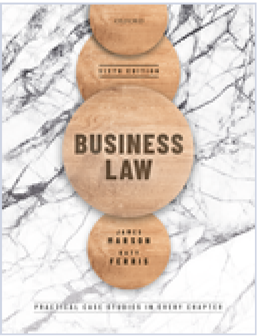

Business Law (6th edn)

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16. Duties Relating to Corporation Finance and Capital

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Abstract

This chapter discusses the details of the various obligations on companies that wish to issue and allot shares, provide debentures and charges over the company's assets, and provide guidance on the maintenance of the company's finances. It continues from the discussion of the administration of the company to consider the broad issue of corporate governance and identifies how a company may raise capital, while also considering the obligations placed on the directors to protect and maintain the capital of the company for its members. To appreciate the effects of the Companies Act (CA) 2006 on companies, it is important to understand the rules regarding the issuing of shares and granting of debentures to protect the company and the creditors from abuse, and how dividends are to be agreed upon and provided to shareholders.

Keywords: companies, shares, debentures, assets, finances, corporate governance, capital, dividends

Companies have to adhere to the requirements of the Companies Act (CA) 2006 when issuing shares, altering and reducing their share capital, and granting charges to creditors. Detailed regulation exists and directors who fail in certain duties in these areas may be fined, and even imprisoned on conviction. Those who are lending money (creditors) to the company may wish to secure the loan through a charge over its assets. This ensures that the creditor can take control of the assets subject to the charge if the company is in default. Registration of charges is required to secure them and whilst failure may lead to the director(s) in default being subject to a fine, for the creditor such a situation will result in the loss of the charge and secured creditor status. Hence, the chapter contains vital information for directors, members, and creditors.

Business Scenario 16

Jimmy, Andy, and Ollie operate a business named Jimmy's Pizzeria Ltd. The business was incorporated in January 2015 and its shares, with a nominal value of £1 each, are distributed as follows. Jimmy, Andy, and Ollie (the company's only directors) own 1,000 shares each, Bob owns 3,000 shares and the remaining 1,200 shares are owned by several investors. The following events have occurred:

Jimmy's Pizzeria Ltd has never declared a profit and consequently no dividends have been issued. This has continually angered Bob. Bob is unaware of whether this is a deliberate choice by the directors or simply a lack of ability on their behalf. Bob has sought to change the directors of the company but has been blocked by the current directors at general meetings.

- Bob attempts to secretly purchase shares from the other investors in order to gain the majority needed to replace the directors. When Jimmy, Andy, and Ollie discover this fact, they cause the company to issue 2,000 more shares and offer these to Jimmy's friend Jack. Jack, they believe, will be favourable to the directors and vote in their favour.
- Jack has a cash flow problem and thus offers to pay £1,300 in cash and has used his boat as consideration for the remaining £800. The boat is not valued and this matter is not referred to the members of the company.

Learning Outcomes

- Explain the nature and characteristics of a share and the different types of shares (**16.2–16.6**)
- Understand the requirement of the necessity of maintaining capital (**16.4.2–16.4.2.1**)
- Identify the procedures involved in issuing shares (**16.9**)
- p. 403 Explain the nature of a company obtaining secured and unsecured loans (**16.12–16.13.1**)
- Explain the registration procedure process for charges applied to company assets (**16.13.2–16.13.3**).

16.1 Introduction

This chapter continues from the discussion of the administration of the company to consider the broad issue of corporate governance. It identifies how a company may raise capital, and considers the obligations placed on the directors to protect and maintain the capital of the company for its members. There are rules regarding the issuing of shares and granting of **debentures** to protect the company and the creditors from abuse; how **dividends** are to be agreed and provided to shareholders; and these must be understood to appreciate the effects of CA 2006 on companies, and to ensure these rules are not (innocently, negligently, or fraudulently) transgressed.

16.2 Shares

A share is a bundle of rights and duties that the holder possesses in relation to the company and the other members. Under CA 2006, s. 540 a share means a share in the company's share capital which includes rights to attend meetings, vote, and/or receive a dividend. The share also provides liabilities to the owner to contribute the amount of capital required to be paid when called up by the company (if the shares, for instance, had not been fully paid for—The Companies (Model Articles) Regulations 2008, Art. 21). However, shareholders are only liable for this investment and do not have to contribute more if the company cannot satisfy its debts. This is the concept of the shareholders' limited liability. Shares are considered as personal property (and are not in the nature of real estate—CA 2006, s. 541), and as such the shares of any member may be transferred in accordance with the company's articles (CA 2006, s. 544). The share must have a fixed nominal value (or it is void) and each share must be distinguished by its appropriate number except when the shares are fully paid up and rank without preference (***pari passu***), or all the issued shares of a particular class are fully paid up and rank *pari passu* for all purposes (CA 2006, s. 543).

16.3 Shareholders

CA 2006 refers to a company's members, but essentially this refers, in this instance, to the shareholders of the company. The shareholders are deemed to 'own' the company because they will have made an investment, such as by purchasing shares, and whilst this will be performed in the expectation of a return on their investment (such as through dividends or an increase in the value of the shares) they are entrusting their investment to a body with its own legal personality. Despite 'ownership', each of the shareholders could not expect to play an active role in the company's day-to-day management. As such, the members delegate the task of management to directors who are answerable (to varying degrees) to the shareholders. However, whilst the powers of the directors may be very broad and can bind the company into contracts and provide and take loans on the company's behalf, the role and powers possessed by shareholders must not be underestimated.

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16.4 Share capital

When the company limited by shares is formed, the subscribers identify the amount of capital received from the share issue. The nature of limited companies, and hence the limit to the personal liability of its members, is very important to those doing business with the organization. The identification of the share capital reassures the company's creditors that sufficient funds (capital) are present in the event that the business fails and that the company will be in a position to satisfy its debts. It is for this reason that there are detailed provisions on how a company may alter or reduce its share capital.

A company having a share capital is considered under CA 2006 to possess a power under its constitution to issue shares (CA 2006, s. 545). These shares are required to have a nominal value (CA 2006, s. 542), identified in Sterling, euros, or some other nominated currency. This nominal value is the amount that the company and the purchaser have agreed as the purchase price for the share and this value may not be lowered (or this would constitute a fraud on the company). This nominal value is the lowest price that the share will be sold for. However, it may be possible (and indeed could prove advantageous) for the share to be transferred at a higher value than this, and this value is the share premium. It must be noted that when a company manages to receive a premium on the shares issued, this must be transferred into a share premium account and not distributed to the members as dividends. The money in the share premium account cannot be used to write off expenses such as when debentures are issued or for any costs incurred in forming the company, although it may be used to offset expenses incurred in the issuing of the shares involved (CA 2006, s. 610). This figure is then treated for the purposes of the company as capital and would be included in the company's balance sheet at the end of the year.

