

27/11/08



IN THE GRAND COURT OF THE CAYMAN ISLANDS
IN OPEN COURT IN THE GRAND COURT

CAUSE NO. 531 OF 2008

IN THE MATTER OF SECTIONS 14 TO 16 OF THE COMPANIES LAW
(2007 REVISION)

IN THE MATTER OF M LIMITED

Appearances:

Mr. C. McKie with Mr. S. Firth and Ms. C. Moran, all of
Maples and Calder for the Petitioner

Heard: 21st November 2008

CORAM: Foster J.

JUDGMENT

This is a Petition by M. Limited ("the Company") seeking an order confirming a reduction of the Company's issued share capital to nil pursuant to a special resolution by the sole shareholder of the Company passed in accordance with the Company's articles of association.

Following the hearing I duly made the order requested but in light of the unusual legal issues I said that I would give my reasons for determining that the Court had jurisdiction to make the order.

There are two unusual features of this application. First, the Company is a company limited by guarantee but with an issued share capital. Second, the resolution was for reduction of the issued share capital of the Company to nil, with the effect that the Company would consequently have no issued share capital.

It is not necessary for me to go into detail as to the reasons for the proposed reduction of the whole issued share capital of the Company in view of the limited scope of this judgment and it is sufficient to indicate that the capital reduction is part of a transaction pursuant to which the current sole guaranteeing member of the Company is to retire and a third party is to be admitted and registered as replacement guaranteeing member in exchange for a payment by the third party to the retiring guaranteeing member. For various reasons, as to which I was satisfied, the issued shares in the Company are not proposed to be transferred to the third party and are proposed to be cancelled. The rationale for the Company having issued shares has now gone. I was satisfied that this was a case in which it was appropriate to confirm the cancellation of all the issued shares in the circumstances, provided the Court had jurisdiction to confirm a reduction of the issued shares of the Company to nil.

As noted above, although the Company is limited by guarantee it also has a share capital, established as such pursuant to Section 9(3) of the Companies Law (2007 Revision) (“the Law”). On incorporation the Company had and still has one guaranteeing member. The same guaranteeing member was however also issued with a nominal number of shares from the authorised share capital of the Company, all of which are fully paid up.

Section 9(3) of the Law provides that a company limited by guarantee may have a share capital (my emphasis). Share capital may mean either authorised share capital or issued share capital according to the context (see *Channel Collieries Trust Limited etc* [1914] 1 Ch 568 at 576). It seems to me that the reference to “share capital” in Section 9(3) of the Law must be to authorised share capital as opposed to issued share capital. A company cannot issue shares unless it first has an authorised share capital. Similarly in my view the reference to “may” have a share capital in Section 9(3) of the Law does not mean that a company limited by guarantee which does have an authorised share capital must therefore issue shares.

In this regard it was quite properly pointed out by counsel for the Petitioner that Section 7(2) of the Law, relating to the matters required to be included in the memorandum of association of a company, provides that “no subscriber shall take less than one share”. Although this language appears to be mandatory and on its face to extend to companies generally, it does not seem to me that it can apply to a company limited by guarantee which is not required to have shares.

It was also pointed out to me that the Companies Law of 1961 originally set out the requirements to be included in the memorandum of association of a company limited by shares and the requirements in the case of a company limited by guarantee in two separate sections (Companies Law 1961 Sections 6 and 7). At that time, a company limited by guarantee was not permitted to have a share capital and accordingly the

requirement that no subscriber shall take less than one share clearly could only apply to companies limited by shares. The Companies Law (1987 Revision) amalgamated the requirements in respect of companies' articles into a single section relating to both types of company (Section 7 Companies Law (1987 Revision)).

It was submitted, in my view correctly, that by amalgamating the two previous sections it was not intended thereby to require a company limited by guarantee to issue shares to subscribers to its memorandum of association. In fact the Companies Law (1987 Revision) had no equivalent of Section 9(3) of the Law and did not permit the incorporation of companies limited by guarantee with a share capital. Thus a company limited by guarantee could not in any event issue shares to subscribers to its memorandum. The requirement that no subscriber could take less than one share could therefore not possibly apply to a guarantee company. It was not until Section 8(3) of the Companies Law (1995 Revision) that companies limited by guarantee were permitted to have a share capital and at that time the amalgamated section was apparently simply reproduced.

