Dividends, repurchases, redemptions and surrenders of shares

Service area / Corporate

Location / Cayman Islands

Date / February 2017

Overview

This legal guide summarises the main methods of making distributions to shareholders of an exempted company limited by shares (a "Company") incorporated under the Companies Law (as revised) of the Cayman Islands (the "Companies Law"). It also summarises how shares in a Company ("Shares") may be surrendered to the Company for nil consideration. Shares which have been repurchased, redeemed or surrendered pursuant to the Companies Law may be held as treasury shares ("Treasury Shares") or cancelled.

Payment of dividends

Although it ultimately depends on the relevant provisions of the memorandum and articles of association of a Company (the "Articles"), it is customary for directors of a Company to be able to pay dividends to its shareholders without having to obtain shareholder consent. Dividends are therefore usually paid pursuant to a resolution of the board of directors passed either by way of written resolution or at a board meeting. Dividends may be paid out of "profits" (determined in accordance with common law principles) or "share premium" (as defined in the Companies Law).

- **Profits** – There is no statutory definition of "profits" under Cayman Islands law. Based on Cayman Islands common law principles, profits may result from income as well as realised and unrealised gains. Profits do not include share capital (i.e. amounts equal to the par value of the Shares in issue) or amounts credited to the "share premium account" (as defined below).
- **Share Premium** – Under the Companies Law, where a Company issues Shares at a price higher than the par value of such Shares, a sum equal to the difference between the issue price and the par value must be transferred to an account called the "share premium account". It is important to note that where a Company issues Shares without a par value, the entire share price is considered to form part of the share capital of the Company and accordingly cannot be used to pay dividends. For this reason, Companies with Shares of no par value are not popular in the Cayman Islands. A Company may use amounts in the share premium account to pay dividends to its members provided that, immediately following payment of any dividend out of the share premium account, the Company is able to pay its debts as they fall due in the ordinary course of business (the "Solvency Test").

- **Unlawful Payment of Dividends** – Under the Companies Law, the Company and any director who knowingly and wilfully authorises or permits any dividend to be paid out of the share premium account where the Solvency Test is not satisfied commits an offence and is liable on summary conviction to a fine of approximately US$18,000 and up to five years' imprisonment. Under Cayman Islands common law, a director may be personally liable to repay an unlawful dividend. A shareholder who receives an unlawful dividend is not generally liable to return the dividend unless it knew that the dividend was unlawful. However, this is a complicated area of the law and so specific legal advice should be sought in cases where a dividend may have been paid unlawfully.

Repurchases and redemptions

Repurchase and redemption of share

It is necessary to consult the provisions of the Articles to ascertain the manner in which a Company may repurchase or redeem its Shares. Often the Articles require the directors to obtain shareholder approval for the repurchase or redemption.

The statutory rules for the repurchase and redemption of Shares are as follows:

- no Share may be repurchased or redeemed unless its par value is fully paid up;
- a Company may not repurchase or redeem any of its Shares if, as a result of the repurchase or redemption, there would no longer be any issued Shares (Treasury Shares are not counted as issued Shares for this purpose);
- the repurchase or redemption of Shares may be effected in such manner and upon such terms as may be authorised by or pursuant to the Articles (including, for example, on such terms as the directors may approve);
- Shares may only be redeemed if they are issued as redeemable Shares or if their terms are varied in accordance with the Articles to make them redeemable;
- if the Articles do not authorise the manner and terms of a repurchase, a Company may not repurchase any of its Shares unless the manner and terms of purchase have first been authorised by a shareholder resolution; and
- a payment out of capital by a Company for the redemption or repurchase of its Shares is not lawful unless immediately following any such payment the Solvency Test is satisfied.

Payment for repurchased and redeemed shares

Subject to satisfying the Solvency Test, Shares may be repurchased or redeemed out of share capital, out of profits, out of the share premium account or out of the proceeds of a fresh issue of Shares made for the purposes of the repurchase or redemption. Unless classified as Treasury Shares, any redeemed or repurchased Shares are deemed to be cancelled and are immediately available for re-issue by the Company.

Unlawful repurchase or redemption shares

Under the Companies Law, the Company and any director who knowingly and wilfully authorises or permits any redemption or repurchase to be paid out of share capital where the Solvency Test is not satisfied commits an offence and is liable on summary conviction to a fine of approximately US$18,000 and to five years' imprisonment. A shareholder who receives a payment in respect of an unlawful repurchase or redemption of Shares is not generally liable to return payment unless it knew that the repurchase or redemption was unlawful. However, this is a complicated area of the law and so specific legal advice should be sought in cases where a repurchase or redemption may have been effected unlawfully.

Surrenders

Subject to any express provisions of the Articles to the contrary, a Company may accept the surrender for no consideration of any fully paid Share (including a redeemable Share) unless, as a result of the surrender, there would no longer be any issued Shares other than Shares held as Treasury Shares. Unless classified as Treasury Shares, any Shares surrendered to the Company are deemed to be cancelled on surrender and are immediately available for re-issue by the Company.

Treasury shares

Classification of treasury shares

Shares that have been repurchased or redeemed by a Company or surrendered to the Company may be held as Treasury Shares if:

- the Articles do not prohibit the Company from holding Treasury Shares;
- the relevant provisions of the Articles (if any) are complied with; and
- the Company is authorised in accordance with the Articles (or by a resolution of the directors) to hold such Shares in the name of the Company as Treasury Shares prior to the purchase, redemption or surrender of such Shares.

Continued

Rights of treasury shares

For so long as any Treasury Shares are in issue, the Company must be entered in the register of members as holding those Shares, however:

- the Company will not be treated as a member for any purpose and may not exercise any right in respect of the Treasury Shares, and any purported exercise of such a right shall be void;
- a Treasury Share shall not be voted, directly or indirectly, at any meeting of the Company and shall not be counted as an issued Share at any given time, whether for the purposes of the Articles or the Companies Law; and
- no dividend may be declared or paid, and no other distribution (whether in cash or otherwise) of the Company's assets (including any distribution of assets to members on a winding up) may be made to the Company, in respect of a Treasury Share.

Disposal of treasury shares

Treasury Shares may at any time be cancelled or, subject to the Articles, transferred to any person (whether or not for any consideration).

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