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**MODERN COMPANY
LAW**

For a Competitive Economy

Capital Maintenance:

Other Issues

A Consultation Document from The Company Law Review Steering Group

Introduction

1 This document has been prepared for consultation with those already familiar with the Company Law Review and the work it has done on capital maintenance. It focuses on a small number of residual technical issues on which we would find further comment particularly helpful. It follows work in a small working party considering the responses to the consultation document *Company Formation and Capital Maintenance* published in October 1999¹ (“the October Document”). The four issues on which comments are sought are:

- no par value shares: transitional provisions and adaptations (paragraphs 8-23);
- distribution of profits and assets: *Aveling Barford* (paragraphs 24-43);
- “realised” profits and losses (paragraphs 44-71); and
- specific rules relating to distributable profits (paragraphs 72-75).

2 Like other consultation documents published during the Review, this document is issued under the authority of the Steering Group. The membership of the Steering Group and the capital maintenance working party is at Annex A. But the views expressed in this document should not necessarily be regarded as attributable to any particular individual or group which has participated in the Review. Nor does it represent Government policy. Those to whom this document is being circulated are listed at Annex B, though others with an interest in the issues raised are, of course, equally free to comment.

3 In this document references to the Act are to the Companies Act 1985, and references to parts, sections and schedules are references to parts, sections and schedules of that Act, unless otherwise specified. The Act does not apply to companies incorporated in Northern Ireland (see section 745), though it does cover Scotland and Wales. Company law matters relating to Scotland are reserved to Parliament under the Scotland Act 1998 and those relating to Wales have not been transferred to the National Assembly for Wales under the Government of Wales Act 1998.

4 We would welcome comments on the issues raised in this document and in particular the questions for consultation posed in it. These are summarised for ease of reference in paragraph 76. Although this is a technical subject which is likely to be of

¹ URN99/1145, available from the Department’s Publications Orderline or via the Company Law Review pages on the Department’s website – see paragraph 7.

interest primarily to specialists, it is important that the detail is right. Once responses have been received it is intended to complete the instructions for the draftsman on these issues to enable draft clauses to be prepared and, it is hoped, published as part of the final report of the Review next spring. (The publication of such draft clauses would, of course, represent a very early stage in the process towards any legislation to be put forward by Government.)

5 The deadline for comments on the document is **7 August 2000**. Responses before the deadline would be welcome. We appreciate that this represents a tight deadline. But given the tight time constraints within which we are working there is a real possibility that we will not be able to take responses which arrive after this date fully into account. Responses should be in writing and should be sent – by e-mail whenever possible – to:

Edwin James
Secretary
Company Law Review
Room 505
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 0219
Fax: 020 7215 0234
E- Mail: edwin.james@.dti.gov.uk

6 In accordance with the code of practice on open government, comments will be made publicly available unless consultees specifically request otherwise.

7 Additional copies of this document may be obtained by telephoning the Department's Publications Orderline, 0870 1502 500; it is also available from the Review pages on the Department's Internet site: <http://www.dti.gov.uk/cld/review.htm>.

PART I: NO PAR VALUE SHARES: TRANSITIONAL PROVISIONS AND ADAPTATIONS

8 We proposed in paragraph 3.8 of the October Document that for private companies it should no longer be possible to issue par value shares, and that existing par value shares should be deemed to have no par value. We also made clear that we would wish to extend this proposal to public companies if the necessary amendment could be made to the EU Second Company Law Directive.

9 The proposal would thus have the following characteristics: the switch to no par value (npv) would be compulsory, not at the discretion of the company; it would be effected by the operation of the new Companies Act, and there would be no obligation on any company to adopt a new constitution or to reregister; and it would apply initially only to private companies. Most responses to the October Document agreed that par value shares are, in economic terms, an anachronism and favoured giving private companies the option of having either par value or npv shares. But there was concern about the practical implications of a forced move to npv, particularly for existing companies and particularly if public companies were required by EU law to retain par values. This concern centred on: the constitutional change which would be required to the companies concerned; the redefinition of rights of third parties, including creditors and the holders of convertible securities, which are defined in terms of par values; and how a private company would convert back to par values on re-registration as a public company. At this stage it is uncertain whether it will be possible to persuade our European partners that it would be desirable to permit public companies to have npv shares. While that uncertainty remains the merits of the mandatory option and indeed of the move to npv shares at all, also remain uncertain. However, the issues addressed in this paper, and the solutions proposed, are relevant to any introduction of npv shares, whether on a compulsory or a voluntary basis, and whether for all companies or for private companies only, although it may be argued that a less complete solution may be sufficient if the move to npv is to be optional, because companies can be expected to evaluate the risks of any consequent uncertainties in their particular circumstances. We therefore believe that it would be of value at this stage to consult on the merits of the solutions to the transitional problems which would be applied if the move were to be made mandatory.

10 We would suggest that references in the present legislation to nominal capital and related terms (e.g. share premium, amount paid/unpaid) should be adapted to a new npv environment, with as little change as possible to the effect of the legislation, except where we propose change for other reasons, and that a new version or versions of Table A should similarly reflect a npv environment.

11 These changes would provide a regime for a company incorporated after commencement with npv shares. But it would also be necessary to provide transitional arrangements for a company with par value shares which is converted by the new legislation into a company with npv shares. These arrangements would deal with the effect of references to nominal value and related terms in the company's memorandum and articles, and in contracts and other documents. The objective of such provisions would be to preserve the substantive effect of such documents, and the rights and

obligations created by them, unchanged so far as that is practicable. (Similar provisions would be needed for a public company with par value shares which reregisters after commencement as a private company – which would be required to have only npv shares.) Where a private company re-registers as public after commencement there may be equivalent references in contracts etc. to the proportionate value of shares: we would suggest that there is no need for transitional provisions to deal with this case, since such shares will not lose their proportionate value. But we would welcome comments if there is disagreement or doubt on this point.

12 We recognise, however, that this change, while of little economic significance, could have wide ranging effects and that companies would wish to review their memoranda and articles, and their contracts and other documents, in the light of the move to npv, and might wish to make changes. We would therefore propose that provisions in the new legislation abolishing par value shares for existing companies and making consequential arrangements should come into force a significant time after Royal Assent. We suggest that this period of delay should be of the order of one year.

Transitional Provisions

13 Par value shares were abolished in Australia by a new corporations law which entered into force two years ago. The relevant transitional provisions are set out in Annex C. These provisions, introduced in a jurisdiction in the same legal tradition as ours and of equivalent sophistication, are a useful starting point for our consideration.

14 The general provision (254C) is that henceforth new shares are to have no par value. This applies to all shares (including redeemable and preference shares).

15 The first transitional provision (1444) is that the general provision applies to shares issued before commencement (with par values).

16 The second transitional provision (1445) deals with references to amounts paid (and unpaid) on a share. “Amount paid” refers, as in British law, to that part of the nominal capital which is paid. The effect is that references to amounts paid – which might be expressed as a proportion of nominal value – are to be understood as references to the sum of all the amounts paid to the company at any time for the share; and amounts unpaid are to be understood as the difference between that and the issue price, disregarding in each case any element of premium on nominal value.

