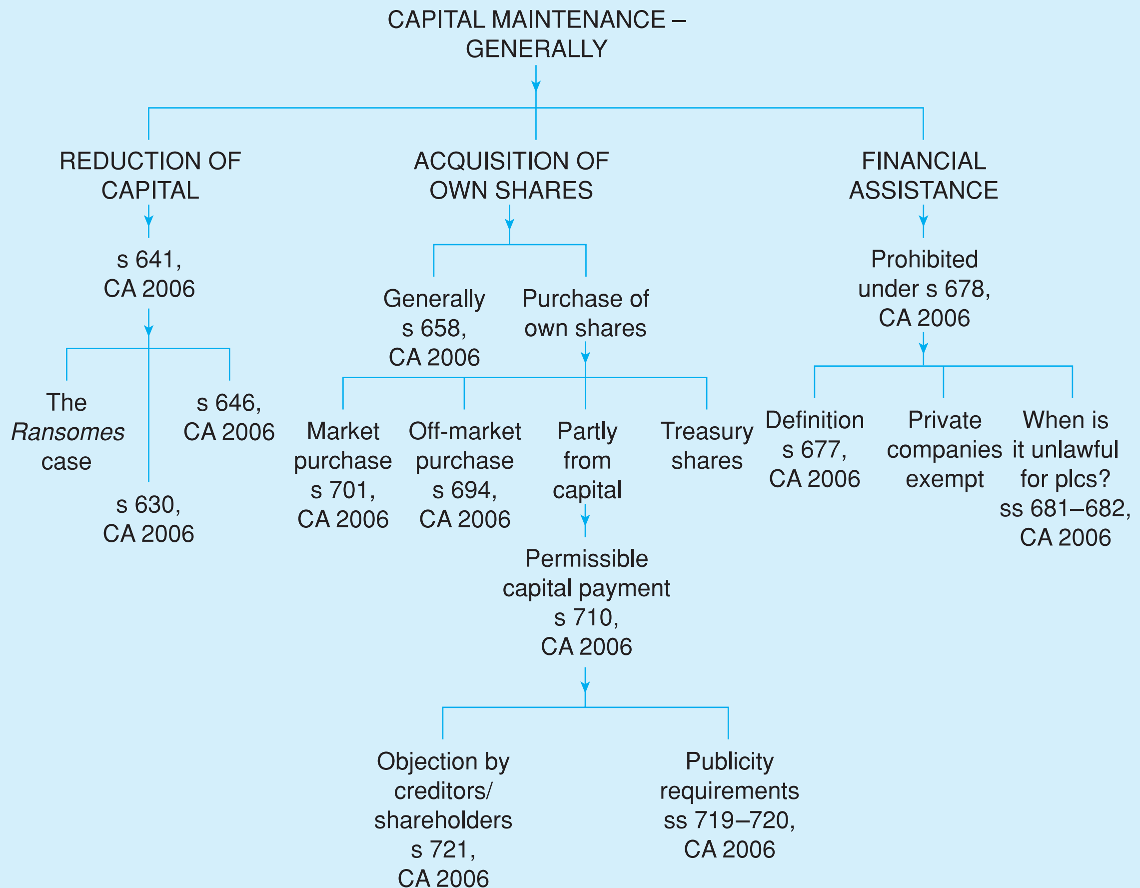
8 Capital maintenance – generally



The acceptance by English company law of the concept of limited liability has led to a need to protect the capital contributed by the members of such a company since those members cannot be required to contribute funds to enable the company to pay its debts once they have paid for their shares in full.

A creditor of a company must expect that the company's capital may be lost because of business misfortune. However, he can also expect that the company's shares will be paid for in full and that the company will not return the capital to its members.

Company legislation therefore deals with the legal freedom which companies have to reduce their share capital, focusing on such issues as the protection of the creditors' fund and the class rights of members such as preference shareholders; for which both groups would appear vulnerable within the context of capital reduction.

Borland's Trustee* v *Steel Bros & Co Ltd [1901] 1 Ch 279

The plaintiff was the trustee in bankruptcy of Mr J. E. Borland, and he claimed a declaration that the defendant company were not entitled to require the transfer of certain shares held by the bankrupt at any price whatever, and that the transfer articles of the company purporting to give them power to compel such transfer were void. He also claimed an injunction to restrain the company, their officers and agents, from calling for, enforcing, or effecting, a transfer of all or any of the bankrupt's ordinary shares at any price, or, alternatively, at any price less than the fair and actual value of such shares. Farwell J stated:

> It is said that the provisions of these articles compel a man at any time during the continuance of this company to sell his shares to particular persons at a particular price to be ascertained in the manner prescribed in the articles. Two arguments have been founded on that. It is said, first of all, that such provisions are repugnant to absolute ownership. It is said, further, that they tend to perpetuity. They are likened to the case of a settlor or testator who settles or gives a sum of money subject to executory limitations which are to arise in the future, interpreting the articles as if they provided that if at any time hereafter, during centuries to come, the company should desire the shares of a particular person, not being a manager or assistant, he must sell them. To my mind that is applying to company law a principle which is wholly inapplicable thereto. It is the first time that any such suggestion has been made, and it rests, I think, on a misconception of what a share in a company really is. A share, according to the plaintiff's argument, is a sum of money which is dealt with in a particular manner by what are called for the purpose of argument executory limitations. To my mind it is nothing of the sort. A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se in accordance with s. 16 of the Companies Act, 1862. The contract contained in the articles of association is one of the original incidents of the share. A share is not a sum of money settled in the way suggested, but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.

Held – the article was valid and enforceable. The rule against perpetuities had no application to personal contracts such as this.

Reduction of capital

A company limited by shares may only reduce its share capital in accordance with the procedures outlined in ss 641–653 (Chapter 10 of Part 16) of the Companies Act 2006 as stated in s 617(2)(b). In this regard, s 641 states that a limited company may reduce its share capital:

(a) in the case of a private company limited by shares, by special resolution supported by a solvency statement (ss 642–644);
(b) in any case, by a special resolution confirmed by the court (ss 645–651).

Once again, as noted in the previous chapter, s 641(2) underlines the fact that a company may not reduce its share capital if, as a result of the reduction, the only remaining shares held by members consisted entirely of redeemable shares.

Section 641(3) of the 2006 Act states that a company may reduce its share capital 'in any way', which may, in certain instances, lead to issues surrounding the possible variation or abrogation of class rights. Indeed, there are many examples of variations in share capital being linked with class rights. For instance, in ***Re Northern Engineering Industries plc*** [1993] BCLC 1151 the High Court decided that the rights of preference shareholders were to be regarded as varied by a reduction of capital in which the capital paid up on their shares was to be paid off and the shares cancelled. It could not be successfully argued that the word 'reduction' referred only to a situation in which the reduction was to a figure above zero. Therefore, the reduction had to be approved by class meetings of the company's three classes of preference shareholders.

