

UPDATE

Strike Out Applications: The Perils of Putting the Cart Before the Horse

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Last month, the Cayman Islands Court of Appeal (the **CICA**) handed down a comprehensive judgment analysing important questions relating to the availability and purpose of just and equitable winding-up petitions as a statutory remedy in Cayman. In doing so, the CICA overruled a judgment of the Grand Court, which had struck out a contributory's petition brought by Tianrui (International) Holding Company Limited (the **Petitioner**) against China Shanshui Cement Group Limited (the **Company**). In its judgment, the CICA warned against reaching premature conclusions on a strike out application.

We previously reported the Cayman Grand Court's initial judgment, in which it struck out a shareholders' just and equitable winding-up petition. You can read that earlier update [here](#).

On 5 April 2019, the Cayman Islands Court of Appeal (**CICA**) allowed the Petitioners' appeal against that strikeout.

The facts

The background facts, set out in our earlier update, concerned a long-running struggle between rival shareholders of China Shanshui (the **Company**), regarding the control of that company. The Petitioner was a significant shareholder which, between 2015 and May 2018, had controlled the Company's board of directors. Subsequently, two rival major shareholders obtained control over the Company, and replaced the Petitioner's board nominees with their own.

The Petitioner's main complaints arose from an issue of convertible bonds by the Company in late 2018, after the change of directors, which the Petitioner considered to be part of a wider offensive designed to dilute its shareholding to render it incapable of resisting certain special resolutions, paving the way for a squeeze-out merger by those two other major shareholders.

The Grand Court's decision

The Grand Court initially struck out the winding-up petition on the grounds that:

- (a) the Petitioner had alternative remedies available to it, which it had unreasonably failed to pursue; and
- (b) the petition had been brought for an improper collateral purpose.

Ms Justice Mangatal (the **Judge**) found that the Petitioner had several alternative remedies to a petition, including a Writ action against the Company and an application for declaratory or injunctive relief, but that it had pursued a petition for the improper purpose of obtaining the equivalent of an injunction without providing an undertaking in damages or meeting the other requirements of an injunction application.

The CICA's ruling

Two complaints

The CICA noted that the Petitioner had made two main factual complaints¹.

The first (in time) was that during the period in which the Petitioner had been in control of the Company's board of directors, the two rival shareholders had conspired to prevent the Company having control over its principal subsidiary, which was its most valuable asset. Such steps included:

- (a) the removal from the Group's office in Hong Kong of books, records, data and computers belonging to the Company and its subsidiaries;
- (b) the removal of the principal subsidiary's chop (its official seal), without which it could not conduct business in the PRC; and
- (c) the unlawful alteration of the subsidiary's articles of association to entrench existing management and remove financial oversight.

The Petitioner's second complaint concerned the convertible bonds which the CICA described as *merely the latest stage in the conspiracy*.

Just and Equitable Petitions

The CICA initially noted that:

- the only gateway to any alternative relief under section 95(3) of the Companies Law is to establish that it would be just and equitable for a winding-up order to be made in respect of the Company; and
- a company may be wound up on the just and equitable ground if it is established that there has been a justifiable loss of confidence in management, for example on account of serious misconduct or serious mismanagement of the affairs of the company by its directors or majority shareholders.

In this case, the Company's challenge to the petition was not based on an assertion that there was no basis on which a court could find that the Petitioner had justifiably lost confidence in the Company's management. Its challenge rested solely on the asserted availability of alternative remedies and the allegation that the petition had been brought for an improper collateral purpose. Aligned with that position, the Company argued that the presentation of the petition had the potential to cause it reputational and financial damage.

High Threshold for Strike-Out Applications

The CICA observed that a strikeout application is *not the place for the resolution of factual issues*, a point that the CICA regarded as having been recognised by the Grand Court, but of which it then appeared to have lost sight.

