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Directors' initiation of winding up proceedings: contrasting the approaches of offshore jurisdictions

KEY POINTS

- Directors are often caught between the interests of creditors and shareholders.
- Their duties may sometimes lead them to need to seek the winding up of the company.
- There is a divergence of approach to their powers to do so across the offshore jurisdictions, which differ from the UK position.

INTRODUCTION

The inclusion of an offshore vehicle in an investment structure will give rise to competing interests and duties in circumstances where there is no longer enough money to pay every creditor in the chain. Those behind the structure will wish to limit the ability of the directors of the offshore vehicle to act in a manner that is contrary to the overarching scheme of the investment. However, the directors will still generally owe fiduciary duties to the company over which they have been appointed. When the company is in financial difficulties the interests of its creditors become paramount. This may lead the directors to conclude that the interests of the creditors are best served by putting the company into an insolvency process. Whether the directors unilaterally have power to take that step will fundamentally affect the viability of the investment structure.

A recent change of judicial approach in the Cayman Islands provides the opportunity to consider the different approaches in some of the key offshore jurisdictions. In each of these jurisdictions shareholder approval is needed for the directors to petition for the winding up of a solvent company, but a divergence is notable when the company is insolvent. Although all of the jurisdictions recognise that the embodiment of the company's best interests (and therefore the assessment of a director's fiduciary duties) changes from the contributories to the creditors when a company enters the zone of insolvency, there is a marked difference between those jurisdictions that restrict the directors' powers (Cayman, BVI and Isle of Man subject to developing case law), those that expressly give the directors powers to bring the company to an end (such as the Channel Islands) and those that interpret the legislation in accordance with the directors' wider duties (such as Bermuda).

INFLUENCE OF ENGLAND AND WALES

As many offshore jurisdictions are common law jurisdictions and/or British dependencies, the various Companies Acts of England and Wales often form the basis of local legislation, commercial practice in England and Wales is often followed and the common law jurisprudence of England and Wales is generally persuasive to offshore courts. The Companies Act 1948 restricted the ability to present a petition for the winding up of a company incorporated in England and Wales to the company, a creditor or a shareholder (subject to certain qualifications immaterial to this debate). The practice developed that in the case of an insolvent company, a petition could be presented by a company acting by the agency of its directors without reference to its shareholders – the practice was recognised in the 13th edition (1957) of *Buckley on the Companies Acts*.

This practice came to be considered by Brightman J in *Re Emmadart Ltd* [1979] 1 Ch 540. A receiver, appointed by a debenture which granted him powers to act as agent of the company, sought to petition for the winding up of the company. Brightman J accepted for the sake of submissions that the receiver had the same power to present a petition for a compulsory liquidation as the directors themselves would have possessed had the receiver not been appointed and accordingly considered the competency of the board of directors to petition to wind up the company.

After a review of authorities on the subject and recognising that it had become the practice of directors of insolvent companies to petition for their winding up without reference to the shareholders, he held that the practice was wrong and ought no longer to be pursued: that unless the articles of a company expressly conferred the requisite authority on the directors (which the standard Table A articles did not), or the shareholders approved the actions of the directors in a general meeting, then the directors were acting without authority.

He concluded, however, that the authority of a receiver was not co-terminous with the authority of the board of directors and that the receiver had the requisite authority to present the winding up petition to protect the assets under the control of the receiver from depletion, exercising the discretion of the court to allow the receiver to bring a petition, rather than the right to petition ex debito justitiae.

The decision as regards the actions of directors was effectively reversed in the UK by the Insolvency Act 1986 which granted directors express statutory authority to petition for the winding up of a company (whether or not that company is solvent).

CAYMAN

Under the Cayman Islands Companies Law 'where expressly provided for in the articles of association of a company the directors of a company incorporated after the commencement of this Law have the authority to present a winding up petition on its behalf without the sanction of a resolution passed at a general meeting'. Although English case law is not binding in Cayman, it is highly persuasive, and the rule in *Re Emmadart* was accepted as still being good law in the Cayman Islands in the 1998 case of *Banco Economico SA v Allied Leasing and Finance Corporation* [1998] CILR 102.

In 2011, in the case of *Re China Milk Products Group Ltd* [2011] 2 CILR 61, Jones J had to consider a petition for the winding up of an insolvent company, by its directors on behalf of the company. The petition was presented with the aim of appointing provisional liquidators to effect a scheme of arrangement. (This is an approach to the restructuring of debts that has evolved in the Cayman Islands in the absence of a provision similar to the administration process in England and Wales or Chapter 11 of the US Bankruptcy Code.) The petition, provisional liquidation and proposal for a scheme were supported by the bondholders but not the shareholders – who no longer had an economic interest given the insolvency of the estate.