Shares are usually issued to raise capital and the most common form is in money (although some companies issue shares in return for assets or work completed and part of the payment is in the issue of shares—although this is subject to strict rules). The issue of raising capital in this manner is particularly important. Whereas loans taken by the company (and possibly **secured** on the company's assets) have to be repaid in accordance with the loan agreement, shares that are issued for an investment of capital do not involve any loan, and despite the dilution of the percentage of their shareholding of the major shareholder(s) by issuing shares to others, there is no right to a dividend on the shares held unless this is agreed at the general meeting (and from the company's profits). Loans have to be repaid whether the company has dispersible profits or not.

A company's share capital may be considered under the following headings.

16.4.1 Share Capital

This refers to the amount of capital that the company was registered with (the share capital may be raised by the decision of the directors (unless the articles provide otherwise) or through a resolution at a later date if required—CA 2006, s. 617). For example, a public company with a minimum £50,000 of share capital may have this divided into 50,000 £1 shares, and these will be distributed as the subscribers see fit.

- *Issued share capital:* Issued share capital refers to the amount of the authorized share capital that has been issued (a company does not have to issue all of its shares in the authorized share capital—CA 2006, s. 546). This relates to the funding that the company has received from the members. To continue the
p. 405 example above, that the company has the power to issue 50,000 shares does not mean that they have all been issued at the formation of the company. The company may have issued 40,000 of the £1 shares and hence it has an authorized share capital of £50,000, but an issued share capital of £40,000. It is this fund that the creditors will go to in the event of the company's insolvency.
- *Allotted share capital:* Allotted share capital naturally refers to shares that have been allotted. Both issued and allotted shares include those taken on the formation of the company by the subscribers to the company's memorandum (CA 2006, s. 546). Shares are allotted when a person acquires an unconditional right to be included in the company's register of members in respect of the shares (CA 2006, s. 558). A person who has been allotted shares may not necessarily take up these shares personally and may choose to transfer their right to others. However, the directors can (and at some time will) call up any payment owing on the shares because the subscribers, when forming the company, enter into a contract with it regarding the shares and their willingness to take these (and pay the nominal value).

- *Paid-up share capital:* The paid-up share capital is the amount of the nominal share capital that has been paid for by the company members (albeit that any premium paid does not count in this calculation). In the earlier example, when shares are allotted to the members it may not, at that time, require payment in full. The £1 shares remain at £1 but the company may have only required 50 pence per share to be paid. Hence, of the £40,000 issued share capital, the paid-up capital is £20,000.
- *Called-up share capital:* This refers to the share capital that the directors have 'called-up', including any share capital paid up without being called, and any share capital to be paid up on a specified future date under the articles. It includes the terms of allotment of the relevant shares or any other arrangements for payment of those shares (CA 2006, s. 547).

16.4.2 Alteration of Share Capital

Whilst a private company is not required to have any prescribed amount of share capital, compared with a public company's requirement of £50,000, it will identify its share capital on formation but may, at a later date, wish to vary this amount in light of its changing circumstances. Whilst generally it is prevented from doing so (CA 2006, s. 617) there are exceptions where the company wishes to increase its share capital by:

- allotting new shares, reduce its share capital in accordance with Chapter 10 of CA 2006, where it wishes to subdivide (e.g. to change 100£1 shares to 1,000 10p shares) or consolidate (e.g. to change the existing shares to a smaller number of shares—1000 10p shares to 100 £1 shares) all or any of its shares, where it wishes to reconvert stock into shares (however, CA 2006, s. 620 prevents shares from being converted into stock, unless they were converted into stock before the Act—where they can be reconverted), or where it wishes to redenominate any or all of its shares (e.g. to convert the shares from one currency to another).

Where a company wishes to allot new shares, a contract has to be established between the parties that identifies the important information such as the amount of capital involved, when this capital is to be contributed, the nature and class of the shares to be allotted, and when the shares will provide the allottee with their rights attached to the shares. Chapter 2 of CA 2006 governs the allotment of shares and identifies the authority of directors to allot (CA 2006, s. 549). Where a private company has only one class of share, the p. 406 director(s) is ↵ empowered to allot shares in the company unless the articles prevent this (CA 2006, s. 550). Where a company has more than one class of share, or the company is a PLC, there must be authority provided by the company's articles or through a resolution of the company (a resolution of a company to give, vary, revoke, or renew authorization under this section may be an ordinary resolution, even though it amends the company's articles—CA 2006, s. 551). This authority may be conditional or unconditional, and it must state the maximum amount of shares that may be allotted, and specify the date on which the power will expire (which must not be more than five years from the date of incorporation (where the power is from the company's articles) or the date that the resolution was passed). This power may be extended for a period not exceeding five years. Having received the authority to allot shares, any further resolution will identify the maximum amount of shares to be allotted and identify the expiry date of the power. To maintain the company's capital, it is not permitted to issue the shares at a discount (CA 2006, s. 552), although the company may pay the subscriber a commission for their subscribing or agreeing to subscribe (CA 2006, s. 553). Having allotted shares, the company must inform the Registrar (of Companies) as soon as practicable and in any event within two months after the date of allotment (CA 2006, s. 554), and within one month of making the allotment, the company must deliver to the Registrar a return of allotment detailing the statement of capital (CA 2006, s. 555).

Shares may be consolidated for convenience by altering shares that were issued in small denominations into larger amounts. This does not change the percentage of the total number of shares. Subdividing is the contrary situation and involves the shares being 'reduced' into smaller denominations because, for example, in their current division the price is too great to attract investors. In relation to subdividing and consolidating shares, the proportion between the amount paid and the amount unpaid (if any) on each share must be the same as it was from the share from which it derived (CA 2006, s. 618). The company is empowered to make such a change where the members pass an ordinary resolution to that effect (although the company's articles may require a higher majority or may exclude or restrict any power conferred by CA 2006). If the company does make such a change, it must inform the Registrar within one month of having made the change along with a statement of capital (detailing the total number of shares of the company, their nominal value, the amounts of paid and unpaid shares, and so on—CA 2006, s. 619).

Where the shares are to be redenominated, the company's articles may impose restrictions and the members must pass a resolution authorizing this (which may specify conditions that must be met before the redenomination takes effect—CA 2006, s. 622). This will include details such as the exchange rate utilized, and the redenomination must take place within 28 days, ending on the day before the resolution was passed. Following the redenomination, the company must notify the Registrar of the changes within one month of doing so (CA 2006, s. 625), including a statement of capital and, within 15 days of the resolution being passed, a copy of the resolution. It is also important to note that redenomination does not affect any rights or obligations of the members under the company's constitution, or any restrictions affecting members (CA 2006, s. 624).

