COMPANY LAW TOPIC 4 & 5
SHARES

Shares

Capital of a company is divided into certain divisible units called shares.

A share is a unit of a company.

Shares was defined in the case of Borland Trusteed Ltd vs Steel brothers (1901) as a unit of company capital which in the first place measures a members liability in the company and the second place measures the members, interest, and it also consist of a series of covenants.

- **CHARACTERISTICS OF SHARES.**

1. A measure of member's liability in the company.

Member is liable to the company in case of winding up to the amount unpaid on shares he holds

2. A measure of member's interest in the company.

Members interest in a company is measured inform of dividend paid by them

3. Series of covenant

   A share consist of a series of covenant between members and the company.

4. Share is a form of personal property transferable.

   Can be sold, bought or given as security for a loan.

N.B: Shares grant a member certain primary and secondary rights:

✓ Primary rights:
- Right to dividend
- Right to vote in companies general meetings.
- Right to capital in winding up of the company

✓ Secondary rights:
- Right to receive notices in general meetings of a company
- Right to receive copies of a balance sheet laid before the company in general meeting and its annexures
- Right to Copies of the memorandum and articles.
- Right to inspect the minute books of general meetings
- Right to inspect copies of charge various registrar maintained by the company.
- Petition for the alternatives remedy in the event of operation of the minority.

Class/ Type of shares.
Check; June 2011QN 4c

1. Ordinary shares.
2. Preference shares.
3. Deferred/ founders shares.
4. Employer shares/ corporate shares.
5. Treasury shares.

a) Ordinary shares

Also called equity capital/ common shares. Members holding ordinary shares are said to be the owners of the company.

✓ <u>Rights attached to ordinary shareholder.</u>

- After providing for any dividend that is payable on preference shares the whole of the profit can be made available to them.
- Entitled to use of their voting power at the general meeting to control the company.
- In winding up of the holders of ordinary shares entire residue after payment of the companies liabilities.

b) <u>Preference shares.</u>

As the name suggest they have the following preference:

- Earn dividend first before other classes of shares
- Earn dividend at a fixed rate.
- Event of winding up there is a preferential right to the repayments of the paid up capital.
- When they are classified as cumulative, the arrears of dividend cannot be lost but is carried forward to subsequent years.

• **<u>Classification of preference share:</u>**

- Participating and non-participating preference shares.
- Cumulative and non- cumulative preference shares
- Redeemable and irredeemable preference shares.

➢ **Cumulative & non- cumulative preference shares**.

Cumulative are shares whose arrears of dividend are not lost but carried forward to subsequent years when dividend will be declared (cumulative) while non-cumulative, such arrears are not carried forward but are lost.

➢ **Participating & non participating preference shares.**

Check; November 2017 QN 4

Participating preference shares after earning a dividend at a fixed rate participate in the balance of profits with ordinary shareholders.They also have a right to share in the surplus assets of the company in the event of winding up.Non participating preference shares after earning a dividend at a fixed rate do not participate in the balance of profits with ordinary shareholders.They also do not have a right to share in surplus assets of the company in the event of winding up.

N.B: *Dividend paid to preference shareholders is fixed but the below points should be remembered as regards to priority.*
1. Payment of dividend is entirely at the discretions of the directors and if they decide to transfer the whole of the profit to capital reserves no one can questions the decisions.
2. If the dividend was not declared and the company goes into liquidations even preference shareholder will not be paid.
3. Payment of the dividend to preference shareholders only becomes due once the dividend has been recommended and approved and the date of payment is due.
4. If it was declared before the company went into liquidation and was not paid then the right will not be lost i.e. they will be paid.

➢ **Redeemable & irredeemable preference shares**

- Irredeemable: They are shares not supposed to be bought back by the company. They retain their status and can only be redeemed when the company goes into liquidation.
- Redeemable shares are shares whose dividend is fixed but are issued for a specific period. These are shares that the company agrees to buy back at a future date. A limited company may issue redeemable preference to be redeemed of the option of the company or the shareholders.

✓ <u>Condition for issuing redeemable preference shares</u>
Check; December 2013 QN 3b

1. The issue must be authorised by the articles.
2. Company must pass an ordinary resolution in general meetings.
3. The company's capital must be divided into different classes of shares i.e. they should have other shares not redeemable.
4. The issue of must be disclosed in the company's prospectus or statement in lieu (instead) of prospectus.
5. The registrar must be notified to the issue.

✓ <u>Condition for redemption of redeemable preference shares</u>
Check; Dec 2012 QN 4b, November 2015QN 4b

- The redemption must be authorised by the article.
- The shares must be fully paid

- The shares must be redeemed out of profits or proceeds of a special issue for that purpose
- Any premium payable must be provided out of profits of the company or out of share premium account.
- If the shares are redeemed otherwise than out of proceeds of a special issue, the capital redemption reserve fund account (CRRF) must be created.
- The registrar must be notified of the redemption within 30 days thereof.

➢ **Convertible & non-convertible preference shares**

Convertible preference shares are issued on a condition that on a future date they shall be converted into ordinary shares or other securities.

Non-convertible shares maintain their identity and are not liable for conversion by a company into other different classes of shares

c) <u>Deferred /Founders/ Management shares</u>

These are shares reserved to founders of a company i.e. promoters.
It is one way of remunerating promoters by giving them management shares free of charge.
These shares do not carry any voting rights but they are entitled the holders to some dividend after other classes are paid.
The particulars of founder's shares and the interest of the shares in the company must be stated in the prospectus.

d) <u>Corporate /Employee shares</u>

Are given to employees as a way of motivating them for their service.
Have no voting rights.
Are paid dividends after other classes are paid

e) <u>Treasury shares. (sec 526[1])</u>

It applies to a purchase or acquisition of shares by a limited company of its own share in accordance with the act and,

- The purchase or acquisition is made out of distribution profits
- The shares are qualifying share if: - a) are included in the official list and in accordance with the provisions capital market b) Share are treated on a required market (nse).

TRANSFER OF SHARES
Is a voluntary conveyance (transfer) of title in shares from one person to another
Shares are moveable property transferable in maximum process by the article of the company
Shares in public and private companies are transferable.

