

Commencing proceedings against a Cayman Islands company in liquidation

Insights - 18/02/2021

The Grand Court of the Cayman Islands (the "**Grand Court**") recently considered the statutory moratorium against commencing proceedings against a Cayman Islands company which has been placed into liquidation. In the case of *BDO Cayman Ltd. and BDO Trinity Ltd. v Ardent Harmony Fund Inc. (in Official Liquidation)*^[1] the Grand Court held that a plaintiff which launches originating proceedings against a company in liquidation, seeking adverse orders against that company, "*patently requires leave*" of the Court to bring the proceedings. The Grand Court also held that the plaintiffs in that case did not have "*a case worth entertaining*" in respect of either basis on which they had brought the applications in question.

Background

Ardent Harmony Fund Inc. (in Official Liquidation) ("**Ardent**") is a Cayman Islands fund which invested in receivables financing by way of contractually engaged Credit Advisors. One of those Credit Advisors defrauded Ardent of approximately 90% of its assets under management, with the result that Ardent was placed into official liquidation in 2016.

In November 2019, Michael Pearson and Andrew Childe of FFP Limited, the Joint Official Liquidators ("**JOLs**") of Ardent, commenced proceedings on Ardent's behalf against BDO Trinity Ltd ("**BDO Trinity**"), in the Supreme Court of the State of New York, Nassau County (the "**New York proceedings**").

In April 2020, BDO Trinity and Ardent's statutory auditor, BDO Cayman Ltd ("**BDO Cayman**", and together with BDO Trinity, "**BDO**"), took out an Originating Summons against Ardent, seeking anti-suit injunctions to restrain the New York proceedings and damages, on the basis the New York proceedings had been brought in breach of:

- a. the engagement letters entered between Ardent and BDO Cayman in respect of BDO's audits of Ardent; and

- b. a tolling agreement in place between Ardent, BDO Cayman, BDO Trinity and other BDO affiliates, which suspended Ardent's claims against BDO pending the resolution of claims brought against BDO by another Cayman fund called Argyle Fund SPC ("**Argyle**"), which was defrauded by the same Credit Advisors.

Unusually, BDO did not seek leave of the Grand Court to commence the proceedings, as required by section 97 of the Companies Act (2020 Revision)^[2] ("**section 97**"), before taking out the Originating Summons. Instead, BDO sought section 97 leave as the first item of relief in its Originating Summons. In response to a Summons taken out by Ardent, the Grand Court considered whether BDO required leave under section 97, and whether it would grant such leave, as preliminary issues in BDO's application for an anti-suit injunction.

Section 97 principles

Section 97 provides that:

1. When a winding up order is made or a provisional liquidator is appointed, no suit, action or other proceedings, including criminal proceedings, shall be proceeded with or commenced against the company except with the leave of the Court and subject to such terms as the Court may impose.
2. When a winding up order has been made, any attachment, distress or execution put in force against the estate or effects of the company after the commencement of the winding up is void.

Relevantly, section 97(1) imposes a moratorium on commencing or continuing proceedings against a Cayman Islands company in liquidation without leave of the Grand Court.

In its decision, the Grand Court held that the rationale of section 97(1) was:^[3]

"...that a company in liquidation is not to be harassed and its assets wasted by unnecessary litigation, and the leave of the Court is therefore required as a safeguard. Before any action can be brought or continued against a company, the court must investigate the intended litigation."

The Court then considered the relevant authorities for section 97, and found that:

"The principles to be extracted from the case law governing section 97 leave are that:

(1) The applicant for leave must first establish an arguable case to be litigated;

(2) If it establishes an arguable case, the Court then has to consider whether it would be fair, in the context of the liquidation as a whole, for the JOLs to have to deal with the

burden of that litigation. The Court's discretion is wide and unfettered - there is no presumption in favour of or against giving leave - and each case turns on its own facts;

(3) In deciding what would be fair, the Court can give s. 97 leave subject to conditions subject to a consideration of what would be fair, in the context of the liquidation as a whole.

