# KEY FACTS COMPANY LAW

KEY FACTS

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HODDER EDUCATION

# 7

# *Shares*

**The nature of shares:**

A **share** is a form of property – it does not give the shareholder an interest in the assets of the company

**Rights** depend on terms of issue of a particular class of shares. Shareholders generally have:

- a right to vote
- a right to dividends when declared
- a right to return of contributed capital and surplus assets on winding up.

**Class rights**

- Different classes of share carry different rights
- Class rights only arise when a company has more than one class of share
- Variation of class rights – procedure under ss 630–633 CA 2006

**SHARES**

**Offering shares to the public**

- Shares in a **public company** may be offered to the public
- Transfer of shares in a **private company** may be restricted by the company's constitution
- The offer of shares to the public is regulated to ensure a fair market and protect investors

# 7.1 Shares

## 7.1.1 The nature of shares

1. A company can raise capital either by issuing equity securities (shares) or by borrowing.
2. Shareholders undertake to contribute an agreed amount of capital to the company and, if the company is limited by shares, this is then the limit of the shareholders' liability.
3. A share is a way of measuring each member's interest in the company. So if a company has an authorised and issued share capital of £10,000 divided into £1 ordinary shares and shareholder A owns 1,000 shares, he will have a 10% interest in the company.
4. In *Borlands Trustee v Steel Bros & Co Ltd* (1901) Farwell J said: 'The share is the interest of the shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and interest in the second, but also of a series of mutual covenants entered into by all the shareholders *inter se* in accordance with [s 33 CA 2006]'.

## 7.1.2 Effects of shareholding

- Shareholders have a right to a distribution of profits by way of a dividend declared on the shares.
- Except in the case of non-voting shares, each shareholder has the right to vote.
- If the company is wound up when not insolvent, capital is returned to members in proportion to their shareholding.
- Shares are transferable and may, in the case of a plc, be offered to the public. In a private company there may be restrictions on the transfer of shares if so provided in the articles.
- Shareholders have rights and obligations as defined in the company's constitution by virtue of s 33 of the Companies Act 2006 (CA 2006) (see chapter 4, section 4.2 above).

## 7.1.3 Share capital

1. Under s 9(4) CA 2006 an application for registration of a company that is to have a share capital must contain a statement of share capital and initial holdings.

2. Section 542 provides that all shares must, as under the 1985 Act, have a fixed nominal value.

3. Section 10 provides that the statement of share capital must give details of:
   - the total number of shares to be taken by the subscribers on formation;
   - the aggregate nominal value of those shares;
   - details with respect to each class of share;
   - the amount to be paid and the amount (if any) unpaid on each share. Details of the subscribers will also have to be given as well as the number, nominal value and class of share taken by each subscriber and the amount paid up.

4. A company may issue different classes of shares, each class having different rights (see section 7.3 below).

5. The concept of authorised share capital is abolished by the CA 2006.

6. *Paid up share capital* is the amount actually contributed to the share capital of the company, excluding any premium and excluding calls made but not yet paid. If partly paid shares are issued, the shareholder will pay part of the price when the shares are issued and will be liable to pay the remainder at some time in the future.

7. *Called up share capital* is the total amount already paid plus any share capital that must be paid on a future date as specified in the articles or terms of allotment.

## 7.1.4 Alteration of share capital

Under s 617 CA 2006 share capital may be altered in a number of ways, including:

- new shares may be allotted to increase the share capital;
- reduction of capital (see chapter 8);
- subdivision;
- consolidation;
- redenomination, by which the shares are denominated in a different currency. Associated with this, capital may be reduced by up to 10% in order to arrive at a sensible, rounded amount.

The Act sets out detailed provisions associated with all of these procedures.

