

UPDATE

## 'Cayman' derivative actions abroad

Update prepared by Zachary Hoskin (Senior Associate, Cayman Islands)

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The Grand Court of the Cayman Islands, in *Top Jet Enterprises Limited v. Sino Jet Holding Limited & Anor* (Unreported, 19 January 2018 per Segal J), held that a shareholder of a Cayman Islands company does not require leave from the Cayman courts to pursue a derivative action in a foreign jurisdiction, and identified the circumstances in which a derivative action may be brought against a third party.

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### Background

Top Jet Enterprises Limited (the **Plaintiff**), as a 50% shareholder of the Cayman Islands company Sino Jet Holding Limited (the **First Defendant**), commenced derivative proceedings in Missouri, USA in the name of the First Defendant claiming that Jet Midwest Inc (the **Second Defendant**) had breached a consignment agreement entered into between the First and Second Defendants, that the Second Defendant was liable to account and pay damages to the First Defendant, and that the directors of the First Defendant, some of which are closely connected with the Second Defendant, had failed to enforce the First Defendant's rights against the Second Defendant in respect of the breach (the **Missouri Proceedings**). In the Missouri Proceedings, the Second Defendant challenged the Plaintiff's standing to bring a derivative action on behalf of the First Defendant. The Plaintiff therefore applied to the Cayman courts (i) for leave to continue the Missouri Proceedings derivatively on behalf of the First Defendant (if required) and (ii) for a declaration that it was entitled to bring the Missouri Proceedings as a matter of Cayman law.

### Application for leave to continue the Missouri Proceedings

The Grand Court Rules (**GCR**) require a plaintiff in a derivative action to apply to the court for leave to continue the action once the defendant has given notice of intention to defend. However, Justice Segal held that O.15, r.12A (Derivative actions) and O.15, r.12 (Representative proceedings) only apply to proceedings commenced in the Cayman Islands and have no application to foreign derivative actions. Further, there is no free-standing requirement independent of the GCR to apply for leave. Accordingly, as a matter of Cayman law the Plaintiff did not require leave from the Cayman courts to continue the Missouri Proceedings.

### Application for a declaration that the Plaintiff is entitled to bring a derivative action as a matter of Cayman law

The eponymous rule in *Foss v. Harbottle*<sup>1</sup> provides that the proper plaintiff in respect of losses suffered by a company is the company itself and not its shareholders. There are, however, four recognised exceptions to the rule. The Plaintiff in this case relied on the 'fraud on the minority' exception which allows a shareholder to bring an action on behalf of the company if there is a fraud on the company that is otherwise unable to be remedied due to the protection afforded to the fraudulent shareholders or directors by their majority power.

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<sup>1</sup> [1843] 67 ER 189.

Justice Segal accepted in line with English authorities<sup>2</sup> that the concept of 'fraud' extends beyond simple fraud and includes a fraud on a power, namely breaches of duty which confer a benefit on the directors or third parties but which are detrimental to the company.

In the present case it was alleged that three of the First Defendant's six directors had an interest in shielding the Second Defendant from a claim by the First Defendant, that those directors therefore had a conflict of interest, had turned a blind eye to the Second Defendant's breaches of the consignment agreement, and that by their majority would block the First Defendant from enforcing the consignment agreement. Justice Segal found that, assuming those allegations were true, and assuming that the First Defendant had a good claim against the Second Defendant, the conflicted directors appeared to be in breach of their fiduciary duties to the First Defendant by protecting the Second Defendant at the expense of the First Defendant and all of its shareholders.

Justice Segal noted that derivative actions were typically brought against directors or shareholders of an aggrieved company. However in this case the derivative claim had been brought against a third party (the Second Defendant). The Judge doubted that a derivative claim could be brought against an *independent* third party that had 'neither participated in the conduct constituting the fraud on the minority nor received corporate assets'<sup>3</sup>. However, if the third party is an 'accessory to or closely associated with the conduct which gives rise to the fraud on the minority' (ibid), a derivative claim against the third party may be permissible. Justice Segal noted and relied upon the fact that the Plaintiff had pleaded matters in the Missouri Proceedings which, if proved at trial, would satisfy this requirement (neither the First nor Second Defendant had appeared at the hearing to challenge those matters). He therefore held, and made a declaration, that if the facts and matters set out in the Petition filed by the Plaintiff in the Missouri Proceedings are proven at trial, then the Plaintiff is entitled under Cayman law to bring the Missouri Proceedings against the Second Defendant derivatively on the First Defendant's behalf.

## Comment

This is understood to be the first time the Cayman courts have been faced with the question of whether a shareholder of a Cayman Islands company requires leave from the Cayman courts to pursue a derivative action in a foreign jurisdiction. As it stands, leave from the Cayman courts is not required. The judgment is also important because it confirms that, as a matter of Cayman law, derivative actions may be brought not only against directors and shareholders but also against third parties, and sets out the test for determining when such a claim will be permissible.

## Contacts

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<sup>2</sup> *Daniels v. Daniels* [1978] Ch 406.

<sup>3</sup> At paragraph 39.