Understanding the inspectorship remedy in the Cayman Islands

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The Grand Court of the Cayman Islands has recently seen an uptick in applications by aggrieved shareholders of Cayman-incorporated companies for the appointment of inspectors under s 64 of the Companies Act (2023 Revision). The inspectorship remedy, which allows the Court to appoint inspectors to investigate and report on the affairs of a Cayman company, has historically been rarely used by shareholders of Cayman companies,[1] and the recent increase in inspectorship applications may be attributable to a broader increase in shareholder activism in the context of ongoing global economic uncertainty.

In three recent decisions, the Grand Court was asked by aggrieved shareholders to consider whether to appoint inspectors. However, in only one of those decisions was the applicant successful. The recent decisions provide helpful guidance on the circumstances in which a Court will appoint inspectors and illuminate the broader purposes and benefits of the remedy.

The Cayman legislative scheme

Section 64 of the Companies Act empowers the Grand Court to appoint one or more inspectors to examine a company's affairs[2] and to prepare a report to be filed with the Grand Court on the application of members holding at least 20% of the issued shares in the company.[3]

The inspectors are given very broad statutory powers to:

- compel officers and agents to produce all books and documents in their custody or power for examination; and
- examine company officers and agents under oath in relation to the company's business.[4]

Once the investigation has concluded, the inspectors file a report with the Grand Court (not the applicant shareholder) setting out their opinions which is not available for public inspection unless the Court directs.[5] The inspectors' report is admissible in legal proceedings as evidence

of the opinion of the inspectors in relation to any matter contained in the report,[6] but is not necessarily admissible as evidence of fact.[7] Despite the broad terms of the statutory powers, the inspectors' investigation must have a purpose and focus, and the Court will usually define the purpose and focus in its order of appointment.[8]

The recent decisions

Re Unicon Holdings

The first of the three recent inspectorship judgments was the decision of Segal J in *Re Unicon Holdings*[9] (***Unicon***) which involved an applicant shareholder who held 50% of the shares in a company co-owned with her ex-husband. Following the applicant's divorce, a judgment debt was granted in her favour which was secured over 50% of the company's shares. After the ex-husband defaulted on making payments to the applicant, she exercised her rights as secured creditor over the shares and had them registered in her name.

The applicant wrote to the company requesting certain company documents including minutes of meetings, copies of written resolutions, financial statements and documents relating to the transfer of assets. However, when no response was received, the applicant sought the appointment of inspectors on the basis that she had received no information about the performance of the company or its subsidiaries since she became a member.

Segal J found on the facts that the application was justified in the circumstances given the applicant's need to establish the value of her shares, the financial position of the company and its subsidiaries and whether further action needed to be taken on her part.

Re Avivo Group

In the next decision of *Re Avivo Group****[10]*** (***Avivo***), an applicant shareholder sought orders for the appointment of inspectors to examine the affairs of a company on the basis of its corporate governance arrangements. The company's investment manager had a strong constitutional position and ordinary shareholders had no power to remove it as manager. In addition, the board was dominated by directors appointed by a related party to the manager (although the applicant shareholder had its own nominee). The company's articles also did not give shareholders the right to inspect its books and records.

The applicant shareholder wrote to the company setting out its concerns about the manager, including some of its investment decisions and that it was invoicing the company for management fees whilst providing no apparent management services. The company responded offering to meet with the applicant shareholder and to support the appointment of independent directors. This did not satisfy the applicant who sought the appointment of inspectors.

However, after setting out in detail the threshold criteria for the appointment of inspectors,

Parker J found that the applicant had not clearly established grounds for the appointment as he had not shown that the company had ignored concerns or concealed matters.[11] Rather, Parker J observed that the evidence instead showed that the company had done its best to answer the substantive points raised by the applicant.[12]

Re Jutal Offshore Oil Services Limited

The most recent inspectorship decision of Kawaley J in *Re Julal Offshore Oil Services Limited*[13] (***Julal***) involved an applicant shareholder which had lost control of the board of directors of a Hong Kong Stock Exchange listed company and was involved in a hotly contested takeover battle with other shareholders. The applicant shareholder filed two sets of proceedings in Hong Kong against the company and unsuccessfully sought to appoint independent directors. Injunctions were granted by the Hong Kong Court to prevent the issue of further shares which was said to be improperly motivated by the majority faction's desire to increase their control.

