

COMPANY LAW – PART II

(EQUITY CAPITAL OF A COMPANY – SHARES)

(1) WHAT IS CAPITAL AND WHY DOES A COMPANY NEED CAPITAL?

- Generally, capital is wealth in the form of money or other assets owned by a person or organization or available for a purpose such as starting a company or investing. It is the money or wealth needed to produce goods and services. Capital is necessary to startup the company and to expand the company. All businesses must have capital in order to purchase assets and maintain their operations.
- Business capital comes in two main forms: **debt** and **equity**. Debt refers to loans and other types of credit that must be repaid in the future, usually with interest. Equity, generally does not involve a direct obligation to repay the funds. Instead, equity investors receive an ownership position in the company which usually takes the form of shares.
- Private companies are prohibited from raising capital from the general public [Section 27 (a)]. Public companies have no such prohibition and may freely raise capital from the general public. Public companies can advertise the fact that they are offering shares to the public through prospectus. In doing so company must issue a prospectus giving a detailed and accurate description of the company's plans. Once the shares are issued to the public such companies become public listed companies.

(2) SHARES

- A share is the **interest** of a shareholder in the company measured by a **sum of money**, for the purposes of liability in the first place, and of interest in the second and carrying **various rights** contained in its terms of issue.
- Section 49(1) – a share in a company is **movable property**.
- Section 49(5) – a share in a company is **transferable** in the manner provided for by its Articles of Association (“articles”) and such articles may limit or restrict the extent to which the share is transferable.
- Shareholders are the owners of the company, which are of 2 types: individual shareholders and institutional shareholders (e.g.: EPF, Unit Trust).
- Rights attached to a share:
 - Section 49(2) – Subject to the company's articles, a share in a company confers on the holder:
 - (a) the right to 1 vote on a poll at a meeting of the company on any resolution;
 - (b) the right to an equal share in dividends paid by the company;
 - (c) the right to an equal share in the distribution of the surplus assets of the company on liquidation.
 - Shares can be issued conferring rights other than those set out above by the board of directors of a company in conformity with section 51.
- Classes of shares
 - Section 49(3) – A company may issue different classes of shares, and in particular may issue shares which:
 - (a) are redeemable;
 - (b) confer preferential rights to distributions; or
 - (c) confer special, limited or conditional voting rights or confer no voting rights.
 - **Ordinary/ voting shares** – these constitute the **risk taking share** of the company. If the company fails financially, ordinary shareholders carry the main financial burden of the company. If the company performs profitably, greater financial reward is enjoyed by them. These shareholders obtain a right to vote at general meetings for the decisions to be taken by the company.

- **Preference shares** – these carry preferential rights particularly in comparison to ordinary shares. Generally, confer a right to **preferential dividends**.
- **Redeemable shares** – these are created on the understanding that they **may be bought back** by the company. A share is redeemable if articles provide for the redemption of shares by the company (a) at the option of the company; (b) at the option of the holder of the share; or (c) on a date specified in the articles for redemption (Section 66).
- **Non-voting shares** – ordinary shares without voting rights.
- **Deferred shares** – **deferred in priority** to ordinary shares. For instance, deferred shares may be issued with a right to income or profit after paying ordinary shareholders.

(3) STATED CAPITAL – SECTION 58

- Stated capital in relation to a company means the total of all amounts received by the company or due and payable to the company:
 - (a) in respect of the issue of shares; and
 - (b) in respect of calls on shares. [“Call on shares” is the demand made by the company on its shareholders holding partly paid shares to pay part or full unpaid amount on the shares.]
- Where a share is issued for consideration other than cash, the board is required to determine the cash value of the same.
- Simply, stated capital represents **the value of the assets received or receivable by the company on the issue of its shares.**

(4) ISSUE OF SHARES

- Section 51(1) – subject to the provisions of the Companies Act, No.7 of 2007 (as amended) (“Companies Act”) and the company’s articles, the **board** of a company **may issue** such shares to such persons as it **considers appropriate**.
- Section 53(1) – **pre-emptive rights** to new issues – subject to the company’s articles, where a company **issues shares** which **rank equally with or above existing shares** in relation to voting or distribution rights, those shares shall be **offered to the holders of existing shares** in a manner which would, if the offer was accepted, maintain the relative voting and distribution rights of those shareholders.
- Consideration for issue of shares – section 52
 - Before issuing any shares, the **board** must:
 - (a) **decide** the **consideration** for which the shares will be issued; and
 - (b) **resolve** that in its opinion that consideration is **fair and reasonable** to the company and to all existing shareholders.
 - The consideration may take **any form**, including cash, promissory notes, future services, property of any kind or other securities of the company.
 - Upon receipt of the consideration, the company is required to, within a period of **20 days**, make an **allotment** of the shares.
- Method of issuing shares – section 54
 - A share is deemed to be issued when the **name** of the holder is **entered on the share register** as a shareholder.
 - Such entry must be made prior to giving statutory notice to the Registrar General of Companies of the issue of shares.

(5) SHAREHOLDERS

- A company is a separate legal entity with its own rights and obligations, independent and distinct from its shareholders. Although a company is a separate legal entity, it cannot act on its own. It can only act through individuals, i.e. shareholders and directors. Shareholders are the **proprietors** of a company and considered as the **owners** of the company. However, they do not own the company’s property. Shareholders **provide the capital** required and in lieu thereof become stakeholders of the company.

