become shareholders by improper concealment of facts' …

It is quite clear, therefore, that Oakes might originally have disaffirmed that contract, and divested himself of his shares, and that he never did any act to affirm it, nor was aware of the true state of the firm of Overend, Gurney & Co at the time of the formation of the new company, nor until after the failure …

Such was the position of Oakes when the order for winding up the company was made on 22 June 1866. His name being upon the register of shareholders, was placed (as a matter of course) by the liquidators upon the list of contributories …

On the part of the creditors, it is said that every person whose name is found upon the register at the time when the order for winding up is made is a shareholder, and liable to contribute towards the payments of the debts of the company to the extent of the sums due upon his shares, unless he can prove that his name was put upon the register without his consent.

Did the appellant then agree to become a member? His counsel answer this question in the negative; because they say that a person who is induced by fraud to enter into an agreement cannot be said to have agreed; the word 'agreed' meaning having entered into a binding agreement. But this is a fallacy. The consent which binds the will and constitutes the agreement is totally different from the motive and inducement which led to the consent. An agreement induced by fraud is certainly, in one sense, not a binding agreement, as it is entirely at the option of the person defrauded whether he will be bound by it or not. In the present case, if the company formed on the basis of the partnership of Overend, Gurney & Co had realised the expectations held out by the prospectus, the appellant would probably have retained his shares, as he would have had an undoubted right to do. But when the order for winding up came, and found him with the shares in his possession, and his name upon the register, the agreement was a subsisting one. How could it then be said that he was not a person who had agreed to become a member? To hold otherwise would be to disregard the long and well-established distinction between void and voidable contracts …

[His Lordship then held that the supervening rights of the creditors in a winding up barred the right of a member to avoid the contract on the ground of fraud. He concluded:] It only remains to observe that all that has been said with respect to Oakes applies with greater force to Peek, even if his situation as a purchaser of shares in the market did not preclude him from most of the objections which have been raised in Oakes' case.

LORD CRANWORTH and LORD COLONSAY delivered concurring opinions.

Availability of the remedy of damages

Damages are available instead of rescission, or in addition to rescission for consequential losses: (i) at common law if the misrepresentation was fraudulent (*Derry v Peek* (1889) 14 App Cas 337): see **(p. 503)** the important and detailed analysis of Lord Steyn in *Smith New Court Securities Ltd Citibank NA* [1997] AC 254; (ii) at common law for negligent misstatement;[17] and (iii) under the Misrepresentation Act 1967, but only between parties to an induced contract, for any form of misrepresentation, unless the misrepresentor can prove that he or she had reasonable grounds to believe, and did believe, up to the time the contract was made, that the facts represented were true (s 2(1)).[18]

➢ Notes

1. For over a hundred years, the rule laid down in *Houldsworth v City of Glasgow Bank* (1880) 5 App Cas 317, HL, prevented a person who had been induced by fraud to take shares in a company from claiming damages against the company while he or she remained a member. The same principle was applied where damages for breach of contract were sought, based on the contract of shareholding: *Re Addlestone Linoleum Co* (1887) 37 Ch D 191, CA. The juridical basis of this rule was never satisfactorily explained, but it has now been reversed by statute: CA 2006

s 655. There is one statutory exception: CA 2006 s 735 expressly excludes the possibility of a claim in damages when a company has broken an obligation to redeem or repurchase shares (but without prejudice to other remedies, which may include an action for specific performance or an application for relief under s 994 (unfairly prejudicial conduct) (see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff) or for winding up on the 'just and equitable' ground (see 'Compulsory winding up on the 'just and equitable' ground', pp 795ff)).

