

COMPANY SHARES

Very often when setting up a company shares are issued to the persons who were involved in the set up. Often there is very little thought given to what it actually means to hold shares and how holding a specific percentage of the shares can change the dynamics in a company. Take advice from Lime One before you issue shares in your company about the right way to do it and the impact it may have on future investments.

1 BASICS

Share Capital is the investment made in a Company by its members. In exchange for the investment the member gets to hold shares. This will be shown in the memorandum of association

One share entitles the holder to one vote. The right to vote means the ability to promote or block decisions which affect the running of the Company. These will be Annual General Meetings (AGM) Extraordinary General Meetings (EGM) and will vary from Company to Company so, if someone holds 10 shares and another holds 5, the holder of 10 can outvote the holder of 5. This is the most simplistic way of looking at shareholding of course!

In addition, once a Company is profitable, shares may attract dividends. Dividends are usually decided by Directors and is an amount of money paid for each share, so again, the holder of 10 shares will benefit in that they will be paid more than the holder of 5.

2 DIFFERENT TYPES OF SHARES

These are also different types of shares

(a) Ordinary

The basic type of shares which are usually issued and have no special rights but no restrictions either.

(b) Ordinary – differential

However, you can have different classes of different value which are differential so you can have several classes of ordinary shares (for example, Class A, Class B, Class C) with each class having different rights to vote and/or have dividends.

(c) Preference

Unlike the ordinary shares these do carry a right which means that the holder gets paid dividends preferentially to other types of shares

(d) Cumulative Preference

Similar to the preference shares except that if there is no dividend paid in 1 year, that right is carried to the next year

(e) Redeemable

Companies can have just these types of shares. This is because when these shares are issued, it is already agreed that the Company will buy them back after a certain date or period of time.

3 SHARE CAPITAL

(a) Value

Shares usually have a nominal value of £1. This has nothing to do with the actual true value of the shares which will be calculated by your accountant, according to the “worth” of the Company.

(b) Number

This depends on the set up of the Company but usually a company starts off with 1000, although usually not all of those will be allocated at the start. In private companies there is no minimum share capital but Public Limited Companies (PLC) need to have at least £50,000.

(c) Payment

In private limited companies shares do not have to be paid for until the Company needs them to be “paid up”. When they are “paid up” the payment is made to the Company and is reflected in the accounts.

If shares are not “paid up” if a company goes into liquidation, then the Liquidator will require the shareholder to make payment to satisfy the creditors, otherwise there is other claim against shareholders.

4 RIGHTS OF SHAREHOLDERS

Most shareholders are not actually aware of what rights they have and so consequently, the rights are not used. In the table below, we are highlighting just some of the rights that shareholder’s have, dependent on the percentage of shares that they hold.

Percentage of shares	Rights	Legislation which allows this IA = Insolvency Act CA = Companies Act
Any shareholder	Right to vote Right to ask the Court to call an EGM Right to restrain an unlawful “Ultra Vires” act Right not to be unfairly prejudiced Right to a dividend Right to have the Company wound up if it is just and equitable Right to a copy of the accounts Right to inspect Minutes of General Meetings Right to pursue a derivative claim in respect of an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. The shareholder doesn’t need to show that the director(s) being pursued control majority shares or that those director(s) personally benefited from the alleged breach.	CA 1985 - S370 CA 1985 - S371 CA 1985 –n S35(2) CA 1985 - S459 Table A Article 104 IA 1986, - S122(1)(g) CA 1985 - S240 CA 1985 - S382, S382A, S383 CA 2006 - S260-269
5%	Right to have an item placed on an AGM agenda (with prior written request) Right to circulate a written statement Right to refuse to consent to short (less notice to members than is normally required) notice Right to demand an AGM if it is more than 12 months since shareholders last met	CA 1985 - S376 CA 1985 - S376 CA 1985 - S369(4) CA 2006
10%	Right to call an EGM (with prior written request) Right to demand an AGM (can be 5% in restricted circumstances)	CA 1985 - S368 CA 2006
25% +	Ability to block special resolutions	
50%+	Right to pass ordinary resolutions, including, for example: any item of routine business where CA 1985 requires approval of the matter by members in general meeting Exercise authority to alter (not reduce)	CA 1985 - S121

	authorised share capital pay a final dividend removal of a director (providing special notice of the resolution has been given) Right ordinary resolutions, provided that special notice of the intention to propose such a resolution has been give, including, for example: Remove a Director	CA 1985 - S303 CA 1985 - S303(2)
75%+	Pass a Special Resolution (these require 75% majority & at least 21 days notice to members & there is some restrictions because Court can set these aside) including, for example: Winding up Change of name Ratification of an act beyond the power of the directors Pass a Extraordinary Resolution	CA 1985 - S378(2) IA 1986, S122, S84(1)(b) CA 1985 - S28 CA 1985 - S35 as inserted by CA 1989 - S108 CA 1985 - S378(1)
95%+	Hold an EGM on short notice	CA 1985 - S369
100%	Pass an Elective Resolution passed by all members & at least 21 days notice to members including, for example: Election to dispense with holding AGMs	CA 1985 - S366A

Put simply, a shareholding of 50%+ is a controlling interest which can mean that the shareholder can dictate who is on the Board of Directors and do most things which would be regarded as the everyday running of the Company as a business.

