



Neutral Citation Number: [2025] CICA (Civ) 19

**IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS
ON APPEAL FROM THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION**

CICA (CIVIL) APPEAL NO: 16 of 2023

(FORMERLY CAUSE NO: FSD 190 of 2021 (DDJ))

IN THE MATTER OF THE COMPANIES ACT (2023 REVISION)

AND IN THE MATTER OF HQP CORPORATION LIMITED (IN OFFICIAL LIQUIDATION)

AND

CICA (CIVIL) APPEAL NO: 14 of 2024

(FORMERLY CAUSE NO: FSD 108 of 2024 (NSJ))

IN THE MATTER OF THE COMPANIES ACT (2023 REVISION)

**AND IN THE MATTER OF DIRECT LENDING INCOME FEEDER FUND LTD (IN
OFFICIAL LIQUIDATION)**

Before: **The Hon John Martin KC, Justice of Appeal**
 The Hon Sir Richard Field, Justice of Appeal
 The Rt Hon Sir Jack Beatson, Justice of Appeal

Appearances: **Re HQP Corporation Ltd:** Mr Steven Thompson KC instructed by Conyers, Dill & Pearman LLP for Access Industries Holdings and AI Autoparts LLC, Mr Tom Smith KC instructed by Walkers (Cayman) LLP for the Joint Official Liquidators and Mr Robert Levy KC instructed by Campbells LLP for DCM Ventures China Fund and JenCap Helmet;
 Re Direct Lending Income Feeder Fund Ltd: Mr Richard Millett KC instructed by Mourant Ozannes (Cayman) LLP for Eiffel eCapital US Fund, and Mr Tom Smith KC instructed by Collas Crill for the Joint Official Liquidators

Date of Hearing: **25 – 28 November 2024**

Draft circulated: **20 October 2025**

Judgment Delivered: **7 November 2025**

MARTIN JA:

A. INTRODUCTION

1. This is the judgment of the Court to which each member has contributed.
2. The two appeals before the Court are from the orders of Doyle J in *Re HQP Corporation Limited* (in Official Liquidation) dated 19 July 2023 and Segal J in *Re Direct Lending Income Feeder Fund Ltd.* (in Official Liquidation) dated 8 May 2024 following applications to the Grand Court by the liquidators (“the JOLs”) of the two companies for directions. The applications concerned the treatment in the liquidations of claims for misrepresentations by investors who subscribed for shares. Hereafter we refer to the companies as “HQP” and “Direct Lending”.
3. Following hearings in HQP on 17-18 May 2023 and in Direct Lending on 25-26 May 2023, in decisions respectively delivered on 7 July 2023 and 13 March 2024, Doyle and Segal JJ gave different and effectively irreconcilable answers to the two main questions in both cases. The appeal in HQP was originally listed for 1 and 2 May 2024 but on 1 May 2024 it was adjourned in circumstances we describe at paragraphs [15] – [18] below to enable it to be heard with any appeal in Direct Lending.
4. Direct Lending and HQP are exempted Cayman Islands companies with limited liability respectively incorporated in June 2016 and December 2017 and placed in liquidation by the Grand Court on 25 July 2019 and 5 April 2022 in circumstances summarised at paragraphs [19] – [21] and [24] - [25] below. Direct Lending is part of a master-feeder investment structure in which it is the offshore feeder fund. Its onshore counterpart is Direct Lending Income Fund LP and the master fund is DLI Capital Inc. HQP is the parent company of a group operating a business-to-business automobile trading platform in the People’s Republic of China and Hong Kong whose founder and former CEO admitted that he had provided false representations and accounting details to current and prospective investors misrepresenting its true financial position.
5. The circumstances of these cases reflect the tension that can exist between claims by investors and principles concerning the retention of capital favouring external unsecured creditors over the members of a company in an insolvency by subordinating shareholders’ claims in their capacity as shareholders.

(1) The statutory framework

6. The material provisions of the Companies Act (2023 Revision) for the purposes of these appeals are sections 49(g), 139(1) and 140(1). Section 139(1), on provable debts, specifies that:

“All debts payable on a contingency and all claims against the company whether present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company ...”

and requires the official liquidator to estimate their value so far as this is possible.

7. Section 140(1), on the distribution of the company’s property, provides that subject to a provision concerned with contractual subordination, set-off and netting agreements which is not relevant to these appeals:

*“... the property of the company shall be applied in satisfaction of its liabilities *pari passu* and subject thereto shall be distributed amongst the members according to their rights and interests in the company”.*

8. Section 49 is concerned with the liability of present and past members of a company. Section 49(g) qualifies the position under section 140(1) that unsecured claims are to be paid *pari passu* and ahead of shareholders by providing for further subordination as follows:

*“[N]o sum due to any member of a company **in that person’s character of a member** by way of dividends, profits or otherwise, shall be deemed to be a debt of the company, payable to such member in a case of competition between that person and any other creditor not being a member of the company; but any such sum may be taken into account for the purposes of the final adjustment of the rights of the contributions¹ amongst themselves.”* (emphasis added)

(2) The questions for decision

9. The same two main questions fall for decision in both cases. The first is whether, in the Cayman Islands, after the presentation of a winding up petition, claims for damages for misrepresentation inducing a subscription for shares in a company can be admitted to proof in a liquidation or whether such claims are barred by the decision of the House of Lords in *Houldsworth v City of Glasgow Bank* (1880) 5 App Cas 317 (“*Houldsworth*”), an appeal from the First Division of the Court of Session in Scotland. We shall refer to this as the “the bar on proof question”.
10. The second question, which we shall refer to as “the priority question”, is where, if such claims are provable, they rank in a liquidation in relation to other claims made by members, former

¹ The word “contributions” is a clear misprint for “contributories”.

members and external unsecured creditors. In particular, do they fall within section 49(g) so the claims of members and former members are subordinated to the claims of external unsecured creditors.

11. These questions have not previously been fully considered in these Islands.

(3) The Parties

12. The parties to the appeals are the JOLs of the two companies and preferred shareholders who invested in them. The JOLs of Direct Lending are Mr Bradley Sharp, a US Permanent Receiver, and Mr Christopher Johnson and the JOLs of HQP are Messrs Christopher Smith and Martin Trott of R&H Restructuring (Cayman) Ltd.

13. The appellants in HQP are Access Industries Holdings and AI Autoparts LLC, the holders of approximately 7% of the Series C preferred shares and 73% of the Series D preferred shares in HQP. The respondents are JenCap Helmet and DCM Ventures China Fund (DC VIII), DCM VIII, LP and DCM Affiliates Fund VIII, LP (“the JenCap and DCM funds”), preferred shareholders holding the majority of the Series B and C shares and approximately 10% of the Series D shares, and the JOLs. The appellants in Direct Lending are Pretons Ensemble 2, Eiffel eCapital Global Fund, and eCapital US Fund, three funds (“the Eiffel Funds”) holding preferred shares in Direct Lending. The respondents are the JOLs.

14. Before us, Mr Tom Smith KC appeared for both sets of JOLs. In HQP Mr Steven Thompson KC appeared on behalf of the appellants² and Mr Robert Levy KC on behalf of the respondents, and in Direct Lending Mr Richard Millett KC appeared on behalf of the appellants. We are grateful to all counsel for their efficiency in dealing with what are not straightforward issues in three and a half days.

(4) The timetabling history of these appeals³

15. Before giving an overview of the decisions and summarising the underlying facts, we observe that it was unfortunate that two cases with the same main questions came before different judges within a week of each other. We do not know when the parties first became aware of the position and whether, when they did, there was time to address the matter by appropriate case

² At the hearing on 1 May 2024 Mr Alan Steinfeld KC, who had settled Access and AI Autoparts’ skeleton argument, appeared on their behalf. He sadly died on 26 August 2024 and was replaced by Mr Thompson KC.

³ See further [5] – [7] of Segal J’s judgment in Direct Lending and the transcripts of the hearings before Doyle J on 18 May 2023, Segal J on 25 May 2024, and before this Court on 1 May 2024.

management and liaison with the Grand Court. We summarise what we understand of the circumstances below. We observe only that, despite the different answers given in the decisions below, it appears that the parties either saw no need to ensure that appeals from them were conjoined or were content for them to come before this Court separately. We consider that they should have informed this Court of the position soon after the judgment in Direct Lending was delivered on 13 March 2024, a month before the commencement of its spring session at which the appeal in HQP was to be listed.

16. The appeal in HQP was originally listed to be heard on 1 and 2 May 2024. On Friday 26 April 2024 the members of this Court who were to hear the appeal⁴ first became aware of Direct Lending from the supplementary skeleton argument of the appellant in HQP. On 1 May 2024 they adjourned the hearing to enable it to be heard together with the appeal in Direct Lending. They did so notwithstanding the submissions by all leading counsel for three reasons. First, the main questions of law in both are substantially identical and had not previously been considered in these Islands. Secondly, as was accepted by the parties on 1 May 2024, the differences in their underlying facts do not bear on the resolution of the main questions. Thirdly, it was inevitable that a court hearing one of the appeals would have to consider whether the decision in the other case was correct but without submissions from the parties in the other case, and as the order in Direct Lending had not been filed and sealed it was possible that there would be an appeal in that case after this Court's decision in HQP.
17. At the hearing of HQP Mr Smith informed Doyle J that Direct Lending was to be heard in the following week. Segal J found out about HQP's listing when he received the parties' skeleton arguments in Direct Lending shortly before the hearing. He raised it at the beginning of the hearing, expressing the view that duplication of expense and the risk of inconsistent judgments would have been avoided had the common issues of principle been listed before one Grand Court judge. He was informed that the liquidation committees wished there to be a separate adjudication of the issue in each liquidation. Because by then the hearing in HQP had taken place and all parties in Direct Lending wished to go ahead, Segal J decided to proceed with the hearing but to wait for the judgment in HQP to be delivered before finalising his own decision.
18. After the delivery of the judgment in HQP on 7 July 2023, Segal J asked the parties in Direct Lending whether they wished to make further submissions in the light of it but they said they did not. Segal J does not state whether by then he knew that he took a different view to Doyle J on the main issues. He does record that both leading counsel firmly requested him not simply to follow Doyle J's reasoning and decisions in HQP and leave the determination of the main

⁴ Goldring P, and Birt and Beatson JJA.

questions to this Court. By the time Segal J delivered judgment in Direct Lending, leave to appeal had been given in HQP. At the hearing on 1 May 2024, Mr Smith KC informed the Court that the order in Direct Lending was deliberately not sealed because of the pending appeal in HQP “so that the matter can be left open” and there would be an ability to appeal in Direct Lending to bring the position into line with whatever this court determined in HQP. That approach did not commend itself to the Court which adjourned the hearing for the reasons given at paragraph [16] above and strongly indicated that the order be drawn up within 7 days.

(5) Overview of the decisions below

(a) HQP

19. HQP’s Articles of Association contained what was described as a post-liquidation “contractual waterfall of priorities” giving the various series of preferred shareholders a fixed 120% return in the event of a liquidation or redemption with the holders of each new series ranking ahead of all previous series in descending order from Series D to Series B.⁵ Before us, the arrangement was described as a deal by which all holders of preferred shares expected to be paid out in the order “last in, first out”: Transcript 25 November 2024 p 118 lines 11-12. The shareholder parties to the proceedings were initial subscribers to the various series of shares under contracts with HQP rather than market purchasers.
20. Following the admissions by HQP’s founder and former CEO that he had made misrepresentations about its financial position to current and prospective investors, on 17 and 18 February 2021 AI Autoparts and Access Industries applied to HQP to redeem their preferred shares. As stated, they respectively held approximately 7% of the Series C preferred shares and 73% of the Series D preferred shares.
21. HQP then required other holders of preferred shares who wished to participate in the redemption to give notice. The JenCap and DCM funds, whose shareholding meant they had a less favourable ranking under the waterfall of priorities, did so. Subsequently they presented a winding up petition and applied to the Grand Court for the appointment of liquidators. After their appointment, on 11 November 2022 Messrs Smith and Trott sought directions from the court on *inter alia* the two questions summarised at paragraphs [9] – [10] above. We observe that the effect of the waterfall of priorities together with the fact that HQP’s articles provided

⁵ Article 102 and section 2(a) of Schedule A to HQP’s Fifth Amended and Restated Memorandum of Articles of Association. Holders of Series A were to receive 100%.

that redemption did not occur until payment meant that there were no shareholders who had in fact redeemed.

22. Doyle J's judgment reviews the treatment of English precedent in Cayman Islands law and a number of other jurisdictions,⁶ and the limited circumstances in which this Court will decline to follow a decision of the House of Lords or the UK Supreme Court: see [24] – [38] and [70] – [74]. At [75] – [164] he analysed the decision in *Houldsworth* and cases that considered it in the United Kingdom and other jurisdictions, in particular those of the House of Lords in *Soden v British & Commonwealth Holdings Plc* [1988] AC 298 ("*Soden*"), the High Court of Australia in *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1, [2007] 3 LRC 462 ("*Sons of Gwalia*"), and the Supreme Court of Bermuda in *Re Televest* [1995] Bda LR 71 ("*Televest*"). He also considered textbook commentary, section 111A of the UK Companies Act 1985 (now section 655 of the 2006 Act) which he stated at least in part overrode the *Houldsworth* principle, section 139 of the Companies Act (2023 Revision), and noted the brief references to *Houldsworth* in the Grand Court.⁷
23. He concluded that he should not follow *Houldsworth* for five reasons. It is arguably contrary to or an unjustifiable restriction to the plain wording of section 139 of the Companies Act (2023 Revision). It has been abandoned by the UK Parliament and has been persuasively criticised and not followed in Australia and Bermuda. Its reasoning is inconsistent with contemporary company law. It is an obsolete English common law decision which has ceased to be authoritative in England, and it is simply not persuasive in the context that was before him. Doyle J held:
 - (1) The rule in *Houldsworth* does not operate in these Islands to bar claims for misrepresentation inducing a subscription for shares in a company by shareholders: [172] – [173].
 - (2) The foundation of such misrepresentation claims is a pre-contractual tort rather than the shareholders' agreements or the statutory contract: [187].
 - (3) Accordingly, sums due to shareholders in respect of such misrepresentation are not due to them in their capacity as members of the company, and thus fall outside section 49(g), rank *pari passu* with external creditors' claims rather than being subordinated to them, and are provable in competition with the company's external creditors' claims: [199].

⁶ The Isle of Man, Jersey, Guernsey, Bermuda, Hong Kong, and New Zealand: see [39] – [69]

⁷ At [115] – [117]. See Smellie CJ in *Re SPhinX Group of Companies* [2010 (2) CILR 1] and Segal J in an earlier judgment in *Direct Lending* (Unreported) 10 November 2022 concerned with the appropriate procedural routes for the determination of the substantive issues.

- (4) Such claims were therefore not subject to the post-liquidation “contractual waterfall of priorities” in HQP’s Articles of Association because the cause of action is a pre-contractual tort and not based on the statutory contract: [200].

(b) Direct Lending

24. In late 2018, the DLI group encountered liquidity difficulties and the Eiffel Funds’ preferred shareholders in Direct Lending made requests to redeem their entire shareholding. However, prior to payment, redemptions were suspended and they were not paid. In April 2019, as a result of a complaint by the United States Securities and Exchange Commission, the US District Court for the Central District of California placed Direct Lending and the rest of the group in receivership and appointed Mr Sharp as Receiver. Mr Sharp obtained the District Court’s approval to exercise the rights of Direct Lending’s managing shareholder to place it in voluntary liquidation in this jurisdiction and appoint Mr Johnson as his co-liquidator.
25. In a summons dated 23 February 2022, Messrs Sharp and Johnson applied to the Grand Court *inter alia* for orders which, although formulated differently, reflected the answers they sought to the two main questions summarised at paragraphs [9] – [10] above. In the order dated 8 May 2024 giving effect to his judgment dated 13 March 2024, Segal J ordered that: (a) the JOLs be directed to exercise their function of adjudicating claims on the basis that any claims by Direct Lending’s shareholders based on misrepresentation by Direct Lending in relation to their subscription for shares are not barred as a matter of law solely because Direct Lending is in liquidation; and (b) such claims would be payable *pari passu* with any admitted redemption claims.
26. Segal J considered the judgment in HQP and the decisions cited by Doyle J. He considered that, absent binding authority in these Islands, and given the dispute as to the meaning and effect of *Houldsworth* and the English cases, the proper approach was to determine the legal position under English law and then consider whether it applied or should be applied in these Islands: see [11(a)]. He proceeded on the basis that the misrepresentation claimants had lost their right to rescind their subscription agreements on the commencement of Direct Lending’s winding up: see [11(b)]. Before us the case proceeded on the same basis. Segal J’s suggestion that the issue of whether the right is permanently lost or is only barred to the extent that its exercise would prejudice third party creditors may need further consideration by an appellate court was not taken up.
27. Segal J’s judgment focuses on the common law rule which prohibits the return of capital to shareholders except as authorised by statute: see [118(a)] and [120(a)]. He concluded that this

“capital maintenance rule” is the basis of the rule in *Houldsworth*, supported by other authorities, in particular *Soden*, barring a shareholder from proving in a winding up for damages for misrepresentation which induced the subscription contract at all or in competition with external non-shareholder creditors: see [120] – [128]. He did not consider that the reasoning in the Australian authorities required or justified a different approach to that which he derived from the English cases and did not find the approach in *Televest* persuasive: see [169] ff. and [188] – [191].

28. He stated that, once external creditors have been paid in full, there is no need or justification for an absolute bar on such claims: see [11(c) and (g)], [152], and [163]. The common law rule operated alongside the statutory regime governing the right to prove in a winding up, and since statute, now section 49(g), subordinated such claims to those of external unsecured creditors, he could see the force of the argument that there is no longer a need for an absolute common law bar: see [11(h)], [150] and [166]. He, however, considered that there “may be” advantages in retaining a common law rule containing a qualified bar alongside the statutory rule “*to present a rational and integrated view of the law*”: see [163] and [168].
29. Segal J rejected the Eiffel Funds’ submission that redemption creditors, although subordinated as regards ordinary creditors by section 49(g), ranked ahead of members’ claims including any misrepresentation claims. He stated that once the claims of external unsecured creditors admitted to proof were suitably provided for by the JOLs, the misrepresentation claims rank *pari passu* with the claims of any admitted redemption claims: see [12(b),(c)], [264], [273] – [274]. He held:
 - (1) The rule in *Houldsworth* applies alongside the statutory regime for subordination.
 - (2) A claim for damages for misrepresentation inducing a subscription for shares in a company could only be considered after claims by external unsecured creditors had been adjudicated and, if admitted to proof, suitably provided for by the JOLs.
 - (3) Such misrepresentation claims rank *pari passu* with any admitted redemption claims.

(6) The grounds of appeal:

30. In *HQP*, three grounds were advanced at the hearing on behalf of Access Industries and AI Autoparts. They are that Doyle J erred:
 - (1) in deciding not to follow *Houldsworth*,
 - (2) in holding that misrepresentation claims fell outside the scope of section 49(g) and,

(3) in holding that the contractual waterfall in HQP’s articles was not applicable.

The written grounds and skeleton argument also complain of “serious procedural irregularities”. They maintain that Doyle J did not give the parties a proper opportunity to make submissions on cases and points the parties had not put before him but which he deployed in his judgment. Mr Thompson did not make oral submissions on this ground although he did not abandon it. A Respondent’s Notice on behalf of the JenCap and DCM funds advanced additional reasons (summarised at [40] below) for upholding Doyle J’s decision in HQP.

31. In Direct Lending, two grounds were advanced on behalf of the Eiffel Funds and the JOLs gave notice that they intended to contend that the decision be varied. The Eiffel Funds’ grounds are that Segal J erred:

- (1) in holding that *Houldsworth* does not totally bar shareholders from proving in a winding up for such misrepresentations but only precludes them from doing so in competition with external non-member creditors, and
- (2) in holding that all member claims falling within section 49(g) rank equally.

The JOLs’ Respondent’s Notice contended that Segal J was wrong to consider that the rule in *Houldsworth* sits alongside the statutory regime for subordination. They submit that he should have concluded that the statutory regime means there is no longer a basis or need for the rule.

(7) The submissions of the JOLs and other parties

32. We here give a general summary of the parties’ submissions. Where necessary, fuller summaries are given in the sections discussing the *Houldsworth* rule and priority.⁸ We note that Doyle and Segal JJ analysed the nature of claims for damages for misrepresentation inducing a subscription for shares in a company and then considered priority. In their submissions before this court the JOLs in both cases first addressed priority. This was because they consider that the resolution of that issue assists with the resolution of whether the claims are subject to a bar on proof as a result of the decision in *Houldsworth* and its underlying principle, and that analysis of the scope of the subordination provision in section 49(g) gives a strong indication as to whether the misrepresentation claims are barred as a matter of Cayman Islands law.⁹

⁸ On the *Houldsworth* “bar on proof” rule, see below [158] – [184] and [187] – [194], and on priority, see [233], [241] – [246], [249], [253]– [255] .

⁹ See the JOLs’ Skeleton Argument in *HQP* at §§10 and 20, and in *Direct Lending* Skeleton Argument, at §3.

- 33 We also note that, as seen from the summary of the decisions below, the determination of the two main questions also involved consideration of a number of sub-issues. Two concern Lord Browne-Wilkinson’s proposition in *Soden* (a market purchase case) that negative claims based on money paid to the company under the statutory contract which the member says he is entitled to have refunded are “*claims necessarily made in his character as a member*”.¹⁰ The first is whether the focus should be on the relevance of a claim to the return of capital principle rather than whether the claim is *anterior* to the membership contract. The second is whether the subordination of shareholders’ claims to those of external unsecured creditors should be limited to those who claim under a direct contract of subscription with the company and not apply to claims for misrepresentation inducing a market purchase of shares.
- 34 The third sub-issue only arises in HQP. It is whether the contractual waterfall applies so that claims by Series D shareholders fall to be paid in priority to claims by other shareholders. The fourth sub-issue only arises in Direct Lending. It is the ranking of subscription claims and redemption claims.

(a) ***Submissions on the “bar on proof” question:***

- 35 The position of the JOLs on the “bar on proof question” is that Doyle J was correct to determine that the rule in *Houldsworth* did not operate to bar claims by shareholders in all circumstances, and that Segal J was wrong to hold that the rule in *Houldsworth* sits alongside the statutory regime for subordination. In their Respondent’s Notice the JOLs submit that Segal J should have concluded that the statutory scheme for subordination means that there is no basis or continued need for the rule in *Houldsworth*.
- 36 In the HQP appeal, it was submitted on behalf of Access Industries and AI Autoparts that Doyle J erred in deciding not to follow *Houldsworth*. Mr Thompson submitted that Segal J’s analysis in Direct Lending of the position and the effect of the cases such as *Soden*, *Televest* and *Sons of Gwalia*, discussing *Houldsworth*, was more coherent than Doyle J’s. He said that the criticism of some of the language in *Houldsworth* and other 19th century judgments by Doyle J and in the judgments of the High Court of Australia in *Sons of Gwalia* did not take sufficient account of the fact that at that time courts were working out the effect and the operation of what were newly invented companies. Although some of the language used was not precise and

¹⁰ [1988] AC 298 at 325F. He contrasts such “negative” claims with claims to dividends and profits which he describes as representing “*what might be called positive claims of membership*”.

would be considered “loose” today, Mr Thompson maintained that “it is absolutely clear when read in context what [those] cases are deciding”.¹¹

- 37 Mr Thompson also submitted that Doyle J did not follow guidance in *National Trust for Cayman Islands v Planning Appeals Tribunal* [2002 CILR 59] and *Schramm & Hiscox v Financial Secretary* [2004-05] CILR 104 as to the limited circumstances in which a Cayman Islands court may not follow a decision of the House of Lords or the UK Supreme Court. He submitted that Doyle J also erred in concluding that a statutory alteration of a common law rule in the United Kingdom was a reason for refusing to apply that common law rule in these Islands. Mr Thompson further submitted that Doyle J erred in stating that following *Houldsworth* would be an unjustified restriction on the plain wording of section 139 of the Companies Act, something not raised by the parties and, in any event, flawed *inter alia* because there were materially identical provisions to section 139 in United Kingdom Companies Acts between 1862 and 1985. Section 158 of the 1862 Act was alluded to by counsel in *Houldsworth* but did not find favour with the court and none of the senior company lawyers or judges in all the courts which dealt with *Soden* thought about this point.
- 38 In the Direct Lending appeal, Mr Millett stated that Mr Thompson had covered the ground but submitted that the priority point only arose because both Doyle and Segal JJ got the proof point wrong, albeit in different ways. *Houldsworth*, he maintained, is not a case about priorities; it is a rule against proof. Segal J’s qualification that it only applied to protect external creditors from competition with claims by members and former members erred because it failed to apply the decision in *In re Hull and County Bank* (1880) 15 Ch. D. 507 (“*Burgess’s Case*”) and introduced an unnecessary restriction on the scope of the principles governing the unlawful return of capital.
- 39 Mr Levy, on behalf of the JenCap and DCM funds, the respondents in HQP, submitted that Doyle J correctly identified the relevant principles governing the impact of English precedent in Cayman Islands law and did not err in his treatment of the authorities. He submitted that there was no authority suggesting that the *Houldsworth* principle was recognised in the Cayman Islands before 1880 and thus formed part of its common law. Doyle J was entitled to consider the policy considerations he did and there was no evidence that not applying *Houldsworth* would adversely affect investors in these Islands.
- 40 The JenCap and DCM funds’ Respondent’s Notice for upholding Doyle J’s decision in HQP states:

¹¹ Transcript, 25 November 2024, p 35 lines 7-8.

