Defining a 'variation' of class rights

The only light thrown on this issue by the Act itself is in s 630(5) and (6). Section 630(5) states that amendment or insertion of a 'variation of rights' provision in the articles is itself a variation of rights. Section 630(6) deals with the extinction of rights but not the extinction of the share itself: *Re Saltdean Estate Co Ltd* **[10.03]**.

Paradoxically, the judges have not shown themselves anything like so solicitous for the interests of class members in the cases concerned with the interpretation of the term 'variation'. In many cases it may be possible to make class rights less effective without effecting any technical 'variation' of the rights themselves: this is illustrated by*White v Bristol Aeroplane Co* **[11.08]** and *Greenhalgh v Arderne Cinemas Ltd* **[11.09]**.

Right of dissenting member to object to court

CA 2006 s 633 gives dissenting members of a class, who hold at least 15% of the shares of that class, the right to challenge the variation in court within 21 days. They are thus given access to the court free from the hazards of *Foss v Harbottle* **[13.01]**, but the requirements of 15% and the need to act within 21 days may lead to difficulties, especially in a large company.

Rights enjoyed by a member may be class rights although they are not referable to particular shares.

[11.05] Cumbrian Newspapers Group Ltd v Cumberland and Westmorland Herald Newspaper and Printing Co Ltd [1987] Ch 1 (Chancery Division)

The plaintiff had acquired 10.67% of the ordinary shares in the defendant company ('Cumberland') in 1968 as part of an arrangement designed to concentrate the local newspaper publishing business under one title and to make it difficult for an outsider to acquire control of this paper. The articles of Cumberland were altered so that the plaintiff had (i) rights of pre-emption over the company's other ordinary shares (arts 7 and 9); (ii) rights in respect of unissued shares (art 5); and (iii) the right to appoint a director, so long as it held at least 10% of the shares (art 12). Scott J held that these were class rights enjoyed by the plaintiff which could only be altered pursuant to CA 1985 s 125 [CA 2006 s 630].

> **(p. 565)** SCOTT J: I turn to the critical question: are the plaintiff's rights under articles 5, 7, 9 and 12, rights attached to a class of shares?
>
> Rights or benefits which may be contained in articles can be divided into three different categories. First, there are rights or benefits which are annexed to particular shares. Classic examples of rights of this character are dividend rights and rights to participate in surplus assets on a winding up. If articles provide that particular shares carry particular rights not enjoyed by the holders of other shares, it is easy to conclude that the rights are attached to a class of shares, for the purpose both of s 125 of the Act of 1985 and of article 4 of Table A [1948]. It is common ground that rights falling into this category are rights attached to a class of shares for those purposes. Mr Howarth submitted at first that this category should be restricted to rights that were capable of being enjoyed by the holders for the time being of the shares in question. Such a restriction would exclude rights expressly attached to particular shares issued to some named individual, but expressed to determine upon transfer of the shares by the named individual. *Palmer's Company Precedents*, 17th edn (1956), Pt I, p 818, contains a form for the creation of a life governor's share in a company. Mr Howarth accepted that the rights attached to a share in accordance with this precedent would be rights attached to a class of shares. He accepted, rightly in my judgment, that a provision for defeasance of rights on alienation of the share to which the rights were attached, would not of itself prevent the rights, pre-alienation, from being properly described as rights attached to a class of shares. The plaintiff's rights under articles 5, 7, 9 and 12 cannot, however, be brought within this first category. The rights were not attached to any particular shares. In articles 5, 7 and 9, there is no reference to any current shareholding held by the plaintiff. The rights conferred on the plaintiff under article 12 are dependent on the plaintiff holding at least 10% of the issued ordinary shares in the defendant. But the rights are not attached to any particular shares. Any ordinary shares in the defendant, if sufficient in number and held by the plaintiff, would entitle the plaintiff to exercise the rights.

