Cayman Litigation & Dispute Resolution Review

Welcome to the Stuarts litigation and dispute resolution review. Stuarts' litigation and dispute resolution team acts in a wide range of company, commercial and insolvency related disputes arising under Cayman Islands law. This Review addresses the "sufficient interest" rule in respect of contributories' Just and Equitable Petitions.

Just and Equitable Winding Up Petitions – The "Sufficient Interest" Rule

It is well established that, as a general rule, a contributory who is the holder of fully paid shares[1] must demonstrate a "*sufficient*" interest in a company in order to have standing to present a winding up petition on just and equitable grounds. In order to call upon the equitable jurisdiction of the Court, it is necessary for the Petitioner to have "*a legitimate current interest in the winding-up of the Company*"[2,3]

The Rule in re Rica Gold Washing Co (1879)

The rule derives from the English Court of Appeal decision in In re Rica Gold Washing Co (1879) 11 Ch.D. 36, where Jessel M.R. held as follows (emphasis added):-

> *"Now I will say a word or two on the law as regards the position of a petitioner holding fully paid up shares. He is not liable to contribute anything towards the assets of the company, and if he has any interest at all, it must be that after full payment of all the debts and liabilities of the company there will remain a surplus divisible among the shareholders of sufficient value to authorise him to present a petition. That being his position, and the rule being that the petitioner must succeed upon allegations which are proved, of course* ***the petitioner must show the court by sufficient allegation that he has a sufficient interest to entitle him to ask for the winding up of the company. I say "a sufficient interest," for the mere allegation of a surplus or of a probable surplus will not be sufficient.*** *He must show what I may call a tangible interest. I am not going to lay down any rule as to what that must be, but if he showed only that there were such a surplus as, on being fairly divided, irrespective of the costs of the winding up, would give him £5, I should say that would not be sufficient to induce the court to interfere in his behalf".*

A Petitioner needs to both allege and prove, on a balance of probabilities, a "*sufficient*" and/or "*tangible*" interest in the winding-up and this will need to be verified by way of Affidavit.

The rule in In re Rica Gold Washing Co has stood the test of time, approved in the leading English decision of In re Othery Construction Ltd. [1966] 1 W.L.R.69 at 72 and subsequently by the Privy Council in Gamlestaden Fastigheter AB v Baltic Partners & Others [2007] 5 LRC 500[4] where, in a unanimous advice, Lord Foscotte referred to:-

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1 A holder of shares which are partly-paid is liable to contribute to the company's assets and hence the question of "*sufficient interest*" in terms of demonstrating a surplus upon the winding-up does not apply to such a shareholder.
2 Principles of Corporate Insolvency, 3rd Edition, Roy Goode at paragraph 5-11.
3 Interestingly, in the Scottish case of O'Connor –v- Atlantis Fisheries Ltd. 1988 S.L.T. (Sh Ct) 61, the question was put by the Court in terms of whether the contributory was "*qualified*" to bring the Petition.
4 A members petition to wind up a Jersey Company on the grounds of the Jersey statutory equivalent of "*unfair prejudice*".

> *" ... the well-established rule that a shareholder cannot petition for a winding-up order to be made in respect of a company that is insolvent. The reason is that the petitioning shareholder cannot obtain any benefit from the winding-up. The company's assets will be realised; dividends may be paid to creditors but nothing, if the company is insolvent, will go to the members."*

This is also a settled rule under Cayman Islands law. For instance, in In the matter of Gatx Flightlease Aircraft Company Limited [2004-05] CILR Note 38, it was held that a contributory petitioning for a winding up must show that:–

1. there is likely to be a substantial surplus of assets available for distribution among the shareholders;
2. it has a tangible interest in the winding up; and
3. there is a probability that it will share in the surplus assets.

