

## Bringing Cayman Derivative Claims In NY Just Got Easier

By **Rob Quirk and Stephen Younger**

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A shareholder bringing a contested derivative claim in the Cayman Islands must seek leave from the Cayman Grand Court before proceeding. This litigation prerequisite — imposed by Rule 12A of the Rules of the Grand Court of the Cayman Islands — requires a prima facie factual showing, with the aim of protecting corporations from “vexatious or unfounded litigation.”[1] But when a Cayman Islands-related derivative claim is brought in New York’s Commercial Division, does the same leave-of-court rule apply? The New York Court of Appeals recently answered “no,” holding in *Davis v. Scottish Re Group Ltd.* that Rule 12A is a procedural rule that does not apply to matters litigated in New York courts.[2]



Robert Quirk

### Substance vs. Procedure

Whether Rule 12A’s leave-of-court provision applies to claims litigated in New York courts turns on whether the requirement is a part of substantive Cayman Islands corporate law, or instead is a procedural rule applicable to cases brought in Cayman Islands courts. The substance of Cayman Islands corporate law is implicated in a derivative claim because such a claim is brought by a shareholder on behalf of the corporation. Since New York follows the internal affairs doctrine — which requires application of the substantive law of the place of incorporation to the internal relations of a corporation — if Rule 12A were a substantive law provision, it would have to be applied to derivative claims involving a Cayman corporation.[3] Matters of procedural law, however, are governed by the law of the forum. As a result, if Rule 12A were procedural in nature, it would not apply to claims litigated in New York courts.[4]



Stephen Younger

### Davis v. Scottish Re

In *Davis*, plaintiff Paul Davis brought both direct and derivative claims against several defendants, including Cayman Islands-based reinsurer Scottish Re Group Ltd., in the New York County Commercial Division. Justice O. Peter Sherwood of the Commercial Division dismissed two of the derivative claims for lack of standing on two alternative bases: first, that Davis had failed to comply with Cayman Rule 12A, and second, that Davis lacked standing under Cayman Islands common law.[5] The First Department affirmed the holding that noncompliance with Rule 12A required dismissal of the derivative claims and certified an appeal of its decision — which did not address common law standing — to the

Court of Appeals.[6]

Before the Court of Appeals, Scottish Re argued that Rule 12A operates as a substantive gatekeeper in derivative actions and must be applied in New York litigation pursuant to the internal affairs doctrine. In other words, Scottish Re contended that Rule 12A is best understood as a substantive component of the Cayman Islands Companies Law designed to raise the threshold for bringing derivative claims. In addition, Scottish Re analogized Rule 12A to statutes of repose, which create barriers to certain claims regardless of the time when any injury accrued, and which have been held by the Court of Appeals to constitute substantive laws for choice-of-law purposes.[7]

Davis countered that Rule 12A is a procedural rule that governs the method for bringing a claim in Cayman Islands courts, and does not speak to the substantive law governing those claims. The core of Davis' argument was textual: Rule 12A is, on its face, a rule of court. In Davis' view, Rule 12A is analogous to the provisions of the CPLR that serve as procedural gatekeepers at certain stages of a litigation, such as CPLR 3211 (governing motions to dismiss) and 3212 (governing motions for summary judgment).[8]

In an opinion by Judge Paul Feinman, the Court of Appeals agreed with Davis' view that Rule 12A is procedural in nature, and cited four main reasons for its conclusion. First, the court noted that the rule applied to derivative actions "commenced by writ," and was triggered by a "notice of intention to defend." [9] The fact that both of these procedures are specific to litigation in the Cayman Islands courts evinced a procedural function behind the rule. Second, the court noted that Rule 12A applied to "every" shareholder action, not only those involving Cayman entities, thereby counseling against an interpretation of the rule as a substantive component of the law governing Cayman Islands corporations. [10] Third, the court observed that if the drafters had "intended that Rule 12A apply to derivative actions involving Cayman Islands companies anywhere in the world, it could have expressly provided as such" as both the British Virgin Islands and Canada have done for corporations based in their respective jurisdictions.[11] Finally, turning to policy concerns, the court noted that "were Rule 12A held to be substantive, it is unclear what procedural path a party seeking to bring a derivative action in New York on behalf of a Cayman company would follow to comply with Rule 12A." [12] Specifically, the court cited the practical uncertainty about where and how to initiate a claim, as well as ambiguity about the binding effect of a Cayman court's Rule 12A determination on later stages of the proceedings before a New York court.[13]

The Court of Appeals also rejected Scottish Re's analogy to statutes of repose. Unlike a statute of repose, which can operate to bar a claim before it accrues and thus "creates an absolute barrier to a plaintiff's right of action," the court found Rule 12A more analogous to a statute of limitations — which is considered procedural for choice-of-law purposes — because it "neither creates a right, nor defeats it." [14] The court further noted that New York courts apply "other states' and countries' substantive laws with regularity" [15] and that New York has its own gatekeeper provisions that are designed to weed out meritless claims.

## **Conclusion**

The court's decision in Davis removes a significant practical hurdle to bringing derivative claims involving Cayman corporations. With Rule 12A out of the picture, shareholders need not arrive at the courthouse door already equipped with evidence to support their claim. Nonetheless, there remain other potential barriers to bringing a Cayman derivative claim in a New York court.

Personal jurisdiction must be established over the defendants — including the corporation. Furthermore, shareholders will face an obstacle that Davis himself has yet to overcome: establishing standing to bring a claim under Cayman Islands common law, which limits the circumstances in which a shareholder may assert a derivative claim.<sup>[16]</sup> Moreover, the case may present forum non conveniens issues, particularly if the witnesses are located outside of New York.

Ultimately, the Davis decision confirms that New York courts are open to shareholders in foreign companies who seek to bring derivative lawsuits in New York in appropriate circumstances. In such cases, New York courts will not import foreign procedural rules that require a preliminary evidentiary showing. Although the foreign substantive corporate law continues to define such claims, shareholders will be afforded all the procedural mechanisms available under New York law in order to advance and build the evidence for their case.

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[1] *Renova Res. Private Equity Ltd. v. Gilbertson*, [2009] CILR 268, 283 (citing Cayman Islands Grand Court Rule 12A (1995)).

[2] *Davis v. Scottish Re Grp. Ltd.*, No. 111, 2017 NY Slip Op. 08157, 2017 N.Y. LEXIS 3277 (Nov. 20, 2017).

[3] *Id.* at \*5.

[4] *Id.*

[5] *Id.* at \*2.

[6] *Id.*; see *Davis v. Scottish Re Grp. Ltd.*, 138 A.D.3d 230, 239, 28 N.Y.S.3d 18 (1st Dep't 2016).

[7] See *Tanges v. Heidelberg N. Am. Inc.*, 93 N.Y.2d 48, 53, 687 N.Y.S.2d 604 (1999).

[8] *Davis*, 2017 N.Y. LEXIS 3277, at \*6, 13.

[9] *Id.* at \*7.

[10] *Id.* at \*8.

[11] *Id.* at \*8-9.

[12] *Id.* at \*12.

[13] *Id.* at \*12-13.

[14] *Id.* at \*10-11.

[15] Id. at \*13.

[16] The Court of Appeals declined to review the trial court's application of Cayman common law to the specific facts in Davis, but did not question whether Cayman law governed Davis' standing to bring a derivative claim. Id. at \*14