The misconduct complained of by the applicant in support of the appointment was related to the ongoing takeover battle, including findings by the Hong Kong Court that the board had breached its duty by failing to give fellow directors sufficient information, the company's financial condition, the alleged dilution of the applicant's shares and procedural complaints. However, applying the principles outlined in *Avivo*, Kawaley J found that none of this conduct rose to the level of requiring the appointment of inspectors.

The jurisdictional threshold

Unlike the English remedy, which requires the applicant shareholders to show "good reason" for requiring the investigation,[14] there is no jurisdictional threshold set out in the Companies Act and the matter is left at large for the Court to fashion the applicable principles. Accordingly, the threshold criteria for exercising the jurisdiction that can be extracted from the above decisions (particularly Parker J in *Avivo*) are as follows:

- The appointment of inspectors is fact sensitive and dependent on the discretion of the Court.[15] The appointment is exceptional in the sense that the Court will not, without good reason, appoint inspectors over a company.[16]
- The appointment of inspectors is a serious step which may have severe reputational implications for the company and the Court should therefore balance the competing interests of the parties.[17] The Court will take into account the cost and potential reputational implications of the appointment when exercising its discretion and will be unlikely to exercise the power to appoint if some alternative, less expensive and intrusive option or remedy is available.[18]
- An order for the appointment of inspectors should only be made on a strong likelihood, well founded on a solid and substantial basis, of some grave misconduct, mismanagement or concealment which related to the management of the company.[19]

- A shareholder cannot appoint inspectors as a matter of right.[20] Before an order will be made, the Court needs to understand what is to be investigated and why the applicant needs the information or opinions sought.[21] The applicant must show that they have a good reason and proper justification for obtaining the information.[22]
- The Court should satisfy itself that the application is brought for a genuine and not collateral or improper purpose and that the remedy is appropriate and proportionate.[23]
- The Court should take into account the weight of shareholder support, although this is not a determinative factor.[24]

The inspectors' investigation

The recent cases suggest that key factors in the success of an inspectorship application will include (i) the specificity by which the terms of the investigation and required information or opinion is identified in the application, (ii) whether the shareholder is entitled to that information and (iii) whether the information has been improperly withheld by the company.

In *Unicon*, Segal J found that the applicant was seeking information that was "highly material" to the value of her shares and position as a member and her focus was on obtaining information relating to the value of her shares and her rights as a shareholder,[25] having only just become a shareholder following a default by her husband of his obligations following their divorce. The investigation to be conducted was narrow and limited to ascertaining the value of the applicant's shares. In addition, the information she sought was being improperly withheld and Segal J noted that the company's abject failure to provide the information requested made it necessary to bring the application.[26]

By contrast, in *Avivo*, it was relevant that although the articles did not allow ordinary shareholders access to the books and records, such books and records were available to the directors and the applicant shareholder had its own nominee on the board. No evidence was adduced suggesting that the applicant's nominee had been denied access to materials.[27] Accordingly, it was not clear to Parker J what the applicant aimed to achieve from the investigation which was widely drawn.[28]

In *Julal*, the company's listed status was relevant to the decision to deny the application, with Kawaley J finding that whilst shareholders in closely held private companies could legitimately expect generous access to information, in publicly listed companies where there are no regulatory concerns from the listing authority, the case for access for information would have to be quite clear to be acceded to.[29]

(Mis)conduct of the company

In *Avivo*, after examining many of the authorities from other jurisdictions, Parker J settled on the

test as requiring "*serious misconduct, mismanagement or concealment*". Kawaley J subsequently adopted this test in *Julal*,[30] and it is likely to be the benchmark test adopted in future cases.

In *Unicon*, the relevant conduct was concealment, as the company's refusal to provide documents which the applicant was entitled to, coupled with its breach of its statutory obligations by failing to maintain a registered office, was enough for Segal J to identify legitimate concerns regarding the company's management and financial position.[31]

However, in *Avivo*, it was critical that the company had shown an openness to providing information and addressing the concerns of the applicant shareholder. In any event, Parker J found that a failure of corporate governance had not been made out and the evidence showed that the Board had "a number of experienced directors with access to good professional advice."[32]

In *Julal*, although there was evidence of antagonistic conduct by the board aligned shareholders vis-à-vis the applicant shareholder, Kawaley J was careful to note that it took place in the broader context of a heated takeover battle and that what one faction does to another in the heat of a takeover battle is not a reliable indicator of probity of the company's corporate governance systems overall.[33]

Evidence in support of the application

The evidentiary standard for inspectorship applications is high and an applicant must establish that the grounds for the appointment exist based on "a strong likelihood, well founded on solid and substantial basis".[34] As such, the evidence in support of the application must be clear and compelling in order for the Court to accede to the application.