General procedure for a reduction of capital

Section 641(1)(b) states that all limited companies may reduce their share capital by a special resolution confirmed by the court (ss 645–651). It is worth noting two points at this stage. First of all, the involvement of the court is designed so as to protect the interests of the company's creditors as well as those of any minority shareholders who may suffer as a result of such proposals. Secondly, it is worth noting that the previous requirement under s 135 of the Companies Act 1985 that the company has power under its articles of association to reduce its capital has been removed, streamlining the process involved.

The most obvious point to note is the fact that securing a special resolution may prove difficult for a company to achieve, especially where it chooses to undertake a reduction of capital which does not impact on all classes of shares in a similar fashion (see discussion in the previous chapter ➡). There is also the added complication of s 630 which states that if class rights are to be varied or abrogated then the company may be accomplished this only:

➡ See p. 144

(a) in accordance with provisions in the company's articles for the variation of class rights; or
(b) where the company's articles contain no such provision, if the holders of shares of that class consent to the variation in accordance with this section.

Furthermore, s 630(4) goes on to provide that the consent required under s 630(2)(b) is either (a) consent in writing from the holders of at least three-quarters in nominal value of the issued shares of that class; or (b) a special resolution, passed at a separate general meeting of the holders of that class, sanctioning the variation. Consequently, a resolution to vary the rights of a particular class is of no legal effect unless the consent of the class is obtained.

The question arises as to whether the reduction of share capital, in particular the reduction of a company's preference shares, falls within the scope of s 630. In this regard, it may be noted that s 645 only requires a copy of the resolution of the company (and not of the specific class). As such, there is an argument that the court could, in theory, approve such a reduction that impacts on class rights. However, in practice, this would not take place as the general

principle is that the court will require that the proposed reduction treats all shareholders equitably; ***Re Ransomes Plc*** [1999] 2 BCLC 591, CA.

Re Ransomes Plc [1999] 2 BCLC 591, CA

T agreed to take over RIC. The deal was structured so that a subsidiary of T, A, would acquire all of the ordinary shares in the company, most of its preference shares, and most of its convertible stock. An Australian company, W, was holder of preference shares. The proposal was to distribute shares to A and, inter alia, to cancel the share premium account. An extraordinary general meeting was called to approve this plan. W petitioned the court under the Companies Act 1985 s 137 to object that the proposal had not been explained in sufficiently clear terms and that the proposals had been generally put forward with undue haste. W further contended that the cancellation of the share premium account benefited the ordinary shareholders to the detriment of the preferred shareholders.

Held – dismissing the application – an application under s 137 was not equivalent to ordinary litigation, given that many such applications were made by one party only. The court was required to give its approval under s 137 to proposed restructurings and therefore the applicant would be subject to a duty of full and frank disclosure which should not be diluted in any way. It was within the ambit of the discretion of the trial judge to decide, as he had done, that the proposal was fair and that it did not prejudice the rights of preferred shareholders to receipt of future dividends. There had not been any deliberate lack of openness in the company's dealings with the court and therefore the judge was entitled to sanction the cancellation on the material before him.

Comment

The judge approved a reduction even though there was short notice of the meeting to pass the special resolution (without formal member approval). He did so, he said, because, in fact, the vast majority of the shareholders approved of the reduction. However, he warned that other companies would not be advised to infringe the procedural rules, especially where a significant minority was likely to withhold their consent.

If one considers the interests of the company's creditors, then according to s 645(2), if a proposed reduction of capital involves either (a) diminution of liability in respect of unpaid share capital; or (b) the payment to a shareholder of any paid-up share capital, then s 646 will apply unless the court directs otherwise.

Section 646 goes on to outline that every creditor of the company who at the time is entitled to any debt or claim, that would be admissible in proof against the company if it were to be wound-up, is entitled to object to the reduction in capital. In this regard, s 646(2) provides that the court shall settle a list of creditors entitled to object and is supported by s 647 which outlines the fact that it is an offence for an officer of the company to intentionally or recklessly conceal the name of a creditor entitled to object to the reduction of capital. If such an omission does in fact occur and a creditor discovers that they have been omitted from the list, s 653 provides that every person who was a member of the company at the date on which the resolution took effect under s 649(3) is liable to contribute for the payment of the debt or claim.

The general position under s 648(2) is that the court must not confirm the reduction of capital unless all of the creditors who have objected to the proposed reduction have consented, or their claims have been discharged or secured by the company (see ***Re Lucania Temperance Billiard Halls (London) Ltd*** [1966] Ch 98).

However, it should also be noted that s 646 does not automatically guarantee the position of creditors, since s 646(4) provides that the court may, if it thinks fit, dispense with the consent of a creditor securing payment of his debt or claim. Equally, s 648(1) provides that the court may make an order confirming the reduction of capital 'on such terms and conditions as it thinks fit'. With respect to this latter section, it may work both for and against the company, in essence providing that it is up to the court to determine the basis for a proposed reduction of its share capital.

Following confirmation by the court, s 649 provides on production of an order of the court confirming the reduction of a company's share capital and the delivery of a copy of the order and of a statement of capital approved by the court, the Registrar shall register the order and statement. (This is subject to the effect of s 650 on public limited companies.) Furthermore, under s 649(2), the statement of capital must outline:

(a) the total number of shares of the company;
(b) the aggregate nominal value of those shares;
(c) for each class of shares; (i) prescribed particulars of the rights attached to the shares; (ii) the total number of shares of that class; and (iii) the aggregate nominal value of shares of that class; and
(d) the amount paid up and the amount unpaid on each share.

Finally, according to s 649(4), notice of the registration of the order and statement of capital must be published in such a manner as the court may direct. Once registration has taken place, the order confirming the reduction will take effect (s 649).

Procedure available to private companies

The Companies Act 2006 introduces an alternative procedure for the reduction of capital by private companies, for which court confirmation is not needed and as such seeks to minimise the cost and time associated with securing confirmation from the courts. However, with respect to public limited companies, the law remains unchanged.

Section 641(1)(a) states that a private company may reduce its share capital by special resolution supported by a solvency statement.

The solvency statement must be in the prescribed form (s 643(3)) and the details required within it are outlined in s 643 and are based on the company's current and future financial positions. First of all, each of the directors must form the opinion that there is no ground on which the company could be found to be unable to pay its debts. Secondly, the statement requires them to form an opinion relating to one year into the future, in that:

(a) if it is intended to commence the winding up of the company within 12 months of that date, that the company will be able to pay its debts in full within 12 months of the commencement of winding-up; or
(b) in any other case, that the company will be able to pay its debts as they fall due during the year immediately following the date of this statement.