- <u>For public</u>
  Shares are freely transferable however the directors may declare to register the of shares. (Not being a fully paid shares)
  1. To a person of whom they shall not approve.
  2. On when the company has a lien (right to retain share as a security for debt)
- <u>For private</u>
  Transfer of shares is restricted by:

- Pre- emption clauses that require directors to offer the shares to existing members at the first instance.
- Conferring upon directors, total discretion to refuse to transfer a share.

N.*B it is important to note that article of a company restrict but not forbid the transfer of shares since it is a statutory right of member of a company which cannot be taken away by the articles since the article is subordinate to companies act.*

The rules on the exercise of the discretion to refuse to register transfer of shares by directors

<u>***Check;*** *June 2020 qn 2b*</u>

1. To exercise their power, the directors must consider the transfer and take a decision to refuse to register it.
2. The directors in reaching their decision must act to borne tide for the best interest of the company.
3. Where articles specify grounds of refusal
4. The power of refusal must be exercised within a reasonable time from the receipt of the transfer.
5. Company is required to give a notice of refusal within 60 days.

Shares may be transferred by :-

1. A registered holder
2. A personal representative of a deceased shareholder (administration executor).
3. Trustee in bankruptcy of an undischarged bankrupt

Restriction on transfer of shares

Shares are movable property transferable in manner provided by the article of association

- A transfer of shares to a state corporations (parastatals) without prior written consent from the treasury is void.
- For a transfer of shares tobe effected, a proper instrument of transfer (transfer form must be presented to the company)
  - **Procedure of transfer of shares**

a) Total transfer
   - The parties enter into an agreement to sell and buy shares.
   - They execute the proper instrument of transfer.
   - The executed instrument of transfer must be presented for stamping and payment of tax.
   - The executed instrument of transfer and share certificate are presented to the company for registration of the transfer
   - On registration of the transfer the share certificate is cancelled and another issued in the name of the transferred (the buyer)

b) Partial transfer
   - The parties enter into an agreement to buy and sell shares.
   - They execute the proper instrument of transfer (transfer form)
   - The executed instrument of transfer and share certificate are presented to the company for certificate.
   - The share certificate is retained by the company for cancellation.
   - The certified instrument of transfer is presented for stamping
   - The certified instrument of transfer is presented to the company for registration.
   - On registration, the share certificate is cancelled and two others are issued in the name of transferred and the transfer for the shares retained and acquired respectively.

CERTIFICATE OF TRANSFER.

- This is a characteristic of partial transfer if a person is not transferring his entire sharehoding.
- If a person is not transferring his entire holding, it will not be appropriate for him to hand over to the transferee a share certificate.
- In such a case, the holder sends his signed transfer with his share certificate to the company for cancellation and the transfer form is returned to the transfer who then delivers it to the transfer for stamping and representation to the company.
- It is effected by inserting the words 'certificate lodged" and the words to the effects on the instrument of transfer by the daily-authorized officer of the company who must sign his name.
- A person who suffers loss by relying on a false certification may hold the co liable.

Circumstances when certification is necessary

1. Where the transferor is transferring only part of his holding
2. Where the transferor is transferring all his shares to two or more transferees
3. Where the transferor has not yet received a certificate from the company but has been issued with the document of title to the shares (allotment letter).
4. Where the transferee is not satisfied with the transferor title to the shares.

Electronic Transfers

With coming in to force the central depositories Act 2001 all tradeable securities or shares ought to be:

- Immobilised and shareholders who desires to transfer shares are required to open a securities account with the central depositing and settlement corporation(CDSNC)
- To transfer shares in a members account the shareholder must give written instructions to the broker or investment bank, which confirms that the shareholder has shares in his account.
- The stock/broker or the investment bank offers the shares for it at the NSE when the shares are sold the s/holders account is debited and the proceeds are credited to the stockbroker or investment bank (client account).

Unregistered transfer

If two or more transferee are beneficiaries, over an unregistered transfer, the equities are said to be equal and the first in time prevails.

Forged transfer

An instrument of transfer on which the signature is forged is called a forged instrument and any transfer effected on such instrument is called a "forged transfer".

The transfer effected through a forged instrument is a nullity and it confers no right and imposes no obligations on the parties.

Consequences of a forged transfer *Check; Nov 2015 QN 3c*

1. The transfer effected through a forged instrument is a nullify and it confers no right and imposes no obligations on the parties
2. The transfer is void and therefore cannot affect the title of the shareholder whose signature is forged.
3. If a company has removed a shareholder name from the register in registering the transfer, it will be compelled to restore it.
4. The company must also pay dividends which have been declared during the time his name had been wrongly removed from the register
5. The company is equally liable to any person whom it had issued a share certificate from the reliance of the forged document (share certificate).
6. The company is required to be indemnified by the person who submits the forged transfer even if he was unaware of forgery.
7. The person submitting a forged transfer can sue his forgeror or to recover his losses.

Oral Transfer

This is a word of mouth not withstanding anything in the articles of a company.

It is not lawful for a company to register transfer of shares unless a proper instrument of transfer has been delivered to the company. It means that an oral transfer is illegal and void.

Implied terms in the transfer of shares

The law implies the following terms:

- That the transferee will pay the price of the shares.
- That the transferor will hand over the genuine instrument of transfer and the share certificate.
- That the share certificate carries the rights and interest which it purports to convey.
- That the transferor will do nothing to prevent the transfer from being registered or delay the process.
- It is the responsibility of a transferee to ensure that it is registered.
- That the transferee will indemnify the transferor with respect of all calls and other liabilities arising on the shares after the transfer.

Effects of transfer

Property in shares remains with the transferor until the name of the transferee is entered in the register. The effects include:

1. The transferor continues to be the legal owner of the shares but holds such shares in trust for the transferee.
2. The transferee cannot exercise the rights of a shareholder.
3. The transferee has an equitable claim on the shares.
4. If calls are made, the transferor must pay for them but they can recover the amount so paid from the transferee.
5. If dividends are paid, the transferor is entitled to them however, he holds on trust for the transferee.
6. The transferor must vote as the transferee directs him since the voting rights attaching to the shares have passed to the transferee (acts as a proxy).