17 The third transitional provision (1446) deals with share premium account and capital redemption reserve, concepts which would be rendered obsolete by the switch to npv (though in the case of the latter it will be necessary to provide that where shares are cancelled on redemption or repurchase the capital reserve is not reduced). Amounts credited to each become, along with nominal value, amalgamated into (combined) share capital. This would enable the company to comply with new accounting rules for the npv environment.

18 The fourth transitional provision (1447) deals with the permitted uses of amounts standing to the credit of share premium account immediately before commencement.

19 It preserves the company's right to: use such amounts after commencement to provide the premium payable on redemption of debentures or redeemable preference shares issued before commencement; to write off the preliminary expenses of the company incurred before commencement; and to write off expenses incurred, payments made or discounts allowed, on or before commencement, in respect of any issue of shares in, or debentures of, the company. This preserves permitted uses of share premium account regardless of whether such uses of (combined) share capital after commencement were otherwise permitted. We are in fact proposing to disallow such uses, both of share premium account and of share capital after commencement (see the October Document, paragraphs 3.18 and 3.21 and Questions 47 and 48 - this is not envisaged as preventing the share capital being stated as the net fair value received after deduction of issue costs). So generally speaking there would be no place in the British regime for a provision equivalent to section 1447 of the Australian Act. However, it is for consideration whether we should make an exception for the use of amounts attributable to share capital or premiums on shares issued before commencement (share premiums will cease to be separately identifiable in the accounts but the relevant records will be available) in relation to expenses incurred, payments made and discounts allowed before commencement. (The normal transitional provisions should also ensure that where premiums on redemption are due before commencement their payment out of share capital or share premium account continues to be lawful.)

20 The fifth transitional provision (1448) deals with the liability (post commencement) of a shareholder for calls in respect of money unpaid on (par value) shares issued before commencement – whether in respect of par value or premium. This liability is not affected by the share ceasing to have a par value.

21 The sixth transitional provision (1449) seeks to deal generally with the interpretation after commencement of references to par value and related terms (share premium, right of return of capital, aggregate par value) in pre-commencement contracts and trust deeds and other documents. This provision appears to need extension to cover references to nominal values of shares not yet issued on commencement but in contemplation in contracts in force – for example the nominal value of shares to be issued on the conversion of a convertible security.

Question 1: How far do the provisions set out in paragraphs 14-21 (other than 1447) offer a sound basis for transitional provisions to accompany the abolition by law of par value shares, whether for all companies or for private companies only, and to the extent that they do not, in what respects should they be changed or extended?

Question 2: In particular, does there need to be specific provision securing the appropriate effect in the new regime of references to par value and related terms in the company's memorandum and articles?

Question 3: Do the various references in the provisions to shares issued before or after commencement need to be expressly extended to cover shares in contemplation but not yet issued – e.g. shares into which other issued securities may be converted?

Other Adaptations

22 We are in the process of identifying references to nominal value and related concepts in the existing companies legislation with a view to establishing:

- a) the adaptations needed for companies formed with npv shares after the commencement of the new legislation; and
- b) the transitional provisions needed for companies in existence at the commencement of the new legislation whose par value shares are converted by the legislation to npv.

23 The following examples illustrate the kind of changes which would be necessary:

- a) section 89 requires a pre-emptive offer to be made in proportion to the nominal value of the “relevant” shares held. In cases where these are npv shares of the same class we would propose to adapt this so that the pre-emptive offer has to be made in proportion to the capital entitlements of the relevant shares. This works both for companies newly formed with npv shares and for companies converted to npv by the legislation. Where there is more than one class of relevant npv shares and where section 89(2) does not apply to make special provision for such a case, we believe that the effect of this provision will also be to achieve the appropriate result since the amount of the entitlement attributed to the shares will be in proportion to their former nominal value;
- b) section 74(2)(d) of the Insolvency Act 1986 states that contributories are liable for amounts unpaid on shares. We would propose that where the shares of a company formed after commencement have no par value, contributories should be liable for the amount, if any, unpaid on the issue price of the shares. For companies existing at commencement whose shares are compulsorily converted to npv, we would propose to retain the effect of the present section 74(2)(d) so that any amount which is unpaid for the purposes of the section before commencement remains an amount unpaid until paid;
- c) companies are currently able to make bonus issues by transferring share premium account to share capital and using it to pay up new shares. With the disappearance of the distinction between share premium and share capital, the equivalent transaction would be that shares would be allotted to members as bonus shares without consideration and without alteration of subscribed capital. This would apply both to companies

newly formed with npv shares after commencement and to companies existing at commencement and compulsorily converted to npv. (Such a transaction is, in a npv context, no different from a sub-division under section 121(2)(d) and no special provision in the legislation would be required for it); and

- d) section 160(2) relates to redeemable shares issued at a premium to nominal value. We would propose that for companies newly formed with npv shares after commencement, the rule should be that redeemable shares may be redeemed from distributable profits or from the proceeds of a new issue. We would propose that the same rule should apply to companies in existence at the commencement of the new legislation and who had par value redeemable shares in issue at commencement. (Such shares will have no par value at redemption, so there will be no way of replicating the present distinction between rules for the redemption of nominal value and rules relating to any redemption of premium.)

Question 4: Do you have any comments on the proposals for dealing with the four cases outlined in paragraph 23?

Question 5: Are you aware of other cases where the adaptations needed to the existing provisions of the Act to accommodate a switch to npv shares are likely to cause difficulty, either for companies newly formed with npv, or for companies with par value shares converted by law to npv and whether in response to the needs of legislative provisions currently in place or in response to current commercial practice and existing legal relations?

PART II: DISTRIBUTION OF PROFITS AND ASSETS: *AVELING BARFORD*

Introduction

24 In paragraph 3.66 of the October Document we set out our proposals to clarify the concept of a “distribution” to deal with a problem which was widely perceived as a result of the decision in the case of *Aveling Barford v. Perion Ltd*². In this part of the document we re-examine the issues arising out of the decision in *Aveling Barford* and, in the light of the responses to the October 1999 consultation, put forward revised proposals to deal with these issues.

Aveling Barford

25 The *Aveling Barford* case involved a sale by one company to another, associated (but not grouped) by reason of a common controlling shareholder company, of land at an undervalue which was known to both sides.

26 *Aveling Barford* owned land which was surplus to requirements but which was suitable for development. It sold the land to Perion for £350,000. At the time the land was believed to be worth £800,000 and the bank to which the land was charged as security valued the land at £1.15 million. A few months later the land was sold to a third party for £1.5 million.

27 At the time of the sale the transferor company’s accounts showed net assets below the level of its share capital (i.e. it had negative reserves). The effect of the transaction was thus substantially to extract a valuable asset, for the benefit of the owner, from a company which was not free to make distributions, thus avoiding the distribution rule and, in a sense, the constraints on the reduction of capital. However, the transaction was not expressed as a reduction of capital in that the company’s share capital and undistributable reserves remained intact on the liabilities side of the balance sheet.