This is further supported by s 643(2) which outlines the fact that when forming these opinions, the directors must take into account all of the company's liabilities including any contingent or prospective liabilities. (It is worth comparing this requirement with the wording of s 123(1)(e) of the Insolvency Act 1986 whereby there is a noticeable similarity in approach.)

In addition, s 643(5) provides that an offence is committed by every officer who makes a solvency statement without having reasonable grounds for the opinions expressed therein. This reinforces the responsibility that has been placed on directors if this particular choice of approach is pursued by a company as opposed to seeking confirmation by the courts; the criminal sanctions outlined in s 643(5) reinforce the importance attached to the accuracy of the solvency statement.

Following the resolution to reduce its share capital, the company must within 15 days, deliver to the Registrar a copy of the solvency statement and a statement of capital (s 644(1)). With regards to the statement of capital, it must state with respect to the company's share capital as reduced by the resolution (s 644(2)):

(a) the total number of shares of the company;
(b) the aggregate nominal value of those shares;
(c) for each class of shares; (i) prescribed particulars of the rights attached to the shares; (ii) the total number of shares of that class; and (iii) the aggregate nominal value of shares of that class; and
(d) the amount paid up and the amount unpaid on each share.

With respect to the solvency statement, s 644(5) provides that the directors must deliver to the Registrar within 15 days after the resolution is passed, a statement confirming that the solvency statement was (a) not made more than 15 days before the date on which the resolution was passed; and (b) provided to members in accordance with s 642(2) or (3). If this latter issue is not complied with, then s 644(7) provides that an offence is committed by every officer of the company who is in default. Equally, if there is a delay in the process which takes the solvency statement outside the parameters set down by this section, the directors will be required to review and republish their solvency statement so as to comply with s 644(1).

Finally, s 644(3) provides that the Registrar must register the documents delivered to him under s 644(1) on receipt, with the resolution taking effect once registration (and, in essence, once the documentation has been made public) has taken place (s 644(4)).

Types of reduction

Under s 641 share capital can be reduced 'in any way'. The section, however, envisages three forms of reduction in particular (see s 641(4)):

(a) to extinguish or reduce the liability on any of its shares in respect of share capital not paid up;
(b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital that is lost or unrepresented by available assets;
(c) either with or without extinguishing or reducing liability on any of its shares, repay any paid-up share capital in excess of the company's wants.

In the first and third forms of reduction, it is clear that the creditors of the company are potentially in a worse position than prior to the reduction, thus falling within the intended scope of s 646 as outlined above. However, the second situation would appear to involve the company bringing its legal capital in line with its net asset position and as such not having the same impact on creditors. It is worth considering that s 641(4) enables a company to reduce for the reasons set out below:

(a) The company may have more capital than it needs and may wish to return some of it to shareholders. For example, a company may wish to return paid-up capital which is in

excess of its requirements where it has sold a part of its undertaking and intends in the future to confine its activities to running the remaining part of its business. The company may achieve its purpose by reducing the nominal value of its shares. Suppose that before the reduction the company had a share capital of 50,000 shares of £1 each, fully paid. On reduction it could substitute a share capital of 50,000 shares of 50p each fully paid, and return 50p per share in cash to the members.

(b) Share capital already issued may not be fully paid and yet the company may have all the capital it needs. Reduction in these circumstances may be effected as follows. If the company's share capital before reduction was 50,000 shares of £1 each, 50p paid, the company may reduce it to 50,000 shares of 50p each fully paid. However, liability for unpaid capital cannot be reduced by crediting a partly paid share as paid up to a greater extent than it has in fact been paid up (***Re Development Co of Central and West Africa*** [1902] Ch 547). Thus, it is not possible to leave the nominal value of the shares at £1 and cancel one share from every two held by shareholders, regarding the remaining one of the two as fully paid.

(c) Where the assets have suffered a realised loss as in ***Re Jupiter House Investments (Cambridge) Ltd*** [1985] 1 WLR 975 where the company had incurred a substantial loss on the sale of some of its property. In such a case a share capital of 50,000 shares of £1 each fully paid could be reduced to 50,000 shares of 50p each fully paid and no capital would be returned to shareholders.

(d) To comply with the law relating to distributions. The provisions relating to reduction have been increasingly used in more recent times to comply with the law relating to distributions, under which companies cannot pay a dividend unless and until any deficit on the profit and loss account is made good. In such a situation the company may wish to cancel a share premium account in order to offset a capital loss. Let us suppose that there is a balance of £5,000 in the P and L account, but the company has sold assets at a loss and suffered a realised loss of £6,000. There is, in effect, a deficit of £1,000 on the P and L account and no dividend can be paid. But if the company has a share premium account of £2,000, it can ask the court to approve a reduction in that account and write off the capital loss against it.

Payment of shareholders on reduction

The matter of repayment of shareholders should be treated as if the company was being wound up. Thus, if the capital is being repaid for the reasons given in methods (a) and (b), the preference shareholders should be paid or reduced first if they have priority in a winding-up. If the reduction is due to loss of assets, the ordinary shareholders should be paid or reduced before the preference shareholders. This order, however, may be varied if the preference shareholders consent. The court has no discretion to confirm a reduction without separate class meetings of the shareholders affected.

Prudential Assurance Co Ltd v Chatterley-Whitfield Colliers Ltd [1949] AC 512

Under the Coal Industry Nationalisation Act 1946, the undertaking of a colliery company carrying on business in England became vested in the National Coal Board, subject to the payment of compensation, the amount of which had not yet been assessed. The company intended thereafter to carry on a colliery business in Eire and Northern Ireland and engaged in prospecting with that end

in view. Its capital being considered larger than was required, it was proposed to reduce it by paying off, out of reserves, the whole of the preference capital. By Art 7 of the articles of association the holders of preference shares had the right, in the event of a winding-up of the company, to repayment of capital in priority to the claims of the holders of ordinary shares but they were given no other rights to participate in the assets of the company. Viscount Maugham stated:

