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UPDATE

No-Petition Clauses and the Conflict of Laws: *KES Power Limited*

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KES Power Limited (Unreported, 31 May 2024) was an application to strike out a shareholder petition on the basis that the Petitioner was contractually bound not to petition. The application was dismissed, with the Court concluding there was no such agreement. The decision deals with the need for clear and unequivocal drafting of no-petition clauses and the potential dangers where a no-petition clause is governed by the laws of another jurisdiction.

Background

IGCF SPV 21 Limited (the **Petitioner**) presented a just and equitable petition (the **Petition**) against KES Power Limited (the **Company** or **KESP**).

The original shareholders, Al Jomaih Power Limited and Denham Investment Ltd. (together, the **Applicants**) sought declaratory relief to have the Petition struck out pursuant to section 95(2) of the Companies Act (2023 Revision) (the **Act**), on the basis that the Petitioner had contractually agreed not to petition for the winding up of the Company.

Section 95(2) of the Act states: "*The Court shall dismiss a winding up petition or adjourn the hearing of a winding up petition on the ground that the petitioner is contractually bound not to present a petition against the company*."

Decision

Construction

The primary question was whether the Shareholders Agreement (**SHA**) on its proper construction amounted to a contractual bar which precluded the Petitioner from presenting the Petition.

The key clause to be construed was in Schedule 4 of the SHA:

> "*The Company covenants that and each Shareholder undertakes to exercise all his powers as a shareholder or otherwise so as to procure that none of the following matters shall be undertaken without the consent of [the Petitioner] and the Original Shareholders [the Applicants]. The Shareholders covenant that the following matters shall not be undertaken without the consent of [the Petitioner] and the Original Shareholders [the Applicants] (it being acknowledged by each party that none of the following matters are within the competence of the Board).*
>
> ...
>
> *Liquidation* *The solvent liquidation, winding-up or dissolution of the Company or KESC*".

The Court began by trying to clarify the wording in Schedule 4, finding that the provision properly expressed was to the effect that:

> "*the solvent liquidation, winding-up or dissolution of [the Company] or KESC*[1] *shall [not] be undertaken without the consent of [the Petitioner] and the [Applicants].*"[2]

Having untangled the language in the SHA, the Court looked to the Company's Articles and noted that the Articles provided *only* for the voluntary winding up of KESP. The Court also noted that provisions in the Articles were in similar, but not identical terms to Schedule 4 requiring unanimous shareholder agreement before a voluntary liquidation was commenced.

Having reviewed the Articles and the SHA, the Court concluded that Schedule 4 was simply intended to cross refer to the type of winding up provided for in the Articles; that is, a voluntary winding up. This conclusion was reached on the basis that neither the Articles, nor the SHA, referred explicitly to a winding up petition or a winding up by the Court. Therefore, it was reasonable to conclude that the exclusion of such petitions could not have been contemplated. Had such an exclusion been contemplated, the parties would have stated this in the Articles, the SHA or both.

The Court found that this construction made good commercial sense within the factual matrix known to the parties at the time of the agreement. The Court suggested that parties would want unanimity before the Company was dissolved on grounds of commercial, financial or operational disputes, but that the shareholders would not have wanted to remove their right to have recourse to the Court in the event of equitable wrongdoing.

In dealing with the adjective "*solvent*" in Schedule 4, the Court considered that this was of no assistance in interpreting whether the clause referred to a voluntary or compulsory winding up. Both a voluntary and compulsory winding up can be effected in respect of a solvent company. The Court found that the word "*solvent*" applied to all three forms of liquidation within the clause and the word was included so that the Company, if faced with any sort of insolvent process, would not require shareholder approval to petition. This, the Court found, simply tracked the state of the law in that where a company is insolvent, the views of the shareholders carry no weight.

Unenforceability

In addition to the issues of construction, arguments were put forward to suggest that section 95(2) of the Act was not enforceable. The Petitioner put forward three arguments.

(i) The SHA was governed by English law. Under English law a clause that purports to remove a shareholder's right to apply for the winding up of a company is unenforceable as a matter of public policy. Accordingly, any such clause in the agreement could not be enforced by the Cayman Court.

(ii) The no-petition clause was entered into before section 95(2) came into effect.

(iii) Section 95(2) was intended to apply to creditor petitions only and not to shareholder petitions.

Given the Court had decided for the Petitioner on the construction point, it did not definitively deal with the three arguments and remarked only on the first and third.

As to the first argument, the Court stated that it was not clear that the enforceability of a no-petition clause by a shareholder would, in all respects, be a matter for the proper law of the contract instead of the law of incorporation, it being the law governing the constitution and the winding up of the Company. However, the Court went no further to resolve this issue.

As to the third argument, the Court was not at all persuaded. Section 95(2) by its terms was unqualified and referred, without qualification, to "*Petitioners*" who are contractually bound "*not to present a petition*". The legislation, therefore, made no distinction between shareholder and creditor petitions. In addition, the Court noted, the Court of Appeal has applied section 95(2) to shareholder petitions and has explicitly found the provision not to be contrary to public policy. Accordingly, the Court considered that the argument had little prospect of success.

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[1] KESC is Karachi Electric Supply Company Limited, a subsidiary of KESP

[2] *In the Matter of KES Power Limited* (Unreported, 31 May 2024) at [37]

Conclusion

Whilst the Court's decision on construction is robust, it seems a marginal call. The terms of Schedule 4 on another day could be seen to include a winding up by the Court. The expression solvent liquidation is very often used as shorthand for a voluntary winding up, just as a winding up is very often used as shorthand for the compulsory winding up by the Court. A Court which applied a less rigid approach may have considered that on this basis, Schedule 4 was a no-petition clause.

It is also odd that the Court would find that the word 'solvent' was needed to delineate the clause from a situation where the Company was insolvent. If Schedule 4 was meant to refer *only* to voluntary liquidations, then the need for shareholder approval would fall away whether or not the word 'solvent' was included.

However, the Court's conclusion serves as a warning for those drafting no-petition clauses. Due to the lack of precision in the language used, the no-petition clause did not have what may have been its desired effect. This decision, therefore, emphasises the importance of clear and unequivocal language in drafting these clauses.

As to the issues of enforceability, it now seems settled that section 95(2) of the Act applies both to shareholder and creditor petitions and arguments to the contrary will fall on stoney ground.

However, the conflict of laws issue, namely whether the proper law of a contract governs the enforceability of a no-petition clause, remains unresolved. To avoid getting entangled in such arguments, it would be wise to ensure that the governing law of any agreement containing a no-petition clause is the law of the Cayman Islands and not a jurisdiction where such clauses are open to challenge.

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