Transmission of shares

This is an involuntary conveyance where title changes hand by operation of law.

Transmission takes place in the event of death or bankruptcy of a shareholder.

Transmission by death

Upon death, the shareholder ceases to be a member and his shares passes to the personal representative who becomes a member when his name is entered in the register of members.

However, he is free to transfer the shares to a third party before his name is entered in the register.

Transmission by bankruptcy

When a member is declared bankrupt, his shares passes to the trustee in bankruptcy but remains a member as long as the name remains in the register.

The trustee in bankruptcy may transfer the shares to a third party before his name is entered in the register.

NB: *if the company refuses to register, transfer or to give the transferee a notice of refusal, the company and every officer in default is liable to a fine not exceeding ksh 500,000. If the offence continues, the company and every officer in default are liable to a fine of 50,000 every day.*

Share certificate

Every person who is entered as a member in the register of members of a company has a right to receive a share certificate in respect of shares he holds in the company.

A share certificate is a document issued by the company under its own common seal specifying the number of shares held by the registered holder and the extent to which they are paid up.

Companies are required to issue a share certificate within 60 days or 2 months of allotment or transfer of shares.

Failure to comply renders the company and every officer in default liable to a default fine not exceeding ksh 500,000. If the offence continues, a default fine not exceeding ksh 50,000 per day is imposed.

- **Contents of share certificate**

1. Name and common seal of a company
2. Date of issue
3. Name of the registered holder
4. Number of shares and class of shares
5. Extent to which they are paid up
6. Serial number of shares
7. Serial number certificate
8. Signature of at least two directors

Legal position of a share certificate

- A share certificate is prima facie the conclusive evidence of ownership or title of shares.
- The company requires the shareholder to surrender its share certificate for cancellation when it transfers or any of his shares.
- If the company issues a share certificate that is incorrect, it is estopped (prevented) from denying that it is correct but only against a person who has relied upon it and thereby suffered loss
- The issue of share certificate makes a company liable in two ways:
    a) **<u>EStoppel as to title-</u>** It implies the company cannot deny the truth of the certificate as to the title of the holder as indicated therein. It also means if innocent person relies on the certificate and suffers loss or suffers damage as a result

of his reliance, he can hold the company liable i.e. the company cannot deny the genuiness of the title at the time the certificate was issued either for the purpose of transfer of share.

b) **Estoppel as to payment**- A company may be estopped from the denying the amount stated to be paid on the shares e.g. if a share certificate states that the shares are fully paid, the company may be estopped from denying that the shares are fully paid.

Condition for estoppel to apply

1. A legal relationship between the parties must exist
2. There must be a promise or a representation by one party intended to affect the legal relation and to be acted upon by the other
3. There must be a reliance upon the representation
4. There must be a change in the legal position as result of the reliance
5. It will be unfair not to estoppel the plaintiff.

Exceptions of the Doctrine of estopell

1. Does not operate where the third party is aware of the falsity of the representation.
2. The share certificate relied upon is forged and the forgery was discovered before registration was effected.

Mortgage of shares

- As personal property, shares may be used as a security/collateral for a loan.
- Mortgage of shares is payable as transaction whereby shares are used as a collateral of security for loans.
  Types of mortgages of shares.
  1. Legal mortgage
  2. Equitable mortgage

Legal mortgage*Check; May 2017 QN 3A*

The borrower transfers shares to the mortgagee (lender) and the lender becomes the registered holder subject to a separate agreement by which the lender undertakes to retransfer the shares to mortgagor on repayment of loan. The lender becomes the temporary owner of the shares.

The main disadvantage of this is it involves formalities of transfer and retransfer.

Equitable mortgage

There is a deposit of share certificate and a blank instrument of transfer with the lender (mortgagee).

The borrower retains title and membership rights. A blank transfer is a transfer signed by the mortgagor as registered mortgagor but without the name of a transferee inserted in it.

Difference between legal and equitable mortgage.

Legal mortgage	**Equitable mortgage**
Borrower transfers his shares to the lender	No absolute transfer of shares to the lender but only a deposit of a share certificate and a blank transfer
Lender becomes the owner of shares	Shareholder(Borrower) remains the registered holder of the shares
The lender pays the calls if any but recover the same from the shareholder	Shareholder pays for the calls
Lender receives dividend as registered shareholder	The shareholder/ borrower receives dividend as registered holder
The lender has a right to attend meeting as a special proxy (representative)	Shareholder/ borrower attends the meeting
Upon repayment of the loan, there is a retransfer of shares to the shareholder	Upon repayment, the lender hand over the share certificate to the shareholder
In case of default, the transfer becomes absolute	In case of default, the lender may sell the shares if the A.O.A permits.
No notice of right in lien as required to the company	A notice of lien must be served to the lender
Lender is 100% secured	Lender is partially secured.

Stocks

Stock is one unit of a company's capital comprising several numbers of shares put together i.e. Consolidated shares put into one mass.

Rules of converting shares into a stock

1. The company must be registered as a limited company and having a share capital.
2. Conversion must be authorised by articles.
3. Members must pass an ordinary resolution.
4. Shares to be converted must be fully paid
5. The company must give a notice of conversion to the registrar within 30 days of the resolution.
6. Share certificate should be substituted with a stock certificate.

Difference between shares and stock

Shares	Stock
A unit of capital	several number of shares put together
Shares are issued directly by the company	Stocks cannot be issued directly by the company.
They need not to be fully paid	Stocks must be fully paid
Shares may be numbered	Stocks are not numbered
Fractional transfer is not permitted	Fractional transfer is permitted

N.B: *Under companies, Act 2015 conversion of shares into stock by companies is prohibited.*

Variation of class rights sec396 (1)

Class of shares: - shares are in the class if the rights attached to them are in all respects uniform.

Procedure of variation of class rights

1. Variation must be in accordance with the provisions of the articles.
2. A special resolution passed at separate general meeting of the holders of that class sanctioning the variations
3. Holders of not less than an aggregate of 15% of the issued share of the relevant class may apply to the court to have the variation cancelled.
4. The court may confirm or decline the confirmed variation. It may decline if it is unfairly prejudicial to the shareholders of that class.The high court decision is final.
5. Within 14 days after making the court order, the company lodges special resolution and a copy of the court order confirming the registration with the registrar for registration.

