Thashira Gunatilake
LLB(Colombo) LLM(Auckland)
Attorney-at-Law

What is a Company Share

the
GREAT
LITTLE
CAKE
COMPANY

Idea → **CAPITAL**

Equity **Debt**

- Share is – An interest in the company, measured by a some of money, carrying *various rights* contained in its terms of issue.

- ***Borlands Trustee V. Steel Bros & Co Ltd [1990] 1 Ch 279.***

Characteristics of a Share

1. A Share is a Movable Property - Sec 49(1)

   - It is transferable in a manner mentioned in the Articles of the company.

   - The Articles may limit or restrict the extent to which it is transferable. Section 49(5).

   - ***Ratwatte* V. *Gunasekara* [1987]2 SLR 260**.

     A share is a movable property only so for the purposes of the Act.

2. It does not give rights to the underling asserts of the company. But only to the profit of the Company (**Dividends**).

   - *Macaura* V. *Northern Assurance Co Ltd* [1925] AC 619.

3. A share may be subject to equitable assignments

- It may be seized by a creditors.
- BUT, the creditor or the assignee is Only eligible to obtain the interest the debtor had.
- However, if the Articles provide for Directors permission for transfers, the debtor can not compel the courts to register such shares to their names.

Eg. *Phillips* V. *Paloma Sweets Ltd* [1921] 51 OLD 125.

Attached To A Share

- Presumption that Shares in a company are usually equal in all respects.

  Eg. *Birch v. Cropper* [1889] 14 App Cas 525.

- In General Company Law –

  a) Each share confers on its holder a right to ONE vote on a poll at a meeting.

  b) A right to an equal share in dividends.

  c) A right to an equal share in the distribution of a surplus assert of the company on liquidation - Section 49(2).

Types of Shares

1. Ordinary Shares –

- Basic form of share. Voting power

- Gives unrestricted participation in the dividends and to the distribution of remaining property.

- Have both advantages and disadvantages to shareholders.

Disadvantages -

- Shareholder is entitle to dividends only if the company makes profits.

- Repayment of the capital invested will be settled only after satisfaction of all claims against the company upon winding up.

Advantages–

- Shareholder is entitle to unlimited rights to share the profits of the company.

2. <u>Preference share</u> –

- This category of shares carry preferential rights above ordinary shares in specified aspects – Section 49(3)(b).

<u>Features</u> –

- Hold rights to preferential dividends.
- Priority to re-payment of capital on the winding up of the company. Eg. ***Driffield Gas Light Co*** **[1898] 1 Ch 451.**
- <u>Could</u> hold special class voting rights. *Not guaranteed*.
- Called as "golden shares" –Gives the holder more <u>rejection</u> rights in strategic decisions.

Eg. Privatization scenarios -
State tends to own more of these

3. <u>Deferred Shares</u> –

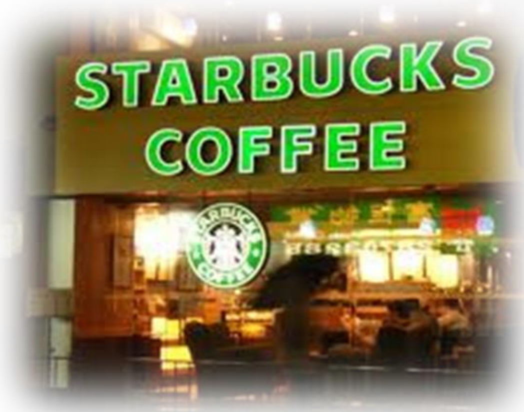
- These shares are issues with limited rights.
- For an example – They may get dividends or profit <u>ONLY</u> after ordinary shares.

4. <u>Non Voting Shares</u> –

- These shares do not carry Voting rights at all or limited rights of voting – Sec 49 (3)(c).
- These shares are usually issued to retain the CONTROL of a company.
  Eg. To avoid foreign control over local companies.
- However, they are <u>entitle to dividends</u> similar to ordinary shares.
- Normally they sell at a discounted price. Therefore, can be attractive.

Issue of Shares

Invest some money



Will you just Invest money with this unknown party

Equity

Loan

- When companies want financial assistance, they invite 3rd parties to invest on the company.

- Such investments can be made either by equity or debt. In return, the investors are issued with "shares" or "debentures" . (securities)

- Prior to investing, they should be given access to all material information relating to the securities in order to make informed investment decisions.

  Eg. ***Central Railway Co of venezuel V. Kisch [1867] LR 2 HI 99.***

- The Document which such details are communicated is called as a **PROSPECTUS**.

1. Prospectus Requirements -

- The Act defines Prospectus as – Including any notice, circular, advertisement or other invitation to the PUBLIC .

- Therefore, an **OFFER** to invest on shares or debentures is made when a Prospectus is been released to the Public.

