

ORIGINAL CIVIL.

Before Lord-Williams J.

In re NEW RING MILLS CO., LTD.
(in liquidation).

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April 25;
May 11.

*Company—Winding-up—Surplus assets—Right of preference shareholders—
Dividends not declared—Arrears of preferential dividends, if payable.*

The memorandum of association of a company provided that the preference shares should rank both as regards dividend and capital in priority to the ordinary shares. The articles of association provided that the holders of preference shares should receive out of the profits of the company, if any, as a first charge thereon, a cumulative preferential dividend of 7 per cent. per annum on the paid up amount of the preference shares held by them and, subject to the rights of the holders of preference shares and to the provisions of other articles, the surplus profits should belong to and be divided among the holders of the ordinary shares and that, in the event of the company being wound up, the surplus assets should be applied in the first place in repaying to the holders of the preference shares the amount paid up thereon and the residue should belong to the holders of the ordinary shares. The company went into voluntary liquidation. No dividend on preference shares had been declared for several years prior to liquidation.

Held: (i) that the surplus assets were to be applied in the first place in repaying to the holders of the preference shares the amount paid up thereon and the residue belonged to the holders of the ordinary shares;

(ii) that the arrears of preferential dividends could not be treated as "debts," and so could not be paid out of the assets of the company before the "surplus assets" were ascertained.

In re Driffeld Gas Light Company (1); In re London India Rubber Company (2); In re Ramel Syndicate, Limited (3); Bond v. Barrow Haematite Steel Company (4); Bishop v. Smyrna and Cassaba Railway Company (5); In re New Chinese Antimony Company, Limited (6); In re Springbok Agricultural Estates, Limited (7) and In re Roberts and Cooper, Limited (8) referred to.

SUMMONS in the winding-up of the abovenamed company.

The summons was issued by the liquidators to determine whether, upon a true construction of the memorandum and articles of association, the liquidators should pay to the holders of the preference

(1) [1898] 1 Ch. 451.

(2) (1868) L. R. 5 Eq. 519.

(3) [1911] 1 Ch. 749.

(4) [1902] 1 Ch. 353.

(5) [1895] 2 Ch. 265.

(6) [1916] 2 Ch. 115.

(7) [1920] 1 Ch. 563.

(8) [1929] 2 Ch. 333.

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shares, in addition to the amount paid up thereon, a further sum representing arrears of preferential dividends. The company went into voluntary liquidation on March 7, 1938. No dividend on preference shares had been declared or paid for several years prior to liquidation. In the last half-yearly report dated December 31, 1937, the balance sheet showed a debit of Rs. 6,418-9 on the profit and loss account.

Clough for the liquidators. No dividend having been declared, the preference shareholders are not entitled to be paid anything for arrears of dividend: In *In re Roberts and Cooper, Limited* (1); In *re Springbok Agricultural Estates, Limited* (2) and In *re New Chinese Antimony Company, Limited* (3) there were special provisions in the articles of association for payment of arrears of preferential dividends.

Sir Asoka Roy, Advocate-General, and *P. C. Ghosh* for *Praladrai Dhanuka*. Arrears of preferential dividend are debts of the company and there cannot be any surplus assets unless the liability to the preference shareholders have been paid: *Bishop v. Smyrna and Cassaba Railway Company* (4).

Susil Sen, in person. Preference capital and dividend on preference shares are to be paid in priority to the ordinary shares: Clause 5 of the memorandum of association.

Clough, in reply. *Bond v. Barrow Haematite Steel Company* (5).

Cur. adv. vult.

(1) [1929] 2 Ch. 383.

(2) [1920] 1 Ch. 563.

(3) [1916] 2 Ch. 115.

(4) [1895] 2 Ch. 265.

(5) [1902] 1 Ch. 353.

LORT-WILLIAMS J. This is a petition by the liquidators for directions whether in distributing the assets of the company the preference shareholders are to be paid any, and if so, what sums other than an amount equivalent to the amounts credited as paid-up capital on preference shares.

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By a special resolution of the company passed at a meeting held on March 7, 1938, it was resolved that the company should be wound up voluntarily.

The company was incorporated on August 14, 1896, with an authorised share capital of Rs. 6,00,000 divided into 3,000 preference shares and 3,000 ordinary shares of Rs. 100 each.

All the authorised capital is fully paid up.