- (1) The bar in *Houldsworth* is inconsistent with section 14(1) of the Contracts Act (1996 Revision) which introduced liability to pay damages for negligent misrepresentation.
- (2) A shareholder's claim for misrepresentation is not inconsistent with the (implied) terms of the statutory contract because it is not made under the statutory contract and does not amount to an indirect return of capital.
- (3) Although subsequently interpreted as applying to limited companies, *Houldsworth* should have been distinguished as a case on an unlimited partnership.

(b) Submissions on the “priority” question:

- 41 The position of the JOLs and of Access Industries and AI Autoparts on the “priority question” is that Doyle J erred in holding that misrepresentation claims fell outside the scope of section 49(g) because they were creditor debts based on misrepresentations prior to becoming members and not member debts. Mr Smith, with whom Mr Thompson agreed, submitted that Segal J was correct to hold that claims by shareholders for damages for misrepresentation fall within section 49(g) and are therefore subordinated to the claims of external unsecured creditors.
- 42 They submitted that Doyle J erred in his treatment of the authorities, in particular *In re Addlestone Linoleum Company* (1887) 37 Ch D 191 (“*Addlestone*”) and *Soden*, on the meaning and scope of “sums due to a member in his character as a member”. He also erred in not taking proper account of the distinction between a claim for misrepresentation inducing a subscription contract with the company and a misrepresentation inducing a market purchase of shares.
- 43 Mr Levy submitted that Doyle J was correct to conclude that a claim for a pre-contractual tort was anterior to and not derived from the statutory contract, and did not err in his consideration of *Soden* which concerned a market acquisition of shares from a third party and left open the position of a contract of subscription. He was also correct to criticise (HQP at [186] – [187]) Lord Browne-Wilkinson’s statement that negative claims for the refund of money paid to the company under the statutory contract are claims necessarily made in his character as a member.
- 44 Mr Millett submitted that Segal J erred in holding that all member claims falling within section 49(g) rank equally, regardless of the nature of the claim. He also criticised the JOLs for not taking sufficient account of the sui generis nature of a misrepresentation claim by shareholders with no redemption rights. That he stated is in essence a claim for the return of invested capital by a continuing member and to be distinguished from claims by redemption creditors who are *ipso facto* former members.

(c) Submissions on the applicability of the contractual waterfall in HQP's Articles:

45 The JOLs and Mr Levy submitted that Doyle J was correct to conclude that the contractual waterfall in section 2(a) of the Articles of Association in HQP does not apply to claims for misrepresentation. The reasoning of the JOLs, however, differs from Doyle J's. Mr Smith submitted that it makes no sense to regard section 2(a) as applying to such claims because the shareholders' allegations were that the fraudulent conduct induced them not only to subscribe for shares but also to agree to the creation of new classes of investors whose rights under the Articles had priority. Mr Levy submitted that Doyle J did not err in construing the Articles as concerned with distributions of dividends or HQP's capital upon winding up and not with the proceeds of damages claims for misrepresentation which all or some members have.

46 Mr Thompson's position was essentially based on Lord Browne-Wilkinson's formulation in *Soden* in the context of a market purchase rather than a subscription that negative claims based on money paid to the company under the statutory contract are "claims necessarily made in his character as a member". He submitted that the clear wording of section 2(a) of Schedule A to the Articles, reflected its commercial purpose of entrenching the priority of the Series D shareholders and then in descending order that of the other series of shareholders. In the light of Lord Browne-Wilkinson's formulation, Doyle J erred in failing to place any weight or sufficient weight on the agreement between the parties and the meaning of the clear wording and commercial purpose of section 2(a) of Schedule A to the Articles.

B. THE APPLICABILITY OF *HOULDSWORTH* IN THE CAYMAN ISLANDS: THE "BAR ON PROOF" QUESTION:

47 We turn to consider the question whether the so-called rule in *Houldsworth* should be treated as part of the common law of the Cayman Islands. It was the submission of Mr Thompson KC, leading counsel for the appellant in the HQP proceedings, that by late 1997 in consequence of a number of important decisions subsequent to *Houldsworth* including *Addlestone*; *Burgess's Case*; *Trevor v Whitworth* (1887) 12 App Cas 409; *Ooregum Gold Mining Co of India v Roper* [1892] AC 125 ("*Ooregum*"); *Webb Distributors (Aust) Pty Ltd and Another v State of Victoria and Another* (1993) 179 CLR 15 ("*Webb*"); and *Soden*, there was a common law rule known as the *Houldsworth* rule that a proof for damages in the liquidation of a company by a person induced by a misrepresentation by the company to subscribe for shares who has not rescinded or is unable to rescind their subscription contract was inadmissible on the ground that to satisfy the claim would involve a prohibited return of capital.

48 We propose to answer this question in a number of stages. First, we consider the historical background to the *Houldsworth* decision and the reasoning of the members of the House of Lords who decided the appeal. Next, we examine the development of the different explanations and underpinnings of the rule down to and including the decision of the House of Lords in *Soden* decided in October 1997 and reported at [1998] AC 298. We then consider the statutory abolition of the rule in England in 1989 by the insertion of section 111A into the UK Companies Act 1985 and the post *Soden* jurisprudence in Australia and elsewhere in the Commonwealth where the rule has ceased to find favour, including the decision of Doyle J in the HQP proceedings or has been modified, as Segal J did in the Direct Lending proceedings. Next, we consider the submissions of the parties on whether the *Houldsworth* rule should be treated as part of the common law of the Cayman Islands and express our conclusion on this issue. Finally, in the light of our conclusions in going through these stages, we consider whether the decisions of Doyle J in the HQ proceedings and Segal J in the Direct Lending proceedings on the proof of debt issue can be upheld.

(1) The historical background to the rule and the reasoning expressed by the judges who decided the case

(a) *The 1862 Companies Act (“the 1862 Act”)*

49 This UK statute consists of 212 sections and 3 schedules and is divided into 9 Parts including: (1) The constitution and incorporation of companies and associations under the Act. (2) The distribution of the capital and liability of members of companies and associations. (3) The winding up of companies and associations under the Act. (4) Companies authorised to register under the Act. (5) The application of the Act to unregistered companies.

50 Under section 4, Companies, Associations and Partnerships of twenty or more persons had to be registered under the Act¹² and under section 6, seven or more subscribers to a memorandum of association were empowered to form an incorporated company with or without liability if they registered the entity under the Act. Sections 7, 8 and 9 provided that the liability of members of a company formed in accordance with the Act could be limited as stated in the memorandum of association as to the amount unpaid on shares or as to the amount the members undertook to contribute to the assets of the company in the event of it being wound up. Under section 10, the memorandum of association of an unlimited company had to contain the particulars listed in the section.

¹² Unless they carried on banking business, in which case it was ten or more persons.

- 51 By section 14, the memorandum of association of a company limited by shares could be accompanied, and that of an unlimited company or company by guarantee had to be accompanied, by Articles of Association that could adopt all or any of the regulations contained in Table A set out in the first Schedule to the act. Under section 15, if the memorandum of association of a company limited by shares was not accompanied by Articles of Association or if there were Articles of Association that did not exclude or modify the regulations contained in Table A, the Table A regulations would be deemed to be the regulations of the company.
- 52 Under section 16 (the precursor to section 12 of the Cayman Islands Companies Act) the Articles of Association had to be signed by each subscriber and when registered the articles bound the company and the members thereof to conform to all of the regulations contained in such articles.
- 53 By section 18, upon the registration of the memorandum of association and the articles of association, the registrar had to certify that the company was incorporated and in the case of a limited company, that the company was limited, the subscribers of the memorandum of association, together with such other as may from time to time become members of the company were thereupon to be a body corporate but with such liability on the part of the members to contribute to the assets of the company in the event of the company being wound up as was mentioned below.
- 54 Section 38 (the precursor to section 49 of the Cayman Islands Companies Act (“the CICA”)) provided that, subject to seven listed qualifications,

“in the event of a Company formed under this Act being wound up, every present and past Member of such Company shall be liable to contribute to the Assets of the Company to an Amount sufficient for Payment of the Debts and Liabilities of the Company, and the Costs, Charges and Expenses of the Winding-up, and for the Payment of such Sums as may be required for the Adjustment of the Rights of the Contributories amongst themselves, with the Qualifications following;”

- 55 Three of the qualifications, (1), (2) and (3) exempted past members in certain situations, a fourth (4) the precursor to section 49(d) of the CICA, exempted a member of a company limited by shares from making contributions exceeding the amount, if any, unpaid on his shares in respect of which he was liable as a present or past member and the seventh (7), the precursor to section 49(g) of the CICA, provided:

“No Sum due to any Member of a Company in his Character of a Member by way of Dividends, Profits or otherwise, shall be deemed to be a debt of

the Company, payable to such Member in a Case of Competition between himself and any other Creditor not being a Member of the Company; but any such Sum may be taken into account, for the Purposes of the final Adjustment of the Rights of the Contributories amongst themselves”.

56 Under section 74, the term “contributory” meant every person liable to contribute to the assets of a company under this Act, in the event of the company being wound up.

57 Section 158 (the precursor to section 139 of the CICA), provided:

“In the event of any Company being wound up under this Act, all Debts payable on a Contingency and all Claims against the Company, present or future, certain or contingent, ascertained or sounding only in Damages, shall be admissible to proof against the Company, a just Estimate being made, so far as is possible, of the Value of all such Debts or Claims as may be subject to any Contingency or sound only in Damages, or for some other reason do not bear a certain Value”.

58 Finally, section 199 provided that subject to certain specified exceptions, all Partnerships, Associations and Companies consisting of more than seven members and not registered under the Act, could be wound up under that Act with all the Act’s provisions with respect to winding up applying to such a company.

(b) *Decisions after the enactment of the 1862 Act but prior to the decision of the House of Lords in Houldsworth on 12 March 1880.*

59 In *Oakes v Turquand* (1867) LR 2 HL 325, Mr Oakes was an original allottee of 25 shares in Overend, Gurney & Co Limited (“the company”) that was registered in 1865 under the 1862 Act. The company was formed to acquire Overend, Gurney & Co, a firm that carried on business as bill brokers and money dealers. Mr Peek was also a shareholder in the company having acquired his shares in the market either from an allottee or a purchaser from an allottee. On 22 June 1866, the company was ordered to be wound up on the ground that it was hopelessly insolvent. The liquidators, Messrs Turquand and Harding, placed the names of both Mr Oakes and Mr Peek on the list of contributories and made a call of 10% on them and the other members of the company in respect of the unpaid portion of their shares.

60 Messrs Oakes and Peek then moved motions before Vice Chancellor Malins to remove their names from the list of contributories on the grounds that they had acquired their shares in reliance on fraudulent misrepresentations as to the financial state of the business made by the

directors of which they (Oakes and Peek) had only become aware after the business had failed. Both motions were dismissed by the Vice Chancellor.

- 61 On appeal to the House of Lords, it was argued on behalf of Mr Oakes that there was no privity of contract between him *qua* shareholder and the creditors who transacted business not with him but only with the company in its corporate capacity. It followed, so the argument ran, that the creditors could not, through the liquidator, subject Mr Oakes to any liability to which the company could not have subjected him and the liquidator could only take up the rights of the company subject to such equities as could be pleaded against it including Mr Oakes' right to set aside the contract under which he became a shareholder on the grounds that it had been induced by the fraud of the company.
- 62 Lords Chelmsford (Lord Chancellor), Cranworth and Colonsay held that, by reason of the fraud, the contract under which Mr Oakes was allotted his shares was voidable and not void and since Mr Oakes had not taken any steps to avoid the contract prior to the winding up, his name was rightfully on the list of contributories in accordance with the 1862 Act, and Mr Peek was in the same position as Mr Oakes.
- 63 Lord Chelmsford dismissed the submission advanced on behalf of Mr Oakes that the 1862 Act was merely to be regarded as adjusting the rights of the shareholders inter se and that, as the liquidators represented the company, the liability of the appellant had to be determined as between himself and the company, and not as respects creditors with whom he had not contracted. In Lord Chelmsford's view, the liability of the shareholders was not under a contract with the creditors, but was "a statutable liability" under which the creditors had a right which attached upon the shareholders to compel them to contribute to the extent of their shares towards the payment of the debts of the company. He cited with approval the following passage in the judgment of Lord Campbell in the Queen's Bench Division in the pre-1862 Act case of *Henderson v The Royal British Bank* 7 E. & B. 356 ("*Henderson*") in which it was held that a creditor of the insolvent defendant bank could levy execution against a shareholder thereof who had given notice that he had ceased to be a shareholder by reason of the contract under which he had acquired his shares having been induced by a fraud practised by the directors:

"It would be monstrous to say, he having become a partner and a shareholder, and having held himself out to the world as such, and having so remained until the concern stopped payment, could by repudiating the shares on the ground that he had been defrauded, make himself no longer a shareholder, and thus get rid of his liability to the creditors of the bank, who had given credit to it on the faith that he was a shareholder."

- 64 Lord Chelmsford referred to the dictum of Lord Cairns in *The Reese River Mining Company, Ex parte J. Smith*¹³ (“*ex parte Smith*”) that there was with regard to companies established under the 1862 Act no contract whatever between a creditor and a shareholder. Instead, the contract was between the creditor and the company. Responding to an argument that decisions made before the 1862 Act such as that in *Henderson* were not applicable after the enactment of that statute, Lord Chelmsford pointed out that the Limited Liability Act 1855 gave the same remedy by execution against the shareholders as creditors could use against the shareholders of companies. Under the Joint Stock Companies Act 19 & 20 Vict. 47, a creditor was enabled to become a party to the winding up of a company whether with limited or unlimited liability. That remained the position under the subsequent Companies Acts down to the 1862 Act which continued the power conferred on creditors to petition for a winding-up. It followed that the 1862 Act did not change the right of the creditor or the liability of the shareholder and accordingly counsel’s argument that the cases upon the Companies Acts prior to 1856 were inapplicable after the enactment of the 1862 Act was rejected. In the light of sections 18, 23, 38 and 74 of the 1862 Act, a “contributory” was a person who had agreed to become a member of the company and whose name was upon the register liable to contribute, from which it followed that Mr Oakes, not having rescinded the contract under which he acquired his shares in the company, was liable to contribute to the assets of the company as part of the process of the company being wound up at the suit of the company’s creditors.
- 65 Lord Cranworth noted that under the Act to Regulate Joint Stock Companies 1844 and the Banking Act of the same year, the course which a creditor was to take to enforce a debt or demand was to sue the incorporated company and if execution of the judgment obtained did not satisfy the sum owed, he was entitled to issue execution against any shareholder. He also noted that in the case of *Henderson* it had been held that a shareholder against whom execution had sought to be levied by a creditor of the company could not avoid such execution on the ground that he had been induced by fraud to become a shareholder. The two 1844 Acts had been repealed by the 1862 Act and the question was whether the decision in *Henderson* was applicable in light of the important differences between those Acts and the 1862 Act under which a creditor had no right to levy execution against a shareholder if a judgment against the company did not lead to satisfaction of the debt, but instead, had to obtain a winding up order against the company. In Lord Cranworth’s view, the change from a right in the creditor to levy execution to a right to wind up the affairs of the company made by the 1862 Act did not affect the question who are the creditors and nor did the introduction of the principle of limited liability. The 1862 Act had done no more than introduce the principle of limited liability and

¹³ (1867) Law Rep. 2 Ch App 604, 616.

substitute a winding up for execution against individual shareholders, leaving the law just as it had stood when *Henderson* was decided.

- 66 Lord Colonsay, the former Lord President of the Court of Session, rejected the argument advanced on behalf of Mr Oakes referred to in paragraph [61] above. The company had been formed under the provisions of the 1862 Act which was a comprehensive, repealing and consolidating Act collecting into one code the provisions that were thenceforth to be applicable to such companies, including: (a) the definition of a “contributory” in section 74 as a person liable to contribute to the assets of a company in the event of it being wound up; (b) the liability imposed by section 38 on members of companies to contribute to the assets of a company that was being wound up; and (c) the definition of a “member” in section 23 as “a person who has agreed to become a member of the company whose name is registered on the register of members”. The alleged fraud practised by the directors that induced the contract under which Mr Oakes was allotted the shares rendered that contract voidable, not void, so that he was a contributory under section 74 and liable to contribute to the assets of the company.
- 67 *Tennent v The City of Glasgow Bank and Liquidators* (1879) 4 App. Cas. 615 was another case arising out of the insolvent collapse of the City of Glasgow Bank. The bank was established in 1839. The original capital was £750,000, divided into shares of £10 each. In 1858 the shares were converted into stock; and in 1873 additional capital was created, making the total capital of the bank £100,000. By the Articles of Co-Partnership, the shareholders’ liability was unlimited. In 1862 the bank was registered under the Companies Act of that year. Since 1873, the appellant’s name had appeared on the register of shareholders as the holder of £6000 of stock which he had acquired in three tranches: in December 1872, he acquired £2500 of stock from a Mr Matthew; in July 1873 he acquired £2500 of stock from a Mr Bell; and in August 1873, he acquired £1000 of stock directly from the Bank. Messrs Mathew and Bell had acted as trustees of the bank.
- 68 On 2 October 1878, the bank suspended payment on account of its insolvency. On 5 October 1878, the directors gave notice by means of circulars and advertisements of a general meeting to be held on 22 October 1878 with a view to wind up the bank. On 19 October 1878, the appellant received by post a report published on the previous day that disclosed that the directors had known before that date that the Bank was irretrievably insolvent and could only pay its debts by making large calls. On 21 October 1878, the appellant brought an action in the Court of Session against the bank and Mr Matthew and Mr Bell for reduction of the share transfers and entries in the bank’s books and stock certificates in respect of the above stock on the ground of fraud. He also reserved his right of action for the price paid for the stock. On 22

October 1878, an extraordinary resolution was passed to wind up the Bank voluntarily and subsequently a list of contributors was made up in which the appellant's name was placed. The liquidators contended that whatever might have been the appellant's rights had he taken steps to avoid his contract while the bank was a going concern, he could not be allowed to do so when he took no steps to avoid the contract till after the known irretrievable insolvency of the bank; the rights of innocent third parties had intervened and restitution in integrum was no longer possible.

- 69 The First Division of the Court of Session refused the appellant's petition holding that the action on 21 October 1878 had come too late after the bank had stopped payment and had declared its insolvency.
- 70 On appeal to the House of Lords, the question was whether the appellant's disaffirmation of the contracts to acquire the stock on 21 October 1878 when he brought his action in the Court of Session, coming as it did only two days after discovering the fraud and prior to the passing of the extraordinary resolution to wind up the Bank voluntarily on 22 October 1878, constituted an effective rescission of those contracts.
- 71 Earl Cairns LC handed down the sole judgment with which Lords Hatherley, Selborne and Gordon concurred.
- 72 Earl Cairns began his judgment agreeing with the first two of the following three propositions stated by the Lord President of the Court of Session: "In the first place, a contract induced by fraud is not void, but only voidable at the option of the party defrauded; secondly, this does not mean that the contract is void till ratified, but it means that the contract is valid until rescinded; and thirdly, the option to void the contract is barred where innocent third parties have in reliance on the fraudulent contract, acquired rights which could be defeated by its rescission". In respect of the third proposition, Earl Cairns said there was no dispute as to the principle thereof and the only question was to its precise wording, and the extent and mode of its application. He noted that whilst *Oakes v Turquand* had established that it is too late, after winding up had commenced, to rescind a contract for shares on the ground of fraud, that case did not decide affirmatively the converse case that, up to the time of the commencement of a winding up, a contract to take shares could be rescinded on the ground of fraud. In his view, whether the contract could be rescinded up to that time depended upon the particular circumstances of the case.
- 73 Earl Cairns then went on to posit the case where, at a time when a company is a going concern, a shareholder "throws his shares back on the company" on the ground that he has been induced

to acquire them by fraud, this being a situation where the shareholder would have the right to transfer his shares without reference to creditors, and the company, being a going concern and therefore assumed to be solvent, able to meet its engagements and possessing a surplus, the company taking the shares back and repaying what was due to the shareholder would be an affair of the company and not of its creditors. This was to be contrasted with a case where the company had become insolvent and stopped payment where, even irrespective of a winding-up, a wholly different state of things would arise and the assumption by the company of new liabilities would be an affair not of the company but of its creditors. The repudiation of shares would now of necessity inflict a serious injury upon the creditors and therefore his Lordship “would be disposed ... to hesitate before admitting that, after a company has become insolvent and stopped payment, whether a winding-up has commenced or not, rescission of a contract to take shares could be permitted as against the creditors.”

- 74 Earl Cairns then considered whether on the facts of the instant case, the appellant’s disaffirmation of the contracts to acquire by bringing the proceedings in the Court of Session on 21 October 1878 constituted an effective rescission of those contracts and concluded that on the aforesaid facts, particularly the directors’ notice of 5 October 1878 of a general meeting with a view to winding up the bank, the Appellant’s raising of an action for reduction of his contract to take stock came too late.

(2) The decision in *Houldsworth*

- 75 We come now to the decision of the House of Lords in *Houldsworth* which came hard on the heels of their Lordships’ decision in *Tennent*. The appellant, Mr Arthur Hooton Houldsworth, had purchased £4000 of the bank stock from the bank itself at a price of £9000 in February 1877, following which he was duly entered as a partner in the register of members and received dividends. As already recorded above, under the Articles of Co-Partnership, the shareholders’ liability was unlimited. The bank stopped payment on 2 October 1878 and was wound up later that month on the 22nd upon the passing of an extraordinary resolution to that effect followed by the appointment of liquidators who subsequently entered the appellant’s name on the list of contributories.
- 76 On 21 December 1878, the appellant began an action against the bank and the liquidators in the Court of Session founded on the fraudulent misrepresentations of the bank’s manager and directors in which action he did not seek rescission of the contract by which he acquired the bank stock but sought the following sums as damages: (a) £9046 5s 3d (the price of the stock

and stamp duty); (b) £20,000 being the loss sustained through paying the first call; and (c) £200,000, the estimated amount of future calls that may be made on him.

77 It was submitted on behalf of the appellant that on general principles he could retain the shares and obtain damages since the right of action for fraud arose before the liquidation and the liquidators had sufficient means to meet the claim because the old shareholders had not yet been called upon. In support of this submission, reliance was placed on section 158¹⁴ of the 1862 Act and it was contended that the appellant's claim was not prejudiced by section 38 (7) of that Act, it being accepted that he would be liable to pay calls pro tanto with other members that provided for proof against the company of debts including damages. The appellant admitted before their Lordships that after the winding up of the company commenced, it was too late to repudiate his stock and that he must remain as a partner in the bank and as a contributory.

78 The respondents to the appeal were not called upon. All four members of the court, Earl Cairns and Lords Selborne, Hatherley and Blackburn were of the view that under the law of agency, a company could be vicariously liable for a fraud committed by an agent thereof and proceeded on the basis that if the appellant had rescinded the contract under which he became a partner in the bank in good time, the bank may have been liable to compensate the appellant for his losses resulting from the fraud, but the appellant had affirmed that contract and could not at one and the same time as being a shareholder recover damages resulting from the fraud committed against him. In what follows, we concentrate on what their Lordships had to say as to the consequences of the appellant's failure to rescind the contract.

79 As Earl Cairns observed in his judgment, the question to be decided was:

“Can a man, induced by the fraudulent misrepresentations of agents of a company to take shares in the company, after he discovers the fraud, elect to retain the shares, and to sue the company for damages?”

80 In answering this question, Earl Cairns considered whether the established principle that a purchaser induced by a fraudulent misrepresentation to acquire a chattel or goods may retain the chattel or goods and recover damages sustained by the fraud was applicable to a purchase of a share in a partnership registered as a company induced by a representation that the liabilities of the company were £100,000 and no more. In such a case, said Earl Cairns, the “contract as between [the purchaser] and those with whom he becomes a partner, is that he will be entitled to one hundredth part of all the property of the company, and that the assets of the company shall be applied in meeting the liabilities of the company contracted up to the time of his joining

¹⁴ See para [57] above; cf section 139 of the CICA.

them, whatever their amount may be, and those to be contracted afterwards, and that if those assets are deficient the deficiency shall be made good by the shareholders rateably in proportion to their shares in the capital of the company . . . It is only through this contract and through the correlative contract of his partners with him, that any liability of him or them can be enforced”.