In *Avivo*, Segal J noted that all of the evidence in support was on affidavit, and he had no reason to disbelieve the evidence of the company in the absence of cross-examination or contradictory contemporaneous documents.[35] Similarly, in *Julal*, although the Hong Kong Court granted an injunction on the basis of a breach of duty relating to the board's failure to provide directors with sufficient information, Kawaley J noted that this finding was based on affidavit evidence which does not give the findings the same persuasive weight.[36]

These findings suggest that, in heavily contested cases, an applicant may wish to consider calling witnesses of fact to give oral evidence and be cross-examined.

Conclusion

The inspectorship remedy remains a useful information-gathering tool for shareholders in Cayman companies who feel "left in the dark" in potential instances of minority oppression or corporate misfeasance. An inspectorship application offers a more proportionate remedy for

shareholders and allows them to make an informed decision as to the possible next steps as it is less invasive than more "nuclear" options such as presentation of a just and equitable winding up petition, seeking the appointment of provisional liquidators and/or bringing a derivative action on behalf of the company against the potential wrongdoers.

However, the above cases illustrate that the appointment of inspectors is not a step which the Court will take lightly and it remains an extraordinary remedy which will only be granted in specific circumstances. Shareholders concerned about potential corporate wrongdoing should carefully consider whether the grounds are made out, seek strong and cogent evidence of misconduct and frame the proposed investigation narrowly to target information that is likely to resolve their concerns.

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[1] Until recently, the inspectorship remedy appears to have been rarely used in the Cayman Islands, with the first and only reported judgment (prior to the three decisions examined in this article) being a decision of Henderson J in *Re Fortuna Development Corporation* [2004-05 CILR 197].

[2] English cases have defined the "affairs of the company" broadly to include *"its goodwill, its profits or losses, its contracts and assets including its shareholding in and ability to control the affairs of a subsidiary, or perhaps in the latter regard a sub-subsidiary": R v Board of Trade Ex p. St Martin Preserving Co Ltd* [1965] 1 QB 603 at 613.

[3] In the case of a "banking company", the members must hold one third of the issued shares in the company: Companies Act, s 64(a). An inspector may also be appointed by a special resolution of members: Companies Act, s 67.

[4] Companies Act, s 65.

[5] Companies Act, s 66.

[6] Companies Act, s 68.

[7] *Savings and Investments Bank v Gasco* [1984] 1 WLR 271.

[8] *Fortuna* at [19].

[9] (Unreported, Segal J, 21 November 2022).

[10] (Unreported, Parker J, 16 December 2022).

[11] *Avivo* at [67].

[12] *Avivo* at [70].

[13] (Unreported, Kawaley J, 30 March 2023).

[14] Companies Act 1985 (UK), s 431(3).

[15] *Avivo* at [41(a)].

[16] *Julal* at [5].

[17] *Avivo* at [41(b)], [72].

[18] *Unicon* at [41]; *Avivo* at [41(o)].

[19] *Avivo* at [41(g)-[h)] citing *Re San Imperial* HCMP 179/1978; *Re Mercantile Finance* (1893) 12 NZLR 248; *Nafte v Allied Minerals Ltd* 1966 (3) SA 94; *Sage Holdings v Unisec* [1982] 1 WLD 337.

[20] *Avivo* at [41(e)] citing *Re Mercantile Finance* (1893) 12 NZLR 248.

[21] *Unicon* at [41]; *Avivo* at [41(l)].

[22] *Unicon* at [41].

[23] *Avivo* at [41(n)].

[24] *Avivo* at [41(m)].

[25] *Unicon* at [29].

[26] *Unicon* at [30].

[27] *Avivo* at [69].

[28] *Avivo* at [75].

[29] *Julal* at [19].

[30] *Jutal* at [29].

[31] *Unicon* at [45].

[32] *Avivo* at [68].

[33] *Jutal* at [21].

[34] *Avivo* at [71(h)].

[35] *Avivo* at [63]-[67] citing *Long v Farrer* [2004] EWHC 1774 Ch at [57].

[36] *Julal* at [21].

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