2. In *Peek v Gurney* (1873) LR 6 HL 377, the House of Lords held that a prospectus should be regarded as addressed only to those who might become allottees of shares directly from the company, and that it could not be relied on by someone who had bought shares from another source. FSMA 2000 now imposes civil liability for breach of the listing particulars and prospectus requirements in favour of any person who has acquired securities, and this is defined in terms sufficiently wide to include both original allottees and persons who have purchased shares on the market (see 'Liability for misleading statements and omissions in prospectuses ', pp 727ff). In *Possfund Custodian Trustee Ltd v Diamond* [1996] 2 BCLC 665, Lightman J held that, in the light of changes in market practice, a person who had bought shares on the market might nowadays be regarded as someone to whom a prospectus was addressed, particularly if the prospectus made reference to future dealing on that market. (This judgment also contains an excellent summary of the various remedies available to a person deceived by misstatements in a prospectus, and their historical development.)

3. In *Erlson Precision Holdings Ltd (formerly GG132 Ltd) v Hampson Industries plc* [2011] EWHC 1137 (Comm), income and customer forecasts were provided to representatives of the purchaser on behalf of the vendor listed company; these were found to have carried an implied representation of fact, namely that the company had reasonable grounds, or knew of facts, that justified the forecasts. The forecasts turned out to be false, as the second largest of the company's customers had already notified Mr Ward, CEO of the company, of its final decision to terminate its relationship with the company entirely. In holding that the share purchase agreement was induced by a fraudulent misrepresentation as alleged by the claimant, Field J said the following, at [43]:

> If an individual in the position of Mr. Ward, the CEO of a listed company, knows that a forecast has been falsified by events to which he is privy but remains silent intending that the forecast should **(p. 504)** be relied on by persons to whom the forecast is directly communicated, dishonesty on the part of that individual will have been proved without it being necessary distinctly and separately to show a conscious awareness of a duty to correct the statement.

4. Where there is no fraudulent misrepresentation, by reason of there being no dishonest intent and/or reliance by the *representee*, the court may nonetheless find that there has been a breach of warranties contained in the sale and purchase agreement: *Belfairs Management Ltd v Matthew Sutherland, Christie Jane Sutherland* [2010] EWHC 2276 (Ch).

Collecting in the company's capital: payment for shares

Issue of shares at a discount

A company is, in general, forbidden to issue shares[19] at a discount: see CA 2006 s 552 and the following case extracts. But the professional people and institutions who handle new issues must, of course, be remunerated for their services, or compensated for taking the risk of an issue not being fully subscribed for by the public (ie for 'underwriting' the issue). Accordingly, CA 2006 s 553 authorises the payment of commissions and discounts up to a statutory limit (currently 10%), subject to certain safeguards.

A company may not issue shares at a discount.

[9.05] Ooregum Gold Mining Co of India Ltd v Roper [1892] AC 125 (House of Lords)

This action was brought by a holder of ordinary shares to test the validity of an issue of preference shares which had been made by the directors, in accordance with resolutions duly passed by the members, on the basis that

each new share of £1 nominal value should be automatically credited with 75p paid, leaving an actual liability of only 25p per share. The transaction was bona fide thought to be the best way of raising further funds for the company, especially since the ordinary shares stood at a great discount. The House of Lords held, however, that it was beyond the power of the company to issue the shares at a discount, and that in consequence the holders were liable for the full nominal amount of the shares.