81 It was Earl Cairns’ view, on the scenario under consideration, that it cannot have been intended that the assets of the company and the contributions of the shareholders should pay the new partner damages for a fraud committed on himself by the company, that is by himself and his co-partners, in inducing him to enter into the contract which alone could make him liable for that fraud. Any such application of the assets and contributions would not be in accordance but at variance with the contract into which the new partner had entered. If the new partner were to find out that the liabilities were not £100,000 but £500,000, he would be entitled to rescind his contract, leave the company and to recover any money he has paid or any damages he has sustained. But the position would differ if he affirmed his contract, viz the contract by which he agreed that the assets of the company should be applied in paying its antecedent debts and liabilities, and later brought an action against the company to recover out of its assets the sum, say £4,000, which would fall upon his share to provide for liabilities over and above what his share would have had to provide if the liabilities had been as represented to him. If the action succeeded he would be paid £4000 out of the assets and contributions of the company. However, under the contract by which he became a shareholder that remained on foot, these assets had to be applied in payment of the debts and liabilities of the company, among which the £4,000 could not be reckoned. In short, he would be making a claim which was inconsistent with the contract into which he had entered and by which he had wished to abide. In other words, the new partner would in substance, if not in form, be approbating and reprobating, a course which is not allowed either in Scotch or English law.

82 Lord Selborne stated that where a shareholder has suffered a wrong inflicted by the company through its agents but is obliged under the contract by which he became a shareholder to contribute rateably with others towards the company’s indebtedness, including his own claim, as was the case before the House, it is impossible to separate his claim from his status as a shareholder unless that status can be put an end to by rescinding that contract. Accordingly, rescission of the contract was the only way in which the company could justly be made answerable for the fraud on the shareholder and since the appellant had not rescinded the contract but had admittedly affirmed it, his appeal had to be dismissed.

83 Lord Hatherley observed that once the appellant had paid his money in respect of the transfer of shares into his name, he became entitled, on the one hand, to any profits made by the

company in the proportion which his shares bore to all the other shares, whilst at the same time he was obliged to bear a like proportion of the debts and liabilities of the company incurred in the course of the company's business. Amongst the debts, if the appellant were right, would be the debt due to himself in respect of the alleged fraud. Suppose that ten or twelve other shareholders were in a like position of the appellant. Each would have the same claim for damages as claimed by the appellant who would by his partnership contract have to bear his aliquot share of the damages that might be claimed by other misled shareholders who had been placed on the list by the same course of misrepresentation as himself. Yet the appellant would clearly have to account for dividends received as between himself and his fellow sufferers who would be claiming relief on the same grounds as himself. Lord Hatherley then continued:

"In truth, the Appellant is trying to reconcile two inconsistent positions, namely, that of shareholder and that of creditor of the whole body of shareholders including himself. As has been observed already by those of your Lordships who have preceded me, amongst the various cases which have been brought before the Courts in respect of dealings with joint stock companies, no case can be adduced in which a person so claiming to be a shareholder has at the same time successfully asserted his claim against the company in liquidation for such a debt as this, namely one in which he is himself co-debtor with all his fellow shareholders to himself, and is himself in common with them responsible again to them individually for like liabilities irrespective of representations made by their common agent ... If the Appellant obtains the relief he has sought, every other shareholder in the same position as himself might come forward to a similar relief. What has really happened is that both he and those other shareholders in a like position, have suffered from the misfortune of having employed a dishonest agent. As between third parties to the company and the Appellant, he might well be entitled to rescission of the contract whereby he became a shareholder, but, if time and circumstances have prevented that remedy and he must remain a shareholder, I do not see how he can escape the burden occasioned by the common misfortune of himself and many of the other shareholders in having employed dishonest agents. I therefore feel that whatever rights this gentleman may have acquired in the first instance, his case had been rendered hopeless by what has taken place since, by reason of which it has been placed beyond his to put things in such a position that his name can be struck off the share list altogether, in which case he would, according to some of the authorities which have been cited, have stood in the position of a stranger with reference to the misrepresentations made by the agents of the company".

84 It was Lord Blackburn's opinion that the case before their Lordships was governed by the previous decision of the House of Lords in the Scottish case of *Addie v The Western Bank*¹⁵

¹⁵ (1866-69) Law Rep. 1 H. L., Sc. 145.

since such differences of fact as there were between the instant case and Addie's case made no distinction in law between the two decisions. In the course of his judgment, Lord Blackburn drew attention to the fact that in both *Addie* and *Houldsworth* the contracts under which the claimants in each of those cases acquired their shares were contracts with a joint stock company that were equally in substance an agreement with the company to become a partner in the company on terms that the partner shall, in common with all his co-partners for the time being, contribute to make good all liabilities of the co-partnership as if this incoming partner had been a member of the partnership from the beginning. Further, the incoming partner consents that any one of his co-partners may, by procuring a person to take his shares, get rid (at least *inter socios* [inter partners]) of his liability, substituting that of the incoming shareholders.

85 Lord Blackburn also observed that: (i) the statement made by the Lord President in the Court of Session below that “when the result of a fraud is the making of a contract between the party deceiving (not personally but through an agent) and the party deceived, I am not aware that any remedy is open to the latter, except a rescission of the contract, or at least without a rescission”, was a statement that had been much controverted; and (ii) whilst there were strong reasons for concluding that the remedy where a contract for shares in a joint stock company is induced by a fraud for which the company is liable by which the representee becomes a partner is rescission, there were reasons which would not apply to every case in which a contract has been induced by fraud.

86 It is instructive to give further consideration to the circumstances of and the decision in *Addie* referred to by Lord Blackburn. The headnote records that the Western Bank of Scotland was established in 1832 under the Bankers of Scotland Act 1826 as an unincorporated joint stock banking company. After an apparently prosperous career of twenty-five years, during which time the respondent, Mr Addie, had paid for and accepted 135 shares in the bank in respect of which he became a partner on the terms of the bank's partnership deed, the bank collapsed on the 9th of November 1857, with a deficiency of £3,000,000. On the 8th of December 1857, for the purposes of a voluntary winding-up, the concern was incorporated and registered under the Joint Stock Companies Act of 1856, as amended by the Joint Stock Companies Act of 1857. Subsequently to the winding-up, the respondent had had to meet calls. In November 1859, he commenced proceedings against the bank and its liquidators to have the contracts of sale and purchase of the 135 shares on which he had received various dividends rescinded on the ground that the purchase of those shares had been induced by false and fraudulent representations contained in the reports of the directors. In the alternative to rescission, he sought damages for the losses resulting from the fraud that had induced the contracts. The action, though nominally

against the bank, was, in effect, against the shareholders, because all the creditors had been paid.

- 87 Their Lordships in the First Division of the Court of Session pronounced an interlocutor that the Pursuer had stated on record matter relevant to entitle him to go to trial and ordered that the claim should be disposed of on the basis of the issue proposed by the Pursuer, that being the appropriate and suitable issue. There then followed a trial of the claim before the Lord President and a jury which ended with a verdict in favour of Mr Addie.
- 88 The main question before the House of Lords was whether the pronouncement of the Court Session should be set aside, in which case the trial verdict in favour of Mr Addie would automatically fall away.
- 89 Lord Chelmsford LC stated that he entertained considerable doubt whether the respondent in his statement had connected the directors sufficiently with the alleged misrepresentations to make them imputable to the company, and whether he had not failed to state a relevant case upon the record on this ground. But on the question whether on his pleadings Mr Addie had not been deprived of his right to rescind the contract by which he acquired the shares by the change in the character and condition of the company, his Lordship had no doubt that the relevancy of his case altogether failed because the change of the company from an unincorporated to an incorporated banking company for the purpose of more conveniently winding up its affairs prevented Mr Addie from being in a situation so as to be able to put the parties into the position in which they were before the contract. Further, there was no question of Mr Addie being entitled to recover damages in the alternative to rescission.
- 90 Lord Cranford was of the same opinion as Lord Chelmsford on the question whether Mr Addie was entitled to rescind the contract. He stated that, assuming the company had by its directors fraudulently induced Mr Addie to purchase 135 of the shares so as to entitle him to relief against the company, Mr Addie could not insist on *restitutio in integrum* unless he were in a condition to restore the shares which he purchased, but this was impossible. The purchase was made in 1855 but in 1857 Mr Addie was party to a proceeding whereby the company from which the purchase was made was put an end to consequent on the extraordinary resolution that it be wound up. It thereupon ceased to be unincorporated and became an incorporated company, with many statutable incidents connected with it which did not exist before the incorporation. This new company was now in course of being wound up; but even if that were not so, if it were still carrying on the business of bankers, *restitutio in integrum* would have been impossible. Mr Addie might in that case have given up 135 shares of the new company, and these shares might have been as valuable as, or even more valuable than, the shares which he was induced to

purchase, but they would not have been shares in the same company; and unless he was in a position to restore the very thing which he was fraudulently induced to purchase, he could not have relief by way of *restitutio in integrum*. The time had gone by during which he could have repudiated the contract.

91 Lord Cranford also held that Mr Addie could not recover damages in compensation as an alternative to rescission because the appellants were not the persons who were guilty of the fraud; and though the incorporated company was, by the express provisions of the statute under which it was incorporated, made liable for the debts and obligations incurred before the incorporation, the statute could not be read as transferring to the incorporated company a liability to be sued for frauds or other wrongful acts committed by directors before the incorporation. An incorporated company cannot, in its corporate character, be called on to answer in an action for deceit. But if, by the fraud of its agents, third persons have been defrauded, the corporation may be made responsible to the extent to which its funds have profited by those frauds.

92 Lord Colonsay did not give an opinion on the arguments addressed to the House because he had not heard them all. Instead, he simply expressed a view on the form the order should take following the decision to allow the appellants' appeal.

(3) The development of the different explanations and underpinnings of the rule in *Houldsworth* down to and including the decision of the House of Lords in *Soden* in October 1997

93 The decision of the House of Lords in *Houldsworth* was published on 12 March 1880. Just short of twelve weeks later, on 5 June 1880, the decision of Sir George Jessel MR ("the MR") sitting in the Chancery Division in *Burgess's Case*¹⁶ was issued. In this case, on 19 September 1879, Mr Burgess was allotted 50 shares of £10 each in the Hull and County Bank Ltd on payment of £1 per share, whereupon he was duly registered in the company's books as the owner of such shares. Eight days later, on 27 September 1879, Mr Burgess wrote to the company secretary enclosing the allotment letter and seeking cancellation of the allotment of the shares unless in the meantime a dispute he had heard about probably leading to litigation and giving rise to the chance of his being called on to pay 25% expenses on account of shares was settled to the satisfaction of all parties. By letter dated 29 September 1879, the secretary returned the allotment letter to Mr Burgess informing him that his request could not be complied with as the contract was complete. Thereafter, Mr Burgess took no further steps and retained the letter of

¹⁶ (1880) XV Ch Div 307.

allotment. In the event, the company never did any business and in November 1879 it was wound up voluntarily.

94 It appeared that the assets of the company in the hands of the liquidators were sufficient to pay the creditors of the company, together with all costs of the winding up. In these circumstances it was contended by Mr Burgess (“the applicant”)¹⁷ that, notwithstanding the winding up order, he was still, as against other contributories, entitled to call for a rescission of his contract to take the 50 shares, on the ground that he had been induced to enter into the contract by fraudulent misrepresentations in the company’s prospectus. The liquidators issued a summons that Mr Burgess be placed upon the list of contributors in respect of the 50 shares in his name in the books of the company and that he be ordered to pay £50, being the amount payable on allotment in respect of the shares. In the course of the argument presented on behalf of the liquidators that the case was covered by the decision in *Houldsworth*, the MR intervened stating, “[t]he doctrine is that after the company is wound up it ceases to exist, and rescission is impossible. There are only creditors and co-contributories and no company, and that is the meaning of Lord Cairns’ observations in *Houldsworth*.”

95 Counsel for Mr Burgess contended that *Houldsworth* was not a case of rescission. There the contract was treated as binding and all that was decided in *Oakes and Turquand* was that the shareholder was not entitled to rescind if there were creditors to be paid. Counsel submitted that in two cases Bramwell LJ had treated *Oakes* as having been decided on the principle that the power to rescind a contract is gone, because the rights of creditors are to be adjusted. At this point the MR observed that that judge’s attention did not appear to have been drawn to the particular wording of section 38 of the 1862 Act.

96 In the course of his extempore judgment, the MR observed that if the applicant had rescinded his contract in due time whilst the bank was a going concern he could have got rid of his shares. But instead, the applicant had let the matter rest and could not now be relieved after the winding-up. He stated, “the winding-up order entirely alters the positions of the parties — that is, it makes the shareholders contributories, and contributories in a totally different way in some respects as regards to the debts and liabilities of the concern from what they were before”.

97 The MR went on to say that it had been decided by a series of decisions in the House of Lords, commencing with *Webb v Whiffin*¹⁸ that section 38 of the 1862 Act¹⁹ was not to be read otherwise than literally, and was not to be read with reference to the previous liabilities of the

¹⁷ As named by the MR although the original applicants were the liquidators.

¹⁸ (1872) Law Rep. 5 H. L. 711.

¹⁹ See paras [54] - [55] above.

shareholders or by analogy to the law of partnership whether of a limited or unlimited character, but it was to be read as imposing new liabilities on the members of the company -- liabilities imposed and defined by that section. The result therefore is that the member is liable to contribute to the assets of the company, not only to an amount sufficient for the payment of the debts and liabilities and the costs, but to the payment of such sums as may be required for the adjustment of the rights of the contributories amongst themselves.

98 The MR went on to observe that after winding up the company, the position of the parties is altogether changed. Before winding up, the creditor has no right to a personal demand against any one shareholder. He looks to the company, and if the company is a going concern he would look to it as a solvent person for payment; but after winding up, the company, though it does not technically cease to exist for all purposes, it does for this purpose. The liabilities are no longer the liabilities of the company except to the extent of the assets realized, which under section 38 of the 1862 Act are to be appropriated towards the satisfaction of such liabilities, but they become liabilities of the shareholders who are such at the time of the winding up, that is, of the past and present members, including those who have been shareholders within the year; and those liabilities are defined by section 38. The other shareholders are as innocent of the fraud as the applicant; they themselves were defrauded in like manner. Therefore, they acquired rights as innocent parties under section 38 which the applicant seeks to take away from them. It is quite true that in *Oakes v Turquand*, the only persons whose rights were decided upon were creditors, but the rights of other persons equally innocent were not required to be considered because there was not enough to pay the creditors. In this case, however, it was said that the assets of the company contributed by the other shareholders were sufficient to pay the creditors in full and all costs and, therefore, that, the creditors having been paid or provided for, those rights are not to be considered. But the other contributories are also innocent persons and have acquired rights and there was no reason why those rights should not be considered.

99 The MR noted that he was assisted in coming to the aforesaid conclusion by two dicta of Lord Cairns. First, in *Tennent*, where Lord Cairns said that the House of Lords had established in *Oakes v Turquand* that, after winding-up has commenced, it is too late to rescind the contract for shares on the ground of fraud, no doubt on the ground that innocent third parties might be affected, but that did not at all affect the absolute dictum that it is too late. Second, in *Houldsworth*, Lord Cairns said that the Winding-Up Act had no provisions for the payment of claims against the company except the claims of creditors who are supposed to be paid *pari passu* and there is no provision after they are paid for opening up fresh claims by a contributory against the company. (There are indeed provisions which after the debts are paid enable any

inequalities in the contributions of the contributories to be set right, but that is quite a different matter).

- 100 That showed, continued the MR, that the present claim, being a claim against the company, cannot be enforced against the other contributories who are innocent. To follow out logically the theory contended for by the applicant would be that, if you come for rescission, and you have paid for your shares, you will be entitled to get your money back. Therefore, if you have paid for your shares, and your payment has been applied in the payment of creditors, and the other contributories have not fully paid, they being equally innocent, you would be entitled on that theory to claim back the sum you have paid, and to have it paid to you by making a call on the other contributories. Of course, that would not be enforcing the adjustment of the rights of the contributories amongst themselves, because, these other contributories are not the persons who committed the fraud, and they are not liable, and, consequently, if you cannot have total rescission of the contract, it is plain you cannot have partial rescission either, and the claim must wholly fail.
- 101 In *Addlestone*, the Addlestone Linoleum Company Ltd had been incorporated in 1877 with a nominal capital of £25,000 in 2500 shares of £10 each. In January 1881, in light of the fact that only one third of the shares had been subscribed for, the directors issued a report stating that the working capital was insufficient and recommending an issue of 750 £5 per cent preference shares of £10 each at par, every present shareholder to be entitled on payment of £7 10s to a preference share of £10. At the annual general meeting held the following month, a unanimous resolution was passed that the report be adopted and the issue of preference shares in accordance therewith be adopted. Various of the shareholders including the applicants/appellants applied for and were allotted preference shares and were issued with a certificate certifying, inter alia, that they were holders of the number of preference shares allotted to them being preference shares of £10 each. In May 1885, the company was wound up and later the applicants and other preference shareholders were included in the list of contributories and an order was made on them for a call of £2 10s per share, which the applicants paid.
- 102 The applicants then applied by summons for leave to tender proofs in the winding up in damages for breach of contract or otherwise in relation to the preference shares in respect of which they had been placed on the list of contributories. The summons was heard by Mr Justice Kay. It was argued by the applicants that the company having failed to give them what they had contracted for, namely fully paid shares, they were entitled to prove for damages in the sum of £2 10s per share. The official liquidator submitted that the claim was in contravention of section 38 (7) of the 1862 Act on the grounds that the general words “or otherwise” covered the claim.

Further, the decision in *Houldsworth* applied. The claimants had contracted that the capital subscribed by them shall be applied in payment of the company's debts and their claims were "not within" the contract. The contract had not been rescinded and accordingly there could be no proof for damages.

- 103 Although it was too late for the applicants to assert any remedy by way of rescission of the contract of allotment, Kay J assumed throughout his judgment that the company had power to issue fully paid-up shares at a discount if it had duly registered an agreement under section 25 of the Companies Act 1862 and he began his judgment assuming that the applicants could elect to retain the shares and sue the company for damages in which case the question would be whether they could prove for such damages in competition with any other creditor not being a member of the company or whether the case came within section 38 (7) of the Companies Act 1867²⁰. He then said:

"Now, unquestionably the Applicants – retaining these shares and claiming damages because the shares are not exactly what they were represented to be – are making such claims in the character of members of the company, and the only question is whether such claims are for sums due 'by way of dividends, profits or otherwise ...'

"Now, is the mischief against which [s.38 (7)] is intended to provide the same as the case before me? Practically, what these applicants are seeking to recover by their proof is a dividend in respect of £2 10s per share which they have been compelled to pay in the winding-up. But as shareholders, they contracted that they will pay this money, and that it shall be first applied in payment of the creditors whose debts are not due to them as members of the company of the company – that is, they are practically admitting their liability to pay the £2 10s per share to such other creditors and yet seeking to get part of it back out of the pockets of those very creditors themselves. I confess it seems to me that the money so claimed is not only claimed in the character of members but that the claim is just as unreasonable as if it were a claim of dividends or profits, and that, accordingly, it comes within the words "or otherwise", which I have read from section 38..."

"The Applicants, not being at the time creditors of the company, simply paid £7.10s for £10 shares. No consideration was given for the remission of the £2.10s per share which was not paid. I therefore hold that if these shareholders can claim damages at all, that claim cannot be made in competition with creditors in the winding up whose debts are not due to them in the character of shareholders. But is it the law that this claim for damages could be supported if the company were not being wound up? If

²⁰ See paragraph [55] above.

it could, the consequence would be that the company would receive and must then return, in the shape of damages, £2.10s a share in respect of these so-called paid-up shares. That would practically render nugatory section 25 of the Companies Act 1867²¹. A solvent company may issue shares, nominally paid up, at a discount, and omit to register the contract, and take with one hand and repay with the other the discount on each share, and if the Applicants' argument is sound no one could interfere. But suppose the company in solvent, and that the other shares were bona fide paid up and that the creditors who had a right to treat the shares as not paid up had no other property to look to except the unpaid calls upon them, could it be said that the case was not touched by the statute?...But if the shareholder elects to keep the shares, how can there be any such breach of contract? An action against the insolvent company would proceed upon the election of the shareholder to retain his shares. Would not the answer to such an action be -- "Your only remedy is rescission; you cannot have approbate and reprobate; you cannot be heard to say, "I am a shareholder, who has contracted to pay £2.10 shillings a share when called on", -- which is the effect of approbating the contract,-- "but I ask to recover that amount from the company as damages because I did not so contract;" -- that would be reprobating the contract."

"The truth is as was said by Earl Cairns in Houldsworth v City of Glasgow Bank (1) -- that a share taken from a company is not like an ordinary chattel, in respect of which the purchaser may have a choice of remedies. By accepting such a share the allottee merges himself in a society and contracts to pay calls when made. Much of the reasoning of the learned Lords in that case applies very closely to this. Here, as there, the shareholder "is making a claim which is inconsistent with the contract into which he has entered, and by which he wishes to abide". (2) The loss against which he seeks to be indemnified is, in effect, what he has contracted to contribute to the debts and liabilities of the company. He seeks to throw this amount on the other shareholders. He is "trying to reconcile two inconsistent positions, namely, that of shareholder and that of creditor of the whole body of shareholders, including himself." (3) My opinion is that he could not maintain an action for such damages against the company if it were not being wound up, and that he cannot maintain such a claim as this in the winding-up, either against the creditors, or shareholders, or the company."

- 104 On appeal, the appellants contended that they were not caught by section 38 (7) of the 1862 Act because their claim was not made in their character of members in respect of dividends, profits or otherwise. The liquidators contended that the appeal must fail because the contract by which

²¹ Which prescribed that every share in any company shall be deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash, unless the same shall have been otherwise determined by contract duly made in writing, and filed with the Registrar of Joint Stock Companies at or before the issue of such shares.

the appellants acquired the shares was invalid being a contract to issue shares at a discount which involved a return of capital. It was further submitted that the decision in *Houldsworth* showed that a shareholder cannot prove where his claim cannot be severed from his status as a member.

- 105 Cotton LJ was of the view that the appeal should be dismissed because the contract under which the appellants acquired their shares was a contract to issue shares at a discount which the company had had no power to enter into. But if the contract was to issue fully paid up shares, the decision in *Houldsworth* precluded the Court from allowing the proof which the appellants sought to be admitted. There it was held the claimant had irreversibly fixed himself with the liabilities of a shareholder and could not claim out of the assets of the company a sum not included in the debts and liabilities to the payment of which he, as a shareholder, had agreed that those assets should be devoted. The shareholders could have insisted that their names be taken off the register of members in which case they might have had a remedy in damages. But they were before the Court as shareholders retaining in substance their shares and were seeking to sue the company for damages for breach of the contract under which they took them.
- 106 In Lindley LJ's view, if the contract was to issue fully paid-up shares, the appellants could have repudiated them, but they had kept them and could not sue for the loss resulting from the shares not being fully paid up. The decision in *Houldsworth* governed the present case. "The principle on which the House of Lords decided that case was that a shareholder contracts to contribute a certain amount to be applied in payment of the debts and liabilities of the company, and that it is inconsistent with his position as a shareholder, while he remains such, to claim back any of that money -- he must not directly or indirectly receive back any part of it."
- 107 Lopes LJ assumed that the contract was to issue fully paid up shares and on this assumption was of the view that the case was governed by the decision in *Houldsworth* where it was held that a shareholder cannot claim damages against the company of which he is a member for misrepresentations by which he was induced to take his shares; instead his proper remedy was rescission of the contract and if that has become impossible, the shareholder has no remedy at all against the company.
- 108 We now move forward 106 years to the decision in *Webb* the facts of which were as follows. In December 1990, three building societies in the State of Victoria were wound up under section 122 of the Building Societies Act 1986 (Vic) ("the BSA"). Each of the societies was deemed to have been incorporated and registered under the BSA. Previously, from late 1986, the societies had begun to market "non-withdrawable" shares. Proceedings were started in the Supreme

Court of Victoria by the liquidator for directions as to the “non-withdrawable shareholders” who were complaining that they had been misled as to the nature of the shares they had purchased by statements that the shares were redeemable and were like deposits. The Victorian Supreme Court was asked to assume that there had been misleading and deceptive conduct such as would ground an action in deceit under section 52 of the Commonwealth Trade Practices Act 1974 and perhaps gave rise to other causes of action. Three separate entities were appointed to represent the non-withdrawable shareholders in each of the separate societies. The questions asked by the liquidators were primarily aimed at determining whether: (a) unliquidated damages claimed by non-withdrawable shareholders were provable in the liquidation; and (b) non-withdrawable shareholders were now precluded from prosecuting an action for damages against the societies in relation to the acquisition of the shares.