### 7.1.5 Types of share

1. *Ordinary shares* will usually carry one vote per share on a poll. The dividend is that recommended by the directors, and the amount payable on a distribution of assets on a winding up is proportional to the nominal value of the shares.
2. *Preference* shares usually entitle the holders to a dividend of a fixed amount per share to be paid in priority to other shareholders. Note, however, that there is no entitlement until the dividend is declared. Preference shares may be:
   - cumulative: if the dividend is not paid in one year, then the shareholder will be entitled to receive the arrears from profits in subsequent years. Unless the articles or terms of issue provide otherwise, preference shares are cumulative.
   - non-cumulative: the dividend will lapse if the company is unable to pay it in any one year.

   Preference shares may also entitle the holder to prior return of capital on a winding up where the company is solvent.
3. *Deferred shares* (sometimes called *founders' shares*) are now rare. Promoters used to take shares which would not qualify for a dividend until the ordinary shareholders had received one.
4. *Redeemable shares* are issued with a provision that they may be bought back by the company at a later date, at the option of either the company or the shareholder.
5. *Non-voting shares* carry similar rights to ordinary shares, but no right to vote.

## 7.2 Allotment of shares

### 7.2.1 Allotment and issue

1. Shares are allotted when a person acquires the unconditional right to be entered in the register of members in respect of that share (s 558 CA 2006).
2. Shares are issued when the holder's name is entered in the register of members (*Re Heaton's Steel and Iron Co, Blythe's Case* (1876); *National Westminster Bank plc v Inland Revenue Commissioners* (1995)).

3. Members have some control over how directors allot new shares. In principle, directors may not allot shares (except in specified circumstances) unless they have authority to do so either by the articles or by ordinary resolution. The CA 2006 provides:
   (a) s 550 – in the case of a private company with only one class of shares the directors will have unrestricted power to allot new shares unless there are restrictions in the articles.
   (b) s 551(1) – in the case of any other company the directors cannot allot new shares unless they are authorised to do so either by the articles or by ordinary resolution. A public company cannot give such authority for a period of more than five years at any one time.
   (c) s 551(8) – authority to allot shares can be given, varied, revoked or renewed by ordinary resolution, even if such authority is provided by the articles.
   (d) resolutions authorising directors to allot shares and resolutions revoking authority must be notified to the Registrar.

## 7.2.2 Payment for shares

1. Shares may be issued in exchange for cash or for other forms of property, for example in a takeover the offeror company may offer its shares in return for shares in the offeree company.

## 7.2.3 Pre-emption rights

1. Further capital can be raised by way of a rights issue.
2. A member's influence within a company depends upon the proportion of shares held. The provisions governing pre-emption rights are complex and are contained in ss 561–573 CA 2006. They aim to ensure that the interests of existing shareholders are not diluted, while allowing for certain exceptions to the general rule and also allowing companies to disapply the provision.
   (a) s 561 provides that before any equity securities are allotted in exchange for a cash contribution, they should first be offered to existing shareholders on the same or more favourable terms.
   (b) s 562 provides that the offer must be communicated to shareholders and sets out how this should be done.
   (c) s 563 – failure to comply with the above sections is a criminal offence and the company and any officer in default must compensate shareholders to whom the offer should have been made.

(d) ss 564–566 provide for certain exceptions:
- allotment of bonus shares;
- where shares are issued for a non-cash consideration;
- where shares are held under an employees' share scheme.

(e) s 569 provides that in the case of private company with only one class of share the right of pre-emption may be excluded.

(f) Under s 570 if directors of any public or private company are generally authorised under s 551 to allot shares, they may be given power in the articles or by special resolution to allot new shares as if s 561 does not apply.

(g) s 571 allows for the disapplication of s 561 by special resolution in relation to a specific allotment of equity securities.

# 7.3 Class rights

## 7.3.1 General details

**1.** Companies may issue shares such as ordinary shares or preference shares, with different rights attached to them.

**2.** Different classes of share will have different rights attached to them, which may be set out in the articles of association, terms of issue or unanimous shareholder agreement.