> LORD HALSBURY LC: My Lords, the question in this case has been more or less in debate since 1883, when Chitty J decided that a company limited by shares was not prohibited by law from issuing its shares at a discount. That decision was overruled, though in a different case, by the Court of Appeal in 1888, and it has now come to your Lordships for final determination.
>
> My Lords, the whole structure of a limited company owes its existence to the Act of Parliament, and it is to the Act of Parliament one must refer to see what are its powers, and within what limits it is free to act. Now, confining myself for the moment to the Act of 1862, it makes one of the conditions of the limitation of liability that the memorandum of association shall contain the amount of capital with which the company proposes to be registered, divided into shares of a certain fixed amount. It seems to me that the system thus created by which the shareholder's liability is to be limited by the amount unpaid upon his shares, renders it impossible for the company to depart from that requirement, and by any expedient to arrange with their shareholders that they shall not be liable for the amount unpaid on the shares, although the amount of those shares has been, in **(p. 505)** accordance with the Act of Parliament, fixed at a certain sum of money. It is manifest that if the company could do so the provision in question would operate nothing.
>
> I observe in the argument it has been sought to draw a distinction between the nominal capital and the capital which is assumed to be the real capital. I can find no authority for such a distinction. The capital is fixed and certain, and every creditor of the company is entitled to look to that capital as his security.
>
> It may be that such limitations on the power of a company to manage its own affairs may occasionally be inconvenient, and prevent its obtaining money for the purposes of its trading on terms so favourable as it could do if it were more free to act. But, speaking for myself, I recognise the wisdom of enforcing on a company the disclosure of what its real capital is, and not permitting a statement of its affairs to be such as may mislead and deceive those who are either about to become its shareholders or about to give it credit.
>
> I think … that the question which your Lordships have to solve is one which may be answered by reference to an inquiry: What is the nature of an agreement to take a share in a limited company? and that that question may be answered by saying, that it is an agreement to become liable to pay to the company the amount for which the share has been created. That agreement is one which the company itself has no authority to alter or qualify, and I am therefore of opinion that, treating the question as unaffected by the Act of 1867, the company were prohibited by law, upon the principle laid down in *Ashbury Co v Riche*,[20] from doing that which is compendiously described as issuing shares at a discount.
>
> LORDS WATSON, HERSCHELL, MACNAGHTEN and MORRIS delivered concurring opinions.

➢ Notes and Questions

1. The position in which this company found itself is not at all uncommon: unprofitable trading had led to a depressed market price for the shares, and the company was seeking an injection of new funds to 'keep head above water' while the directors endeavoured to surmount the immediate financial difficulties and find a way back to profitability.[21] The classical solution of an earlier generation was to issue preference shares, so that those who provided the new capital ranked ahead of the existing shareholders as regards both income and capital rights (see 'Classes of shares and class rights', pp 556ff). The other possible solution—to issue new shares ranking*pari passu* with the existing shares but at a discounted price—is, on the authority of this case, unlawful in England. Does the rule protect the company's creditors? Does it protect the existing shareholders?

2. One way of making such a course of action possible would be for the law to authorise companies to create and issue *no par value* shares—something which is permitted in many jurisdictions and, indeed, compulsory in some. There is, after all, something unreal and simplistic about the concept of a par or nominal value. If the share in question was originally issued at a premium, or in exchange for a non-cash consideration, it may never have been worth its face value; and certainly after the date of its issue its market value is never again likely to bear any relation to the historic figure which was once ascribed to it. If it were lawful for companies to issue shares of no par value, many of the misunderstandings associated with the concept of a nominal value would disappear, and in addition it would be possible for a company to issue shares, ranking *pari passu*, at a price of £1 in January, £1.05 in February and £0.90 in March (depending on what the market would stand), without any implication that there was a par value which was being enhanced by a premium or reduced by a discount. Recommendations have been made at different times for such an innovation to be made in the UK—eg by the Gedge Committee (Cmnd 9112, 1954), the Jenkins Committee (Cmnd **(p. 506)** 1749, 1962, paras 32–34) and the Wilson Committee (Cmnd 7937, 1980, para 735), as well as by professional bodies—but the response from successive governments has been nil. The CLR also considered the possibility of allowing (or even requiring) private companies to issue no-par shares. (This would not be possible for public companies unless the Second EU Directive were to be amended.) In the end, no change was proposed.

3. In more modern company law codes where shares of no par value are permitted, the 'maintenance of capital' rules do not apply (see Chapter 10); but the payment of dividends and other distributions to shareholders, and analogous transactions such as the repurchase by a company of its issued shares, are permitted only if the company is able to satisfy a statutory 'solvency test' at the relevant time. In consequence, attention is focused on the company's current financial position rather than on what may be quite misleading historic costs as shown in the accounts—indeed, the whole business of accounting is made much more straightforward and meaningful.