- 109 By reason of section 121 (4) of the BSA , Part XII of the Companies (Vic) Code (“the Code”) applied with such modifications as were necessary to the winding up of a building society and the matter proceeded on the footing that the winding up of each society was to be treated as though it were the voluntary winding up of a company under the Code. Section 360 (1) of the Code provided that on the winding up of a company members were liable to contribute to the company’s debt subject to, inter alia: (e) in the case of a company limited by shares, no contribution was required from a member exceeding the amount (if any) unpaid on the shares in respect he was liable as a present or past member (cf s. 49(d) of the CICA); and (k) a sum due to a member in his capacity as a member by way of dividends, profits or otherwise shall not be treated as a debt of the company payable to that member in a case of competition between himself and any other creditor who is not a member, but any such claim may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves (cf section 49(g) of the CICA).
- 110 At first instance, question (a) asked by the liquidators was answered “yes” by Vincent J and question (b) “no”. On appeal, the Appeal Division of the Supreme Court of Victoria (in *State of Victoria v Hodgson* [1992] 2 VR 613) (Tadgell J, with Fullagar and Gobbo JJ concurring) answered question (a) “no” and question (b) “yes”.
- 111 Such is the learning and high level of analysis deployed in the judgment of Tadgell J we find it appropriate to refer to various passages in his judgment before we consider the judgments of the High Court of Australia.

“The central issue seems to be this: whether a person who has subscribed share capital, and would in a winding up rate for repayment of capital behind unsecured creditors, may, instead of being left to his rights as a

contributory, prove as an unsecured creditor for an unliquidated sum if he can make out a cause of action sounding in damages designed to compensate him for having subscribed the share capital ... That formulation of the issue is reminiscent of the question posed for resolution by Earl Cairns L.C. in Houldsworth v. City of Glasgow Bank ... at p. 323, namely: "Can a man, induced by fraudulent misrepresentations of agents of a company to take shares in the company, after he discovers the fraud, elect to retain the shares, and to sue the company for damages?" The House of Lords answered the question No. ... Later commentators have not been altogether agreed on the ratio decidendi of the case or its scope ..."

"In this court counsel for the appellant, the State of Victoria, contended chiefly on two bases that the issue, as I have stated it, should be resolved against the holders of the non-withdrawable investing shares. The first basis was that the principles of Houldsworth's Case apply .. The Solicitor-General claimed two bases for the principle, namely (a) that the recovery by a shareholder of damages of that kind is inconsistent with his contract that the assets of the company are to be applied in payment of its debts, other than any debt claimed by the shareholder; and (b) that the principle protects the capital of a company for persons who entered into transactions with it in the belief that the shareholding, and therefore the capital, was as represented. The opposing argument ... was that Houldsworth's Case is distinguishable because it was concerned with an unlimited company; and that Re Addlestone Linoleum Co is also distinguishable because, although dealing with a company limited by shares, it was concerned with a claim for damages for breach of an agreement to issue shares at a discount. Moreover, the respondents argued that some of the reasoning in Houldsworth's Case is obscure and is in any event inconsistent with later authority".

"There are several bases on which the conclusion in Houldsworth's Case appears to be founded. One is that, to allow a present shareholder to sue the company would in effect involve his making a claim against himself along with his fellow members. This seems to have influenced Lord Hatherley: at p. 333. In so far as it did so this basis would seem to justify part of Professor Gower's criticism [that the decision failed fully to recognise the separation between the company as a corporate entity and its members]. ... Lord Hatherley also referred to the prospect, if a claim for damages by a person in the position of the appellant were allowed, of a series of interlacing claims for damages by several members, leading to endless calls... The point is relevant, if at all, only when the claim is made against an unlimited company, which is not this case. Another basis for the conclusion in Houldsworth's Case is that the allowance of a claim for damages by a member against a company of which he is a member would be inconsistent with implied terms of the contract by which the member became a member, in that the claim would entrench on share capital to the detriment of creditors and other members ... It derives support from the

speeches in Houldsworth's Case of Lord Cairns, at p. 325, and Lord Selborne, at p. 329, whose remarks suggest the thesis that one of the implied terms of the contract of membership is that the company's property is to be used only for the purpose of achieving its objects, which do not include payment of compensation to defrauded subscribers ..."

"There was a concession in the course of argument in Houldsworth's Case that, if a shareholder at the commencement of the winding up could validly raise a claim for damages of the kind sought against the company and its liquidator after the commencement of the winding up, he must also have had a right before the winding up to have remained a shareholder and yet to maintain an action for damages against the company. Hence the form of the question posed by Lord Cairns, quoted above, which did not suppose that the company was in liquidation. Accordingly, save that the winding up precluded rescission of the contract to take shares, the burden of the reasoning of their Lordships appears not to have depended on the fact that the company was in liquidation, or particularly upon the winding up provisions of the Companies Acts."

"In my opinion the principle of limited liability leads inevitably to the conclusion that a member at the commencement of the winding up of a company limited by shares cannot prove in the winding up for damages designed to indemnify him for loss sustained in subscribing capital to the company. The member's only title to such damages would depend on his having sustained loss through a subscription of share capital. If he were to obtain indemnity from the company in respect of that loss he could not logically be regarded as having subscribed the share capital for the subscription of which the company had indemnified him. Central to his liability is s. 360(1) of the Code. That section requires that, on the winding up of a company to which it applies, every member is liable to contribute to the property of the company in accordance with the formula it prescribes. That is an ineluctable obligation of those who are members at the commencement of the winding up, as it has been ever since the Companies Act 1862, s. 38 of which was the model for s. 360. The obligation is to contribute to an amount sufficient for payment of the company's debts and liabilities and the costs, charges and expenses of the winding up, and for the payment of such sums as may be required for the adjustment of the rights of the contributories among themselves, with the qualifications that the section sets out ... As Lord Macnaghten put it in Ooregum Gold Mining Co. of India Ltd. v. Roper and Wallroth [1892] A.C. 125, at p. 145, citing Buckley on the Companies Acts: "The dominant and cardinal principle of these Acts . . . is that the investor shall purchase immunity from liability beyond a certain limit, on the terms that there shall be and remain a liability up to that limit."

"This conclusion does not depend on an acceptance of the whole of the reasoning in Houldsworth's Case but is indicated by much of it. It is more

particularly indicated by the reasoning of Kay J. and the Court of Appeal in Re Addlestone Linoleum Co. Ltd., which applied the more general approach in Houldsworth's Case - and in my respectful view naturally and inevitably applied it - to the case of a winding up of a company limited by shares. Lindley L.J., at pp. 205-6, stated the position thus: "The principle on which the House of Lords decided Houldsworth v. City of Glasgow Bank was that a shareholder contracts to contribute a certain amount to be applied in payment of the debts and liabilities of the company, and that it is inconsistent with his position as a shareholder, while he remains such, to claim back any of that money - he must not directly or indirectly receive back any part of it ... " Kay J., at p. 200, had said much the same thing at first instance, namely "the loss against which [the shareholder] seeks to be indemnified is, in effect, what he has contracted to contribute to the debts and liabilities of the company. He seeks to throw this amount on the other shareholders." Cotton L.J., at p. 204, reached the same conclusion by a slightly different but not dissimilar route. He said that a member who had remained a member until the commencement of the winding up, "Having thus irrevocably fixed himself with the liabilities of a shareholder, he could not come to claim out of the assets of the company a sum not included in the debts and liabilities, to the payment of which he, as a shareholder, had agreed that those assets should be devoted".

- 112 On appeal to the High Court of Australia (1993) 179 CLR 15, by a majority of 4:1 (Mason CJ and Deane, Dawson and Toohey JJ) the judgment of the Appeal Division of the Supreme Court of Victoria was upheld. McHugh J dissented.
- 113 The majority noted that there were two streams of authority decided after the enactment of the 1862 Act underlying the conclusion reached by the Appeal Division, the first of which included *Trevor v Whitworth* and *Ooregum Gold Mining Co of India v Roper*; the second of which included *Oakes v Turquand*, *Houldsworth and Burgess's Case*. They cited the following well-known passages from the judgment of Lord Watson in *Trevor v Whitworth* and the judgment of Lord Macnaghten in *Ooregum Gold Mining Co*:

"One of the main objects contemplated by the legislature, in restricting the power of limited companies to reduce the amount of their capital as set forth in the memorandum, is to protect the interests of the outside public who may become their creditors. In my opinion the effect of these statutory restrictions is to prohibit every transaction between a company and a shareholder, by means of which the money already paid to the company in respect of his shares is returned to him, unless the Court has sanctioned the transaction. Paid-up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for

the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business.”
[Lord Watson in *Trevor v Whitford*]

“I cannot, I think, do better than adopt the language Mr. Buckley has used in speaking of the Limited Liability Acts. “The dominant and cardinal principle of these Acts,” he says, “is that the investor shall purchase immunity from liability beyond a certain limit, on the terms that there shall be and remain a liability up to that limit.” [Lord Macnaghten in *Ooregum Gold Mining Co*]

- 114 The majority noted that the appellants challenged *Houldsworth* in so far as that decision also precluded any claim for damages and went on to observe that whatever criticisms may be made of the reasoning in *Houldsworth*, the decision had been applied or treated as applicable to limited companies not only in the United Kingdom²² but also in Australia²³ and Canada²⁴. The majority were also of the view that the decision in *Houldsworth* was perhaps best explained by Lindley LJ in *Addlestone* where he stated that the principle of *Houldsworth* was that a shareholder contracts to contribute a certain amount to be applied in payment of the debts and liabilities of the company, and that it is inconsistent with his position as a shareholder, while he remains as such, to claim back any of that money – he must not directly or indirectly receive back any part of it.
- 115 The majority further noted the exchange of views on *Houldsworth* between Mr Hornby²⁵ and Professor Gower in the *Modern Law Review*,²⁶ Professor Gower’s description of the rule in the second edition of his book *The Principles of Modern Company Law* as being “anomalous” but explicable on the grounds that recovery of damages would be inconsistent with the terms of the implied contract between all the shareholders and the recognition of share capital as a guarantee fund for creditors. In the majority’s view, the preservation of share capital for the protection of creditors was an argument against the recovery of damages by a shareholder as well as rescission.
- 116 In the opinion of the majority, the critical question was not whether *Houldsworth* was right or wrong but whether the proposition which the House of Lords distilled in the case from the provisions of the 1862 Act was incorporated in the provisions of the Code. The majority

²² *In re Addlestone Linoleum Company*

²³ *Re Dividend Fund Inc (in liquidation)* [1974] VR 451

²⁴ *Milne v Durham Hosiery Mills Ltd* [1925] 3 DLR 725.

²⁵ Later Professor Hornby, one time Dean of the Faculty of Law, Bristol University.

²⁶ Gower in “Notes of Cases”, *Modern Law Review*, vol 13; Hornby, “*Houldsworth v City of Glasgow*”, *Modern Law Review* (1956) 54; reply by Gower at p. 61; response by Hornby a p. 185.

answered that question affirmatively. The statutory provisions authorising the return of capital were not inconsistent with the *Houldsworth* proposition and the conclusion reached by Tadgell J in the Appeal Division that *Houldsworth* received statutory recognition in section 360 (1) (k) of the Code was correct.

- 117 The majority also rejected the contention advanced on behalf of the non- withdrawable shareholders that any claim under section 52 of the Trade Practices Act (Cth) was unaffected by section 360 (1) of the Code. They agreed with Tadgell J's view that it was not the intention of the Trade Practices Act to overturn by implication a cardinal tenet of limited liability which had prevailed for 130 years and it was in any event inappropriate to decide the point in a factual vacuum.
- 118 In his dissenting judgment, McHugh J said that the rule in *Houldsworth* was misconceived and a source of injustice. It was misconceived because a company is an entity separate from its shareholders and there was no reason in legal principle or commercial necessity why, after the commencement of a winding up, a shareholder should not be able to sue a company for damages arising out of a fraudulent misrepresentation concerning the allotment of shares to the shareholder. However, the rule was too deeply entrenched to be set aside by judicial decision. That said, the *Houldsworth* rule could not prevail against the manifest width of the provisions of the Trade Practices Act, section 82 of which empowers the court to award damages for breach of section 52.
- 119 It remains to conclude this section of our judgment with our consideration of the House of Lords' decision in *Soden*. Here, the first Defendant ("B & C") acquired the whole of the share capital in Atlantic Computers Plc ("Atlantic") purchasing nearly 8 ½ million Atlantic shares in the market, following which it made a successful offer for the remaining Atlantic shares all for a total price of about £434 million. Thereafter, B & C discovered that Atlantic was worth far less than it had paid for it and it and Atlantic collapsed and went into administration in 1990. It was B & C's case that it had been induced to purchase the shares in Atlantic by false or misleading representations made by Atlantic and its directors as to Atlantic's value. In 1994, B & C, acting by its administrators, Mr Soden and Mr Padmore, sued Atlantic and its directors for damages for negligent misrepresentation and gave notice to Atlantic's administrators that its claim was made on the basis that it was a scheme creditor. By an originating summons, Messrs Soden and Padmore sought the determination by the court of a number of questions, the principal one for the purpose of this judgment being whether, if B & C obtained an order for damages in its action against Atlantic, such damages would be owing to B & C in its character "as a member of the company" within section 74(2)(f) of the UK Insolvency Act 1986 (the wording of which is for all intents and purposes identical to section 49(g) of the Cayman Islands

Company Act)²⁷. At first instance and in the Court of Appeal, the answer given to this question was “no”.

- 120 On appeal to the House of Lords, the Respondents were not called on. The lead judgment was given by Lord Browne-Wilkinson with Lord Lloyd of Berwick, Lord Steyn, Lord Hoffmann and Lord Hope of Craighead concurring.
- 121 In his judgment, Lord Browne-Wilkinson declined to accept B & C’s submission that there was no reason why a claimant who is induced by misrepresentation to purchase shares in a company from a third party, rather than from the company itself, should be in a different position from purchasers to whom shares are allotted by the company who, pursuant to the decisions in *Addlestone* and *Webb*, are not allowed to compete with general creditors.
- 122 Lord Browne-Wilkinson said, “[i]n the absence of any other indications to the contrary, sums due in the character of a member must be sums falling due under and by virtue of the statutory contract between the members inter se constituted by section 14 (1) of the Companies Act²⁸ ... To the bundle of rights and liabilities created by the memorandum and articles of the company must be added those rights and obligations of members conferred and imposed on members by the Companies Acts. It was the combined effect of section 14 and the other rights and liabilities of members that constituted “the statutory contract”.
- 123 In Lord Browne-Wilkinson’s view, the words “by way of dividends, profits” in section 74(2)(f) of the UK Insolvency Act 1986 were not to be construed under the ejusdem generis rule; instead, the words “by way of dividends, profits or otherwise” were illustrations of what constituted sums due to a member in his character as such. They neither widened nor restricted the meaning of that phrase. This construction accorded with principle. The principle was not “members come last”; a member having a cause of action independent of the statutory contract is in no worse position than any other creditor. The relevant principle was that the rights of members *as members* come last, i.e. rights founded on the statutory contract were, as the price of limited liability, subordinated to the rights of creditors based on other legal causes of action. The

²⁷ Section 74 (2) (f) of the UK Insolvency Act reads: “a sum due to any member of the company (in his character of a member) by way of dividends, profits or otherwise is not deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company, but any such sum may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves”. Section 49(g) of the CICA reads: “no sum due to any member of a company in that person’s character of a member by way of dividends, profits or otherwise shall be deemed to be a debt of the company, payable to such member in a case of competition between that person and any other creditor not being a member of the company; but any such sum may be taken into account for the purpose of the final adjustment of the rights of the [contributories] among themselves”.

²⁸ “Subject to the provisions of this Act, the memorandum and articles, when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles”. Cf section 12 of the CICA.

rationale of the section was to ensure that the rights of members as such do not compete with the rights of the general body of creditors. It followed from this dividing line between sums due in the character of a member and those not so due, that there was no room for including in the former class cases where membership, though an essential qualification for acquiring the claim, was not the foundation of the cause of action.

124 Lord Browne-Wilkinson referred to that part of the judgment of Kay J in the *Addlestone* case that is set out in the first two subparagraphs of paragraph [103] hereinabove. He also observed that Kay J decided that the claim was excluded by the *Houldsworth* principle. If there had been a cause of action in the *Addlestone* case, it must have been based upon the statutory contract between the member and the company. Dividends and profits represent what might be called positive claims of membership; the fruits which have accrued to the member by virtue of his membership. But the principle must apply equally to negative claims; claims based upon having paid money to the company under the statutory contract which the member says that he is entitled to have refunded by way of compensation for misrepresentation or breach of contract. These, too, are claims necessarily made in his character as a member. But in any event the reasons given by Kay J for treating the case as falling within section 38(7) were directed exclusively to matters relevant to a claim involving the issue of shares by the company but irrelevant to a claim relating to the purchase of fully paid shares from a third-party. Under the statutory contract (including the obligation in the winding up to pay all sums not previously paid on the shares) the claimants were bound to pay £2.10 shillings in respect of each share. If such a payment were not made the capital of the company would not be maintained and the general body of creditors would be thereby prejudiced. If, in such a case, the member could recover by way of damages for breach of the contract to issue the shares at a discount the same amount as he was bound to contribute on the winding up that would indirectly produce an unauthorised reduction in the capital of the company. Such a failure to maintain the capital of the company would be in conflict with what Lord Macnaghten (in the *Ooregum* case) said was the dominant and cardinal principle of the Companies Acts i.e. “that the investor shall purchase immunity from liability beyond a certain limit, on the terms that there shall be and remain a liability up to that limit”.

125 In Lord Browne-Wilkinson’s view, there was nothing in the *Addlestone* case to justify the application of that decision to cases where the claim against the company was founded on a misrepresentation made by the company on the purchase of existing shares from a third-party. To allow proof for such a claim in competition with the general body of creditors did not either directly or indirectly produce a reduction of capital. The general body of creditors are in exactly the same position as they would have been in had the claim been wholly unrelated to shares in

the company. The decision of the High Court of Australia in *Webb* stood on exactly the same footing. The High Court held that the claim was excluded by the *Houldsworth* principle and held that the proposition deducible from that case was that a shareholder may not directly or indirectly receive back any part of his or her contribution to the capital save with the approval of the court. The High Court further relied on the *Addlestone* decision and section 360(1) of the Companies Code of Victoria but carefully delimited its application to cases of contracts to subscribe for shares. They held that the claim in that case “falls within the area which section 360 (1) (k) sought to regulate: the protection of creditors from indirect reductions of capital. Those are factors relevant to cases of subscription for shares issued by the company but wholly irrelevant to purchases from third parties of already issued shares. It was therefore quite clear that both the decision and the reasoning of the High Court were dependent upon the same factors as those in the *Addlestone* case, i.e. the protection of creditors from indirect reductions of capital. Those are factors relevant to cases of subscription for shares issued by the company but wholly irrelevant to purchases from third parties of already issued shares.

- 126 Lord Browne-Wilkinson declined to express any view as to the present law of the United Kingdom where the sum due is in respect of a misrepresentation or breach of contract relating to the issue of shares. He referred to section 111A of the UK Act of 1985 and observed that it was plain that this section operates so as, at least in part, to override the *Houldsworth* principle. But to what extent and with what consequential results was not yet clear. All that was necessary for the decision of the case before him was to demonstrate, as he had sought to do, that the decisions in *Addlestone* and *Webb* do not apply to claims other than those relating to the issue of shares by the company.

(4) The statutory abolition of the Houldsworth rule in 1989 in the UK and the demise of the rule in Australia and elsewhere in the Commonwealth

- 127 In 1989, by way of section 131 of the UK Companies Act 1989, section 111A was inserted into the UK Companies Act 1985 which provides: “A person is not debarred from obtaining damages or other compensation from a company by reason only of his holding or having held shares in the company or any right to apply or subscribe for shares or to be included in the company's register in respect of shares.”²⁹
- 128 This legislative initiative followed a recommendation of the Company Law Committee of the English Law Society (approved by the Law Reform Committee of the General Council of the Bar) that the *Houldsworth* rule be abolished by statute on the ground that it had long been a

²⁹ See now section 655 of the Companies Act 2006

mere footnote in most textbooks and largely ignored by practitioners but whose practical effects were potentially serious for investors.

- 129 The *Houldsworth rule* was given its quietus so far as Australia was concerned by the High Court of Australia in *Sons of Gwalia*. The factual background to this case was as follows. Eleven days after Mr Margaretic (“the respondent”) purchased on the Australian Stock Exchange 20,000 shares in the appellant gold-mining company for A\$ 26,000, the company collapsed and went into administration. Later the company entered into a deed of arrangement to enable the administrators to distribute its assets in the order of priority as if the company was being wound up. The respondent claimed that the company, in breach of the Stock Exchange’s listing rules, had failed to notify the Stock Exchange that its gold reserves were insufficient to meet its gold delivery contracts. He claimed damages measured by the difference between the price paid for the shares and their nil value resulting from company’s breach of its statutory obligations of disclosure under section 674 of the Corporations Act 2001(Cth) (“the 2001 Act”), alternatively in respect of the company’s misleading and deceptive conduct in breach of section 52 of the Trade Practices Act 1974 (Cth).
- 130 Following receipt of the respondent’s notice that he intended to submit his claim for proof in the deed of company arrangement, the deed administrators applied to the Australian Federal Court for a declaration that the respondent’s claim was not provable in the deed of company arrangement, or a declaration in terms of section 563A³⁰ of the 2001 Act that payment was to be postponed until all debts owed to or claims made by persons otherwise than in their capacity as members of the company had been satisfied.
- 131 At first instance, Emmett J held that the appellant was a creditor of the company and that his claim was not postponed until all debts owed to or claims made by persons other than the respondent or others in his position had been satisfied. This decision was upheld on appeal to the Full Court. On appeal to the High Court of Australia, the administrators and a non-shareholder creditor contended, inter alia, that the respondent’s claim was made in his capacity as a shareholder and therefore pursuant to section 563A of the 2001 Act his claim was to be postponed until all debts owed to or claims made by persons otherwise than in their capacity as members of the company had been satisfied. The non-shareholder creditor also contended that

³⁰ “563A “Payment of a debt owed by a company to a person in the person's capacity as a member of the company, whether by way of dividends, profits or otherwise, is to be postponed until all debts owed to, or claims made by, persons otherwise than as members of the company have been satisfied.”

since the respondent had not rescinded the contract under which he acquired his shares, his claim must fail in accordance with decision of the House of Lords in *Houldsworth*.

- 132 In paragraph [14] of his judgment, Chief Justice Gleeson (“Gleeson CJ”) described the principle in *Houldsworth* as “famously elusive” and remarked that the view of the High Court in *Webb* that the proposition identified by the House of Lords in *Houldsworth* was distilled from the provisions of the 1862 Act was at variance with the fact that the judgments in *Houldsworth* made no reference at all to the provisions of that Act and instead propounded a wider principle.
- 133 In paragraph [16], Gleeson CJ observed that in *Webb*, the High Court had abstained from deciding whether the rule in *Houldsworth* was right or wrong on the basis that the critical question was whether the proposition distilled in the case had been incorporated in the provisions of the Code, which the Court found to be the case in section 360(1) (k). In Gleeson CJ’s view, the issue in the instant case was to be decided upon the true construction of the provisions of 2001 Act and, in particular, section 563A.
- 134 Gleeson CJ then went on to comment in paragraphs [17] to [20] on the arguments of both sides in favour of their constructions of section 563A founded on policy and the historical context. As to policy, modern legislation, such as that invoked by the respondent in his claim for damages, had greatly extended the scope for “shareholder claims” against corporations with consequences for ordinary creditors who may find themselves, in an insolvency, proving in competition with members now armed with statutory rights. Legislation that conferred rights of damages upon shareholders necessarily increased the number of creditors in a winding up. Such an increase normally would be at the expense of those who previously would have shared in the available assets. On the other hand, since the need for protection of investors often arises only in the event of insolvency, such protection may be illusory if the claims of those who are given the apparent benefit of the protection are subordinated to the claims of the ordinary creditors. One thing was clear. Section 563A did not embody a general policy that, in an insolvency, “members come last”.
- 135 As to the construction argument based on history, including in particular the principle in *Houldsworth*, this argument had overstated the width of that decision, and of others that had followed. In *Houldsworth*, the investor was attempting to obtain from the company reimbursement in respect of his liability to pay calls in the winding up in circumstances where he could no longer obtain rescission of the contract under which he was allotted the shares. Gleeson CJ noted the different reasons given on the one hand by Kay J and on the other by Lindley LJ for dismissing the shareholder’s claim in *Addlestone* and observed that the majority in *Webb*: (a) treated the rationale of *Houldsworth*, as identified by Lindley LJ, as relevant to the

interpretation of section 360 (1)(k); and (b) considered that the claim before them was covered by section 360 (1)(k) for the same reasons as Kay J had concluded in *Addlestone* that the claimants were subordinated by the corresponding UK statutory provision.