> My Lords, the facts in this appeal are sufficiently stated in the speech of my noble and learned friend Lord Simonds and no useful purpose would be served by my repeating them. It is not in dispute that if the company had thought fit to pass a voluntary resolution for a winding up or to do so in the near future the rights of the preference shareholders (apart from any possible action by the Tribunal appointed under s 25 of the Coal Industry Nationalisation Act 1946) would be to receive a repayment of their share capital together with any arrears of preference dividend and they would have no other right to participate in the assets of the company. The unusual position is that the appellants as holders of a substantial number of preference shares object to the proposed reduction of capital by a repayment in full of their preference capital. Desiring to retain their preference shares though the undertaking of the company has been entirely changed, they invite the court to hold that the proposed repayment is unfair and inequitable and that the reduction ought not therefore to be approved. They acquired their shares on the footing that, subject no doubt to the approval of the court, they might be paid off under Art 43; but this they urge at the Bar is not the occasion or the method which should be adopted for such a reduction. They perhaps wisely do not tell us when that course would in their view be appropriate.
>
> My Lords I do not propose to restate the grounds on which the majority in the Court of Appeal or my noble friends in this House have declined to accept this contention; but I should like to add a few observations of my own; for the simplest arguments sometimes escape attention merely because they are assumed. In the present case the main fact is that the undertaking of the company has been compulsorily acquired by the National Coal Board under the Coal Industry Nationalisation Act. There is no longer therefore any reason for the retention by the company of the assets and funds of great value which have been slowly added to year by year with a view to meeting contingencies or spending enormous sums in improving or reconstructing or enlarging the colliery undertaking. The obvious thing to do would be to wind up and distribute all the assets after paying debts and liabilities in accordance with the articles. It is not I think suggested that the holders of preference shares could properly object to such a course. They would cease to own a well-secured 6 per cent investment, and the ordinary shareholders would no longer possess shares paying in recent years double that amount in dividend. The object of the Coal Industry Nationalisation Act was not of course the benefit of shareholders, but if we ask whether in this case preference or ordinary shareholders are the most injured by the transfer, subject to compensation, of the colliery undertaking to a State enterprise, I think the current view of commercial men would probably be that the ordinary shareholders are the greater victims.
>
> The company, however, does not propose to go into liquidation, at any rate at present, but to embark on two entirely new ventures in Eire and Northern Ireland, one of them a new colliery, if prospective operations should prove satisfactory, and the other the business of digging for clay and the manufacture of tiles and like articles. The working capital necessary for those enterprises is only a fraction of the available existing funds of the company; accordingly the special resolution duly passed by the company in general meeting on 30 October 1947, provided for the reducing the capital of the company from 400,000 *l* to 200,000 *l* by returning to the preference shareholders the amounts paid up on their shares. It is in my opinion from the point of view of those shareholders an accidental circumstance that a large majority of the ordinary shareholders have approved of the starting of two entirely new and it may be highly speculative enterprises with which the preference shareholders, if the reduction goes through, will obviously have no concern. If the preference shares are not paid off, and the new undertaking proved to be a success, the preference shares would become more and more valuable as the assets of the company became increasingly substantial. If on the other hand the undertaking were unsuccessful, those shares might nevertheless be worth par in a winding up while the ordinary share might have become valueless. The risk in short would be the risk of the ordinary shareholders, while the gain might well be that of the preference shareholders.

> That proposal does not commend itself to me as a fair one; and the same objection, with smaller figures affected, must apply to a proposal for a *pari passu* reduction of the ordinary and the preference shares. In short, like my noble friend Lord Simonds, I am at a loss to see what other method of reduction is to be preferred as more fair and equitable in the circumstances of this case.
>
> The question of the effect of s 25 of the Coal Industry Nationalisation Act on the present case is one with which your Lordships have dealt in the very recent case of the ***Scottish Insurance Corporation Ltd* v *Wilsons & Clyde Coal Co Ltd***. That was also the case of a company whose undertaking was a colliery; and the dispute, as here, was between two classes of shareholders; but that company proposes to go into liquidation as soon as the amount of compensation payable under the Coal Industry Nationalization Act has been ascertained, and the preference shareholders were claiming (but unsuccessfully) to be entitled to rank equally in the winding up with the ordinary shareholders in the surplus assets of the company, that is, in the assets available after payment of debts and liabilities and the amounts of capital paid on the ordinary and preference shares. Counsel for the preference shareholders there, as here, relied on s 25 of the Coal Industry Nationalisation Act and said that the proposed reduction of capital deprived the preference shareholders of their right to an adjustment of their interest in the company's assets. Your Lordships have now dealt with the appeal in that case and have considered the regulations which have now been made under s 25. They have held that there was no ground in that case for postponing the decision of the court on the petition before the court; and they were not persuaded that there was good reason for thinking that the apparent fairness of the proposal before the court would be affected or displaced by any order which was in the least likely to be made under the jurisdiction derived from s 25. The reduction here proposed, in my opinion, is in itself fair and equitable, and there is here, as in the previous case, no real ground for the speculation that the Tribunal might give the preference shareholders anything more than they would become entitled to receive in a liquidation.
>
> In my opinion therefore this appeal should be dismissed with costs.

Held – the reduction proposed was fair and equitable and should be confirmed and that there was no ground to suppose that under s 25 of the Act of 1946 that preference shareholders might receive anything more than they would have been entitled to receive in a liquidation.

If priority is given to the different classes of shares in accordance with their terms of issue, then no separate class meeting is necessary to approve a reduction of the company's share capital, (subject to the specific terms of a company's articles of association), (***Re Saltdean Estate Co Ltd*** [1968] 1 WLR 1844).

Re Saltdean Estate Co Ltd [1968] 1 WLR 1844

A company's capital consisted of 20,000 preferred shares of 10 shillings each, and 50,000 ordinary shares of 1s each. By Art 8 of the articles of association, in order to 'affect, modify, deal with or abrogate in any manner' the rights and privileges attaching to any particular class of shares, an extraordinary resolution, passed at a separate general meeting of the members of that class, was required, the quorum necessary at such meeting being members holding or representing by proxy three-fourths of the capital paid up, or credited as paid up, on the issued shares of that class. Article 21 provided that 'the net profits of the company which the directors shall determine to distribute by way of dividend in any year' should be applied, first, in paying a dividend of 10 per cent on the preferred shares, secondly, in distributing to the ordinary shareholders an amount equivalent to the total sum paid as dividend to the preferred shareholders, and thirdly, 'the balance of profits' was to be divided equally between the preferred and ordinary shareholders.

Article 24 provided that, on a winding up, the preferred shareholders were first to receive the capital paid up on their shares, then 'the surplus assets (if any)' were to be applied in repayment of the capital paid up, or credited as paid up, on the ordinary shares, 'the excess (if any)' to be

distributed among the ordinary shareholders in proportion to their shareholding, at the commencement of the winding-up. Every share carried one vote at a general meeting and consequently the ordinary shareholders could carry an ordinary resolution, but not a special or extraordinary resolution, against the holders of the preferred shares, if all the latter opposed it.

On 8 July 1968, at an extraordinary general meeting of the company, a special resolution was passed to reduce the capital of the company by repaying the capital paid up on the preferred shares, together with a premium of 5s per share out of money surplus to the company's needs. No separate meeting of the preferred shareholders had been held, but the owner of all, or virtually all, of the ordinary shares approved the proposal, and a large number of the preferred shares were held by the holder or holders of the ordinary shares. The company's business was very profitable, and dividends totalling 1,000 per cent had been paid to the preferred shareholders during the seven years ending 30 September 1966, and a further 100 per cent gross had been proposed for the period from 1 October 1966, to 31 March 1968, at which date £324,924 stood to the credit of the revenue reserve, from which, if it were to be distributed, the preferred shareholders would receive 1,625 per cent on their shares. Some preferred shares had, however, been sold during 1966 and 1967 at 11s per share.