28 It was held that the transaction was void because it was:

- an unlawful reduction of capital at common law, being a disguised distribution or return of capital to shareholders in circumstances where there were no assets available for distribution, and therefore *ultra vires* and incapable of ratification by the shareholders; and
- a breach of duty by the directors which was known to the purchaser.

29 The transferee company was merely a constructive trustee and had to account to the transferor company for the profit on the resale of the property.

30 The case was decided by reference to common law rules on distributions and maintenance of capital, rather than the statutory rules on distributions set out in Part VIII. Section 281 expressly preserves these rules to the extent that the provisions of

2 1989 BCLC 626

Part VIII might be construed as replacing them. At common law the courts took a wide view of the meaning of a distribution, looking at the substance, not the form of the transaction. Common law rules were closely tied in with the concept of *ultra vires* and operated without specific reference to the accounts of the company. Thus, the sale by a company lacking profits of an asset at an undervalue to another company controlled by its main shareholder was held to be a distribution in the nature of a return of capital.

Issues

31 The case did not decide anything about the situation where a company has positive distributable reserves. But there is a body of opinion, prompted by the decision, that an intra-group sale of an asset may constitute a distribution for the purposes of section 263 if the asset concerned is sold for an amount equal to its book value, where this is less than its market value, even where the company has distributable reserves.

32 The result of *Aveling Barford* and the debate it has engendered have cast doubt on the validity of intra-group asset transfers conducted by reference to book value rather than by reference to market value. It is understood that such transactions are often carried out by reference to book value rather than to market value for a variety of business, administrative or tax reasons. Because of this doubt such transactions are therefore commonly carried out in a more complicated way (often involving revaluation of the asset concerned and then its sale/distribution, relying on section 276, which provides that a distribution in kind of an asset carrying an unrealised profit is to be treated as a realisation of the profit) or do not proceed at all.

33 The view has also been expressed that “distribution” in section 263 may include any amount by which the sale price of an asset is less than its market value (whether or not the asset in question has been revalued in the accounts and whether or not the sale consideration exceeds the book value). This is apparently because section 263 defines “distribution” as “every description of distribution of a company’s assets to its members whether in cash or otherwise”. It is arguably difficult to reconcile this view with section 270(2), which refers issues about the amount of a permissible distribution to items “as stated” in the relevant accounts, thus ensuring that any amount which is not recognised in the accounts is disregarded. If the effect of this provision is to reduce the amount distributed to nil or less it is argued by some that such a transaction can hardly be regarded as an unlawful distribution. Section 276 will also ensure that if an unrealised profit is attributable to the asset in question as a result of that profit being recognised in the accounts it will be disregarded in determining the amount of the distribution; it is not, however, clear that such a rule would be applied at common law. It is also argued that the sale of an asset at an undervalue to a person proposed by a member is to be regarded as a distribution to that member so as to fall within the definition of distribution “of a company’s assets *to its members*” within section 263(2) with the effect that Part VIII applies to distributions to a wider range of beneficiaries than appears on the face of the legislation.

34 On this cautious view of the effect of *Aveling Barford*, which we understand has been widely adopted, the statutory accounting rules on distributions are apparently conflated with the common law rules (essentially by treating all transactions falling within the common law rules as distributions under Part VIII) and a wide range of transactions is thus required to be covered by distributable reserves.

The October Document – Original Proposal

35 In paragraph 3.66 of the October Document we proposed to add to the definition of “distribution” in section 263 that a distribution for the purpose of this part of the legislation will be a distribution of assets to members “in their capacity as members”. Thus the transfer of company assets to a person would not have been subject to challenge under the statutory distribution rules merely because that person happened to be a member of the company and *a fortiori* not where he was merely an associate of a member. It was also proposed that the distribution rules should displace any common law rules prohibiting a distribution as such, but without prejudice to the general fiduciary duties and duties of skill and care of a director, nor to provisions in any enactment or in the company’s constitution (thus ensuring, for example, the continuing effect of insolvency law and in particular the law on wrongful trading (Insolvency Act 1986, section 214) in this context).

36 A significant number of responses doubted whether the proposal would materially assist in removing the current uncertainty, due to the differing legal interpretations which may be placed on the words “distribution of assets to members” and “in their capacity as members”, so that intra-group transfers might still be caught by the statutory distribution rules. Concern was also expressed that to displace common law rules was dangerous and likely to have unpredictable results. In particular, it might permit companies to rely on the latest published accounts when their position had since deteriorated. Doubts were expressed as to the wisdom of applying distribution rules solely to transfers of assets to members in their capacity as such, excluding transfers to others at the direction, or substantially at the direction, of members. It was suggested that to restrict the scope of all distribution rules in this way might give rise to undesirable avoidance. We are persuaded by these views. In the light of these responses we put forward the following revised alternative proposals for consultation.

Alternative Proposals

37 The first proposal refines the original proposal (framed as Question 88 of the October Document) for an exhaustive statutory approach. Under this proposal the definition of a distribution in section 263 would be extended so as to provide that the distribution rules apply to transfers of assets to members or to others at the direction, or substantially at the direction, of members. This would ensure that an *Aveling Barford* type transaction would fall within the statutory provisions in Part VIII. Since there appears to be doubt whether the rules in section 270 apply for determining not only whether the amount of a distribution is justifiable, but also whether there is a distribution at all where the amount in question is not recognised in the accounts, we would also propose that this doubt should be resolved so as to ensure that where there

is a distribution of an amount which is not recognised in the accounts that amount is to be disregarded.

38 Having clarified the statutory distribution position it is then necessary to consider the common law rule which was invoked in *Aveling Barford* – namely that a company cannot return its capital to shareholders other than by way of lawful dividends, reductions of capital or other lawful procedures. In our original proposal we proposed that the statutory distribution rules should have effect in place of any common law rule prohibiting distributions as such, but without prejudice to the general fiduciary duties and duties of skill and care of directors or to provisions in any enactment or in the company’s constitution. This would in effect have partially reversed the position under section 281. We would suggest retaining this proposal. However, we now believe that additional safeguards would be necessary. The first of these would be to preserve the common law rule that if a company is aware that it has incurred losses which would have reduced distributable profits in the relevant accounts since the date to which the latest accounts showing a profit were made up, that loss has to be deducted from the profit in ascertaining the amount available for dividend. Thus when determining whether to make a distribution and if so of how much, the directors and members would be under an obligation to take appropriate post balance sheet losses into account in assessing the availability of distributable profits. This provision seems a desirable amendment to Part VIII in any event. Yet a further difficulty with this proposal is that a distribution of an asset by way of a sale at an undervalue but at book value would not be treated as an unlawful distribution even in the absence of distributable reserves. This suggests that the statutory rules would need supplementing by a further safeguard that the book value and unrealised profit rules should not be available where the company has a deficiency in distributable profits or would do so after the distribution.

39 The alleged merit of this approach is that it would codify the law relating to distributions and remove the uncertainty of the common law. However, there may be doubts about whether the proposal is sufficient to achieve the objective. The decision in *Aveling Barford* proceeded on the basis that the transaction was not only an unlawful distribution but also an unlawful return of capital. It would need to be made clear that in so far as such a return of capital is achieved by a lawful distribution to members the statutory provisions are exhaustive of the law.