136 Gleeson CJ also stated that to draw the line between a shareholder claiming in his capacity as a shareholder and a shareholder claiming otherwise than in the capacity of a member it is necessary to analyse the nature of the claim; it was not sufficient to describe its effect on creditors.

137 In paragraphs [31] – [32], Gleeson CJ said that what determined the present case was that the respondent’s claim was not founded upon any rights he obtained or any obligations he incurred by virtue of his membership of the company. He did not seek to recover any paid-up capital, or to avoid any liability to contribute to the company’s capital. His claim would be no different if he had ceased to be a member at the time it was made, or if his name had never been entered on the register of members. The respondent’s membership of the company was not definitive of the capacity in which he made his claim. The obligations he sought to enforce arose, by virtue of the first appellant’s conduct, under one or more of the statutes pleaded in the respondent’s claim. The respondent’s claim therefore fell outside section 563A of the 2001 Act.

138 In paragraphs [35] – [36] of the judgment, Gummow J stated that the implicit premise in the arguments addressed to the Court that there had been an apparently seamless continuity in the reception and development of the common law in Australia was apt to distract attention from the importance of statute law. There were no “general principles of company law” applicable in a winding up and in any quest to locate such general principles excessive significance should not be attributed to statements in nineteenth century British cases, decided at a time of endeavours to “flesh out” the developing body of statute law, by use of principles derived from a range of sources in the general law.

139 In paragraphs [63] & [67], Gummow J stated that *Houldsworth* cannot be explained in terms of subscribed capital being a protection to creditors. Instead, it is the gradual development of legal thought respecting the nature of corporate personality and the use of an inapt analogy drawn from established areas of the law which is manifested in that decision. Neither in the Court of Session nor in the House of Lords was the litigation in *Houldsworth* determined by reference to the law respecting the ranking of claims in a winding up. Rather, the appellant *Houldsworth* failed at the threshold; his action in damages did not lie against the bank. It was also to be noted that the explanation given by Earl Cairns for the difference between a sale of goods and shares subscribed for was founded on analogies with principles of partnership, see [69]. Further, in following and applying the earlier decision of the House of Lords in *Addie*, the House of Lords

in *Houldsworth* was accepting that whilst a company might be responsible for the frauds of its directors to the extent that they had benefited from the fraud, the companies could not be sued as wrongdoers, although the directors could be, see [72]. Further, it was not easy to discern why an action for damages was inconsistent with the features of the contract whereby shares were taken up and nor was it clear why this inconsistency should have prevented the shareholder from claiming that the fraud of the directors was imputable to the company, see [78].

140 As to Professor Gower's thesis that *Houldsworth* was explicable by the notion that share capital was a "guarantee fund" for creditors, in Gummow J's opinion the validity of this thesis had ceased to exist after the enactment the 1862 Act which repealed the Limited Liability Act 1855, including section 13 thereof which had provided that a company should be wound up once three quarters of its subscribed capital stock had been lost, see [84]. Further and in any event, there was much to be said for the view that a company satisfying its liability in tort to a member should not be characterised as attempting an unauthorised reduction of capital. Large awards may adversely affect the market value of shares in the company, but they do not require any return of capital, see [85].

141 In paragraph [135], Hayne J stated that the questions to be answered in the appeal depended on the provisions of Pt 5.6 of the 2001 Act and did not depend upon any principle of judge-made law, particularly the rule in *Houldsworth*. In paragraphs [149] – [167] the learned judge traced the legislative origins of the applicable modern statutory provisions from the enactment of the 1862 Act. In paragraph [184], he observed that in *Webb*, the central question was whether the shareholders had claims that could be proved in the winding up, not what priority was to be afforded to a claim that is admissible to proof in the application of the assets of the company in the winding up. He also noted that in *Addlestone*, Kay J had explained *Houldsworth* as depending on the application of section 38 (7) of the 1862 Act. Claims for damages for misrepresentation were characterised as a claim to recover a dividend and for that reason were held to be claims in the character of a member with the consequence that they were deemed not to be debts of the company payable to members. This decision, coupled with the various criticisms that have been levelled at the decision in *Houldsworth* revealed the difficulties implicit in taking the state of judge-made law as the starting point for consideration of issues of the kind considered in *Webb*.

142 In paragraphs [194] – [205] Hayne J considered what is meant by the words, "sum due to any member of a company, in his character of a member, by way of dividends, profits, or otherwise". In his view, this was a question of statutory construction rather than adopting what Lord Browne-Wilkinson had called "negative claims: claims based upon having paid money to the

company under the statutory contract which the member says he is entitled to have refunded by way of compensation for misrepresentation or breach of contract”. “Membership” of a company was a statutory concept. That was why the connection between the obligation and membership that must be shown, if the obligation is to fall within section 563A, will find its ultimate foundation in the relevant legislation. It is the legislation that defines the obligations owed by and to the members of the company. If money is paid to the company under the statutory contract, whether a claim founded on an obligation which it is then sought to enforce by a claim against the company is a claim made in the character of a member may depend on the individual facts and would likely be much affected by the company’s constituent documents. But if the money is paid to the company to *create* the relationship of member (as will be the case when a person subscribes for shares) the company’s obligation to pay damages for fraudulent misrepresentation, inducing that subscription, or to pay damages because loss was occasioned by the company’s misleading or deceptive conduct, will not, in the absence of specific legislative provision to the contrary, be an obligation whose foundation can be found in the legislative prescription of the rights and duties of members.

- 143 The obligation which the respondent sought to enforce was not an obligation which the 2001 Act had created in favour of the company’s members. In so far as it was based on statutory causes of action it was rooted in the company’s contravention of the prohibition against the company’s conduct of engaging in misleading or deceptive conduct. In so far as it was put forward in the tort of deceit, it was a claim that stood apart from any obligation created by the 2001 Act.
- 144 Callinan J dissented. In paragraph [255] he expressed the opinion that the decision of his brother judges was grossly unfair to the company’s creditors and possibly to other shareholders who may have purchased shares long before the respondent had purchased his shares. In his view, it was desirable that the 2001 Act be read so as to maintain coherence in the law and promote fairness, if a construction to achieve those ends was reasonably available. The construction contended for by the respondent did not achieve those ends, indeed the contrary.
- 145 In paragraph [250], in response to Gleeson CJ’s suggestion that “assets and liabilities” are matters of more significance to creditors than paid up capital, Callinan J observed that the difference between liabilities and assets, namely members’ equity, stands in place of, and assumes the importance of paid-up capital and is the real measure of the worth of a company. Given that the 2001 Act continued to make elaborate provision for and limited the circumstances in which funds may be returned to shareholders, he could not dismiss as irrelevant the discussion of the courts on paid and unpaid shares in past cases which were

concerned primarily with questions relating to access by members to capital and returns of capital to members. Whatever criticisms may be made of *Houldsworth*, the High Court in *Webb* had accepted that the decision stood for a proposition which the House of Lords had distilled from the provisions of the 1862 Act and that it had received statutory recognition in section 360(1) of the (Victorian Companies) Code. It had also stood as the law, as to the effect of relevant parts of the companies legislation in a relatively unchanged form from 1880.

- 146 In paragraphs [252] and [253] Callinan J said that he did not think anything turned upon whether the purchase price of shares was subscribed to the company or paid to a third party. The claim in both cases was for damages because the shares were not what they were represented to be and both the subscriber or the transferee fell within the same areas of intense concern to creditors, the solvency and the maintenance of capital of the company, whether in an enhanced or diminished form. Any participation by members in the funds of a company not postponed to ordinary creditors would inevitably effect a major reduction in the nett funds of the company, whether described as capital, paid up capital or owners' equity. It followed that, apart from *Soden*, the relevant case law did not support the position of the respondent and *Soden* was open to the criticism that it did not take due account of the importance of the maintenance of both paid up capital and owners' equity, and therefore the continuing solvency of the company.
- 147 Heydon J agreed that the appeal should be dismissed. The respondent's claim was not a claim for payment of "a debt owed by a company to a person in [his] capacity as a member of the company" within the meaning of section 563A, for the reasons given by Hayne J. He also agreed with the reasons given by Hayne J that *Webb* and *Houldsworth* were not determinative.
- 148 Crennan J agreed that the appeal should be dismissed. In his view, the claims made by the respondent were not founded on any obligation owed by or to him as a member of the company. The respondent relied on statutory causes of action not confined to members. Further, any obligation on the company to pay compensation to the respondent for fraudulent misrepresentation inducing him to become a member and occasioning him loss did not answer the description of being owed to the respondent in his capacity as a member.
- 149 In the course of a concise review of the decisions in *Oakes*, *Tennent*, *Houldsworth*, *Burgess's Case* and *Addlestone*, Crennan J observed in paragraph [268] that: (a) when Earl Cairns spoke in *Houldsworth* of the appellant's claim as being "inconsistent with the contract into which he has entered", he was referring to the appellant's contract "as between himself and those with whom he becomes a partner" i.e. other shareholders; and (b) it was clear that Lord Selborne's reasons in *Houldsworth* "concerned the "contract between the shareholders" and Lord Selborne regarded the action as being in truth, an action against co-contributories, innocent of any fraud.

150 Crennan J then went on in paragraphs [270] and [271] to refer to the observations of Sir George Jessel MR in *Burgess's Case* cited in paragraphs [96] & [99] hereinabove, noting that the MR's explication of *Houldsworth* was supported by section 101 of the 1862 Act as it applies to contributories of an unlimited company. In Crennan J's view, the notion that the "inconsistency" in Houldsworth's position as a shareholder turned on an implied term in the contract between the shareholder, or a "principle", seemed to have been first suggested by Kay J in *Addlestone* at p. 200 of the report³¹ and repeated on appeal by Lindley LJ at p. 206: "[A] shareholder contracts to contribute a certain amount to be applied in payment of the debts and liabilities of the company, and ... it is inconsistent with his position as a shareholder, while he remains such, to claim back any of that money."

151 Crennan J then proceeded to make the following two points on the assumption that the inconsistency in *Houldsworth* is explicable by reference to the specific provisions of section 38 of the 1862 Act:

"First, Salomon v Salomon & Co ... disposes of the conception that an action by a shareholder against the company in respect of fraud inducing the taking up of the shares is, in effect, an action against individual innocent co-contributors. Secondly, if the significance of Houldsworth's case for section 38, including section 38(7), was as explained almost contemporaneously by Sir George Jessel MR in Burgess's case, namely that the legislation imposed and defined obligations of and to shareholders, it is difficult to understand why its significance for section 38 was characterised much more widely as turning on a principle that share capital represents a "guarantee fund" for creditors which should not be returned to shareholders other than in a lawful reduction of capital. In any event, the idea that it is "the legislation which defines the obligations owed by and to the members of a company" has remained a constant, notwithstanding critical legislative changes dealing with members' debts which have been described by Hayne J (at para [202], above)."[272]

"The claims Mr Margaretic makes are not founded on any obligations owed by or to him as a member. He relies on statutory causes of action not confined to members which are available to a person who has suffered, or is likely to suffer, loss or damage ... Any obligation on the company to pay compensation to Mr Margaretic for fraudulent misrepresentation inducing him to become a member and occasioning him loss does not answer the description of being owed to Mr. Margaretic in his capacity as a member of the company."[273]

³¹ See the last paragraph of Kay J's judgment set out in para [103] above.

- 152 That part of the High Court’s decision in *Sons of Gwalia* that declared that shareholders in the position of Mr Margaretic fell outside section 563A of the 2001 Act and could prove in the liquidation of the company on an equal footing with external creditors was regarded as being so unfair that it was reversed by the Australian Federal Parliament by introducing an amendment to section 563A to the effect that any claim brought by a shareholder against a company that arose from the buying, selling, holding or otherwise dealing with a shareholding is to be postponed in an external administration until after all other claims have been paid.
- 153 In the Bermuda case of *Telewest Ltd* (Reasons For Order, unreported, 12 July 1995), preferred shareholders of redeemable shares claimed they were entitled to prove in the liquidation of the company for damages for loss suffered in reliance on misrepresentations made on behalf of the company as to its financial position in the relevant prospectuses which induced the allotment contracts by which they had become shareholders. On an application by the Liquidators for directions as to whether, inter alia, the preferred shareholders’ claims were inadmissible by reason of the *Houldsworth* rule, Ground J held that the decision in *Houldsworth* was distinguishable from the case before him and directed that proofs of debt filed by the preferred shareholders should not be disallowed on the grounds of the *Houldsworth* rule but considered on their merits in the light of section 158(g) of the Bermuda Companies Act 1981, the equivalent of section 49(g) of the Cayman Islands Companies Act.
- 154 In reaching this view, Ground J focussed on the allotment contract made between Mr Houldsworth and the City of Glasgow Bank under which the shareholders became co-partners of a Bank that had unlimited liability, which situation stood to be compared with the subscription contracts made between the preferred shareholders and Telewest Ltd, a limited liability company, under which the shares allotted were fully paid up, carried no voting rights under the Articles of Association and there was no contract between the shareholders inter se to contribute to the liabilities of the company. In Ground J’s view, the preferred redeemable shares in Telewest Ltd were “essentially an investment vehicle and not in any real sense to be compared with the type of shareholding envisaged by their Lordships in *Houldsworth*’s case”.
- 155 Although Ground J was referred to the Court of Appeal’s decision in *Addlestone*, it seems that this was merely to show that the *Houldsworth* rule had been extended to claims in contract.

(5) The decisions under appeal

- 156 We turn to the decisions of Doyle J that the *Houldsworth* rule should not be treated as part of the common law of the Cayman Islands and of Segal J that the *Houldsworth* rule as it became

following *Addlestone* and *Soden*³² was part of the common law of the Cayman Islands, at least where the shareholder's claim would be in competition with claims made by external creditors.

(a) Doyle J's decision

157 The key paragraphs in Doyle J's judgment are paragraphs [154] - [172], particularly paragraphs [165] – [172] which read as follows:

[165] Attempts may be made to distinguish *Houldsworth* from the facts of the present case before the Court. In *Houldsworth* the relevant entity was an unlimited co-partnership. In the present case, the Company is a limited liability company and the shares are fully paid up. The present case does not involve investors seeking to claim back money which they have contracted to contribute to pay the debts and liabilities of the Company. To that extent, it can easily be distinguished on the facts. However, the *ratio* of *Houldsworth* appears to have been interpreted subsequently as applying to limited companies. I have set out the headnote and some of the textbook commentary earlier in this judgment. I have also set out the comments of Lindley LJ in *Addlestone* at pages 205-206 and the comments of Peter Gibson LJ and Lord Browne-Wilkinson in *Soden* in respect of the *ratio* of *Houldsworth*. If *Houldsworth* were good English and Cayman Islands law, I do not think I could legitimately distinguish it.

[166] Having had the benefit of detailed submissions on the issue I have however concluded that *Houldsworth* can no longer be regarded as good English law (indeed it has been abandoned by the UK Parliament). It is not a part of Cayman Islands common law. In my judgment, this is one of those rare cases where this court is justified, indeed obliged, to decline to follow an English decision.

[167] Mr Millett, with hints against inappropriate 'judicial activism', submitted that it would be "positively dangerous for the court to play lawmaker", and stressed the importance of certainty to investors who choose Cayman. He respectfully suggested that if the Grand Court refuses to follow

³² Namely, that a proof for damages in the liquidation of a company by a person induced by a misrepresentation by the company to subscribe for shares who has not rescinded or is unable to rescind their subscription contract is inadmissible on the ground that to satisfy the claim would involve a prohibited return of capital.

Houldsworth there would be significant risks of "serious adverse unintended consequences", including "a serious impact on the willingness of lenders to lend". His warnings advanced to an assertion that if the Grand Court refused to follow *Houldsworth* it would "open floodgates to investor claims" and would turn the decision of the Cayman Islands Court of Appeal and the Privy Council in *Herald Fund SPC (in official liquidation)* [2016] 2 CILR 330 on their heads and would mean that investors would be far readier to redeem to exit their investment, for fear of being subordinated to investors who stayed in and then decided to file a misrepresentation claim. I also note the comments of Lord Collins in *Singularis Holdings Limited v PricewaterhouseCoopers* [2014] UKPC 36 in respect of judicial law-making and the respective roles of the judiciary and the legislature.

[168] I do not, for one moment, accept the charge that in not following *Houldsworth* I would be playing lawmaker or becoming an inappropriate judicial activist. If there has been any judicial over-reach in this area of law it has arguably been committed by the House of Lords who in their judicial capacity in *Houldsworth* in effect amended or restricted section 158 of the English Company Act 1862 (not referred to in the judgments) to exclude claims by those who invested into an unlimited banking company with articles of partnership on the basis of fraudulent misrepresentation made by the directors and other bank officials. All I am doing is applying section 139(1) of the Companies Act (2023 Revision) of the Parliament of the Cayman Islands and declining to follow a judgment from a foreign jurisdiction which has been abandoned by its own Parliament and not followed in other jurisdictions including Australia and Bermuda. I am simply applying a local statutory provision untainted by a foreign judgment abandoned by its own Parliament. That is far from acting as a lawmaker or an inappropriate judicial activist.

[169] Section 139 provides as follows

"Provable debts

(1) All debts payable on a contingency and all claims against the company whether present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company and the official liquidator shall make a just estimate so far as is possible of the value of all such debts or

claims or claims which for some other reason do not bear a certain value.

(2) Foreign taxes, fines and penalties shall be admissible to proof against the company only if and to the extent that a judgment in respect of the same would be enforceable against the company pursuant to the Foreign Judgments Reciprocal Enforcement Act (1966 Revision) or any laws permitting the enforcement of foreign taxes, fines and penalties.

[170] Debts arising from claims for damages for misrepresentation fall within the wide wording of section 139(1) of the Companies Act (2023 Revision). By Cayman Islands statute these claims are admissible to proof against the Company. In arriving at that conclusion I am not injecting any uncertainty into this area of law. I am simply applying a local statutory provision untainted by *Houldsworth*, an authority arising in a foreign jurisdiction and not binding on this court and subsequently abandoned by its own Parliament. If the Parliament of the Cayman Islands wishes to legislate to amend section 139(1) or in respect of any "severe adverse unintended consequences" of this judgment, to use the cautionary words of Mr Millett, then that is a matter for Parliament.

[171] If policy considerations are relevant one factor to consider would be investor protection in a country whose vibrant economy is in large part based on the attraction of outside investors using Cayman corporate vehicles. If those investments are based on fraudulent misrepresentations it would be unfortunate, to put it mildly, if such defrauded investor did not have a remedy against the relevant Cayman company. A remedy against a director may be insufficient. I was not addressed on any persuasive policy reasons as to why an investor in such circumstances should not in its capacity as a creditor have a claim against the Cayman company.

[172] I have decided that I should not follow *Houldsworth* for a number of reasons:

- (1) it is arguably contrary to or adds an unjustifiable judicial restriction to the plain wording of a local statute (section 139 of the Companies Act);

- (2) it has been abandoned by the UK Parliament, and has been heavily and persuasively criticised by others and not followed in the High Court of Australia and the Supreme Court in Bermuda at first instance;
- (3) its reasoning is inconsistent with contemporary company law;
- (4) it is an obsolete English common law decision which has ceased to be authoritative in England;
- (5) and it is simply not persuasive in the present context.

(b) *The parties' submissions challenging, or alternatively upholding, Doyle J's decision not to follow Houldsworth.*

158 Ground 1 of the updated skeleton argument of the Appellants in the HQP proceedings, Access Industries Holdings and AI Autoparts LLC, contends that in deciding not to follow *Houldsworth* Doyle J erred: (a) in his approach to the precedential value and effect of decisions of the Court of Appeal of England and Wales and the House of Lords which may be departed from only if there is a compelling case for doing so; (b) in holding that the courts in Bermuda (*Televest*) and Australia (*Sons of Gwalia*) had likewise decided not to follow *Houldsworth* when in fact in those cases, *Houldsworth* was distinguished; (c) changes to the common law as represented by the *Houldsworth* rule as it was developed in subsequent cases should only properly be made by statute; (d) the fact that the *Houldsworth* rule had been abrogated by legislation in England was not a basis from departing from the rule in the Cayman Islands without more; and (e) Doyle J erred in relying on section 139 of the Companies Act as overruling the *Houldsworth* rule.

159 Mr Thompson submitted that the rule in *Houldsworth* is the correct description of the law in the Cayman Islands. The decision establishing the rule was an authoritative decision of the House of Lords, which has not been overruled or discredited by any court in the Cayman Islands or England or the UK and it ought to be followed and should have been followed by Doyle J.

160 *Addlestone* makes it clear, contended Mr Thompson, that the rule is that a shareholder who subscribed for shares cannot after a winding up claim from the company damages for misrepresentation or indeed a breach of contract by which he was induced to take his shares. The principle is applicable to limited and unlimited companies and is not restricted to companies where the shares are partly paid up. The rationale for the rule is that you cannot approbate and then reprobate i.e. if you cannot rescind, it is not open to you to say simultaneously that you have the shares you acquired of which you cannot divest yourself and at the same time bring a claim which has the function of recovering the money that represents

those shares in the hands of the company because effectively what you are trying to do is to get back the very thing which you gave to the company in consideration for the shares in the first place. That rationale has been authoritatively refined to the idea that the claim is a claim for recovery of capital and therefore against the principle of the maintenance of capital because, as a subscriber, at least some of the money you pay the company will form part of the capital of the company.

- 161 Mr Thompson referred to Lord Browne-Wilkinson's observation in *Soden* that sums due to a member in his character as a member are only those claims the right to which is based by way of a cause of action on the statutory contract. *Addlestone* was a claim for breach of contract and in *Houldsworth*, it was a claim for fraudulent misrepresentation but based on a cause of action on the statutory contract because it is the misrepresentation and the breach of contract which have triggered or empowered the company to enter into the statutory contract with the member. That is not the case where a person buys their shares on the open market.
- 162 Responding to Doyle J's reliance on section 139 of the Companies Act and his observation that none of their Lordships in *Houldsworth* had referred in their judgments to section 158 of the 1862 Act, the precursor to section 139 (1) of the Companies Act, Mr Thompson pointed out that their Lordships in *Houldsworth* would have been well aware of section 158 since it was referred to by Counsel for Mr Houldsworth who pointed out that it expressly provided for the proof against the company of the debts of all descriptions including damages. Mr Thompson also observed that all of the judges involved in the *Soden* proceedings from first instance to the House of Lords would have been well aware of rule 12.3 of the 1986 Insolvency Rules that was the same in substance as section 139 (1), from which it could be safely inferred that that provision did not have the effect that Doyle J said that it had.
- 163 Turning to reception of the *Houldsworth* rule in Cayman Islands law, Mr Thompson accepted that the Cayman Courts are not bound as a matter of strict stare decisis to follow decisions of any other jurisdiction whether it is the UK or Australia or anywhere else. The only strictly binding decisions are those of the Privy Council sitting on an appeal from the Cayman Islands Court of Appeal, but persuasive decisions of the Privy Council, the House of Lords and the UK Supreme Court and the English Court of Appeal on questions of common law should be followed, save only in certain limited circumstances. The decision in *Houldsworth* and the later decisions of the English Court of Appeal in *Addlestone* and the House of Lords in *Soden* (where *Webb* was cited with approval) focused on equivalent provisions to section 49(g) and were therefore highly persuasive and should have been followed: see *de Lasala v de Lasala* [1980] A.C. 546.

- 164 Mr Richard Millett KC, who appeared for the Eiffel Funds in the Direct Lending proceedings representing redemption shareholders who had redeemed pre-liquidation, adopted and supported Mr Thompson's submissions on the *Houldsworth* rule. He was at pains to emphasise that under that rule shareholders who sought to prove for damages for misrepresentations made by the company which had induced non-rescinded subscription contracts by which they became shareholders were absolutely barred from proving for such claims so that the priority point in the appeals only arose because Mr. Justice Doyle and Mr. Justice Segal got the proof point wrong.
- 165 Mr Millett also contended that the proposition that the *Houldsworth* rule was limited to the protection only of creditors through the maintenance of capital principle was inconsistent with Sir George Jessel MR's judgment in *Burgess's Case* where the applicant's case that he could rescind the contract for the acquisition of shares in the company on the ground that all the creditors had been paid was rejected.
- 166 In their written submissions, the petitioners in the HQP proceedings, represented by Mr Robert Levy KC, contended that Doyle J's review of the principles governing the applicability of English and Commonwealth decisions in the determination of Cayman Islands proceedings was sound and that his reasons for deciding not to apply the *Houldsworth* rule (as explained in *Addlestone*, *Burgess's case*, *Webb* and *Soden*) were well founded and beyond successful challenge. In particular, the fact that the criticisms of the *Houldsworth* rule made in *Sons of Gwalia* were strictly obiter was fundamentally beside the point and it was clear that contrary to the submission of the appellants, Doyle J had taken careful account of *Soden* in reaching the decision that *Houldsworth* was not to be treated as part of the law of the Cayman Islands.
- 167 In addition, the Petitioners served a Respondent's Notice on the back of which they contended that Doyle J erred in holding in paragraph 156 of his judgment that *Houldsworth* was not distinguishable from the instant case because it was held in *Addlestone* and *Soden* (at all levels) that the rule applied to limited companies.
- 168 In his oral submissions, Mr Levy argued that the *Houldsworth* rule had no obvious merits. In particular, it was contrary to the general principle that no wrong should be without a remedy. He also referred to the opening words of McHugh J's judgment in *Webb* noted in paragraph [118] above and urged this court to accept the reasoning behind the High Court's decision in *Sons of Gwalia* that the *Houldsworth* rule is not part of the law of Australia, which in Mr Levy's submission, strongly supported Doyle J's decision not to apply the *Houldsworth* rule in this case.