16.4.2.1 Reduction of share capital

A company may seek to reduce its share capital because its assets have permanently decreased in value, it may be a tactic to eliminate book debts (this is an uncollected debt owed to a company), or to return capital to shareholders where the capital involved is surplus to the company's requirements, and so on. A private company may achieve a reduction in the share capital by a special resolution supported by a **solvency statement**. However, the reduction must still leave at least one member with a share(s) (and one that ↵ is
p. 407 not a redeemable share—CA 2006, s. 641). Private and public companies may, through a special resolution confirmed by the court, reduce their share capital. However, the company may have provisions in the articles that restrict or prohibit such a reduction. The private company that wishes to reduce its share capital, supported by a statement of solvency, requires the directors of the company to make the statement not more than 15 days before the date on which the resolution is passed, and the resolution and the statement are registered in accordance with s. 644 (CA 2006, s. 642). The statement must identify, with respect to the company's share capital as reduced by the resolution, the total number of shares of the company, the aggregate nominal value of those shares, the amount paid up, and the amount (if any) unpaid on each share; and for each class of share, the rights attached to the shares, the total number of shares of that class, and the

aggregate nominal value of shares of that class. The validity of a resolution is not affected by a failure to deliver the documents required, but an offence is committed and is punishable by a fine of the company and every officer of the company who is in default.

Where the resolution is proposed as a written resolution, a copy of the solvency statement must be sent or submitted to every eligible member at or before the time the proposed resolution is sent or submitted. Where the resolution is proposed at a general meeting, a copy of the solvency statement must be made available for inspection by the members of the company throughout that meeting. The validity of the resolution is not affected by a failure to comply with these sections of the Act (CA 2006, s. 642). The solvency statement requires the directors to have formed the opinion, with regard to the company's situation at the date of the statement, that there is no ground on which the company could then be found to be unable to pay (or otherwise discharge) its debts. Further, the directors must have formed the opinion that if it is intended to commence the winding-up of the company within 12 months of that date, that the company will be able to pay (or otherwise discharge) its debts in full within 12 months of the commencement of the winding-up, or in any other case that the company will be able to pay (or otherwise discharge its debts) as they fall due during the year immediately following that date. The resolution for the reduction is effective when the documents are registered with the Registrar.

Where a company has sought to reduce its share capital through a special resolution as noted earlier, it may have this confirmed by the court. If this proposed reduction of capital involves a diminution of liability in respect of unpaid share capital or the payment to a shareholder of any paid-up share capital, s. 646 allows the creditors to object to the reduction unless the court directs otherwise (CA 2006, s. 645). If the court does not disapply the provision of s. 645, every creditor of the company who is entitled to any debt or claim is entitled to object to the reduction of capital (CA 2006, s. 646). In practice, the company will provide the court with evidence that all the creditors have consented to the action, producing guarantees where necessary. Where an officer of the company intentionally or recklessly conceals the name of a creditor entitled to object to the reduction or they misrepresent the nature or amount of the debt or claim of a creditor, or where they are knowingly concerned in any such concealment or misrepresentation, they commit an offence punishable by a fine (CA 2006, s. 647).

The court may make an order confirming the reduction of capital on such terms and conditions as it thinks fit. Where it confirms the reduction, the court may order the company to publish the reasons for the reduction, or other information that it thinks fit to give proper information to the public. It may also require the company, where special reasons exist, to add to its name the words 'and reduced' during a period specified in the court's order (CA 2006, s. 648). When the court has provided its order confirming the reduction, the Registrar will register the order and the statement of capital (CA 2006, s. 649).

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16.5 Share Certificate

A share certificate that is correctly issued is evidence of the holder's legal title to the shares identified in the certificate (CA 2006, s. 768). The nature of such a document enables the holder to use the ownership as a form of collateral/security. The company must issue certificates on allotment within two months unless the issue provides otherwise; the allotment is to a financial institution; or if, following the allotment, the company has issued a **share warrant** in respect of the shares (CA 2006, s. 769).

16.6 Types of Share

Due to the nature of shares and the fact that companies may issue shares to generate capital, the company must ensure that as many of the shares issued are taken up to realize the investment of capital required. The shares provide rights and impose duties on the shareholders but a company has an ability to issue different types of share, with different rights attached to them, depending on what shares it considers investors will wish to purchase and so on. The articles of the company may provide the company with authority to issue different classes of shares. The Companies (Model Articles) Regulations 2008 provide for the right to issue different classes of share subject to the provisions of CA 2006, and where not to prejudice the rights of existing shareholders. Where different types of share are issued, these are placed in identifiable 'classes' and the 'class rights' that attach to the shares will ensure the shareholders have knowledge of the class and their rights under this class. This is important as the classes of shares may, for example, entitle the holder to more votes per share in company meetings, to preferential treatment when dividends are announced, and so on. When the company issues shares of different classes, this will be identified in the articles of association or the articles may be amended for this purpose through an ordinary resolution, and the details of the different shares and the rights attached have to be sent to the Registrar.

There are a variety of shares that a company may issue but the most commonly used are ordinary and preference shares, and these may or may not be redeemed by the company at a later date.

- *Ordinary shares:* These are the most common form of shares, and unless different classes of shares exist, all shares will be ordinary shares. When compared with preference shares the ordinary shares have a lesser status and the holders are more at risk if problems affect the company's ability to pay dividends or its solvency. The ordinary shareholders have the right to vote at general meetings and the right to receive a dividend if one is declared. However, they are only entitled to a dividend after preference shareholders receive theirs, and there may also be provision for the preference shareholders to receive a share from the company's remaining assets before ordinary shareholders in the event of the company being wound up.
- *Preference shares:* The nature of the distinction between ordinary shares and preference shares relates to the rights that attach to the shareholders of each class. The preference shareholder's main benefit over ordinary shareholders is in the right to a fixed dividend ahead of any dividend payment made to any other class of shares. However, as with any other dividend, this may only be paid from the company's profits and hence there is no guarantee to a payment being declared. The company will fix the amount
p. 409 of the dividend and this may be on a cumulative or non-cumulative basis. Cumulative preference shares provide the right for a fixed dividend, but if there are insufficient profits in the given year then there is no payment made. However, the dividend cumulates to the next year and is added to the dividend that is applicable to that year. For example, if a company issues James with 100 £1 preference shares with a fixed dividend of 5 per cent, and at the end of the first year that James has held these shares the company has insufficient funds to issue a dividend, James gets nothing. Next year, the company has

profits to distribute as dividends and as James' situation has not changed: he is entitled to 5 per cent of the profits for the current year (£5) and 5 per cent of the dividends owed for last year (£5). As a consequence, James receives £10 in dividends.