Failure to comply with this attracts a fine not exceeding sh 200000.

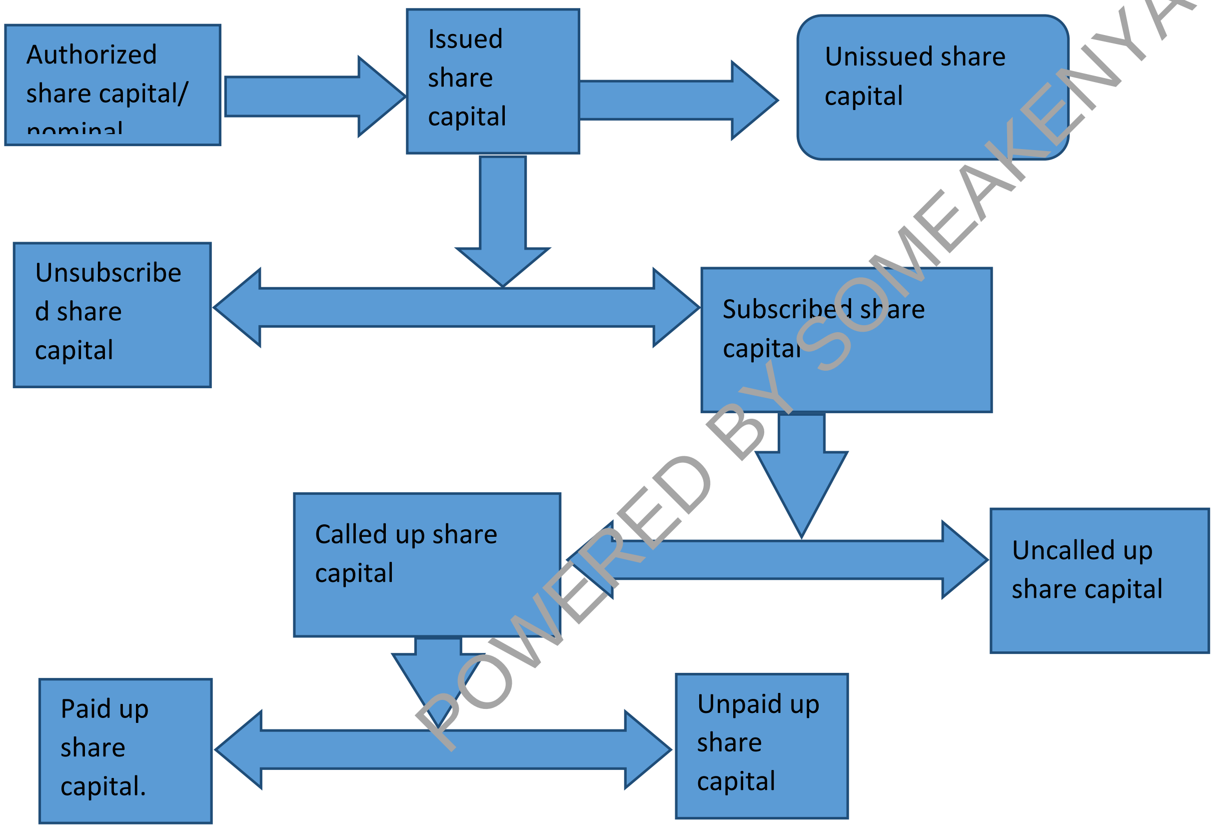
Issue of shares for consideration other than cash

- A company may agree to accept some other form of payment other than cash for shares issued.
- Such consideration should be legal and mostly consist of consideration inform of property.
- Private company may issue share for consideration other than cash.
- Public company may not allot shares in return for performance of work or services, however, it may issue shares in extension for transfer of property provided there is valuation report regarding the property which must be done property is valued within 6 months preceding the issue and allotment of such shares
- The valuation report should be registered with theregistrar of companies

SHARE CAPITAL

Meaning and structure/ classification of share capital

Auto



From the law point of view, the capital of a company refers to the nominal/ authorized/ registered capital and it is a fixed amount, which remains constant until some steps are taken to alter it.

From the accountant point of view, it is the net worth of the business. (ASSETS-LIABILITIES)

TYPES OF SHARE CAPITAL

Check; December 2013 QN 4B

1. Authorised/ Nominal/registered share capital.

- This is the amount of share capital, which the company is authorised to raise by issue.
- It is the amount specified by the capital clause of the MOA and the statement of nominal capital.
- It is known as registered capital because it is the amount that the company is registered with.

2. Issued and unissued share capital

   a) Issued share capital represents a number of share out to the total authorised shares that have been issued to the public for subscription.

   b) Unissued share capital represents the number of shares being part of the authorised shares retained for a future issue.

3. Subscribed and unsubscribed share capital.

   a) Subscribed – this is the part of issued share capital that is already taken up by public

   b) Unsubscribed – It is the part of issued share capital that is not yet taken up by the public.

It forms the basis of companies name to search for an underwriter/ insurer to avoid the risks of under subscription.

4. Called up and uncalled up share capital.

   a) Called up share- is the part of subscribed share capital that the directors have already announced a call upon.

   b) Uncalled up share capital- is part of subscribed share capital, which the directors are yet to announce a call upon.

5. <u>Paid up and unpaid up share capital</u>
   a) Paid up- It is the part of called up share capital whose payment has already been made or received by the company.
   b) Unpaid up share capital- It is part of called up share capital whose payment is not yet made or received by the company. It represents calls in arrears and it is always subject to forfeiture or lien by the company.
6. <u>Reserve capital or Capital reserve</u>

Also known as reserve liability, its where a company may resolve by a special resolution that the whole or any part of the uncalled up capital shall not be capable of being called up except for purpose of winding up. It acts as a security of creditors.

CHANGE ON SHARE CAPITAL

Changes include-

1. Alteration of share capital.
2. Increase of share capital.
3. Reduction of share capital.(*check: June 2010 QN 1c*)

The company may alter the provision of MOA, relating to its registered capital clause.

Procedure/ condition for alteration of capital.

