Unanimity Number K0221007
Section **A** Question **1**

Most shareholders regard the company as a place in which they can invest their money and expect a return in the form of a dividend at the end of the day. They provide the capital while the power to run the company is delegated to directors. Basically there are two types of investor, those looking for growth and those looking for income, and usually shares provide a mixture of the two.

By first looking the nature of the share the Companies Act 1985 defines it as an item of personal property transferable in the manner provided by the company's articles[1]. It is stated that in fact a share is a chose in action, one of those property interests which do not give the owner the right to posses anything tangible[2]. Furthermore, in the case of *Borland's Trustee v Steel Brothers & Co Ltd*[3], Farwell J, described the share as the interest of the shareholder in the company, measured by a sum of money which for the most part can be used for the purpose of liability and of interest if necessary, consisting of a various covenants entered into by all the shareholders[4]. As a general rule a share is not a sum of money, contrary is just an interest which is measured by a sum of money. Thus, this theory seems to be that the statutory contract[5], constituted by the articles of association, defines the nature of the rights which are not purely personal rights but as an alternative confer some kind of proprietary interest in the company though not in its property[6].

Furthermore, there is a presumption by the law that all shares confer the same rights and impose the same liabilities. Nevertheless, a registered company may divide its share capital into different classes, although this would be relatively unusual for a private company. The power to create shares with varying rights is normally contained in the articles of association[7], or in certain circumstances in the memorandum of association. It is very important to express these rights because a shareholder may rely upon these rights in the case of a winding up. In the worst case scenario where there is a conflict between the articles of association and the memorandum as what rights are conferred on the particular class of shareholders the memorandum prevails[8]. On the other hand in the case of *Angostura Bitters Ltd v Kerr*[9], it was held that if there is ambiguity in the memorandum, the articles of association will come to resolve the issue concerned.

Additionally, in the case of *Birch v Cropper*[10], it was held that in the absence of any express provision in the agreement between a company and its members of a particular

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[1] Section 182 (1)
[2] John Birds & AJ Boyle, *Company Law*, 4th Ed., 2000, Jordans.p.233.
[3] [1901] 1 Ch 279 at p 288
[4] In accordance with section 14 Companies Act 1985
[5] Companies Act 1985, s. 14
[6] Andrew Hicks & S. H. Goo, *Cases and Materials on Company Law*, 5th Ed. 2004, Oxford University Press
[7] Article 2 Table A
[8] Re Duncan Gilmour and Co Ltd [1952] 2 All ER 871
[9] [1933] AC 35
[10] (1989) 14 App Cas 525

class concerning their class rights, all members must be treated equally.[11] There is however, a possibility in a case that a provision is made in the agreement concerning a particular matter then it is presumed to be exhaustive[12].

As the time passes by, and various cases have been decided[13], shareholders have ceased to be regarded as having an equitable right in the company's assets[14] and according to the decision of Evershed L.J. in *Short v Treasury Commissioners*[15], shareholders are not to be regarded as a matter of law as owners of the undertaking. Thus, shareholders no longer share any property in common but instead they share certain rights in respect of return of capital in the case of a winding up[16], dividends, and certain voting rights[17].

Currently every company is required to file with the registrar details of the all shareholder's rights not contained in documents already filed[18]. Whatever new shares are allotted by a company with rights different from its existing shares a new statement of the rights must be filed with the registrar[19] unless they are in document required to be filed under s. 380[20].

Moreover, there are many classes of shares, including ordinary shares, preference shares and non voting shares. Their classification depends on the rights associated with the shares. It is persuasively established that a member of a company who has more capital than another will want a greater share in contributions of the company's profits and also a greater influence on the company's dealings. This may also depend to the number and class of shares of the company that the member may hold. Thus, each share is required to have a sum of money assigned to it as its nominal value[21]. Consequently, a description of each member's shareholding must be entered in the company's register of members[22].

Ordinary share which distinguishes from other types of shares[23], is the most usual type of share. The most common stock market investment is to deal in ordinary shares. These are the shares that are usually referred to when discussing the company's share price. Ordinary shares confer upon the holder a share in the ownership of the company with each share entitling the holder to an equal share of the profits and vote at company meetings. Profits will be distributed by way of dividends and are paid net of 10% tax.

