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UPDATE

Contributories winding up petitions: nullity and the ability to substitute a petitioner

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In a recent decision delivered by the Honourable Mr Justice Segal, the Grand Court of the Cayman Islands has expressly considered the issue of whether a contributory's winding up petition filed by a petitioner who did not have legal standing to petition is null and void; and, if not, whether the court has an inherent jurisdiction to substitute a petitioner to cure such a defect. The decision of Mr Justice Segal has significant implications for a company's members (and those asserting to be its members) wishing to present a petition to wind up a company on just and equitable grounds where the shares are not registered in the petitioner's name and were not for at least six months prior to presentation of the petition.

Background

The decision stemmed from a contested contributory's petition (the **Petition**) seeking to wind up Natural Dairy (NZ) Holdings Limited (the **Company**) on just and equitable grounds pursuant to section 92(e) of the Companies Law (2016 Revision) (as amended).[1]

Following the appointment of Joint Provisional Liquidators (the **JPLs**) to oversee certain functions of the Company,[2] it was discovered that the petitioning contributory (the **Petitioner**) was not a registered shareholder, but rather held its shares through a nominee arrangement.[3]

Section 94(3) of the Companies Law provides the circumstances in which a contributory is entitled to present a winding up petition (either: the shares, or some of them are partly paid; or they were allotted to him, or have been held by him, and been registered in his name for at least six months prior to presenting the petition; or they have devolved to him through the death of the former holder). As the Petitioner met none of these requirements (being only a beneficial owner of the share at the time of the presentation of the petition, the nominee bank being registered on the Company's register of members), the Company sought to strike out the petition on the basis that the Petitioner failed to comply with the strict statutory requirements of section 94(3)(b) of the Companies Law and as a result the petition was a nullity. In the alternative, the Company argued that even if the petition were not a nullity, it should be struck out on the basis of, amongst other things, the Petitioner's failure to comply with the statutory requirements; that there was no extant application for substitution before the court; and, in any event, the court did not have jurisdiction to make an order for substitution on a contributory's petition and, even if it did, the court should not make such an order in this case.

[1] In the matter of *Natural Dairy (NZ) Holdings Limited*, cause number FSD 186 of 2016 (NSJ) (2 March 2017), unreported.

[2] As the court has broad discretion upon an application to appoint provisional liquidators to grant them any powers it considers appropriate, the JPLs in this case were given limited powers to discharge two primary functions: preparing a proposal to be submitted to the Stock Exchange of Hong Kong (**SEHK**) for the shares to resume trading; and to investigate potential claims against the Company's former directors.

[3] As the Company is listed in the SEHK (though its shares are not currently trading), many of its shares are held through nominee banks. The Petitioner held its shares in the Company through such an arrangement.

In response, the Petitioner argued that the Petitioner had standing; that even if it did not (and had failed to comply with the statutory requirements), it was not a nullity; that while the court had the discretion to strike out the petition, it should not do so in circumstances where there were contributories registered on the Company's register of members who were willing to be substituted as petitioners and where, the Petitioner submitted, the court had the power to order substitution despite there being no express power to do so under the Companies Winding Up Rules (the CWR).[4] The Petitioner went on to argue that if the court was not minded to make an order substituting the proposed contributories onto the petition, the court should grant the Petitioner leave to amend its petition and rely on its claims that it was a creditor.

The Petitioner also argued, amongst other things, that as the requirement to have been a registered shareholder for at least six months prior to the petition was designed to prevent vulture funds or other parties acquiring shares with a view to presenting a petition immediately or shortly after acquisition, the mischief which the statute intended to prevent did not apply.[5]

Did the Petitioner have standing?

The court was not willing to apply a purposive interpretation to section 94(3) of the Companies Law in order to limit its application to those cases that were within the mischief the section was seeking to remedy (ie seeking to protect companies from opportunistic buyers seeking liquidation as a means of realising value). In support of its argument on standing, the Petitioner also sought to rely upon cases dealing with the meaning of members in the context of members' schemes of arrangement. However, the court was not persuaded by either of these arguments as this would require a departure from the settled approach (not to mention directly contrary to the statutory requirement) of requiring petitioners to be registered members for at least six months prior to petitioning and the authorities are clear that a beneficial owner of a share is not a contributory.[6] Accordingly, the Petitioner was unable to satisfy the statutory requirements of section 94(3) and did not have standing to present the petition at the time when the Petition was presented.

Is a Petition a nullity if presented by a person with no standing?

The Company's position was that the ability to petition for the winding up of a company is entirely statutory and, if the requirements set out in the enabling statute are contravened, the consequence is that a petition brought is a nullity. This approach was consistent with a number of authorities which concluded that proceedings which appear to be duly issued, but fail to comply with a statutory requirement, were held to be nullities.[7] The Company further argued that the consequence of the petition being a nullity was that everything done in support of the Petition was incurably bad, including the appointment of the JPLs.[8] In those circumstances, the Company argued that the petition should be struck out and the JPLs' appointment discharged.

The court accepted, as a matter of principle, that there are cases in which proceedings issued without complying with a statutory condition can result in those proceedings being a nullity. However, while the court saw some force in the argument that the requirement to be a registered shareholder was a jurisdictional condition (and not merely a procedural requirement) which must be satisfied in order for a petitioner to have the right to petition, it ultimately considered that where a petitioner lacked standing that, of itself, did not result in the petition being a nullity. This is a surprising finding given that standing to bring a claim (and in this case to present a petition) is a fundamental element, without which proceedings would ordinarily be considered defective. The court also made an analogy to creditors' petitions which had been

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[4] The CWR only expressly provide for substitution of a petitioner on a creditor's petition (CWR, O. 3, r. 10).