A petition seeking the court's sanction to the proposed reduction was opposed by the holder of 80 preferred shares on the grounds (1) that it was an abrogation of the rights attached to the preferred shares which required an extraordinary resolution to be passed at a separate class meeting, and that no such meeting had been held; (2) that the failure to obtain the preferred shareholders' approval prevented the dissentient minority from availing themselves of the protection intended to be given by s 72 of the Companies Act 1948, and (3) that it was unfair in that it discriminated against the holders of the preferred shares by preventing them from sharing in the fruits either of the company's future or its past prosperity; that the preferred shares were, in truth, a form of 'equity' capital, and that the undistributed trading profits belonged to the two classes of shares equally, and were not included in the 'surplus assets' referred to in Art 24. It was further contended that there was no present prospect of the company being wound up and that continued large distributions of profits were to be anticipated.

Held – (1) The proposed reduction of the company's capital, by means of the cancellation of the preferred shares, was in accordance with the rights attaching to the preferred shares, and was not an abrogation of those rights within the meaning of Art 8 of the company's articles of association, and that the liability to prior repayment, forming as it did an integral part of the bundle of rights which went to make up a preferred share, was a liability, of which a person had only himself to blame if he were unaware.

(2) Section 72 of the Companies Act 1948 had no application, since it related to a variation and not to a cancellation of share rights.

(3) That on the true construction of the company's articles of association, Arts 21 and 24 were not inconsistent with each other; that the 'balance of profits', which, under Art 21, was divisible equally between the preferred and ordinary shareholders, related solely to the 'net profits which the directors' should 'determine to distribute' and not to the undistributed profits, and that the natural meaning of Art 24 was that all the property of the company available for distribution in a winding-up, and remaining, after repaying all the paid-up capital, belonged to the ordinary shareholders.

(4) That, therefore, despite the fact that there was no prospect of a winding-up of the company, and that continued large distributions of profits, were to be anticipated, the proposed reduction of capital was not discriminatory or unfair to the preferred shareholders.

It should also be noted that if a company has created reserves by the transfer of retained profits and subsequently suffers a loss of assets, it is the usual practice to write off the loss against the reserves and to reduce share capital only if the reserves are insufficient. Again,

where the company has capital reserves such as a share premium account or a capital redemption reserve, the practice is to write off losses against them before reducing share capital. Losses may be written off against revenue reserves by making an appropriate adjustment in the accounts but as we have seen, losses may only be written off by reducing the share premium account or capital redemption reserve if the same steps are taken as are required for reducing share capital.

Acquisition of own shares – generally

Section 658 of the Companies Act 2006 prohibits a company (whether public or private) from acquiring its own shares (whether by purchase, subscription or otherwise), except in accordance with the provisions of Part 18 of the Act. This confirms the common law rule that a company cannot purchase its own shares; ***Trevor*** v ***Whitworth*** (1887) 12 App Cas 409 HL, in which Lord Watson observed:

> One of the main objects contemplated by the legislature, in restricting the power of limited companies to reduce the amount of their capital as set forth in the memorandum, is to protect the interests of the outside public who may become their creditors. In my opinion the effect of these statutory restrictions is to prohibit every transaction between a company and a shareholder, by means of which the money already paid to the company in respect of his shares is returned to him, unless the Court has sanctioned the transaction. Paid-up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business.
>
> When a share is forfeited or surrendered, the amount which has been paid upon it remains with the company, the shareholder being relieved of liability for future calls, whilst the share itself reverts to the company, bears no dividend, and may be re-issued. When shares are purchased at par, and transferred to the company, the result is very different. The amount paid up on the shares is returned to the shareholder; and in the event of the company continuing to hold the shares (as in the present case) is permanently withdrawn from its trading capital. It appears to me that, as the late Master of the Rolls pointed out in In re ***Dronfield Silkstone Coal Company***, it is inconsistent with the essential nature of a company that it should become a member of itself. It cannot be registered as a shareholder to the effect of becoming debtor to itself for calls, or of being placed on the list of contributories in its own liquidation.

Under s 658(2) if a company purports to act in contravention of this section, an offence is committed by the company and every officer in default. The purported acquisition is also void. It should also be noted that the Companies Act 2006 reinforces this rule with further restrictions:

(a) First of all, according to s 660(2), if the company seeks to avoid the restriction imposed by s 658 by getting a nominee to purchase the shares in question, the shares will be treated as being held by that nominee on his own account and that the company is to be regarded as having no beneficial interest in them. This is particularly relevant as such arrangements

could in the past be engineered by the directors to keep themselves in secret control so that when faced with a takeover bid they could frustrate the bidder by arranging for shares to be acquired by nominees of the company, sometimes without too much attention as to when and how they were to be paid for, who would, of course, refuse to accept the bid.

Section 661 goes a stage further and provides that if the nominee fails to meet his financial responsibilities associated with the shares within 21 days of being called on to do so, then:

(i) In the case of shares that he agreed to take as a subscriber to the memorandum, the other subscribers to the memorandum are jointly and severally liable with him to pay that amount; and

(ii) In any other case, the directors of the company when the shares were issued to or acquired by him are jointly and severally liable with him to pay that amount.

Relief may be granted by the court under s 661(4) in cases where a subscriber or a director would otherwise be liable, if it appears to the court that he acted honestly and reasonably and he ought fairly to be excused, taking into account all the circumstances of the case. The relief may be granted either in any proceedings for the recovery of any amount due or upon the application of a subscriber or a director in anticipation of such proceedings.

(b) According to s 670, a lien or other charge of a public company on its own shares is void, except as permitted by this section.

(c) Section 136(1)(a) provides that a company cannot be a member of its holding company, either directly or indirectly by way of a nominee (s 144). Furthermore, under s 136(1)(b), any allotment or transfer of shares in the holding company to the subsidiary or its nominee is void. Exceptions to this rule are outlined in s 138 (subsidiary acting as personal representative or trustee), and s 141 (subsidiary acting as authorised dealer in securities). In addition, s 137 provides that this prohibition does not apply where a company is not a subsidiary at the time of acquisition of the shares but at a later stage becomes one.

(d) Where a public limited company, or nominee of the company, acquires its own shares and those shares are shown in a balance sheet of the company as an asset, then s 669(1) provides that 'an amount equal to the value of the shares must be transferred out of the profits available for dividend to a reserve fund; this amount not being available for distribution'. In other words, this amount is available to protect the interests of the company's creditors.