Issue of debentures at a discount

There is ordinarily no prohibition on the issue of debentures at a discount, because the 'maintenance of capital' principle does not apply to debt capital. A company may find it attractive to create debentures on terms which give the holders the option at some later date of converting the debentures into shares at a predetermined rate of exchange. Such *convertible* debentures may not be issued at a discount on terms that they may be immediately exchanged for shares of an equivalent nominal value, for this would be only an indirect way of achieving an issue of shares at a discount (*Mosely v Koffyfontein Mines Ltd* [1904] 2 Ch 108). The rate at which the exchange of securities is to take place must, to be above challenge, represent a realistic assessment of future trends in the value of money and the market prices in securities.

➢ Questions

1. What might be the attractions of an issue of convertible debentures, rather than a straightforward issue of shares, for (i) the company, (ii) the investor?

2. The basis of conversion set out in the terms of issue of convertible debentures commonly prescribes a declining tariff, for example 75 shares for every £100 of debentures converted after three years, 70 shares per £100 converted after four years, 65 shares per £100 after five years. Why?

Issue of shares at a premium

The rule that shares may not be issued at a discount means that a company which allots a share of nominal value £1 must get £1 and nothing less for it; but there is no corresponding rule which says that the company must get £1 and nothing more for it. If investors can be found who are willing to pay the company £1.20 or £2 or £5 for a share of nominal value £1, the company is free to charge that sum. (Indeed, it may give the company's existing

shareholders cause for complaint if a new issue of shares is made at par, for that would reduce (or 'water down') the value of their shareholdings.[22])

The excess received by the company over the nominal value of the shares is called a *premium*, and, as noted earlier, CA 2006 requires such sums to be shown in the company's accounts under a separate head, as the 'share premium account'. This ensures that these are treated for almost all purposes as capital in the company's hands and not in any sense as income or profit: see 'Terminology associated with legal capital', pp 490ff.

(p. 507) Shareholders who have paid a premium for their shares have no right to the return of their premium in a winding up: at least in the absence of specific provision in the terms of issue, any surplus remaining after the return of the nominal amount of the shares is distributable on a rateable basis (*Re Driffield Gas Light Co* [1898] 1 Ch 451).

A company is not bound to issue its shares at a premium even though a price above par could be obtained.

[9.06] Hilder v Dexter [1902] AC 474 (House of Lords)

Immediately after its incorporation, the company issued one-sixth of its shares to selected private persons in order to obtain working capital. These shares were issued at par on the terms that the allottees should later have the option to take up further shares at par on a one-for-one basis. Hilder exercised his option at a time when the shares were worth £2 17 *s* 6 *d* [£2.87] per £1 share. Dexter, another shareholder, sought and obtained an injunction restraining Hilder and the company from carrying out the agreement on the ground that such an arrangement was forbidden by s 8(2) of the Act of 1900 [CA 2006 s 582]. The House of Lords reversed this decision and discharged the injunction.

> LORD DAVEY: The advantage which the appellant will derive from the exercise of his option is certainly not a 'discount or allowance', because he will have to pay 20s [100p] in the pound for every share. Nor is it, in my opinion, a commission paid by the company, for the company will not part with any portion of its capital which is received by it intact, or indeed with any moneys belonging to it. But the words relied on are, 'either directly or indirectly', and the argument seems to be that the company, by engaging to allot shares at par to the shareholder at a future date, is applying or using its shares in such a manner as to give him a possible benefit at the expense of the company in this sense, that it foregoes the chance of issuing them at a premium. With regard to the latter point, it may or may not be at the expense of the company. I am not aware of any law which obliges a company to issue its shares above par because they are saleable at a premium in the market. It depends on the circumstances of each case whether it will be prudent or even possible to do so, and it is a question for the directors to decide. But the point which, in my opinion, is alone material for the present purpose is that the benefit to the shareholder from being able to sell his shares at a premium is not obtained by him at the expense of the company's capital …
>
> THE EARL OF HALSBURY LC and LORD BRAMPTON delivered concurring opinions.
>
> LORD ROBERTSON concurred.

Shares may be issued at a premium even though not issued for cash.