- 169 In Mr Levy’s submission, the decision in *Houldsworth* had no application to the present case. In *Houldsworth*, the court was concerned with an unlimited partnership which was registered as a company under the 1862 Act. Thus, the statutory contract there required Mr Houldsworth to contribute an unlimited amount to meet the company’s debts and that obligation included an obligation to contribute to any of Mr Houldsworth’s own claims. All of the shareholders of the same class would have been similarly liable in respect of the debts of the company. This is what Lord Hatherly was referring to when talking about interlacing claims. It was also difficult to distinguish between the company and its members because the company was unlimited and was a co-partnership. Further, two of their Lordships (Lord Selborne and Lord Blackburn) seemed to base their decisions on the principle that an action for deceit did not lie against the company but against the directors personally. The *Addlestone* authority was also inapplicable because in that case there was an outstanding liability in respect of the shares issued to the applicants, whereas in the instant case the shares from the outset were fully paid up and the claimants were not asking to be relieved from any liability under the statutory contract.
- 170 Mr Levy also submitted that the fact that a purchaser of shares in the market in reliance on financial misrepresentations made by the company can prove for a tortious claim in damages in the company’s liquidation but a subscriber for shares who relied on the same misrepresentations is barred from proving for an equivalent claim, throws into question the justification for the *Houldsworth* rule based on the principle of maintenance of capital. In support of this submission, Mr Levy referred to that part of the petitioners’ written submissions which note Hayne J’s observation in paragraph [205] of the *Sons of Gwalia* decision that, if money is paid to the company to create the relationship of member (as will be the case when a person subscribes for shares) the company’s obligation to pay damages for fraudulent misrepresentation inducing that subscription, or to pay damages because loss was occasioned by the company’s misleading or deceptive conduct, will not, in the absence of specific legislative provision to the contrary, be an obligation whose foundation can be found in the legislative prescription of the rights and duties of members.
- 171 Mr Tom Smith KC’s oral submissions on behalf of the JOLs in both the HQP and Direct Lending proceedings may be summarised as follows.
- 172 Consideration of “the priority issue” was the best way of reaching a satisfactory conclusion on “the proof issue” viz whether a shareholder claiming damages for a misrepresentation by the company that induced him or her to subscribe for shares may prove for such a claim at all in the liquidation of the company. The priority issue was whether section 49(g) applies to

subordinate any claims for damages for misrepresentation that induced the subscription for shares (“misrepresentation claims”).

- 173 Section 49(g) applies to misrepresentation claims so as to subordinate such claims to the claims of ordinary creditors. This proposition results from the clear effect of the language of section 49(g) and is strongly supported by what the House of Lords said in *Soden*, particularly Lord Browne-Wilkinson, who specifically addressed this very point. Segal J was correct on this point and Doyle J in *HQP* was wrong. The correct analysis is that such claims can be admitted to proof and paid once ordinary creditors have been paid in full because the basis for the rule in *Houldsworth* is the maintenance of capital for the protection of external creditors. Once the claims of external creditors have been paid and discharged, there is simply no reason or indeed basis for the rule to apply at that stage to exclude misrepresentation claims by a subscription shareholder where the only person(s) they are competing with are other shareholders. By definition, at that point, the external creditors have been discharged.
- 174 This approach represented an entirely satisfactory result as a matter of policy. It balances the two factors which are in play: (i) the interest of the creditors secured by the principles relating to the maintenance of capital; and (ii) the factor that someone who is a shareholder who has suffered loss by reason of a misrepresentation by the company causing him or her to buy shares in the company has suffered a wrong at the hands of the company and should have a claim for compensation for that tort. This is the position that today applies in most other common law jurisdictions such as England, Australia, Hong Kong, Canada and Bermuda, largely by reason of legislative intervention.
- 175 Although section 49(g) uses the language of “shall not be deemed to be a debt”, in effect it is subordinating a claim. In so far as there are competing external creditors, misrepresentation creditors are not to be treated as a debt in the liquidation. By the words “any such sum may be taken into account for the purposes of the final adjustment of the rights of the contributions ” (which should read contributories) “amongst themselves”, the provision was basically saying that once external creditors have been paid the subordinated claims come in and will rank ahead of anything left over to be paid to the shareholders in their capacity of shareholders.
- 176 The misrepresentation claims fall within section 49(g) for the reasons given by Kay J in *Addlestone* who expressed the view that the claim for damages was not only made in the character of members but also it was just as unreasonable as if it were a claim for dividends or profits and so it came within the words “or otherwise” in section 38(7) of the 1862 Act. On this point Kay J was upheld by the Court of Appeal by Cotton and Lopes LJ. (Lindley LJ did not deal with this priority point; he just dealt with the proof point.) The fact that in *Addlestone* the

shares were not fully paid up but were only partly paid up is not a material distinction. As a matter of substance, in both cases the claimants were seeking to diminish the fund of capital that would otherwise be available to meet the claims of external creditors.

- 177 The “statutory contract” referred to in *Soden* was not limited to the rights and liabilities under the memorandum and articles; it also specifically includes the rights and obligations under the Companies Act. By entering into a subscription agreement, a putative shareholder acquires rights and becomes subject to obligations under the Companies Act from the moment of entering into the subscription agreement. It is at that moment that he becomes entitled to be put on the company’s register of shareholders by applying for rectification of the company’s register of members if it refuses his application. And from that time the shareholder becomes liable under the statute to pay the purchase price due under the subscription agreement which would be a debt enforceable against him if there were a liquidation of the company. Thus, from the moment the putative shareholder signs the subscription agreement he is on the hook, including under the statute. As Lord Browne-Wilkinson put it: “The principle must apply equally to negative claims; claims based upon having paid money to the company under the statutory contract which the member says he is entitled to have refunded by way of compensation for misrepresentation or breach of contract. These, too, are claims necessarily made in his character as a member”.
- 178 A transferee who sues on a misrepresentation made by the company is not bringing a claim for loss of the same nature as is the case where shares were subscribed for in reliance on the misrepresentation. In the transferee case the subscription has already taken place when the original subscriber has put the capital into the company. Then, sometime later, a sale takes place in which the purchaser pays the purchase price to the seller who may or may not be the original subscriber. What the purchaser is claiming in these circumstances is not a return of capital from the company. He is claiming the loss he has suffered under the contract having acquired shares from the seller which are worth less than they should have been. There is therefore no real difference from that case or any other sort of case where the company has committed a tort against someone. The fact that the company is obliged to pay damages for compensation for the loss caused by its conduct is not in substance a return of capital. This was the point Lord Browne-Wilkinson made where he said: “There is nothing in the *Addlestone* case to justify the application of that decision to cases where the claim against the company is founded on a misrepresentation made by the company on the purchase of existing shares from a third party. To allow proof for such a claim in competition with the general body of creditors does not directly or indirectly produce a reduction of capital. The general body of creditors are in exactly

the same position as they would have been had the claim been wholly unrelated to the shares of the company.”

- 179 With all due respect to Mr Levy, it was plain beyond argument that a subscriber case falls within section 49(g), section 74(2) (f) of the UK Insolvency Act and section 38(7) of the 1862 Act, since the claimant is clearly claiming back the return of the subscription price whereas in the purchaser case the subscription has already taken place possibly years earlier and the purchaser is seeking compensation from the company for the loss he has been caused by acquiring shares subsequently.
- 180 Justice Hayne in *Sons of Gwalia* took a different view as to the priority point from that taken by the House of Lords in *Soden*. In *Sons of Gwalia*, the causes of action with which Justice Hayne was concerned were rights of action conferred by consumer protection legislation and Justice Hayne focused on where the right of action was found – in the statutory contract or elsewhere. That was the wrong approach. The correct approach is that taken by Kay J in *Addlestone* and Lord Browne-Wilkinson in *Soden*, namely, to look at whether the relief being claimed amounts directly or indirectly to a return of capital and thereby infringes the rules relating to the maintenance of capital. The *Soden* approach is to be preferred. Given that a misrepresentation subscriber had to pay to become a member of the company, it is not a misuse of language to say that his claim for damages is made in the character of a member, which effectively was what Lord Browne-Wilkinson said in terms in *Soden*. The shareholder is trying to recover capital which he has contributed and on the basis of which creditors are to be presumed to have contracted with the company and that is the substantive reason which Kay J identified in *Addlestone* and which was approved by Lord Browne-Wilkinson for finding that the claim is made in the character of a member.
- 181 The essence of Doyle J’s contrary view on this point was the distinction he drew between the contract of subscription and the articles of association, the former being anterior to the latter so that the statutory contract was effectively confined to the articles of association. That was too narrow a view of the statutory contract because the contract of subscription is the means by which one becomes a party to the articles of association. The subscription contract and the articles are very closely linked but entry into the subscription agreement gives rise to the rights and obligations under the Companies Act itself.
- 182 The fact that misrepresentation claims fall within section 49(g) is strongly supportive of the conclusion that the rule in *Houldsworth* does not operate to bar those claims absolutely as a matter of Cayman Islands law.

- 183 Although the judgments in *Houldsworth* do not speak in terms of the maintenance of capital it is that principle that underlies the rationale for the conclusion the House of Lords reached. The reason why the damages claim was excluded was because it would amount in substance to the shareholder claiming that which he had agreed to pay to meet the claims of creditors; see the judgment of Lindley LJ in *Addlestone*. Further, the principle of approbation and reprobation is essentially the same thing as maintenance of capital because what that principle is saying is that the shareholder cannot contract on the one hand to put the money in as a shareholder and on the other hand claim it back whilst the external creditors remain unpaid.
- 184 The answer to Mr Millett's submission on *Burgess's Case* was that that case was a rescission case and not a damages claim, so, unlike in *Houldsworth* itself, it is not a case concerned with the ability to bring a damages claim. Secondly, there is some doubt as Segal J pointed out whether it would still be followed today because it was not clear why the shareholder would not be allowed to rescind where all the creditors have been paid and there is no possibility of an adjustment to the rights of contributors because all the shares are fully paid up. The third problem with *Burgess's Case* is how, ignoring section 38(7) of the 1862 Act, it seems to rely on what was said in *Houldsworth* with Sir George Jessel MR stating that he was assisted by the dicta of Lord Cairns in *Houldsworth* where he remarked that it appeared to have been contended below that Mr Houldsworth might be able to claim against the company after all the other creditors were satisfied but the Winding-up Act had no provisions for the payment of claims against the company except the claims of creditors who were supposed to be paid *pari passu*, and there is no provision after they are paid for opening up fresh claims by a contributory against the company. There were provisions which, after the debts are paid, enabled any inequalities in the contributions of the contributories to be set right, but that was quite a different matter.

(c) A summary of Segal J's decision on the applicability of the *Houldsworth* rule - "the proof issue"

- 185 Segal J's conclusions on the proof issue are set out in paragraph [11] of his judgment and may be relevantly summarised as follows:
- (i). There was, before the legislative intervention in 1989, a common law rule in England to the effect that where a shareholder was not entitled to rescind his/her subscription contract after the commencement of the winding up the shareholder was not entitled to

prove in a winding up for damages for a misrepresentation which induced him/her to enter the subscription contract (“the no- proof proposition”).

- (ii) Properly understood, the rule only precluded such a shareholder from proving in competition with external (non-shareholder) creditors and did not give rise to an absolute bar on proof after non-member creditors had been paid in full (or were suitably provided for).
- (iii) This common law rule operated alongside the statutory regime governing the right to prove in a winding up. The English statutory code governing the winding up of companies was (and is) not considered to be complete and was (and is) subject to some long-established judge made (common law) rules including the no-proof proposition.
- (iv) The reasoning in the Australian and Bermudian cases does not undermine the reasoning that supports and justifies the no-proof proposition.

186 Segal J’s reasoning that led him to the conclusions expressed above is extensively and eloquently expressed in a large number of subsequent paragraphs in his judgment. We refer in particular to paragraphs [124], [131], [148], [150] [152], [162], [163], [164], [167], [168] that read as follows:

[124]. It seems to me to be clear that the English authorities establish that as a matter of English law, by 1989 the common law Maintenance of Capital Rule applied to any claim by a shareholder that if paid or admitted in a winding up would involve the company making a distribution out of capital to the shareholder otherwise than as permitted by the statutory rules; and that admission to proof (at least in an insolvent liquidation) of a claim by an original shareholder (who remained a shareholder in the absence of rescission) for damages for misrepresentation inducing entry into the subscription agreement was treated as such an impermissible distribution. It had been held that to permit such claims to be admitted in such a winding up would infringe the Maintenance of Capital Rule in that it would give rise to an indirect return of capital to the shareholders concerned.

[131]. It is undeniable that the facts in Houldsworth are distinguishable from those of this case, that it was decided in the context of shareholders as partners in unlimited companies having a liability to contribute and at an early stage in

the development of the concepts of corporate capital, corporate personality and the Maintenance of Capital Rule. But Houldsworth was one of a number of cases in the 1880s and 1890s (including *Tennent*, *Addlestone*, *Trevor v Whitworth*, *Ooregum* and *Salomon v Salomon*) which together settled the common law rules relating to these core concepts and together stand as authority for the no-proof proposition ...

[148]. In my view it is clear that a common law rule can affect and qualify a creditor's right to prove in a winding up so that it is wrong to say that the no-proof proposition cannot be regarded as good law because it is inconsistent with the statutory statement in section 139 of the Companies Act of what is provable. I do not regard the approach of the majority Justices of the High Court of Australia in *Sons of Gwalia*, in which they appear to regard all issues affecting the right to prove as being a bare matter of statutory interpretation, as consistent with the English cases, whose approach seems to me to be the right one.

[150]. Accordingly, the common law can establish a gloss on and overlay the statutory rules where it is consistent with the statutory regime. The no-proof proposition is consistent with the Companies Act in so far as it gives effect to a core policy of the companies legislation, being the Maintenance of Capital Rule ... Furthermore, section 139 does not purport to deal with whether particular causes of action entitle a creditor to prove. It stipulates that all liabilities that are otherwise properly admissible are provable whatever their legal character (for example whether they are certain or contingent, present or future).

[152]. If the Misrepresentation Claims are admissible but within and subject to section 49(g) then the right of the Misrepresentation Claimants to prove is suspended and subject to the no-competition principle. There is a qualified rather than an absolute prohibition designed to ensure that the rights of members as members come last and the right of creditors to have first recourse to capital is preserved (i.e. to give effect to the Capital Maintenance Rule). It might be said to follow that since section 49(g) gives effect to and ensures respect for the Capital Maintenance Rule, there is no need for a separate common law rule (the no-proof proposition) if damages claims by shareholders in deceit for their loss are within the sub-section (or at least there

is no need for an absolute bar on the admission to proof of such claims), so that cases can be decided solely by reference to and in reliance on the statutory subordination provisions (what I will label the “no need for an absolute bar principle”).

[162]. Lord Browne-Wilkinson in *Soden* clearly did not think that the existence of section 74(2)(f) (and before that of section 38(7)) of itself obviated the need for and was a basis for rejecting as good law the no-proof proposition, although the point was not argued.

[163]. I must say that I see the force of the no need for an absolute bar principle and for saying that there is no need for a common law rule that imposes an absolute and permanent prohibition on the right of the Misrepresentation Claimants to prove. Rather it imposes a qualified bar and works alongside and supports the regime established by section 49(g).

[164]. This is because (a) on the basis that a broad construction of section 49(g) is justifiable so that the Misrepresentation Claims are treated as subject thereto and (b) the relative ranking between the Misrepresentation Claims which will be admitted to proof once all external creditors had been paid, and the rights of shareholders to a distribution, is appropriate and justifiable.

[167]. It does not seem to me that allowing holders of redeemable shares to prove in the winding up for damages for misrepresentation unfairly or improperly prejudices the position of other holders of redeemable shares or shareholders (and therefore the rights and position of other shareholders does not require or justify treating the no-proof proposition as resulting in an absolute bar on the right to prove). It does seem to me that the Capital Maintenance Rule is designed primarily to protect creditors rather than members albeit that shareholders have an interest in ensuring that the company’s capital is maintained so that it can discharge its liabilities and conduct its business. But allowing the Misrepresentation Claimants to prove for damages in deceit after non-member creditors have been paid recognises that they are (also) creditors with a monetary claim against the company who are entitled to rank ahead of shareholders (who have no such claims). As between the shareholders inter se the redeemable shareholders with misrepresentation claims are, at common law, entitled to be treated as

creditors and have priority. The only limitation, which the reasoning in *Houldsworth* and progeny developed and spelt out, is that such shareholders with misrepresentation claims cannot claim as creditors in competition with non-member creditors when such claims involve in substance a return of the capital. It is true that on this approach the Misrepresentation Claimants are entitled to prove while they retain their shares but this does not prejudice the other shareholders because the Misrepresentation Claimants have to bring into account and reduce their claim by the value of the shares they retain. There is therefore no question of double recovery to the prejudice of the other shareholders (which would occur if the Misrepresentation Claimants could prove for their loss without giving credit for the value of the shares which they retain). Of course, the relative ranking of the monetary claims of holders of redeemable shares with rights under section 37(7), redemption creditors and with misrepresentation claims is also and primarily governed by section 37(7) and section 49(g) of the Companies Act, which I discuss in detail below.

[168]. I appreciate that, as I have explained, this approach has not been adopted in the English case law and that it is inconsistent with the decision in *Addlestone* where the preference shareholders were held to have no right to prove. It might also be said to be inconsistent with the cases on the "no rescission (sic) following the winding up" rule which reject the argument that the right to rescind should revive after all external creditors have been paid and the company is solvent. Furthermore, I can see that it can also be argued that since the statutory regime also provides for the subordination of the Misrepresentation Claims to non-member creditors it pre-empts and obviates the need for the common law rule. However, because it has never been held that the statutory subordination that started with section 38(7) of the 1862 Act has that effect, and because I can see that there may be benefits in retaining a consistent common law rule alongside the statutory regime, I have concluded that the preferable approach is to treat the no-proof principle as good law in the formulation I have set out (which seems to me to reflect, as I have explained, the underlying reasoning in the cases and the underlying policy and to present a rational and integrated view of the law in this area).

(d) The parties' submissions challenging, or alternatively, upholding, Segal J's decision to follow Houldsworth on the basis that the rule applies in favour of external creditors but does not apply where the external creditors have been paid or accounted for

187 The Eiffel Funds representing the interests of redemption creditors submitted that although Segal J was correct in law that the principle established by *Houldsworth* and later English cases that followed established a common law rule to the effect that a shareholder was not entitled to prove in a winding up for damages for misrepresentation (“the Misrepresentation Claim”) which induced them to enter into the subscription contract, Segal J erred in holding that the *Houldsworth* principle was qualified or limited such that it only precluded such a shareholder from proving in competition with external (non-member) creditors in respect of a Misrepresentation Claim and did not give rise to an absolute bar on proof in respect of such of a claim after non-member creditors had been paid in full (or were suitably provided for). In so erring Segal J wrongly treated the *Houldsworth* principle as one relating to priorities, whereas, properly characterised, it governed the question whether a Misrepresentation Claim lay at all once a winding up had supervened.

188 In his oral submissions on behalf of the Eiffel Funds, Mr Millett submitted that Segal J's qualification to the *Houldsworth* rule that permitted the admission of a proof for damages for misrepresentations inducing a subscription where all external creditors had been paid or would be provided for was novel and wholly unsupported by any authority, or academic text or extrajudicial view. There was no intermediate ground between the propositions (i) that *Houldsworth* is correct as a binding authority that a claim for damages by a shareholder for misrepresentations that induced a subscription contract that has not been, or cannot be, rescinded, is not admissible at all as a proof in the winding up of the company; and (ii) *Houldsworth* is not to be followed because misrepresentation claimants rank with external creditors under section 49(g). Section 38 (7) of the 1862 Act, the precursor to section 49(g) of the Companies Act, was before the House in *Houldsworth* and it is not credible to suppose that the members of the House and the members of the English Courts of Appeal in the years that followed, overlooked it. Moreover, section 49(g) only helps if one assumes that a misrepresentation claim for damages by a subscriber is admissible at all, which involves assuming that the twin pillars of principle that support *Houldsworth*, are for some reason inapplicable. The problem with Mr Smith's contention that section 49(g) (previously section 38 (7) of the 1862 Act) does all the work in respect of misrepresentation claims is that it is not credible to suppose that the members of the House of Lords in *Houldsworth* and the members of the successive Courts of Appeal in the years that followed, overlooked these provisions. Mr Smith's contention was as available in 1880 as it was when he advanced it at the hearing and

there is a good reason why those before the bar in *Houldsworth* and later cases did not advance it: it is a bad point.

- 189 Mr Millett also relied on the fact that it is plain that the members of the House of Lords in *Houldsworth* and of the English Courts of Appeal in the years that followed would have been well aware of section 38 (7) in response to Mr Smith's contention that Sir George Jessell MR in *Burgess's Case* should not have accepted and relied on Lord Cairns' judgment in *Houldsworth* that stated that there was no provision in the companies legislation to allow a claim in once all the external creditors had been paid off. He observed that they plainly proceeded on the basis that the *Houldsworth* rule applied independently thereof.
- 190 Mr Millett further contended that Segal J erred in not giving sufficient weight to the approbation/reprobation principle, the other twin pillar of the *Houldsworth* line of cases.
- 191 Mr Millett went on to focus on the position of the redemption creditors in the Direct Lending winding up on the basis that Segal J's view that misrepresentation claims can be proved if the external creditors have been paid or otherwise taken care of. We deal with these submissions in section C of this judgment below in which we consider the issues of priority that arise if misrepresentation claimants can prove as Segal J held in his judgment they could in these circumstances.
- 192 In his reply, Mr Thompson adopted Mr Millett's submissions criticising Segal J's decision that the *Houldsworth* rule did not bar misrepresentation claims if external creditors were all paid or otherwise dealt with. He went on to submit that the legislative abandonment of the *Houldsworth* rule was not a sound reason for concluding that the rule should not be followed in the Cayman Islands. Doyle J had been shown the Hansard Report in the House of Lords and the Law Society's paper on which the House of Lords relied in that debate. In Mr Thompson's submission, what had happened by the time of the debate was that there had been a partial abrogation of the principle by reason of the "Big Bang" legislation contained in the UK Finance Services Act of 1986 and it was quite clear from the Law Society's paper that that was done as part of the deregulation of the City of London, leaving an anomalous situation whereby the rule was not there for certain companies with certain types of prospectuses but was there for other companies.
- 193 Mr Thompson also argued that Mr Smith's submissions relating to the relationship of the subscription contract and the articles of association forming the statutory contract contemplated by Lord Browne-Wilkinson in *Soden* contemplated a more structured process than was the case. Instead of the putative shareholder enforcing the subscription contract using the right to apply

for the rectification of the company's share register, once the subscription contract had incepted the putative shareholder would be entitled to enforce it by seeking a decree of specific performance which would result in the shareholder's name going on the company's register of members.

- 194 Mr Thompson echoed Mr Millett's observation that it is not just external creditors who rely on the share capital of the company which can be shown by taking two examples. First, the company, with partly paid-up shares. If a potential investor was asked to subscribe for a round of such shares he would want to check who the other subscribers were and rely on the identity of the other shareholders in making his decision to invest. Secondly, take the case of fully paid-up shares. The potential investor would want to know what the share capital was and to ask himself if the other shareholders have put in enough money to keep the company going; or is the company thinly capitalised, which is exactly the scenario in HQP. It is therefore not only creditors that rely on share capital; it can also be relied on by subsequent investors and that is the immediate answer to the question whether the maintenance of capital is only there for the benefit of creditors.

(e) The decision on the appeal against Doyle J's decision on the proof of debt issue in the HQP proceedings

- 195 We begin by referring to a number of pertinent authorities on the weight to be given by Cayman Islands Courts to decisions of the House of Lords (now the Supreme Court) and decisions of the English Court of Appeal.

