to prevent inappropriate judicial activism in 'second-guessing companies with regard to the appropriateness or wisdom of the terms of any transaction' (per Lord Mance, *Progress Property Co Ltd v Moore*, **[10.15]**)?

Further Reading


ARMOUR, J, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law?' (2000) 63 MLR 355.
Find This Resource

CLEMENTELLI, F, '(Under)valuing the Rules on Capital Maintenance' [2012] *International Company and Commercial Law Review* 191.
Find This Resource

DAVENPORT, B, 'What Did *Russell v Northern Bank Development Corporation Ltd* Decide?' (1993) 109 LQR 533.
Find This Resource

FERRAN, E, 'Simplification of European Company Law on Financial Assistance' (2005) 6 *European Business Organisation Law Review* 93.
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FERRAN, E, 'Corporate Transactions and Financial Assistance: Shifting Policy Perceptions but Static Law' [2004] CLJ 225.
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HO, LC, 'Financial Assistance after *Chaston* and *MT Realisations*: Deepsix and Double Think' [2003] *Journal of International Banking Law and Regulation* 424.
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MICHELER, E, 'Disguised Returns of Capital—An Arm's Length Approach' [2010] CLJ 151.
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NIRANJAN, V and NARAVANE, S, 'A Reassessment of Fundamental Dividend Principles' [2009] *International Company and Commercial Law Review* 88.
Find This Resource

PAYNE, J, 'Unjust Enrichment, Trusts and Recipient Liability for Unlawful Dividends' (2003) 119 LQR 583.
Find This Resource

PROCTOR, C, 'Financial Assistance: New Proposals and New Perspectives?' (2007) 28 *Company Lawyer* 3.
Find This Resource

THAM, CH, 'Unjust Enrichment and Unlawful Dividends: A Step Too Far' [2005] CLJ 177.
Find This Resource


## Notes:

[1] A limited statutory exception allowing companies to issue redeemable *preference* shares had existed since 1929. Now redeemable shares can be of any class.

[2] Also revisit some of the further reading from Chapter 9: see especially J Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law?' (2000) 63 MLR 355; J Rickford et al, 'Reforming Capital?' (2004) 15 *European Business Law Review* 919; J Armour, 'Legal Capital: An Outdated Concept?' (2006) 7*European Business Organization Law Review* 5; E Ferran, 'Creditors' Interests and "Core" Company Law?' (1999)

20 *Company Lawyer* 314; and also E Ferran, 'Financial Assistance: Changing Policy Perceptions but Static Law' [2004] CLJ 225.

[3] If the company's articles prohibit reductions of capital, then the company's articles will first have to be altered before this procedure can be followed: see CA 2006 s 641(6) and 'Permitted reductions of capital', p 513.

[4] A creditor can object only by demonstrating 'a particular present assessment about a future state of affairs'; thus the 'entirely theoretical possibility' of certain pension claims does not suffice: *In re Liberty International plc* [2010] EWHC 1060 (Ch), per Norris J.

[5] See 'Classes of shares and class rights', pp 556ff.

[6] [1894] AC 399.

[7] These articles dealt respectively with the paying off of the preference capital out of a reserve fund, and the distribution of capitalised profits, in the form of bonus shares, to the ordinary shareholders.

[8] These are important qualifications—see the following extract.

[9] A company, in reducing its capital, is not bound to pay off its shareholders in cash: see *Ex p Westburn Sugar Refineries Ltd* [1951] AC 625, HL.

[10] [1937] AC 707.

[11] There is no return of capital to the member in such cases: the company keeps whatever payments have already been made on the shares, and under the terms of the company's articles the forfeited shares may normally be re-issued to another holder.

[12] Treasury shares cannot vote or receive dividends (other than by way of bonus shares); they can be sold (or used to fund a bonus issue or employee share scheme), or may be cancelled (ss 726–731).

[13] There are exceptions for subsidiaries acting as personal representatives or trustees, or as authorised dealers in securities.

[14] But not a subsidiary which is a foreign company: CA 2006 s 1(1), as applied to s 678, and giving effect to *Arab Bank plc v Mercantile Holdings Ltd* [1994] Ch 71 (Millett J).

[15] There is also a prohibition on the provision of financial assistance by a *public* company subsidiary for the acquisition of shares in its *private* holding company (s 689).