In the half-yearly report dated December 31, 1937, the balance-sheet shows a debit of Rs. 6,418-9 on the profit and loss account. The reserve account is shown as amounting to Rs. 2,989-12-8.

Paragraph 5 of the Memorandum of Association is as follows:—

The capital of the company is Rs. 9,00,000 divided into 3,000 preference shares and 3,000 ordinary shares of Rs. 100 each and Rs. 3,00,000 5 per cent. debentures and such preference shares shall confer the right to a fixed cumulative preferential dividend at the rate of 7 per cent. per annum on the capital paid up thereon from the date the mill starts working and shall rank both as regards dividend and capital in priority to the ordinary shares.

The Articles of Association provide *inter alia* as follows:—

Article 3. The share capital of the company is Rs. 6,00,000 divided into 3,000 preference shares and 3,000 ordinary shares of Rs. 100 each. The holders of the preference shares shall receive out of the profits of the company, if any, as a first charge thereon, a cumulative preferential dividend of 7 per cent. per annum on the paid up amount of the preference shares held by them respectively, and subject to the rights of the holders of preference shares and to the provisions of these Articles, the surplus profits shall belong to and be divided among the holders of the ordinary shares.

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RESERVE AND DEPRECIATION FUNDS.

Article 62. Such portion of the profits of the company may be set apart by the Managing Agents as they think fit as a Reserve Fund and shall be applicable at the discretion of the Managing Agents for the liquidation of any debentures, debts or other liabilities of the company for equalization of dividends or for any other purposes of the company with full power to employ the assets constituting the Reserve Fund in the business of the company and that without being bound to keep the same separate from the other assets.

DIVIDENDS.

Article 127. Subject to the rights of members entitled to shares with preferential or special rights attached thereto the profits of the company which it shall from time to time be determined to divide in respect of any year or other period shall be applied in the payment of a dividend on the ordinary shares of the company.

Article 128. The company in general meeting may declare a dividend to be paid to the members according to their rights and interests in the profits and may fix the time for payment.

Article 129. No larger dividend shall be declared than is recommended by the directors, but the company in general meeting may declare a smaller dividend.

Article 130. No dividend shall be payable except out of the profits of the company, and no dividend shall carry interest as against the company.

Article 131. Subject to the provisions of these articles the declaration of the directors as to the amount of the net profits of the company shall be conclusive.

Article 132. The Managing Agents may from time to time pay to the members such *interim* dividends as in their judgment the position of the company justifies.

WINDING-UP.

Article 163. If the company shall be wound up, the surplus assets shall be applied in the first place, in repaying to the holders of the preference shares the amount paid up thereon, and the residue shall belong to the holders of the ordinary shares.

It is clear that the question which I have to decide depends upon the correct interpretation of the Memorandum and Articles of Association. In such circumstances precedents are of little help, depending as they do upon the construction of different memoranda and articles of association.

The first point to be noted, however, is that a provision in the Articles as to how dividends are to be distributed while the company is a going concern does not, *per se*, govern or affect the distribution of

surplus assets in a winding-up. [In re *Driffield Gas Light Company* (1).] Moreover, it was decided in *In re London India Rubber Company* (2) that upon the winding-up of the company no profits having been realised, there being a provision only for preferential dividend, and no provision as to the division of capital upon breaking up, the surplus assets must be distributed between both classes of shareholders *pro rata*, without reference to their rights in respect of dividend.

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In that case Sir R. Malins V. C. said as follows at p. 525 :—

I am sorry to say that I am obliged to adhere to the opinion which I expressed upon the former occasion. I am "sorry" because, having regard to the original position of the A and B shareholders, I think the justice of the case would be best met by saying, that upon the dissolution of this insolvent concern the whole surplus should go back to those who found the money, rather than to those who allured them into the adventure. I cannot, however, decide the case upon any abstract notion of justice, but only according to the contract which the parties have entered into, and their rights arising out of that contract. The event which has happened, of the company breaking up and its property being all sold, is a contingency which was wholly omitted, both from the preliminary contract and the articles of association. The case, therefore, of any surplus capital remaining to be divided is not provided for: the only stipulation is, that the A shareholders shall have a preferential dividend. But no dividend has ever been declared, and the company has never made any profits. When a dividend is declared it becomes a debt from the company; but until that time the dividend is only a thing that may possibly come into existence.