BDO's application

(a) Defensive Proceedings

BDO contended that it did not in fact require leave of the Grand Court to commence its application for anti-suit injunctions against Ardent, on the basis that its application was "*defensive in nature*". This contention relied on a series of English decisions, which were to the effect that a company could not commence proceedings itself then subsequently use the equivalent of section 97 to stymie the defendants.

The Grand Court held that these decisions were not applicable authority, in circumstances where BDO Cayman is not a party to the New York proceedings and was not:

1. appealing a judgment in favour of the liquidators;
2. making an application for security for costs as a defendant in proceedings instituted by the company in liquidation;
3. bringing a counterclaim in a suit brought by the company in liquidation; or
4. seeking costs against the company.

Rather, the Grand Court held that "*BDO has launched originating proceedings against Ardent seeking adverse orders against the company, and patently requires leave.*"

(b) Audit Engagement Letters

BDO sought an anti-suit injunction to restrain Ardent from continuing the New York proceedings on the basis of a sole recourse clause in the audit engagement letters, pursuant to which Ardent agreed that it would not pursue a claim against any affiliate of BDO Cayman, which includes BDO Trinity, unless the claim was founded on an allegation of fraud or wilful misconduct or other liability that cannot be excluded under applicable laws (the "**carve out**"). BDO contended that the pleadings in the New York proceeding, which alleged fraud and gross negligence, were defective as a matter of New York law, and so did not fall within the carve out in the sole recourse clause.

The sole recourse clause was in terms materially the same as the clause considered by the Grand Court then the Court of Appeal ("**CICA**") in the Argyle proceeding.^[4] In the Argyle case, the

Grand Court at first instance granted the requested anti-suit injunction restraining proceedings against BDO Trinity, however the CICA reversed this decision, holding that the claims Argyle had filed in New York (also materially the same as those filed by Ardent) fell within the carve out. The CICA held that claims against the BDO affiliates falling within the carve-out were not subject either to arbitration or to the exclusive jurisdiction clause in the agreements made between BDO Cayman and Argyle.

In respect of the Audit Engagement Letters in the Argyle proceeding, the CICA held that:

"...it is manifest that these claims are founded on an allegation of fraud or wilful misconduct within the wording of the carve-out. They may not comply with the pleading requirements in England and the Cayman Islands, but Mr. Laffey deposed in his affidavit that they complied with New York's pleading requirements and there was no admissible evidence to the contrary.

and:

"...the intended effect of the carve-out was that Argyle should be free to bring claims that fall within the carve-out in judicial rather than arbitration proceedings".

In its decision, the Grand Court considered that the CICA had considered the claim in professional and gross negligence made at paragraphs 221-234 of Argyle's New York complaint to be a claim of wilful misconduct falling within the carve-out, whatever the deficiencies in the pleadings might be as a matter of Cayman law. On this basis the Grand Court held that: "As Ardent makes similar allegations of professional and gross negligence against BDO Trinity, I see no reason for this Court to give the question any new consideration."

The Grand Court further held that:

"...the mere fact that BDO Cayman has a lawyer who will say that Ardent's claims do not, in fact, comply with New York pleading requirements, does not mean they have a case which is 'worth entertaining'. Even if I were wrong, and the fact that there would be dueling opinions on New York law is a basis for holding BDO Cayman has an arguable case that the pleadings are inadequate, then I would also hold that the inadequacy of the pleadings has already been raised in the New York proceedings by BDO Trinity, that the New York Court is best suited to determine a question of New York law and that I should not grant leave."

For these reasons, the Grand Court held that it would not be right or fair to Ardent's creditors to require Ardent's Liquidators to deal with a challenge to the adequacy of the pleadings in the New York proceeding on two fronts, and that the costs of doing so would be an undue burden on the liquidation estate of Ardent.

