

## Chapter 16 Share Capital

Here, basic guidance to the end-of-chapter questions will be provided.

**1. Define the following terms:**

- nominal value;
- share premium;
- authorized share capital;
- allotted share capital;
- paid-up share capital;
- called-up share capital;
- pre-emption right;
- transmission of shares.

Term	Definition
nominal value	The fixed value attached to shares in a limited company
share premium	The amount that a share is sold for in excess of its nominal value
authorized share capital	The total nominal value of shares that may be allotted by a company
allotted share capital	The total nominal value of shares that a company has allotted
paid-up share capital	The combined total of nominal share capital that has been paid to the company
called-up share capital	The paid-up share capital plus the amount called for or instalment due
pre-emption right	A right granted to existing shareholders under which newly-issued shares must first be offered to them in proportion to their existing holdings
transmission of shares	Where shares pass from one person to another through the operation of law (e.g. where a shareholder dies, or is declared bankrupt)

**2. State whether each of the following statements is true or false and, if false, explain why:**

- the allotment of shares occurs before the issuing of shares;
- the directors of a private company have the authority to allot shares only if the articles so provide;
- a private company can exclude pre-emption rights via its articles;
- a member to whom shares have been allotted must be provided with a share certificate in relation to those shares;
- a share certificate provides conclusive proof of share ownership;
- share cannot be allotted for less than their nominal value;
- shares must be paid for in cash;

- **class rights may only be varied via the procedure set out in the CA 2006.**

- **The allotment of shares occurs before the issuing of shares:** This statement is true.
- **The directors of a private company have the authority to allot shares only if the articles so provide:** This statement is false. Where a private company only has one class of share, then the directors are authorised to allot shares of the same class and do not require authorization from the articles (although the articles may restrict their authority).
- **A private company can exclude pre-emption rights via its articles:** This statement is true.
- **A member to whom shares have been allotted must be provided with a share certificate in relation to those shares:** This statement is false. There are several instances where a share certificate will not be provided (e.g. where it is a condition of the share issue that no certificate will be issued, where the shares are uncertificated).
- **A share certificate provides conclusive proof of share ownership:** This statement is false. A share certificate only provides *prima facie* proof of title to the shares.
- **Share cannot be allotted for less than their nominal value:** This statement is true.
- **Shares must be paid for in cash:** This statement is false. The CA 2006 provides that shares must be paid for in money or money's worth. Meaning that shares can be paid for with non-cash consideration (e.g. with goods or property).
- **Class rights may only be varied via the procedure set out in the CA 2006:** This statement is false. If the company's articles contain a class variation clause (i.e. a clause setting out the process for varying class rights), then a variation will be valid if it complies with this clause.

3. The memorandum of Dragon plc provides that its authorized share capital is £2 million. Since the company's incorporation, it has allotted 1.2 million shares, all with a nominal value of £1.50. The terms of all allotments to date have provided that shares can be partly paid for with a minimum of 90 pence payable at allotment and the remainder due when called for. Of the 1.2 million shares, 500,000 have 90 pence paid up, 400,000 have £1.20 paid up, and the remainder are fully paid up. The company calls for 10 pence per share on all unpaid shares, but not all the members pay the called-for amount. Based on the information provided, calculate Dragon's:
- issued share capital;
  - unissued share capital;
  - paid-up capital;
  - called-up capital, and;
  - uncalled capital.

#### Issued share capital

- Issued share capital represents the total nominal value of shares that have been issued.

- Dragon has allotted 1.2 million shares, with each share having a nominal value of £1.50. Accordingly, if all of those shares have been issued, the issued share capital is £1.8 million.

### Unissued share capital

- Unissued share capital represents the difference between the authorized share capital and the issued share capital (i.e. the amount of shares that the company can issue before it hits the maximum set out by its authorized share capital).
- Dragon's authorized share capital is £2 million and its issued share capital is £1.8 million. Accordingly, its unissued share capital is £200,000.

### Paid-up capital

- Paid-up capital is the combined total of the nominal share capital that has actually been paid.
- Not all the 1.2 million shares allotted have been fully paid up. The breakdown is as follows:

Number of shares	Amount paid up per share	Total paid up
500,000	90 pence	£450,000
400,000	£1.20	£480,000
300,000	£1.50	£450,000
		<b>Total: £1,380,000</b>

- Accordingly, the paid-up capital is £1.38 million.

### Called-up capital

- Called-up capital is the paid-up capital plus any amount called for. Dragon has called for 10 pence per share on all unpaid shares. There are 900,000 shares that are not fully paid, so the amount called for is £90,000.
- If we add this to the paid-up capital, the called-up capital is £1.47 million.