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[11] Mayson, French & Ryan, Company Law, 21st Ed. 2004-2005, Oxford University Press
[12] Will v United Lankat Plantations Co. Ltd [1914] AC 11
[13] First decision in the case of *Child v Hudson's Bay Co* [1723] 2 P. 207
[14] *Macaura V Northern Assurance Co. Ltd* [1925] AC 619, CA
[15] [1948] 1 K.B 122, CA
[16] *Macaura V Northern Assurance Co. Ltd* [1925] AC 619, CA
[17] Companies Act s 370 (6).
[18] Companies Act 1980 s. 33(5)
[19] Companies Act 1985 s. 128
[20] Companies Act 1985 Rights conferred by resolution.
[21] Companies Act 1985 s.2 (5) (a)
[22] Companies Act 1985 s. 352
[23] Such as preference shares which pay a fixed dividend

These shares are sometimes referred to as equity in the company. Of all the types of shares they carry the greatest risk but when it comes to payment shareholders may receive the greatest return. The nominal value of shares is fixed but the exchange value of the shares in the stock market varies in relation to the performance of the company and the awareness of those dealing in the Stock Exchange.

Despite the articles and the memorandum of association, an ordinary shareholder is entitled to receive dividends, in order to have his appropriate proportion of the company's assets in the case of a winding up and also to exercise one vote for each share that he holds at the general meetings of the company[24]. However, the holder of an ordinary share is not confined to receive back the value of his share if the value of the assets available for distribution among the ordinary shareholders goes beyond the nominal amount of the issued ordinary shares.

Likewise, as mentioned above another important type of share is preference share. The basic principle of preference shares is that they pay investors a dividend at a fixed rate. A company which needs new capital and rather issuing ordinary shares, preference shares may be issued at a guaranteed annual dividend, and as the company's own capital[25]. The preference share is primarily an income instrument but it does not offer a fixed income. The capital value of these shares can not rise much from their current levels. If interest rates are to rise, the dividend of the share will with out any doubt be adjusted upwards, but investors should know that in such situations it will not cause the value or the price of the share to rise much. Basically there is no possibility of any capital growth on these shares.

Moreover, they do offer investors a good cover against a possible rise in interest rates, since the cash dividend that is declared is calculated carefully on the strength of the willing prime interest rates. It is therefore a good investment in an environment of rising interest rates. In the case of falling interest, it offers the investor no protection, because the dividends also pursue the fall in interest rates. Preference shares are considered less risky than ordinary shares because they are higher up the pecking order should the company be liquidated. Similarly their dividend is paid before that of ordinary shares and so is more secure, though not guaranteed. But it is important to note that they are still shares, and the holders of preference shares are members of the company[26]. Nevertheless, they contain a mechanism which allows the investor to call for conversion into ordinary shares in sufficient numbers to pay back the original issue price of the hybrid.

These shares involve less risk than ordinary shares. They may have priority over ordinary shares in two respects, dividends and repayment. In addition, preference shares carry a fixed rate of dividend. The important point to note, however, is that this fixed dividend has to be paid before any payment can be made to ordinary shareholders. The dividend payments made to preference shares are usually less than that enjoyed by ordinary shares.

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[24] Companies Act s 370 (6).
[25] *Scottish insurance Corporation Ltd v Wilsons & Clyde Coal Co. Ltd* [1949] AC 462, H/L
[26] Companies Act 1985, s. 14

Such rights are cumulative unless otherwise provided. This means that a failure to pay a dividend in any one year has to be made good in subsequent years before the current payment of the ordinary dividend. In the event where the dividend. Dividends are usually fixed at a certain percentage, though where stock is participating, investors are entitled to a share in profits should they reach a certain level.

Consequently, the main benefit to owning preference share is that the investor has a greater claim on the company's assets than ordinary shareholders. Preferred shareholders always receive their dividends first and, in the event the company goes insolvent, preferred shareholders are paid off before ordinary shareholders. In general, preferred shareholders have a greater claim on the company's assets than ordinary shareholders do.

