Focus on fraud and asset tracing: Cayman Grand Court opens the door to investor claims against companies

Insights - 06/12/2023

This article will look at the recent decision of David Doyle J in *In the Matter of HQP Corporation Limited (in Official Liquidation)* (7 July 2023) and its effect on the ability of investors to recover damages from a company in which they have acquired shares as a result of a fraudulent misrepresentation.

Introduction

The case involved an application by liquidators for direction in relation to three issues in the winding up of the Company:

1. whether Preferred Shareholders who had submitted redemption requests remained members of the Company or became creditors in respect of their unpaid redemption proceeds
2. whether the Preferred Shareholders could assert claims against the Company for damages for misrepresentation in relation to their subscription for shares in the Company
3. to the extent the misrepresentation claims were available, how they should rank in the liquidation of the Company

Issue one: the status of shareholders who had submitted redemption requests

The answer to issue one focused on the construction of the Company's Articles of Association. It was agreed that the Preferred Shareholders remained unredeemed shareholders of the Company in respect of any instrument which had been the subject of a redemption request. This was not a case, like *Culross Global SPC v Strategic Turnaround* [1] and *Re Herald SPC*, [2] where it was possible under the Articles for a redeeming shareholder to be fully redeemed (and so cease to be a member)

and yet remain unpaid and become a creditor for the redemption price. [3]

Issue two: whether shareholders could claim against the Company for damages

Issue two was hotly contested, and in part at least, required the Judge to decide whether he should follow a decision of the English House of Lords from 1880 or a much more recent decision of the High Court of Australia.

This gave the Judge the opportunity to consider the role that English case law plays in Cayman Islands law and the circumstances in which the Cayman Islands Court can decline to follow a decision of the English Court, and instead follow the decision of some other common law Court, such as the Australian Court. It is well known that English cases are not binding in the Cayman Islands, but the judgment contains an illuminating discussion of the circumstances in which the Cayman Islands Court may decline to follow a decision of the English Court. [4]

All this was by way of prelude to the main question on issue two, which the Judge described as follows:

"74… should this Court reasonably be expected to follow a[n English] House of Lords decision from 1880 which has been much criticised, abandoned by the UK Parliament and not followed by the High Court of Australia or by the Supreme Court of the Bahamas at first instance?"

The House of Lords case in question was *Houldsworth v City of Glasgow Bank*, [5] and it is generally taken to be authority for the proposition that a person who has been induced to buy shares in a company as a result of a misrepresentation cannot sue the company for damages unless the allotment is rescinded, and that once a company has entered liquidation rescission was impossible.

In the High Court of Australia case, *Sons of Gwalia Ltd v Margaretic*, [6] the Court held that the shareholders could sue the company for damages and that their claim ranked with those of the unsecured creditors.

The question of priority was subsequently changed by the Australian Parliament, by the Corporation Amendment (Sons of Gwalia) Bill 2020, which subordinated the claims of such shareholders below the claims of other creditors. This was apparently as a result of lobbying by lenders. However, that part of the decision that held that a claim could be made was left unchanged.

Doyle J followed *Sons of Gwalia* and held that debts arising from claims for damages for misrepresentation fell within the wide wording of Section 139(1) of the Companies Act 2023, [7] saying:

"166… this is one of those rase cases in which this court is justified, indeed, obliged to decline to follow an English decision."

As to why the Grand Court considered that the English case was wrong and the Australian case was right, the judgment is quite lengthy. But one reason given was that the separation between a shareholder and the company was not so well-developed in 1880 as it is today. Indeed, the company in *Houldsworth* had some features that might be regarded today as being more like those of a partnership than a company.

In another recent Cayman Islands case, *Re Direct Lending Feeder Fund Ltd*, [8] Segal J recorded that the Joint Official Liquidators had been advised that it was an open question under Cayman Islands law whether a shareholder who had been induced by a misrepresentation to subscribe for shares could claim damages against a company in liquidation. This was said to be because *Houldsworth* was arguably inconsistent with section 14 of the Contracts Act (1996 Revision) (which is in similar terms to section 2(1) of the Misrepresentation Act 1967 in England), which clearly permitted a plaintiff to sue for damages for misrepresentation without rescinding the contract. This would seem to provide another reason why the Cayman Islands Court could decline to follow *Houldsworth*. [9]

Counsel for the creditors in *HQP Corporation Ltd* regaled the Judge with arguments that he should not depart from *Houldsworth* because it would have, "a serious impact on the willingness of lenders to lend," and "open the floodgates to investor claims," but to no avail.

Issue three: where do misrepresentation claims rank?

On the third issue, the Judge held that the misrepresentation claims rank as unsecured debts of the Company. This was on the basis that they were not shareholder debts but creditor debts. In doing so, he followed the decision of the High Court of Australian in *Sons of Gwalia* as well.

Conclusion

HQP Corporation Ltd is therefore welcome news to investors who have purchased shares in a Cayman Islands company on the strength of a misrepresentation, including a fraudulent one.

On 11 August 2023, Doyle J gave the creditors leave to appeal to the Cayman Islands Court of Appeal. Interestingly, he did so on the grounds that the case gave rise to an issue of public interest rather than because he thought that the appeal had a realistic (as distinct from a fanciful) prospect of success. [10]

[1] [2010 (2) CILR 364]

[2] [2016 (2) CILR 330] (CICA); [2017 (2) CILR 75] (PC))

[3] As the Privy Council said in *Culross Global SPC v Strategic Turnaround* at paragraph [16]: "The existence and extend of any power to suspend the payment of redemption proceeds after the redemption date is a subject upon which members are at liberty to make 'any contract inter se which

they pleased' as the Earl of Selborne, L.C. said in *Walton v Edge* (1884) 10 App. Cas. 33 at 35."

[4] Paragraphs [70] to [74]

[5] (1880) 5 App Cas. 317 (H.L. (Sc.))

[6] [2007] HCA 1; [2007] 3 LRC 462

[7] Section 139(1): "All debts payable on a contingency and all claims against the company whether present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company and the official liquidator shall make a just estimate so far as is possible of the value of all such debts or claims as may be subject to any contingency or sound only in damages or which for some other reason do not bear a certain value."

[8] *Unreported, FSD 108 of 2019 (10 November 2022)*

[9] Doyle J referred to *Direct Lending*, briefly, at paragraph [116] of *HQP Corporation Ltd*

[10] These are the two grounds on which leave to appeal can be given: see *Wang v Credit Suisse AG* (unreported FSD judgment delivered on 10 May 2022) referring to *Telesystem International Wireless Incorporated v CVC/Opportunity Equity Partners LP* [2001 CILR N-21 (Grand Court: Sanderson J) amongst many other cases. Doyle J also thought that the status of foreign (including English) authorities in the law of the Cayman Islands should be considered by the CICA in the public interest.

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