[5] In the Memorandum and Objects of and Reasons to the Companies Amendment Bill, 2007, Jones J remarked that '[section 94(3)'s] effect is to impose a constraint upon "vulture funds" and those who wish to buy shares with the intention of realizing value by liquidating the company'. It should be noted that section 94(3)(b) is in near identical terms to section 244(1)(a)(ii) of the English Companies Act 1948 and case law decided on that section (and its predecessor, section 40 of the Companies Act 1867) contends that where ownership of shares in a company is in dispute, or where it cannot be shown that someone is a registered member of a company, the question of standing should be determined outside of liquidation proceedings (see, for example, *Brightman J in re J.N. 2* Ltd [1978] 1 W.L.R. 183 at 188; and Vaughan Williams J in *Re A Company* [1894] 2 CH 349 at 351).

[6] *Hannoun v R Limited and Banque SYZ Company Limited* [2009] CILR 124 and *Kelly v Mawson* (1982) 6 ACLR 667.

[7] See for example, *Re Pritchard* [1963] Ch 502.

[8] Citing *MacFoy v United Africa Co Ltd* [1961] 3 WLR 1405 at 160.

brought on the basis of a disputed debt and found that although in such circumstances creditors lacked standing, the petition was considered demurrable rather than a nullity or void.[9] Ultimately, and having regard to the modern practice of limiting cases in which proceedings are treated as a nullity, the court did not consider that it should extend the classes of nullity to this type of case and refused to strike out the petition.

Inherent jurisdiction to substitute

Given the court's finding that a petition which was defective for lack of standing was nonetheless not a nullity, it went on to consider whether it was possible for a registered contributory to be substituted as petitioner. This raised a jurisdictional issue: namely whether the court had the power to order substitution on a contributory's petition in the absence of any express power, either in the Companies Law or the CWR.

Indeed, the only reference to substitution in either the Companies Law or the CWR is expressly confined to creditors' petitions; both the Companies Law and the CWR are silent regarding substitution in the context of a contributory's petition. The Company argued that the use of the court's inherent jurisdiction to permit substitution in the case of a contributory's petition would be inconsistent with the CWR and therefore impermissible. The Company relied on the decision of the Cayman Court of Appeal in *HSH Cayman I GP Limited* to argue that the court is only entitled to invoke its inherent jurisdiction to fill a lacuna left by the CWR where doing so would be consistent with the scheme established by the CWR.[10] As the legislature had excluded a power to substitute on a contributory's petition, the Company argued that to use the court's power to invoke its inherent jurisdiction in making such an order would be inconsistent with the scheme provided for by the CWR, particularly where they specifically provide for a power of substitution in relation to creditor petitions.

The Petitioner argued that the court had the inherent power to control its own process and that the power could be used in any way which was not inconsistent with their overall scheme, pointing out that the inherent jurisdiction had been exercising to permit amendments to petitions, order security for costs and to make representative orders.

Ultimately, the court determined that such a power did exist within its inherent power. It held that the omission of an express power to substitute on a contributory's petition did not indicate an intention to exclude such a power but was instead the likely result of there being less of a need for its express inclusion. The express inclusion of a power of substitution in relation to creditor's petitions had been necessary to prevent companies from paying off their creditors one by one in order to avoid a winding up. The court considered that the same issue does not arise in relation to a contributory's petition as contributories cannot just be paid off and tend to have a longer term and different relationship with the company than creditors.

The court ultimately held that the power to substitute a new petitioner was within the scope of the court's inherent power to regulate its own procedures and to facilitate the efficient and cost-effective management of proceedings. Invoking its inherent power to do so would not to be inconsistent with the CWR.

While the failure of the Petitioner to verify its status as a registered member prior to presenting the petition was regarded as serious, Segal J considered that on balance, he would allow substitution. The court was heavily influenced by the impact any dismissal would have on the appointment of the JPLs. The evidence relied on by the Petitioner in its application for the appointment of JPLs was said to remain unaffected by the issue over its standing and, in circumstances where the court considered that the JPLs' appointment was warranted, it was appropriate that the JPLs remain in office. By permitting the substitution of another contributory, the need for the discharge and fresh application for the appointment of the JPLs was avoided.

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[9] There are a number of English cases which found contributory's petitions which lacked standing to be demurrable (see *Re Gattopardo Ltd* [1969] 2 All ER 344; *Re A Company* [1894] 2 CH 349).

[10] [2010] 1 CILR 114 (CA).

Comment

This decision provides a clear indication that the court is willing to exercise its inherent power to regulate its own procedures and to facilitate the effective management of proceedings, even if doing so involves a liberal and expansive interpretation of the prevailing statutory scheme in issue.

It is also, however, a decision that raises some considerable concerns. As the reader is no doubt aware, there is no statutory unfair prejudice regime in the Cayman Islands by which minority shareholders can apply to court to protect their interests: the only right a member has (save in circumstances where the wrong occasioned results in a cause of action which vests in the company (ie a derivative claim)), is the draconian step of presenting a petition to wind up the company on just and equitable grounds. This is particularly significant when dealing with a contributory's petition. The company will usually be solvent and trading. The presentation of a winding up petition (absent directions to the contrary) must be advertised. It also means that from the date of presentation of the winding up petition, and if a winding up order is eventually made, all dispositions of the company are voidable absent an order of the court. It follows that a company can be harmed irreparably both in terms of reputation and by potentially impeding the company's business from continuing to run as an ongoing concern – which is precisely why a line of English authorities has required that the question of standing of a contributory be determined prior to the presentation of a petition, and where there was found to be no standing, the petition was struck out.

Accordingly, whilst the court has found it has an inherent jurisdiction to substitute a new petition onto a contributory's petition, the decision should be read with caution and should not dissuade a prospective petitioner from settling the question of standing prior to presenting its petition.

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