[9.07] Henry Head & Co Ltd v Ropner Holdings Ltd [1952] Ch 124 (Chancery Division)

The defendant company was formed to acquire by way of amalgamation the shares of two shipping companies, and did so by exchanging the shares in these companies for shares in itself of equivalent nominal value. In this way it acquired assets worth some £7 million in exchange for shares of a nominal value of £1,175,000. The court held that the difference of just over £5 million had rightly been shown in the company's balance sheet as carried to a share premium account.

HARMAN J: The directors have been advised that they are bound to show their accounts in that way, and not only they but the plaintiffs, who are large shareholders, regard that as a very undesirable thing, because it fixes an unfortunate kind of rigidity on the structure of the company, having regard **(p. 508)** to the fact that an account kept under that name, namely, the Share Premium Account, can only have anything paid out of it by means of a transaction analogous to a reduction of capital. It is, in effect, as if the company had originally been capitalised at approximately £7,000,000 instead of £1,750,000.

The question which I have to determine is whether the defendants were obliged to keep their accounts in that way. That depends purely on s 56 of the Companies Act 1948 [CA 2006 s 610], which is a new departure in legislation and was, it is said, intended to make compulsory that which had long seemed to be desirable, namely, the practice of putting aside as a reserve and treating in the ordinary way as capital cash premiums received on the issue of shares at a premium …

Counsel for the plaintiff company asks who would suppose that a common type of transaction of the sort now under consideration was the issue of shares at a premium and says that nobody in the city or in the commercial world would dream of so describing it. It is with a sense of shock at first that one hears that this transaction was the issue of shares at a premium. Everybody, I suppose, who hears those words thinks of a company which, being in a strong trading position, wants further capital and puts forward its shares for the subscription of the public at such a price as the market in those shares justifies, whatever it may be, [£1.50] a £1 share, £5 a £1 share, or any price obtainable; and the [50p] or £4 above the nominal value of a share which it acquires as a result of that transaction is no doubt a premium. That is what is ordinarily meant by the issue of shares at a premium. The first words of sub-s (1) are: 'Where a company issues shares at a premium'. If the words had stopped there, one might have said that the subsection merely refers to cash transactions of that sort, but it goes on to say 'whether for cash or otherwise'.

What 'otherwise' can there be? It must be a consideration other than cash, namely, goods or assets of some physical sort.

➢ Note

The general principle expressed in this case remains valid, but CA 2006 (and its predecessors) contain relief against the application of the share premium restrictions in the case of certain mergers and reconstructions (ss 611–613), and the Secretary of State has power to make further regulations, either amplifying or restricting the relief so provided (s 614).

Issue of shares in exchange for property

It is not necessary that shares be allotted for cash. It is very common instead for the issue price to be satisfied by the transfer to the company of property, such as a business, previously owned by the allottee: this is what Mr Salomon **[2.01]** did. Or the new shares may be exchanged for shares in another company: see, for example, *Henry Head* **[9.07]**.

Two problems may arise here. If the property taken by the company as consideration is worth *more than* the nominal value of the new shares, then the shares will have been issued at a premium, and this will bring into play the burdensome and restrictive accounting provisions of CA 2006 ss 610ff discussed earlier. If, on the other hand, the property is worth *less than* the nominal value of the shares (as may well have been true in Mr Salomon's case), then in practical terms the shares will have been issued at a discount, contrary to law. Creditors who assume that the shares have been paid for in full may then suffer loss, or at least be exposed to risk, and existing shareholders also may be prejudiced through the 'watering down' of their own investment.

The common law leaves this problem to be settled by the business judgement and integrity of the directors, and

courts will normally accept the valuation made at the time of the allotment unless it is shown to have been made dishonestly or falsely or the contract for allotment is itself set aside for fraud (*Re Wragg* **[9.08]**). This means that the rule against issuing shares at a discount can be circumvented fairly easily, for challenges to the board's decisions are rarely **(p. 509)** mounted, and those that are face the formidable procedural obstacles of *Foss v Harbottle* **[13.01]**: compare the analogous cases of *Pavlides v Jensen* [1956] Ch 565 (sale of assets at alleged undervalue) and*Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* **[13.21]** (purchase of assets at alleged overvalue). The case for some form of statutory control has always seemed a strong one.