- 196 In *Schramm v Financial Secretary, Registrar of Companies* [2004-05 CILR 104], Collett JA stated in paragraph9:

*"Quite apart from the respect which this court pays to the decisions of established courts of similar jurisdiction in the Commonwealth, it was pointed out to us that the decisions in question were subsequently approved by the House of Lords in **Russian & English Bank v Baring Brothers & Co Ltd** [1936] AC. 405]. It is rarely, if ever, that a court at this level fails to follow a line of authority so established. We are not prepared to do so in this case since there is no compelling reason for us to do so."*

- 197 In the Privy Council case of *Frankland v R* on an appeal from a Manx court [1987-89 MLR 65], Lord Ackner, delivering the opinion of the Board, stated at p. 80:

"Decisions of the English courts, particularly decisions of the House of Lords and the Court of Appeal in England, are not binding on Manx courts, but they are of high persuasive authority. Such decisions should generally be followed unless either there is some provision to the contrary in a Manx statute or there is some clear decision of a Manx court to the contrary, or, exceptionally, there is some local reason for not following the particular English decision. The persuasive effect of a judgment of the House of Lords, which has largely the same composition as the Judicial Committee of the Privy Council, the final Court of Appeal from a Manx court, is bound to be very high."

- 198 In *de Lasala v de Lasala* [1980] AC 546, the Privy Council held that recent Hong Kong family law legislation whose wording and legislative history were the same as that of its English counterpart should be interpreted by the Hong Kong courts following any decision of the House of Lords as to the interpretation of the English legislation as if it were binding on the Hong Kong courts. The opinion of the Board was given by Lord Diplock who said at p.558 C-F:

"Different considerations in their Lordships' view, apply to decisions of the House of Lords on the interpretation of recent legislation that is common to Hong Kong and England. Here there is no question of divergent development of the law. The legislature in Hong Kong has chosen to develop that branch of the law on the same lines as it has been developed in England, and, for that purpose, to adopt the same legislation as is enforced in England and falls to be interpreted according to English canons of construction. What their Lordships have already said about a common membership of the Judicial Committee of the Privy Council and the Appellate Committee of the House of Lords applies a fortiori to decisions of the House of Lords on interpretation of recent English statutes that have been adopted as the law of Hong Kong. Since the House of Lords as such is not a constituent part of the judicial system of Hong Kong it may be that in juristic theory it would be more correct to say that the authority of its decision on any question of law, even the interpretation of recent common legislation can be persuasive only: but looked at realistically its decisions on such a question will have the same practical effect as if they were strictly binding, and courts in Hong Kong would be well advised to treat them as being so".

- 199 In *National Trust for Cayman Islands v Planning Appeals Tribunal* [2002] CILR 59, Sanderson J observed in [19] that in *de Lasala v de Lasala* the Privy Council stated that on questions of the common law, a decision of the House of Lords was of very great persuasive authority locally because of the common membership of those courts save where circumstances locally make it inappropriate to do so.

200 In *Miller v R* (a criminal appeal) [1988CILR 161], Zacca P. stated:

"A decision of the English Court of Appeal, while not formally binding upon this court automatically, is necessarily one of great persuasive authority, especially where it is unanimous and is directed towards a doctrine of the common law."

201 We turn to the judgment of Doyle J on the proof issue. In our judgment, with great respect to Doyle J, his decision not to recognise and apply the *Houldsworth* rule that a shareholder is not entitled to:

- (i) rescind a share subscription contract induced by an actionable misrepresentation made by the company after the commencement of the company's winding up; and
- (ii) prove in the winding up for a claim against the company for the resulting loss,

cannot stand.

202 Although the rule has the sobriquet "Houldsworth", it is the product not only of the 1880 decision of the House of Lords but also the subsequent decision of the English Court of Appeal in *Addlestone*, the decision of Sir George Jessel MR in *Burgess's Case* and the decision of the House of Lords in *Soden* (adopting the important decision of the Australian High Court in *Webb*). The rule is a long-standing common law rule that existed alongside the insolvency provisions in the UK companies legislation, including in particular section 74(2)(f) of the UK Insolvency Act 1986 and its UK predecessors (the equivalent of section 49(g) of the Cayman Islands company legislation), until its abrogation in 1989 by legislative intervention. It is a rule soundly based on the principle of the maintenance of capital as explained in *Addlestone*, *Burgess's Case*, *Webb* and *Soden*, which are decisions of high persuasive authority with significant direct relevance to the issues arising from HQP's insolvency governed by statutory provisions that are the equivalent of English provisions. For these reasons, the rule ought to have been adopted and followed, notwithstanding the criticism of the rule in the text books and academic articles referred to by Doyle J; the legislative abrogation of the rule in England and elsewhere in the Commonwealth; and the decision of the Australian High Court in *Sons of Gwalia*.

203 True, the rule was abrogated in England by statute in 1989, but we accept Mr Thompson's submission that the reasons for this step were principally driven by a perceived need to avoid possible inconsistencies arising from legislation introduced in preparation for the "Big Bang" deregulation of the City of London, rather than by a settled conclusion that the rule was wrong in principle.

- 204 More to the point, in the intervening 35 years, the Cayman Islands has not chosen to abrogate the rule by statutory intervention and it is to be noted that during this period Chief Justice Smellie proceeded on the basis that the rule applied in the Cayman Islands when making the following (obiter) observation in *Re SPhinX Group* [2010 (2) CILR1]:

“On the long-standing authority of the House of Lords' decision in Houldsworth...., the SPhinX companies having been placed into liquidation, an investor seeking rescission of his share purchase contract and restitutio in integrum on the grounds of misrepresentation may well no longer have available to him such remedies. For the SPhinX companies, having long since been placed in liquidation and all their assets and liabilities subject to the liquidation regime through the courts, such remedies are no longer possible. Investors must therefore resort only to such rights as their shares might afford them in the context of the liquidation of the SPhinX estates.”

- 205 In the Bermuda decision in *Televest Ltd*, Ground J declined to follow the *Houldsworth* rule on the ground that the case before him involved a limited company whose shares were fully paid up whereas in *Houldsworth* the company concerned was an unlimited partnership where the shareholder partners had accepted individual responsibility for the company's debts. In doing so, apart from noting that in *Addlestone* the rule was applied where the claim against the company was for breach of a contract made between the applicant and the company, Ground J failed to consider the justification for the rule founded on the maintenance of capital principle articulated in *Addlestone*, Professor Gower's 2nd edition (1957) of his acclaimed text book on Company Law, or *Webb*.

- 206 With respect to Doyle J, we do not think that the decision of the Australian High Court in *Sons of Gwalia* affords a sound basis for concluding that the *Houldsworth* rule should not be recognised as part of the common law of the Cayman Islands. The causes of action sued on in that case were derived from consumer protection legislation, not tortious fraudulent misrepresentations made by the company, and the High Court held that the crucial question was whether the claimants' claims were made in their capacity as members so as to be caught by section 563A of the Corporations Act 2001 (the effective equivalent of section 49(g)), which was answered in the negative. Further, the claimants were not subscribers for shares in the company but had purchased their shares in the market so that, as explained by Lord Browne-Wilkinson in *Soden*, the satisfaction of their claims would not in any event breach the maintenance of capital principle, in contrast to the satisfaction of claims made by subscription claimants in the HQP proceedings. In addition, it is reasonably arguable that the High Court's disregard for the *Houldsworth* rule, based as it is on the maintenance of capital principle, in favour of exclusively considering the application of section 563A, a priorities provision, was

an unsatisfactory approach, leading as it did to a statutory reversal of the decision to permit the claimants to prove in competition with the ordinary creditors of the company.

207 Finally, Doyle J's justification for declining to accept and apply the *Houldsworth* rule based on the ground that the rule is inconsistent with the meaning and effect of section 139 of the Companies Act, ignores the fact that the 1862 Act contained the equivalent provision in the form of section 158 and it is simply not credible implicitly to suggest that the House of Lords overlooked this provision in deciding *Houldsworth* or that Kay J and the Court of Appeal overlooked it in *Addlestone*.

208 For the reasons given in paragraphs [195] – [207] above, we allow the appeal against the decision of Doyle J so far as concerns the bar on proof question but the application of the *Houldsworth* rule in the HQP proceedings will be subject to the implications of our decision on the appeal against Segal J's decision in the Direct Lending case, to which we now turn.

(f) The decision on the appeal against Segal J's decision on the bar on proof question in the Direct Lending proceedings

209 We agree with and uphold the conclusions reached by Segal J set out above in paragraph [185]: (i) (confirmation of the common law *Houldsworth* rule in English law down to legislative intervention in 1989); (iii) (the common law rule operated alongside the statutory regime governing the right to prove in a winding up); and (iv) (the reasoning in the Australian and Bermudian cases does not undermine the reasoning that supports and justifies the *Houldsworth* rule).

210 Turning to conclusion (ii) (properly understood, the rule only precluded such a shareholder from proving in competition with external (non-shareholder) creditors and did not give rise to an absolute bar on proof after non-member creditors had been paid in full (or were suitably provided for)), we accept that the purpose and intent of the *Houldsworth* rule as developed in *Addlestone*, *Burgess's Case* and explained in *Webb* and (implicitly) in *Soden* was to protect the interests of non-shareholder creditors by application of the maintenance of capital principle confirmed in *Trevor v Whitworth* and *Ooregum*. But in our view the rule did not contemplate allowing shareholder creditors to prove for loss caused by misrepresentations made by the company that had induced the subscription contract by which they had become a shareholder if the creditors had all been paid or otherwise taken care of. In our judgment this is clear from the House of Lords' decision in *Houldsworth* and the rejection of the preferred shareholders' claim in *Addlestone* and the decision in *Burgess's Case*.

- 211 However, we agree with Segal J's conclusion that, where the company's creditors *have* been paid or dealt with, the *Houldsworth* rule should not prevent a subscription shareholder from proving in the winding up of the company in competition with other shareholders for loss incurred by relying on a misrepresentation made by the company that induced the subscription contract. In our view, Segal J's reasoning for this conclusion is compelling. Such misrepresentation claimants are creditors of the company and if the external creditors have been paid or dealt with they ought to be able, consistently with sections 49(g) and 37(7), to prove for their claims. True, they may remain shareholders but if it be necessary that they rescind their subscription contracts, they should be permitted to do so in light of the fact that they are not competing with external creditors.
- 212 In *Frankland v R* (op cit)³³ Lord Ackner recognised that it could be appropriate for a Manx Court (a near equivalent to a Cayman Islands Court) not to follow a decision of the House of Lords or a decision of the English Court of Appeal where there is some local reason for not following a particular English decision. In our view, the large number of open ended investment funds incorporated in the Cayman Islands in which investors purchase their investment by subscribing for redeemable shares and where, in a liquidation, it is to be expected that the total debts owed by the company to external creditors will be much smaller than the total of the claims made by shareholders who had served dishonoured pre-liquidation redemption notices, is a very good reason for limiting the application of the *Houldsworth* rule to situations where there are insufficient assets to pay the external creditors or otherwise to see that they are provided for.
- 213 We accordingly uphold Segal J's decision in the Direct Lending proceedings for the reasons we have given. At the same time, we would observe that the impact of Segal J's decision on liquidations generally in the Cayman Islands is likely to be limited because we expect there will be a great many where there are insufficient assets to pay external creditors or ensure they are dealt with, in consequence of which the *Houldsworth* rule will apply in its full vigour.

C. THE PRIORITY QUESTION

- 214 The conclusion expressed above means that it is necessary to consider the relative priorities of the misrepresentation claimants and the redeeming shareholders. It is a consequence of our decision on the bar on proof question that collectively they rank behind external creditors, since

³³ See paragraph [197] above.

none of them can prove until the external creditors have been paid or provided for; but nothing in the above analysis indicates the order in which non-external creditors are to rank.

215 In Direct Lending, the contest is between misrepresentation claimants, redeeming shareholders and other shareholders. In HQP, it is between misrepresentation claimants and redeeming shareholders (all shareholders having given notice to redeem). However, it is to be noted that the position of redeeming shareholders is different in the two cases. In Direct Lending the redeeming shareholders ceased to be members on giving notice to redeem, even though they were not paid, and became creditors instead. In HQP, however, redeeming shareholders remained shareholders until payment, which had not occurred at the commencement of the winding up; and as stated above one consequence of the *Houldsworth* rule is that they cannot now rescind the contract by which they acquired their shares. They are therefore still shareholders. It is also to be noted that in neither case do any of the redeeming shareholders fall within section 37(7) of the Companies Act, although as appears below the section is said to have relevance to the priority question in Direct Lending.

216 It is necessary to note too that the claims of all the misrepresentation claimants are founded on the assertion that they were induced by the company's misrepresentations to subscribe for shares in the company (and in some cases in HQP, to agree to the subsequent issue of shares with higher priority in the contractual waterfall). Unlike *Soden*, this is not a case where any of the misrepresentations induced an open market purchase of the company's shares.

217 Finally by way of preamble, it is notable that although section 49(g) of the Companies Act contemplates a final adjustment of the rights of the contributories amongst themselves, it does not prescribe the basis on which any adjustment is to be made. Some things are clearly to be taken into account, for example contractual rights attaching to classes of shares such as the contractual waterfall in HQP; but factors relevant to the adjustment are to be found, if at all, not in the section itself but in rights and obligations arising externally to it.

218 We have summarised the parties' contentions on the priority question in paragraphs [41] to [46] above. Further reference to their contentions will be made as necessary in the discussion below.

(1) The position of the misrepresentation claimants

219 It is desirable to consider first the position of the misrepresentation claimants.

220 Key to that consideration is the effect of section 49(g) of the Companies Act. The subsection is set out in paragraph [8] above. It is concerned with priority as between external creditors and

shareholders with claims against the company; but for present purposes the question is whether the amount payable to a successful misrepresentation claimant is a “sum due to any member of the company in that person’s character of a member by way of dividends, profits or otherwise”. If it is, the stated consequence is that the claim is deferred to that of “any other creditor not being a member of the company”. This is of course the position anyway so far as regards external creditors, because of the application of the *Houldsworth* rule as we have interpreted it. If, on the other hand, the amount payable to a misrepresentation claimant is not such a sum, the claims of misrepresentation claimants are liabilities of the company which, but for the rule in *Houldsworth*, would rank equally with external creditors and therefore in priority to shareholders.

221 As we have indicated, Doyle J and Segal J came to different conclusions on this point.

222 Doyle J’s view was stated in paragraph [199] of his judgment as follows.

“Section 49(g) of the Companies Act (2023 Revision) does not apply to misrepresentation claims. These debts are not debts due to Preferred Shareholders in their capacity as members and any sums due to those successfully advancing misrepresentation claims would not be due to them under the statutory contract between members and the company and the members inter se constituted by the relevant statutory provision. I do not find Lord Browne-Wilkinson’s obiter comment in Soden on “negative claims” relied upon by Mr Millett persuasive. I agree with Mr Levy that a subscription contract is necessarily anterior to and separate from the statutory contract. A claim for misrepresentation as envisaged in the case presently before me arises from a tort independent to the statutory contract. The cause of action is not founded on the rights arising by virtue of and derived from the statutory contract. There is considerable force in Mr Levy’s submission that on Lord Browne-Wilkinson’s own analysis, a claim for damages for misrepresentation in the sense relevant to the case presently before me is not a claim brought “in the character of a member”. This position is also strongly and persuasively supported by Sons of Gwalia (see in particular Gummow J at [52], [87]-[93]; Hayne J at [205] and [206]). I appreciate that on this ranking point Sons of Gwalia has in effect been abandoned by the Australian Parliament apparently following representations by the lending industry. I nevertheless still find the judicial reasoning on this ranking point highly persuasive”.

223 Segal J summarised his view on this aspect as follows at paragraph [12] of his judgment (quoted above but repeated here for ease of reference).

“I have, as already noted, held that the Misrepresentation Claims are not provable in competition with the claims of non-member creditors but are provable once external creditors have been paid (or fully and properly

*provided for). This ranking is the result of both the no-proof proposition and section 49 (g) of the Companies Act. In my view, the Misrepresentation Claims are subject to section 49 (g) since they are “due to [a] member of a company in that person’s character of a member by way of dividends, profits or otherwise”. As a result they are not “deemed to be a debt of the company, payable in... competition [with]... any other creditor not being a member of the company”. I consider that the reasoning of Lord Browne-Wilkinson in **Soden v British & Commonwealth Holdings plc** [1998] AC 298 is sound and represents the law in this jurisdiction and, furthermore, is to be preferred to that of the majority of Justices in the High Court of Australia in **Sons of Gwalia Ltd v Margaretic** [2007] 3 LRC 462”.*

224 It is desirable also to quote some of the detailed analysis of Segal J appearing at paragraphs [253]-[260] of his judgment. He said this:

[254] *“It seems to me that section 49(g) is to be understood and interpreted as regulating the right of shareholders to prove in a winding up so as to give effect to and ensure respect of the Maintenance of Capital Rule ... The claims of shareholders relating to or derived from the contribution of capital cannot compete with and must rank after the claims of non-member creditors. The damages claims of holders of redeemable preference shares must, in my view, be characterised and treated as claims relating to or derived from their contribution of capital”.*

[255] *“I have already explained that I consider that the damages claim by original holders of redeemable preference shares provides them with compensation for (and to that extent can be said to represent), the value of what they paid on subscription.... They are therefore seeking to recover a sum representing their capital contribution. In the absence of rescission, they remain a shareholder and receive back the value of what they paid for the shares. To allow a claim for damages for misrepresentation made by the company inducing the subscription for shares in competition with the general body of creditors would, in substance, result in a return of capital”....*

[260] *“The cause of action in deceit relates to the shareholder’s continuing rights as a member (since he/she is unable to rescind the subscription contract and remains a member) and seeks compensation calculated by reference to the amounts subscribed as capital. He/she is not claiming that he/she has never been a member but has suffered loss as a result of dealings with the company. The substance of the claim, as I have said, is to recover the value and financial equivalent of the shareholders’ capital contribution, which contribution is an obligation derived from the company’s constitution and statute and arises because of his/her status as a member”.*

225 In our judgment, Segal J’s analysis is correct. As he indicated, the key lies in the proper characterisation of the misrepresentation remedy. Each of the misrepresentation claimants remains a member of the relevant company; and their essential claim, based upon their assertion

that they would not have become members at all but for the misrepresentations, is for damages reflecting the sum paid for the shares (no doubt giving credit for such value as the shares may have, and for any dividends or other benefits received in respect of them). In essence, the claim is for the return of the contributions to the company's capital which the member is required by the subscription contract and the articles to make. The subscription moneys were paid to acquire the character of a member, and the claim to what is in effect their return is similarly made in the character of member. In this respect, the position differs from a position in which the fact that the claimant is a member of the company is entirely incidental – such as a contract for supply of goods to the company, or damages arising from the supply by the company to the member of defective goods pursuant to such a contract. His position is distinguishable also from a situation such as that in *Soden*, where the claim is based upon an open market purchase and the measure of damages is not the subscription price but the price payable pursuant to the purchase.

226 We consider that the weight of authority supports this conclusion. We have already referred to the relevant cases in the context of the discussion of the *Houldsworth* rule. They are *Addlestone*, *Webb* and *Soden*.

227 In *Addlestone*, Kay J held that the claim fell within section 38(7) of the Companies Act 1867 (the progenitor of section 49 (g)). We have quoted what he said in paragraph [103] above, and it is not necessary to repeat it in full here; but it is clear that his view was that the claims were made in the character of members and fell within the expression “by way of dividends, profits or otherwise”. On appeal, the main focus was on the *Houldsworth* principle; but Cotton LJ said in relation to the section 38(7) point that “I think it would have been very difficult to come to the conclusion that they could compete with the outside creditors”, and Lopes LJ said that he agreed with the construction put by Kay J on section 38(7).

228 We have set out the facts in *Webb* in paragraph [108] above, and in paragraph [109] have pointed out that section 360(1)(k) of the Companies (Vic) Code is broadly equivalent to section 49(g). Relevantly to the present discussion, the majority of the High Court of Australia said this (1993)11 ACSR 731, 741:

“Paragraph (k) of section 360(1) will not prevent claims by members for damages flowing from a breach of contract separate from the contract to subscribe for the shares.... But, in the present case, the members seek to prove in the liquidation damages which amount to the purchase price of their shares, which is a sum directly related to their shareholding. Moreover, they sue as members, retaining the shares to which they were entitled by virtue of entry into the agreement and they seek to recover damages because the shares are not what they were represented to be.

Accordingly, the claim falls within the area which section 360(1)(k) seeks to regulate: the protection of creditors by maintaining the capital of the company”.

As the English Court of Appeal said in *Soden* at p. 314 F-G:

“[Webb] is therefore of high persuasive authority for the proposition that damages in tort for misrepresentation by a company as to the nature of its shares, which induces a contract to subscribe for shares in the company, come within section 74(2)(f). The decision supports the views on section 38(7) expressed in [Addlestone] and the two cases are in all material respects but one identical, the only difference being that the claim in [Webb] was in tort and not contract”.

229 The case we regard as most compelling is *Soden* itself. Our discussion of this case starts at paragraph [119] above, and some of the passages from the Opinion of Lord Browne-Wilkinson are already set out there. Since they represent the reasoning of the House of Lords, however, it is useful to set out what he said again.

“Section 74(2)(f) requires a distinction to be drawn between, on the one hand, sums due to a member in his character of a member by way of dividends, profits or otherwise and, on the other hand, sums due to a member otherwise than in his character as a member. In the absence of any other indication to the contrary, sums due in the character of a member must be sums falling due under and by virtue of the statutory contract between the members and the company and the members inter se constituted by section 14(1) of the Companies Act 1985.... To the bundle of rights and liabilities created by the memorandum and articles of the company must be added those rights and obligations of members conferred and imposed on members by the Companies Acts. For ease of reference I will refer to the combined effect of section 14 and the other rights and liabilities of members imposed by the Companies Acts as “the statutory contract”. In my judgment, in the absence of any contrary indication sums due to a member “in his character of a member” are only those sums the right to which is based by way of cause of action on the statutory contract.... The words “by way of dividends, profits or otherwise” are illustrations of what constitutes sums due to a member in his character as such. They neither widen nor restrict the meaning of that phrase. But the reference to dividends and profits as examples of sums due in the character of a member entirely accords with the view I have reached as to the meaning of the section since they indicate rights founded on the statutory contract and not otherwise.... If this is the correct dividing line between sums due in the character of a member and those not so due, there is no room for including in the former class cases where membership, though an essential qualification for acquiring the claim, is not the foundation of the cause of action. This is illustrated by the decisions on directors’

remuneration.... Although membership is a necessary qualification for appointment as a director, the cause of action to recover the remuneration is not based on the rights of a member but on a separate contract to pay remuneration.... If there had been a cause of action in the Addlestone case, it must, as it seems to me, have been based upon the statutory contract between the member and the company. “Dividends” and “profits” represent what might be called positive claims of membership; fruits which have accrued to the member by virtue of his membership. **But the principle must apply equally to negative claims, claims based upon having paid money to the company under the statutory contract which the member says that he is entitled to have refunded by way of compensation for misrepresentation or breach of contract. These, too, are claims necessarily made in his character as a member.** But, in any event, the reasons given by Kay J for treating the case as falling within section 38(7) are directed exclusively to matters relevant to a claim involving the issue of shares by the company but irrelevant to a claim relating to the purchase of fully paid shares from a third party. Under the statutory contract (including the obligation in the winding up to pay all sums not previously paid on the shares) the claimants were bound to pay the unpaid £2 10s. in respect of each share. If such a payment were not made the capital of the company would not be maintained and the general body of creditors would be thereby prejudiced. If, in such a case, the member could recover by way of damages for breach of the contract to issue the shares at a discount the same amount as he was bound to contribute on the winding up that would indirectly produce an unauthorised reduction in the capital of the company.... There is nothing in the Addlestone case to justify the application of that decision to cases where the claim against the company is founded on a misrepresentation made by the company on the purchase of existing shares from a third party. To allow proof for such a claim in competition with the general body of creditors does not either directly or indirectly produce a reduction of capital. The general body of creditors are in exactly the same position as they would have been in had the claim been wholly unrelated to shares in the company. The decision of the High Court of Australia in the Webb case... stands on exactly the same footing.... It is therefore quite clear that both the decision and the reasoning of the High Court were dependent upon the same factors as those in the Addlestone case, i.e. the protection of creditors from indirect reductions of capital. Those are factors relevant to cases of subscription for shares issued by the company but wholly irrelevant to purchases from third parties of already issued shares.... All that is necessary for the decision of the present case is to demonstrate, as I have sought to do, that the decisions in Addlestone ... and Webb... do not apply to claims other than those relating to the issue of shares by the company” (emphasis added).

- 230 We acknowledge that the passage we have emphasised is obiter, since the decision was that the proposition enunciated in that passage did not apply to a case of an open market purchase. However, the case is of the highest authority; and we in any event find the reasoning convincing,

based as it is firmly in the reduction of capital rule which is itself the foundation of the *Houldsworth* principle.