The exceptions to the rule prohibiting a limited company from acquiring its own shares are contained in s 659 and may be summarised as follows:

(a) the acquisition of shares in a reduction of capital duly made;

(b) the purchase of shares in accordance with a court order under s 98, s 721(6), s 759, and Part 30 of the Act (see below for discussion of unfair prejudice and protection of members);

(c) the forfeiture of shares or the acceptance of shares surrendered in lieu under provisions in the articles for failure to pay any sum payable in respect of those shares.

In addition, s 659(1) provides that a company may acquire any of its own fully paid shares otherwise than for valuable consideration. In other words, the company may acquire them by way of a gift.

The issue of redeemable shares has already been covered in the previous chapter as an exception to this general rule.

Finally, as noted above, under Part 30 of the 2006 Act, a company may be ordered by the court to acquire shares from a shareholder as a remedy under the unfair prejudice provisions contained in ss 994–996.

Purchase of own shares

Generally

Formerly the rule of capital maintenance designed to protect creditors prevented a limited company from using its resources to purchase its own shares from its shareholders. This principle first appeared in case law, the leading case being ***Trevor* v *Whitworth*** (1887) 12 App Cas 409, and later in company legislation. The strictness of that rule was later relaxed and purchase by a company of its own shares is allowed subject to safeguards. The procedures to be followed are set out in ss 690–708.

Section 690 provides that a limited company having a share capital may purchase its own shares subject to the provisions of Chapter 4 of Part 18 of the Companies Act 2006 and any restrictions or prohibitions that may be contained in the company's articles. Furthermore, s 691(1) sets down the same restrictions as for the redemption of shares; the shares must be fully paid.

Why purchase own shares?

Among the most important reasons for a company's purchase of its own shares are the following:

1 So far as private companies are concerned, it gives their shares some marketability. Individuals may be more easily persuaded to invest in private companies if they know that the company can buy them out even if the other shareholders have insufficient resources to do so.
2 In family companies a shareholder may die or want to, in effect, resign or retire. Perhaps the other shareholders cannot agree how many shares each should take, or they cannot afford to buy them anyway. In order to avoid an outsider taking them the company can buy them.
3 In the case of shareholder disputes, there is now the possibility of reaching a compromise with a member or members whereby they are bought out by the company thus avoiding the introduction of an outsider as the price of getting rid of a disenchanted member.
4 The provision is useful also in the case of executive directors who have taken shares in the company. Suppose a finance director has taken shares in the company but leaves at the end of his contract for, say, a better position. The company can buy his shares so that he truly severs his connection with the company. The shares must be cancelled, but this does not affect the authorised capital and new shares can be issued to the next finance director on appointment.

Types of purchase: generally

There is a 'market purchase' and an 'off-market' purchase. A market purchase includes only purchases of shares subject to a marketing agreement on a recognised investment exchange (i.e. one authorised by the Financial Services Authority: see s 693(5)). An off-market purchase is a purchase of any other types of shares.

Market purchase

According to s 701(1), a company may make a market purchase of its own shares provided that the purchase has been authorised by an ordinary resolution of the members in general meeting. The authority must:

(a) specify the maximum number of shares which the company may acquire under the resolution (s 701(3)(a));
(b) state the maximum and minimum prices which the company may pay for those shares. There will normally be a minimum price set out in the resolution, but for the maximum a formula would be used (e.g. an amount equal to 105 per cent of the average of the upper and lower prices shown in the quotations for ordinary shares of the company in the daily list of the London Stock Exchange on the three business days immediately preceding the day on which the contract to purchase is made) (s 701(3)(b));
(c) specify a date when the authority given by the resolution will expire. This must not be later than 18 months after the passing of the resolution (s 701(5)).

In addition, the authority may:

(a) be general or limited to the purchase of shares of a particular class or description (s 701(2)(a));
(b) be unconditional or subject to conditions (s 701(2)(b)).

The authority given may be varied, revoked or renewed by a further ordinary resolution of the members (s 701(4)).

Section 701(6) provides that a company may complete a purchase after the date of the authority given by the ordinary resolution has expired, given that the contract for the purchase was made before the expiry date and the terms of the ordinary resolution cover execution of the contract after the expiry date.

The ordinary resolution giving the authority must be filed with the Registrar within 15 days of being passed and a copy must be embodied in or annexed to every copy of the articles issued thereafter (s 701(8)). This ensures that the market is aware of the company's intentions as well as the specific limits within which the directors may operate in terms of price, quantity and timescale.

Off-market purchases

Section 694 provides that a company may make an off-market purchase only under a specific contract which has received advance authorisation by a special resolution of the company. That authorisation may be varied, revoked or, if subject to a time limit, renewed by special resolution under s 694(4) and with regard to a public company the resolution must give a date on which the authority will expire, this being not later than 18 months after the date on which the resolution was passed (s 694(5)).

The shareholder whose shares are being purchased should not vote the shares being purchased on a special resolution to confer, vary, revoke or renew an authority, though there is nothing to prevent him from voting against the resolution if he has changed his mind (s 695(2)). If he does, the authority will not be effective unless the resolution would have been passed with the requisite majority without his votes (s 695(3)). If he holds other shares, then he cannot vote at all on a show of hands but can vote those shares on a poll

See p. 379 (see further Chapter 19). Any member of the company may demand a poll on the resolution (s 695(4)).

According to s 696, a copy of the contract of purchase, or a memorandum of its terms if it is not in writing, must be available for inspection by any member at the registered office for at least 15 days prior to the date of the meeting at which the special resolution is to be passed and available at the meeting itself, otherwise the resolution is of no effect.

The contract, or the memorandum of it, must include or have annexed to it a written memorandum giving the names of the shareholders to which the contract relates, if they do not appear in the contract or memorandum (s 696(3)).

The above provisions might appear to rule out the use by private companies of the unanimous written resolution procedure, since the member whose shares were being purchased would, of necessity, be voting for the purchase in respect of all his shares. However, s 695(2) of the 2006 Act states that the person whose shares are being purchased is not to be regarded as a person who can vote in respect of any of his shares. So, the resolution must be agreed unanimously by the other members and the one whose shares are being purchased is not included.

Furthermore, where the 2006 Act requires contracts or documents of one sort or another to be laid before the meeting at which the resolution is passed, that provision does not apply if the written resolution procedure is used. Instead the relevant documents must be supplied to each member at or before the time at which the resolution is supplied to him (s 696(2)).

A written resolution will therefore shorten the procedure since the relevant documents are sent to the members with the resolution.

Private companies: financing the purchase out of capital

Section 709 of the Companies Act 2006 provides that a private limited company may, in accordance with Chapter 5 of Part 18 of the Act, and subject to any restriction or prohibition in the company's articles, make a payment in respect of the redemption or purchase of its own shares otherwise than out of distributable profits or the proceeds of a fresh issue of shares.

