IN THE GRAND COURT OF THE CAYMAN ISLANDS
HOLDEN AT GEORGE TOWN
FINANCIAL SERVICES DIVISION

Cause No: FSD 82/2012

IN THE MATTER OF s.46 OF THE COMPANIES LAW (2011 REVISION)
AND IN THE MATTER OF FULCRUM UTILITY INVESTMENTS LIMITED

Appearances: **Ms. Caroline Moran of Maples and Calder on behalf of the Applicant**

Before: **The Hon. Mr. Justice Charles Quin**

Heard: **12th July 2012**

JUDGMENT

INTRODUCTION

1. On Thursday the 12th July 2012, this Court heard the Application, brought by Fulcrum Utility Investments Limited ("the Company"), for the following relief:

   i. A declaration that the purported issue of 950 million A ordinary shares, with a par value of £0.001 each, by the Company on the 25th January 2012 is void;

   ii. A declaration that the purported issue of 50 million A ordinary shares, with a par value of £0.001 each by the Company on the 7th March 2012 is void;

iii. An Order that, pursuant to s.46 of the Companies Law (2011 Revision), the Register of members of the Company be rectified accordingly.

2. The Company's application is grounded by the affidavits of James Corsellis ("Mr. Corsellis") and Mark Watts ("Mr. Watts") both sworn on the 15th May 2012.

RELEVANT CHRONOLOGY AND BACKGROUND

3. The Company was incorporated on the 14th December 2009 under the name of Marwyn Capital Investments I Limited, and as an exempted limited company under the law.

4. The Company's authorised share capital is £2,000,000 divided into 1,000,000,000 ordinary shares with a par value of £0.001 each and, 1,000,000,000 A shares, with a par value of £0.001 each.

5. Fulcrum Utility Services Limited ("FUSL") holds the sole ordinary share in issue. FUSL has held the share since the date of incorporation. FUSL was incorporated on the 4th December 2009 under the name Marwyn Capital 1 Limited as an exempted limited company under the law and has been listed on the Alternative Investment Market ("AIM") of the London Stock Exchange since the 24th December 2009.

6. Mr. Corsellis confirms that both the Company and FUSL were incorporated as investment companies by the investment fund, Marwyn Value Investors LP ("MVI") for the purpose of acquiring a utilities infrastructure group, Fulcrum Group Holdings Limited ("FGHL") and its subsidiaries from National Grid PLC.

7. As a result of the acquisition Mr. Corsellis confirms that FUSL became the ultimate parent holding company of the Fulcrum Group. The Fulcrum Group is an independent utilities infrastructure organisation, providing technical engineering, design, project management, consultancy and audit services in respect of gas, electricity, water and telecoms connections and services for residential and commercial building products.

8. As at the 1st May 2012 FUSL shares were trading at £0.19 on AIM, and it had a market capitalization of £29.5 million.

ROLE OF MARWYN

9. Mr. Corsellis's evidence shows that MVI is an investment fund, with an investment strategy to acquire stakes in publicly listed companies with up to £500,000,000 of equity value. MVI is managed by Marwyn Investment Management LLP ('Marwyn") and Mr. Corsellis and Mr. Watts are partners in Marwyn.

10. Mr. Corsellis avers that MVI makes its investments by initially listing a shell company on AIM, focused on pursuing a particular acquisition strategy. This shell company is typically funded by investments made by MVI and other financial institutions. Once listed, Marwyn works with the shell company to identify leading management teams and companies within its particular strategy, with the objective of supporting a management team in the acquisition and control of an operating company or group. Mr. Corsellis avers that FUSL was such a shell company.

11. On the 24th December 2009 the ordinary shares of FUSL were admitted to trading on AIM ("Admission") and FUSL raised capital by way of a first placement of

ordinary shares on the 24th December 2009, followed by a second placement of ordinary shares on the 8th July 2010, in order to complete the acquisition of FGHL.

12. Mr. Corsellis avers that, typically, Marwyn partners are appointed to board positions in each of MVI investment companies. As such, until the 8th July 2010, the directors of the company and FUSL and all Marwyn partners were related parties. On completion of the acquisition, the original directors of each company resign. Mr. Watts is now the sole director of the Company, and FUSL, that is related to Marwyn. Mr. Corsellis confirms that the other directors of the Company are either independent, or form part of the management team.

INCENTIVE SCHEME

13. FUSL was of the opinion that once the acquisition of FGHL was completed, the future success and value of the Fulcrum Group would depend to a high degree on the future performance of the FUSL Management Team (the "Management Team"). FUSL therefore sought to implement incentive arrangements which would reward the Management Team if shareholder value was created, thereby aligning the interest of the management directly with those of the FUSL shareholders.

14. As Mr. Corsellis explains, prior to the completion of the acquisition, FUSL sought to establish an incentive scheme, whereby, the members of the Management Team would subscribe for A shares in the Company. The A shares were to be issued by the Company, rather than FUSL, because this was more tax efficient for the Management Team.

15. Mr. Corsellis explains that as the A shares were to be issued as part of a management incentive scheme they never intended to require the Management Team to make further equity investments in the company.

16. The Company and the Management Team always intended that the A shares to be issued to the Management Team would be fully paid without any further liability for capital calls.