The CICA stated that unless:

'... an available alternative remedy can be seen, without full examination of the facts, to be capable of satisfying the petitioner's concerns to an extent that would make it clearly impossible for him to persuade the court that it would be just and equitable to wind up the company, the petition should proceed'

The CICA noted that there is a significant overlap between cases in which it is alleged that alternative remedies exist and in which it is alleged that a winding-up petition has been brought for an improper collateral purpose. Accordingly, similar considerations apply when determining whether to restrain or strike out petitions in both cases.

In applying the above principles, the CICA formed the view that the Petitioner's complaints were more wide-ranging than the Judge had found, comprised serious allegations of conspiracy and could potentially

¹ A third had been overtaken by events and was no longer significant

justify a winding-up order if they were proved. Accordingly, it reversed the decision to strike-out the petition.

CICA's Observations

In reaching its decision, the CICA observed:

'In our judgment, [the Petitioner] may legitimately take the view that it prefers the Company to be wound up to having to pursue piecemeal a series of actions, by litigation or otherwise, or by a combination of litigation and some other steps, that might be capable of redressing some, or even all, of its concerns. It is entitled to have the circumstances investigated in the context of a winding up petition that it is entitled to bring; and if it succeeds in establishing its complaints it is entitled under the statutory scheme to have the court consider at the end of the investigation whether the appropriate remedy is winding up or another of the remedies set out in section 95(3) of the Law.'

The CICA disagreed with the Grand Court's statement that an examination of the Petitioner's complaints would require a trial process and, therefore, would be more amenable to an action by writ. This, according to the CICA, was *'to put the cart before the horse'*. It observed, *'If [the Petitioner] is entitled to petition... the procedures of the court will have to be adapted so that the issues of fact can be resolved in the petition. This is in fact a commonplace in just and equitable petitions and (in England and Wales) in unfair prejudice petitions.'*

The reality is that, in Cayman, minority shareholders must bring a just and equitable petition to obtain the same relief sought by way of an unfair prejudice action in England and Wales. Filing a petition is the relevant gateway in Cayman. As the CICA observed, that is simply *'the result of the structure of the legislation'*. In that context, it is difficult to see how it could be an abuse of process to present a petition where the primary purpose is to obtain the alternative relief set out in section 95(3) of the Companies Law².

Class Remedies

Perhaps the most interesting point to come out of this judgment was the CICA's comment on the Grand Court's determination that the fact that the petition *'was not presented with the purpose of advancing a class remedy on behalf of the shareholders'* meant that it was abusive.

To this, the CICA, whilst noting that the point had not been fully argued before it (and that it therefore was not expressing a concluded opinion on the matter) said:

'Although we accept that in the context of a creditor's petition the fact that the petitioner is not invoking a class remedy may mean that the petition is an abuse... we are very doubtful whether the principle can apply in the context of a contributory's petition brought on the just and equitable ground. In such a case, it is likely that the petitioner will complain of matters specific to him that may not necessarily apply to any other shareholder. We do not think that fact alone can be a reason for restraining the petition: at most, it may support an argument that the petition is brought for an improper purpose.'

The logic behind this view seems sound. In many cases, acts of minority oppression may be directed at small numbers of shareholders, or even individual ones. As those shareholders can only access alternative relief through a just and equitable winding-up petition, it is difficult to see how they could then be validly criticised for acting in their own interests, rather than those of a wider class.

Comment

The CICA's decision provides an illuminating reminder of the potential pitfalls around which the courts have to navigate when determining applications to strike out winding-up petitions.

It also emphasises the sometimes very different considerations that apply to creditor's winding-up petitions and those brought by shareholders on the just and equitable ground.

² Section 95(3) is the equivalent of section 996 of the UK Companies Act 2006. Unlike the remedy prescribed by section 994 of the UK Companies Act 2006, Cayman does not have a standalone cause of action for unfair prejudice.

Now that the petition is back on foot, the Company's arguments about potential alternative remedies and improper collateral purpose will likely fall to be determined by the Grand Court after hearing full evidence. Therefore, there may well be another judgment to look forward to, which considers these issues in more detail.

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