Thus, a private family company could purchase the shares of a retiring member and so keep out non-family members even though profits were insufficient to make the purchase in full and the members of the family did not wish to subscribe to a fresh issue which would be enough to pay the full purchase price.

This type of payment is referred to as being a payment 'out of capital' (s 709(2)) but is restricted in scope by way of s 710 which provides that payment may be made by a company out of capital after first applying for that purpose (a) any available profits of the company; and (b) the proceeds of any fresh issue of shares made for the purposes of the redemption or purchase, in order to meet the price of redemption or purchase. In other words, the permissible capital payment (PCP) as per s 710(2).

Available profits are defined under s 711 of the Act as being the profits of the company that are available for distribution (within the meaning of Part 23 of the Act) and are determined according to the procedure outlined in s 712.

According to s 713, in order to be lawful, a payment out of capital by a private company must satisfy the requirements of ss 714 (directors' statement and auditor's report), 716 (approval by way of a special resolution), 719 (public notice or proposed payment) and 720 (directors' statement and auditor's report to be available for inspection).

Section 714 states that the company's directors must make a statement, in the prescribed form (s 714(5)), which must:

(a) specify the amount of the permissible capital payment for the shares in question (s 714(2));
(b) state that having made full inquiry into the affairs and prospects of the company, the directors have formed the opinion:
  (i) as regards its initial situation immediately following the date on which the payment out of capital is proposed to be made, that there will be no grounds on which the company could then be found unable to pay its debts (s 714(3)(a)); and
  (ii) as regards its prospects for the year immediately following that date, that having regard to (a) their intentions with respect to the management of the company's business during that year; and (b) the amount and character of the financial resources that will in their view be available to the company during that year, that the company will be able to continue to carry on business as a going concern throughout that year (s 714(3)(b)).

In many respects these issues are similar to those found in the solvency statement to be submitted by the directors of a private limited company on a proposed reduction of capital out of court (see discussion of s 643 above) in that the company's directors are required to take into account both contingent and prospective liabilities (s 714(4)). The statement must also have annexed to it a report from the company's auditor (s 714(6)). It is also interesting to note that the Act, under s 715, applies the same criminal liability for negligence as under the insolvency statement.

A special resolution of the company is required to approve the payment out of capital (s 716(1)) and this must be passed on, or within the week immediately following, the date which the directors make the statement required by s 714.

Publicity

Section 719 states that within the week immediately following the date of the resolution under s 716, the company must publish in the *Gazette*, a notice stating that the company has approved a payment out of capital for the purpose of acquiring its own shares by purchase (or redemption) and specify the amount of the permissible capital payment in question and the date of the resolution. The notice must also state where the directors' statement and auditor's report are available for inspection and that any creditor may, within five weeks following the date of the resolution, apply to the court under s 721 for an order preventing the payment.

Section 720 provides that the directors' statement and auditor's report must be kept available for inspection at the company's registered office and give notice to the Registrar as to the place at which these documents are being kept for inspection by any member or creditor of the company (s 720(3),(4)).

Dissentient shareholders/creditors

If a member who has not consented to, or voted in favour of, the resolution or any creditor of the company wishes to object, then s 721 provides that they may apply to the court for the cancellation of the resolution.

In line with the time requirements contained in s 719, s 723(1) goes on to state that the payment out of capital must be made no earlier than five weeks after the date on which the resolution under s 716 is passed and no more than seven weeks after that date.

Failure by company to purchase shares

Section 735(2) provides that a company is not liable to pay damages in respect of a failure to purchase (or redeem) its shares. However, a shareholder may apply to the court for specific performance of the contract of purchase (or the terms of redemption) but no order is to be made if the company can show that it could not pay the price from distributable profits (s 735(3)).

In a liquidation a shareholder may enforce a contract of purchase (or the terms of redemption) against the company as a deferred debt provided that the due date for purchase (or redemption) was before the date of commencement of the winding-up, unless it is shown that the company could not at any time between the due date for purchase (or redemption) and the commencement of the winding-up have paid for the shares from distributable profits (ss 735(4) and (5)).

In a winding-up, because it is a deferred debt all other debts and liabilities are paid in priority to the purchase price (or redemption price) as are shareholders with a prior right to return of capital (e.g. preference shareholders). Subject to that the purchase or redemption price is paid in priority to amounts due to other members as members, e.g. share capital in a winding-up.

Provisions to ensure preservation of capital

As noted above, companies may purchase (or redeem) shares from profits or from a fresh issue of shares. Where the purchase or redemption is from profits, an amount equivalent to the nominal value of the shares purchased or redeemed must be transferred to a capital redemption reserve. Thus, the creditors' fund is protected because the shares purchased (or redeemed) are replaced by a new issue of shares or a capital reserve.

However, where a private limited company has made a payment out of capital, then a transfer to the capital redemption reserve is only required to the extent that distributable profits have been used in part to fund the purchase of shares (s 734(4)).

Permissible capital payment (PCP)

The following examples show how this is calculated in practice.

(a) Where the PCP is less than the nominal amount of the shares purchased

Here the difference must, under s 734, be transferred to Capital Redemption Reserve (CRR).

Shareholders' funds before purchase

	£
Share capital	100
Share premium	10
Total capital	110
Profit and loss balance	20
Net assets	130

Assume that there is now a purchase of 20 shares of £1 each at a premium of 50p and there is no fresh issue of shares.

The PCP is – cost of purchase £30 less all available profits of £20. PCP = £10. The premium is written off to P & L under s 160 and the £10 difference between the nominal value and the PCP is transferred to CRR as s 734 requires.

The journal entries would be as follows:

	£	£
Dr Share capital	20	
Dr Profit and loss a/c	10	
Cr Cash		30
	30	30
(being purchase of shares at a premium of 50%)		
Dr Profit and loss a/c	10	
Cr CRR		10
	10	10
(Being transfer to CRR *per* s 171)		

Shareholders' funds after purchase

	£
Share capital	80
Share premium	10
CRR	10
Net assets	100

Net assets are reduced because we have used £30 of our cash to buy the shares.

(b) Where the PCP is greater than the nominal amount of the shares purchased

Here, under s 734, the difference is written off to CRR or share premium account or revaluation reserve (if any) or even in the last analysis share capital. Suppose that in the example given in (a) above the company had purchased 30 shares of a nominal value of £1 each at £2 each with no fresh issue.

The PCP is – cost of purchase £60 less all available profits of £20. PCP = £40. The nominal amount of the shares purchased is £30, so £10 must be written off against a capital account. We shall take the share premium account because we do not have any other capital reserve, but if that had not been enough we should have had to proceed to reduce the share capital.