17. Mr. Corsellis goes on to explain that the terms of the A shares reflect that they are to operate to incentivize the Management Team and the economic value of the A shares is therefore linked to the value that accrues to shareholders in FUSL. Fundamentally, the economic value attached to the A shares is dependent on the "Hurdle Condition" being met. The Hurdle Condition relates to the growth in value of the shares in FUSL. The Hurdle Condition is satisfied if the compound annual growth rate of FUSL's share price (adjusted for dividends paid, any other capital return to FUSL shareholders and any new subscription proceeds received by FUSL from its shareholders) had been greater than 12.5% on the relevant "Measurement Date" as defined in the Articles of Association. So, for example, under the provisions of Article 4.2, the A shares have no right to receive a dividend before the 8th July 2013 and after that the date only in the event the Hurdle Condition is met.

18. Article 4.8 and 4.11 show that the A shares only receive distributions on a winding up or on a portion of the sale proceeds on a sale of the Company, if the Hurdle Condition is met.

19. When one examines the subscription letters exhibited to the affidavits of Mr. Corsellis and Mr. Wattts, it is accepted that if the Hurdle Condition has not been

met by the 5th anniversary of admission, the A shares must be sold to the Company for the amount of the original subscription price.

20. Article 16.10 puts in place a put option, whereby, if the Hurdle Condition has been met, the holders of the A shares have the option to require FUSL to purchase their A shares.

21. Paragraph 3.2 of the subscription letter set out the circumstances in which the put option can be exercised (e.g. between the 3rd and 5th Anniversary of Admission on the sale of the Company). The put price was calculated as 10% of the increase in shareholder value in FUSL since Admission, divided between the A shares on a pro-rata basis, and can be satisfied either in cash or by issuing ordinary shares in FUSL to the holders of the A shares.

22. In other words, the A shares can be considered as an option to purchase ordinary shares in FUSL, providing the Hurdle Condition has been met. The A shares were also subject to a vesting period which ends on the 3rd anniversary following the Admission. During the vesting period, the holder of the A shares cannot sell the A shares unless he leaves the Company's employment, in which case the A shares are sold back to the Company in accordance with the terms set out at paragraph 4 of the subscription letters exhibited to the affidavits of Mr. Corsellis and Mr. Watts.

THE MISTAKE WHEN PURPORTING TO ISSUE "A" SHARES

23. Mr. Corsellis avers that the Company purported to issue the first tranche of A shares to the Management Team by way of board resolution dated the 8th July 2010. Mr. Watts avers that on the 21st July 2011 the Company then purported to issue a further trance of A shares to a new member of the Management Team by way of a board resolution. However, the Register of the Company in relation to the first tranche of A shares was not updated to reflect the purported issue of the A shares until the 25th January 2012. And, in relation to the second tranche, the register was not updated to reflect the purported issue of the A shares until the 7th March 2012.

24. As Mr. Corsellis explains, the Management Team is composed of all UK tax residents and, for the purposes of English Tax Law the subscription price for the A shares was required to reflect "fair market value" to avoid potentially onerous capital gains tax. The fair market value is considered to be the value that would be obtained from a sale of the shares on the open market, or, in other words, the price that a willing buyer would pay to a willing seller to acquire the shares.

25. Mr. Corsellis's evidence shows that the fair market value for the A shares was calculated by Marwyn Capital LLP ("Marwyn Capital"). This Marwyn entity provided corporate support services to the Company and FUSL.

26. Marwyn Capital calculated the fair market value on the basis that the A shares constituted an option to purchase ordinary shares in FUSL (i.e. pursuant to the put option and based on the put price) once the Hurdle Condition was met. The value took into account the likelihood of the Hurdle Condition being met. Based on the share price of the ordinary shares in FUSL at the time, the probability that the share

price would increase in the future (based on historic movements in the share price), the length of time within which the Hurdle Condition could be met and the restriction on the rights attaching to the A shares. Based on all these factors Mr. Corsellis states that Marwyn Capital considered that the fair market value of 100% of the A shares should be £5,000.00, meaning that the value of 95% of the A shares to be issues would be £4,750.00.

27. Mr. Corsellis avers that Marwyn Captial then proceeded to prepare the subscription letters for the A shares on behalf of the Company. However, a fundamental error was made in preparing these letters, as they were drafted on the mistaken assumption that all of the authorised A share capital of the Company, (i.e. 1,000,000,000 A shares) would be issued for the purpose of issuing shares in accordance with agreed percentages, rather than that sufficient shares would be issued at their par value, to be equal to the fair market value in accordance with the agreed percentages. This had the result of the subscription price of the A shares being set at £0.000005 per share, which would constitute a discount to the par value of £0.001 per share.

28. Regrettably, this error was repeated on the 21st July 2011 when the Company purported to issue the balance of the authorised share capital (i.e. 5%) to a Mr. Ray Jardine ("Mr. Jardine") in recognition of Mr. Jardine's ongoing contribution to the Fulcrum Group, in his capacity as Human Resources Director. Mr. Watts states in his affidavit that at this time the fair market value of all the A shares has increased and was calculated at £25,400.00, such that 5% of the shares was valued at £1,270.00.

The Company therefore purported to issue 50,000,000 A shares to Mr. Jardine at a subscription price of £0.0000254 per A share. Both Mr. Corsellis and Mr. Watts depose to the fact that the Company did not give any real thought to the precise legal characterization of the A shares, when purporting to issue either the first or the second tranche of the A shares.

29. Ms. Moran, Counsel for the Company, submits that the evidence shows that neither the Company nor the Management Team obtained Cayman Islands legal advice in respect of the subscription price for the A shares. Counsel for the Company further contends that it is clear from the evidence of Mr. Corsellis and Mr. Watts that the Company never intended the A shares to create an obligation for any member of the Management Team to make a further equity investment in the Company, and the Management Team subscribed for the A shares on this basis.

