Thursday, January 25.

FIRST DIVISION.

MACKINNON AND ANOTHER (LIQUIDATORS OF THE MONKLAND IRON COMPANY), PETITIONERS.

Public Company—Winding-up—Surplus Assets—Preference Shares—Companies Act 1862 (25 *and* 26 *Vict. cap.* 89), *sec.* 138.

The articles of association of a public company provided that the "preference shares" of the company were to receive a specified dividend, "guaranteed by the ordinary shares," and further, that no dividends were to be paid "except out of profits." In a winding-up, surplus assets amounting to £8000 remained after payment of all the debts. *Held* that these assets, except in so far as consisted of profits earned, were subject to no preference, but fell to be distributed among all the shareholders of the company in proportion to the number of their shares.

The Monkland Iron and Coal Company (Limited) was incorporated in 1872, and carried on business from June of that year down to 30th May 1881. At an extraordinary general meeting of the company held on the last-mentioned day it was resolved to wind-up the company voluntarily, and liquidators were appointed with the powers conferred by the Companies Acts.

The fifth section of the memorandum of association of the company provided—"The capital of the company is £400,000, divided into 40,000 shares of £10 each, of which 20,000 may be preferential, and with power on increase of capital to issue preferential or guaranteed shares as part or as the whole of such capital." Section 2 of the articles of association provided that of the 40,000 shares, "20,000 are to be guaranteed preferential seven per cent. shares, and 20,000 are to be ordinary shares. The preference shares are to receive a dividend of seven per cent. per annum guaranteed by the ordinary shares, and to be cumulative, and for additional security a guarantee reserve fund is to be created out of the surplus profits of 1872, after paying the guarantee dividends for that purpose, to the amount of £30,000, being in excess of two years' guaranteed dividends. In the event of the reserve fund having to be resorted to for the purpose of making up the guaranteed dividend, it shall be made up to the original amount of £30,000 out of any profits which may accrue after payment of a dividend of not less than 20 per cent. per annum on the ordinary shares in any one year." A subsequent section provided that no dividend should be payable except out of the profits arising from the business of the company, or, in case of the preference shares, out of the reserve fund.

At an extraordinary general meeting in May 1876, the resolutions of which were thereafter duly confirmed, the directors were authorised to accept surrenders of the preference shares, and issue in lieu of them shares carrying a 5 per cent. preference dividend, having the same priority as the preference share surrendered, any deficiency therein to be made good out of the profits of succeeding years before any dividend was paid on ordinary shares. Sundry other special resolutions were also passed and confirmed, which need not here be referred to.

The liquidators after paying the debts of the company found that there was in their hands a sum of about £8000 of surplus assets, as well as a sum of £62, 17s. 6d., at the credit of the guarantee reserve fund. They proposed to divide the latter sum among the preference shareholders in proportion to their shares, and to divide the former sum among the whole shareholders of the company in proportion to the number of their shares. The preference shareholders claimed an entire preference in the division over ordinary shareholders. For determining the question which thus arose between the preference shareholders and the liquidators regarding the distribution of the £8000, and especially as to the proportion to be paid to the preference and to the ordinary shareholders, the present application to the Court was made by the liquidators, under sec. 138 of the Companies Act 1862, which is in these terms —"Where a company is being wound up voluntarily, the liquidators or any contributory of the company may apply to the Court in England, Ireland, or Scotland, or to the Lord Ordinary on the Bills in Scotland in terms of vacation, to determine any question arising in the matter of such winding-up, or to exercise, as respects the enforcing of calls, or in respect of any other matter, all or any of the powers which the Court might exercise if the company were being wound up by the Court; and the Court, or Lord Ordinary in the case aforesaid, if satisfied that the determination of such question, or the required exercise of power will be just and beneficial, may accede, wholly or partially, to such application, on such terms and subject to such conditions as the Court thinks fit, or it may make such other order, interlocutor, or decree on such application, as the Court thinks just."

Certain of the preference shareholders entered appearance in the application.

Argued for the liquidators—Under the original articles of association the preference shareholders were entitled only to a preference out of profits, and not out of capital. The present claim was really for a payment out of capital, which neither the directors of the company nor the liquidators would be justified in meeting. None of the articles of association warranted this claim. The £8000 of surplus assets should thus be divided among the whole shareholders of both classes in proportion to the number of their shares.

Argued for respondents—The present claim was founded on words in section 2, "guaranteed by ordinary shares;" the word "guaranteed" meant more than preferential. These dividends were also to be "cumulative." If no profits were earned, the payments must be made out of capital. This might not be done in a going concern, but in a liquidation the preference shareholders were entitled to be paid all arrears. There was no attempt or desire here to compete with creditors, only surplus assets were claimed.