It seems to me that the Law provides for only two types of limited liability company, namely a company in which the liability of members is limited to the amount unpaid on shares held by them (a company limited by shares) and a company in which the liability of the members is limited to the amount which they respectively undertake to contribute to the assets of the company in the event of its being wound up (a company limited by guarantee (Section 6 of the Law)). Although Section 9(3) permits a company limited by

guarantee to have a share capital that does not, in my opinion, change the nature of the company. It remains a company limited by guarantee and the fact that such a company may have a share capital and therefore may issue shares does not turn it into a company limited by shares or, indeed, result in there being a third type of company. A company limited by guarantee does not require to have shareholders, whereas a company limited by shares clearly does. I accepted the submission on behalf of the Petitioner that the requirement pursuant to Section 7(2) of the Law that no subscriber shall take less than one share can logically only be intended to apply to a company limited by shares and the history of the legislation supports that. As I have already pointed out, the provisions of Section 9(3) of the Law, while permitting a company limited by guarantee to have an authorised share capital, do not thereby require such a company to issue shares. By definition a guarantee company is one in which the liability of members is limited to the amount which such members guarantee to contribute on a winding up of the company and there is no need for such a company to issue shares even if it has an authorised share capital pursuant to Section 9(3) of the Law and therefore no need for subscribers to the memorandum to take shares.

The second issue was whether the Court had jurisdiction to confirm the reduction of the Company's share capital to nil. Section 14(1) of the Law permits a company limited by guarantee and having a share capital to pass a special resolution to reduce its share capital if so authorised by its articles. Such a resolution is only effective if confirmed by an order of the Court. In the present case the Company was so authorised by its articles of association and duly passed a special resolution reducing its issued share capital to nil.

There is apparently no Cayman Islands authority concerning the proposition that the wording of Section 14 of the Law "reduce its share capital in any way" permits a reduction of share capital to zero. Section 37(2) of the Law permits a company limited by shares or a company limited by guarantee and having a share capital to redeem or purchase its own shares but Section 37(3)(b) provides that a company may not do so if as a result of the redemption or purchase there would no longer be any member of the company holding shares. It seems to me that this requirement is subject to the same reasoning as in relation to Section 7(2) of the Law as outlined above. Section 37(3)(b) appears to have no rationale in the case of a guarantee company even if it does have a share capital. The requirement for such a company to have shareholders in order to be properly constituted simply does not exist, it requires to have guaranteeing members and has no need of shareholding members.

I was referred to some English authorities supporting the proposition that the words "reduce in any way" should be interpreted as permitting even a company limited by shares to reduce its capital to zero, albeit for a fraction of time. In re *Northern Engineering Industries Plc* [1994] BCLC 704 at 709 Millet LJ noted that "In the context of the reduction of a company's share capital the word "reduction" is constantly used in the sense of reduction to nothing". He further stated that "It is not disputed before us that this allows a company to which the section applies to reduce its share capital to nil, even though by reason of other requirements of the Companies Acts it must immediately increase its share capital to a positive amount. Such confirmations are frequently

confirmed by the Court. They cannot be justified by arguing that in Section 135(1) the word "reduction" refers to the end result of the reduction and the increase, since this would preclude the Court from confirming a reduction of the capital to nothing and a subsequent increase to the original or greater amount. Such reductions too are frequently confirmed by the Court".

It was submitted on this basis that Section 14 of the Law gives the Court jurisdiction to confirm a reduction of share capital to nil both in the case of a company limited by shares and in the case of a company limited by guarantee with a share capital. However, it is not necessary for me for the purpose of this application to determine whether the Court has jurisdiction to confirm a reduction of share capital to nil in the case of a company limited by shares. We are concerned here with a company limited by guarantee, albeit one with a share capital. Since, as I have already noted, the provisions of Section 9(3) of the Law are permissive only and my view is that a company limited by guarantee which has an authorised share capital is not required pursuant to Section 7(2) of the Law to actually issue shares or under Section 37(3) of the Law to maintain shares, it seems to me to follow that in the case of such a company the cancellation of the whole of its issued share capital, if any, must be permissible. The statement by Millet LJ that "even though by reason of other requirements of the Companies Acts it must immediately increase its share capital to a positive amount" could not have been intended to include a company limited by guarantee with a share capital; it was not possible in England at that time for a company to be incorporated as or to become a company limited by guarantee with a share capital. In fact that case related to a public company limited by shares. Clearly a

company limited by shares must have shares in issue, otherwise the company would have no members. That is equally clearly not the case with a guarantee company. A company limited by guarantee does not require shareholder members in order to be properly constituted, and even if it has an authorised share capital, is not in that position.

I am therefore satisfied that the Court has jurisdiction, in appropriate circumstances, to approve the reduction to nil of the issued share capital of a company limited by guarantee with an authorised share capital without requiring it to immediately issue new shares. As already noted above, in the particular circumstances of this company I was satisfied that it was appropriate to exercise the discretionary power of the Court to confirm the special resolution of the Company reducing its issued share capital to nil.



Foster J
Judge of the Grand Court



Dated: 27th November 2008