40 It has been suggested that there is an existing common law rule that directors must not make distributions without paying due regard to the working capital requirements of the business and to the present and future solvency of the company which should also be preserved. In circumstances where directors authorise a distribution (in the broader common law sense of a gift or disposal at undervalue of the company’s assets) in circumstances where creditors’ interests might be prejudiced, such action would in our view constitute a breach of fiduciary duties and the duties of care and skill and we therefore doubt whether any additional protection for creditors would be provided by the preservation of any such rule.

41 In relation to fiduciary duties it is worth noting that a number of British and Commonwealth court judgements³ have suggested that once a company is insolvent or in danger of becoming so, the interests of “the corporators as a general body” give place to the interests of the creditors as a general body. The significance of this doctrine is that it opens up the possibility of challenges at common law to dispositions by management which reduce the pool of assets available to satisfy the creditors when insolvency is in prospect even when the dispositions have been ratified by the shareholders. There are also a number of statutory provisions under the Insolvency Act 1986 which enable such a challenge to be mounted, for example the fraudulent and wrongful trading remedies. These issues were discussed in Chapter 3 of the consultation document *Developing the Framework* (URN 00/656) published in March of this year.

42 A further difficulty may arise with this approach in circumstances where it is the shareholders who resolve to enter into an *Aveling Barford* type sale as distinct from the directors. Shareholders are not subject to fiduciary duties (though if they give instructions to directors they may well be so subject as *de facto* directors) and therefore the principle outlined above might not be available to invalidate such a resolution. However, any instruction by shareholders to directors to engage in transactions which breached insolvency law would be of no effect and there is therefore arguably no gap in the scheme of protection for creditors where a decision to make a distribution is taken by shareholders. But the uncertain extent of these protections may suggest that a solution to the problem which leaves the common law on distributions and return of capital to shareholders in place would be preferable. Such an approach is adopted in the second alternative, below.

Question 6: Do you agree that the legislation should make clear that the statutory distribution rules apply to transfers of assets to members or to others at the direction or substantially at the direction of members, and that the amount of and existence of a distribution should be determined by reference to the company’s accounts, including treating unrealised profits attributable to an asset distributed as realised and treating a “distribution” of an asset which is treated as without value in the books as not a distribution, so long, in either case, as the company would have no deficiency in distributable profits after the distribution?

Question 7: Do you think that the legislation should also make clear that the distribution rules have effect in place of any rule of law prohibiting distributions as such, but without prejudice to the general fiduciary duties and duties of skill and care of directors and without prejudice to provisions in any enactment or in the company’s constitution, provided that if a company has knowingly incurred any loss, which would have been deductible from distributable profits in the relevant accounts, since the balance sheet date for those accounts, that loss shall be deducted from the

³ *Nicholson v. Permakraft (NZ) Ltd* [1985] 1NZLR, *West Mercia Safety Wear v. Dodd* [1988] BCLC 250 CA.

profit in ascertaining the amount of distributable profits available for distribution? Or do you consider that any existing common law rule that directors must not make distributions should also be preserved in addition to the general fiduciary duties of directors?

Question 8: If you disagree with Questions 6 and 7, do you agree that the statutory distribution rules should be extended to provide that if a company has knowingly incurred any loss which would have been deductible from the distributable profits in the relevant accounts, since the balance sheet date for those accounts, that loss should be deducted as proposed under Question 7?

43 An alternative proposal to that outlined above would be to leave the statutory and common law regimes to continue to operate in parallel, but to amend the position at common law so as to make specific provision for distributions involving a sale/transfer or other disposition of a non-cash asset. This would preserve the common law rule relied on in *Aveling Barford* but would make clear that certain transactions would not contravene the common law. We have identified two possible approaches:

- a) to amend section 263 to the effect that, for the purpose of any rule of law restricting a company's power to make a distribution, the amount of any distribution comprised in the sale, transfer or other disposition of an asset would be determined solely by reference to the amount at which the asset is stated in the company's accounting records. To avoid the anomaly which would arise in cases where an unrealised profit was attributable to the asset and this had been recognised in the company's accounts, the rule in section 276 which treats such unrealised profits as realised upon the distribution would also need to be applied. This would mean that a sale at such book value amounted to a nil distribution and there would be no requirement for the company to have distributable reserves, but that to the extent that a sale was made at less than book value such reserves would be required. This would preserve the common law rules relating to unlawful distributions (including *Aveling Barford*), which would continue to apply to a company with insufficient distributable reserves entering into an intra-group sale at an undervalue. However, the effect would be that so long as the book value of an asset distributed was met by consideration the distribution would be of nil value so that a distribution in the absence of distributable reserves would be lawful; or
- b) to amend section 263 as above, but for the provision to apply only where the company has and would retain no deficiency of distributable reserves. This would answer the objection mentioned to the rule proposed in a), above. It would still have the arguably arbitrary effect that minimal reserves would be all that was necessary to allow such a transaction to continue to be lawful; but the counter argument, which appears convincing, is that the capital maintenance rules only require

that a company should retain assets sufficient to match its share capital and undistributable reserves.

- Question 9:** As an alternative to the proposals in Questions 6-8, do you consider that the Act should be amended to the effect that the amount of any distribution in kind should be determined, both for the purposes of Part VIII and at common law, solely by reference to the amount in the company's books (treating unrealised profits on the assets distributed as realised)? If so, do you think that the provision should only apply where the company has no deficiency in distributable reserves?
- Question 10:** Do you consider that the proposals in Questions 6-8 and Question 9 would equally well remove the uncertainty surrounding the application of the distribution rules to intra-group transfers of assets at book value to which the case of *Aveling Barford* appears to have given rise? Which of the two proposals do you favour (bearing in mind that it is one of the underlying objectives of the Review to simplify the law and render it more accessible to users - objectives which arguably tend in favour of some variant of the first alternative which removes the common law regime)?
- Question 11:** If you consider that neither of the proposals achieve the stated objective, do you have any suggestions as to how either or both might be adapted to achieve this aim? Do you have an alternative approach to suggest? Would you favour leaving the law as it stands with no attempt to deal with the alleged difficulties arising from the *Aveling Barford* decision?

PART III: “REALISED” PROFITS AND LOSSES

Introduction

44 This part of the document is concerned with the problems which have arisen with the provisions of the Act dealing with “realised” profits and losses and the meaning of “realised”.

45 We describe:

- the present law and practice;
- the difficulties; and
- a proposed way forward for consultation.

Present Law and Practice

Distribution Rules

46 Part VIII of the Act lays down the conditions subject to which a company may make distributions (i.e. typically, pay dividends). These rules are also important for identifying distributable profits which may be used for other purposes, e.g. purchase of a company’s own shares.

47 The main substantive provision in the Act concerning realised profits and losses is section 263(3) which provides that

“... a company’s profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made”.

This is extended by section 742(2) which provides that “References in this Act to “realised profits” and “realised losses”, in relation to a company’s accounts, shall be construed in accordance with section 262(3)”.