- 231 We acknowledge also that the decision of the High Court of Australia in *Sons of Gwalia* (see paragraph [129] et seq above) is to different effect. On this aspect, we think that the effect of the decision is accurately summarised in the headnote to the report of the case at [2007] 3 LRC 462 as follows:

“An obligation did not fall within s563A unless there was a connection between the obligation and membership of the company and the obligation which the respondent sought to enforce against the company was not founded on any rights he obtained or any obligations he incurred by virtue of his membership of the company and was not an obligation which the 2001 Act created in favour of a company’s members. He was not seeking to recover any paid-up capital, or to avoid any liability to make a contribution to the company’s capital and his claim would be no different if he had ceased to be a member at the time it was made, or if his name had never been entered on the register of members.”

- 232 The decision in *Sons of Gwalia*, and the reasoning supporting it, were driven by the fact that this was a case of acquisition of shares in the open market. The same is of course also true of *Soden*. It is easier in those circumstances to come to the conclusion that a claim is not made in the capacity of a member, in particular because it does not in substance involve a return of capital. However, *Addlestone* and *Webb* both concern cases of contracts to subscribe, and the rationale for the conclusion that a misrepresentation claim in that situation is based on the statutory contract and so made in the capacity of member is clearly expressed by Lord Browne-Wilkinson in his reference to negative claims. As we have acknowledged, the reference is undoubtedly obiter; but so are the statements in *Sons of Gwalia*, whereas those in *Webb* are not. We repeat that we find Lord Browne-Wilkinson’s description of the rationale persuasive. In particular, it is consistent with our conclusion as to the underlying rationale of the *Houldsworth* rule, and we would follow it even if it did not represent the concluded view of the House of Lords.

- 233 Mr Levy KC suggested that Lord Browne-Wilkinson’s identification of what he described as the statutory contract was unsatisfactory, since it conflated the subscription contract with the articles and the rights and obligations derived from statute. Only the latter two correctly constituted the statutory contract: it was only they which defined the rights and obligations of members inter se and in relation to the company, and it was only claims based on the articles or the statutory rights which constituted claims made in the capacity of a member. The subscription contract was no more than a preliminary to the creation of the statutory contract and formed no

part of it; and claims asserting that the subscription contract was procured by misrepresentation were accordingly not made in the character of member. We do not agree. The articles and the statutory framework bind those who are members, and the subscription contract is the route by which membership is created and the statutory contract comes into existence as regards the member. A claim whose essence is the avoidance of the subscription contract is a claim whose essence is also the avoidance of the statutory contract. It may properly be described as a negative claim based on the statutory contract.

234 The position thus reached is that the claims of misrepresentation creditors in both the cases under appeal are claims made in their character of members. They are nevertheless creditor claims, and the question then arises as to whether they have priority over the redemption shareholders in either case (or, in Direct Lending, over the general body of shareholders who are not redemption shareholders). Once again, that issue was determined differently by Doyle J and Segal J.

235 Having decided that the *Houldsworth* rule did not apply and misrepresentation claims were not claims made in the character of a member, Doyle J simply treated the misrepresentation claimants as ordinary creditors having priority over all shareholders, including redeeming shareholders. He said this:

“200. Furthermore, the contractual waterfall set out in the Articles is not applicable. Article 102 of the Articles provides that if the company shall be wound up, the assets available for distribution amongst the members shall be distributed in accordance with section 2 of Schedule A. I agree with Mr Levy that Article 102 applies to the members in their capacity as members and the debts arising from misrepresentation claims are not debts arising in their capacity as members. The cause of action in tort is not based on the statutory contract. The debts are not member debts, they are creditor debts of those who are determined to have valid claims based on misrepresentations prior to becoming members. I do not agree that section 2(c) of Schedule A is wide enough to cover debts arising from damages claims for misrepresentation.

201. In respect of Issue 3 I have decided that I should direct that the Liquidators may proceed with the conduct of the liquidation on the basis that the claims of any admitted proofs of debt submitted by Preferred Shareholders in respect of damages for misrepresentation against the Company shall rank as unsecured debts of the Company”.

236 Immediately relevant parts of Segal J’s judgment are as follows:

“262 Eiffel argues that the redemption creditors rank ahead of all other shareholders who have claims subject to section 49(g) including the Misrepresentation Claimants and of unredeemed holders of redeemable shares with rights under section 37(7)(a).

263 Eiffel’s main point seems to be that this conclusion follows from the conversion of holders of redeemable shares into creditors upon giving notice to redeem. This status means that in the “final adjustment of the rights of the contributions amongst themselves” they are entitled to a higher ranking than those who remain shareholders at the date of the winding up. Their claims should only be subordinated to those of non-member creditors. Being creditors, and having become creditors before the commencement of the winding up, they are entitled to a superior ranking and status to that of mere shareholders. Eiffel says that the priority of the redemption creditors’ claims would then be the same as the outcome of a successful claim made under section 37(7)(a), which ranks ahead of other shareholder claims by virtue of section 37(7)(b).

264 I do not accept that this argument justifies giving the redemption creditors, or treating them as having, priority over the Misrepresentation Claimants. Eiffel’s analysis does not apply to the Misrepresentation Claimants. The Misrepresentation Claimants’ cause of action in deceit arose prior to the winding up and to that extent they are also creditors before the commencement of the winding up. I do not accept that the adjustment between member claims referred to in section 49(g) requires or permits the Court to order that the Late Redeemers rank and should be paid ahead of the Misrepresentation Claimants. Once the external non-member creditor claims have been paid in full both the Late Redeemers and the Misrepresentation Claimants are member creditors in respect of liabilities owing by DLIFF. The fact that the Late Redeemers gave notice to redeem prior to the commencement of the winding up does not justify such priority. The time at which the shareholder became a creditor, provided that they were a creditor before winding up, does not govern priorities (if timing were key, it could be said that the Misrepresentation Claimants’ cause of action in deceit arose and was complete before the shareholders who had given notice to redeem became creditors, depending on when the Misrepresentation Claimants were able to say that they had suffered damage)”.

(2) The position of the redeeming shareholders

237 As with the position of misrepresentation claimants, we think it is useful to consider the position of redeeming shareholders as a precursor to identifying how they rank in relation to misrepresentation claimants.

238 We have already pointed out that a distinction is to be drawn between the redemption shareholders in Direct Lending and those in HQP. In Direct Lending, the effect of giving notice

of redemption was that a redeeming shareholder ceased to be a shareholder and became a creditor, regardless of the fact that payment was not made; whereas shareholders in HQP who attempted to redeem have only the status of shareholders.

239 The fact that redemption shareholders in Direct Lending have the status of creditors has a consequence in terms of the priority to be accorded to them. As explained in *Pearson v Primeo Fund* [2017] UKPC 19 (“Primeo”, the consequence is that they are entitled, by virtue of their status as creditors, to priority over the other shareholders - see per Lord Mance at paragraph 32: “Primeo, as a former member, ranks after creditors who were not formerly members, but ahead of all current members”. No such preferential treatment is available to redeeming shareholders in HQP: they are not creditors at all.

240 Against that background, how do redeeming shareholders rank in relation to misrepresentation creditors?

(3) Priority in Direct Lending

241 So far as Direct Lending is concerned, we consider that Segal J’s conclusion and reasoning is correct. Mr Millett KC criticised that reasoning on two main grounds: first, that it failed to give proper weight to the fact that the redeeming shareholders were no longer shareholders, whereas the misrepresentation claimants remained such; secondly, that it failed to give proper weight to the position of shareholders seeking to redeem within section 37(7) of the Companies Act.

242 As to the first of these grounds, Mr Millett accepted that the redeeming shareholders fell within section 49(g), since that section applied to former shareholders (see *Primeo* at paragraphs 30-31); but he contended that they did so only for the purpose of deferring to external creditors, and that as against all other persons and in reality they had only the status of creditor and as such were superior to all mere shareholders, including the misrepresentation claimants.

243 We do not accept this contention. The question is as to the relative ranking of “sums” falling within section 49(g). The amounts due to the redeeming shareholders and successful misrepresentation claimants are such sums. For the purposes of section 49(g), both redeeming shareholders and misrepresentation claimants are to be treated as members: it is irrelevant that for other purposes the redeeming shareholders have ceased to be shareholders. That fact does not create a point of difference sufficient to justify priority in the adjustment contemplated by section 49(g). Nor does the fact that the redeeming shareholders are creditors: so are the

misrepresentation claimants. Both of them are entitled to priority over other shareholders, but there is nothing to distinguish them from each other so as to affect the priority between them.

244 Mr Millett's second ground is based on the position of attempted redeemers falling within section 37(7). There are no such attempted redeemers in either case, but we accept that the point is nevertheless capable of having relevance.

245 Section 37(7) is in the following terms.

“(a) Where a company is being wound up and, at the commencement of the winding up, any of its shares which are or are liable to be redeemed have not been redeemed or which the company has agreed to purchase have not been purchased, the terms of redemption or purchase may be enforced against the company, and when shares are redeemed or purchased under this subsection they shall be treated as cancelled.

Provided that this paragraph shall not apply if

(i) the terms of redemption or purchase provided for the redemption or purchase to take place at a date later than the date of the commencement of the winding up; or

(ii) during the period beginning with the date on which the redemption or purchase was to have taken place and ending with the commencement of the winding up the company could not, at any time, have lawfully made a distribution equal in value to the price at which the shares were to have been redeemed or purchased.

(b) There shall be paid in priority to any amount which the company is liable by virtue of paragraph (a) to pay in respect of any shares

(i) all other debts and liabilities of the company (other than any due to members in their character as such); and

(ii) if other shares carry rights whether as to capital or as to income which are preferred to the rights as to capital attaching to the first mentioned shares, any amount due in satisfaction of those preferred rights, but subject to that, any such amount shall be paid in priority to any amounts due to members in satisfaction of their rights (whether as to capital or income) as members.”

246 Mr Millett's argument was that a shareholder coming within section 37(7)(a) (ie one who was entitled to redeem before the winding up in circumstances where the company could have paid the redemption price) has by section 37(7)(b) priority over “any amounts due to members in satisfaction of their rights (whether as to capital or income) as members”; that that includes priority over amounts payable to misrepresentation claimants, which – because they come within section 49(g) – are amounts due to them in satisfaction of their rights as members; and that it would be extraordinary if shareholders who had in fact redeemed had lesser priority than that accorded to those who were merely entitled to redeem. Reference was made to *Primeo* in

the Privy Council and in this court (for the latter see *Herald Fund SPC (in official liquidation)* [2016 2 CILR 330] - “*Herald*”) and to *Somers Dublin Ltd v Monarch Pointe Fund Ltd.*, Eastern Caribbean Supreme Ct. (BVI C.A.), Case No. HCVAP 2011040, 11 March 2013, unreported (“*Somers*”).

247 In *Primeo* Lord Mance pointed out the difficulties raised by the language of sections 37(7) and 49. He said this:

“33. This language raises some questions. Are the references to (1) debts and liabilities “due to members in their character as such” and (2) “amounts due to members in satisfaction of their rights (whether as to capital or income) as members” references to the same subject matter? Are both or either of (1) and (2) references to past and current members? The phrase “members in their character as such” in (1) might be seen as paralleling the later phrase “any member of a company in his character of a member” in s.49(g). But the two are not identical, and it should be borne in mind that ordinary redeemable shares only entered English law through s.45 of the Companies Act 1981, later consolidated as s.159(1) of the Companies Act 1985. Similarities with pre-existing language of the entirely different s.212(1) of the Companies Act may not be as significant as might at first glance appear. Further, the reasoning adopted in English authority on the English equivalent of s.49 shows that the significance of any reference to “member” is highly contextual.

34. If the answer to the questions posed in the previous paragraph is that both (1) and (2) refer to past and current members, the (on its face incongruous) result would be that s.37(7) claimants, who had not (due to the company’s default) achieved redemption but were entitled to enforce it in the winding up would rank higher in priority than those like *Primeo*, who had achieved redemption, but had simply not been paid. The Board cannot contemplate such a result as the intended or actual effect of ss.37(7) and 49(g).

35. There are two alternative possibilities. One is to read both (1) and (2) as referring only to current members. The effect then is that s.37(7) claimants will, pursuant to (1), rank behind claimants like *Primeo* falling within s.49(g). That would not be incongruous. On the other hand, the Court of Appeal took a different view, considering, without detailed explanation, that claims such as *Primeo*’s would rank equally with those of any s.37(7) claimants (see CA judgment, [55]). This could be achieved by reading (1) as referring to former as well as current members, but (2) as referring only to current members. This would involve reading in different senses two references to “members” in the same subsection, the latter of which (“members as ... members”) might or might not be seen as echoing, rather than differing from, the earlier (“members in their character as such”). However, the Board itself heard no detailed submissions on this possibility, and prefers in the circumstances to say no more on the question of priorities as between s.49(g) and s.37(7) claimants.

The likelihood in practice of successful s.37(7) claimants may well also be slight.”

248 In *Herald* at paragraph [54] Field JA said this:

“As Mitchell, J.A. said in reference to s.197 of the BVI Insolvency Act in the Somers Dublin Ltd. decision, any adjustment within s.197 must give higher priority to former members who have become creditors as a result of a redemption than to mere continuing members.”

249 We reject Mr Millett’s argument on this point. The most that section 37(7)(b) does is to give payments due to section 37(7)(a) shareholders priority over amounts due to members in satisfaction of their rights as such. That is what the statement in *Somers* and its citation in *Herald* recognise. Although Primeo’s claim was, like those of the redeeming shareholders in Direct Lending, deemed by section 49(g) to be made in the character of a member, it is obvious that to give section 37(7)(a) shareholders priority over shareholders who have actually redeemed would be an incongruous result, as the Privy Council accepted. But all that that shows is that actual redeemers and section 37(7)(a) shareholders have priority over other shareholders: they are both treated as creditors. What it does not show is that creditors of that type have priority over other creditors who – just like actual redeemers and section 37(7)(a) shareholders - are deemed to be shareholders within section 49(g). That question did not arise in *Primeo*. We acknowledge the difficulties identified by Lord Mance, but consider that it would also be incongruous to afford priority to section 37(7)(a) shareholders over other persons who are both shareholders within section 49(g) and creditors. To put it at its lowest, we are insufficiently persuaded that the effect of section 37(7) in those circumstances is as Mr Millett would have it to regard it as a reason to accord the redeeming shareholders in Direct Lending priority over the misrepresentation claimants.

250 We therefore agree with Segal J that the fact that the redeeming shareholders have become creditors does not require that they be given priority over the misrepresentation claimants. Nor does the analogy with section 37(7). To hold otherwise is to ignore that the misrepresentation claimants are themselves creditors. The claims of each fall within section 49 (g) since both claims are made in the character of a member. Their status as creditors gives each category priority over the general body of shareholders, but not over other creditors, and hence not over each other.

251 For these reasons, the priority question appeal in Direct Lending fails.

(4) Priority in HQP

- 252 In relation to HQP, we have already made the point that Doyle J's decision proceeded on the basis that misrepresentation claimants were not within section 49(g), a view with which we disagree, and that they were entitled to priority as creditors. He also took the view that the wording of HQP's articles was not appropriate to cover misrepresentation claims so as to subject them to the contractual waterfall.
- 253 For the appellants, Mr Thompson KC's simple contention was that once it is accepted that a misrepresentation claim is made in the character of a member, it necessarily follows that the contractual waterfall must apply. Any misrepresentation claim must take its place in the queue represented by the contractual waterfall: it cannot obtain greater priority than that accorded to the class of shares held by the misrepresentation claimant. Thus, for example, a claimant who asserts that he purchased class B shares in consequence of a misrepresentation will rank *pari passu* with the other class B shareholders but not with anyone else.
- 254 Mr Levy KC, for the JenCap and DCM funds, contended that the contractual waterfall by its terms was concerned only with the application of assets available to shareholders in a liquidation, and provided a system of distribution to members as such. A payment made to a misrepresentation claimant would be made in his capacity as creditor, and would be paid from the company's general assets, not from assets available for distribution to members (those assets being identifiable only when creditor claims had been satisfied). Doyle J had reached the right conclusion.
- 255 The JOLs' position was that it made no sense, or was circular, to regard the contractual waterfall as extending to claims for damages for misrepresentation, particularly where it is said that the effect of the misrepresentation was to cause the shareholder wrongly to agree to the effect of the contractual waterfall.
- 256 The contractual waterfall is contained in HQP's Article 102, which provides that if the company shall be wound up "the assets available for distribution among the members" are to be distributed in accordance with Section 2 of Schedule A. That section is concerned with "liquidation preference", and sets out a clear order of priorities. To demonstrate how it works, it is sufficient to quote the following:

“(a) *Liquidation Preferences.* Subject to the applicable laws, upon any liquidation, dissolution, or winding up of the Company, whether voluntary or involuntary:

- (i) *Before any distribution or payment shall be made to the holders of the Ordinary Shares, the Series C Preferred Shares, the Series B Preferred Shares, the Series A+ Preferred Shares, the Series A Preferred Shares, the Series Seed Preferred Shares and any other class or series of shares (other than the Series D Preferred Shares), each holder of the Series D Preferred Shares shall be entitled to receive an amount equal to one hundred and twenty per cent (120%) of the Original Series D Issue Price, plus all dividends declared but unpaid with respect thereto (as adjusted for any share splits, share dividends, combinations, recapitalizations and similar transactions) for each Series D Preferred Share then held by such holder. If upon any such liquidation, dissolution or winding up of the Company, the assets of the Company available for distribution to its Members shall be insufficient to pay the holders of Series D Preferred Shares the full amount to which they shall be entitled under this Section 2(a)(i), the holders of Series D Preferred Shares shall share ratably (sic) in any distribution of the assets available for distribution in proportion to the respective amounts which would otherwise be payable in respect of the shares held by them upon such distribution if all amounts payable on or with respect to such shares were paid in full. The aggregate amount which a holder of Series D Preferred Shares is entitled to receive on a per share basis under this section 2(a)(i) is hereinafter referred to as the “Series D Liquidation Amount”.*
- (ii) *If there are any assets or funds remaining after the aggregate Series D Liquidation Amount has been distributed or paid in full to the holders of the Series D Preferred Shares pursuant to clause (i) above, before any distribution or payment shall be made to the holders of the Ordinary Shares, the Series B Preferred Shares, the Series A+ Preferred Shares, the Series A Preferred Shares, the Series Seed Preferred Shares and any other class or series of shares (other than the Series D Preferred Shares and Series C Preferred Shares), each holder of the Series C preferred Shares shall be entitled to receive an amount equal to one hundred and twenty per cent (120%) of the Original Series C Issue Price, plus all dividends declared but unpaid with respect thereto (as adjusted for any share splits, share dividends, combinations, recapitalizations and similar transactions) for each series C Preferred Share then held by such holder”;*

and so on.

- 257 The logic of our conclusion on the priority point in relation to Direct Lending – namely that the misrepresentation claimants are entitled to priority over mere shareholders (although not over the redemption creditors in that case) by virtue of their status as creditors even though they fall within section 49(g) – might be thought to apply also to the misrepresentation claimants in

HQP. If that were the case, the position would be – as Doyle J for different reasons concluded - that the misrepresentation claimants had priority over all shareholders, including those who had sought to redeem (but, because redemption did not occur until payment, remained mere shareholders).

258 In our view, however, the position is not the same. In Direct Lending there was nothing to dictate a difference in status between redemption shareholders and misrepresentation claimants; but in HQP there is, in the shape of the contractual waterfall. It is impossible to treat the provisions of Section 2 of Schedule A as applying in terms to misrepresentation claims, not least because of the percentage uplifts on the subscription prices. But what the contractual waterfall at a high level does is to evince a clear agreement between members that some shareholders have priority over others. The misrepresentation claimants remain shareholders, and make their claims in that capacity as negative claims under the statutory contract; and in that capacity they remain bound by the agreement. They cannot in our view now claim a greater priority than they agreed to.

259 The JOLs point out that misrepresentation claimants may claim also on the basis that they were induced to agree to dilution of the priority attached to their shares; but in our view that point, properly examined, fortifies the conclusion we have reached. To explain why that is so, it is necessary to consider the nature of the claim of a misrepresentation claimant. The basis of the claim is a misrepresentation made by the company inducing the misrepresentation claimant to acquire shares in the company. Depending on where the shares issued to the misrepresentation claimant lie within the contractual waterfall, a claim may also proceed on the basis that the misrepresentation caused the claimant to consent to postponement in a winding up as new shares were issued with a higher priority in the waterfall. In either case, an element in the assessment of the damages will be the value of the shares acquired by the claimant. So far as the claim is based on the subscription contract, the damages will be the difference between the price paid and the value of the shares; but the value of the shares will to an extent depend upon their position in the contractual waterfall. Shares which have an enhanced entitlement in a liquidation will have a higher value than those which do not. Similarly, to the extent that the claim is based upon agreement to the issue of shares with an enhanced entitlement, an element in the computation of loss will be the consequent reduction in the value of the shares held by the claimant. In each case, therefore, the damages claim will take into account the ranking within the contractual waterfall of the shares actually acquired by a misrepresentation claimant. It would be inconsistent with that fact to claim parity in the liquidation with all other shareholders, even those with shares ranking higher in the waterfall. The only way to maintain

consistency would be to accord the misrepresentation claimants the same priority in respect of their misrepresentation claims as they have in respect of the shares which they retain.

260 Accordingly, in HQP we hold that the claims of misrepresentation claimants rank *pari passu* with the holders of the same class or classes of share as those to which the relevant misrepresentation claim relates.

261 We recognise that our decision in HQP may be thought to be unfair to the misrepresentation claimants, since its practical effect is to deprive them of any remedy. That is because the assets available to shareholders are sufficient only to pay the shareholders ranking first in the contractual waterfall (ie the holders of Series D Preferred Shares). The only persons capable of ranking *pari passu* with them are misrepresentation claimants who themselves hold Series D Preferred Shares; and they will be paid anyway and so have no reason to make such a claim. Misrepresentation claimants holding shares in prior series cannot achieve similar status to the Series D Preferred Shareholders, and so cannot share with them in the available assets. But there is no solution which achieves fairness for all interested parties, even if it could be reconciled with statute and case law. Doyle J's solution, which gave priority to misrepresentation claimants over all shareholders, meant that redeeming shareholders could not participate at all unless they too chose to make a misrepresentation claim; but even that would mean forgoing their position in the contractual waterfall, on which they will have relied in making their investments. Segal J's solution in Direct Lending, which means misrepresentation claimants sharing available assets *pari passu* with redeeming shareholders, is not available in HQP because in that case redeeming shareholders do not become creditors; but even if it were it would again negate the contractual waterfall and ignore the reliance on it of investors acquiring shares with superior ranking in it. In the absence of a perfect solution, we are satisfied that the outcome is at least consistent with the applicable law.

D. SUMMARY OF CONCLUSIONS

262 We summarise our conclusions as follows.

- (i) The *Houldsworth* principle remains part of Cayman Islands law.
- (ii) It prevents any person claiming damages for misrepresentations inducing subscription for shares from proving in a liquidation in respect of that claim until all non-member creditors have been paid or provided for, but permits them to prove thereafter.
- (iii) Redeeming shareholders (including those who have completed the steps necessary to redeem and so have ceased to be shareholders and become creditors instead, but have not been paid), and members claiming damages on the footing that they were induced

to subscribe for shares or subordinate their shares by misrepresentations made by the company, claim in the capacity of members and are subject to section 49(g) of the Companies Act.

- (iv) The claims of redeeming shareholders and misrepresentation claimants in Direct Lending are made also in the capacity of creditors and rank *pari passu* with each other, but have priority over the claims of other shareholders.
- (v) The claims of misrepresentation claimants in HQP rank *pari passu* with (but only with) the claims of redeeming shareholders holding the same class of shares as those which are the subject of the relevant misrepresentation claim.
- (vi) Accordingly, the appeal in Direct Lending is dismissed, and that in HQP allowed to the extent of substituting for paragraph 3 of Doyle J's order a direction to the effect set out in subparagraphs (iii) and (v) above.

263 We encourage the parties to draw up a draft order in each case to reflect our decision and our following provisional views as to the content of the orders. In Direct Lending, an order dismissing the appeal is likely to suffice. In HQP, where the appeal is against paragraphs 2 and 3 of the order, we think that paragraph 2 can stand but that the appeal in relation to paragraph 3 is to be allowed, there being substituted for that paragraph a direction to the effect that any admitted proofs of debt submitted by Preferred Shareholders pursuant to paragraph 2 shall be treated as claims subject to section 49(g) of the Companies Act (2023 Revision) and shall rank *pari passu* with (but only with) the claims of all other Preferred Shareholders holding the same class of shares as those whose issue or subordination formed the subject of the claim for damages for misrepresentation.

E. COSTS

264 We did not have substantive submissions as to costs, although it was variously suggested that the costs should come from the relevant liquidation estate or that the question should be deferred until after the outcome of the appeals was known.

265 In the circumstances, we invite the parties to make concise written submissions as to costs (ideally meaning no more than ten pages for each party) by Friday 31 October 2025. If any party wishes to reply, it may do so by Friday 7 November 2025. We will then determine the matter on the papers.