Cayman Islands Court of Appeal rules on restraint of foreign claims against third parties

In a judgment delivered on 8 October 2018, the Cayman Islands Court of Appeal ("**CICA**") allowed a partial appeal by the joint official liquidators of Argyle Funds SPC Inc. (in Official Liquidation) (**"Argyle"**) against an anti-suit injunction of the Grand Court of the Cayman Islands that had restrained Argyle from continuing litigation in the Supreme Court of the State of New York against three parties related to Argyle's former statutory auditor, BDO Cayman Ltd (**"BDO Cayman"**). The judgment addresses issues concerning the interpretation of jurisdiction clauses and the question of the extent to which claims against non-parties arising from the performance of a contract fall within the scope of contractual exclusive jurisdiction clauses.

Background

Argyle was a Cayman Islands mutual fund with significant exposure to debt factoring via investments made through two credit advisors which each perpetrated major frauds at Argyle's expense, leading to Argyle's liquidation in 2016.

BDO Cayman was Argyle's statutory auditor. The audit engagement letters between Argyle and BDO Cayman (the **"Engagement Letters"**) contained Cayman arbitration agreements and Cayman exclusive jurisdiction clauses. Three of the four Engagement Letters contained sole recourse (or 'covenant not to sue') clauses, which prevented Argyle from suing affiliates of the statutory auditor that had performed work on the audits, save in respect of claims founded on allegations of fraud or wilful misconduct by such parties.

Having failed to make recoveries from the fraudsters, Argyle's liquidators sued its auditors. In 2017, they brought proceedings in the Supreme Court of the State of New York (the **"New York Proceedings"**) against four entities: BDO Cayman and three of BDO Cayman's affiliates: BDO Trinidad and Tobago, BDO USA and Schwartz (the **"Affiliates"**), seeking damages in excess of US$280 million. The allegations advanced by Argyle in the New York Proceedings concerned the audit years 2010 – 2013, and went beyond the 'usual' allegations of professional negligence to include fraud and wilful misconduct.

In February 2018, BDO Cayman obtained an anti-suit injunction from the Grand Court to restrain the liquidators from continuing the New York Proceedings against all four defendants in breach of the Engagement Letters. Justice Parker found that the clear contractual scheme could not be conveniently side-stepped to obtain procedural or other strategic advantages in a chosen foreign court.

Justice Parker was critical of the overwrought claims in the New York Proceedings and the manner in which they

had been advanced by Argyle on the evidence, holding that the claims in fraud and wilful misconduct (which he described as "inherently implausible") did not contain the bare facts necessary to support them. His Lordship also accepted BDO Cayman's evidence that BDO USA and Schwartz had played no part in the relevant audits.

Partial appeal by the Argyle liquidators

No appeal was made in respect of the anti-suit injunction restraining the continuation of Argyle's claims in New York against its statutory auditor and sole contractual counterparty, BDO Cayman. However, Argyle appealed the anti-suit injunction granted to restrain the New York Proceedings concerning the claims against the Affiliates, arguing that those claims had not been brought in breach of contract. Argyle further argued that it was not open to Mr Justice Parker to have made a summary determination that BDO USA and Schwartz played no part in the relevant audits: that was a question to be decided after discovery and cross-examination.

BDO Cayman argued that the Engagement Letters, construed as a whole, provide a clear contractual scheme whereby claims were only to be brought against BDO Cayman in arbitration, save for certain claims which were to be brought in the Grand Court of the Cayman Islands pursuant to the exclusive jurisdiction clause. BDO Cayman also contended that Justice Parker was right to take account of evidence that BDO USA and Schwartz had no involvement in the relevant audits.

CICA Judgment

The CICA allowed Argyle's partial appeal, permitting its claims in New York against the three Affiliates (but not BDO Cayman) to continue (subject to any further appeal to the Privy Council).

Justice Field, with whom Justices Moses and Morrison agreed, held that Justice Parker had been wrong to make a summary determination that BDO USA and Schwartz had not had any involvement in the relevant audits. While, according to Justice Field, "*even if Messrs Trenouth and Ali* [of BDO] *were clear winners on points in the evidence of contest… [the] [t]rial of an issue on affidavits without the benefit of discovery and cross-examination in interlocutory proceedings such as were before the judge is almost never appropriate, and it was not appropriate in the instant case.*" However, this finding alone was insufficient for Argyle to succeed on its appeal because Justice Parker's summary determination of this factual question did not go to his findings that Argyle had brought the New York Proceedings in breach of contract. Justice Field therefore proceeded to address the issues of contractual interpretation.

The CICA held that the claims against the Affiliates in the New York Proceedings did not breach the sole recourse clauses contained in three of the Engagement Letters because they fell within the carve-out stated within that clause: "*…it is manifest that these claims are founded on an allegation of fraud or wilful misconduct within the wording of the carve-out. They may not comply with the pleading requirements in England and the Cayman Islands, but Mr. Laffey [of Reed Smith, US attorneys for Argyle] deposed in his affidavit that they complied with New York's pleading requirements and there was no evidence to the contrary.*"

The CICA then considered whether the claims against the Affiliates nonetheless breached the exclusive jurisdiction clause, which provided that *"[t]he courts of the Cayman Islands shall have exclusive jurisdiction in relation to any claim or matter arising from this Agreement."* The main point of contention was whether this

clause applied to claims against the Affiliates, who were non-parties to the Engagement Letters. After reviewing the relevant authorities and summarising the principles of law as stated by Deputy Judge Lawrence Rabinowitz QC in the English case *Team Y & R Holdings Hong Kong Ltd v Ghossoub* [2017] EWHC 2401 (Comm), Justice Field found that the exclusive jurisdiction clause did not apply to claims brought by or against third parties.

In his judgment, *"...notwithstanding the breadth that results from the words "any claim or matter arising from this Agreement" and the problems that arise from the same issues being litigated in two jurisdictions, the clause does not extend to claims brought by Argyle against third parties pursuant to the carve-out in the Sole Recourse Clause".* Justice Field continued: *"Further, there is no machinery in the Engagement Letter contract that would result in the third party sued under the carve-out submitting to the jurisdiction of the Cayman Courts, an omission that would render the carve-out right to sue of little, if any, value...".*

In reaching this conclusion, the CICA declined to follow the decision of the New South Wales Court of Appeal in *Global Partners Fund Ltd v Babcock & Brown Ltd & Ors* (79 ACSR 383) which was based upon broadly analogous facts but reached the opposite conclusion: an exclusive jurisdiction clause in a limited partnership agreement was held to require a party to bring proceedings against three non-party affiliates in the stipulated jurisdiction (England) even though (as in the present case) the clause did not expressly state that it applied to claims against third parties.

Conclusion

The judgment of the CICA has resulted in the uncommercial outcome that claims against the statutory auditor are required to be brought in the Cayman Islands whereas claims against the Affiliates founded on fraud or wilful default may be brought in New York. This is arguably contrary to the well-established principle that parties are to be taken to have intended that any dispute arising out of the relationship into which they have entered be determined in a single forum.

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