Authorities—*London India Rubber Company*, January 29, 1868, L.R., 5 Eq. 519; *Eclipse Gold Mining Company*, January 31, 1874, L.R., 17 Eq. 490; *Griffith* v. *Paget*, July 12, 1877, 6 Chan. Div. 511; *Bangor Slate Company*, April 24, 1875,

20 Eq. 59; Buckley, Companies Acts, 4th ed. p. 262-3; *Ex parte Maude*, November 25, 1870, 6 Chan. App. 51; *Hutton* v. *Scarborough Cliff Hotel Company*, April 25, 1865, 34 L.J., Chan. 643; Lindley on Partnership, p. 662; *In re Metropolitan Bank*, 15 Chan. Div. 139; *Sdeuard* v. *Gardner*, March 10, 1876, 3 R. 577.

At advising—

LORD PRESIDENT—The winding-up of the Monkland Iron and Coal Company is now completed, and it appears from the petition that the liquidators are now in a position to make a division of the surplus assets of the company, amounting to about £8000. A question however seems to have arisen between certain of the preference shareholders, and the liquidators acting on behalf of the general body of shareholders, as to whether this sum of £8000 is to be viewed as unpaid preference dividends, and so is to be paid exclusively to the preference shareholders, or whether it is to be distributed *pro rata* among the whole shareholders of the company.

The present application has accordingly been made under the 138th section of the Companies Act of 1862, to have that question determined. Now, it appears to me that the contention of the preference shareholders rests entirely upon one clause in the articles of association, and but for that clause the principle which they here contend for could not be maintained. The fifth section of the memorandum of association is in these terms: — "The capital of the company is £400,000 divided into 40,000 shares of £10 each, of which 20,000 shares may be preferential, and with power on increase of capital to issue preferential or guaranteed shares as part or as the whole of such capital." But section 2 of the articles of association provides—"The preference shares are to receive a dividend of 7 per cent. per annum guaranteed by the ordinary shares, and to be cumulative, and for additional security a guarantee reserve fund is to be created out of the surplus profits of 1872, after paying the guarantee dividends for that purpose, to the amount of £30,000, being in excess of two years' guaranteed dividends." Now, the words specially founded on by the preference shareholders are "guaranteed by the ordinary shares," and the question comes to be whether they gain anything by the existence of these words in this second section.

The position of these preference shareholders comes to be this—They are first of all to get a preference for a 7 per cent. dividend, and for that they are to rank *primo loco* on the profits of the year. *Second*, These preference dividends are to be cumulative—a provision which was unnecessary perhaps, but which came to mean this, that if in any one year less than the 7 per cent. should be paid, the balance might be made up in some succeeding year. *Third*, For the additional security of these shareholders a reserve fund is to be created out of the surplus profits of a particular year, and it is provided that if that fund should be made use of in part payment of this preference dividend, then it is not to be restored until a 20 per cent. dividend is paid upon the ordinary shares of any one year. Now, it appears to me that when a dividend of this kind is called "guaranteed," any one so describing it cannot be charged with using extravagant language. But it is maintained that in addition to all this the ordinary shares are also pledged in security of these preference dividends—that is to say, that if it should become impossible to pay 7 per cent. out of profits, then the preference shareholders are to have recourse against the ordinary shares, or are to be paid out of that portion of the capital held by the ordinary shareholders. This proposition is so extravagant that I am not surprised that the Lord Advocate hesitated to face it, for it seems to me to be opposed to some of the fundamental principles of the law of partnership, and also to the articles of association of this company. It is neither more nor less than a proposal that if this 7 per cent. cannot be earned as profit it is to be paid out of capital. The reserve fund from which this dividend may be made up is accumulated profits, and while it lasts the guaranteed dividend may be claimed by these shareholders. It is further urged in support of this contention that the dividends on these shares being cumulative, a claim which would not be good while the company was a going concern became good in a winding-up, and especially in a case like the present, when there is to be a division of surplus assets. It is a curious circumstance that from beginning to end of these articles of association there is not a single provision having reference to the winding-up of the company, and yet the Court are asked to insert after the words "guaranteed by the ordinary shares" the clause "in the event of the company being wound up and there being surplus assets to be distributed." I am not prepared to insert these words, nor am I prepared to hold that they are to be implied by the use of the words "guaranteed by the ordinary shares."

The question then comes to be, whether the capital of the company is to be used in payment of the dividends upon these preference shares; Had the directors so disposed of the capital, there can be no doubt that they would have acted most imprudently, and would have involved themselves in serious responsibilities.

I am therefore of opinion that the surplus assets fall to be distributed, without discrimination, amongst the whole shareholders of the company.

LORD MURE—I agree with your Lordship in the opinion which you have expressed. The general rule of law relating to preferential or guaranteed shares, as stated by Lindley, is that such shareholders are to have a certain recognised preference in the distribution of the profits of the company. That being so, as there is nothing special in the articles of association, the ordinary rule of law must prevail. On a fair construction, section 2 of the articles of association, to which your Lordship referred, comes to this—that the preference shareholders are to receive a 7 per cent. dividend out of the profits of the year, that this dividend is to be cumulative; and that for the greater security of these preference shareholders a guaranteed fund is to be created out of surplus profits.