48 This provision applies to both public and private companies. So in this respect the problems considered in this paper apply to even the smallest companies if they make distributions. This is a matter of concern – such companies need to be able to recognise with reasonable ease and without specialist professional advice what distributions are legitimate.

49 Section 264 imposes an additional constraint on distributions by public companies, restricting them to the excess of net assets over called-up share capital and undistributable reserves. Undistributable reserves include share premium account, capital redemption reserve and

“the amount by which the company’s accumulated unrealised profits ... exceed its accumulated unrealised losses”.

50 Clearly unrealised and realised profits and losses are converse concepts. Once “realised” is defined it will follow that “unrealised” is its opposite.

51 Section 270 provides that the amount of a distribution which may be made is to be determined by reference to the relevant items as stated in the company’s relevant accounts.

Accounting Rules

52 The main substantive provision in the accounting rules is Schedule 4, paragraph 12(a), which provides, amongst the “accounting principles”, that

“only profits realised at the balance sheet date shall be included in the profit and loss account”.

53 However, paragraph 15 enables directors to depart from this rule where there are special reasons to do so, so long as particulars, reasons and the effect are shown in the notes. The annual accounts must still, of course, give a true and fair view in accordance with section 226.

54 Section 262(3) provides that generally references in Part VII, which includes the accounting schedules, to “realised profits” and “realised losses”

“are to such profits and losses as fall to be treated as realised in accordance with principles generally accepted ... with respect to the determination for accounting purposes of realised profits or losses”.

Practice

55 Thus both for accounting purposes and for determining the lawfulness of distributions the Act refers the question of whether a profit or loss is “realised” to generally accepted accounting practice. The main guidance in Accounting Standards on whether a profit is realised is in SSAP2, which deals with the disclosure of accounting policies. This states that “... profits are not anticipated but are recognised by inclusion in the profit and loss account only when realised in the form either of cash or of other assets the ultimate cash realisation of which can be assessed with reasonable certainty ...”. However, SSAP2 was issued nearly thirty years ago and markets have developed to the extent that it is often possible to be reasonably certain that a gain exists even if no disposal has occurred. Consequently the Accounting Standards Board (ASB) has recently issued an exposure draft which attempts to modify the concept of realisation. Instead it suggests “that a gain should be recognised only if there is reasonable certainty that it exists and if it can be measured reliably”. In addition the Institute of Chartered Accountants in England and Wales (ICAEW) is revising its 1982 guidance on the determination of realised profits and realised losses in the context of profits available for distribution.

European Union Law

56 Section 263(3) (net aggregate realised profit rule) implements Article 15(1)(c) of the Second Directive, which provides that

“... a distribution may not exceed the amount of the profits at the end of the last financial year, plus any profits brought forward and sums drawn from reserves available for the purpose, less any losses brought forward and sums placed to reserve in accordance with law or the [company constitution]”.

57 Section 264 (net asset rule) for public companies implements Article 15(1)(a) and (b) of the Second Directive, which prohibits any distribution where

“... net assets as set out in the company’s annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital [less any uncalled capital] plus those reserves which may not be distributed ...”

58 Schedule 4 paragraph 12(a) implements Article 31(1)(c)(aa) of the Fourth Directive, which applies to all limited companies and requires that profits must be “made” before they may be included in the profit and loss account. The combined effect of this provision and Article 15 of the Second Directive is generally accepted as requiring that distributions may only be made out of net aggregate realised (or “made”) profits on a running profit and loss account basis.

59 Nothing in European law requires us to restrict distributions by private companies as is done by section 263. However, the accumulated net realised profit rule represents a restatement of the common law (which, however, was notoriously obscure on the distributability of unrealised capital profits and defective as to the extent to which prior year losses were to be taken account of). The Steering Group indicated in the October Document that it proposed to keep both the private company and the public company rules substantially unchanged and the overwhelming balance of the responses to consultation on this has been supportive of this view.

Difficulties with Present Law and Practice

60 There are two main justifications for the present rules – first that they are necessary to achieve prudence in the disposal of company assets to members for the benefit of creditors; and second that they are necessary for the maintenance of capital.

Need for More Flexible Rules on the Retention of Working Capital

61 One possible general objection to the rules is that a prudent approach to distribution questions requires that directors should retain an appropriate level of working capital to secure that the business remains viable. Absolute distribution rules of the kind in the Act, as opposed to a flexible standard, may be neither sufficient nor necessary to achieve this, depending on the condition of the business. A closer approximation to such a results-oriented policy would be the New Zealand Companies Act approach, which allows directors to make distributions so long as they sign a declaration of solvency assuring that the business will remain a going concern

notwithstanding the distribution. This approach to capital maintenance issues would have wide effects on all the relevant rules. It would be a major departure from the established European approach which would be most unlikely to be attractive to other Member States, and from current practice in the UK. It has been rejected by the Steering Group and by consultees. It is well established that the general directors' duties, and in particular the duties of loyalty and care and skill, require directors to consider the prudence of a distribution before recommending it, even where the specific distribution rules are satisfied. So the problem that the rules may be insufficiently stringent is met to that extent.

Rigidity of the “Realisation” Concept

62 A second line of criticism is that the concept of realisation is ill suited to achieve the evident object of the rules, which is to ensure that only where profits can be identified with sufficient certainty and reliability as having accrued should distributions take place.

63 While the concept of realisation is left by Parliament for accounting practice to develop and interpret, there are clearly some limits on what the word “realised” is capable of embracing. In particular it is difficult to conceive of a profit as having been realised without some transaction with a third party giving rise to the surplus in question. It has even been suggested that the word legally requires a conversion into cash. Moreover, if the possibility is envisaged of allowing a profit to arise in relation to an asset without the asset being disposed of the profit will need to be incorporated into the amount at which the asset is stated; this raises issues as to whether this transaction is a revaluation. Profits arising on a revaluation are regarded as unrealised and carried to revaluation reserve, which is not distributable (Fourth Directive, Article 33, Companies Act 1985, Schedule 4, paragraph 34).

64 Many events, such as an exchange of one asset for another, may clearly lead to a reliable profit even though money has not been used as a medium of exchange. Some events, such as a currency movement or a movement of the price of a listed security, may give rise to a profit which is just as reliable as a profit which arises on an actual transaction, at least if in the latter case the proceeds are immediately converted into assets of dubious or difficult realiseability. It seems absurd that a profit resulting from the appreciation in a listed security with a liquid and deep market should have to be realised by means of a “bed and breakfast” transaction before it can be treated as having been made for accounting or distribution purposes. (Section 275, which requires provisions for depreciation and diminution in value to be treated as realised losses, needs to be borne in mind in this context.)

65 In addition, international developments in accounting are moving away from realisation as a recognition technique. A recent example is in respect of investment properties.

