



## Legal Issues for Private Companies to consider when issuing new shares



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## Preliminary

The Companies Act 2006 ("2006 Act") has made significant changes to the law regarding share issues. The position is complicated by the fact that a number of the changes are subject to transitional provisions. This means there are different rules for companies that were incorporated before 1 October 2009 which was the date when the relevant provisions of the 2006 Act took effect. Sadly the consequence of this is that provisions designed to deregulate the administration of private companies have made matters significantly more complicated!

## Restrictions on Share Capital

Although the concept of authorised share capital has been abolished by the 2006 Act, a company may still restrict the number of shares that it can issue by including a suitable provision in the Articles. Indeed for companies incorporated prior to 1 October 2009 the authorised share capital as set out in the Memorandum or Association will continue to operate as a restriction on the number of shares that may be allotted.

This restriction will fall away if the Company passes an ordinary resolution removing the restriction. It will also fall away if either:

- 1) the Company adopts new Articles that make no reference to a limit; or
- 2) the Company passes a special resolution altering its Articles authorising the Directors to allot shares in excess of the stated authorised minimum.

Where the Articles also set out the authorised share capital it is not clear that an ordinary resolution will be sufficient. In such situations it would be prudent to adopt new Articles.

The logic of the draftsman of the 2006 Act cannot be faulted: a pre-existing company that was fettered by an authorised share capital should have to pass an (equivalent) ordinary resolution as would have been needed before 1 October 2009. The complication has

arisen because of the practice of stating the authorised share capital in the Articles as a statement of historical record, even though this is not required.

## Private Companies with only one class of share

Historically the Directors of all companies needed authority to allot shares. This was granted by an ordinary resolution under Section 80 Companies Act 1985. The authority could be given for up to 5 years and had to state a maximum number of nominal value of shares.

Under Section 550 of the 2006 Act a private company, provided it has only one class of share, no longer requires shareholder authority for the Board of Directors for any allotment of shares. (Section 550 cannot be used by a *public company* even if it has only one class of shares).

Again, however, there are transitional provisions that are a trap to the unwary. A private company incorporated before 1 October 2009 can only take advantage of the new Section 550 2006 Act if it has passed an ordinary resolution to that effect.

So for "old companies" it is necessary first to check to see whether the authority under Section 80 Companies Act 1985 (which is likely to have been for 5 years) has expired or the maximum number of shares previously authorised, is not to be exceeded.

## Section 551 Companies Act 2006

Where Section 550 does not apply (i.e. public companies, private companies with more than one class of share and "old" private companies that have not passed a resolution adopting Section 550) then the Directors need authority to allot shares under Section 551 2006 Act. This authority is given either by ordinary resolution of the shareholders or given by the company's Articles and must state a maximum number by nominal value of shares and a period not exceeding 5 years for the authority to run.

Section 551 applies to allotments not just of shares but to convertible loan

stock and options to acquire shares.

However, the Section 551 authority (like Section 80 before it) is not needed for allotments under any "employees' share scheme". There is also an exclusion for a share issue under conversion rights that have already been authorised.

## Pre-emption rights on new share issues

The 2006 Act (like the 1985 Act) includes statutory rights of pre-emption on new share issues: Section 561 2006 Act. This gives an existing shareholder a 21 day right of first refusal before shares are issued to a third party.

The provisions apply to "equity securities" which are defined so as to include rights to convert debt or preference shares into equity and to the grant of share options. There is an exclusion for issues of shares under an employees' share scheme.

It is common for private companies to exclude these statutory pre-emption rights and this continues to be allowed under the 2006 Act. However, it is equally common for Articles of private companies to incorporate their own bespoke rights of pre-emption: these might allow shareholders to opt to take excess shares not subscribed by others. So the Articles must be carefully checked for any pre-emption procedures.

A private or a public company may also exclude Section 561 generally or for a specific share issue.

## Prohibition of public offer by private company

A private company must not offer shares to the public: Section 755 of the 2006 Act.

## Payment for shares

A company cannot allot shares at a discount. Since shares must be given a par or nominal value (typically £1 per share) this sets the minimum price per share at which shares can be subscribed. Shares can, however, be issued as "partly paid" so that not all of the nominal value (plus share premium, if any) is paid at the time of subscription.

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A shareholder will be liable to pay the balance of the subscription price on demand from the company or if the company becomes insolvent.

## Post Allotment

Under the 2006 Act, a company should

issue a share certificate within 2 months of an allotment unless the terms of issue stated otherwise, or unless the allotment falls into certain other very limited exceptions.

A Return of Allotments should be made

within one month of the allotment on Form SH01, available from <http://www.companieshouse.gov.uk>

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