- Preference shares may also be non-cumulative, and in this situation the holder is entitled to a fixed dividend from the company's profits, but where no profits are available, no dividend is paid. In the subsequent years, where there are profits and the company can issue dividends, the holders of preference shares are entitled to their fixed dividend. Further, where the company is wound up but is still solvent after paying the creditors, the preference shareholders may have the right to claim repayment of capital ahead of the ordinary shareholders.
- Where preference shareholders may be at a disadvantage compared with ordinary shareholders is that the company may not provide the holders of preference shares with the right to vote at general meetings (unless their dividends are in arrears). As such they have no right to influence the company in its decision-making. They are also unable to share in any surplus of the company that has been wound up and still solvent. When the creditors and other liabilities have been paid, if there is money left over, the ordinary shareholders will share in this distribution and the preference shareholders will not (however, of course, this is rather unlikely).
- *Redeemable shares:* A limited company that has a share capital has the power to issue shares that are to be redeemed or are liable to be redeemed at the option of the company or the shareholder (CA 2006, s. 684). A private limited company may exclude this right through its articles and does not require any express authorization to do so, but a public limited company may only issue redeemable shares if its articles authorize such an action. Redeemable shares may be issued only where other shares are in issue that are not redeemable (CA 2006, s. 684(4)). This ensures that a company does not issue redeemable shares and, once redeemed, there are no shareholders but only the directors left.
- A private limited company is only able to redeem shares out of capital in accordance with Chapter 5 of CA 2006, but specifically from distributable profits of the company or the proceeds of a fresh issue of shares made for the purposes of the redemption (CA 2006, s. 687). Having redeemed the shares, they are to be treated as cancelled and the amount of the company's issued share capital is diminished according to the nominal value of the redeemed shares (CA 2006, s. 688).

16.7 Changing class rights

Where the company has just one class of share that carries with it the same rights, duties, and liabilities, then this is identified in the articles and all the members are in the same position with regard to votes at meetings, p. 410 dividends, and so on (CA 2006, s. 629). ↵ However, the company may decide that it wishes to have different classes of shares, and with these different rights and liabilities. To achieve this change the company must look to its articles to identify any specific requirements that must take place for an alteration, and if none exist, then the shareholders of the class of share to be altered have to provide their consent (CA 2006, s. 630). The consent is provided through the holders of at least three-quarters of the nominal value of the issued shares of that class giving their written approval. Further, the company may gain the consent through the passing of a special resolution at a general meeting of the holders of that class of shares sanctioning the variation. These are minimum requirements required by CA 2006 and the company's articles may insist on more onerous requirements if it sees fit. Having successfully varied the class of shares, the company must inform the Registrar of the particulars of the variation within one month of so doing (CA 2006, s. 637).

Where the company has varied the class of shares as noted above, there is a provision for holders of not less than 15 per cent of the issued shares of the class in question (and who did not consent or vote in favour of the special resolution) to apply to a court to have the variation cancelled (CA 2006, s. 633). Where an application is made, the variation will not take effect until the court confirms the variation, and a variation may be refused by the court where to allow it would unfairly prejudice the holders of the shares concerned (CA 2006, s. 633).

16.8 The Company's Purchase of its Own Shares

A general rule exists that a limited company is prevented from acquiring its own shares, whether by purchase, subscription, or otherwise, except in accordance with Chapter 1, Part 18 of CA 2006. Contravention of this rule by the company and its directors in default is punishable on conviction on indictment for a term of up to two years' imprisonment (CA 2006, s. 658). Exceptions exist because it may lead to greater investment where venture capitalists may be willing to purchase shares if permitted to sell the shares back to the company; shareholdings in smaller companies (such as those which are completely family-owned) may be more easily managed if a shareholder wished to sell shares but no other member was in a position to purchase them and they could simply sell them to the company and so on. Therefore, CA 2006 makes provision for such sales.

A limited company that has a share capital may purchase its own shares (including redeemable shares—CA 2006, s. 690), subject to Chapter 4 of CA 2006 and any restrictions in the company's articles. The limited company is prevented from purchasing its own shares where to do so would result in there no longer being any issued shares of the company other than redeemable shares or shares held as treasury shares. The company may not purchase its own shares unless they are fully paid for, and the company, as purchaser, pays for them on purchase (and as such it cannot purchase unissued shares—CA 2006, s. 691). The authority for the company's purchase of its shares requires the agreement by the seller, and the appropriate authority for the company to act in this way. The company may finance the purchase only through distributable profits or the proceeds of a fresh issue of shares made for the purpose of financing the purchase; and any premium paid for its own shares must be paid out of distributable profits. However, this premium may only be paid in this circumstance up to an amount equal to the lesser of the aggregate of the premiums received by the company on the issue of the shares purchased; or the current amount of the company's share premium account (CA 2006, s. 692).

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16.9 Share issue

A company may wish to issue shares. These shares can be purchased from the company directly, they may be bought and transferred from an existing member, or they may be transferred by an operation of law (such as where shares have been inherited on the death of a member). This information will be provided through the company's annual return.

Shares relate to a company's share capital, and references to shares in CA 2006 include stock, unless a distinction between them is expressed or may be implied (CA 2006, s. 540). When a decision is taken to issue shares or to grant rights to subscribe for, or to convert any security into shares (of more than one class) by the directors of the company, the express authorization of the members must be secured (CA 2006, s. 549). This, however, does not apply to the allotment of (or right to subscribe for) shares under an employees' share scheme. The CA 2006, s. 558 provides: 'For the purposes of the Companies Acts shares in a company are taken to be allotted when a person acquires the unconditional right to be included in the company's register of members in respect of the shares.' Any director who knowingly contravenes or permits/authorizes such a contravention commits an offence under the Act and is subject to a fine on conviction. CA 2006, s. 550 continues that in private companies with only one class of shares, a director may exercise their power to allot shares of that class; grant rights to subscribe for shares; or convert any security into such shares, except where they are prohibited from doing so by the company's articles. A director(s) may exercise the power to allot shares if they are authorized to do so by the articles of association or by a resolution of the company (CA 2006, s. 551). The issue must be for a 'proper purpose' and not, for instance, to prevent a takeover by another person. Such an authorization is usually provided by an ordinary resolution at a general meeting and may take the form of a general power to allot shares (with a stated maximum amount of shares to be allotted under the authorization) or authorization for the specific shares being allotted. The power is provided in this respect for a fixed period of five years but may be renewed at such intervals. This authority may be revoked or varied by an ordinary resolution where the power has not been exercised. As soon as practicable after the allotment (or in any event no later than two months following the date of allotment) the company must register this fact unless the company has issued a share warrant in respect of the shares (CA 2006, s. 554). A company limited by shares may, if authorized by its articles, issue in relation to any fully paid shares a warrant providing the bearer with entitlement to the shares specified on it. The company may, if authorized by its articles, provide for the payment of future dividends on shares included in the warrant (CA 2006, s. 779). An offence, subject to a fine on conviction, is committed where a company fails to comply with the registration requirement.