[16] Although of course there are other control mechanisms, eg directors' duties ('General issues', pp 309ff), 'wrongful trading' provisions (*Re Produce Marketing Consortium Ltd (No 2)* **[16.16]**), and other CA 2006 and Insolvency Act 1986 (IA 1986) rules.

[17] It follows that where a company has re-registered as a private company since the shares were acquired and is a private company at the time the post-acquisition assistance is given, the prohibition will not apply. On the other hand, if at the time the shares were acquired the company was a private company, but at the time the post-acquisition assistance is given it has re-registered as a public company, the prohibition will apply.

[18] Note that the prohibition does not have extra-territorial effect, so assistance can be given by an overseas subsidiary for the purchase of shares in its UK holding company:*Arab Bank plc v Mercantile Holdings Ltd* [1994] Ch 71. The fact that such assistance reduces the value of the subsidiary's shares, and so reduces the net assets of the holding company, does not turn the arrangement into financial assistance by the holding company: *AMG Global Nominees (Private) Ltd v Africa Resources Ltd* [2008] EWCA Civ 1278, [2009] 1 BCLC 281.

[19] In applying those findings to cases concerning acquisitions of shares in *private* companies, however, they have been superseded by CA 2006 s 678.

[20] It was also claimed that the transfer by Brady of its assets was *ultra vires*. In the Court of Appeal, Nourse LJ

accepted this contention; but the House of Lords held that the transfer was within the company's objects.

[21] Given the detailed legal examination that this problem must have been subjected to, it seems remarkable that no one had thought of this option well before the case was concluded in the House of Lords.

[22] By contrast, see the comment made earlier in the judgment that assistance is generally considered to be given on the date when the commitment to provide it is entered into, rather than the date on which the money is paid: *Parlett v Guppys (Bridport) Ltd* [1996] BCC 299. This is because the net assets of the company making the commitment are impaired at the date it is given.

[23] See especially the much criticised case of *Victor Battery Co Ltd v Curry's Ltd* [1946] Ch 242. This case has now been disapproved or not followed in a series of subsequent cases, and is accepted as wrong.

[24] [1967] 2 AC 224 (sub nom *Churchill v Walton*).

[25] [1974] 1 WLR 991.

[26] [1961] CA Transcript 388.

[27] [1964] AC 287.

[28] See, however, the ruling in the *Belmont* case **[10.10]**.

[29] This was never the law in Scotland: *Westburn Sugar Refineries Ltd v IRC* [1960] TR 105.

[30] The term 'realised' is not defined in the Act (although see s 841), but formal guidance is given by accountancy practice. It is, however, acknowledged that the concepts of realised profits and losses will change over time, reflecting changes in the financial environment, and accountancy guidelines change accordingly.

[31] Given the general rule on available profits in s 830, this requirement seems to add nothing, but it is specifically included in s 831(1) for public companies.

[32] A declaration was held to be unlawful on the ground that no accounts had been prepared: *Vardy Properties v Revenue and Customs Commissioners* [2012] UKFTT 564 (TC), [2012] SFTD 1398.

[33] These proprietary remedies may now be excluded by the analysis adopted in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, HL.

[34] Bonus issues may also be financed out of the share premium account and capital redemption reserve.

[35] This confirms the position at common law declared by Buckley J in *Dimbula Valley (Ceylon) Co Ltd v Laurie* [1961] Ch 353, but the judge's reasoning (based on the view that such profits were distributable) has not survived the statutory changes of 1980.

[36] See 'The courts' discretion to order a compulsory winding up', pp 803ff.

# 11. Shares

**Chapter: (p. 556)** 11. Shares
**Author(s):** Len Sealy and Sarah Worthington
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## The nature and classification of shares

Recall the description of a share given at 'The legal nature of shares', p 493, and in *Borland's Trustee v Steel Bros & Co Ltd* **[9.01]**. It indicated that shares are a means of denoting three things: first, the shareholders' *financial stake* in the company (including the shareholders' liability to contribute funds to the company, and rights to capital and income receipts from the company); secondly, their *interest in the company as an association* (including rights as members, especially voting rights and rights conferred by statute and the company's constitution); and, thirdly, their rights as owners of a species of *property* (which is able to be bought, sold, charged, etc, and in which there can be both legal and equitable interests).