66 These constraints could be somewhat reduced if the term “realised” were abandoned or redefined to correspond with the Fourth Directive requirement “made”. But this term is not consistently used throughout the Directive; and there would still be some doubt as to whether a transaction was required before a profit could be regarded

as “made” and also over the distinction between realisations, revaluations and any alleged intermediate category. These doubts are strengthened, or confirmed, by the fact that it has proved necessary for the Community to propose a directive amending the Fourth Directive to permit the practice of “marking to market” of certain securities. Under the proposed amendment companies would be permitted to use “fair value” accounting for certain of their financial instruments (e.g. the current market value of a financial instrument) as opposed to valuation on a historical cost basis or alternatively at valuation or current cost. This permits “profits” on certain securities to be carried to profit and loss account and treated as distributable.

Reductions of Capital and Other Reconstructions

67 Where the effect of a reduction of share capital or any other undistributable reserve is to free a reserve or part of a reserve, doubt arises as to whether the resulting reserve is distributable. No external transaction has taken place and the effect of the transaction arguably does not give rise to a “profit”. So far as capital maintenance policy is concerned, there is no objection to a distribution. There is also a strong argument that, at least in the case of share capital, such a reconstruction can be regarded as a realisation, since the effect of the capital reduction is a relief of the liability of the company in respect of the share capital in question. But these arguments have not been sufficient to allay the doubts.

Proposed Way Forward

68 Subject to consultation, it is our intention that the provisions of Schedule 4, including paragraph 12(a) and the other accounting principles, should cease to be in the Act. They would become a matter for accounting standards in their new form (see *Developing the Framework*, Chapter 5). The remit of the new accounting standards body would include implementation of the Fourth Directive on this matter. It would then be open to the ASB or its successor body to decide what terminology to use to implement the Directive. Section 262(3), which makes the meaning of the words “realised profit or loss” dependent on accounting practice would similarly be devolved. It would be for that body to decide whether to retain the rule or to replace it with a more detailed accounting standard defining the meaning of the concept. This would, of course, have to comply with the Directive and it will be seen from *Developing the Framework* (paragraph 5.59) that it is proposed that the Secretary of State should have a reserve power to direct such compliance *in extremis*.

69 This would not resolve the difficulty of whether an external transaction is necessary for a “realisation” or “making” of a profit, or incurring of a loss, to occur, but it would enable the rules to develop flexibly as developing practice and thinking allows. We would not expect that the standards body would have any difficulty with capital reductions etc., which are in essence transactions between companies and their shareholders.

70 The problems of Part VIII on distribution rules would not be resolved for these purposes unless the references to realised and unrealised profits and losses in that Part were removed and there was instead a cross reference to the accounting rules in a sufficiently open form to enable those rules to govern what was to be treated as an

actual profit or loss. We would be minded to favour such an approach which would also involve the ancillary provisions in Part VIII which are related to the realisation concept (i.e. sections 275 and 276) being devolved. This might be done by rephrasing the rules in Part VIII to refer to profits and losses which appear in the company's profit and loss account prepared in accordance with law and generally accepted accounting practice. However, this would need to be extended to cover those rare cases where a profit is treated as realised without being passed through the profit and loss account. An example is where a subsidiary is disposed of in respect of which a merger reserve was set up. On such a disposal the reserve becomes realised and the profits distributable but the resulting profit is not necessarily transferred to the profit and loss account. Express provision may be needed for cases such as this. Alternatively the reference in the distribution rules could be to profits and losses which are treated by generally accepted accounting practice and accounting standards as having been made or incurred with sufficient certainty and reliability that they ought to be regarded as contributing to or reducing a company's distributable profits.

71 It would be possible to go further and to remove the whole of Part VIII from the Act, allowing the whole question of what are distributable profits to be determined by accounting standards. (If the common law rules were removed at the same time this would also devolve the *Aveling Barford* problem as a matter of accounting rules.) However, we think this would be too radical a step. The basic structure of the legislation as to what profits are distributable seems to us too important a matter of principle to be removed from the control of Parliament.

Question 12: Do you agree that the definitions of the concepts of “realised” and “unrealised” profits and losses should be devolved on the new accounting standards body both for accounting purposes and for the purposes of the distribution rules, and the term “realised” removed from the legislation? If so, which of the approaches suggested above would you favour, or what other approach? If not, what would you suggest?

Question 13: Do you agree that it would not be appropriate to devolve the whole definition of what is to be regarded as distributable onto the accounting standards body?

PART IV: SPECIFIC RULES RELATING TO DISTRIBUTABLE PROFITS

72 Sections 270-276 provide in detail for the accounts and accounting rules to be used in determining whether a distribution can be made without contravening sections 263 and 264⁴. Subject to the views of consultees, we propose that these provisions should be delegated to the accounting standards body. However, if consultees believe that they should be retained in primary legislation we believe that some changes would be necessary.

73 We believe that the following elements of section 275, which contains a number of provisions relating to the treatment of assets in the relevant accounts, would need to be retained:

- a) the provision in section 275(1) that a provision, as defined in paragraphs 88 and 89 of Schedule 4, is to be treated as a realised loss. (The exception in this subsection is discussed below.) The Schedule 4 provisions have the effect here of requiring that all provisions for depreciation or diminution in value and for liabilities and charges reduce distributable reserves. It may be noted in this context that since the main body of Schedule 4 is likely (subject to consultation) to be devolved to an appropriate accounting standards body the substance of the Schedule 4 provisions would need to be enacted in the primary legislation if this provision were to be retained;
- b) the provision in section 275(2) which addresses the case where a fixed asset is revalued upwards, resulting in an unrealised profit. It is provided that if in a given period a sum is written off or retained for depreciation, the difference between that sum and the sum which would have been written off or retained had the asset not been revalued, is to be treated as a realised profit made over that period. The result is that the realised loss recorded for distribution purposes is the amount of depreciation and amounts written off which would have been charged if the asset had not been revalued upwards, which is appropriate, given that the revaluation does not augment distributable reserves. However, there may be a case for expressing this thought more simply, by providing that where provision is made for depreciation or diminution in value of a fixed asset in respect of which an unrealised profit is shown the amount of the realised loss attributable to those provisions should be the amount that would have been provided on the amount of the asset without the unrealised profit; and
- c) the provision in section 275(3) that where there is no record of the original cost of an asset, or none which can be obtained without unreasonable cost or delay, the company may take the value of the asset in the latest available record, made on or after the acquisition by the

⁴ This document does not address the provisions in sections 265, 268 and 279 which apply to investment, insurance and banking companies.

company, for the purpose of determining whether the company has made a profit or a loss on it.

74 Section 275(1) contains an exception to the effect that a provision need not be treated as a realised loss if it represents a diminution in the value of a fixed asset appearing on a revaluation of all the company's fixed assets, or all of them except goodwill. This exception is further elaborated in subsections (4)-(6). Subsection (4) allows the directors to count any consideration of the value at a particular time of a fixed asset as a revaluation; and subsection (5) qualifies this by providing that where there has been no actual revaluation, the exception in subsection (4) is only available if the directors are satisfied that the overall aggregate value of those assets is not less than their book value. We understand that when these provisions were introduced in 1980, it was contemplated that companies would undertake comprehensive revaluations of assets at regular intervals as one element in the adoption of current cost accounting. In that context, it was logical not to fix the company with a realised loss on one asset when the revaluation as a whole produced an unrealised profit. But in the present environment it seems to us that the exception in subsection (1) may be open to abuse, since it may offer companies the option of undertaking an opportunistic revaluation of all their fixed assets for the sole purpose of avoiding a realised loss on a particular asset known to have fallen in value. We are therefore inclined to suggest that the exception in section 275(1) should be omitted, and with it section 275(4)-(6). The effect will be substantially to simplify a provision which applies to all companies, even the smallest, and the logic and form of which is not easy to understand. However, the effect of this will be that any provision for diminution in value will reduce a company's distributable reserves, even though there are other recognised unrealised profits which would compensate, and even though there are no net unrealised losses. If it is agreed, however, that this section should be devolved in its entirety to the accounting standards body these issues can be resolved over time in that expert context.