Consider

The shares offered to Jack will affect the shareholdings of the other members of the company. Dilution of shareholdings is an issue and existing shareholders have pre-emption rights. This does not invalidate the issue, but means the directors responsible may have to compensate the shareholders who could have benefited from the offer—such as Bob.

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- *Pre-emption rights:* Where shares are being issued under CA 2006, s. 549, in both public and private companies, and hence the members have provided their authority for this action, the company is obliged to offer ordinary shares (in CA 2006, s. 561 these are referred to as equity securities), but not necessarily preference shares, to the existing members on a proportionate basis to their existing number of shares held (known as a right of **pre-emption**—CA 2006, s. 561). This is a requirement to ensure that existing shareholders do not have their stake in the company reduced (diluted) without the opportunity to purchase a proportion of the new issue. Where this obligation is contravened, the company and every officer of it who knowingly authorized or permitted it are jointly and severally liable to compensate any person to whom the offer should have been made, in accordance with those provisions for any loss, damage, costs, or expenses which the person has sustained because of the contravention (CA 2006, s. 563). There is a provision to exclude this obligation to offer shares to existing members. A private company may achieve this through making an additional clause to its articles (CA 2006, s. 567), specifically removing the pre-emption rights, although this position can be varied through a special/written resolution altering the articles (CA 2006, s. 571), or if the private company ceases to be a private company (this is a permanent measure). The private company may also use a written resolution to dispense with the pre-emption rights for a particular allotment or a general restriction of the rights for a period of five years (which is renewable). Public companies may remove pre-emption rights through a special resolution that can apply to a particular allotment or a general provision (although, as with private companies, this must be renewed every five years). Where the company is listed on the stock exchange, Listing Rules insist that only 5 per cent of the company's securities can be issued to persons other than existing shareholders in any year. The pre-emption rights do not apply to bonus issues (CA 2006, s. 564), shares issued and to be paid up wholly or partly otherwise than in cash (CA 2006, s. 565), or shares held under an employees' share scheme (CA 2006, s. 566).

- *Directors' duties on share issue:* The directors of a company who possess authority to allot shares are obliged to do so in an equitable manner and CA 2006 codifies existing common law requirements and wider duties to the company (CA 2006, s. 170). Therefore, when allotting shares, directors must refrain from basing the allotment on promoting persons favourable to themselves (such as those sympathetic to the directors and who would follow their decisions in the control and direction of the company). The members have some control in authorizing the allotment of shares and decisions to extend this allotment to persons outside the company (non-existing members).

16.10 Payment

To reiterate the point, shares must not be offered at a discount. Where they are, the allottee is liable to pay the company an amount equal to the amount of the discount and any interest owing (at an appropriate rate—CA 2006, s. 580). The shares that are issued or allotted have to be paid for; however, this does not necessarily mean that such payment must be in cash (CA 2006, s. 582; s. 583 defines the meaning of 'cash').

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Consider

Jack has not paid in cash for the full value of the shares. Whilst this is not problematic, an issue regarding the value of the boat needs addressing. Could this constitute offering shares at a discount? Also, the value of the boat has not been independently assessed and, though this is a requirement for public companies, private companies are not subject to the same requirement. For where private companies accept non-cash consideration for shares, the directors must act in good faith. However, *Re Wragg Ltd* [1897] limits the possibility of Bob seeking a remedy in the absence of fraud.

Typically, where companies purchase shares or another corporation they may pay for these through the allocation of shares from their own company or through providing assets. With a private company, the equalization of the value of the items traded for the shares will be a matter for the company.

Re Wragg Ltd (1897)

Facts:

Assets belonging to a business were sold to a company below their real value. A part of this consideration for the business was paid in shares. When the company was wound up, the liquidator pursued the directors, seeking a payment for the shares above their value to reflect the lower value of the assets.

Authority for:

It was for the company and the seller to determine the price for the business—but they must do so honestly. The extent, however, is to whether the non-cash consideration was based on fraud. In its absence, the value of services or property may not be inquired into.

However, with public companies, the shares may only be sold for cash (CA 2006, s. 584). Where the shares are traded for, say, assets (but not for work or services performed for the company—CA 2006, s. 585), the value of the non-cash items must be independently valued to ensure they represent an equivalent value and consequently ensure that the shares have been fully paid up. An auditor (or a person appointed by the auditor) must conduct, independently, the valuation in these circumstances (CA 2006, s. 593). Where non-cash consideration has been accepted for the shares, the contract to this effect must be sent to the Registrar within one month, and the public companies must enclose the valuation report with this contract (CA 2006, s. 597). Having received the information, the Registrar publishes the notice in the London Gazette.

16.11 Dividend payments

When an investment is made in a company, there is the hope (if not expectation) that a return will be provided and that may be through a rise in the premium of the shares held, but also on dividends in respect of the shares held. As stated previously, dividends ↵ may only be paid from the company's distributable profits (and in cash unless otherwise stated in the articles) as to do otherwise would be to reduce the company's capital. A profit available for distribution is defined as 'its accumulated, realized profits [these are the amounts of income produced through sales of assets that exceed its expenses], so far as not previously utilized by distribution or capitalization, less its accumulated, realized losses [these are the amounts of expenses that exceed the income generated through the sales of its assets], so far as not previously written off in a reduction or reorganization of capital duly made' (CA 2006, s. 830). Whilst it is expected that a company will generate profits and at least a proportion of these will be returned to the members in dividends, there is no automatic

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right to receive a dividend. Indeed, a company will wish to retain certain monies to enable growth, reinvestment, and a safeguard for any unexpected costs. This would simply be evidence of prudent management of the company. However, the company must also ensure that the members receive some form of return or else these investors may take their money to another business.

The company's directors recommend a dividend and the amount is contained in the directors' report, and is declared by the members at a general meeting (for a public company). Only public companies have to hold a meeting to declare a dividend. The members have to agree to the amount of the dividend, and they may require the amount to be reduced (but have no right to increase the dividend). Where a director(s) refuses to reduce the dividend, the members can move to have the director(s) concerned removed from office. Creditors have no rights to prevent a dividend being paid to the members. The company's articles may also give the directors the power to pay an interim dividend. Where a dividend is declared but is not paid, then the member(s) affected has up to 12 years in which to bring an action against the company to realize the money owed. This is, however, a contentious point and it will be interesting to see if the courts follow this interpretation of the limitation period or follow the pre-CA 2006 position of limiting claims to six years.

Consider

As no profits are declared, the directors may not issue a dividend. Bob may be angered by this, but the directors are restricted by the CA 2006 from making an issue.

16.12 Loan capital

When a company is formed, the members will contribute money to the business, but at some stage the company may have to borrow money to buy stock, invest in technology or premises, and so on. Due to the company's separate legal personality, it has the right to enter into contracts (such as to obtain goods on credit and loan money from banks) and the rights to raise finance are usually contained in the memorandum. These are express rights but the company may have implied rights if it is a trading company. A trading company has the power to buy and sell items as part of its functions, and implicitly to borrow money, and issue its assets as part of security for the loan.