This statement with regard to dividend is of importance, because it has been held in many cases that the term "surplus" assets may mean either what remains after paying the costs, charges and expenses of the winding-up and debts, or after making those payments and returning the paid up capital to the shareholders. In re *Ramel Syndicate, Limited* (3).

On the question, whether a dividend must be declared before any claim can be made in respect of it, it was held in *Bond v. Barrow Haematite Steel Company* (4) that the common Article requiring

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dividends to be declared by the directors applies to fixed cumulative dividends on preference shares. And Farwell J. said as follows at p. 362:—

It is argued that the provisions as to the declaration of a dividend do not apply to shares on which a fixed preferential dividend is payable. In my opinion this is not so. The necessity for the declaration of a dividend as a condition precedent to an action to recover is stated in general terms in Lindley on Companies, 5th ed., p. 437, and where the reserve fund article applies, it is obvious that such a declaration is essential, for the shareholder has no right to any payment until the corporate body has determined that the money can properly be paid away.

In *Bishop v. Smyrna and Cassaba Railway Company* (1), Kekewich J. seems to have been of a different opinion. It was held in that case that a sum of money standing to the revenue account of a limited company at the date of the commencement of the liquidation of the company, and representing net profits earned by the company down to that date, was applicable in the liquidation to the payment of arrears of dividend due at that date to the preference shareholders, in priority to the payment of a deficit on the capital account and of the costs of the liquidation.

That case, however, is not applicable to the circumstances of the present case because in that case at the time of the liquidation there existed undistributed profits.

Similarly, in *In re New Chinese Antimony Company, Limited* (2) it was held that arrears of preferential dividends payable could not be limited to dividends actually declared, and the holders of preference shares were entitled to be paid preferentially out of the surplus assets 10 per cent. per annum on the amount paid up on their shares from the date of their issue to the commencement of the winding-up. *Semble*, it would have made no difference if the surplus assets had not included any profits, but as there plainly were profits the point did not arise.

(1) [1895] 2 Ch. 265.

(2) [1916] 2 Ch. 115.

That case, however, is not applicable to the circumstances of the present case. In that case it was specifically provided that the preference shareholders were entitled in a winding-up to have the surplus assets applied, firstly, in paying off their capital, and secondly, in paying the arrears, if any, of the preferential dividend at the commencement of the winding-up.

Similarly, in *In re Springbok Agricultural Estates, Limited* (1), it was held that all unpaid preferential dividends were "arrears" of preferential dividends although no profits had been earned by the company, so that subject to the payment off of the preference shares the surplus assets were applicable in the first place in paying off the whole of the unpaid preferential dividends down to the commencement of the winding-up. In that case also, however, it was specifically provided that in the event of a winding-up the holders of the preference shares should be entitled to have the surplus assets applied, first, in paying off the capital paid up on preference shares; secondly, in paying off the arrears, if any, of the preferential dividend to the commencement of the winding-up.

In *In re Roberts and Cooper, Limited* (2), the memorandum of association of the company provided that in the event of a winding-up the preference shareholders should be entitled to receive in full out of the assets the amount of capital paid up on their shares, and also all arrears of dividend due thereon at the date of winding-up. At the date of the winding-up no dividends on the preference shares had been declared or paid for over four years. After the winding-up there was a surplus sufficient to pay arrears of dividend due. It was held that no dividends having been declared between 1921 and 1925, none were due, and the preference shareholders were not entitled to be paid anything in respect of arrears.

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That decision obviously turned upon the word "due" in the memorandum of association. Nevertheless it is an authority for the proposition that dividends are not due, and therefore, do not become debts of the company until a dividend has been declared.

In the present case, as I have already shown, there is a specific provision in Article 163 as to how the surplus assets shall be applied. I cannot help feeling like Sir R. Malins V. C. sorry for the result of what, in my opinion, is a correct interpretation of the memorandum and articles of association of this company. But like the learned Vice-Chancellor, I cannot decide this case upon any abstract notion of justice but only according to the contract which the parties have entered into and their rights arising out of the contract.

The result is that there must be a direction, in the terms of Article 163 that the surplus assets must be applied in the first place in repaying to the holders of preference shares the amount paid up thereon and the residue belongs to the holders of the ordinary shares.

In my opinion, it is clear that the arrears of preferential dividends cannot be treated as "debts" and therefore to be paid out of the assets of the company before the "surplus assets" are ascertained.

Directions given.

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A. C. S.