**3.** Section 21 of the CA 2006 provides that, subject to the provisions of the Act and to conditions contained in the articles, a company may, by special resolution, alter its articles of association. A company cannot deprive itself of its statutory power to alter the articles (*Allen v Gold Reefs of West Africa Ltd* (1900)), but if any alteration involves the variation of class rights then ss 630–635 (designed to give protection to minorities in relation to their class rights) will apply and such rights can only be varied if the proper procedures are followed.

**4.** Class rights will only arise if the company has more than one class of share.

**5.** There is no statutory definition of a class right but the nature of class rights was considered in *Cumbrian Newspapers Group Ltd v Cumberland and Westmorland Herald Newspaper and Printing Co Ltd* (1986). It was held that rights and benefits may be:
- rights annexed to particular shares such as the right to a dividend or voting rights;

- rights conferred on individuals not in their capacity as members, i.e. outsider rights. These are not class rights;
- rights conferred on individuals in their capacity as members, but not attached to shares.

The first and third categories only may be described as class rights.

## 7.3.2 Variation of class rights

1. The general rule is that rights of one class of shareholders should not be altered by another class by just amending the articles.
2. CA 2006 restated the previous law with some amendments intended to simplify the procedure and to take into account the fact that the articles are the main constitutional document under the 2006 Act. It also extended protection of class rights to companies without a share capital.

## 7.3.3 Meaning of 'variation of rights'

1. The legislation does not make it clear what is meant by 'variation of class rights'.
2. The courts have taken a restrictive view and have sought to distinguish between the rights themselves and the 'enjoyment of the rights'.
3. It may thus be possible to make rights less effective without any technical 'variation' of rights (*White v Bristol Aeroplane Co* (1953); *Greenhalgh v Arderne Cinemas* (1946)).

## 7.3.4 Procedure for variation

1. Section 630 sets out the procedure for companies with a share capital.
2. If the articles provide for a variation of rights procedure, this must be complied with (s 630(2)(a)). Provision in the articles may be more or less demanding than the statutory procedure.
3. Neither the model articles for public companies nor those for private companies limited by shares make provision for the variation of class rights.
4. In the absence of any procedure in the articles, class rights may only be varied with the consent of the members of that class.
5. Consent can be given:

- by the holders of at least three quarters of the nominal value of the issued shares in that class signifying their agreement in writing (s 630(4)(a)), or
- by special resolution passed at a separate general meeting of that class (s 630(4)(b)).

6. Section 631 sets out the procedure required for companies without a share capital. In this case, in the absence of any provision in the articles, consent may be given:
   - in writing by three quarters of the membership of that class (s 631(4)(a)), or
   - by special resolution passed at a separate general meeting of that class (s 631(4)(b)).
7. Section 633 gives dissenting members of a class who hold not less than 15% of shares of that class the right to apply to the court to have the variation cancelled. However, they must act within 21 days of the variation, which may cause difficulties in large companies.
8. The court may disallow the variation if it can be shown that the variation would unfairly prejudice the class. Otherwise the court must confirm the variation.

# 7.4 Offering shares to the public

## 7.4.1 Introduction

1. Only a public company may offer its shares to the public. Most companies are set up as private companies, so if a company wishes to offer its shares more widely it will have to 'go public'. There are a number of reasons why a company may wish to do this, including to enable the company to raise capital from new investors and to provide a market for existing shareholders to sell their shares. Because there is a ready market for the sale of the shares, public companies are attractive to investors.
2. There are also disadvantages. A public company is subject to more rigorous disclosure requirements and much greater public scrutiny by the press. It may also be an easier target for a takeover bid.
3. Previously, under s 81 CA 1985, a private company committed an offence if it offered shares to the public, but this is no longer the case under the Companies Act 2006.