This chapter is about the nature of the asset held by shareholders, and the rights that accrue as a result of that ownership.[1] It does not consider the *uses* that shareholders may make of their voting power in the company or their rights to influence and control the management of the company in other ways. That is discussed at various stages in this book, especially in Chapters 4, 6 and 13. It does, however, look at the initial allocation of financial and voting rights to different classes of shares and the variation of those rights, the rights to transfer shares and the protections associated with that and, finally, the valuation of shares.

In total, these combined privileges and limitations on voting and financial rights raise the question of what it means when we say that the shareholders 'own' the company. The answer is material in differentiating the rights of shareholders from those of creditors, employees and other outsiders, as highlighted in the corporate governance debates associated with this: recall the 'shareholder' and 'stakeholder' views of a company and their impact on corporate governance issues (see 'Directors' duties are owed to the company', pp 319ff).

## Classes of shares and class rights

'Classes of shares' and 'class rights' are not defined in the Companies Act 2006 (CA 2006), other than in s 629. Nevertheless, the shares in a company may be divided into different classes, either by the company's constitution, or by the terms of the share issue itself. The differing rights usually relate to entitlements to vote, entitlements to dividends and entitlements to a return of capital when the company is wound up. Some classes of shares may fall into a well-known category such as 'preference shares', but even so there is no fixed formula defining such shares: it is a matter of construction of the terms of issue in each case what the **(p. 557)** rights of the particular class are. In broad terms, however, we may describe some well-known types of shares as follows:

*Ordinary shares*: this is the basic or residual category. If all the company's shares are issued without differentiation, they will be ordinary shares. If the shares are divided into classes, and the special rights of such classes are set out, the remaining shares will be ordinary shares. Where the class or classes of shares are preference shares, then the ordinary shares are commonly called 'equity' shares; but in CA 2006 this term has a more elaborate definition (see s 548).

*Preference shares*: these shares will usually be entitled to have dividends paid, at a predetermined rate (eg at a rate of 10% on their nominal value) in priority to any dividend on the ordinary shares. Of course, it is first necessary for the company to have distributable profits, and for a dividend to be declared. However, if these conditions are met, the first claim on the corporate profits in any year will be that of the preference shareholders. The right to a preference dividend may be *cumulative* (in which case arrears of preference dividends not declared in earlier years must be paid, as well as that for the current year, before any dividend is paid to the ordinary shareholders) or *non-*

*cumulative* (when only the current year's preference dividend is payable). Where the preference shares are *participating*, they will be entitled to a further distribution after the ordinary shareholders have received a dividend equivalent to their own 10% (or whatever the rate is). A company may have more than one class of preference shares, ranking one behind the other.

Preference shareholders commonly also have a right to priority over the ordinary shareholders when capital is returned to the members in a winding up. It is quite usual for preference shareholders to have no voting rights at shareholders' meetings, or alternatively to have a vote only if the preference dividend is in arrears.

*Deferred shares*: these are sometimes called 'founders' shares' reflecting the founders' offer to defer their own entitlements to those of other investors from whom additional capital is sought. They are not common today except as part of tax-saving schemes. As the name implies, deferred shares normally enjoy rights to distributable profit or to return of capital ranking *after* the claims of the preference shareholders (if any) and the ordinary shareholders.

*Redeemable shares*: these are created on terms that they shall be (or, at the option of the company or of the member, may be) bought back by the company at a future date. The rules governing such shares and their redemption are set out in CA 2006 ss 684ff. Prior to 1981, only preference shares could be issued as redeemable. Although that rule fell away, it is now clear that a company must always have *some* non-redeemable shares (s 684(4)). The rules on the issue of redeemable shares and their redemption were discussed at 'Redemptions and repurchases of shares', pp 520ff.

*Non-voting shares*: these may be issued where it is sought to restrict control of the company to the holders of the remaining shares. This is quite commonly desired when a family-controlled company looks to outside investors for additional capital (although it may, of course, find that the latter are not prepared to invest on those terms). A capital structure which includes non-voting shares may also be imposed on a company by an outside body, for example as a condition of obtaining a broadcasting licence (see*Heron International Ltd v Lord Grade* **[7.07]**). The Stock Exchange does not encourage listed companies to create non-voting shares, although it does not ban them altogether; they must, however, be clearly designated.