30. Accordingly, the Company purported to issue and the Management Team subscribed for the A shares under the mistaken belief that no further amounts would be payable by the Management Team in respect of the A shares.

31. However, both Mr. Corsellis and Mr. Watts point out, in effect, the Company purported to issue the A shares to the Management Team at a discount to par value.

DISCOVERY OF THE MISTAKE

32. Mr. Watts states that in September 2011 Mr. Christopher Dwyer ("Mr. Dwyer"), a member of the Management Team, sought to leave his employment with FUSL. The A shares attributable to Mr. Dwyer were to be re-purchased by FUSL in accordance with the terms of the subscription letter. Consequently in late January 2012 Marwyn Capital, in its capacity as corporate finance advisor to the Fulcrum Group sought advice on behalf of the Company from the Company's Cayman Islands attorneys in respect of re-purchasing Mr. Dwyer's unvested shares. Marwyn Capital then realized that when the Management Team subscribed for A shares in July 2010 and July 2011 MCS, the corporate service provider that maintained the Company's register and provided the registered office, had not been notified of the new share issue, and therefore, the register had not been updated. Marwyn Capital therefore instructed MCS to update the register based on the subscription letters and board minutes from July 2010 and July 2011. Consequently, acting on this instruction MCS updated the register and recorded that the A shares had been issued as partly paid shares.

33. Mr. Watts confirms that the error in respect of the A shares was then discovered when the Company's Cayman attorneys advised the Company that the A shares had been issued for less than par value, that, on the face of it, they were therefore partly paid shares and could not be repurchased from Mr. Dwyer until the par value was paid up in full, and that the other members of the Management Team would, in theory, also be liable for the unpaid balance on their A shares.

34. It appears from the evidence of Mr. Corsellis and Mr. Watts that it was never the intention of the Company or the Management Team that further amounts would be payable by the management on the A shares.

35. The Company maintains that the rights attached to the A shares have never been exercised, the A shares have not been transferred or dealt with in any way by the Management Team, nor has any dividend ever been declared on the A shares.

36. Mr. Watts has set out the financial position of the Company and has exhibited the unaudited financial statements of the Company for the period ending the 31st March 2012. This demonstrates that the Company holds cash £17,084.00, and, on the assumption that no amounts would be payable on the A shares, the Company has debtors of £3,937.00. Mr. Watts points out that the Company also has the value of its investments in its subsidiaries. Mr. Watts avers that the value of these investments is now considerably more than the investment value recorded on the balance sheet at cost and that the market capitalization of FUSL was approximately £29.5 million as at the 1st May 2012. In addition, the Company's liabilities comprise an inter-company loan, due to FUSL of US15,040.00 and consideration of £4 payable to FGHL for the acquisition in July 2010.

37. The evidence shows that the Company is solvent both on a cash flow and balance sheet basis, and can pay its current liabilities from its cash, and, in addition, Mr. Watts points out, the Company's creditors have consented in writing to this application.

38. Counsel on behalf of the Company relies on the affidavits of Mr. Corsellis and Mr. Watts, and on the exhibits attached thereto, and submits that it was never intended

that the A shares would create an obligation for the Management Team to make a further equity investment in the Company. Counsel for the Company submits that the Company purported to issue, and the Management Team purported to subscribe to the A shares on the understanding that no further amounts would be payable by the Management Team in respect of the A shares. The Management Team was entered on the Company's register as members and holders in the A shares on the 25th January 2012.

39. The Company submits that as a result of an administrative error, the Company inadvertently purported to issue the A shares at less than par value. Consequently the Company did not follow the procedure set out in s.35 of the Companies Law in order to lawfully issue the shares at a discount. To put it another way, the Company submits that issuing shares at a discount, without complying with s.35 of the Companies Law would constitute an unauthorized reduction of capital, and as a result, shares issued in these circumstances could be treated as partly paid shares.

40. In order to ensure that the Management Team cannot be considered liable for any perceived unpaid balance on the A shares, the Company therefore seeks a declaration that the issue of the A shares was void as a result of the Company and the Management Team entering into the subscription contracts on the mistaken belief that no further amounts would be payable by the Management Team in respect of the A shares. Accordingly, the Company finally seeks an Order permitting the consequential rectification of the register. The Company also presents evidence that as soon as the Company and the Management Team were made aware that the shares had not been lawfully issued at a discount, they began to

explore options to ensure that the Management Team would not be considered liable for the unpaid balance of the shares. Mr. Watts's evidence shows that these deliberations were ongoing during the course of February and March 2012 and included seeking to pursue out of court commercial solutions. However, once it became apparent that an out-of-court solution would not be possible, the Company commenced preparing this application, which was duly filed on the 18th May 2012.

41. The Company contends that at no time from the 25th January 2012 did the Management Team acquiesce to having agreed to take the A shares, other than at a discount. All the efforts of the Company since that time were directed at ensuring the Management Team would avoid any liability.

42. Accordingly, the Company contends that the subscription letters are void contracts as being an unlawful issue of shares at a discount, and the Management Team did not agree to take the A shares, other than at a discount and further have never exercised any of their rights in respect of these shares. Consequently, Counsel for the Company submits that the Management Team is entitled to rectification of the register and return of their subscription monies.