1. There must be an authority of the articles of association to alter the capital.
2. The company must convene a member's general meeting.
3. The members must pass an ordinary resolution
4. The registrar of the companies must be notified of the alteration within 30 days from the date of passing the resolution.

Methods/ Modes of alteration of share capital

Check; June 2013 QN 2B

The alteration of the share capital is made by:-

1. **Increasing** the share capital through issuing new shares of such amount as the meeting may approve.
2. **Consolidation and dividing** all or any class of shares into shares of larger amounts than those existing.
3. **Subdividing all or any class of shares into shares of smaller amount** than is fixed by the MOA
4. **Converting all or any of the paid up share capital into stock** or conveying the stocks into paid up shares of any denomination.
5. **Cancelling shares where have not been taken up** thereby diminishing the amount of share capital.

Diminution of share capital

- When the shares have not taken up, the unsubscribed shares are cancelled and thereby the company diminishes or it eliminates the amount of that capital.
- This method of alteration is known as **diminution of share capital** and should not be taken as reduction of share capital.

Increase of share capital.

A company limited by share or by guarantee and having a share capital can increase its authorised share capital by any amount even if the initial authorized share capital has not been fully issued.

Conditions/ procedures for increasing share capital

1. There must be authority to increase the capital in the AOA.
2. The company must convene a member's general meeting.
3. The members must pass an ordinary resolution.
4. The registrar of the companies must be notified of the increase within 30 days from the date of passing resolution.

Members' pre-emptive rights

- Companies Act 2015 permits public companies and private companies to exercise pre-emptive rights.
- Private companies may restrict pre-emptive rights on its article.
- **A member's pre-emptive rights means that the existing members are given priority for consideration to buy new shares or towards transfer of shares between members before they are offered to the members of the public.**

The pre-emptive rights on the issue of shares do not apply if:**(Nov 2016 Q 7B)**

- the memorandum or articles of a private company exclude them or provide alternative Provisions, e.g. to make more detailed provisions in respect of different classes of
- The company passes a special resolution to exclude them.
- the shares are issued for non-cash consideration;
- Shares within employees' share scheme

a) Reduction of share capital

The general rule is that it is illegal for a company to reduce its share capital.
Reduction in this case means any attempt by a company to return or to refund part of the monies already received as share capital to share holders
This move is strictly prohibited because: -
a) It reduces the security available to the creditors.
b) It gives a bad public image to the company.
However, a company can reduce its share capital subject to the following conditions:

Procedure/ conditions for reduction of share capital.*Check; June 2010 QN 1c*

- The Act provides an exception to the above general rule where a company can reduce its share capital.A company with share capital can reduce its capital subject to the following conditions:-

- **Authority of the articles**: - A company having a share capital may if authorised by its Articles reduces its share capital.
- **Special resolution**:- The companies Act requires that a company limited by shares or guarantee may by special resolution passed by members at General meeting reduce its share capital, this resolution if passed is known as Special resolution of Reducing of share capital.

- **Application to the court for confirmation**

- The Act requires that after the resolution has been passed, a company must then apply to the court by way of petition for confirmation of reduction.
- The court must then satisfy its self that **the resolution passed does not unfairly compromise the interest of members and creditors.**
- The court may order that the **company prepare and submit to it a list of all creditors entitled to object.**
- It must also satisfy itself that **all creditors entitled to object have consented to the reduction**;
- The court must satisfy itself that **creditors' claims have been discharged or secured**
- However, the court is empowered to do away with the creditors consent or objection.If it is satisfied that the company has followed the procedure, it may go ahead and confirm the reduction.

- **Confirmation of reduction**

- The Act provides that if the court is satisfied that every creditor entitled to object has consented or that his claims has been discharged or secured, it may then make an order confirming the reduction on such terms and conditions it may deem fit.
- The court may for any reason if it thinks fit to do so order the company to add the words "and reduced" at the end of its name for a specified duration.

- **Notification to the registrar and registration of reduction**

- The Act states that upon production of **certified copy of the court order** confirming the reduction, **copies of the special resolution**, **minutes approving the same** and other document as may be required, the registrar registers the reduction and issues the certificate confirming the reduction of companies capital and this certification acts as a conclusive evidence that the requirement of the companies act in respect to the reduction of capital have been complied with.
- A reduction of capital takes effect when registered by the registrar.

N.B:- A private company's resolution for reducing the share capital (if the company is limited by share) must be supported by a solvency statement (that the company is able to pay its debts in the next 12 months.)
How the interest of following persons is protected in reduction of capital of a company

1. General public
2. Companies creditors
3. Companies members.

a) **General public**

- The general public are potential shareholders or creditors in future and must be informed the truth regarding the reduction of the capital.
- The general public is protected by the high court order which requires the company seeking to reduce its capital to compulsorily change its name to add the words **"and reduced**" at the end of its name for a period of at least 2 months or as the circumstances may deem fit .
- It enables the public to make enquiries to ascertain the reason for reduction of capital to make informed decisions.

b) Companies creditors

- Where the reduction involves the cancellation of unpaid up capital or repayment to shareholder payback capital,the creditors have statutory right to object to the proposed reduction.
- Upon such objection, the company is required to prepare list of creditors to forward to the high court, the high court after considering the risk may reject or confirm the reduction.

- **It can only confirm the reduction if satisfied that*Check; June 2010 Qn 1(c):-***
  1. Creditors have consented to the proposed reduction
  2. Creditors have been given alternative security
  3. Creditors' claims have been discharged or paid off.

c) **Companies members**

- Minority membership

Minority members can seek court protection where they are of opinion that the resolution passed by the majority is not fair and equitable at all

- Majority membership

They are protected by Act, which provides that the membership must pass a special resolution.It is most unlikely that (2/3 or 75%) or ¾ of the majority members can agree to pass a resolution for reducing capital against their interest.

Methods/ modes of reduction of capital*Check; May 2017 QN 6A*

1. **EXTINGUISHING the liability on any of its shares in respect of share capital not paid up**. E.g. par value of share is sh 10, shares are 1 million paid amount is per value sh five, balance not paid is par value sh. 5. A company may pass a special resolution to eliminate/ extinguish liability of balance of sh.5.