In that case, the sole asset of the company was a claim for breach of contract. The Cayman Islands Court concluded that the Petitioner must establish to the satisfaction of the Court a probability of surplus assets being returned to the contributory and in which it would share. The Cayman Islands Court considered various tests adopted in earlier cases such as it being "*likely*" that there would be a surplus, that there was a "*realistic prospect*" of there being a surplus and that there was a "*reasonable possibility*" of there being a surplus and concluded that there was little real difference between those various formulations. In the event, the Court concluded that in fact there was no realistic or reasonable prospect that the claim (the company's sole asset) would succeed and there was no likelihood of success. As a result, the Petition was dismissed.

In the Cayman Islands Court of Appeal decision in In the Matter of Strategic Turnaround Master Partnership Limited [2008] CILR 447, [5] the company, in an application to strike out a Petition, argued that the Petitioner as a continuing member of the company, did not have *locus standi* to Petition on the grounds of the company's insolvency. The Court of Appeal again did not question the rule in In Re Rica Gold Washing Co and did not doubt its application under Cayman Islands law in the event that a company was insolvent, as, in such circumstances, there would be nothing available for the Petitioner as a contributory ranking behind third party unsecured creditors. However, there was no need for the Court of Appeal to consider the point further because the Court found that the company was solvent.

What is a tangible interest?

The most common way of demonstrating a "*sufficient*" and/or "*tangible*" interest is by demonstrating on the evidence that there will be a surplus (addressed further below) after payment of (broadly speaking) (i) the costs of winding up; (ii) creditors and (iii) any prior ranking shareholders.

In the In re Rica Gold Washing Co decision, the court held that a surplus of £5 would not amount to a "*tangible interest*". There are, of course, various methods for catapulting the courts judgment by 137 years to 2016 and translating that into value today, which may result in anything from £450 to £8000. In Re Greenhaven Motors [1997] B.C.C. 547, Harman J, carried out a similar analysis and arrived at a figure of £1,000. However, the ratio of the Court of Appeal's judgment is clear in that there needs to be more than a negligible surplus for the benefit of the shareholder. The test that appears to be adopted in the In re Rica Gold Washing Co decision is whether the surplus is tangible enough to warrant the courts interference in the company's affairs.

In determining whether a shareholder has a "*tangible interest*" it was argued in Bryanston Finance –v-de Vries (No.2) (English Court of Appeal) that the petitioner's shareholding was so small that he could not "qualify" as a petitioner. This was given short shrift by the Court of Appeal, Buckley LJ finding (emphasis added):-

> *"... In my judgment, the smallness of a minority shareholder's holding is no bar to his petitioning for a winding up order if what he may hope to recover in a liquidation of the company is likely to be appreciable in relation to the size of his shareholding. If it would be de minimis, he might well be treated as having no locus standi, but otherwise he should be treated as having as good a right to seek a winding up order as any other contributor".*

5 Overturned on appeal to the Privy Council but not on this point.

A similar argument was raised in the Cayman Islands case of In the Matter of CVC Opportunity Equity Partners Limited [1999] CILR 378. In that case, even though the Petitioner only had 1 share in the fund and the fund itself was worth many millions of dollars, the Cayman Islands Court held that the Petitioner had a tangible interest in the company's assets whether his share was assessed at 1% or 3.5% of the fund.

Interest in the Shareholder's capacity as a shareholder in the Company

The "interest" that the shareholder claims must be in his capacity as a shareholder. In In re Chesterfield Catering Co. Ltd. [1975] 1 Ch 373, a Petition was brought by the personal representatives of a deceased member and the company was alleged to be insolvent. The company's business had been discontinued and it had no directors. The Petitioners wanted an independent liquidator to be appointed to enable them to proceed with the administration of the testator's Estate, but no benefit was going to be derived to the Estate from the shares of the deceased member.

The court recognised that the shareholder could well have legitimate interests in wanting to ascertain the assets and liabilities of a company or to determine claims against the company, but those matters amounted to indirect benefits from the liquidation process and were not benefits deriving from the shareholder's status *qua shareholder*; they were merely a "*private advantage*" that was "*unconnected with his membership of the company*" and did not therefore give the shareholder standing to present a just and equitable petition.

