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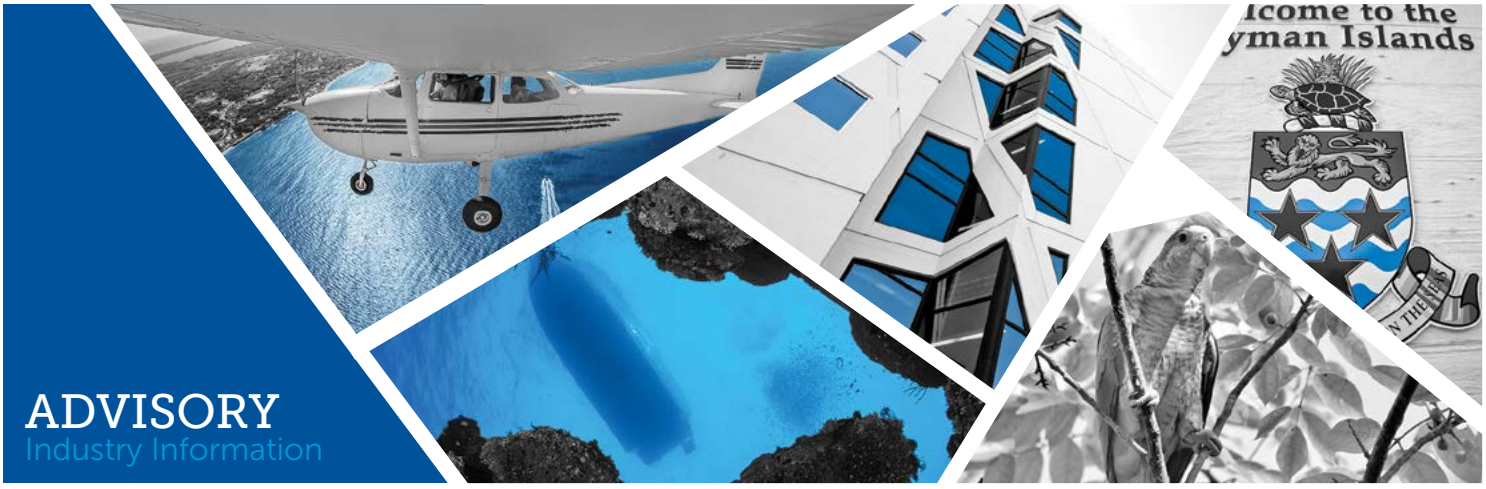

CAYMAN UPDATE:

July 2022

Grand Court warns investment managers that indemnity costs will loom large should they contest the identity of official liquidators in solvent liquidations.

Overview

In a recent decision of the Grand Court of the Cayman Islands (the "Court") concerning a supervision order in respect of a Cayman company in voluntary liquidation, Kawaley J considered the settled principles in a solvent Cayman Islands liquidation involving a dispute as to the identity of the official liquidators to be appointed.

The Proceeding

In the Matter of Sciens Alternative Assets Recovery Fund II (in Voluntary Liquidation) (the "Fund") [FSD 103 of 2022 (IKJ)], the incumbent voluntary liquidator presented a petition seeking orders to bring the voluntary liquidation of the Fund under supervision of the Court, and for the appointment of the incumbent voluntary liquidator as official liquidator of the Fund. It was common ground amongst the parties that a supervision Order should be made. The dispute arose as to the identity of the official liquidator, with the critical question arising being which party's interest should be afforded more weight: the management shareholder (seeking the appointment of the incumbent voluntary liquidator) or the majority economic shareholder in the Fund (seeking the appointment of David Griffin and Andrew Morrison of FTI Consulting (Cayman) Ltd (the "FTI Nominees")).

By way of brief background, the Fund went into voluntary liquidation by operation of the law on 1 February 2017, following the expiration of its limited term. In accordance with the wishes of the majority economic shareholder in the Fund, the management shareholder appointed the FTI Nominees as voluntary liquidators on 20 April 2021. On 25 March 2022, the management shareholder passed a resolution removing the FTI Nominees as voluntary liquidators and appointed an alternative liquidator, without notice to the FTI Nominees or the majority economic shareholder.

Kawaley J prefaced his analysis of the legal principles at play with the reminder that the "*dominant commercial interest to be taken into account in a solvent liquidation were clearly those of shareholders*". In this case, that interest was predominantly the 76.4% shareholder in the Fund. Whilst the management shareholder had solicited the support of a minority shareholder for the appointment of the incumbent voluntary liquidator, that support was given little weight in circumstances where its support comprised a two word email ("We support"), and it did not put on any evidence of its own or appear at the hearing of the supervision petition.

Kawaley J noted in his judgment that it was settled Cayman Islands law that "*where a fund company is being wound-up on a de facto solvent basis, the interests of the participating shareholders are given precedence over the interests of the management shareholder as regards the course of the winding-up and the identity of the voluntary or official liquidators", as clearly established in the Adamas Asia Strategic Opportunity Fund Limited* (et al) [2020 (1) CILR 134] decision. On this basis, Kawaley J found that there should not have been any reasonable controversy that the economic stakeholder's wishes as to the identity of voluntary or official liquidators should ordinarily prevail in relation to a company's winding-up. The views of a majority stakeholder may be overridden or not given effect to by the Court, if they lack objective validity. The objective merits of the stakeholder views being advanced will almost invariably be a significant guide as to whether the relief being contended for should be granted or not.

Kawaley J summarised the principles applicable to stakeholder views regarding the appointment of official liquidators (at [21]):

1. The majority stakeholder views are potentially always entitled to considerable deference, provided they pass a minimum objective validity test.
2. Economic stakeholders are best able to judge what is in their best commercial interests.
3. Factors like incumbency and knowledge obtained in related appointments, whilst relevant, are unlikely to carry the same evaluative weight in all cases.
4. Deciding who the official liquidator should be must ultimately be in accordance with the interests of relevant stakeholders as a whole.

Decision

The majority economic shareholder's desire to appoint the FTI Nominees was found to be objectively reasonable in the circumstances. The management shareholder was unable to displace this strong starting assumption, despite the potential for non-alignment in shareholder interests, arising by virtue of the support from a minority shareholder for appointment of the incumbent voluntary liquidator. The FTI Nominees were not the subject of any conflict of interest, and the management shareholder was unable to present any evidence to displace the strong starting assumption that the views of the majority economic shareholder should prevail. The Court was therefore satisfied that it should appoint the FTI Nominees.

Costs

A further point of significant interest in this case arose from Kawaley J's observations on costs (this having been the third time this issue has been before the Court in recent times), with His Lordship laying down an important marker for any future applications (at [33]):

> *"... costs on the indemnity basis are likely to loom large in future cases where a management shareholder without good and substantial cause makes another unsuccessful attempt to prevent those most interested in a liquidation from reasonably directing its course."*

These comments provide a clear warning that management shareholders should act carefully in contesting the interests of the primary economic stakeholder(s), without just cause, in future solvent liquidations.

Barnaby Gowrie (Partner), Chris Keefe (Senior Counsel) and Sam Hall (Associate) of Walkers act for the majority economic shareholder, which was wholly successful in obtaining (i) the appointment of the FTI Nominees as official liquidators, and (ii) costs against the management shareholder.

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