- When you decide you want to issue shares or debentures to the Public, such allotment of shares or debentures should satisfy the followings;

  (*a*) An offer of the shares or debentures for sale to the public be made within six months after the allotment or agreement to allot ; or

  (*b*) That at the date when the offer was made, the whole consideration to be received by the company in respect of the shares or debentures had not been so received.

Distributions

- What do you think distribution means..?

- What can you distribute in a company..?

Distributions Generally –

- Act – Direct or Indirect Transfer of Money or Property to or benefit of a shareholder.

- This does Not include shares of the Company.

- Distribution could include
  - Payment of a Dividend
  - A redemption/ improvement

History of Company Distributions

- Historically, when a company distribute money or property, they need to comply with TWO principles.

  A. Capital maintenance Rule

  B. The Solvency Test

A. Capital Maintenance –

- Companies should maintain the Capital.

- However, the Consent of the Courts should be taken prior to any of the distributions.

- There are few rule.

  a) Prohibits companies from buying out their own shares.

  b) Prohibits paying dividends out of capital.

  c) Prohibit companies from giving financial assistance to 3rd parties for the purchase of their shares

<u>Repurchase of Its Own Shares</u>

- **How does re-purchase come under the meaning of distribution..?**

- **The new Companies Act allows companies to purchase its own shares in specific situations – [Sec 63]**

- **What normally happens when you purchase a company share…?**

- **Features of repurchasing its own shares –**
  - **The company has to pay the value of the share**
  - **The share gets cancelled immediately after acquisition**
  - **The share does Not get transferred under the companies name**

- **Important – As this is a distribution, the company has to satisfy the <u>solvency test</u> prior to buying its own shares.**

- However, under the New Companies Act, a company is permitted to assist 3rd parties to buy its own shares.

- A company has to comply with formalities set down in Section 70 of the Act.

- Further, the following criteria should be met –
  - Board must declare that such assistance is for the best interest of the company
  - Terms and conditions of assistance are fair to the company and to shareholders not receiving such.
  - The company satisfy the Solvency Test soon after such distribution.

B. Solvency Test –

- This test plays a critical role in jurisdictions like New Zealand, Canada and USA.

- In General – This test prohibits distributions if the company was insolvent or would be insolvent as a result of the distribution.

- In New Zealand –
  - The company should be able to pay their debts as they become due in the normal course of business and ensure that their asserts are greater than their liabilities.

- In Sri Lanka –
  - Identical to the NZ provision.
  - However, one addition phase added to it.
  - It has resulted in Capital Maintenance Rule included in the definition of the solvency test in Sri Lanka.

<u>Sri Lankan Approach</u>

- **Under the Companies Act [Section 57(1)] it states as follows;**

  The solvency test is deemed satisfied if the company is able to pay its debts as they become due in the normal course of business, and the value of the company <u>Asserts</u> are <u>Greater than</u> the value of its <u>Liabilities</u> and the company's <u>Stated Capital</u>.

- Reason why Sri Lanka adopted the Capital Maintenance Rule -

  For greater protection of the <u>Creditors/ Shareholders</u>. However, this has ultimately resulted in <u>limiting</u> the freedom of companies to make distributions.

<u>Stated Capital</u> –

- The total amount received by it or due and payable to it, in respect of the <u>issue of shares</u>.

- **Directors Responsibility on distribution –**
  - **Board has to ensure that the Solvency Test be satisfied immediately after the distribution.**
  - **Ensure that the Company obtains a Certificate of Solvency from an Auditor.**
  - **Any director voting in favor of the distribution must sign a certificate confirming that the solvency test will be satisfied after the distribution – Section 56(2)**
- **Any distribution made to shareholders without satisfying the solvency test may be recovered from him.**
- **However, a director will be *Personally Liable* to pay the company IF;**
  - **Distribution is made without satisfying the solvency test**
  - **A director did not have reasonable grounds to believe that the company would satisfy the test when he signed the certificate.**

Debts and Debentures

- When doing a business, companies face financial difficulties.

- Few alternatives –
  1. Borrow equity from 3rd parties in return of issuing Shares.
  2. Borrow money as a Debt.

Debt –

- Companies borrow money from creditors. Then the company becomes the Debtor.

- Do creditors expect anything in return…???

- **YESSSS**. They lend money to the company with a
  a liquidated sum.

- There are 2 types of Debts. (Secured and unsecured)

1. Secured debts –
    - The creditor holds the right to inspect the assets of the company for satisfaction.
2. Unsecured debts –
    - The creditor does not hold any right to inspect the asserts of the company
    - He only holds the right to claim.

What is a Debenture –

- Any document that creates or acknowledges a debt of a company. Eg. *Levy V. Abercorris Slate and Slat Co.* [1887] 37 Ch D 260.
- Companies frequently issue Debentures to 3rd parties.
- Claims on such acknowledgements could or could not be on the asserts of the company.
- However, unlike equity, repayments MUST be made on debts.
- **Can you claim Dividends….?**
- **Two types –**

  1. **Secured Debentures**
     - Fixed Charges
     - Floating Charges
  2. **Un-secured Debentures**