circumstances, or on the application of the persons, mentioned in the Act is to say that it is formed contrary to the provisions of the Act, and upon conditions which the Court is*

1 This Quarterly Review does not address the position of creditors although it should be noted that a creditors non-petition clause was held not to be contrary to English public policy in In the Matter of Colt Telecom Group Plc [2002] EWHC 2815; such clauses do not offend against public policy and will be enforced (Principles of Corporate Insolvency Law, Roy Goode, 4th Edition (2011) para 5-18).

Key Contacts

Richard Annette
Head of Litigation
Tel: (345) 814-7920
richard.annette@stuartslaw.com

bound to ignore". [2]

The Court at both first instance and on appeal did not consider whether there could be a valid separate agreement with an individual shareholder not to petition. Notwithstanding that the Peveril Gold Mines decision related to provisions in Articles of Association, the Court concluded, obiter, in the first instance English decision of Exeter City Association Football Club Ltd -v- Football Conference [2004] 1 WLR 2910, that the principle that certain shareholder rights "*cannot be diminished or removed by contract or otherwise*", applied where such restrictions were agreed *by way of separate contract*, in the context of a Section 459 Petition under the English Companies Act 1985.

The Court relied upon the Australian case of A. Best Floor Sanding Pty Ltd. –v- Skyer Australia Pty. Ltd [1999] VSC 170 (Supreme Court of Victoria) in which the parties had entered into a joint venture agreement containing an arbitration provision which, on its face, included any dispute relating to "*the dissolution or winding-up*" of the joint venture's business. Relying on that provision, A. Best Floor applied to the Australian Court for an Order to have the dispute referred to arbitration and for the winding-up application to be stayed. The Court relied squarely on the same logic as was applied in the Peveril Gold Mines case and held:-

> *"The arbitration clause in the joint venture agreement is null and void insofar as it purports to subject the parties to an arbitration with respect to the dissolution or winding-up of the company. The provision is null and void because it has the effect of obviating the statutory regime for the winding-up of a company. More so, the arbitration clause, if adhered to, would frustrate the contributory, Skyer Australia in its efforts to seek relief from the court under the winding-up provisions of the Law. In essence, the arbitration clause in the joint venture agreement is contrary to the provisions of the Corporations Law and cannot be applied".*

That such a contractual restriction would, in principle, be contrary to English public policy has also been supported in leading practitioner's texts[3]. Given the above, it is unsurprising that the assertion that such restrictions are contrary to public policy has formed a key basis on which Section 95(2) has subsequently been attacked in the Cayman Islands Courts (to date unsuccessfully).

Cayman Islands Case Law

The only substantive consideration of Section 95(2) of the Companies Law is to be found in the Grand Court and Court of Appeal decisions In the Matter of Rhone Holdings, L.P.[4]

The Parties

The proceedings related to Rhone Holdings, L.P. (the "**Partnership**"), a Cayman Islands exempted limited partnership. Reservoir Capital Master Fund II L.P. and a number of associated parties (the "**Petitioners**") were limited partners in the Partnership. In July 2015, the Petitioners filed a winding-up petition seeking to have the Partnership wound-up on the just and equitable ground. The Partnership had two general partners, one of which was Rhone Capital (GP) Ltd. (the "**Ritchie GP**"). The Ritchie GP was one of the respondents to the petition (the "**Respondents**").

The proceedings related to an exempted limited partnership but the key statutory provision under consideration was Section 95(2) of the Companies Law.

The Background

The Amended & Restated Limited Partnership Agreement of the Partnership (the "**Limited Partnership Agreement**") contained a comprehensive clause contracting out from the right to present a petition.[5]

The day after the petition was filed, an *Ex-Parte* application was heard and Joint Provisional Liquidators (the "**JPLs**") were appointed. Inexplicably, Section 95(2) of the Companies Law was not brought to the attention of the Court at the *Ex-Parte* Hearing. Following the appointment of the JPLs, the Respondents filed a Summons seeking an Order that the petition be struck out as an abuse of the process of the Court and the JPLs be discharged.