Question 14: Do you agree that responsibility for provisions dealing with the matters covered in paragraphs 72-74 should be delegated together with responsibility for the form and content of accounts to the accounting standards body?

Question 15: If you do not agree with Question 14, do you agree that section 275(2) could usefully be more simply expressed along the lines suggested above, i.e. by providing that the amount of the provision for depreciation or diminution in value on a fixed asset which has been revalued to show an unrealised profit should be the amount which would have been provided but for the revaluation?

Question 16: Do you agree that the substance of the provisions of section 269-276, on relevant accounts for the application of the statutory distribution rules, should be preserved, with the omission of the exception to section 275(1), and with it section 275(4)-(6)?

75 Section 265 makes special provision permitting investment companies to make distributions in certain circumstances where this would otherwise be prohibited under Part VIII and sections 266 and 267 make supplementary provisions. Section 268

similarly makes special provision for long term (i.e. essentially life) insurance business requiring, in particular, realised profits allocated to long term policy holders to be left out of account. These sections make substantial provision modifying the distribution rules which it is proposed to retain in the primary legislation and should therefore be retained in the legislation. On the other hand section 269 makes provision for the treatment of development costs. It is suggested that this provision can be appropriately devolved to the accounting standards body.

Question 17: Do you agree that sections 265-268 should be retained substantially unchanged (apart from amendments consequential on other proposals in this document) in the primary legislation but that it would be appropriate to remove section 269, leaving the issue of the treatment as realised and as revenue in character of development costs to be settled by the accounting standards body?

76 Summary of Questions for Consultation:

1 How far do the provisions set out in paragraphs 14-21 (other than 1447) offer a sound basis for transitional provisions to accompany the abolition by law of par value shares, whether for all companies or for private companies only, and to the extent that they do not, in what respects should they be changed or extended?

2 In particular, does there need to be specific provision securing the appropriate effect in the new regime of references to par value and related terms in the company's memorandum and articles?

3 Do the various references in the provisions to shares issued before or after commencement need to be expressly extended to cover shares in contemplation but not yet issued – e.g. shares into which other issued securities may be converted?

4 Do you have any comments on the proposals for dealing with the four cases outlined in paragraph 23?

5 Are you aware of other cases where the adaptations needed to the existing provisions of the Act to accommodate a switch to npv shares are likely to cause difficulty, either for companies newly formed with npv, or for companies with par value shares converted by law to npv and whether in response to the needs of legislative provisions currently in place or in response to current commercial practice and existing legal relations?

6 Do you agree that the legislation should make clear that the statutory distribution rules apply to transfers of assets to members or to others at the direction or substantially at the direction of members, and that the amount of and existence of a distribution should be determined by reference to the company's accounts, including treating unrealised profits attributable to an asset distributed as realised and treating a "distribution" of an asset which is treated as without value in the books as not a distribution, so long, in either case, as the company would have no deficiency in distributable profits after the distribution?

7 Do you think that the legislation should also make clear that the distribution rules have effect in place of any rule of law prohibiting distributions as such, but without prejudice to the general fiduciary duties and duties of skill and care of directors and without prejudice to provisions in any enactment or in the company's constitution, provided that if a company has knowingly incurred any loss, which would have been deductible from distributable profits in the relevant accounts, since the balance sheet date for those accounts, that loss shall be deducted from the profit in ascertaining the amount of distributable profits available for distribution? Or do you consider that any existing common law rule that directors must not make distributions should also be preserved in addition to the general fiduciary duties of directors?

8 If you disagree with Questions 6 and 7, do you agree that the statutory distribution rules should be extended to provide that if a company has knowingly incurred any loss which would have been deductible from the distributable profits in the relevant accounts, since the balance sheet date for those accounts, that loss should be deducted as proposed under Question 7?

9 As an alternative to the proposals in Questions 6-8, do you consider that the Act should be amended to the effect that the amount of any distribution in kind should be determined, both for the purposes of Part VIII and at common law, solely by reference to the amount in the company's books (treating unrealised profits on the assets distributed as realised)? If so, do you think that the provision should only apply where the company has no deficiency in distributable reserves?

10 Do you consider that the proposals in Questions 6-8 and Question 9 would equally well remove the uncertainty surrounding the application of the distribution rules to intra-group transfers of assets at book value to which the case of *Aveling Barford* appears to have given rise? Which of the two proposals do you favour (bearing in mind that it is one of the underlying objectives of the Review to simplify the law and render it more accessible to users - objectives which arguably tend in favour of some variant of the first alternative which removes the common law regime)?

11 If you consider that neither of the proposals achieve the stated objective, do you have any suggestions as to how either or both might be adapted to achieve this aim? Do you have an alternative approach to suggest? Would you favour leaving the law as it stands, with no attempt to deal with the alleged difficulties of the *Aveling Barford* decision?

12 Do you agree that the definitions of the concepts of "realised" and "unrealised" profits and losses should be devolved on the new accounting standards body both for accounting purposes and for the purposes of the distribution rules, and the term "realised" removed from the legislation? If so, which of the approaches suggested above would you favour, or what other approach? If not, what would you suggest?

13 Do you agree that it would not be appropriate to devolve the whole definition of what is to be regarded as distributable onto the accounting standards body?

14 Do you agree that responsibility for provisions dealing with the matters covered in paragraphs 72-74 should be delegated together with responsibility for the form and content of accounts to the accounting standards body?

15 If you do not agree with Question 14, do you agree that section 275(3) could usefully be more simply expressed along the lines suggested above, i.e. by providing that the amount of the provision for depreciation or diminution in value on a fixed asset which has been revalued to show an unrealised profit should be the amount which would have been provided but for the revaluation?

16 Do you agree that the substance of the provisions of section 269-276, on relevant accounts for the application of the statutory distribution rules, should be preserved, with the omission of the exception to section 275(1), and with it section 275(4)-(6)?

17 Do you agree that sections 265-268 should be retained substantially unchanged (apart from amendments consequential on other proposals in this document) in the primary legislation but that it would be appropriate to remove section 269, leaving the issue of the treatment as realised and as revenue in character of development costs to be settled by the accounting standards body?