Such a step has been taken in regard to *public* companies, as a result of the Second EU Directive (which was implemented in 1980). The relevant provisions are now in CA 2006 ss 584–587 and 593–609. Some forms of consideration for the allotment of shares are banned altogether, for example an undertaking to do work for the company in the future (s 585(1)) and an undertaking of a long-term nature (other than a promise to pay cash) which may take five years or more to perform (s 587(1)). Other forms of 'non-cash' consideration have to be valued by an expert (ss 593–594 and 603), and sometimes a second expert has to certify that the first one is competent (s 1150(2))! Rules of even greater severity are laid down for subscribers to the memorandum (ss 584 and 598–599). In all, it is a very elaborate (and costly) procedure that the Act spells out, in the most finicky detail: a pretty large sledgehammer to crack a fairly small nut.

It is not so important, here, to explain all the finer points of the statutory procedure. But something must be said about the code of sanctions for a failure to comply—even with these finer points; and these are formidable. The allottee is obliged to pay to the company the nominal value of the shares and any premium, with interest, regardless of any benefit that the company may already have had (so that he or she may in effect have to pay for the shares twice over); and, in addition, a subsequent holder of the shares is jointly and severally liable with the allottee to pay the same amounts, unless the holder is (or has derived title through) a bona fide purchaser for value without (actual) notice: see ss 588 and 605. The only relief that those who are caught by these provisions have against what may be potentially a double liability to pay for their shares is that they have a right to make application to the court and ask for exemption from some or all of the statutory liability (ss 589 and 606: see *Re Bradford Investments plc (No 2)* in the Note following *Re Wragg Ltd* **[9.08]**). In addition to these civil consequences, criminal penalties are imposed upon the company and its officers; and the transactions which infringe the statutory rules, though enforceable by the company against the allottee, are (by implication, and in the case of a contract with a subscriber to the memorandum, expressly) unenforceable or 'void' as against the company.

There is an exception from the valuation requirement in the case of a takeover in which all or part of the consideration for the shares allotted is the exchange of shares in the offeree company (s 594(1)–(3)); and it also does not apply in a merger (s 595).

One last point is worth emphasising: all of these rules apply only to issues by public companies for non-cash consideration; if the consideration is cash, the rules are not relevant. 'Cash' is defined in CA 2006 s 583(3): it includes undertakings to pay in the future, or to release a liability of the company (the latter is useful in debt for equity swaps).

It should be remembered that the rules stated here govern public companies only; private companies continue to be subject to the common law, as declared in the case next cited **[9.08]**.

➢ Questions

1. Fred comes to an arrangement with the directors of XYZ plc that he will subscribe for 200,000 £1 ordinary shares in the company at their par value. He also agrees to sell to XYZ plc a leasehold shop property for a price of £200,000. On 1 April the shares are allotted to him in exchange for his cheque, payable to the company, for £200,000, and on the same day, the leasehold interest in the shop is transferred to the company in return for the company's cheque, payable to Fred, for £200,000. What legal issues arise?

2. What do you consider is the policy reasoning behind CA 2006 ss 598–599? Suppose that X and Y are the

promoters of a public company and intend within a few days of its incorporation **(p. 510)** to transfer a business to it: is there any need to have regard to ss 598–599 if they take the precaution of ensuring that the memorandum is subscribed only by two clerks in their solicitor's office?

3. Why do you think that the legislation requires a copy of the valuation to be sent to the proposed allottee (s 593(1)(c))? If the valuer's report advises the company that the transferor's property would be a snip at twice the price, can the allottee withdraw from the transaction and negotiate for more? If the valuer negligently overvalues the property, could the allottee sue the valuer in tort?