The Grand Court Judgement substantively addressed whether the Petitioners were precluded from presenting a winding-up petition, although, *obiter*, the Court did also comment on the English decision in In re Chesterfield Catering Co Ltd [1975] 1 Ch. 373 relating to the tangible interest rule (*see our Third Quarterly 2016 Review*).

2 Likewise, in Newton –v- Birmingham Small Arms Company Limited [1906] 1 Ch 378, resolutions passed by a company were held to be *ultra vires*, where they were found to be inconsistent with obligations imposed upon auditors under the companies legislation.

3 McPhearson's Law of Company Liquidation, Third Edition, para 4-007

4 Grand Court, 18 August 2015 and Court of Appeal, 19 November 2015.

5 The Limited Partnership Agreement was governed by Cayman Islands law and the parties submitted to the non-exclusive jurisdiction of the Cayman Islands Courts.

The Respondents' Arguments

It was not disputed that the Petitioners had contracted not to present a winding-up petition. Consequently, there was no argument (in that respect) as to the construction and interpretation of clause 5.12 of the Limited Partnership Agreement. The argument focused on public policy in the context of an exempted limited partnership.

The Respondents maintained that nothing in the ELPL was inconsistent with Section 95(2) of the Companies Law and as a consequence Section 95(2) applied equally to exempted limited partnerships. Further, it was argued that Section 95(2) is in mandatory terms and therefore the Court must dismiss (or adjourn) a petition in circumstances where the petitioner is contractually bound not to present it.[6]

The Petitioners' Arguments

The Petitioners argued, *inter alia*, that clause 5.12 of the Limited Partnership Agreement was unenforceable as being contrary to public policy. The Court had a discretion because Section 95(2) expressly permitted the Court to "adjourn" a petition. It was also argued that Section 95(2) of the Companies Law was inconsistent with the ELPL and specifically Section 36(3)(g) thereof which expressly provides that on an application by a partner, creditor or liquidator the Court may make orders and give directions for the winding-up of an exempted limited partnership as may be just and equitable; it was therefore argued that Section 36(3)(g) prevailed over Section 95(2) of the Companies Law.

The Judgement

At first instance, Justice Mangatal found as follows:-

1. It was appropriate to deal with the issue at an Interlocutory hearing before waiting for the full petition hearing;
2. Partners had the ability to agree amongst themselves to any of the matters set out in clause 5.12 of the Limited Partnership Agreement (relying on Moss –v- Elphick [1909] 1 KB 465);
3. There is nothing in Section 95(2) of the Companies Law that is inconsistent with the ELPL;
4. There is no express provision in the ELPL that would make Section 95(2) of the Companies Law inapplicable;
5. There was no public policy principle that clause 5.12 offended;
6. Section 95(2) is in "mandatory terms" and there was no reason, in this instance, to adjourn the petition;
7. The Court would only adjourn a petition (pursuant to Section 95(2)) *"if there is some useful purpose to be served"*, such as there being a creditor with an interest in having the company (or partnership) wound-up who was not contractually bound not to present a petition and who could be substituted as the petitioner;
8. Once the Court finds that a petitioner is contractually bound not to present a petition, then save for the type of circumstance which warrants an adjournment (such as the existence of an interested creditor who wished to be substituted) the petition must be dismissed; and
9. Section 95(3) of the Companies Law (setting out the Court's ability to make alternative orders on a winding-up) did not apply as the Court would need the power to order a winding-up in the first place.

Importantly, as the petition was struck out as a abuse of process, costs (which would include the JPLs costs) were awarded against the Petitioners on the indemnity basis, the Court finding that such costs were "... *incurred unnecessarily*".

The Court of Appeal Judgement

The Respondents were late in filing an appeal and as a consequence had to apply to the Court of Appeal for permission to appeal. In considering whether or not to grant permission to appeal, the Court of Appeal considered whether the application had any reasonable prospect of success.