43. The Court notes that attached to Mr. Watts' affidavit are the letters from the members of the Management Team, including Mr. Dwyer, confirming that they all,

> "*...consent to and support the application to the Grand Court by the Company seeking a declaration that the purported issue of the A shares to them is void and that the register of members be rectified accordingly.*"

44. Further, or in the alternative, the Company submits that the subscription contracts are void as a result of either a mistake of law or a mistake of fact, and further submit that that distinction between the mistake of law and mistake of fact is no longer relevant. The Company maintains that the mistake in this case renders the contract impossible to perform, as the contract to subscribe for and to issue shares at a discount is unlawful.

45. Finally the Company submits that no prejudice will be suffered by any parties by the rectification of the register. The Company is solvent and able to pay its debts, and further, the Court notes from the letters exhibited to Mr. Watts' affidavit, that the creditors have consented to the application. Additionally, the Company adds that if the Court grants the rectification Order the Management Team will subscribe for new class A shares at current market value, which is significantly higher than the original market value.

ANALYSIS AND CONCLUSION

46. Section 46 of the Companies Law (2011 Revision) reads:

> *"If the name of any person is, without sufficient cause, entered in ... the register of members of any company, or if default is made ... in entering on the register the fact of any person having ceased to be a member of the company, the person or member of the company, the person or member aggrieved, or any member of the company or the company itself may, by motion to the Court, apply for an Order that the register be rectified; and the Court may either refuse such application with or without costs to be paid by the applicant, or it may, if satisfied of the justice of the case, make an order for the rectification of the register...."*

47. The Applicant's counsel submits that the issue of shares at a discount is, on principle, prohibited because it would mislead persons dealing with the Company into thinking that the full value of the issued share capital has been received by the Company at some time during its existence.

48. The principle has been, that issuing shares at a discount is treated at common law as constituting a reduction of capital, and the Applicant's counsel cites the dicta of Lopes LJ in the English Court of Appeal decision of ***Re Almada and Tirito Co.*** (1888) 38 Ch. D. at page 426 where he said:

> *"I can see no practical distinction between issuing shares at a discount and returning to the member a portion of the capital to which the creditors have a right to look as that out of which they are to be paid."*

49. Therefore, counsel for the Company argues that, as with any reduction of capital, unless the statutory provisions permitting the issue of shares at a discount are followed, (i.e. special resolution of the share holders and the Court sanction of the resolution pursuant to s.35 of the Companies Law), the purported issue at a discount is unlawful and any contract between the Company and the shareholder purporting to authorise the issue of the shares at a discount is *ultra vires* the Company.

50. The House of Lords held in ***Ooregum Gold Mining Company of India, Limited v Roper & Ors*** [1862] A.C. 125, that:

> *"A company limited by shares, formed and registered under the Act of 1862, has no power to issue shares as fully paid up, for a money consideration less than their nominal value."*

51. So far as I am aware there are no Cayman Islands authorities dealing with shares purportedly issued at a discount, where there has been no compliance with s.35 of the Companies Law. Section 35 reads a follows:

> " *(1) Subject as provided in this section, it shall be lawful for a company to issue at a discount shares in the company of a class already issued:*
>
> *Provided that-*
>
> *(a) The issue of the shares at a discount have been authorised by resolution of the company, and have been sanctioned by the Court;*
>
> *(b) The resolution specify the maximum rate of discount at which the shares are to be issued;*
>
> *(c) Not less than one year, at the date of issue, has elapsed since the date on which the company was entitled to commence business; and*
>
> *(d) The shares to be issued at a discount are issued within one month after the date on which the issue is sanctioned by the Court or within such extended time as the Court may allow.*
>
> *(2) Where a company has passed a resolution authorising the issue of shares at a discount, it may apply to the Court for an order sanctioning the issue, and on any such application the Court, if, having regard to all the circumstances of the case, it thinks proper so to do, may make an order sanctioning the issue on such terms and conditions as it thinks fit.*
>
> *(3) ....*
>
> *(4) ...."*

52. In England, before the 1st November 1929, there was no equivalent to s.35 of the Cayman Companies Law. Section 47 of the English Companies Act 1929 and subsequently, s.57 of the English Companies Act 1948, were then enacted in a form substantially similar to s.35 of the Cayman Companies Law. Accordingly, until 1980, it was therefore possible to issue shares at a discount to par value in England.

53. In 1980, s.57 of the English Companies Act 1948 was repealed by s.2 of The Companies Act 1980. There is now an expressed statutory prohibition on the issue of shares at a discount in England by virtue of s.580 of the Companies Act 2006 which states that a Company's shares must not be allotted at a discount.

54. The Applicant submits that the following principles can be extracted from the English authorities:

i. Where shares are unlawfully issued at a discount, and the allottee accepts these shares, the allottee will, in general, be treated as holding partly paid shares and considered liable for the balance. See ***Re Addlestone Linoleum Company*** (1887) 37 Ch. D. 191

ii. In general, the allottee cannot obtain rectification of the register and avoid liability on the basis that the unlawful contract was *ultra vires* the Company because shareholders take their shares pursuant to the statutory obligation that they are liable to pay for any unpaid balance on their shares. See ***Re Railway Time Tables Publishing Company Ex Parte Sandys*** (1889) 42 Ch. D. 98.

iii. However, where the allottee has not allowed himself to be treated as a shareholder in respect of the unlawfully discounted shares, he may obtain rectification of the register and avoid liability on the ground that he has not agreed to become a member of the Company other than on the basis that his shares will be discounted. See Re ***Almada and Tirito Co*** (1888) 38 Ch. D. 415.

iv. The allottee may also obtain rectification of the register and avoid liability for the unpaid balance with a contract to allot the shares at a discount is void, as a result of a mistake of fact. See ***Re Derham and Allen Ltd*** [1946] Ch. 31

v. As a result of the decision of the House of Lords in ***Kleinwort Benson Ltd. v. Lincoln City Council*** [1999] 2 A.C. 349, the Applicant argues that it appears that a mistake of law may also be grounds for avoiding such a contract.

