

# Who Moved My Class Rights?

## - A Short Study of Cayman Islands Law on Variation of Class Rights

The basic question is whether under Cayman Islands Law, a variation of a right attaching to a particular class of shares has to be consented to by special majority of the members? In other words, can the Article authorising the variation of class rights specify a simple majority or some other majority?

The simple answer to this is that a variation of class rights will always be a two-step process. The rights will be contained in one of following: the company's Articles, a members' resolution or a board resolution. In each case:

- **First step:** a class resolution by the members of the affected class will be required, consenting to the variation,

followed by,

- **Second step:** either a resolution of the voting members (to amend the Articles or to vary the previous members' resolution) or a board resolution (to vary the previous board resolution).

If we reflect on the various scenarios in which this sort of issue arises there are principally two:

### 1. Where class rights are set out in the company's Articles

After taking consideration of the first step, set out above, where the class rights are set out in the company's Articles, the second step will be the passing of a resolution to amend the Articles. Under s 24 of the Companies Law, a company's Articles may only be varied by special resolution which, unless the Articles stipulate a greater number, is a 2/3 majority of the members entitled to vote on the resolution. The resolution amending the Articles only needs to be passed at a single meeting of all members who are entitled to attend and vote, and do attend and vote; it does not require separate meetings of each class.

Where the class rights are set out in the Articles at least a 2/3 majority of all members who are entitled to attend and vote, and do attend and vote, will be required to amend the Articles to give effect to the proposed variation. Arguably, in these circumstances, it would be prudent for the variation to be consented to by a like majority of the members of the affected class. However, there is no

express legal requirement for a special majority to give such consent.

### 2. Where class rights are not set out in the company's Articles

Often a company's Articles confer on the directors the power to issue shares of differing classes. Sometimes they allow for the creation of differing classes by resolution of the members. A variation to class rights created in either of these ways will not involve an amendment to the Articles. Apart from the consent of the requisite majority of members of the affected class, the second step would involve either:

- (a) a members' resolution to vary the previous members' resolution passed by the requisite majority that passed the previous resolution; or
- (b) a board resolution to vary the previous board resolution.

Once again, in relation to the first step, there is no express legal requirement for a special majority to give such consent; the company's Articles could provide for consent of a simple majority of the holders of shares of the affected class or by some other specified majority.

### Common law limitation

Irrespective of what the Articles of the company may provide, the power conferred on a majority of a particular class enabling them to bind a minority is subject to a general principle; namely that the power given must be exercised for the benefit of the class as a whole and not merely for the particular individual members only. Specifically, the power must be exercised in good faith. This does not act as an impediment to an individual shareholder who may vote in accordance with his individual interest irrespective of whether these are peculiar to himself and not shared by other members of that class. (See *British American Nickel Corporation v M.J. O'Brien* [1927] AC 473 per Viscount Haldane delivering the judgement of the Privy Council at pp. 371, 374).

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It should be noted that while the general principle applies, a court would still have the power to prevent certain sorts of abuse linked specifically to unfairness or oppression under the *British American Nickel Corporation* case.

### Position under Cayman Islands Companies Law

The Companies Law does not contain any provision for the protection of minority members whose class rights are varied by a decision taken by the requisite majority under a power in the Articles authorising the variation of class rights. For instance, it does not have a provision like that first introduced into UK companies legislation by s 61 of the Companies Act 1929 pursuant to which the holders of not less in the aggregate than 15% of the affected class could apply to the Court for cancellation of the variation on the ground that it unfairly prejudiced those members. (A similar provision was contained in s 127 of the Companies Act 1985.)

Under Article 3 of the Table A Articles to the Cayman Islands Companies Law, class rights may be varied with the consent in writing of the holders of  $\frac{3}{4}$  of the issued shares of that class or with the sanction of a special resolution passed at a separate general meeting of the holders of that class. Curiously, a special resolution only requires a 2/3 majority unless the Articles specify otherwise, and the Table A Articles do not specify otherwise. Despite the fact that the Table A Articles adopt these special majorities for the sanction of the members the affected class, there is no provision in the Cayman Islands Companies Law that requires any particular majority. (Unlike UK companies legislation, the Cayman Islands Companies Law does not contain a statutory mechanism for the variation of class rights in the absence of a provision in the Articles allowing for the variation of such rights: compare section 125 of the UK Companies Act 1985).

### General recommendations and conclusion

Generally, given that the Cayman Islands Companies Law contains no right of objection, similar to section 61 of the 1929 UK Act, it appears that it would be prudent to provide for a required majority of two thirds or three quarters.

There is no impediment to including a lower threshold. Such an approach should contain a necessary health warning in respect of the possibility that it will not pass the scrutiny of whether such a variation is in fact in good faith in respect of the majority. Following this line of thought, were one to opt for a simple majority it is possible that the premise that the majority's right over the minority may be tested when considering whether or not the action taken was for the benefit of the class as a whole. There may also be a question over materiality in respect of the

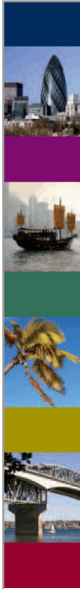
variation and what particularly is being approved by such a reduced minority. Is it, for example, a principle right? As you can see there are a number of considerations to be made in respect of the variation and particularly as they pertain to what can be contained in the Articles for the purposes of structuring. As always commercial considerations can be provided for in shareholders' agreements and the intent be implemented in the Articles as far as possible. Notwithstanding, all of the facts and circumstances of each particular case will undoubtedly be different so that care must be taken to deal with variations in such a way as to ensure the lowest possible risk of challenge and accordingly the ability to deal with variations of class rights is effected in each particular case in a different way.

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