*Shares with limited voting rights or enhanced voting rights*: these may also be created, even to the extent of giving one shareholder a right of veto in specified circumstances. We have seen examples in *Quin & Axtens Ltd v Salmon* **[4.06]** and *Bushell v Faith* **[6.02]**.[2]

**(p. 558)** *Employees' shares*: many companies issue shares to their employees, commonly under an 'employees' share scheme' (defined in CA 2006 s 1166), which carries certain tax advantages. Employees' shares are not usually designated as a separate class of shares by the articles of association, but are issued simply as ordinary shares (or, as the case may be, preference shares, etc) ranking *pari passu* with the other shares of this class. Normally, however, they are subject to special restrictions (eg as to the holder's right of disposal) and would undoubtedly be regarded as a separate class of shares for some legal purposes. Various sections of CA 2006 make special provision for employees' shares, for example s 566 excludes shares that are to be held under an employees' share scheme from the restrictions (but not the benefits) of the usual pre-emptive rights rules.

In addition, of course, classes of shares may be created for other reasons. Thus a 'quasi-partnership' company with three founding shareholders might well have a capital of £300 divided into £100 in 'A' shares, £100 in 'B' shares and £100 in 'C' shares, the shares to rank equally in all respects except that each class should have the right to appoint one of the directors to the board. In this way, the right of each founder to participate in management could be entrenched.

Some common law rules about classes of shares and about the construction of the terms of issue of shares are illustrated by the cases which follow. The question of variation of class rights is discussed in the next section.

***A company may alter its articles so as to take power to issue shares ranking in preference to its existing shares. There is no implied condition in a company's articles that all the shares in a company shall be equal.***

**[11.01] Andrews v Gas Meter Co [1897] 1 Ch 361 (Court of Appeal)**

The facts appear from the judgment.

The judgment of the court (LINDLEY, AL SMITH and RIGBY LJJ) was delivered by LINDLEY LJ: The question raised by this appeal is whether certain preference shares issued by a limited company as long ago as 1865 were validly issued or not … The company's original capital as stated in its memorandum of association was '£60,000, divided into 600 shares of £100 each, every share being sub-divisible into fifths, with power to increase the capital as provided by the articles of association'. By the articles of association which accompanied the memorandum of association, and were registered with it, power was given to the company to increase the capital (article 27), and it was provided that any new capital should be considered as part of the original capital (article 28). The issue of preference shares was not contemplated or authorised. In 1865 the company desired to acquire additional works, and passed a special resolution … altering the articles and authorising the issue of 100 shares of £100 each, fully paid, and bearing a preferential dividend of £5 per cent per annum. Those shares were accordingly issued to the vendors of the works referred to, and are the shares the validity of which is now in question … The learned judge has held that the creation of the preference shares was ultra vires, and that their holders never became and are not now shareholders in the company, and that they have none of the rights of shareholders, whether preference or ordinary … The judgment against the validity of the preference shares is based upon the well-known case of *Hutton v Scarborough Cliff Hotel Co Ltd*,[3] which came twice before Kindersley V-C in 1865, and which Kekewich J [the trial judge] very naturally held to be binding on him. Kindersley V-C's first decision was that a limited company which had not issued the whole of its original capital could not issue the unallotted shares as preference shares unless authorised so to do by its memorandum **(p. 559)** of association or by its articles of association. This decision was affirmed on appeal, and was obviously correct; and would have been correct even if the whole of the original capital had been issued and the preference shares had been new and additional capital. The company, however, afterwards passed a special resolution altering the articles and authorising an issue of preference shares. This raised an entirely different question, and led to the second decision. The Vice-Chancellor granted an injunction restraining the issue of the preference shares, and he held distinctly that the resolution altering the articles was ultra vires. He did so upon the ground, as we understand his judgment, that there was in the memorandum of association a condition that all the shareholders should stand on an equal footing as to the receipt of dividends, and that this condition was one which could not be got rid of by a special resolution altering the articles of association under the powers conferred by ss 50 and 51 of the Act [CA 2006 ss 21 and 283 (changed)]. The judgment of the Vice-Chancellor is a little obscure, because he treats the condition as a condition of the constitution of the company, and he may have meant by that expression either the constitution as fixed by the memorandum of association or the constitution as fixed by the memorandum of association and the original articles. But unless he had meant the constitution of the company as fixed by the memorandum of association his decision is unintelligible; for, so far as the constitution depended on the articles, it clearly could be altered by special resolution under the powers conferred by ss 50 and 51 of the Act …