STATUTORY LIABILITY FOR PAR VALUE

55. Before the 1st November 1929 the English Courts held that, at common law where there is no lawful means available to a company by which to issue shares at a discount, shareholders who had purportedly received shares at a discount, were treated as only partly paid shares and were considered liable for the unpaid balance, notwithstanding the agreement with the Company that the shares should be discounted.

Such shareholders were not entitled to orders rectifying the register to remove their names and return of the subscription monies paid. See ***Re Addlestone Linoleum Company*** (1887) 37 Ch. D. 191; ***Ooregum Gold Mining Co of India v Roper*** [1892 A.C. 125; and ***Re James Pitkin & Co. Limited*** (1916) WN 112. The reason was because the Courts considered that where a shareholder had contracted and agreed to become a member of the Company, he did so on the basis of the statutory provisions in the Companies legislation, which provided that shareholders' liability

was limited to the par value of the shares. The English legislation in question was the equivalent of s.6 and s.49(d) of the Cayman Islands Companies Law.

Section 6 reads:

> "*The liability of the members of a company formed under this law may, according to the memorandum of association, be limited either to the amount, if any, unpaid on the shares respectively held by them, or to such amount as the members may respectively undertake by the memorandum of association to contribute to the assets of the company in the event of its being wound up.*"

And s.49(d), in relation to the liability of members reads:

> "*In the event of a company being wound up, every present and past member of such company shall be liable to contribute to the assets of the company to an amount sufficient for payment for payment of the debts and liabilities of the company, and the costs, charges and expenses of the winding up, and for the payment of such sums as may be required for the adjustment of the rights of the contributories amongst themselves provided that in the case of a company limited by shares, no contribution shall be required from any member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member ....*"

56. As Lord Macnaghten stated in the House of Lords case of ***Ooregum Gold Mining Company of India***:

> "*The dominant and cardinal principle of [the Companies Act] is that the investor shall purchase immunity from liability beyond a certain amount, on the terms that there shall be and remain a liability up to that limit.*"

57. In ***Re Eddystone Marine Insurance Co.*** [1893] 3 Ch. 9 at page 15 the Courts refused to accept the proposition that shareholders could avoid liability on the basis that the agreement to issue the shares at a discount was void as being ultra vires the Company and the register should therefore be rectified.

In ***Re Eddystone Marine Insurance Co.***, Wright J concluded that the shareholder necessarily takes his shares pursuant to the statutory obligation to pay up to the par value of the shares, notwithstanding the issue at a discount may have been *ultra vires*.

Cotton LJ in the English Court of Appeal decision of ***Re Railway Time Tables Publishing Company Ex Parte Sandys*** confirmed at pages 112 and 113 that liability flows, not from any agreement by the shareholder, but from the statute operating on the agreement to become a member of the company.

58. Accordingly, from a review of these English authorities it follows that if shares were issued at a discount (other than in compliance with the statutory provisions) and the allottees were registered as members and acted as the registered members of those shares, they were liable for the full amount of the unpaid par value of their shares.

59. A deciding factor for the Court in each of the decisions referenced above was the fact that in each case the shareholders had assented to being treated as shareholders and acted in this capacity. Therefore in ***Railway Time Tables Publishing Co*** the shareholder in question sold some of the discounted shares, received new share certificates and signed proxies for general meetings. In ***Re Eddystone Marine*** the shareholders in question attended meetings, accepted dividends, voted as shareholders and did everything which would amount to evidence of acceptance of the shares and to knowingly acting as shareholders. In ***Welton v. Saffery*** [1897] A.C. 299 it was noted that the shareholders allowed their names to remain on the register of members until their remedy against the Company was gone. The Courts

considered that once the shareholders had accepted the shares in this fashion, they could not then be heard to say they were not shareholders.

60. In the English Court of Appeal decision in ***Railway Time Tables Publishing Co*** Lindley LJ. set out the position as follows at page 115:

> *"[The shareholder] applies to the Company for shares [to be issued at a discount] and she is registered accordingly.... it is, I think, quite obvious that if she had found out what she says she has now found out, and had said, "This is not in compliance with the real understanding between us; I find these shares cannot be treated as paid up, and I never agreed to take any others", she would probably have been entitled to have the register rectified. If she had come a short time after, she need not have accepted what the Company gave her; but if she does accept the shares the Company gave her, it does not require a fresh bargain on her part to pay for them. That is the fallacy of the whole argument. If I ask for one thing, and have another thing sent me, and I keep it, I must pay for it – not because I made another bargain to pay for it when I say I will not, but because the law imposes on me an obligation to pay for it if I keep it."*

61. By comparison, in ***Re Almada and Tirito Co.***, it was found that the holder of the shares purportedly issued at a discount had not accepted the shares and accordingly was entitled to rectification of the register. In ***Re Almada and Tirito Co,*** certain individuals had agreed to subscribe for shares in the Company on a discounted basis. On the 4th January 1988, the shares were issued. On the 24th January 1988 the allottees became aware of the decision in ***Re Addlestone Linoleum Company*** and therefore brought a motion seeking rectification of the register and the return of the subscription monies on the grounds that the issue of the shares at a discount was ultra vires and void. The English Court of Appeal agreed and held that:

> *"As the Company had put these gentlemen on the list of shareholders, and they did nothing which in any way which was an asset to that being done, the contract [to issue shares at a discount] being one which the Company could not carry into effect, we must make an order that their names be removed from the register ... and to return to each of them (the subscription monies)."*

62. In the case now before the Court the members of the Management Team were not registered as shareholders until the 25th January 2012.