- Section 86(1) – “shareholder” means:
 - (a) a person whose **name is entered in the share register** as the holder for the time being of one or more shares in the company;
 - (b) until a person’s name is entered in the share register, a person **named as a shareholder in an application for incorporation** of a company at the time of registration of the company;
 - (c) until a person’s name is entered in the share register, a person who is **entitled to have his name entered in the share register under a registered amalgamation proposal** as a shareholder in an amalgamated company;
 - (d) until a person’s name is entered in the share register, a person **to whom a share has been transferred** and whose name ought to be but has not been entered in the register.
- Section 86(3) – Where a company has wrongfully failed to enter in the share register the name of a person to whom shares have been transferred, that person will be deemed to be a shareholder in the company; and will in respect of those shares, enjoy all such rights and privileges and be subject to all such duties and obligations under the Companies Act, as if his name had been entered in the share register as the holder of those shares.

(6) LIABILITY OF SHAREHOLDERS

- Section 87(1) – A shareholder is not liable for any act, default or an obligation of the company, by reason only of being a shareholder.
- Liability is limited to express provisions in the articles or the Companies Act.
- If the articles provide that shareholders have unlimited liability (i.e. in the case of an unlimited company), shareholders have unlimited liability to contribute towards the assets of the company.
- If the company is incorporated as a limited liability company, shareholders will only have a limited liability to contribute towards the assets of the company as specified in the articles.

(7) POWERS OF SHAREHOLDERS

- Powers reserved under the Companies Act or the articles may be exercised only at a meeting of shareholders or by a resolution in lieu of a meeting.
- Powers are exercised at a meeting either by way of an ordinary resolution or special resolution.
- Ordinary resolution:
 - This is a resolution approved by a **simple majority** of votes of shareholders who are entitled to vote and voting on the question (Section 529).
 - Section 91 – Unless otherwise provided by the Companies Act or in the articles, a power reserved to shareholders may be exercised by an ordinary resolution.
 - Ordinary resolutions are normally adopted when distributions are made, when appointing and removing directors, when appointing an auditor etc.
- Special resolution – section 143:
 - This is a resolution passed:
 - (a) by a **majority of 75% of** those shareholders entitled to vote and voting on the question;
 - (b) at a **general meeting** of which **not less than 15 working days’ notice**, specifying the intention to propose the resolution as a special resolution has been duly given.
If **less than 15 working days’** notice was given, shareholders having the right to attend and vote at any such meeting, being shareholders together representing **not less than 85%** of the total voting rights at that meeting, must agree on a lesser period of notice.
 - Powers that must be exercised by way of a special resolution: altering the articles; approving an amalgamation; changing the name of the company etc.

(8) MINORITY BUY-OUT RIGHTS

- A shareholder is entitled to have his shares purchased by the company when there is a **fundamental change in direction** of the company. While the majority’s decision in changing the company’s business will be given effect to, the dissenting minority is given the right to exit from the company at a fair price. This brings about a compromise between two competing interests.

- Accordingly, this right will be available for a shareholder where the shareholder votes against any of the following:
 - (a) where a proposed alteration of the company's articles imposes or removes a restriction on the business or activities in which the company may engage;
 - (b) a major transaction;
 - (c) an amalgamation of the company.

(9) DISTRIBUTION TO SHAREHOLDERS – SECTION 56

- Section 529 – “distribution” means:
 - (a) the direct or indirect transfer of money or property, other than the shares of a company, to or for the benefit of a shareholder; or
 - (b) the incurring of a debt to or for the benefit of a shareholder, in relation to a share or shares held by that shareholder, whether by means of a payment of a dividend, a redemption or other acquisition of the share or shares, a distribution of indebtedness or otherwise.
- Before a distribution is made by a company to any shareholder, such distribution must:
 - (a) be **authorised by the board**; and
 - (b) unless the company's articles provide otherwise, be **approved by the shareholders** by **ordinary resolution**.
- The board may authorise a distribution at such time and in such amount as it considers appropriate, where it is satisfied that the company will, **immediately after the distribution is made satisfy the solvency test**, provided that such board obtains a certificate of solvency from the auditors.
- Dividends – section 60
 - A dividend is a **distribution out of profits of the company**, other than an acquisition by the company of its own shares or redemption of shares by the company.
 - The board of a company must not authorise a dividend in respect of some shares in a class and not others of that class or of a greater amount in respect of some shares in a class than other shares in that class, except where:
 - (a) the amount of the dividend is reduced in proportion to any **liability** attached to the shares under the company's articles; or
 - (b) a shareholder has **agreed in writing** to receive no dividend or a lesser dividend than would otherwise be payable.

(10) SOLVENCY TEST – SECTION 57

- A company will be deemed to have satisfied the solvency test, if:
 - (a) it is **able to pay its debts** as they become due in the normal course of business; and
 - (b) the value of the company's **assets is greater than**:
 - (i) the value of its **liabilities**; and
 - (ii) the company's **stated capital**.
- In determining whether a company satisfies the solvency test, the board:
 - (a) **shall** take into account the most recent financial statements of the company prepared in accordance with the Companies Act;
 - (b) **shall** take into account circumstances the directors know or ought to know which affect the value of the company's assets and liabilities;
 - (c) **may** take into account a fair valuation or other method of assessing the value of assets and liabilities.

(11) DIFFERENCE BETWEEN SHARE AND DEBENTURE

- A share is the ownership (equity capital) whereas a debenture is a long term debt capital.
- Shareholders have no assurance of the return. However, if the company is earning profits, shareholders will get the return by way of dividend. Debenture investor will get a fixed return based on the option agreed at the time of the issue.
- Most of the shares carry voting rights. However, debentures do not carry voting right.