[His Lordship examined a number of cases, and continued:] These decisions turned upon the principle that although by s 8 of the Act [CA 2006 changes these rules; see Chapter 1] the memorandum is to state the amount of the original capital and the number of shares into which it is to be divided, yet in other respects the rights of the shareholders in respect of their shares and the terms on which additional capital may be raised are matters to be regulated by the articles of association rather than by the memorandum, and are, therefore, matters which … may be determined by the company from time to time by special resolution pursuant to s 50 of the Act. This view, however, clearly negatives the doctrine that there is a condition in the memorandum of association that all shareholders are to be on an equality unless the memorandum itself shows the contrary. That proposition is, in our opinion, unsound …

➢ Note

Although this case established that there is no implied condition in the constitution of a company that all its shares should rank equally, there is nevertheless a presumption (as is shown by the cases which follow) that all shares do enjoy equal rights unless the terms of issue make some express provision to the contrary.

In many jurisdictions of the United States, the principle of equality as between shares was developed much further by the courts, so that shareholders commonly have pre-emptive rights as regards any new shares issued. This has been achieved in the UK only by legislation; see 'Pre-emption rights governing the issue of new shares', pp 496ff.

***Where the terms of issue make no express distinction between the rights of different categories of share in respect of (i) dividend, (ii) the return of capital (and participation in surplus assets in a winding up), or (iii) voting, the rule of construction in each case is that, prima facie, all shareholders rank equally. The fact that a preference in respect of any one of these matters is conferred does not imply any right to preference in some other respect: the presumption of equality is undisturbed.***

**[11.02] Birch v Cropper (1889) 14 App Cas 525 (House of Lords)**

The articles of the Bridgewater Navigation Co Ltd provided that dividends should be paid in proportion to the amounts paid up on the shares. There was no express provision governing the distribution of assets in a winding up. The company had issued 5% preference shares at £10 each which were paid up in full, and ordinary shares of £10 on which £3.50 had been **(p. 560)** paid. The House of Lords, reversing the Court of Appeal and varying the order of North J, held that in distributing the surplus assets available in the company's liquidation after the return of capital, the paid-up and partly paid shares were to be treated alike; and that the preference shareholders were to participate rateably with the ordinary shareholders in proportion to the nominal amounts of the shares held.

> LORD MACNAGHTEN:… Every person who becomes a member of a company limited by shares of equal amount becomes entitled to a proportionate part in the capital of the company, and, unless it be otherwise provided by the regulations of the company, entitled, as a necessary consequence, to the same proportionate part in all the property of the company, including its uncalled capital. He is liable in respect of all moneys unpaid on his shares to pay up every call that is duly made upon him. But he does not by such payment acquire any further or other interest in the capital of the company. His share in the capital is just what it was before. His liability to the company is diminished by the amount paid. His contribution is merged in the common fund. And that is all.
>
> When the company is wound up, new rights and liabilities arise. The power of the directors to make calls is at an end; but every present member, so far as his shares are unpaid, is liable to contribute to the assets of the company to an amount sufficient for the payment of its debts and liabilities, the costs of winding up, and such sums as may be required for the adjustment of the rights of the contributories[4] amongst themselves …
>
> Amongst the rights to be adjusted, the most important are those which arise when there is a difference between shareholders in the amount of calls paid in respect of their shares. Before winding up no such rights exist; whatever has been paid by the shareholders of one issue in excess of the contributions of their fellow shareholders of a different issue, must have been paid in pursuance of calls duly made or in accordance with the conditions under which the shares were held. While the company is a going concern no capital can be returned to the shareholders, except under the statutory provisions in that behalf. There is therefore during that period no ground for complaint; no room for equities arising out of unequal contributions. In the case of winding up everything is changed. The assets have to be distributed. The rights arising from unequal contributions on shares of equal amounts must be adjusted, and the property of the company, including its uncalled capital not required to satisfy prior claims, must be applied for that purpose. But when those rights are adjusted, when the capital is equalised, what equity founded on inequality of contribution can possibly remain? The rights and interests of the contributories in the company must then be simply in proportion to their shares …
>
> It now only remains to deal with the various claims put forward in the course of the argument.

The ordinary shareholders say that the preference shareholders are entitled to a return of their capital, with 5% interest up to the day of payment, and to nothing more. That is treating them as if they were debenture-holders, liable to be paid off at a moment's notice. Then they say that at the utmost the preference shareholders are only entitled to the capital value of a perpetual annuity of 5% upon the amounts paid up by them. That is treating them as if they were holders of irredeemable debentures. But they are not debenture-holders at all. For some reason or other the company invited them to come in as shareholders, and they must be treated as having all the rights of shareholders, except so far as they renounced those rights on their admission to the company. There was an express bargain made as to their rights in respect of profits arising from the business of the company. But there was no bargain—no provision of any sort—affecting their rights as shareholders in the capital of the company.