4. Where there has been an infringement of s 593, could the company and the allottee effectively agree that the latter should be released from liability under s 593(3) without going to court under s 606?

Private company share issues for non-cash consideration.

[9.08] Re Wragg Ltd [1897] 1 Ch 796 (Court of Appeal)

This case indicates that a *private* company may buy property at any price it thinks fit, and pay for it in fully paid shares. Unless the transaction itself is impeached (eg on the ground of fraud), the actual value of the consideration received by the company for its shares cannot be inquired into. Wragg and Martin had sold to the company on its incorporation their omnibus and livery-stable business for £46,300, which was paid partly in cash and debentures and partly by the allotment to them of the whole of the company's original capital of £20,000 in fully paid shares. The liquidator of the company later sought to show that the value of the business had been overstated by some £18,000; and he claimed either to be entitled to treat shares representing this amount as unpaid, or alternatively to charge Martin and Wragg as directors with misfeasance in connection with the purchase. Both claims failed.

> LINDLEY LJ: … That shares cannot be issued at a discount was finally settled in the case of the *Ooregum Gold Mining Co of India v Roper* **[9.05]**, the judgments in which are strongly relied upon by the appellant in this case. It has, however, never yet been decided that a limited company cannot buy property or pay for services at any price it thinks proper, and pay for them in fully paid-up shares. Provided a limited company does so honestly and not colourably, and provided that it has not been so imposed upon as to be entitled to be relieved from its bargain, it appears to be settled by *Pell*'s case,[23] and the others to which I have referred, of which*Anderson*'s case[24] is the most striking, that agreements by limited companies to pay for property or services in paid-up shares are valid and binding on the companies and their creditors …
>
> [If] a company owes a person £100, the company cannot by paying him £200 in shares of that nominal amount discharge him … from his obligation as a shareholder to pay up the other £100 in respect of those shares. That would be issuing shares at a discount. The difference between such a transaction and paying for property or services in shares at a price put upon them by a vendor and agreed to by the company may not always be very apparent in practice. But the two transactions are essentially different, and whilst the one is ultra vires the other is intra vires. It is not law that persons cannot sell property to a limited company for fully paid-up shares and make a profit by the transaction. We must not allow ourselves to be misled by talking of value. The value paid to the company is measured by the price at which the company agrees to buy what it thinks it worth its while to acquire. Whilst the transaction is unimpeached, this is the only value to be considered …
>
> AL SMITH and RIGBY LJJ delivered concurring judgments.

(p. 511) Note

This common law ruling may be contrasted with *Re Bradford Investments plc (No 2)* [1991] BCLC 688, which illustrates the operation of the statutory rules governing the issue of shares by public companies for a non-cash consideration. Here the four members of a partnership had converted a dormant private company into a public company and transferred the business of the partnership to it in consideration of the allotment to them of

1,059,000 fully paid £1 ordinary shares. No valuation of the business was obtained, as required by CA 1985 s 103 [CA 2006 s 593]. Two-and-a-half years later, the company, now under independent management, claimed £1,059,000 from the original partners as the issue price of the shares. The partners applied to the court under s 113 [CA 2006 s 606] to be relieved from liability to pay this sum. In this they were unsuccessful, for s 113 places the onus of proving that value was given on the applicants, and they were unable to satisfy the court that the partnership business had any net value at the time when it was transferred to the company.

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Find This Resource

Notes:

[1] This is a simplification: as is explained later (see 'Issue of shares at a premium', p 506), the total sum received by the company in exchange for the share may include both a 'capital' sum and a 'premium' sum. Both of these sums are subject to substantially similar restrictions on the possible uses the company may make of them, but the 'company's capital', in the strictest sense, includes only the former sums.

[2] See Chapters 12 and 16.

[3] See Chapter 16.

[4] See Chapter 10.

[5] See Chapter 14.