A second category of rights or benefits which may be contained in articles (although it may be that neither 'rights' nor 'benefits' is an apt description), would cover rights or benefits conferred on individuals not in the capacity of members or shareholders of the company but, for ulterior reasons, connected with the administration of the company's affairs or the conduct of its business. *Eley v Positive Government Security Life Assurance Co Ltd* **[4.36]** was a case where the articles of the defendant company had included a provision that the plaintiff should be the company solicitor. The plaintiff sought to enforce that provision as a contract between himself and the company. He failed. The reasons why he failed are not here relevant, and I cite the case only to draw attention to an article which, on its terms, conferred a benefit on an individual but not in the capacity of member or shareholder of the company. It is, perhaps, obvious that rights or benefits in this category cannot be class rights. They cannot be described as rights attached to a class of shares. The plaintiff in *Eley v Positive Government Security Life Assurance Co Ltd*was not a shareholder at the time the articles were adopted. He became a shareholder some time thereafter. It is easy, therefore, to conclude that the article in question did not confer on him any right or benefit in his capacity as a member of the company. In a case where the individual had been issued with shares in the company at the same time and as part of the same broad arrangement under which the article in question had been adopted, the conclusion might not be so easy. But if, in all the circumstances, the right conclusion was still that the rights or benefits conferred by the article were not conferred on the beneficiary in the capacity of member or shareholder of the company, then the rights could not, in my view, be regarded as class rights. They would not be rights attached to any class of shares …

In my judgment, the plaintiff's rights under those articles do not fall within this second category.

That leaves the third category. This category would cover rights or benefits that, although not attached to any particular shares, were nonetheless conferred on the beneficiary in the capacity of member or shareholder of the company. The rights of the plaintiff under articles 5, 7, 9 and 12 fall, in my judgment, into this category. Other examples can be found in reported cases.

In *Bushell v Faith* **[6.02]**, articles of association included a provision that on a resolution at a general meeting for the removal of any director from office, any shares held by that director should carry the right to three votes. The purpose of this provision was to prevent directors being removed from **(p. 566)** office by a simple majority of the members of the company. The validity of the article was upheld by the Court of Appeal and by the House of Lords; the reasons do not, for present purposes, matter. But the rights conferred by the article in question fall, in my view, firmly in this third category. They were not attached to any particular shares. On the other hand, they were conferred on the director/beneficiaries in their capacity as shareholders. The article created, in effect, two classes of shareholders—namely, shareholders who were for the time being directors, on the one hand, and shareholders who were not for the time being directors, on the other hand.

The present case is, and *Bushell v Faith* was, concerned with rights conferred by articles. The other side of the coin is demonstrated by *Rayfield v Hands* **[4.38]**. That case was concerned with obligations imposed on members by the articles. The articles of the company included an article entitling every member to sell his shares to the directors of the company at a fair valuation. In effect, the members enjoyed 'put' options exercisable against the directors. Vaisey J held that the obligations imposed by the article on the directors for the time being were enforceable against them. He held that the obligations were imposed on the directors in their capacity as members of the company. It follows from his judgment that, as in *Bushell v Faith*, there were in effect two classes of shareholders in the company. There were shareholders who were not for the time being directors, and shareholders who were for the time being directors: the former had rights against the latter which the latter did not enjoy against the former. The two classes were identifiable not by reference to their respective ownership of particular shares, but by reference to the office held by the latter. But the rights of the former, and the obligations of the latter, required their respective ownership of shares in the company. Accordingly, as a matter of classification, the rights in question fall, in my view, into the third category.