## 7.4.2 Listing and markets

1. The public offer of shares is subject to regulation under the Financial Services and Markets Act (FSMA) 2000. The purpose of regulation is to ensure that there is investor confidence in the markets on which shares can be traded. All investments carry a risk and in the trading of shares a key feature of investor protection is to ensure that accurate information is readily available so that potential investors can evaluate the risk involved.
2. The European Union has had a significant influence on legislation relating to public offer of shares, as free movement of capital within the EU depends upon efficient capital markets which in turn requires a harmonised system of regulation. The requirements relating to public offers of shares are now regulated by a series of EC Directives, the Public Offers of Securities Regulations 1995 and the Financial Services and Markets Act 2000, as well as the Stock Exchange Listing Rules.
3. The FSMA 2000 provides that the Financial Services Authority (FSA) is the United Kingdom's financial regulator. Under sections 1–6 FSMA 2000 its role is:
   - to maintain confidence in the financial system;
   - to promote public awareness in the financial system;
   - to protect consumers;
   - to reduce the extent to which financial services can be used for financial crime.
4. In order to be traded on an organised market, securities must be listed and every member state of the EU must have a Listing Authority, responsible for listing.
5. Under the Financial Services and Markets Act 2000, the Financial Services Authority is designated as the United Kingdom Listing Authority.
6. The United Kingdom Listing Authority (UKLA) maintains an Official List of those securities that are deemed suitable for trading on stock exchanges and are admitted to trading on at least one Recognised Investment Exchange (RIE). Of some 2.2 million registered companies in the United Kingdom, only about 2,700 are listed by the UKLA.
7. Listing is a separate process from admitting a company to trading on a stock exchange. A company that is admitted to official listing on a stock exchange must have completed both processes.

8. The London Stock Exchange operates a number of markets for the trading of securities: two of the most important are the Main Market, which is a 'regulated market' and is for listed companies, and the Alternative Investment Market (AIM), designed for younger, growing companies not admitted to the official list.

### 7.4.3 The regulatory framework: the prospectus and listing particulars

1. The principle underlying the regulation of public issues of shares is to ensure that investors are provided with full and accurate information about the issue.
2. Any company wishing to be traded on an organised market must go through the listing process. Under the Listing Particulars Directive (80/390 EEC), a company requiring listing must submit a set of listing particulars, which is a public document, to the UKLA. Detailed rules in relation to this are set out in the Listing Rules with additional provisions in the Financial Services and Markets Act 2000.
3. This is a separate process from admission to a regulated market and when a company applies for admission to a regulated market it must produce a prospectus.
4. A prospectus must also be made available to investors when a company (whether listed or not) proposes to offer shares to the public for the first time: Public Offers of Securities Regulations 1995.
5. The matters to be covered in the listing particulars and the prospectus are laid down in Chapters 5 and 6 of the Listing Rules.
6. Note that listing itself is a regulatory process, but the prospectus forms the basis of a contract for the sale of shares.
7. In general, the prospectus must disclose all the information which investors and their professional advisers would reasonably need in order to make an informed decision of whether to invest.
8. A prospectus must be approved by and filed with the FSA and made available to the public.
9. In July 2005 the New Prospectus Directive 2003/71/EC came into force. The purpose of the Directive is to improve regulation for raising capital on an EU-wide basis.

## 7.4.4 Remedies for misleading statements and omissions in listing particulars and prospectus

1. In relation to a prospectus or listing particulars, s 90 Financial Services and Markets Act 2000 provides that the person or persons responsible for any of the following is liable to pay compensation to a person who has acquired securities to which the particulars or prospectus apply for loss as a result of:
   - including a false or misleading statement in a prospectus or set of listing particulars;
   - failure to disclose information required to be included;
   - failure to publish a supplementary prospectus or set of listing particulars if required to do so.
2. Other remedies are also available to people induced to subscribe for shares by misleading or untrue statements under:
   - the common law, in both contract and tort;
   - Misrepresentation Act 1967;
   - Public Offers of Securities Regulations 1995, Regulations 13–15 if the misleading statement is in the prospectus.
3. It is a criminal offence to give false or misleading information in either the listing particulars or prospectus in connection with an application for a listing offer of shares to the public.