The nature of loan capital is that money is borrowed on the basis of offering some form of security (collateral). With sole traders and simple partnerships, they may raise finance on loans through, for example, providing a bank with a charge over property they own. p. 415 ↵ This may be their own personal property or business property, but a charge is placed on it and it is at risk if the person securing the loan cannot repay. Rather than place a charge over land or property, a company and a Limited Liability Partnership have the ability to provide a 'floating charge' over their assets (such as stock) to the lender, whilst sole traders and partnerships are unable to do so. The company seeking to borrow money may contact a lending institution that is willing to provide this service, but evidently the lender will require certain formalities to be followed to ensure it will have any loaned money returned. To secure a loan, the company may issue the lender with a debenture.

16.12.1 Debentures

A debenture is a document produced in the form of a deed that secures a loan through granting the lender (such as a bank) the right to take control over assets and the business. Therefore, the lender is established as a creditor with the authority to appoint an administrator in the event of non-repayment of the debt. A debenture includes debenture stock, bonds, and any other securities of a company, whether or not constituting a charge on the assets of the company (CA 2006, s. 738). A contract with a company to take up and pay for debentures of the company may be enforced through the courts by an order for specific performance (CA 2006, s. 740).

- *Debenture stock:* Situations involving debenture stock are those where the public have been offered to invest in the company and receive stock certificates rather than investing in shares (and receiving share certificates). These certificates are maintained by the company through a registration process, and the certificates may be transferred in a similar manner to share certificates. Due to the nature of such a way of distributing the assets of the company, and that these debenture holders are 'creditors' of the company (albeit with no contract with the company), there has to be regulation of the company's actions. As such, the creditors enter into a trust deed with trustees who act for the debenture holders, and the trustees possess a charge over the company's assets and may appoint a receiver or administrative receiver when required. A private company limited by shares or by guarantee is not permitted to issue debenture stock to the public, but an offer not made to the public, to a financial institution for example, would be permitted (CA 2006, s. 755). The debenture stock is somewhat different from shares in that whilst it would constitute a fraud to issue shares below their issue value, debentures may be issued at a discount (CA 2006, s. 100).
- *Registration of charges:* When a debenture has been issued or a charge to secure a debenture, it must be registered with the Registrar (CA 2006, s. 860). The reason for registration is that this is a public document and those interested parties may consult the register before deciding to do business with the company. The company is also required to maintain its own copy of the register of charges at its registered office or other suitable place (CA 2006, s. 869), and this must be made freely available for inspection by the company's creditors or members (CA 2006, s. 877). If the company does not register the charge in its register the officers of the company are liable to be fined (CA 2006, s. 876(4)), although lack of such registration does not make the charge invalid. As the registration process is a requirement of law, failure to comply with the obligation to register the charge within 21 days of its creation (CA 2006, s. 870) will result in the charge being void if the company is wound up (and a liquidator appointed) or if an administrator is appointed. This has the effect that the lender does not possess secured creditor p. 416 status (and hence they lose the protection of possessing a right over the property the company charged against the loan). However, this does not mean that the company does not continue to owe the lender the sum involved, and this will become repayable on request. Due to this potential problem of failure to register, and the concern and problems lack of registration brings, those lenders who are securing a loan on secured debentures may require the forms to be completed by the officers of the company and they take the responsibility to send these to Companies House. Where the 21-day registration period has been missed, a court may approve the registration and the charge will be given effect from the date of this registration. The charge will be satisfied and released through application to the Registrar that the debt relating to the charge has been paid or satisfied, or the property or undertaking charged has been

released from the charge or has ceased to form part of the company's property or undertaking. This process will remove the charge from the register (through the issue of a memorandum of satisfaction, a copy of which is sent to the company), and will then enable the company, if it wishes, to secure loans on the property again (CA 2006, s. 872).

16.13 Charges

A charge is a contractual agreement in the form of security (on certain assets) for a loan. The borrower agrees to allow the rights over property to be transferred to the lender on the basis that if the loan is unpaid, the lender will be able to dispose of the property and secure the return of the loan. If such a charge is not made, the issue of limited liability may remove the shareholders' personal responsibility to contribute, beyond the value of the shares or any guarantees made, and the lender, if the borrower (e.g. a company) has insufficient funds to repay all of its debts, will have to join the remaining creditors and may not realize all of the money it is owed. Hence, charges are a valuable way of ensuring, as far as possible, that loans are secured on tangible property.

Faced with a situation where the borrower does not repay the debt, the lender with a charge over property may choose to bring an action for breach of contract, or they may choose to dispose of the assets to which they possess a charge. If, in this disposal, there is more money generated than is owed, then following deductions for expenses in selling the property, it must be returned to the borrower.

16.13.1 Types of Charges

As the charge involves a security over assets, it may be that the lender wishes to secure (fix) this on business premises (such as a factory) to ensure that a valuation can be made, and hence the loan be determined that will ensure the lender's position is secure. Whilst such a charge in this respect is commonplace (providing a mortgage over property) this is not the only method, and there is the second type of charge that is not attached to any particular asset. These are known as 'floating' charges as they float over given assets (such as stock). There are advantages to both and it is for the borrower and lender to identify the most suitable in the circumstances.

- *Fixed charges:* The nature of a fixed charge is that it is 'fixed' to a particular asset owned by the borrower, which may be real property or personal property, and it provides the lender with a proprietary interest over the asset. Real property consists of items such as property and land and whilst a charge rests over the property, there is no requirement to transfer the title to the goods to the lender. This leaves the
p. 417 ownership of the property with the borrower, although the Law of Property Act 1925 provides that the lender with a relevant charge is empowered to sell it without the permission or assistance of the title-holder. Personal property includes equipment and requires the borrower to assign the ownership of the property to the lender to ensure the borrower has the power to dispose of the property in the event of non-repayment.

- The benefit of the fixed charge for the lender, and a reason why they may pursue such a charge in determining whether to loan money, is the control over the property. It therefore represents the best form of security. The borrower may be prevented from selling the property that is subject to the charge until the loan is repaid, and the charge remains until the loan is fully repaid. Further, a lender with a fixed charge is generally considered to rank higher than preferential creditors and creditors who possess floating charges.
- *Floating charges:* A fixed charge, therefore, may involve (e.g.) a bank providing a loan to a company on the basis that it holds a charge over the company's factory. The company may use the factory, although it cannot sell it without the bank's authorization, and insofar as the company continues to make the required repayments, the bank will take no further action.

As opposed to a charge that is fixed to a particular asset, the borrower may apply the charge to a group of assets (such as the stock with which the company trades). The benefit for the borrower in this scenario is that they are free to trade in the goods/assets subject to the floating charge, and in the event of non-payment of the loan when it is due, the charge becomes fixed or 'crystallizes' over them. At this stage, the lender has the ability to dispose of the goods in the same way as someone with a fixed charge.

