New York Court Of Appeals Roundup

Court Clarifies Requirements for Actions Against Cayman Islands Companies

WILLIAM T. RUSSELL, JR. AND LYNN K. NEUNER*
SIMPSON THACHER & BARTLETT LLP

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This month, we discuss a case in which the Court of Appeals clarified the requirements for plaintiffs seeking to bring shareholder derivative actions against Cayman Islands companies in New York State courts. In *Davis v. Scottish Re Group Limited*, the court ruled that a Cayman Islands statute requiring a plaintiff to obtain Cayman Islands court approval before continuing to prosecute a shareholder derivative action does not apply to actions commenced in New York.

Plaintiff was a significant minority shareholder in defendant Scottish Re Group, Limited, a Cayman Islands company that engages in the reinsurance business. Plaintiff owned approximately 48 percent of the preferred shares and 20 percent of the common stock as of June 30, 2011. In November 2012, plaintiff commenced an action in Supreme Court, New York County against Scottish Re and certain of its affiliates and directors, and against certain affiliates of Massachusetts Mutual Life Insurance Company and private equity firm Cerberus Capital Management, L.P. (the Investors). Plaintiff alleged that the Investors worked in concert with certain Scottish Re directors to undertake a dividend strategy and cash-out merger that benefited the Investors but harmed the company and minority shareholders like plaintiff. Plaintiff asserted direct and derivative claims.

The trial court dismissed most of plaintiff's claims including his three derivative claims, finding that plaintiff lacked standing to bring derivative claims: (1) under Cayman Islands common law, and (2) because he failed to comply with Rule 12A of the Rules of the Grand Court of the Cayman Islands. Generally stated, Rule 12A provides that a plaintiff bringing a derivative claim must file an application to the Cayman Islands Grand Court, supported by a factual affidavit, for leave to continue the action once a defendant has given notice of its intention to defend the action. As the court noted in its opinion, Rule 12A requires a plaintiff to make a prima facie showing of merit in order to protect corporate defendants from incurring the time and expense of defending unfounded claims brought by a shareholder for his or her own reasons rather than in the interests of the company. Plaintiff commenced his action in Supreme Court without seeking leave from the Cayman Islands Grand Court in accordance with Rule 12A.

The Appellate Division, First Department affirmed the dismissal of plaintiff's derivative claims based on his noncompliance with Rule 12A. It did not reach the issue of plaintiff's standing under Cayman Islands common law. The First Department granted leave to appeal and certified a question regarding the propriety of its order.

* **William T. Russell, Jr.** *and* **Lynn K. Neuner** *are partners at Simpson Thacher & Bartlett LLP.*

In a unanimous opinion written by Judge Paul G. Feinman (Judge Garcia took no part in the decision), the Court of Appeals determined that Rule 12A was a procedural, rather than substantive, rule and accordingly did not apply to actions brought in New York courts. The Court of Appeals reversed and remanded the action to the First Department for further proceedings to consider whether plaintiff has standing under Cayman Islands common law.

The court began by noting that Cayman Islands law governs the substantive merits of the case but that, under New York common law principles, the procedural rules of New York as the forum state would apply to the conduct of the action. Accordingly, the essential issue before the court was whether Rule 12A was procedural or substantive. The court considered the plain language of the statute, which provides that the rule applies to all derivative actions "commenced by writ" and refers to several procedural issues that are specific to Cayman Islands litigation. The court therefore determined that Rule 12A applies to any derivative action commenced by writ in the Cayman Islands on behalf of any corporation—no matter where that corporation is incorporated. It does not, however, specifically apply to every derivative action involving a Cayman Islands incorporated company—no matter where that action is pending. In other words, it performs a "gatekeeping" function as to derivative actions brought in the Cayman Islands but not as to all derivative actions involving Cayman Island companies.

The Court of Appeals explained that the Cayman Island Rules Committee (which promulgates the procedural rules for the Grand Court) could have expressly provided that Rule 12A applied to actions involving Cayman Islands companies anywhere in the world. The court noted that the British Virgin Islands' Business Companies Act and the Canadian Business Corporations Act both contain such express provisions regarding prior court approval for derivative actions against companies incorporated under their laws.

The court also pointed to several procedural issues that would arise if Rule 12A were deemed to be a substantive rule that applied to actions brought in New York. For example, the court questioned whether a prospective derivative plaintiff would have to commence an action by writ in the Cayman Islands to obtain leave and then discontinue that action before commencing an action in New York. If so, the court continued, that would then lead to the question of whether the Cayman Islands court's finding of merit would have any binding effect on the subsequent New York action.

The case is now back before the First Department for a determination as to whether plaintiff has standing under Cayman Islands common law. It is important to note that, while the Court of Appeals' decision removes an important impediment to New York derivative actions against Cayman Islands corporations, a plaintiff would still need to obtain jurisdiction over the Cayman Islands defendant before commencing an action here. Moreover, the Cayman Islands Rules Committee could follow the example of Canada and the British Virgin Islands and promulgate the court-permission requirement for derivative suits against Cayman corporations no matter where they are sued by amending the rules. Indeed, the Canadian rules go even further and specify that derivative suits against Canadian corporations can only be brought in certain enumerated Canadian courts.

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