In the present case, the rights conferred on the plaintiff under articles 5, 7, 9 and 12 were, as I have held, conferred on the plaintiff as a member or shareholder of the defendant. The rights would not be enforceable by the plaintiff otherwise than as the owner of ordinary shares in the defendants. If the plaintiff were to divest

itself of all its ordinary shares in the defendant, it would not then, in my view, be in a position to enforce the rights in the articles. But the rights were not attached to any particular share or shares. Enforcement by the plaintiff of the rights granted under articles 5, 7 and 9, would require no more than ownership by the plaintiff of at least some shares in the defendant. Enforcement by the plaintiff of the rights granted under article 12 require the plaintiff to hold at least 10% of the issued shares in the defendant. But any shares would do. It follows, in my judgment, that the plaintiff's rights under the articles in question fall squarely within this third category.

The question for decision is whether rights in this third category are within the meaning of the phrase in s 125 of the Companies Act 1985 and in article 4 of Table A, rights attached to a class of shares. [His Lordship examined the language and the background of the section and concluded that this was the case.]

➢ Questions

1. The implications of this case are potentially far-reaching. In the *Bushell v Faith* case, for example, the director's right to deploy super-voting powers on a motion for his dismissal could only be changed by the class rights procedure (s 630, requiring his agreement, as the only member of the relevant class). If the director's right had been classified differently, it could have been changed by the statutory procedure for changing the articles (s 21, requiring a special majority of *all* the shareholders). Which is the preferable outcome? Which outcome was likely to have been contemplated at the time the right was created?

2. Where the rights are not specifically attached to a share issue, how can you tell whether rights are 'class rights' or rights under a shareholders' agreement (see 'Shareholders' agreements', pp 244ff and 'Classes of shares and class rights', pp 556ff)? What practical consequences flow from classifying rights one way or the other? In deciding on the appropriate classification, is it of any significance that a transfer from X to Y of the shares to which the special rights are **(p. 567)** allegedly attached would not be effective to transfer the special rights to Y—that is, the special rights are personal to X? See *Grays Timber Products Ltd v Commissioners for HM Revenue and Customs* [2010] UKSC 4, SC.

A vote on a resolution to modify class rights must be exercised for the purpose, or dominant purpose, of benefiting the class as a whole.

[11.06] British American Nickel Corpn Ltd v O'Brien [1927] AC 369 (Privy Council)

The company had issued mortgage bonds, secured by a trust deed, which provided (inter alia) that a majority of the bondholders, representing not less than three-fourths in value, might sanction any modification of the rights of the bondholders. A scheme for the reconstruction of the company, which involved a modification of the bondholders' rights, was approved by the requisite majority. However, it was objected that one of the bondholders, without whose vote the proposal would not have been carried, had been induced to give his support by a promise of a large block of ordinary stock. The Privy Council, affirming the decision of the Ontario courts, held that the vote was invalid.

The opinion of their Lordships was delivered by VISCOUNT HALDANE: To give a power to modify the terms on which debentures in a company are secured is not uncommon in practice. The business interests of the company may render such a power expedient, even in the interests of the class of debenture-holders as a whole. The provision is usually made in the form of a power, conferred by the instrument constituting the debenture security, upon the majority of the class of holders. It often enables them to modify, by resolution properly passed, the security itself. The provision of such a power to a majority bears some analogy to such a power as that … which enables a majority of the shareholders by special resolution to alter the articles of association. There is, however, a restriction of such powers, when conferred on a majority of a special class in order to enable that majority to bind a minority. They must be exercised subject to a general principle,

which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities; namely, that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only. Subject to this, the power may be unrestricted. It may be free from the general principle in question when the power arises not in connection with a class, but only under a general title which confers the vote as a right of property attaching to a share. The distinction does not arise in this case, and it is not necessary to express an opinion as to its ground. What does arise is the question whether there is such a restriction on the right to vote of a creditor or member of an analogous class on whom is conferred a power to vote for the alteration of the title of a minority of the class to which he himself belongs …

[T]heir Lordships do not think that there is any real difficulty in combining the principle that while usually a holder of shares or debentures may vote as his interest directs, he is subject to the further principle that where his vote is conferred on him as a member of a class he must conform to the interest of the class itself when seeking to exercise the power conferred on him in his capacity of being a member. The second principle is a negative one, one which puts a restriction on the completeness of freedom under the first, without excluding such freedom wholly.

