The Court of Appeal confirms misled shareholders can prove for damages in official liquidations: The 'Houldsworth principle', partially curtailed, lives on in the Cayman Islands

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Introduction

The Cayman Islands Court of Appeal (**CICA**) has recently handed down its decision[1] following the jointly heard appeals in *Re HQP Corporation Limited (in Official Liquidation)[2]* (***HQP***) and in *Re Direct Lending Income Feeder Fund Ltd. (in Official Liquidation)*[3] (***Direct Lending***), regarding the claims in company liquidations by investors whose subscriptions were induced by misrepresentation by the company (**Subscriber Misrepresentation Claims**).

Longstanding authority from the UK House of Lords indicated that such claims were not permissible once liquidation proceedings commenced and subscribing shareholders lost the right to rescind, but Grand Court decisions in 2023 and 2024 found that they were permissible (albeit for different reasons).

The CICA addressed specifically the following questions:

a. whether Subscriber Misrepresentation Claims are (i) admissible to proof in an official liquidation or (ii) barred from proving in an official liquidation in light of the principle emanating from the House of Lords decision in *Houldsworth v City of Glasgow Bank*[4] (the **Proof Issue**); and
b. where Subscriber Misrepresentation Claims (if admitted) are to rank in the distribution waterfall in an official liquidation (the **Priority Issue**).

In a joint appeal, the CICA was faced with conflicting decisions of Justice Doyle in *HQP* and Justice Segal in *Direct Lending*[5] as well as arguments that neither Justice Doyle nor Justice Segal were correct, ie that Subscriber Misrepresentation Claims were not admissible to proof, or, if they were, that they should be subordinated to claims of unpaid redemption creditors.

The proof issue with Subscriber Misrepresentation Claims

The CICA concluded that that Subscriber Misrepresentation Claims are admissible to proof in an official liquidation. In doing so, the CICA found that:

1. The *Houldsworth* principle[6] remains part of Cayman Islands law;
2. The *Houldsworth* principle did not contemplate allowing Subscriber Misrepresentation Claims if the creditors had all been paid or otherwise taken care of;

3. There is nonetheless a very good reason (which is the existence of large numbers of investment funds incorporated in the Cayman Islands which raise capital by issuing redeemable shares) for limiting the application of the *Houldsworth* principle in the Cayman Islands to situations where there are insufficient assets to pay the external creditors or otherwise to see that they are provided for;
4. The *Houldsworth* principle thus applies in the Cayman Islands to prevent a person with a Subscriber Misrepresentation Claim from proving in an official liquidation but only until all non-member creditors have been paid or provided for (and that such a person may prove thereafter).

The priority issue concerning Subscriber Misrepresentation Claims

The CICA concluded that Subscriber Misrepresentation Claims are made in the claimant's character as a member and so are subordinated to the claims of non-member creditors, but (subject to any express contractual provisions) are to rank *pari passu* with the claims of redemption creditors.

In arriving at this conclusion, the CICA agreed with Justice Segal's analysis that section 49(g) of the Companies Act is to be understood and interpreted as regulating the right of shareholders to prove in a winding up so as to give effect to and ensure respect of the principle of maintenance of capital.

The CICA also rejected the argument that section 37(7) of the Companies Act operated in such a way as to confer priority upon redemption creditors as amongst those who are both shareholders within section 49(g) and creditors.

Comment

The lengthy analysis of the CICA reflects the tension that exists between various legal and equitable principles regarding maintenance of capital, contractual certainty and the provision of meaningful remedies for tort victims.

Of particular note is the CICA's rejection of the approach (adopted by the High Court of Australia in *Sons of Gwalia Ltd v Margaretic*[7]) of a rights-based analysis of the nature of the Subscriber Misrepresentation Claims (ie whether the company’s obligation to pay damages for fraudulent misrepresentation inducing that subscription is an obligation founded in the statutory contract of membership) in favour of a relief-based analysis (ie whether the relief being claimed amounts directly or indirectly to a return of capital and thereby infringes the rules relating to the maintenance of capital).[8]

In addition, the decision serves as a timely reminder that decisions of the appellate courts of England and Wales (and the Privy Council) remain of highly persuasive authority, but they will not necessarily be followed in the Cayman Islands if there are relevant local factors which can render it appropriate to not follow them.[9]

The decision brings some welcome clarification to the issues at stake, which will be of particular interest to stakeholders and officeholders of investment funds. It also provides for a practical result for Subscriber Misrepresentation Claims that is aligned with the respective distribution waterfalls in Australia and the United Kingdom.

It remains to be seen whether the CICA's decision will be subject to an appeal to the Privy Council. In the meantime, stakeholders in investment funds who have reason to believe that either their subscriptions (or those of others) might have been obtained by misrepresentation should take prompt advice, as the onset of liquidation might materially affect their position (and making redemption requests may not necessarily be their best option). Conversely, non-member creditors of financially-distressed companies who have grounds for believing that rescission might be available to subscribing members may also wish to take prompt action to minimise the risk of the potential for dilution of their claims by misled investors who may look to rescind prior to the onset of liquidation.

Collas Crill acted for the Joint Official Liquidators of Direct Lending Income Feeder Fund Ltd. (in Official Liquidation), who were the successful respondents in the *Direct Lending appeal*.

Related insight on this topic from Collas Crill

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[1] [2025] CICA (Civ) 19

[2] CICA (Civil) Appeal No: 16 of 2023

[3] CICA (Civil) Appeal No: 14 of 2024

[4] (1880) 5 App Cas 317

[5] Our update from March 2024 on those decisions, 'Houldsworth is worth holding onto', can be found here.

[6] Which principle the CICA noted was a product of not just the decision in *Houldsworth*, but also of the decision of the English Court of Appeal in Addlestone Linoleum Company (1887) 37 Ch D 19, the decision of Sir George Jessel MR in In re Hull and County Bank (1880) 15 Ch. D. 507 *("Burgess's Case"*) and the decision of the House of Lords in Soden v British & Commonwealth Holdings Plc [1988] AC 298 (adopting the decision of the Australian High Court in Webb Distributors (Aust) Pty Ltd and Another v State of Victoria and Another (1993 179 CLR 15))

[7] [2007] HCA 1, [2007] 3 LRC 462

[8] [2025] CICA (Civ) 19, at [180]

[9] Ibid. , at [195] to [200] and [212], citing the Privy Council decision in Frankland v R [1987-89 MLR 65],

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