63. From the evidence of Mr. Corsellis and Mr. Watts it is apparent that as soon as the Company and the Management Team were made aware that the shares had not been lawfully issued at a discount, they began to explore options to ensure that the Management Team would not be considered liable for the unpaid balance on the shares. From the evidence before the Court it is apparent that these deliberations continued through February and March of 2012. However, once it became apparent that an out-of-Court solution was not possible, the Company prepared this application which was filed on the 18th May 2012.

64. It would appear from all the evidence before me that at no time from the 25th January 2012 did the Management Team acquiesce to having agreed to take the A shares other than at a discount.

65. I accept that all the efforts of the Company since that time were directed at ensuing the Management Team would avoid any liability. As such I find that the circumstances of this case can be distinguished from the decisions in ***Railway Time Tables Publishing Co*** and in ***Re Eddystone Marine Insurance***, and, instead, can be dealt with in accordance with the principles set out by the English Court of Appeal in ***Re Almada and Tirito Co.***

66. Accordingly, I find that the subscription letters are void contracts as being an unlawful issue of shares at a discount, and, that the Management Team did not agree to take the A shares other than at a discount, and further, I find that the Management Team have never exercised any of their rights in respect of these

shares and, accordingly, I find that the Management Team is entitled to rectification of the register and return of their subscription monies.

67. I now turn to the second and alternative limb of the Applicant's submissions that the Company and the Management Team were both operating under a mistake as to law.

68. In 1998 the House of Lords in ***Kleinwort Benson Ltd. v. Lincoln City Council*** [1999] 2 A.C. 349 held in a majority decision that on application on the principle of unjust enrichment the rule precluding the recovery of money paid under a mistake of law could no longer be maintained and recognition should be given to a general right to recover money paid under a mistake whether of fact or law subject to the defences available in the law of restitution.

69. Before the House of Lords decision in ***Kleinwort Benson Ltd.***, the orthodox view was that there was a distinction between mistakes of law and mistakes of fact, such that, only mistakes of fact could operate on the minds of contracting parties so as to avoid void contracts.

70. Accordingly, as was found by Cotton LJ. and Lindley LJ in ***Re Railway Time Tables Publishing Company Ex Parte Sandys*** an allotee of shares purportedly issued at a discount could not avoid his statutory liability for the unpaid balance, simply because he was mistaken as to the legal consequences of accepting shares purportedly issued at discount. However, where the allottee established a mistake of fact he could avoid liability on the basis that no binding contract had been concluded. A good example of this is the case of ***United Ports and General Insurance – Beck's*** case [1873-74] LR 9 Ch 392 where the allottee agreed to

subscribe for shares on the basis that they were credited as 50% paid up and the Company issued shares that were wholly unpaid. The allottee was placed on the register but did not find out until after further enquiry that the shares were unpaid. The Court held that the subscription on one set of terms and the allotment being in another set of terms, there was a mistake of fact, and it was held that he ought not to be bound as it was held that there was no contract by both parties agreeing to the same terms.

71. In ***Re Derham and Allen Ltd*** [1946] Ch. 31 Cohen J. considers the position where a company fails to fulfill the statutory requirements to validly issue shares at a discount. In this case the company had purported to issue shares at a discount pursuant to the terms of s.47 of the English Companies Act 1929. The shareholders had duly passed the required resolution and the company had instructed its solicitors to carry out the necessary legal formalities to obtain Court sanction. Due to an oversight by the solicitor, no application was made to the Court to sanction the resolution. One year later, the company's auditors uncovered the mistake. The company took the position that as s.47 permitted shares to be lawfully issued at a discount, it was a question of fact in any case whether the requisite sanction had been obtained. Accordingly, the facts could be distinguished from earlier authorities such as ***Re James Pitkin and Co***. as, where there was no lawful means available to issue shares at a discount any mistake could only be one of law. The English High Court agreed with this assessment and noted that it would have been proper to order the rectification of the register.

72. An analogous case is the case of ***In Re Darlington Forge Company*** [1887] 34 Ch. 522. In this case members of a firm sold their assets to a company pursuant to a verbal contract. In return the Company issued them shares paid up to the value of the assets. At that time in England, pursuant to s.25 of the Companies Act 1867 it was permissible to issue shares other than for cash consideration, provided the agreement was set out in writing and was filed with the Registrar of Joint Stock Companies at or before the issue of such shares. In the event no contract was filed the shares were considered to have been issued for cash, and the shareholders would therefore be liable for any unpaid balance. No written contract was entered into or filed in this case. Approximately fourteen years later the shareholders realised the position and applied to the Court to rectify the register of members to strike out their names to allow a new agreement to be properly executed and registered. The shareholders maintained that they had left all formalities to their solicitors and were ignorant that the proper formalities had not been complied with. They advanced the argument that if the mistake occurred due to their ignorance of law, that might render it more difficult to rectify the matter, but not impossible, and no prejudice could be suffered by the Company's creditors by the proposed course of action (See pages 524 and 525). The English Court found that the parties had agreed to leave it to the solicitor to carry out all steps necessary to perfect the transaction, and were not aware any precaution had been omitted. As no harm could be done by rectifying the register and no prejudice could be suffered by any party in doing so, the Court was prepared to rectify the register provided existing debts were provided for and a new agreement was duly filed.