Buchler and Another v Talbot and Another (2004)

Facts:

The case involved a company granting a debenture to another to secure a loan and incorporating a floating charge. When the company went into voluntary liquidation, the liquidator's costs were to exceed the amount realized and they sought a declaration that their expenses should come from the assets of the company, including those subject to the floating charge.

Authority for:

The case related to the priority of claims in a company's liquidation. The House of Lords held there was no priority for the liquidator's expenses. The proceeds of the realization of a floating charge are held for the debenture holder. The other funds realized are available for the company's unsecured creditors.

Crystallization occurs where a receiver is appointed, if the company goes into administration or is wound up, or where an event that was provided for in the contract establishing the floating charge occurs. Once crystallization occurs and the assets are traded after this event, the holder of the charge may bring an action against the party to whom they were transferred.

Clearly, unlike a fixed charge where the charge is applied to a specific asset, the floating charge, by its nature, does not apply to a specific asset. As such, the borrower appears to be in possession of the assets and may
p. 418 appear to be more creditworthy than they actually are. ↵ To prevent fraud, and perhaps a situation of the

borrower attempting to obtain loans on the assets subject to the floating charge, protection is afforded through a system of registration.

- *Potential difficulties:* What would occur where the parties identify a charge as a fixed charge, when in reality (and legally) it is a floating charge? A lender may wish to obtain a fixed charge, over a floating charge, due to the increased security it provides. However, a company may not have the property available to provide a fixed charge and, further, book debts may represent the company's largest asset. Book debts by their nature involve the company being owed money; that money is then brought into the company (and deposited in the bank) and then the book debt is reintroduced. It therefore appears that as an asset that is traded rather than being 'fixed' to a specific item, it must be a floating charge. This point was considered in the following case.

Siebe Gorman and Co. Ltd v Barclays Bank Ltd (1979)

Facts:

Here the bank attempted to protect its interests by identifying the proceeds of the company's book debts as a fixed, rather than a floating charge. The bank contracted for such an asset to be a fixed charge and as such it allowed the company to collect money owed.

Authority for:

Concerns were raised about the nature of the decision and how such an asset could in reality constitute a fixed charge. In answer to this, the company was required to place the proceeds into a specific bank account and it was not free to draw on the account even when in credit. It was this level of control that gave the appearance of it being a fixed charge.

It took 25 years but eventually the issue was addressed and finalized by the House of Lords in *National Westminster Bank Plc v Spectrum Plus Ltd.*

National Westminster Bank Plc v Spectrum Plus Ltd (2005)

Facts:

In a similar situation to *Siebe* involving the bank lending money with the requirement of establishing the company's book debts as a fixed charge, it was held that such charges were to be considered as floating, not fixed.

Authority for:

This involved a charge over the book debts, a requirement to pay the proceeds into a designated bank account, but the third element is crucial in determining its status. Here, there was a restriction on the disposal of the debts to any other party without the agreement of the lender (the bank). However, unless the bank blocks the account to prevent the lender from having access to the funds, this would not be a fixed charge. Where a company is free to deal with the item (in this case the proceeds of the book debt), its transferable nature signifies the existence of a floating charge and this is how the Lords held.

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16.13.2 Registration of Charges

Similarly with debentures, a charge must be registered with the Registrar within 21 days of its creation (CA 2006, s. 870). The company is obliged to provide the Registrar with this information but it is also possible for the person interested in the registration to register it. The Registrar will then issue a certificate of registration and include details as to its particulars (CA 2006, s. 869). This is because where a charge is not registered, it will be invalid and it will not allow the creditor to have the right to dispose of the assets to which the charge was to relate. This does not mean that the creditor would be unable to bring an action against the company on the debt owed, but they would lose the security that the charge provides. Remember, a creditor without a charge over assets is an unsecured creditor, and on the basis of the company being wound up and unable to settle its debts, this creditor will join the rest in attempting to obtain the money it is owed. A secured creditor will have a greater opportunity (and priority) to have debts owed satisfied. However, it is possible to state that a fixed charge will rank below an existing floating charge, and hence it will rank below such creditors and behind preferential creditors. It is also possible to grant more than one fixed charge over assets (particularly where the asset has significantly grown in value and hence could accommodate such charges). More than one charge may also be made over a floating charge; however, when this occurs, they rank in the order that they were created (hence preventing the company establishing a fraud on the previous creditors through subsequent actions).

By 18 June 2010, the Government ended its period of consultation regarding reform of the process of registration of charges by companies and Limited Liability Partnerships. Its aim was to ‘address the many imperfections of the present system’ by implementing a system of electronic registration of charges (in force since 6 April 2013). An example provided in the consultation document was that ‘charges are now commonly granted over expected future income from major projects while charges to secure issues of debentures are not’. These do not come under the remit of registration as required by CA 2006.

16.13.3 Priority of Charges

If the charges have been correctly registered, they rank in priority as follows. A fixed charge will rank higher than existing floating charges unless the existing floating charge has made provision against this. Fixed charges also have effect from the time they are created. The next level of charge is a floating charge and this takes effect when it crystallizes and attaches to the assets in the agreement. They will also have priority according to when the charge was created (hence the first floating charge will have priority over the last one created over the same asset, unless this is stated to the contrary).

Finally, preferential creditors take priority over the holders of floating charges, but not over fixed charges. Preferential creditors include employees who are owed wages (although limited to £800 per employee earned in the previous four months) and any loan taken to pay the employees' wages. The company will also have to pay any holiday pay due to employees and any loans from third parties taken for the purpose of paying such costs. The costs of the company's contributions to any occupational pension scheme are included. However, payments to the government are no longer included in the list of preferential creditors (following enactment of the Enterprise Act 2002). Preferential creditors are paid monies owed before other creditors are paid from the company's assets (if solvent when wound up). Where insufficient funds exist to satisfy these debts, they will each receive a proportion of the debts owed and they rank equally with each other.

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Conclusion

This chapter has included details of the various obligations on companies that wish to issue and allot shares, provide debentures and charges over the company's assets, and guidance on the maintenance of the company's finances. As the company's directors often make such decisions (followed by the consent of the company's members), the role played by directors and their duties to the company is crucial. These issues are discussed in **Chapter 17**.

Summary of main points

Shares

- CA 2006 refers to members of a company and these are, in the case of a company limited by shares, those who have subscribed to the memorandum and taken shares. They are entered into the register of members.
- A share is a bundle of rights and duties, and it imposes liabilities on the holder.
- Shareholders have no automatic right of management in the company although, through attendance and the right to vote at meetings, they may have influence over the business conducted (such as the moving of resolutions).
- Shares may be ordinary or preference, and may also be redeemable by the company.
- Preference shares are so called because of the right to dividends before ordinary shareholders (these may be cumulative or non-cumulative).
- A company may purchase its own shares in accordance with CA 2006 if authorized to do so through its articles.