Exceptions to the Rule

There are a number of exceptions to the rule of needing to establish a "*sufficient*" and/or "*tangible*" interest.

A Petition will not be struck out in *limine* if the shareholder's inability to prove his standing is due to the company's own default in providing him with information to which he is entitled. In In re Newman and Howard Ltd [1962] Ch 527, it was held that:-

> *"In the case where a petition is based on a failure to supply accounts and information, with the consequence that the petitioner is unable to tell whether or not there will be a surplus available for the contributories, it cannot really be the law that the petitioner is bound to allege and to verify on oath the statement that the company has surplus assets when, by reason of the company's own default, he is not in a position to tell whether or not that statement is true".*

This exception will apply even if the Petitioners have not expressly pleaded the point, if it is in substance and by implication clear that they are unable to state the position due to a lack of information (Re a Company No. 007936 of 1994, [1995] B.C.C. 705).

It should be noted that this exception has its limitations as by the time the case comes to be tried, a Petitioner can be expected to have utilised the Court process to obtain such information and if he has failed to do so, the Petition will fail (Re Commercial and Industrial Insulations Ltd. [1986] BCLC 191).

Secondly, and linked to this is if an investigation is required to establish the position. As held in In re Othery Construction Ltd. [1966] 1 W.L.R.69 at 72, (emphasis added):-

> *"... it remains the rule that, before a contributory can petition successfully for the winding up of the company, he must show either that there will be a surplus of assets available for distribution amongst the shareholders* ***or that the affairs of the company require investigation in respects which are likely to produce such a surplus"****.*

Thirdly, instead of demonstrating a surplus, a Petition will be allowed to proceed if the Petitioner can show that in so doing it will avoid or minimise some disadvantage "*which would accrue to [the petitioner] by virtue of his membership of the company*". In re Chesterfield Catering Co. Ltd. [1975] 1 Ch 373 Oliver J held that (emphasis added):-

> *"I do not, however, think that it can be quite accurate to say that the tangible interest of the fully paid shareholder must necessarily and in all cases be restricted to the existence or prospective existence of a surplus";* and

> *"... it is I think clear that in referring to a "sufficient interest" Jessel MR [In re Rica Gold Washing Co Ltd.] meant an interest by virtue of the petitioner's membership.* ***In order to establish his locus standi to petition a fully paid shareholdermust...showthathewill,asamemberofthecompany,achievesome advantage, or avoid or minimise some disadvantage, which would accrue to him by virtue of his membership of the company ...****".*

The advantage or disadvantage must arise "*by virtue of his membership of the company*". As a result and if, for instance, a shareholder has also made loans to a company, it would appear that he cannot petition for winding up by virtue of his standing as a member in respect of his interests as a creditor.

Conclusion

The question of whether there will be a surplus may be apparent from the outset and may cause no difficulty. However, where there is a substantive debate, it can often be relatively involved and complicated as to whether there will be such a surplus for a Petitioner.

This may especially be the case in respect of cases where different classes of shareholders have competing rights and/or entitlements that may involve complicated questions relating to, *inter alia*, the interpretation of the company's Articles of Association. Depending upon the circumstances, it may be appropriate to obtain Expert accounting advice so that the Petitioner is satisfied as to his position.

In practice, consideration should be given to this threshold issue at the outset of considering winding-up proceedings as if indeed there is not a *"sufficient*" and/or "*tangible*" interest the Petition will ultimately be dismissed (and may be struck out before Trial if the petitioners' allegations of surplus are obviously unsustainable)[6] . The onus will be on the Petitioner at trial to show that there is a tangible interest.

This publication is for general guidance only and it is not intended to be a substitute for obtaining specific legal advice. Advice should be sought about specific circumstances. This review relates to Cayman Islands Law only as at 1 October 2016. If you would like further information please contact Richard Annette or Farrah Sbaiti of Stuarts Walker Hersant Humphries.

6 In Re Chesterfield Catering Co Ltd., it was stated that the issue "*should be left to be determined at trial*" unless the averment that there will be a surplus is "*plainly and almost incontestably bad*".