It seems to me that in the matter of liquidation the liquidators must be guided by the rules of common law, seeing that there is nothing in the articles of association contemplating a providing for the winding-up of the company.

Lord Shand—I am clearly of the same opinion. The cardinal provision of the articles of association as to dividends is that they shall be paid out of profits only, for although under the article dealing with the subject dividends on the preference stock may be taken out of the reserve fund provided for the purpose, that reserve fund is itself to be made up out of profits and not out of capital. Notwithstanding this, the Court is now asked to give dividends to the preference shareholders out of capital, and not out of profits. It would require the clearest language in the special provisions of the articles of association founded on to lead to that result. It appears to me that the argument of the preferential shareholders fails entirely. This argument is rested on a few words in article 2. The words there used are "guaranteed by the ordinary shares." The word "guaranteed" by itself, and without the following words, could not support or suggest the argument, for that word is satisfied by the fact that there is a reserve fund, provided out of profits by the ordinary shareholders as a guarantee to the preference shareholders. The argument then, as I have said, comes to rest on the four words "by the ordinary shares." It is said that by force of these words capital may be resorted to for the payment of the preference dividends. There is no doubt that the word "guaranteed" is frequently used in joint-stock company law, and in the prospectus and articles of association of joint-stock companies. It is often employed where there is no proper guarantee given, either by personal obligation or by a special security fund being provided to which recourse can be had. It is often used when all that is meant is that the right of the preference shareholders to claim dividend is in a sense guaranteed by the right of ordinary shareholders to any share of profits being postponed. It appears to me that it is in that loose sense that the word is here used. The passage quoted from Lord Justice Lindley's work on Partnership shows the practice. He says—"What are called preferential or guaranteed shares are nothing more than shares the owners of which are entitled to share profits to a certain extent in preference to other shareholders." The author there plainly uses the words "or guaranteed" as they are often used, as being merely equivalent to preferential. I have no difficulty in holding that this is the meaning of the word in article 2 of these articles of association. The first paragraph of the article provides that 20,000 of the whole shares are to be "guaranteed preferential seven per cent. shares." In the terms thus used there is nothing to define what "guaranteed preferential shares" exactly are. Those words might no doubt by inference be read as meaning that the claims to dividend of the ordinary shareholders are to be postponed to those of the preferential shareholders, but that would be inference only. The next sentence is, I think, intended to give an explanation of what is meant by those words—"The preference shares are to receive a dividend of seven per cent. per annum guaranteed by the ordinary shares." Now, after the words "seven per cent. per annum" it might have been added, "which shall be paid in priority to the ordinary shares," but instead of that the words "guaranteed by the ordinary shares" are added. That is just a loose way of saying that the preference shares are to have priority to the other shares in the payment of dividends. The phrase actually used is not so accurate as that I have stated, but the words in that sense are intelligible. The guarantee is by the ordinary shares, that is, by these shares having a postponed interest only in the profits—a right to surplus profits, if any, after the dividend on the preference shares has been paid. This reading is consistent with the other clauses of the articles providing for payment of dividends out of profits only. The judgment now proposed is strengthened by the consideration adverted to by your Lordship, that if the words were read in the sense contended for, the result would be that even while the company was a going concern, if in any year there was no profits the ordinary shareholders would be bound to submit to a part of their capital being taken away. That result is so extravagant that the Lord Advocate did not contend for it. His argument came to this, that he must read in the words "in case of a liquidation and of there being no profits, the dividends of the preferential shareholders shall be paid out of the capital of the ordinary shareholders." I am unable to read the article so, and the observation is of great weight against such a reading that nowhere in the whole of the articles do we find one which applies to or contemplates the case of a winding-up of the company. On these grounds I cannot read article 2 of the articles of association as giving any countenance to the argument of the respondent.

Lord Deas was absent.

The Court pronounced this interlocutor:—

"Find that after all the creditors of the company are paid, the surplus assets, except in so far as these consist of profits earned, fall to be distributed among all the existing shareholders in proportion to the shares of capital belonging to them respectively, without any distinction or difference between preference shares and ordinary shares, but that the balance of profits remaining in the hands of the company after paying all the creditors must, in the circumstances stated in the petition and admitted by the respondents, be divided among the preference shareholders only, to the exclusion of the ordinary shareholders, and appoint the expenses of the respondents, as well as of the petitioners, as the same shall be taxed by the Auditor, to be paid out of the funds of the company, and decern."

Counsel for Petitioner — Solicitor-General (Asher, Q.C.)—Mackintosh—Lorimer. Agents—Webster, Will, & Ritchie, S.S.C.

Counsel for Respondents (Preference Shareholders Compearing)—Lord Advocate (Balfour, Q.C.)—Macfarlane. Agents—Thomson, Dickson, & Shaw, W.S.