2. **REDUCING th eliability on any of the shares in respect of the share capital not paid up**. E.g. (the balance of sh 5) the company may pass a resolution to reduce the liability on share I.E the shareholder may be required to pay only sh 2.5 per.
3. **CANCELLING any paid up capital, which is lost or unrepresented by available assets** without extinguishing and reducing liability of members.
4. **REPAYMENT to shareholders of the paid up capital in excess of the companies wants** without reducing or extinguishing liability on shares.
5. **PAYING off paid capital, which is in excess of the companies** need and **reducing** the liability on any shares.
6. **PAYING off paid capital, which is in excess of the companies** need and **extinguishing** the liability on any shares.

Liability of members upon reduction of capital.

- Ordinarily, where company reduces its capital, the members are no longer liable to pay the reduced amount on share capital.
- The Act provides that if the company goes into liquidation within 12 months from the date of reduction of capital, then the member's liability shall be reviewed and shall be liable to meet the claims of the creditors who were never aware of the reduction of share capital and did not consent to it.

➢ **Further issue on share capital**

- A public company limited by shares may at any time increase its subscribed share capital by issuing new shares from any unissued share capital within the limits of its authorised share capital. **This type of issue is known as further issue on share capital.**

• **Members pre-emptive rights**

- Where a company makes a further issue of shares, an obligation is imposed upon the directors by the articles to offer such shares, first to the existing shareholders before they are offered to the public.This right of existing shareholder to have new shares in priority to the public is known as **members pre-emptive rights.**
- Companies Act 2015 requires every public company to exercise pre-emptive right whereas a private company may restrict such a right under its articles.

Maintenance of share capital

1. It is a fundamental principle of a company that a share capital must be maintained thereof, it is considered unlawful for a company to arbitrary interfere with its capital.
2. Maintenance of the capital is important since capital acts as primary security to the creditors thus interfering relate may bring about a compromise of the creditors interest in the company.

Rules of maintenance of share capital

1. **Payment of underwriting and brokerage commission is subject to the following conditions:**
   I. The payment must be authorized by the articles
   II. The commission to be paid should not exceed 10% of the price at which the shares are issued.
   III. The amount or rate of commission must be disclosed in the prospectus or statement in lieu of prospectus

What is underwriting commission?

A public company, which invites the public to subscribe for its share / debenture, must ensure that public subscribes to the issue. To spread the risk of under subscription, the company insures with underwriters. In return, the company will pay under writing commission to underwriter. Underwriter- means a person who agrees to the share or debenture specified in the underwriting agreement if the public fails to subscribe for them.

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Brokerage commission

- This is a payment made to issuing house and brokers, in return for their placing the companies or securities but without under taking to subscribe for them.
- It differs from underwriting commission in that it is payment made to agree to sell companies share on behalf without undertaking to buy its share, which he fails to sell. Unlike underwiritng commission, there are no restrictions on rate of brokerage commission.

2. **Issue of shares at a premium**.

When shares are issued at a premium, a share premium account should be created and the amount of premium on such shares is credited into this account.The share premium account can only be applied in the following:
   I. To issue members fully paid bonus shares
   II. To write off preliminary expenses of the company
   III. To write off expenses incurred on issue of any shares or debentures of the company e.g. discount allowed or commission paid.
   IV. To provide for the premium payable on redemption of any redeemable preference shares or debentures of the company

3. **Issue of shares at a discount**.

- Issue of shares at a discount is unlawful as it amounts to reduction of share capital. However, a company can issue shares at a discount subject to the following conditions/requirements:
   I. The shares are of a class already issued.

II. The issue is authorized by a resolution passed in general meeting
III. The resolution must specify the maximum rate of discount
IV. Not less than 1 year has elapsed since the company was entitled to commence business
V. The issue is sanctioned by the court
VI. The issue must be made within one month after court sanction

4. **Prohibition of a company to buy or purchase its own shares (Trevor vs, Whitworth-1837)**

- In Trevor vs, Whitworth (1837), it was decided that it is unlawful or illegal for a company to purchase its own shares because it amounts to reduction of the share capital of the company.

Exceptions to the rule of Trevor vs. Whitworth. (Where a company can purchase its own shares.)

Check; December 2014 QN 6b, December 2009 QN 3c, December 2011 QN 3c.

I. Where it is a purchase of **redeemable preference share**.
II. Where the share are acquired because of a **resolution of reducing the company's share capital**.
III. Where the shares are purchased because of **court order** in protection of minority interest.
IV. Where the share are **forfeited for non- payment of a call**.
V. Where the shares are **surrendered in lieu of forfeiture**.
VI. Where the companies acquires its own shares **otherwise than for a valuable (cash) consideration**.

5. **Prohibition of financial Assistance by a company to purchase its own shares.**

It is unlawful for a company whether directly or indirectly and whether by means of loan, guarantee, security or otherwise any financial assistance for the purpose in connection with the purchase of any shares in the company.**Penalties for contravening the above provisions.** ***Check November 2017 QN 3 A***

1. The company and every officer in default is liable to a fine not exceeding sh 1 million.
2. The company that has lent the money to finance purchase of its own share irregularly it cannot recover that loan.
3. Any share or debentures issued in connection with financial assistance stands invalid.
4. The agreement to purchase the shares is not enforceable.
5. The company may sue the directors for breach of duty, to recover any loss resulting from the financial assistance.
6. The directors are liable for damages for breach of trust since directors are trustee of the company's resources including money.

Exceptions to this rule include-Prohibition of financial Assistance by a company to purchase its own shares:

I. Where lending of money is part of the ordinary business of the company and the money is lent by the company in the ordinary course of its business e.g. financial institutions like banks.
II. Where the loan is to trustees to enable them purchase fully paid shares to be held under employees share scheme
III. Where the loan is to employees other than directors to enable them purchase fully paid shares by way of beneficial ownership.
IV. Where the company is advancing such monies or financial assistance to a director to enable him perform his duties efficiently.