(c) Tolling Agreement

BDO also sought an anti-suit injunction on the basis that Ardent had breached a tolling agreement made between Ardent and BDO, which suspended the limitation period for Ardent's threatened claims against BDO Cayman and its affiliates, pending the resolution of an anti-suit injunction application by BDO Cayman concerning Argyle. BDO contended that Ardent had commenced the New York proceedings before the end of the tolling period, and so BDO was entitled to strictly enforce the agreement, such that Ardent's claims in New York should be restrained.

The purpose of the agreement was to toll all and any limitation periods in order to preserve Ardent's right to pursue its intended claims. The original agreement provided that the tolling period would accrue from the tolling date until 30 days after final resolution of the Argyle proceedings. This period was extended on three occasions, the final extension providing for the agreement (and the tolling period) to end 14 days after the final resolution of any appeal in the Argyle proceedings.

BDO Cayman did not pursue its appeal to the Privy Council from the decision of the Court of Appeal dismissing the anti-suit injunction granted by the Grand Court against Argyle. The parties to those proceedings signed a Consent Order that the Privy Council appeal be dismissed on 4 November 2019. BDO Cayman thereafter advised the Registry of the Privy Council that it wished to withdraw its Notice of Appeal. The Registrar advised in turn that a formal application to withdraw the appeal had to be made. This application was made on 7 November 2019 and, on 25 November 2019, the Registrar dismissed the appeal on the terms agreed by the parties.

Ardent, which was not a party to the Argyle proceedings, commenced the New York proceedings on 18 November 2019 – 14 days after the parties to the Argyle proceedings agreed to dismiss the Privy Council appeal. BDO contended that that there was no question that this was a clear breach of the tolling agreement and that BDO was entitled to strictly enforce the terms of their agreement and ask the Grand Court to restrain the New York proceedings.

In response, Ardent contended that the bargain between the parties was not to commence the New York proceedings before a particular day, not that there should be no proceedings or that the proceedings should not continue, and that BDO had not suffered any loss by reason of the New York proceedings being commenced 5 days before the date of expiry of the tolling period. In reply, BDO contended that it had lost a limitation defence which would otherwise have been open to it, and had accordingly lost the costs of defending the New York proceeding.

The Grand Court held that BDO had lost nothing, because BDO Cayman is not a defendant to the New York proceedings and, were it not for the Tolling Agreement, Ardent would have filed its suit in 2017 to preserve its position and BDO Trinity would be defending it.

On this basis, the Court held that:

The breach was a technical breach. The fact is the Argyle proceedings were effectively at an end the moment BDO Cayman agreed with Argyle on terms not to pursue its appeal to the Privy Council, whatever formalities remained. The purpose of the Tolling Agreement was to stop Ardent from commencing proceedings until the Argyle Proceedings were concluded, and Ardent's agreement was secured on the basis that all periods of limitation and repose would be suspended. The purpose of the agreement was achieved. For that reason I hold BDO has not established that it has a case worth entertaining. If I were wrong in so holding, and the mere fact of the breach meets the threshold of "an arguable case," then I would refuse the application on the ground that BDO has suffered no loss.

The decision of the Grand Court provides helpful and succinct guidance on the purpose, meaning and application of section 97, and we understand it has already been referred to in another application for section 97 leave. BDO sought leave to appeal the decision, but the Grand Court refused to grant leave on 18 January 2021.

William Jones and Sam Keogh of Ogier's Cayman Islands Dispute Resolution team acted for the JOLs of Ardent in this proceeding, and instructed Clare Stanley QC of Wilberforce Chambers in London to appear at the hearing.

[1] FSD 74 of 2020 (MRHJ) (unreported, 19 November 2020).

[2] Formerly the Companies Law; Cayman Islands Laws have recently been renamed Acts pursuant to the *Citation of Acts of Parliament Law, 2020*.

[3] Referring to the Australian decision of *Vagrand v Fielding* 113 ALR 128, in turn citing *Thompson v Mulgoa Irrigation Co Ltd*. (1893) 4 BC (NSW) 33 .

[4] *Re Argyle Funds SPC Inc. (in Official Liquidation)* [2018 (1) CILR 114] and *Argyle v BDO Cayman Ltd* [2018 (2) CILR 362].

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