Jones J considered the legislative history of recent amendments to the Companies Law and concluded that the rule in *Re Emmadart* had been considered and the Legislature must have intended to abolish or circumscribe it. He therefore ruled that the directors of an insolvent company were entitled to present a winding up petition on behalf of the company without reference to its shareholders, irrespective of the terms of its articles. He accordingly chose to interpret the provision as empowering the directors of insolvent companies incorporated after 1 March 2009 (the implementation of the amendments) to petition for their winding up without the approval of the shareholders.

Jones J noted that the English legislature had decided to overturn the application of *Re Emmadart* and his interpretation had the same effect under Cayman law. Although the decision was subject to academic criticism, the judgment provided a commercially acceptable result as there were no objections from the shareholders, who had no economic interest in the restructuring under the circumstances and therefore took no part in the proceedings. All those with an economic interest supported the restructuring that was facilitated by the decision.

That was not the case four years later, when Mangatal J had to consider a winding up petition in similar circumstances for *China Shanshui Cement Group Ltd* (Unreported, Grand Court, 25 November 2015). The directors sought the appointment of provisional liquidators to effect a restructuring which was supported by the company's principal creditors but opposed by its shareholders. The articles contained no express authorisation for the directors to petition for the company's winding up and no authority was sought in general meeting. Counsel for the directors argued that *China Milk* enabled the directors of the company to petition notwithstanding the objection of the shareholders.

China Shanshui was the first time that *China Milk* came to be judicially considered in the Cayman Islands. Mangatal J was reluctant to undermine judicial comity and certainty, but noted that there had been no party objecting to Jones J's interpretation before the court in *China Milk*. Mangatal J reluctantly decided that Jones J's decision was wrong; that there was no substantive amendment of the section that confirmed Jones J's view that the legislature intended to reverse the effect of *Re Emmadart*. In fact, the section merely confirmed the restriction and left the ruling in *Re Emmadart* intact. She ruled that the directors did not have authority to bring the petition on behalf of the company and accordingly dismissed the petition.

As a result, the restriction in *Re Emmadart* is still alive and well in Cayman: when a company is in the zone of insolvency, the directors' hands are tied to respecting the wishes of the shareholders. This is notwithstanding that Cayman law recognises that when a company enters the zone of insolvency the interests of the creditors are paramount; but absent express provisions in the article the directors are limited to convening a general meeting and seeking the shareholders' approval to present a petition on behalf of the company.

BRITISH VIRGIN ISLANDS (BVI)

The BVI Insolvency Act (s 162(1)) similarly restricts the application to appoint a liquidator to the company, a creditor, a member, the supervisor of a creditors' arrangement, the commission and the Attorney General. A difference of approach between the judges of the Cayman Islands and of the BVI is not unheard of (for example, the difference of approach between Jones J and Bannister J on the circumstances in which a company can be wound up on the 'just and equitable' ground), but the application of *Re Emmadart* has not yet been considered in the BVI.

Historically, the BVI Commercial Court has been prepared to refuse to follow English decisions which, because of subsequent legislative change in England have 'now become dead letters in the jurisdiction in which they previously applied and that for [the court] to apply them here, where they are not binding, would be to introduce into the law in this jurisdiction an archaic rule which would throw English and BVI practice and procedure out of alignment' (*Star Reefers v JFC Group Co* BVIHCM 2012/0008, which was also approved by the Bermuda Court of Appeal in *Kader Holdings Co v Dessarollo*). It is therefore possible that the BVI courts would be prepared not to follow *Re Emmadart* even though the legislation in force there is essentially the same as that in force in the UK at the time of *Re Emmadart*. In support of a more liberal interpretation would be the fact that BVI, unlike Cayman, contains a provision making directors liable for the insolvent trading of a company. Although rarely applied in practice, to leave a director exposed to an action for insolvent trading, while refusing to allow the director a

route to an insolvency process, would be inconsistent with a restrictive interpretation of s 162 limiting the directors' ability to apply for the appointment of liquidators without the approval of the shareholders whose economic interests will rarely be served by the appointment of a liquidator. In those circumstances, the directors' only option would be to resign their position as directors.

BERMUDA

A petition to wind up a company incorporated in Bermuda may be presented by the company, a creditor or a member. The application of *Re Emmadart* came to be considered by Kawaley J in the Supreme Court of Bermuda in 2003 (*Re First Virginia Reinsurance Ltd* [2003] Bda LR 47). The bye-laws of the company provided a general power to the board, that is common in most company bye-laws in Bermuda, to 'exercise all such powers of the Company as are not, by statute or by these bye-laws, required to be exercised by the Company in general meeting…'

Kawaley J focused upon the fact that Brightman J's comments regarding directors were obiter and that a conflicting line of Australian authority that accepted directors' petitions as being: (1) too well settled to be reversed save by an appellate court; and (2) supported by strong practical and commercial reasons.