The journal entries would be as follows:

	£	£
Dr Share capital	30	
Dr Profit and loss a/c	20	
Dr Share premium a/c	10	
Cr Cash		60
	60	60
(being purchase of 30 shares at £2 each in accordance with s 734)		

Shareholders' funds after purchase

	£
Share capital	70
Share premium	–
Total capital	70
Profit and loss balance	–
Net assets	70

The net assets have been reduced because we have used £60 of our cash to buy the shares.

The above examples apply also, with the necessary changes in nomenclature, to a redemption from capital.

Civil liability of past shareholders and directors

Section 76 of the Insolvency Act 1986 contains a limited procedure for unravelling the acquisition outlined above. If the company goes into liquidation within one year of the payment being made to the shareholder, that person is liable to return the amount made out of capital to the company to the extent outlined below:

(a) if winding-up takes place within 12 months of a purchase (redemption) from capital and the company's assets are not sufficient to pay its debts and liabilities; then
(b) the person(s) from whom the shares were purchased (or redeemed) and the directors who signed the statutory declaration; are
(c) jointly and severally liable to contribute to the assets of the company, to the amount of the payment received by the shareholder(s) when the company purchased (or redeemed) the shares. There is a right of contribution between those liable in such an amount as the court thinks just and equitable;
(d) those in (b) above, are given a right to petition for a winding-up on the grounds:
  (i) that the company cannot pay its debts; and
  (ii) that it is just and equitable for the company to be wound up.

The purpose of this is to enable them to limit the amount of their liability by initiating a winding-up before the company's assets are further dissipated leading to an increase in the contribution required of them.

Directors are not liable if they had reasonable grounds for the opinion given in the directors' statement under s 714, though the Companies Act 2006 contains its own penalties in this regard under s 715.

Treasury shares

In general terms shares which are purchased by a company must be cancelled and the amount of the company's share capital account reduced by the nominal value of the cancelled shares (s 706). As noted earlier, a company cannot usually become a member of itself.

An exception was introduced under the provisions of the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 (SI 2003/1116). These have subsequently been restated in Chapter 6 of Part 18 of the Companies Act 2006.

These regulations allow companies listed on the Stock Exchange or the Alternative Investment Market (but not private companies) to buy, hold and resell their shares. The regulations

apply only to 'qualifying shares'. These are shares listed on the London Stock Exchange or traded on the AIM or listed on any other European Economic Area Stock Exchange.

Other main points to note are as follows:

- The shares must be purchased from distributable profits since it was thought unlikely that a company would wish to finance the purchase of shares to be held in treasury from the proceeds of a fresh issue of share capital (s 724(1)(b)).
- The company having bought shares to hold in treasury may cancel or sell them at any time including a sale for a non-cash consideration.
- Cancellation will involve a reduction of capital but there is no need for a special resolution of the members or authorisation by the court.
- Consideration received on a sale of treasury shares is to be treated as profits for distribution purposes.
- The maximum number of treasury shares held at any one time must not exceed 10 per cent of the nominal value of the issued share capital of the company. Where there is more than one class of shares each class is subject to a separate 10 per cent limit. Shares held in breach of the 10 per cent limit are subject to mandatory cancellation (ss 725(1) and (2)).
- A company holding treasury shares must not exercise any voting rights attached to them and if it does the votes are void. No dividend or other form of distribution can be made in respect of them.

Disclosure of dealings in treasury shares

Dealings in treasury shares must be disclosed to the market under arrangements made with the Financial Services Authority and the London Stock Exchange. The Listing Rules were amended with effect from 1 December 2003 to take account of treasury shares. The rules state that shares in treasury will remain listed so that new applications for listing are not required when shares are sold out of treasury. However, to protect the market a company will normally be prohibited from buying or selling treasury shares at a time when its directors would be prevented from dealing in the company's shares under the Model Code of Directors' Dealings (see Chapter 13 ➲). A company is prohibited from buying or selling its treasury shares when in possession of price-sensitive information as by insider dealing (see Chapter 13 ➲). Treasury shares may be included or excluded from a takeover offer and the prohibition on directors dealing in share options will not extend to the purchase of options in treasury shares.

➲ See p. 258

Company dealing in treasury shares: not regulated

The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No 3) Order 2003 (SI 2003/2822), as restated in Chapter 6 of Part 18 of the Companies Act 2006, provides that purchasing its own shares to keep in treasury and the subsequent dealing in those shares is not a regulated activity under FSMA 2000 so that the company does not require FSA authorisation, at least for these activities.

Pre-emption rights

The pre-emption rights of existing shareholders on a new issue of shares apply to the sale of shares held in treasury (s 560). These must therefore be offered first to existing shareholders unless the procedures for disapplying pre-emption rights have been followed.

The City Takeover Panel

So far as the Panel and the City Code are concerned the position is as follows:

- Since treasury shares have few rights attached to them the provisions of the City Code and the rules governing substantial acquisitions of shares will not apply to them.
- A sale and transfer by the company of treasury shares will normally be treated like a new issue.

Financial assistance for the purchase of shares

Previous position

The prohibition on the giving by companies of financial assistance for the purchase of their own shares or the shares of their holding companies by someone other than the company was introduced by the Companies Act 1929 and retained in subsequent legislation until 1981.

The object was largely to defeat the asset stripper who might, for example, acquire shares in a company by means of a loan from a third party so that he came to control it and once in control could repay the loan from the company's funds and then sell off its assets leaving the company to go into liquidation with no assets to meet the claims of creditors. The company concerned was usually one whose shares were, perhaps because of the management policies of the board, undervalued.

The sanction of the law designed to deter this sort of activity was a default fine which could be levied following criminal proceedings.

However, following cases such as ***Heald* v *O'Connor*** [1971] 2 All ER 1105, it was realised that there were civil law consequences since the transactions surrounding the acquisition of the company were illegal. Thus, the loan by the third party was void and irrecoverable at law; if the company had given the lender a debenture to secure the loan, or a guarantee to repay it, these securities were void and unenforceable, as was any guarantee or other security given by anyone else including the asset stripper himself.

The same civil law consequences would apply in so far as a person infringed the present law set out below. Breach of the present law is stated to be 'unlawful' and is attended as before by criminal sanctions, the maximum penalty being a term of imprisonment of two years and/or a fine of unlimited amount.

Problems created by previous legislation

The rule against the giving of financial assistance struck potentially at ordinary commercial transactions of companies as follows:

(a) Management buy-outs

This is the disposal of a company to its management. A holding company may use a buy-out to sell off a subsidiary whose business though successful does not fit the current development plan of the group.

However, the buy-out is more common in the case of private free-standing companies. Suppose that in a family business senior management has reached the age of retirement and is unable to find any purchaser of the business, who knows and can run it successfully other