Then the preference shareholders say to the ordinary shareholders, 'We have paid up the whole of the amount due on our shares; you have paid but a fraction on yours. The prosperity of a company results from its paid-up capital; distribution must be in proportion to contribution. The surplus assets **(p. 561)** must be divided in proportion to the amounts paid up on the shares.' That seems to me to be ignoring altogether the elementary principles applicable to joint-stock companies of this description. I think it rather leads to confusion to speak of the assets which are the subject of this application as 'surplus assets' as if they were an accretion or addition to the capital of the company capable of being distinguished from it and open to different considerations. They are part and parcel of the property of the company—part and parcel of the joint stock or common fund—which at the date of the winding up represented the capital of the company. It is through their shares in the capital, and through their shares alone, that members of a company limited by shares become entitled to participate in the property of the company. The shares in this company were all of the same amount. Every contributory who held a preference share at the date of the winding up must have taken that share and must have held it on the terms of paying up all calls duly made upon him in respect thereof. In paying up his share in full he has done no more than he contracted to do; why should he have more than he bargained for? Every contributory who was the holder of an ordinary share at the date of the winding up took his share and held it on similar terms. He has done all he contracted to do; why should he have less than his bargain? When the preference shareholders and the ordinary shareholders are once placed on exactly the same footing in regard to the amounts paid up upon their shares, what is there to alter rights which were the subject of express contract?…

Then it is said on behalf of the preference shareholders that the provision for payment of dividends in proportion to the amounts paid up on the shares leads to an inference that the distribution of surplus assets was to be made in the same proportion. I do not think that it leads to any inference of the kind. It is a very common provision nowadays, though it is not what you find in Table A, and it is a very reasonable provision, because during the continuance of the company, and while it is a going concern, it prevents any sense of dissatisfaction on the part of those who have paid more on their shares than their fellow shareholders of a different issue. But when it has come to an end I cannot see how it can be used to regulate or disturb rights with which it had nothing to do even while it was in force …

LORDS HERSCHELL and FITZGERALD delivered concurring opinions.

***Where the terms of issue do make express provision as to the rights of a class of shares in respect of (i) dividend, (ii) the return of capital (and participation in surplus assets), or (iii) voting, then that provision is presumed to be an exhaustive statement of the rights of the class in that particular respect.***

**[11.03] Re National Telephone Co [1914] 1 Ch 755 (Chancery Division)**

SARGANT J: [It] appears to me that the weight of authority is in favour of the view that, either with regard to dividend or with regard to the rights in a winding up, the express gift or attachment of preferential rights to preference shares, on their creation, is, prima facie, a definition of the whole of their rights in that respect, and negatives any further or other right to which, but for the specified rights, they would have been entitled …

**[11.04] Scottish Insurance Corpn Ltd v Wilsons and Clyde Coal Co Ltd [1949] AC 462 (House of Lords)**

For the facts and another part of the decision, see **[10.01]**.

The rights of the preference shareholders were, so far as is material, defined by articles 159 and 160 of the articles of association as follows:

> 159. In the event of the company being wound up, the preference shares (first issue) shall rank before the other shares of the company on the property of the company, to the extent of repayment of the amounts called up and paid thereon.
>
> **(p. 562)** 160. In the event of the company being wound up, the preference shares (second issue) shall rank before the ordinary shares but after the said preference shares (first issue) on the property of the company to the extent of repayment of the amounts called up and paid thereon.
>
> LORD SIMONDS: It is clear from the authorities, and would be clear without them, that, subject to any relevant provision of the general law, the rights inter se of preference and ordinary shareholders must depend on the terms of the instrument which contains the bargain that they have made with the company and each other. This means that there is a question of construction to be determined, and undesirable though it may be that fine distinctions should be drawn in commercial documents such as articles of association of a company, your Lordships cannot decide that the articles here under review have a particular meaning, because to somewhat similar articles in such cases as *Re William Metcalfe & Sons Ltd*[5] that meaning has been judicially attributed. Reading the relevant articles, as a whole, I come to the conclusion that articles 159 and 160 are exhaustive of the rights of the preference stockholders in a winding up. The whole tenor of the articles, as I have already pointed out, is to leave the ordinary stockholders masters of the situation. If there are 'surplus assets' it is because the ordinary stockholders have contrived that it should be so, and, though this is not decisive, in determining what the parties meant by their bargain, it is of some weight that it should be in the power of one class so to act that there will or will not be surplus assets …
>
> But, apart from those more general considerations, the words of the specifically relevant articles, 'rank before the other shares … on the property of the company to the extent of repayment of the amounts called up and paid thereon', appears to me apt to define exhaustively the rights of the preference stockholders in a winding up. Similar words, in *Will v United Lankat Plantations Co Ltd*[6] 'rank, both as regards capital and dividend, in priority to the other shares', were held to define exhaustively the rights of preference shareholders to dividend, and I do not find in the speeches of Viscount Haldane LC or Earl Loreburn in that case any suggestion that a different result would have followed if the dispute had been in regard to capital. I do not ignore that in the same case in the Court of Appeal[7] the distinction between dividend and capital was expressly made by both Cozens-Hardy MR and Farwell LJ, and that in *Re William Metcalfe & Sons Ltd*, Romer LJ reasserted it. But I share the difficulty, which Lord Keith has expressed in this case, in reconciling the reasoning that lies behind the judgments in *Will's* case and *Re William Melcalfe & Sons Ltd* respectively. [His Lordship accordingly held that the latter decision should be overruled.]
>
> VISCOUNT MAUGHAM and LORD NORMAND delivered concurring opinions.
>
> LORD MORTON OF HENRYTON dissented.

➢ Note

The conclusion reached in the *Scottish Insurance* case naturally made preference shares a less secure form of investment. It was also thought at the time to be harsh on the holders of such shares, for the overruling of *Metcalfe*'s case inevitably depressed the value of shares carrying a high rate of return. To offset the effect of the*Scottish Insurance* decision, many listed companies have since adopted the 'Spens formula', under which the sum to be repaid to preference shareholders on a reduction of capital is geared to the recent market price of the shares.

(p. 563) ## Variation of class rights

### Statutory requirements

If the share capital of a company has been divided into classes,[8] statutory provisions come into play, defining the ability of the company to alter the rights attached to a class of shares. CA 2006 s 630 provides that class rights may only be varied:

**(i)** in accordance with the relevant provisions in the company's articles; or
**(ii)** if no provision is made in the articles, if three-quarters in value of the shares of that class consent in writing, or a special resolution is passed at a separate meeting of the holders of such shares (also see ss 283 and 334).[9]

The company's articles may specify either more *or* less onerous provisions for variation of class rights than the default provisions in the Act.[10] All three sets of model articles of association (for private companies, companies limited by guarantee and public companies) make provision for the issue of shares of different classes, but make no special provisions for variation of class rights. However, if the company *entrenches* the class rights in its articles (ie sets conditions for change that are more demanding than the special resolution procedure) then that protection cannot be circumvented by changing the rights attached to the class of shares under s 630: see ss 630(3) and 22.

### Additional common law requirements

These statutory provisions are reinforced by a rule of common law established in the *British American Nickel* case **[11.06]**. This case establishes the rule that members voting at a class meeting must act 'for the purpose of benefiting the class as a whole'. This obviously has some links with the principle of *Allen v Gold Reefs of West Africa Ltd* **[4.22]**, that members must vote 'bona fide for the benefit of the company as a whole'. That principle has been extended in some later cases (eg *Re Holders Investment Trust Ltd* **[10.04]**). If taken literally, the rule as so interpreted would not permit the class to subordinate its own interests to those of the company as a whole, and class rights could never be varied except to the class-holders' advantage. This surely cannot have been intended. On the other hand, some limitations on the exercise of majority voting power are now a familiar theme from earlier chapters.

### Meaning of 'class right'

These statutory provisions apply only if the shareholders have 'class rights',[11] and only if those rights have been 'varied'. Both requirements have caused more debate than might be imagined. **(p. 564)** Indeed, some textbooks devote considerable attention to the meaning and scope of the term 'class right'. If the preference shareholders have a right under the articles to a 10% preference dividend, that is obviously a 'class right', but if the articles say nothing about the dividend rights of ordinary shareholders in the same company, is their dividend right a 'class right' too? And if nothing is said about voting in regard to either class of shares in their terms of issue, are their voting rights 'class rights'? In the example given following the list of types of shares in 'Classes of shares and class rights', p 556, where the only expressed right is that of appointing a director, are the dividend rights of each class 'class rights'?