Should the company wind up operations, preferred shareholders are paid any obligations owed to them. Should a dividend be suspended by the Board of Directors, for what ever reason, the preferred share usually has a cumulative clause in it allowing that any unpaid dividends must be paid fully before any dividends may be declared and paid to holders of common stock. This means that the preferred share is a relatively more secure investment. The company issuing preferred shares may add differing features to the share in order to make it more attractive.

A dividend paid on cumulative preference shares that the company is liable for in the next payment period if not satisfied in the current payment period[27]. Unlike a dividend on common stock that the company can pay out to shareholders if they want, dividends on cumulative preferred shares are an obligation regardless of the earnings of the company. The unpaid accumulated preferred stock dividends must be paid before any common stock dividends are[28].

Most irredeemable preference shares are issued by banks and insurers. The banks take this route to raise capital to cover liabilities[29]. This type of company is likely to be with us for many years, so preference shares should be a safe investment.

Moreover, preference shareholders are entitled to vote at class meetings convened to consider any alteration to their particular rights, however, with the added security offered by the guaranteed dividend stream, the holder of preferred shares gives up the right to vote on issues related to corporate governance. Therefore, the preferred holder has little input into corporate policy. Without specific provision, preference shares have the same rights as ordinary shares; but it is usual for their voting rights to be restricted. The rights attached to particular classes of shares are of great importance to those who hold them and the law is particularly sensitive to provide protection to those parties[30]. In most cases

[27] i.e. the dividends accumulate
[28] Sandler, Dido.Financial Times.London (UK), Irredeemable Preference Shares, June 2001.pg.08
[29] Key issuers include Abbey National, Halifax and NatWest, which are relatively solid and low-risk companies.
[30] ss.125 – 127 of the Companies Act 1985

any alteration will require the approval of the majority of those holding such class rights[31], and even then it may be subject to challenge in the courts[32].

Likewise, some companies have a class of members whose rights to dividend and to share in additional assets are like those of ordinary members but who have no right to vote at members' meetings. In such a company there is usually a small class of members who hold ordinary shares with a right to vote and entry to this class is carefully controlled[33].

Warrants are also to be regarded as a highly risk investment. They are not shares themselves, but give their holders a right to buy certain shares at a fixed price and by a certain date in the future. In the case of Scottish National, a split capital investment trust, they conferred the right to buy the highly geared capital shares, which are themselves highly risky. Even though in such situations, highly geared capital shares, the risk is really high, there can be high rewards, and if you are prepared to accept such levels of risk, it can be worthwhile learning about split capital trusts and the opportunities they present[34].

Their position in the row, and the nature of their entitlement, is the key to understanding how risky and how rewarding that particular share class might be. At the head of the row are zero dividend preference shares. These promise a fixed return on deliverance. The risk of a broken promise is almost always negligible.

If a shareholder is not satisfied with his current shares, convertible preference shares confer upon the holder the right to convert into ordinary stock at specific set dates. This means that income seeking investors can take advantage of the usually higher dividend with a view to converting in the future, supposed conditions be appropriate[35].

Conclusively, it is clear that there is no limit to the classes of shares which can be created[36], even within a single company. This kind of shares often issued to promoters, in respect of which the receipt of a dividend was deferred until after the preference and ordinary shares had been paid a dividend at a specified rate. Even though this kind of shares used to be common nowadays is rare. As an alternative, a company may issue shares which, like preference shares carry the right to a fixed preferential dividend, but on the other hand like ordinary shares carry the right to participate in surplus profits after their own dividend and a fixed dividend attached to the ordinary shares have been paid.

[31] Companies Act 1985 s. 125
[32] under s. 127 of the Companies Act 1985
[33] This kind of shares is strongly disapproved of by the London Stock Exchange and the financial press.
[34] Diana Wright, *High risk funds offer big rewards*, 1st Ed., May 24, 1998, Sunday Times, London, pg. 4
[35] De Klerk, *Good dividends, but no capital growth*, 10/18/2004, Finance Week, pg. 83
[36] Companies Act 1985 s. 159

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