

(1938) 05 CAL CK 0007
In the Calcutta High Court
In Re: New Ring Mills Ltd. (In Liquidation)

Date of Decision : 11-05-1938

Acts Referred:

Citation : AIR 1939 Cal 126

Hon'ble Judges : Lort-Williams, J; Lord Williams, J

Bench : Division Bench

Judgement

Lort-Williams, J.—This is a petition by the liquidator for directions whether in distributing the assets of the company the preference share-holders 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. By a special resolution of the company passed at a meeting held on the 7th day of March 1938, it was resolved that the company should be wound up voluntarily. The company was incorporated on the 14th day of August 1896 with an authorized share capital of Rs. 6,00,000 divided into 3000 preference shares and 3000 ordinary shares of Rs. 100 each. All the authorized capital is fully paid up. In the half yearly report dated 31st December 1937 the balance-sheet shows a debit of Rs. 6418-9-0 on the profit and loss account. The reserve account is shown as amounting to Rs. 2989-12-8. Para. 5 of the memorandum of association is as follows:

The capital of the company is Rupees 9,00,000 divided into 3000 preference shares and 3000 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.

2. The Articles of Association provide inter alia as follows:

Article 3. The share capital of the company is Rupees 6,00,000 divided into 3000 preference-shares and 3000 ordinary shares of Rupees 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.

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 preference 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.

3. 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 memorandum 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 Drifffield Gas Light Co. Ltd. (1898) 1 Ch. 451. Moreover, it was decided in In re London India Rubber Co. (1868) 5 Eq. 519 that upon the winding up of the company no profits having been realized, 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. In that case Sir E. Malins V.C. said as follows at page 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.

4. 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 : Re Ramel Syndicate Ltd. (1911) 1 Ch. 749. 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 Co. (1902) 1 Ch. 353 that the common Article requiring dividends to be declared by the directors applies to fixed cumulative dividends on preference shares, and Farwell J. said as follows at page 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, Edn. 5, 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.

5. In Bishop v. Smyrna and Cassaba Ry. Co. (1895) 2 Ch. 265 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 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.

6. Similarly, in *In re New Chinese Antimony Co. Ltd.* (1916) 2 Ch. 115 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. 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.

7. Similarly, in *In re Springbok Agricultural Estates Ltd.* (1920) 1 Ch. 563 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 Ltd.* (1929) 2 Ch. 383 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. 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 E. 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.

8. 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.