6. **It is unlawful for the company to give a loan to a person who is its director, guarantee such a loan, or provide security for such a loan.Exceptions to the rule that a company cannot make out a loan to its directors.**

I. When the company is for the time being private.
II. When the lending company is the subsidiary and the holding company its director.
III. When lending money or giving guarantee is part of the ordinary business of the company and the same is given in the ordinary course of that business.
IV. When the funds are necessary to meet expenditure incurred or to be incurred by the director for purposes of the company or enabling him to properly perform his duties as an officer of the company.
V. When such payment has been approved at the general meeting and the particulars of the payments have been disclosed.

7. **Prohibition for financial compensation for loss of office.**

It is unlawful for a company to make to a director any payment by way of compensation for loss of office.

Director's rights with regard to recovering remuneration and compensation for loss of office- December 2012 question 3A

- Prima facie, directors are not entitled to any remuneration apart from that which is provided in the articles of association of the company
- Where the articles make provision for such payment, directors can claim remuneration out of the funds of the company if the company is not able to pay out of profits.
- Particulars of the proposed payment including the amount has been disclose to members of the company
- The payment has been approved by the company in general meeting
- Amount of remuneration should not be varied except through a special resolution.

- It is unlawful; for directors to be paid compensation for loss of office unless the particulars thereof have been disclosed and approved by members of the company

8. **Redemption of redeemable preference shares**.
   Companies Act provide that every company issuing redeemable preference share should create a capital redemption reserve fund account (CRRFF) to finance the preference share that are redeemed.
9. **Reduction of capital is subject to certain conditions**
10. **Prohibition of payment of dividend out of capital**
    No dividend shall be paid out of capital account, dividend should only be paid out revenue reserve or profit in given year

DIVIDEND

They are profit of trading company distributed among members in proportion to their shareholding.

Provisions of the AOA in regard to payment of dividend

1. A company in general meeting may declare dividend payable and no dividend payment shall exceed the amount recommended by the directors.
2. Directors may from time to time pay to members such an interim dividend in between the years, as it appears justifying on the company's profit.
3. No dividend shall be paid otherwise than out of profit.
4. Directors may default recommending any dividend and transfer all profits to capital reserves
5. Dividend must be paid to the persons and title within 42 days of their declaration.
6. Dividend may be paid up in cash, cheques or warrants.
7. No dividend shall bear interest against the company.

Common law rules on payment of dividend

Common law rules supplement the articles. They include:

a) Losses of previous years need not to be provided for when determining the profits available for distribution.
b) Profits of various years will be brought forward to be distributed as dividend even if there is a revenue loss in current years when company make.
c) Unrealised capital profits on revaluation of assets can be distributed by way of dividend or used to finance a bonus issue.
d) Dividend must not be paid out of capital (capital impairment rule)
e) Dividend cannot be paid if it will result in the company being unable to pay its debt as they fall due. (solvency rule)

f) Losses of circulating assets (current assets) in the current attaining period must be made good before payment of a dividend. (case number 46 exchange banking company ltd)
g) The company financial statement as a role must be taken into account before determining the amount available for distribution as dividend.
h) A shareholder cannot enforce payment of dividend even if company is making huge profits.
i) In the absence of dividend being recommended by directors, the general meeting has no power to declare dividend as available for payment. (case 47 Scott vs Scott)
j) Once dividend are properly declared it becomes a debt due against the company to each shareholder the company of which a shareholder can sue the company.
k) Dividend are payable in cash unless the AOA provides otherwise. (Case 21 Wood vs Odesa water works company.)
l) Dividend must only be paid to the registered shareholder or members.
m) A realised profit on sale of fixed assets may not be treated profits available for distribution.

THE FUNDAMENTAL PRINCIPLE / BASIC PRINCIPLE ON PAYMENT OF DIVIDEND

Dividend should not be paid out of capital.It is a basic principle of the company law that dividend must not be paid out of funds realized by issue of shares and debenture i.e. dividend must not be paid out of capital unless under the following condition/ requirement:-

<u>*Check; December 2009 QN 5A,*</u>

1. Such payment must be authorised by articles.
2. The company must convene member's general meeting to seek consent of its members.
3. Members must pass a special resolution (75%).
4. The payment must be authorized or approved by the registrar of the companies.

N.B: The registrar by approving such payment may appoint a person to inquire and report to him on the circumstances leading to such payment and may require that a company register a guarantee for the payment of the cost of inquiring.If a dividend is improperly paid out of capital, all the directors who are knowingly part of the payment are jointly liable and the dividend so paid shall be recovered from the recipient if they knew that it was paid out of capital.

c) Circumstances when a dividend could become a debt against the company.(May 2014 Q 5 C and D)

- If the articles so expressly provide, dividend will become payable and enforceable.
- In case of preference shares which carry a limited dividend and in respect of which there are no voting rights.
- When the company declares the dividend as a final dividend.

(d) The reasons why a company might seek to control the funds from which dividends are paid.

- To facilitate maintenance of capital
- To maintain a certain level of reserve
- Cash flow issues so that the company can run its business effectively.

CAPITALIZATION OF PROFITS.

- This is conversion of a part of revenue account into nominal capital of the company.
- It is an alternative way to pay cash dividend.
- The company may capitalize its profits in two ways:
    I. By issuing fully paid up shares (bonus share)
    II. By transferring undistributed profits to capital account (transfer to general reserve.) This must be done subject to the following conditions:-
    a) Must be done in accordance with authority in the AOA
    b) A company must pass ordinary resolution
    c) Members must pass ordinary resolution
    d) The distributors must be in the same proportion that the members would have received a cash dividend
    e) The capitalization must be made with the profits available for distributors.

FLOATATION

- Floatation is a process by which acompany avails securities to the public for subscription
- This enables companies to raise capital from the public
- Floatation is only done by public companies since the articles from doing so prohibit private companies.
- A private company, which intends to have its capital floated off to the public, must alter its articles in such a manner that they no longer:
    a) Restrict the maximum number of shares a member holds
    b) Prohibit any invitation to the public to subscribe for any share or debenture of the company.
    c) Restrict the right to transfer shares.
    11. Within 14 days after altering its article, deliver to for registration a statement known as statement in lieu of prospectus.