ANNEX A

MEMBERSHIP OF COMPANY LAW REVIEW STEERING GROUP AND CAPITAL MAINTENANCE WORKING PARTY

Steering Group

Richard Rogers	Director, Company Law and Investigations, Department of Trade and Industry (Chairman)
The Hon Mrs Justice Arden DBE	High Court Judge, formerly Chairman of the Law Commission
Robert Bertram Sir Bryan Carsberg	Formerly partner Shepherd and Wedderburn WS Secretary-General, International Accounting Standards Committee
Paul Davies	Professor of Commercial Law, London School of Economics and Political Science
Sir Stuart Hampson John Kay*	Chairman, John Lewis Partnership plc London Economics
John Parkinson	Professor of Law, University of Bristol
Colin Perry	Chairman LTE Scientific Ltd
John Plender	Broadcaster and journalist
Rosemary Radcliffe CBE	Chief Economist, PricewaterhouseCoopers
Jonathan Rickford	Company Law Review Project Director
Bryan Sanderson CBE	Group Managing Director, BP Amoco plc
Martin Scicluna	Chairman, Deloitte & Touche
Richard Sykes QC	formerly Erskine Chambers

* - until March 2000

Working Party On Capital Maintenance

Jonathan Rickford Chairman

Outside Experts:

Martin Chester	Theodore Goddard
Charles Mayo	Simmons & Simmons
Malcolm Woodford	PricewaterhouseCoopers

ANNEX B

RECIPIENTS OF CONSULTATION DOCUMENT

Company Law Review Working Group B: Outside experts on Capital Maintenance

Brian Cheffins	University of Cambridge
Richard Regan	Association of British Insurers
David Sadler	Lloyds TSB
Ken Wild	Deloitte and Touche

Respondents to Questions on Capital Maintenance Raised in Previous Consultation Document

The Abbey National Group
The Accounting Standards Board
Arthur Andersen
Association of Accounting Technicians
Association of British Insurers
Association of Chartered Certified Accountants
The Association of International Accountants
Association of Investment Trust Companies
Babcock International Group plc
Barclays plc
Bevan Ashford Solicitors
Birmingham Chamber of Commerce and Industry
Birmingham Law Society
John Brady ACIS
Richard Brandt, University of Portsmouth
British American Tobacco
British Bankers Association
The British Chambers of Commerce
British Venture Capital Association
Buddenbrook Consultancy
Campbell Hooper Solicitors
City of London Law Society
Clifford Chance
Confederation of British Industry
Stephen Copp, University of Bournemouth
Janice Dean, Kingston University
Deloitte & Touche
Dundas Wilson
Ernst & Young
Faculty of Advocates
Sheila Fearnley, University of Portsmouth
Dr Eilis Ferran, University of Cambridge
Federation of Small Businesses

Financial Services Authority
Foreign & Colonial Management Ltd
Fork Truck Association
John Francies FCA
John A Franks, Chethams, Solicitors
Freshfields Solicitors
Garretts
General Council of the Bar
Halifax plc
Andrew Hicks, University of Exeter
HW Higginson
The Hundred Group of Finance Directors
Richard Hyde
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants of Scotland
The Institute of Chartered Secretaries and Administrators
Institute of Directors
Institute of Management and Research
International Accounting Standards Committee
Jordans
FAG Kay
KPMG
Labour Finance and Industry Group
K Lavanchy FCIS, FIMgt
The Law Society
The Law Society of Scotland
London Society of Chartered Accountants
London Stock Exchange
Lovells
MAI Services Pty Ltd
Moore Stephens
The National Association of Pension Funds Ltd
NatWest Group
Norwich Union Investment Management Ltd
Pannell Kerr Forster
PricewaterhouseCoopers
Railway Pension Investments Ltd
Royal Institute of Chartered Surveyors
KFJ Slade FCA
Slough Estates plc
Standard Life Assurance Company
Standard Life Investments Ltd
Dr Elaine Sternberg, University of Leeds
Brian G Strand FCA
KSV Thorogood Ceng, MIEE
UK Shareholders' Association
York Place Company Services Ltd

ANNEX C

SECTIONS 245C AND 1444-1449 OF THE AUSTRALIAN SECOND CORPORATE LAW SIMPLIFICATION ACT

Corporations Law - Sect 254C

No par value shares

Shares of a company have no par value.

Note: [Sections 1444 - 1449](#) contain application and transitional provisions that deal with the introduction of no par value shares. See also [subsection 169\(4\)](#).

Corporations Law - Sect 1444

Share capital application of new no par value rule to shares issued before commencement

[Section 254C](#) of the [new Law](#) applies to shares issued before [commencement](#) as well as shares issued after [commencement](#).

Corporations Law - Sect 1445

Share capital references to amount paid on shares issued before commencement

For the purposes of the operation of this Law after [commencement](#) in relation to a share issued before [commencement](#):

- (a) the amount paid on the share is the sum of all amounts paid to the company at any time for the share (but not including any premium); and
- (b) the amount unpaid on the share is the difference between the issue price of the share (but not including any premium) and the amount paid on the share (see paragraph (a)).

Corporations Law - Sect 1446

Share capital transfer of money in share premium account and capital redemption reserve into the share capital account

Immediately after [commencement](#), any amount standing to the credit of the company's share premium account and capital redemption reserve becomes part of the company's share capital.

Corporations Law - Sect 1447

Share capital use of amount standing to credit of share premium account

A company may use the amount standing to the credit of its share premium account immediately before [commencement](#) to:

- (a) provide for the premium payable on redemption of debentures or redeemable preference shares issued before [commencement](#); or
- (b) write off:
 - (i) the preliminary expenses of the company incurred before [commencement](#); or
 - (ii) expenses incurred, payments made, or discounts allowed, on or before [commencement](#), in respect of any issue of shares in, or debentures of, the company.

Note: After [commencement](#), a company will be able to issue bonus shares without transferring an amount to the share capital account (see [section 254A](#)).

Corporations Law - Sect 1448

Share capital calls on partly-paid shares

The liability of a shareholder for calls in respect of money unpaid on shares issued before [commencement](#) (whether on account of the par value of the shares or by way of premium) is not affected by the share ceasing to have a par value.

Corporations Law - Sect 1449

Share capital references in pre-commencement contracts and other documents to par value

(1) This section applies for the purpose of interpreting and applying after [commencement](#):

- (a) a contract entered into before [commencement](#) (including a company's constitution); or
- (b) a trust deed or other document executed before [commencement](#).

(2) A reference to the par value of a share is taken to be a reference to:

- (a) if the share is issued before **commencement** — the par value of the share immediately before **commencement**; or
- (b) if the share is issued after **commencement** but shares of the same class were on issue immediately before **commencement** — the par value that the share would have had if it had been issued then; or
- (c) if the share is issued after **commencement** and shares of the same class were not on issue immediately before **commencement** — the par value determined by the directors.

A reference to share premium is taken to be a reference to any residual share capital in relation to the share.

(3) A reference to a right to a return of capital on a share is taken to be a reference to a right to a return of capital of a value equal to the amount paid in respect of the share's par value.

(4) A reference to the aggregate par value of the company's issued share capital is taken to be a reference to that aggregate as it existed immediately before **commencement** and:

- (a) increased to take account of the par value of any shares issued after **commencement**; and
- (b) reduced to take account of the par value of any shares cancelled after **commencement**.