Share capital

- The company will identify its share capital when formed.
- The share capital may include the following factors: authorized share capital; issued, allotted, paid-up, and called-up aspects of the share capital depending on the actions of the directors and the requirements of the allotment/issue.
- Public companies must have at least £50,000 of allotted share capital to receive a trading certificate.

Alteration of share capital

- Companies are restricted from altering their share capital but may do so when following the rules prescribed in CA 2006.
- Such an alteration may include allotting new shares, consolidating and subdividing existing shares, redenominating shares, or reducing the share capital.
- Public and private companies may reduce the share capital through passing a special resolution that is confirmed by a court.

Share issue

- Shares may be issued to generate revenue for the company, and in the case of ordinary shares, the existing members have the right to be offered the opportunity to purchase such shares as equivalent to their existing holding before the shares are offered to non-members.
- Shares may not be offered at a discount.
- Shares in private companies may not be offered to the public.

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Dividends

- Shareholders may only be paid dividends from distributable profits.
- The directors declare the dividends (and the shareholders must agree). Shareholders may require the dividend to be reduced but cannot increase it.
- There is no automatic right for a shareholder to receive a dividend.

Loan capital

- Companies may wish to obtain a loan and to do so may offer a charge over assets or offer a debenture.

- The charges that are provided over assets must be registered in accordance with CA 2006.
- Charges may be fixed or floating.
- Fixed charges apply to fixed assets (such as a mortgage over a company's factory).
- A floating charge is a security over a class of assets (such as the stock of the company). The charge becomes fixed (crystallizes) on the default of the company.
- Charges must be registered with the Registrar of Companies.

Summary questions

Essay questions

1. What are the various charges that a lender may require to be provided by the company that wishes to borrow money? Explain the nature of each, their priority, and their effect in the event of the company being wound up.
2. Explain the process of a company altering its share capital. Provide examples of why a company may wish to make such an alteration and how the creditors of the company are protected against abuse of this provision.

Problem questions

1. Michelle and Raj operate a bistro business called Café Culture Ltd in Manchester. They have run the business largely by attempting to build solid foundations through paying themselves a relatively small salary and reinvesting any profits back into the business. The business was originally a partnership, but the two owners later incorporated as a private limited company, with Michelle owning 60 per cent of the shares and Raj 40 per cent (and both are directors). Despite their initial introduction of capital, Michelle and Raj wish to increase the growth of the business and so allow Charlie to purchase 20 per cent of Café Culture Ltd's shares (with a reduction of Michelle's and Raj's shareholding by 10 per cent each).

   Upon taking a shareholding in the company Charlie stated that she had no wish to become a director but she did expect to receive an income from the dividends paid to shareholders. Café Culture Ltd makes a profit each year and it has substantial sums in its account (some £400,000) but the directors choose, for the third consecutive year, not to declare a dividend. However, the directors pay themselves fees and have voted for themselves an 'achievement bonus'. Charlie is concerned that this is a policy of the business and that dividends will never be declared. She is concerned that her stake in the business will continue to go unrecognized and unrewarded.

   Advise the parties as to their rights and obligations in this matter.
2. Jackson's Paints Ltd is a company in financial trouble and has experienced the following situations and requires advice on, among other things, the validity of the charges applied to its property and how to proceed.

p. 422 ↵ Jackson's Paints Ltd decided to attempt to raise funds through the directors' decision to issue debentures.

A. One loan of £100,000 was made by Chloe, the wife of one of the directors, and this loan was secured through the issuing of a fixed charge over the property where the company sells its product (paint) to the public. The property was valued at £150,000.

B. A further loan of £20,000 was made by the company's bank by the issuing of a floating charge over the company's entire stock.

C. A final loan of £30,000 was obtained from Dale but the fixed charge issued to him in relation to this loan was over the same property as provided to Chloe.

The company's articles of association require that all loan agreements are first approved by the board of directors before they can take effect. The fixed charge provided to Chloe was not agreed by the board of directors and it was not registered. The floating charge issued to the bank was agreed by the board and was correctly registered. The fixed charge provided to Dale was correctly registered.

Having obtained the loans, Jackson's Paints Ltd failed to make repayments as they became due to the bank or to pay its staff their wages. Further evidence has come to light that before any of these loans were agreed, the auditors of the company had advised the directors of Jackson's Paints Ltd that the company was insolvent and should be wound up. Some of the directors are still of the opinion that the company can trade out of these problems when the economic downturn improves.

Advise:

a. Jackson's Paints Ltd on the validity of the charges it has purported to create over its property;
b. the directors on the potential personal liability for the debts of the company;
c. the options available to a secured creditor when faced with a company unable to pay its debts, and how such a creditor may petition for a company to be wound up;
d. the directors on granting charges when under notice that the company was insolvent.

You can find guidance on how to answer these questions **here** *<https://oup-arc.com/access/content/marson6e-student-resources/marson6e-chapter-16-indicative-answers-to-end-of-chapter-questions?options=name>*.

Further Reading

Books and articles

Chiu, I. H. Y. (2006) 'Replacing the Default Priority Rule for Secured Creditors—Some Reservations' *Journal of Business Law*, Oct., p. 644.

Goldring, J. (2006) 'Floating Charges—The Awakening' *Insolvency Intelligence*, Vol. 19, No. 5, p. 68.

Nolan, R. C. (2006) 'The Continuing Evolution of Shareholder Governance' *Cambridge Law Journal*, Vol. 65, No. 1, p. 92.

Websites and Twitter links

https://www.gov.uk/government/organisations/insolvency-service *<https://www.gov.uk/government/organisations/insolvency-service>*

@insolvencygovuk

The Insolvency Service operates mainly with matters to do with the Insolvency Acts 1986 and 2000, and the Company
p. 423 Directors Disqualifications Act 1986. Among its roles are providing ↵ information and assistance to administer and investigate the affairs of bankrupts and companies wound up by the courts, acting as a trustee/liquidator where no private sector insolvency practitioner is appointed, and authorizing and regulating the insolvency profession.

http://www.london-gazette.co.uk *<http://www.london-gazette.co.uk>*

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The *London Gazette* is the official newspaper of record for the UK, provided electronically to disseminate and record official, regulatory, and legal information.

http://www.legislation.gov.uk/ukpga/2006/46/contents *<http://www.legislation.gov.uk/ukpga/2006/46/contents>*

The Companies Act 2006.

Online Resources

Visit the online resources *<https://oup-arc.com/access/marson6e-student-resources#tag_chapter-16>* for further resources relating to this chapter, including self-test questions, an interactive glossary, and key case flashcards.

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