Rather than enshrining the common law into statute, the new sections 260 to 269 of the Companies Act 2006 ("the Act") introduce a wider range of circumstances in which a derivative claim may be brought by a shareholder. These changes came into force on 1 October 2007 and allow a shareholder to pursue a derivative claim in respect of an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. The general duties of a director are now set out in Part 10 of the Act and have been the subject of considerable debate. A breach of duty will be actionable even if the director has not benefited personally from the breach. Moreover, it will not be necessary for the shareholder to show that those directors who carried out the wrongdoing control the majority of the company's shares

5 DISPUTES

Stages in a dispute

(1) Do the **Company's Articles of Association** relate to the dispute? If not, look at whether there is unfair prejudice.

(2) **Unfair Prejudice** - S459 of the Companies Act 1985 allows a company member/shareholder to apply to the Court to make an Order where "the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or of some part of its members..."

The problem is that “unfairly prejudicial” is not actually defined. However, it does mean a minority shareholders, or group of minority shareholders can ask the Court to make an order where, for example, the shareholder has evidence of occasions where the majority shareholder is managing the Company in such a way that damages the shares value or is misusing Company assets. It wouldn't be enough for minority shareholders to just say that the majority shareholder is managing the Company badly, without being specific.

The Court has wide powers with regard to what orders it can make but often this will be simply ensuring that the majority shareholder buys out the minority shareholders, for a fair market price etc.

6 DEADLOCKS IN 50/50 shareholders/Joint ventures

Many companies are set up with 2 people who decided to opt for the company format for their business. On setting up each of them is given one half of the allocated shares each, for example, 50 each. This can work quite well whilst things are running smoothly, but more often than not there comes a point at which a dispute arises.

Having a 50/50 split can cause a stalemate or deadlock situation. In addition, Courts often see such splits as actually being “quasi partnerships”. The Court will usually be more willing in any dispute to give certain rights to one shareholder than the other if that shareholder has been the one who has been actually “running” the Company. This is particularly so to avoid one of the shareholders, without good reason, from being excluded from the “running” the Company or being forced out in some way.

However, where both parties equally run the company, Courts often consider that the parties must have envisaged such a circumstance at the beginning of their dealings together!

Ultimately, there are 2 ways forward

(1) Negotiation, negotiation, negotiation

Something has to give. It's that simple. If you want to avoid litigation you need to negotiate a compromise for both parties.

Where the situation appear to have reached true breakpoint, then it is worth using the experiences of mediation which will focus both parties and push along to a compromise

(2) Where negotiation truly fails, then you are quite simply left with litigation.

This will be based on the Right not to be unfairly prejudiced CA 1985 - S459, as discussed in the section above, **5 DISPUTES.**

Aside from the fact that S459 disputes are a distraction taking the focus from the day to day running of the Company. There can be long delays and ultimately, even an initial successful company can be looking at financial ruin.

Even if a S459 petition is issued, the Court will still look to encourage the parties reaching an agreement without a final court hearing.

Often, one party will make a Pre-Action offers or offer as soon as a Petition is presented, to settle based on the 5 criteria laid down in the case of O'Neil v Phillips 1999 BCC600HL, which include

(1) a Fair value offer to purchase other parties shares

(2) Value to be determined by a “competent expert” unless both parties agree

(3) The expert will not be acting as an arbitrator but as an expert to give a valuation

(4) Both parties must have had the same access to company information and to have made representations to the expert

(5) Allowing (particularly the Respondent to a petition) a reasonable time investigate the

If subsequently the offer is rejected, the party making such an offer will ask the Court to “set aside” any S459 petition.

7 AVOIDING DISPUTES – SHAREHOLDERS AGREEMENTS

This is quite simply an agreement which is made between the shareholders and sets out what they have agreed. This will be invaluable in the circumstances of any potential dispute.

The simple process of preparing the shareholders agreement helps shareholders to look at and work through key issues and so provide for the potential areas of dispute before they arise. Much of the litigation regarding shareholdings can be avoided by spending some time in planning the best way forward and taking legal advice.

Lime One offers practical business law advice in plain English, with costs commencing at just £35 plus VAT for telephone or email advice.