In considering the application of *Re Emmadart* in Bermuda, Kawaley J considered that the reasoning of Brightman J was fundamentally flawed and the case against applying *Re Emmadart* was compelling. In reviewing the bye-laws of the company, he noted that they did not expressly require shareholder approval. In circumstances where the company was solvent, he accepted that shareholder consent would be required, but that in circumstances of insolvency the authority of the directors had to be informed by the construction of their powers as defined by the Companies Act. In the context of the Companies Act, he concluded that a winding up petition on the grounds of insolvency had to be looked at in the wider context of the winding up provisions of the Act: the directors are exposed to criminal and civil liability for various fraudulent acts linked to the onset of insolvency and were required to have primary regard to the welfare of the company's creditors. Kawaley J reasoned that under those circumstances the goal of protecting the company's creditors should not be restricted by shareholder approval and accordingly, if the interests of creditors dictated that a winding up petition should be filed, the wishes of the shareholders become irrelevant.

Kawaley J concluded that this was consistent with the accepted position that on a creditor's petition little weight will ordinarily be given to the views of contributories (*Re Camburn Petroleum Products Ltd* [1979] 3 All ER 297 at [303c-d]) and the core principle of both corporate and personal insolvency law: that neither shareholders nor the bankrupt may participate in distributions from the estate until creditors are paid in full.

JERSEY

Article 4 of the Bankruptcy (Désastre) (Jersey) Law 1990 permits the directors of a company to make an application to the court that the company be declared 'en désastre'. The directors must show that the company is insolvent on a cash flow test and that it has realisable assets. The court has a discretion as to whether or not to make a declaration of désastre.

GUERNSEY

Pursuant to the Companies (Guernsey) Law 2008 any director is entitled to make an application for the company to be wound up by the court and a liquidator be appointed. While there is no explicit obligation to initiate proceedings, directors' fiduciary duties may require them to consider doing so where the company no longer has any prospect of avoiding an insolvent liquidation.

ISLE OF MAN

In the Isle of Man, absent a supporting resolution authorising the directors or express permission to do so contained in a company's articles of association, directors do not have the power to present a petition in their own name to wind up an Isle of Man company. They may cause a company to petition for its own winding up but require shareholder consent to exercise this power. For companies incorporated under the Companies Act 1931, a special resolution passed by three quarters of the members is required. For companies incorporated under the Companies Act 2006, a resolution passed by over half of the members (or such higher majority as the memorandum or articles may prescribe) is required.

Re Emmadart has not been considered in the Isle of Man but English law is generally persuasive in the absence of any local authority to the contrary. However, in *Spirit of Montpelier & others v Lombard Manx* (2015 SGD) the Island's appellate court held that notwithstanding the absence of an applicable statutory provision, where the 'interests of justice' requires it, the Island's courts are at liberty to make law where there are indications that the English common law has been superseded by statute. Although untested, in the appropriate case this may lead the courts of the Island to liberally interpret the authority of the directors to act in the best interests of the creditors of the company when the company is insolvent, or if insolvency is a real possibility, to present a winding up petition – as permitted by the Insolvency Act 1986 of England and Wales. This may therefore be an area for judicial development if the circumstances of the case are right.

CONCLUSION

The recent authority of *China Shanshui* in Cayman suggests a reining back of the purposive approach of Jones J in *China Milk*, restricting the directors' ability to act when the company is insolvent. While this may be useful for those creating finance structures, when the company enters the zone of insolvency it leaves directors in the invidious position of being unable to act in the interests of creditors. The Channel Islands has taken the legislative stance of giving directors freedom to act in

Biog box

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accordance with their fiduciary obligations, provided that the company is insolvent. Bermuda has achieved this by interpreting the legislation purposively in accordance with the wider duties of directors. Both of these outcomes will have consequences for finance structures that originators will wish to consider.

The position in BVI and Isle of Man is yet to be expressly tested. In circumstances where there is no opposition, the authority of the directors will probably not be explored by the court. However, if opposition to the directors' authority is raised at the hearing of a winding up petition, the courts will need to decide between the application of the strict line of authority in *Re Emmadart* and a more liberal application of the authority, in the light of the articles of the company. Both jurisdictions have recent case law that suggests the judiciary are willing to depart from English authority that no longer reflects the current commercial imperative, but the decision of the courts may affect how creditor or debtor friendly each jurisdiction is perceived to be. ■

Further reading

- LexisPSL Restructuring and Insolvency: Practice note: Cayman Islands – Restructuring and Insolvency Guide
- LexisPSL Restructuring and Insolvency: Practice note: Bermuda – introduction to insolvency and restructuring law and practice: part two
- LexisPSL Restructuring and Insolvency: Practice note: Guernsey: restructuring and insolvency guide

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