Methods of Floatation/ Raising share capital. *Check; May 2016 QN 2A*

1. Prospectus issue
2. Offer by tender
3. Right issue
4. Bonus issue
5. Placings
6. Offer for issue
7. Conversion issue

a) Prospectus issue/ Direct offer

Company sells its shares directly to the public. The company issuing securities prepares prospectus inviting subscription. For a company issuing shares for the first time, it must be licenced by the CMA

b) Offer by tender

The company invites tender for its share and sells turn to the highest bidder.

c) Right issue

The company offers its share to the existing shareholder to buy at a reduced price.

d) Bonus issue

It is an alternative to pay dividend.
Its where company issue fully paid up share to current shareholder for free
It involves capitalization of reserves into share capital

The company may use the following funds in financing bonus issue:

1. Profits available for distribution as dividend
2. Amount credited in the share premium account
3. Unutilised amount in capital redemption reserve fund

Conditions for the right issue and bonus issue.

1. It must be authorised by the articles of the company.
2. It must be sanctioned by the CMA
3. The board at the board members must recommend it.

4. It must be authorised by an ordinary resolution of members in the general meeting.
5. A return must be made to the register within 60 days.

e) <u>Placing</u>
The company arranges with its broker to sell shareson behalf of the company. This method is mostly used by the private companies. The broker then places the shares with its client privately. There is no direct invitation of the public.

f) <u>Offer for sale</u>
This is saleof shares to an issuing house, which in return prepare and issue prospectus-inviting subscription. Company sells its shares to an issuing house to resell shares to public. The issuing house bears the risk of undersubscription.

g) <u>Conversion issue</u>
Conversion issue the holders of one type of shares are given a chance to convert to another type.

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THE PROSPECTUS

A prospectus means prospectus, circular, notice, advertisement or other invitation offering to the public for subscription or purchase of any shares or debentures of the company.

Features of prospectus.

- Every prospectus must be in **writing**. This means that any oral communication through radio, interviews, TV is not prospectus even if it invites public to subscribe for the share. Prospectus is an invitation to treat but not an offer document.
- The prospectus must be addressed to the public i.e. prospectus must make its shares available to the public without any discrimination.

Statutory/ legal provisions relating to issue of prospectus.

<u>Check; November 2016 QN 1c</u>

To protect the public, the following legal or statutory provisions must be complied:-

1. Definition of a prospectus: - The prospectus must be defined by the Act.
2. Dating of the prospectus: - prospectus must be dated, date shall be unless the company is proved be taken as the date in which the prospectus was issued to public.
3. Content of the prospectus: - Authors of the prospectus are legally free to state anything they think is appropriate in the prospectus but they must include the matter specified under the Act.

Circumstances in which a company may issue a prospectus

1. A newly formed company may issue a prospectus inviting prospective investors to subscribe for securities.
2. An existing public company wishing to raise additional capital from the public may issue a prospectus in relation to the issue.
3. If a private company passes a special resolution converting itself into a public company, it must deliver to the registrar for registration within 14 days a statement in lieu of prospectus.

Contents of a prospectus

A prospectus contains matters and reports as follows:

The matters to be stated in a prospectus are:

1. Directors' and Auditors of the company

a) Directors' names, addresses and occupations.
b) Directors' qualification shares, if any, and their remuneration (if there is a provision in the articles).
c) Directors' interest in the company's promotion.
d) Auditors' names and postal addresses.

2. Formation expenses

a) Preliminary expenses.
b) Promoters' remuneration.
c) Particulars of options on shares or debentures.
d) Underwriting commission and brokerage.

3. Investor information

a) The minimum subscription.
b) The time of the opening of the subscription lists.
c) Amount payable on application and allotment.
d) Voting and class rights
e) Deferred shares.

4. **Company's property and business**
a) Particulars of shares and debentures issued otherwise than for cash.
b) Particulars of material contracts.
c) Vendors of property to the company.
d) Amount paid for property to be bought by the company, stating the amount paid for goodwill.
e) Length of time the business has been carried on, if less than three years.

The Reports include:
i)An auditor's report showing:
a) Profits or losses in each of the last FIVE years.
b) Rate of dividend during the last five years.
c) Assets and liabilities at the date of the last accounts.
d) Similar details with regard to subsidiary companies, if any. ii) Where the proceeds of the issue are to be used to buy a business,
ii) A report by named accountants on the profits or losses of the business for the last five years,
Its assets and liabilities at the date of the last account

Contents of a prospectus issued in Kenya by a foreign companySept 2015 Q 1B

- Name of the company and country of incorporation.
- The shareholding structure.
- Details of directors
- Number and classes of shares being issued
- Approval by CMA and NSE for shares to be floated in Kenya.

Actions and omissions that constitute criminal behavior in relation to issuing a prospectus (June 2013 Q 3B)

1. Failure to include matters and reports that are supposed to accompany the prospectus stating that the prospectus includes an expert's statement and the Expert has not given a written consent.
2. A prospectus containing an expert's statement 'and the expert -has not endorsed such a statement
3. Issuing a prospectus without delivering a signed copy thereof to the registrar for registration.
4. Omitting to include material contracts.
5. Including false statements in the prospectus.

Legal principles relating to a misleading prospectus

- The general rule is that a prospectus must disclose all material facts accurately; it must not misrepresent facts thereby improperly influencing and misleading a prospective investor into becoming an alotee of shares or debentures in consequences of which he suffers loss.
- A misled investor has the following remedies:
- Rescind the contract of allotment, return the shares to the company, and recover the money.
- .Recover damages from the company for fraud by proving that the statement was fraudulent.
- Damages for misrepresentation for any loss sustained by subscriber because of untrue statement.
- Damages for negligence at common law if he can show that the defendant owed him a duty of care when issuing the prospectus and there was a breach of the duty of care.

Circumstances under which persons would be exempted from liability on false information contained in a prospectus (JUNE 2011 Q2)

- Reasonable belief that the statement is true and not misleading
- Where the offending statement is made by or on the authority of an expert.
- Where the defendant takes reasonable steps to correct the statement.
- The person used public official statements and documents by official persons.
- The person withdrew the prospectus in writing before it was delivered for registration

The persons who can be made liable for misleading prospectus are:
a) Directors at the time of the issue of the prospectus;
b) Persons who consented to be named in the prospectus as directors or future directors
c) Promoters of the company,
d) Every person who authorised the issue of the prospectus