The Court of Appeal, in a judgement by Rix JA, summarised the issue as being whether the Petitioners could avoid the consequences of the fact (as agreed) that they had contracted out of the ability to present a winding-up petition. The argument was repeated to the Court of Appeal that Section 95(2) of the Companies Law was inconsistent with Section 36(3)(g) of the ELPL and that

6 It was also argued that given Section 95(2) provisional liquidators should not have been appointed as the Petitioners could not properly make out "a *prima facie* case for a winding-up order" as required for the appointment of provisions liquidators by Section 104(2)(a) of the Companies Law.

Cayman Litigation and Dispute Resolution Q4 2016 Review

Key Contacts

Richard Annette
Head of Litigation
Tel: (345) 814-7920
richard.annette@stuartslaw.com

as a result Section 95(2) could not apply in a partnership context and furthermore that the agreement not to present a winding-up petition should be overridden as a matter of public policy given the importance of the jurisdiction of the Court to wind-up and especially so where allegedly the allegations of wrongdoing were (said to be) made out.

The Court of Appeal gave short shrift to both arguments. In respect of Section 95(2) allegedly being inconsistent with the ELPL, this was described by Rix JA as being *"... a simply impossible submission and one that has no reasonable prospect of success on appeal"*. In respect of the ability for a limited partner to contract out of its right to present a winding-up petition, the Court of Appeal found that instead of that being contrary to public policy:-

> *"... on the contrary, [this] represents the policy of the law by express enactment because the express terms of Section 95(2) give statutory strength to what would otherwise merely be a contractual agreement".*

Analysis

Although in the Rhone Holdings case this was not an issue, a preliminary question in this context will be the construction of the relevant clause. If the parties wish to contract out, clear and unambiguous wording should be used as in the Rhone Holdings case.

The Rhone Holdings case concerns exempted limited partnerships and not companies. Part of the analysis is dependent on case law specifically concerning the rights and nature of a partnership (Moss –v- Elphick). The parameters of the decision need to be viewed in that context.

In respect of whether Section 95(2) of the Companies Law can be said to be contrary to public policy in respect of companies, the starting point of any such argument, the Peveril Gold Mines decision, only concerns such restrictions in Articles of Association. In determining such restrictions in the Articles were ineffective, the English Court at first instance *expressly* relied on the right to petition not being qualified by the applicable company legislation and on appeal that the right to petition was a statutory "condition" on which the company was itself incorporated.

The position has now changed under Cayman Islands law on both counts, first, the Companies Law expressly permits the ability to contract out and secondly it is difficult to see how it can be maintained that such a right is a "condition" of the very incorporation of a company when the statute not only permits contracting out but actually makes it *mandatory*, where that has occurred, to dismiss or adjourn a Petition.

On that basis, the rationale of the Peveril Gold Mines decision can certainly be argued to no longer apply to a Cayman Islands company so that Section 95(2) is not contrary to Cayman Islands public policy in a corporate context. To the extent that the public policy objections under English law extend to a non-petition clause being invalid when made separately by way of contract, those objections also arguably no longer apply in the Cayman Islands Law given Section 95(2) of the Companies Law.

Nevertheless, the safest course, if a party is seeking to rely on Section 95(2) of the Companies Law, is to ensure that any such restriction is included not only as part of the Articles of Association but also as a matter of separate contract such as in the subscription agreement[7] and equally that full disclosure is made, in the case of Funds, in the Fund's Offering Documents.

To conclude, the present position is that it remains to be seen whether a public policy objection will succeed in respect of a Cayman company in the event a non-petition clause is contained in the Articles of Association or by way of a separate contract, but the Rhone Holdings case will certainly assist an argument that such a non-petition clause is enforceable.

This publication is for general guidance only and it is not intended to be a substitute for obtaining specific legal advice. Advice should be sought about specific circumstances. This review relates to Cayman Islands Law only as at 20 January 2017. If you would like further information please contact Richard Annette of Stuarts Humphries.

7 The governing law of any subscription document should be considered in light of any complications that may arise if not governed by Cayman Islands law.

Cayman Litigation and Dispute Resolution Q4 2016 Review

Key Contacts

Richard Annette
Head of Litigation
Tel: (345) 814-7920
richard.annette@stuartslaw.com