

Practice questions for Chapter 21 – Shares and capital maintenance

Essay question

'The Companies Act 2006 has improved the effectiveness of some of the rules relating to capital maintenance, but there are still glaring inadequacies that the 2006 Act failed to remedy.'

Discuss.

Introduction

- This question involves a discussion of the capital maintenance regime. You may want to point out the basic aims behind the capital maintenance rules, namely to protect creditors by preventing capital being returned to the members. In theory, this should ensure that there are inviolate funds that can be used to pay the creditors' debts.
- Historically, the capital maintenance rules have been perceived as anachronistic, overly complex and technical, and largely ineffective. The question is have the 2006 reforms altered this perception. How you structure this answer is for you to decide, but I would first discuss those areas where the 2006 Act has appeared to reform the law for the better.

Beneficial reforms

- The Companies Act 2006 contained a number of notable reforms, a number of which appear to be beneficial. You will want to discuss these reforms.
- First, the 2006 Act abolished the concept of authorized share capital. Prior to the 2006 Act, companies had to state in their memoranda the total nominal value of shares that could be issued by the company, and this amount would represent the company's authorized share capital. In practice, however, this requirement was largely pointless, as many companies would simply choose an arbitrary and inflated figure that it knew it would never reach. Even if a company did near in authorized share capital, it could simply raise the amount by passing an ordinary resolution. Given this rule was ineffective, the 2006 Act has abolished the concept of authorized share capital.
- Second, the 2006 Act reformed the procedures by which a company can restructure its capital. In particular, a reduction of share capital can adversely affect the creditors' chances of being paid, so strict rules were put in place. Under the Companies Act 1985, a company could only reduce its share capital if it obtained court approval, but this imposed severe burdens on private companies, and increased the courts' caseload. Accordingly, the 2006 Act provides to private companies only a method of reducing share capital without the need to obtain court approval.
- Third, prior to the 2006 Act, all companies were generally prohibited from providing financial assistance to another to acquire shares in the company. The problem that arose was that the prohibition served to prohibit transactions that were wholly innocent and for the benefit of the company, especially as regards private companies. Accordingly, the 2006 Act has abolished the prohibition in relation to private companies and there exist a number of exceptions to the prohibition in relation to public companies.

Areas of concern

- There is little doubt that the 2006 Act has improved the law, but there were a number of glaring problems that the 2006 Act has failed to rectify.
- First, both the common law and statute have long held that companies cannot issue shares for an amount lower than their nominal value. However, in relation to private companies, this rule has been somewhat weak, and the 2006 Act has not reformed the law in this area to make it more effective. Companies can issue shares for non-cash consideration. Companies can overvalue this non-cash consideration, which results in the share purchaser obtaining the shares for less than their nominal value. In order for non-cash consideration to be valid, public companies must have the value of the non-cash consideration independently valued, but no such requirement is imposed on private companies. In relation to private companies, the only safeguard that exists is court supervision, but the courts have indicated that they will only inquire into the value of non-cash consideration if it appears to be manifestly illusory or inadequate.¹
- Second, public companies cannot conduct any business until it has been issued with a trading certificate. The Registrar will not issue a trading certificate until he is satisfied that the nominal value of the company's allotted share capital is not less than the authorized minimum, which is £50,000.² This requirement has long been criticized as being ineffective, largely because £50,000 is a 'derisory'³ and 'miniscule compared to the size of the debts of most public companies'.⁴ Worse still, the shares do not even need to be fully paid up – only one quarter of the nominal value and the whole of the premium need be paid up at the time of allotment.⁵ The Companies Act 2006 does not reform the requirements relating to minimum capital requirements.

Conclusion

- The statement in our question appears to be accurate. There is little doubt that the 2006 Act has improved the operation and effectiveness of the capital maintenance regime. However, the 2006 Act has also failed to rectify some glaring and long-standing concerns that exist in this area.

Problem question

MultiSoft plc was incorporated in 2005. Its memorandum states that it has an authorized share capital of £2 million. Since then, it has allotted and issued 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 Multisoft's:

- issued share capital
- unissued share capital
- paid-up capital
- called-up capital
- uncalled capital.

¹ *Re Wragg Ltd* [1897] 1 Ch 796 (CA).

² Companies Act 2006, s 763(1)(a).

³ PL Davies and S Worthington, *Gower & Davies' Principles of Modern Company Law* (9th edn, Sweet & Maxwell 2012) 280.

⁴ Louise Gullifer and Jennifer Payne, *Corporate Finance Law: Principles and Policy* (Hart Publishing 2011) 127.

⁵ Companies Act 2006, s 568(1).

- An initial point worth making is that MultiSoft was incorporated prior to the passing of the Companies Act 2006. Accordingly, its memorandum is likely to state information that is not required to be stated under the CA 2006. For example, the 2006 Act does not require companies to state their authorized capital. However, companies incorporated prior to the passing of the 2006 Act that still retain their authorized capital within their memoranda will still be bound by the stated amount.

Issued share capital

- Whereas the authorized share capital was the maximum nominal value of shares that could be allotted, the nominal value of shares that actually has been allotted is known as the issued share capital. MultiSoft has issued 1.2 million shares with a nominal value of £1.50 each. Accordingly, MultiSoft's issued share capital is £1.8 million.

Unissued share capital

- A company's unissued share capital is the difference between its authorized capital and its issued capital. MultiSoft has an authorized capital of £2 million and an issued share capital of £1.8 million. Accordingly, its unissued share capital is £200,000.
- With the abolition of the requirement to state the authorized share capital, the concept of unissued share capital has also been abolished, unless, as is the case here, the company was incorporated prior to the passing of the 2006 Act and states in its memorandum what its authorized capital is.

Paid-up capital

- Shareholders may not be required to pay fully for their shares upon allotment. For example, in our set of facts, purchasers of shares need only pay a minimum of 90 pence upon allotment. The combined total of the nominal share capital that has been paid is known as the paid-up share capital. This is calculated by working out how much has actually be paid on the shares:
 1. 500,000 shares have 90 pence paid up = £450,000
 2. 400,000 shares have £1.20 paid up = £480,000
 3. The remainder (300,000 shares) are fully paid up (£1.50) = £450,000
- Adding these figures together tells us that the MultiSoft's paid-up share capital is £1,380,000.

Called-up capital

- If shares are not fully paid for, the company can call for any outstanding amounts to be paid, or instalments may have become due. The paid-up share capital plus the amount called for constitutes the company's called-up share capital.
- MultiSoft has a paid-up share capital of £1,380,000. It calls for 10 pence to be paid on all unpaid shares. As 300,000 shares have been fully paid for, there are 900,000 unpaid shares. 900,000 multiplied by £0.10 equals £90,000. It should be noted that this £90,000 forms part of the called-up share capital, irrespective of whether everyone actually does pay the amount called up. Accordingly, the fact that some members do not contribute the amount called for, does not affect the called-up capital.
- Adding this £90,000 to the paid-up capital results in MultiSoft having a called-up capital of £1,470,000.

Uncalled capital

- The difference between the company's issue capital and its called-up capital is known as the uncalled share capital (that is, the amount that the company can call on). As MultiSoft's issued share capital is £1.8 million and its called-up capital is £1,470,000, it follows that its uncalled capital is £330,000.