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## *Appointing an Inspector: A Viable Alternative to Liquidation in the Cayman Islands?*

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*In circumstances where the assets of the Cayman company are located outside of the Cayman Islands, the Court will normally appoint a local insolvency practitioner jointly with a foreign practitioner based in the relevant jurisdiction.*

*A provision in the Cayman Islands Companies Law (2013 Revision) (the **Law**) affords the Grand Court (the **Court**) the power to appoint “one or more competent inspectors to examine into the affairs of any company (incorporated in the Cayman Islands) and to report thereon” on the application of the company’s shareholder(s). In this article, we will review the different circumstances under which it might be appropriate for a shareholder to apply for the appointment of an inspector (or joint inspectors, where appropriate); how to make such an application; what powers the inspector might be afforded by the Court; and the respective advantages and disadvantages of seeking such an appointment.*

The attractions of incorporating a company in the Cayman Islands, the fifth-largest banking centre in the world, are numerous: no direct taxes, political and economic stability, and a reliable legal system to name a few. However, the means of redress available to a shareholder who feels he is not being treated fairly are limited: litigation is the main form of dispute resolution used in the Cayman Islands. In some instances a more timely and cost-effective solution would be to apply for the appointment of an inspector.

### **The Law**

The application must be made by a shareholder holding at least one-fifth of the issued shares of the company (or, in the case of a company not having a capital divided into shares, on application by shareholders accounting for not less than one-fifth of their total number). This means that a shareholder who needs protection can easily look to this provision in the Law for assistance.

A “*competent inspector*” is not defined but a qualified insolvency practitioner with relevant experience would make for a suitable appointment.

The main reason a shareholder might want to use this provision in the Law is if they are being denied key information relating to the finances and records of the company: the Law specifies that it shall be the duty of all officers and agents of the company to produce all books and documents in their custody or power to an appointed inspector, and the inspector has the power to examine any officer or agent of the company under oath.

As a Court appointed officer, an inspector is obliged to complete his investigation within a reasonable timeframe. On conclusion of his investigation, the inspector is required to file his findings and opinions with the Court. Although not usually open to public inspection, importantly, any information reported to the Court by the inspector is admissible in any legal proceeding as evidence of the inspector in relation to any of the matters investigated.

The inspector’s report is, therefore, invaluable to a shareholder who might want to take legal action against a company in the Cayman Islands but lacks sufficient evidence pertaining to the Company to bring such action (particularly, in a winding-up on the “*just and equitable*” ground), and has no other resource available to him (access to company information is difficult in the Cayman Islands, which is committed to strict confidentiality laws).

## Fortuna

*In The Matter of Fortuna Development Corporation* [2004-05] CILR 197, a minority shareholder petitioned for the winding-up of a company on the “*just and equitable*” ground based upon allegations that the majority shareholders were acting in an oppressive and prejudicial manner towards the minority. In that case, the Court refused to appoint liquidators but instead appointed inspectors over the company who were granted wide ranging powers to examine documents and question witnesses. The remit of their investigation also included the company’s subsidiaries, whether wholly owned or not. The Court stated that there “*is no question that [the inspectors’] report will be influential, perhaps dramatically so, in any subsequent litigation.*”

That case also determined that the auditors were, for the purposes of the Law, “agents” of the company and had a duty to produce all relevant books and documents in their custody or power.

## The powers afforded to an inspector

Importantly, the Law does not limit the powers the Court can afford to an inspector so the draft order (see below) attached to the application should be drafted appropriately to suit the particular facts of the case. Other than those powers outlined above, the judge may exercise his discretion to empower an inspector to, for example, examine the company’s trading activities, identify its assets and liabilities (and, importantly, those of its subsidiaries), examine the company’s financial statements, review related party transactions, and review all contractual and licensing documentation relating to the business of the company and its subsidiaries.

## How to make the appointment

The application has to be made by a shareholder (or shareholders) holding at least 20 per cent of the issued share capital.

In circumstances where the assets of the Cayman company are located outside of the Cayman Islands, the Court will normally appoint a local insolvency practitioner (who meets the requisite residency qualifications) jointly with a foreign practitioner based in the relevant jurisdiction.

Possible grounds for the appointment would be lack of adherence by the directors to proper corporate governance, unwillingness of the board to report to the shareholders, possible breaches by the board of the fiduciary duties they owe to the company and/or failure to comply with provisions in either or both of the company's Memorandum and Articles of Association or a shareholders agreement.

### **Advantages of appointing an inspector**

The process is relatively quick (the Court has previously ordered that the inspectors file their report within six weeks), cheap (the Court has the discretion to order that the expenses of the appointment be paid out of the assets of the company) and there is not a high burden on the applicant in order to achieve the appointment.

The main benefit is the weight that the Court will attach to the inspector's report. Even in circumstances where the directors of the company are uncooperative or unwilling to abide by the terms of the Court order, this could in itself be evidence of misconduct, mismanagement or breach of fiduciary duties on the part of the directors that could form grounds for winding up a company.

The appointment also presents an alternative option: it may put pressure on the executive directors to cooperate more fully with the shareholders to rebuild a relationship of trust and confidence so as to negate any need to enter into litigation or liquidate the company.

### **Disadvantages of appointing an inspector**

The most commonly occurring difficulty following the appointment of an inspector is that the executive directors fail to comply with the terms of the order appointing them and make no effort to furnish the inspector with the books and records of the company.

Failure on the part of the directors to abide with the terms of the Court order may well in itself form the necessary grounds for bringing a subsequent action against the company.

### **Conclusion**

The appointment of an inspector is a time and cost efficient method of securing information on a company's financial affairs. The enquiry power of an inspector is particularly compelling as the officers and agents of the company will be obliged to provide all documents in their custody or power to the inspector. An inspector may also examine officers and agents under oath and criminal sanctions are imposed for non-compliance with any request made by an inspector. This information would help form the backbone of any subsequent action, such as a derivative claim.

In many cases it may be that the appointment of an inspector is a necessary precursor to a winding-up application. Where a shareholder does not have sufficient evidence to seek the appointment of liquidators, the ability to appoint an investigator to scrutinise the affairs of the company, and report to the court thereon, is likely to assist greatly in such an application.

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