### Uncalled capital

- Uncalled capital is the amount that the company can still call on for payment (i.e. the difference between the company's allotted capital and its called up capital).
- The company's allotted capital is £1.8 million and its called-up capital is £1.47 million. Accordingly, its uncalled capital is £330,000.

**4. Dragon Goods Ltd ('DG') has issued 7,000 £1 shares, with the company's three directors (Sophie, Stanley, and Kim) each holding 1,000 shares. 2,000 shares are held by Sanjeet, a local businessman, and the remaining 2,000 shares are held by a**

**number of smaller investors.**

**Since it was incorporated, DG has run at a loss and Sanjeet believes this is down to the directors' poor management of the company. He believes that, with new management, the company could be extremely profitable. Accordingly, Sanjeet starts buying the shares of the smaller investors in the hope that he can acquire enough shares to dismiss the directors.**

**The directors of DG discover Sanjeet's plan. Accordingly, they cause DG to allot 3,000 new shares (with a nominal value of £1.50) and they are offered to Gabrielle, who is Sophie's partner. However, Gabrielle cannot currently afford to purchase the shares, so she offers to sell her car to DG in exchange for the shares. The car is worth £4,000, but the directors of DG accept the car as full payment, on the condition that Gabrielle use her shares to defeat any resolution that seeks to remove the directors from office.**

**Stanley decides he wants rid of Sanjeet for good. Accordingly, he forges a stock transfer form, which provides that Sanjeet agrees to sell all his shares to Stanley for £1 each. The form is registered by the company and Sanjeet's name is removed from the register of members.**

**Sanjeet approaches you, seeking your advice as the legality of the actions of DG and its directors.**

### **Power to allot shares**

- The first issue to discuss is whether the directors of DG have the power to issue shares on its behalf. The directors can only allot shares on the company's behalf if they have the power to do so.
- Section 550 of the CA 2006 provides that if a private company only has one class of share, then the directors are empowered to allot shares of that class. Accordingly, if DG only has one class of share and the 3,000 shares allotted were of the same class, then the directors were indeed empowered to allot the shares, subject to any limitations in the articles.
- If the 3,000 shares were of a different class or if DG has several classes of share, then s 551 provides that the directors will only have the power to allot the shares if they are authorized to do so by the articles or the members pass a resolution authorizing the allotment.
- We are not provided any information on DG's share structure, so note both outcomes above.
- If the directors have allotted the shares when not empowered to do so, they commit a criminal offence, although the allotment will remain valid.

### **Pre-emption rights**

- The effect of allotting the shares to Gabrielle is that the holdings of the existing shareholders (notably Sanjeet) are diluted. This makes it impossible for Sanjeet to acquire the number of shares he needs to remove the directors.
- Section 561 of the CA 2006 provides the existing shareholders with a right of pre-emption, meaning that any new allotment of shares must be first offered to existing members in a way as to allow them to maintain their current holdings.
- By allotting the shares to Gabrielle, these pre-emption rights have been breached. Note, however, there are some instances where pre-emption rights will not apply, and one of these is where the shares are wholly or partly paid-up otherwise than in cash (s 565). As the shares were purchased using non-cash consideration (Gabrielle's car), pre-emption rights will not apply here.

### **Payment for shares**

- Is it permissible for Gabrielle to pay for the shares using non-cash consideration? Section 582(1) provides that shares can be paid for in money or money's worth, meaning that non-cash consideration is acceptable.
- Here, however, the car is worth £4,000, but the nominal value of the shares allotted to Gabrielle is £4,500. Accordingly, the shares appear to have been allotted at a discount, which is prohibited by s 580 of the CA 2006.
- The consequence of allotting shares at a discount is that Gabrielle will be liable to pay an amount equal to the discount (i.e. £500). In addition, the company and every officer in default commits an offence.
- However, the problem is that the value of non-cash consideration is not as easy to determine as cash consideration. The company may value the car as being worth £4,500. Private companies are not required to have the non-cash consideration valued and the courts will usually only interfere if the consideration is clearly illusory. Here, that may not be the case.

### **Gabrielle's use of the shares**

- The directors agree to accept Gabrielle's car as payment if she agrees to use the votes attached to her shares to defeat any resolution seeking the directors' removal.
- This appears to be a shareholders' agreement between the directors (as members) and Gabrielle. The terms of a shareholders' agreement bind those parties to it, so Gabrielle is bound to act in the way specified. If she does not, she can be sued by the other parties to the agreement, with remedies including damages, injunctions and specific performance.

### **Forged stock transfer form**

- Stanley forges a stock transfer form which states that Sanjeet transfers all his shares to Stanley.
- A transfer brought about by a forged stock transfer form is a nullity, so the transfer will be void. If Sanjeet's name has been removed from the register of members, he can have his name placed back on the register.
- DG will be liable to compensate any transferee who relied on the forged transfer form.