73. Since the House of Lords decision in ***Kleinwort Benson***, where the distinction between mistake of law and mistake of fact was removed in respect of restitutionary claims for money paid by mistake it is now doubtful whether the distinction between a mistake of law and a mistake of fact continues to be so relevant.

74. In ***Brennan v. Bolt Burdon*** [2005] QB 303, the English Court of Appeal reviewed the previous distinction between mistake of law and mistake of fact and found that the removal of the distinction between a mistake of fact and a mistake of law was not confined to the law of restitution, and also applied to the general law of contract.

75. I find it necessary and helpful to review in some detail the judgment of the three presiding Judges namely, Kay LJ, Bodey J, and Sedley LJ., Kay LJ stated in paragraph 8 on page 309:

> *"For 200 years it was an accepted principle of common law that a contract could not be vitiated by a mistake of law. In Furness Withy* ***(Australia) Pty Ltd. v. Metal Distributors (UK) Ltd.*** *[1990] 1 Lloyd's Rep 236, 250 Dillon LJ observed:*
>
> > *"The rule that a contract cannot be set aside on the grounds of mistake if the mistake was a mistake of law, seems to have been first enunciated in unqualified terms by Lord Ellenborough CJ in* ***Bilbie v. Lumley*** *(1802) 2 East 469. It has been criticized not only by Lord Denning in* ***Andre & Cie v. Michel Blanc*** *[1979] 2 Lloyd's Rep 427 but also ... by the eminent authors of Goff and Jones on the Law of Restitution. Lord Ellenborough refers to the use of the Latin tag 'ignorantia juris non excusat' by Buller J. in* ***Lowry v. Boirdeau*** *(1780) 2 Doug KB 468..."*

76. At paragraph 9 of his Judgment Kay LJ states:

*"The turning point for the general principle came in **Kleinwort Benson Ltd. v. Lincoln City Council** [1999] 2 A.C. 349. Kleinwort Benson had made payments to a local authority under swap agreements which were thought to be legally enforceable. Subsequently, a decision of the House of Lords, **Hazell v. Hammersmith and Fulham London Borough Council** [1992] 2 A.C. 1, established that such swap agreements were unlawful. Thereafter Kleinwort Benson sought restitution of the payments on the basis of a mistake of law. The majority in the House of Lords (Lord Goff of Chievely, Lord Hoffmann and Lord Hope of Craighead) held that Kleinwort Benson was entitled to succeed upon that basis. The minority dissented, not on the issue of the ambit of mistake of law in principle but on the question of whether the declaratory theory of the common law required the case to be analysed in terms of mistake of law. **Bilbie v. Lumley** (1802) 2 East 469 was overruled, along with other authorities to the same effect. Referring to the Law Commission's Consultation Paper Restitution of Payments Made Under a Mistake of Law (1991) (Law Com No 120) Lord Goff at p 372, referred to "the main criticisms" of the previously established principle. He described the distinction drawn between mistakes of fact and mistakes law as producing results "which appear to be capricious" and to the exceptions and qualifications which "in truth betray an anxiety to escape from the confines of a rule perceived to be capable of injustice" with the result that "the law appeared to be arbitrary in its effect." He added:*

> *"as a result of the difficulty in some cases of drawing the distinction between mistakes of fact and law, and the temptation for judges to manipulate that distinction in order to achieve practical justice in particular cases, the rule became uncertain and unpredictable in its application.*

He concluded at p375:

> *the mistake of law rule should no longer be maintained as part of English Law ... English Law should now recognise that there is a general right to recover money paid under a mistake, whether of fact or law, subject to the defences available in the law of restitution.*"

Kay LJ went on to add in paragraph 10:

> "*Although the **Kleinwort Benson** case concerned a restitutionary claim rather than a contractual one, it cannot be doubted that its effect now permeates the law of contract."*

77. And at letter F:

"*... further down in paragraph 10 the Editors of Chitty on Contracts, 28th ed (1999), expressed the view, at para 5-018, that:*

> *a fundamental mistake may now render a contract void even though the mistake is one of law." In the 29th edition (2004), this sentence remains at para 5-042, but with the addition of the words "provided the mistake is such that it makes the contract adventure impossible." The addition of that proviso is to accommodate the decision of the Court of Appeal in* ***Great Peace Shipping Co. Ltd. v. Tsavliris Salvage Ltd.*** *[2003] QB 679, which effects a conceptual assimilation between common mistake and frustration. As a result, two of the elements which must be present if common mistake is to avoid [sic] a contract are: "(iv) the non-existence of the state of affairs must render contractual performance imposible; (v) the state of affairs must be the existence, or vital attribute, of the consideration to be provided or circumstances which must subsist if performance of the contractual adventure is to be possible": per Lord Phillips of Worth Matravers MR, giving the judgment of the court, at p 703, para 76."*

Kay LJ stated at the end of paragraph 17 on page 314:

"*For a common mistake of fact or law to vitiate a contract of any kind, it must render the performance of the contract impossible; see* ***Great Peace Shipping Co. Ltd. v. Tsavliris Salvage Ltd.*** *[2003] QB 67."*

78. In ***Brennan v. Bolt Burdon*** Bodey J. stated at paragraph 24 on page 317:

"*In* ***Kleinwort Benson Ltd. v. Lincoln City Council*** *[1999] a A.C. 349, the House of Lords ruled that in the law of restitution, there is no longer a distinction between payments made under a mistake of fact and payments made under a mistake of law.*"

At paragraph 25 Bodey J. continued:

"*In so deciding, the House of Lords overruled* ***Bilbie v Lumley*** *(1802) 2 East 469, the case which is taken to have first enunciated that distinction. In Australia and Canada, the decision in the Kleinwort Benson case (given in the context of restitution) has now been extended to and applied in the law of contract* ***Classic International Pty Ltd. v. Lagos*** *[2002] NSWSC 1155 and* ***Air Canada v. British Columbia*** *(1989) 59 DLR (4th) 161. Further in* ***Pankhania v.***

Hackney London Borough Council *[2002] EWHC 2441 (Ch), Mr. Rex Tedd Q.C., sitting as a deputy judge of the Chancery Division, extended the decision in Kleinwort Benson into the law of contract (specifically as regards misrepresentation), an extension endorsed by several academic commentators including the editors of Halsbury's Lawas of England 4th ed reissue (1999), vol 32, para 11 and Chitty on Contracts, 29th ed (2004), para 5-018."*

Bodey J concluded at paragraph 26:

> *"These various considerations more or less compel a conclusion that in the English law of contract the former distinction between mistake of fact and mistakes of law no longer pertains. For a different approach to survive as between the law of restitution and the law of contract would seem illogical and difficult to justify."*

79. In ***Brennan v. Bolt Burdon*** both Kay LJ and Bodey J accepted that a mistake of law may render a contract void.

80. In the third and final judgment in ***Brennan v. Bolt Burdon*** Sedley LJ stated at paragraph 58:

> *"A further problem, in my view, lies in the formulation of the elements of common mistake set out in the **Great Peace** case, at p 703, para 76. The fourth element is that "the non-existence of the state of affairs must render contractual performance impossible. Where the mistake is as to the existence of goods, or (as in the **Great Peace** case) as to the location of a vessel, this is straightforward. But what is the analogue in a case of mutual mistake of law?"*

81. Sedley LJ then introduced a different test to that of Kay LJ and Bodey J at paragraph 60:

> *"I think that in cases of mutual mistake of law a different test may be necessary. The equivalent question needs to be whether, had the parties appreciated that the law was what it is now known to be, there would still have been an intelligible basis for the agreement. This seems to me to come as close as one can to what was identified as being at issue in the **Great Peace** case at p 691 at*

para 32: a common mistaken assumption (in that case one of fact) which renders the service that would be provided if the contract is performed something different from the performance that the parties contemplated."

82. It appears to me from the evidence of Mr. Corsellis and Mr. Watts that there was a genuine mistake of law and a mistake of fact. However, in light of the ***Kleinwort Benson*** decision and the recent authority of ***Brennan v. Bolt Burdon***, the previous distinction between mistake of law and mistake of fact is no longer relevant. I accept the evidence of Mr. Corsellis and Mr. Watts that the Company did not give any real thought to the precise legal characterization of the A shares. The Company never intended the A shares to create an obligation for the Management Team to make a further equity investment in the Company. I find that the Management Team subscribed for the A shares on this basis. It is clear that neither the Company nor the Management Team obtained Cayman Islands legal advice in respect of the subscription price for the A shares. Consequently, I find that the Company issued, and the Management Team subscribed for the A shares under the mistaken belief that no further amounts would be payable by the Management Team in respect of the A shares.

83. The mistake is one that falls into the category identified by Kay LJ and Bodey J. in the English Court of Appeal case of ***Brennan v. Bolt Burdon***, that is, a mistake that in the true sense renders the contract impossible to perform, as the contract to subscribe for, and issue, shares at a discount is, under common law, unlawful and therefore void.

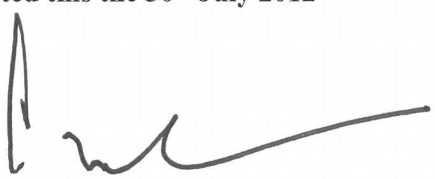
84. Furthermore, if I apply Sedley LJ's test in ***Brennan v. Bolt Burdon***, I find that the Company and the Management Team proceeded on "*a common mistaken*

assumption which rendered the service that would be provided if the contract is performed something different from the performance the parties contemplated."In fact, from the evidence before me I find that the mutual mistake has resulted in something "substantially different" from what the parties intended and thought they had achieved.

85. Accordingly, for the above reasons I am prepared to grant the relief sought in the Company's *ex parte* Originating Summons dated the 18th May 2012. I find that in granting this relief no prejudice will be suffered by any parties by the rectification of the register of members. Furthermore, from the evidence, it is clear that the Company is solvent and able to pay its debts. I am fortified by the fact that the creditors have consented to the application, which satisfies the concerns raised by the English Court of Appeal in ***Darlington Forge Company*** before it was prepared to rectify the register.

86. For all these reasons I grant the Applicant the relief sought in paragraphs 1, 2 and 3 of its *ex parte* Originating Summons dated the 18th May 2012

Dated this the 30th July 2012



Honourable Mr. Justice Charles Quin
Judge of the Grand Court