[6] It is not the same with partnerships, where the partners are personally liable for the debts of the partnership (with limitations on that liability only if the partnership is a Limited Liability Partnership): see 'Companies and partnerships', pp 23ff. Of course, if the company's directors have caused an unwarranted diminution in the company's assets, then the *company*, *not* the creditors, can sue the directors, and the recoveries will augment the company's assets, and be available for the benefit of the company's creditors (and its shareholders, if the company is solvent): see 'Pursuing claims for maladministration', pp 635ff. If the company is being wound up, different rules determine who may sue, and who may be sued: see 'Statutory framework', pp 768ff.

[7] And indeed, as indicated later, a sale of '£100,000 worth of shares' might well net the company more than £100,000.

[8] And note the permission in s 542(3), subject to s 765, to have share capital denominated in different currencies.

[9] And (although this has nothing to do with legal capital) when existing shareholders sell their shares to willing purchasers, whether privately or on a recognised market, they will again sell at whatever price the market will bear. This may be more or less than the nominal value of the shares, depending upon the success of the company and the estimated value of an interest in it.

[10] Note that the shareholder does not receive similar benefits: different shareholders may have purchased the same class of shares for different prices (ie paying different premia for shares of the same par value); if the company goes into solvent liquidation (ie there are assets to be returned to shareholders), then all shareholders will receive a return of their capital (ie the nominal capital associated with the share) and share equally in the division of any surplus profits.

[11] Where conflict of laws rules must be applied to decide which national law is appropriate to determine questions of title etc in relation to the shares, the accepted rule is that where ownership of the shares is recorded in a register, the appropriate law is that of the place where the register is kept, which is normally (but not always) the country of incorporation; but where the shares are in bearer form the certificates or warrants are regarded as negotiable instruments and the relevant law is that of the place where the documents happen to be (*Re Harvard Securities Ltd* [1997] 2 BCLC 369).

[12] See 'Terminology associated with legal capital', p 490, for the meaning of 'par value'.

[13] And, as of 1 October 2009, see the Allotment of Shares and Rights of Pre-Emption (Amendment) Regulations 2009 (SI 2009/2561).

[14] Although pre-emption rights are mandatory in the EU, they have been abandoned in the United States. The reasons for pre-emption rights are examined in Paul Myners,*Pre-Emption Rights: Final Report* (URN 05/679) (DTI, 2005). Also see LCB Gower, 'Some Contrasts between British and American Corporation Law?' (1956) 69 *Harvard Law Review* 1369.

[15] The measure of damages is normally the difference between the price that was paid for the shares and their true value at the time of the transaction, together with any consequential loss. Exceptionally (eg where the defendant's fraud has created a false market or was such as to have prevented the victim from realising the shares at that time), a different value may be substituted: *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254, HL.

[16] This has now been modified by *Collins v Associated Greyhound Racecourses Ltd* [1930] 1 Ch 1, to require that, to the knowledge of the company or its agents, the contract was made on the basis of particular representations that later turned out to be untrue.

[17] See *Hedley Byrne and Co Ltd v Heller and Partners Ltd* [1964] AC 465; *Caparo Industries plc v Dickman* **[8.04]**, but so far no cases seem to have been brought for misstatements in offers.

[18] Under the statute, damages are said to be measured in the same way as for fraud, regardless of the type of misrepresentation: *Royscot Trust Ltd v Rogerson* [1991] 2 QB 297, strongly criticised in R Hooley, 'Damages and the Misrepresentation Act 1967?' (1991) 107 LQR 547.

[19] But not debentures: see ‘Issue of debentures at a discount’, p 506.

[20] [1875] LR 7 HL 653, HL.

[21] As in fact happened in *Ooregum*: soon afterwards, the company struck gold and its ordinary shares rose in value from 12½p to £2.

[22] The directors would not breach any legal duty to the company (see **[9.08]**), but the existing shareholders might complain of unfairly prejudicial treatment (CA 2006 s 994). The statutory pre-emption rights are designed to help, but do not always apply or meet the problem: see ‘Pre-emption rights governing the transfer of existing shares’, p 497.

[23] (1869) 5 Ch App 11.

[24] (1877) 7 Ch D 75.