In the *Cumbrian Newspapers* case **[11.05]**, Scott J was called on to give the first judicial consideration to the meaning of the terms 'class of shares' and 'class rights'. His conclusion was that they might extend to include cases where rights are enjoyed by a particular member or category of members but no specific shares are designated to which those rights are referable.[12] This is a surprisingly wide interpretation, but has the merit of ensuring that the protection conferred by s 630 will be applied fairly comprehensively.

## Defining a 'variation' of class rights

The only light thrown on this issue by the Act itself is in s 630(5) and (6). Section 630(5) states that amendment or insertion of a 'variation of rights' provision in the articles is itself a variation of rights. Section 630(6) deals with the extinction of rights but not the extinction of the share itself: *Re Saltdean Estate Co Ltd* **[10.03]**.

Paradoxically, the judges have not shown themselves anything like so solicitous for the interests of class members in the cases concerned with the interpretation of the term 'variation'. In many cases it may be possible to make class rights less effective without effecting any technical 'variation' of the rights themselves: this is illustrated by*White v Bristol Aeroplane Co* **[11.08]** and *Greenhalgh v Arderne Cinemas Ltd* **[11.09]**.

## Right of dissenting member to object to court

CA 2006 s 633 gives dissenting members of a class, who hold at least 15% of the shares of that class, the right to challenge the variation in court within 21 days. They are thus given access to the court free from the hazards of *Foss v Harbottle* **[13.01]**, but the requirements of 15% and the need to act within 21 days may lead to difficulties, especially in a large company.

***Rights enjoyed by a member may be class rights although they are not referable to particular shares.***

### [11.05] Cumbrian Newspapers Group Ltd v Cumberland and Westmorland Herald Newspaper and Printing Co Ltd [1987] Ch 1 (Chancery Division)

The plaintiff had acquired 10.67% of the ordinary shares in the defendant company ('Cumberland') in 1968 as part of an arrangement designed to concentrate the local newspaper publishing business under one title and to make it difficult for an outsider to acquire control of this paper. The articles of Cumberland were altered so that the plaintiff had (i) rights of pre-emption over the company's other ordinary shares (arts 7 and 9); (ii) rights in respect of unissued shares (art 5); and (iii) the right to appoint a director, so long as it held at least 10% of the shares (art 12). Scott J held that these were class rights enjoyed by the plaintiff which could only be altered pursuant to CA 1985 s 125 [CA 2006 s 630].

> **(p. 565)** SCOTT J: I turn to the critical question: are the plaintiff's rights under articles 5, 7, 9 and 12, rights attached to a class of shares?
>
> Rights or benefits which may be contained in articles can be divided into three different categories. First, there are rights or benefits which are annexed to particular shares. Classic examples of rights of this character are dividend rights and rights to participate in surplus assets on a winding up. If articles provide that particular shares carry particular rights not enjoyed by the holders of other shares, it is easy to conclude that the rights are attached to a class of shares, for the purpose both of s 125 of the Act of 1985 and of article 4 of Table A [1948]. It is common ground that rights falling into this category are rights attached to a class of shares for those purposes. Mr Howarth submitted at first that this category should be restricted to rights that were capable of being enjoyed by the holders for the time being of the shares in question. Such a restriction would exclude rights expressly attached to particular shares issued to some named individual, but expressed to determine upon transfer of the shares by the named individual. *Palmer's Company Precedents*, 17th edn (1956), Pt I, p 818, contains a form for the creation of a life governor's share in a company. Mr Howarth accepted that the rights attached to a share in accordance with this precedent would be rights attached to a class of shares. He accepted, rightly in my judgment, that a provision for defeasance of rights on alienation of the share to which the rights were attached, would not of itself prevent the rights, pre-alienation, from being properly described as rights attached to a class of shares. The plaintiff's rights under articles 5, 7, 9 and 12 cannot, however, be brought within this first category. The rights were not attached to any particular shares. In articles 5, 7 and 9, there is no reference to any current shareholding held by the plaintiff. The rights conferred on the plaintiff under article 12 are dependent on the plaintiff holding at least 10% of the issued ordinary shares in the defendant. But the rights are not attached to any particular shares. Any ordinary shares in the defendant, if sufficient in number and held by the plaintiff, would entitle the plaintiff to exercise the rights.