The distinction, which may prove a fine one, is well illustrated in the carefully worded judgment of Parker J in *Goodfellow v Nelson Line*.[13] It was there held that while the power conferred by a trust deed on a majority of debenture-holders to bind a minority must be exercised bona fide, and while the court has power to prevent some sorts at least of unfairness or oppression, a debenture-holder may, subject to this, vote in accordance with his individual interests, though these may be peculiar **(p. 568)** to himself and not shared by the other members of the class. It was true that a secret bargain to secure his vote by special treatment might be treated as bribery, but where the scheme to be voted upon itself provides, as it did in that case, openly for special treatment of a debenture-holder with a special interest, he may vote, inasmuch as the other members of the class had themselves known from the first of the scheme. Their Lordships think that Parker J accurately applied in his judgment the law on this point …

Their Lordships are of opinion that judgment was rightly given for the respondents in this appeal … [It] is plain, even from his own letters, that before Mr JR Booth would agree to the scheme of 1921 his vote had to be secured by the promise of $2,000,000 ordinary stock of the Nickel Corporation. No doubt he was entitled in giving his vote to consider his own interests. But as that vote had come to him as a member of a class he was bound to exercise it with the interests of the class itself kept in view as dominant. It may be that, as Ferguson JA thought, he and those with whom he was negotiating considered the scheme the best way out of the difficulties with which the corporation was beset. But they had something else to consider in the first place. Their duty was to look to the difficulties of the bondholders as a class, and not to give any one of these bond-holders a special personal advantage, not forming part of the scheme to be voted for, in order to induce him to assent …

➤ Questions

1. Does the limitation described in this case require the shareholders to vote in the class meeting *in* the interests of the class (which might require self-denial of a fiduciary nature from individual shareholders whose own self-interest conflicts with the interests of the class), or does it merely require shareholders to vote for proper purposes (which might require shareholders not to use their power to achieve ulterior ends)? Does the requirement that shareholders vote bona fide add anything? How is such a power exercised *mala fide* ?

2. You are asked to advise a preference shareholder about a class meeting which is to be held to consider a scheme to replace the preference shares with debentures. There is evidence suggesting that this will be to the disadvantage of the preference shareholders as a class, but that the scheme as a whole will benefit the company. Should the preference shareholder have regard to the interests of the class, or of the company, in deciding how to cast her vote; or is she free to weigh the relative merits of each? (See *Re Holders Investment Trust Ltd* **[10.04]** and *Re Hellenic and General Trust Ltd* **[15.05]**, and contrast *Re Chatterley-Whitfield Collieries*

Ltd **[10.02]**.)

3. If all the members of a class are to take account of the same considerations when voting, will a resolution invariably be carried (or lost) by 100% to nil?

[11.07] Assénagon Asset Management SA v Irish Bank Resolution Corporation Ltd (Formerly Anglo Irish Bank Corporation Ltd) [2012] EWHC 2090 (Chancery Division)

This case concerned voting by classes of creditors, not shareholders, but similar rules were held to apply. The claimant was the holder of bonds ('2017 Notes') issued by the bank, which were subordinate to claims by secured and unsecured creditors in the event of insolvency, and ahead only of equity shareholders. Following the global financial crisis, the bank faced a liquidity crisis which resulted in its rescue by the Irish government. Following a series of measures, the government announced in September 2010 that it expected subordinated debt-holders to make a significant contribution towards meeting the costs to the bank in meeting its substantial losses. The bank subsequently adopted a technique known as 'exit consent' in respect of certain series of its notes, including the 2017 Notes. In essence, it was **(p. 569)** proposed that a holding of 20 cents of new notes (the 'New Notes') would be exchanged for every €1 of the 2017 Notes, that is, an exchange ratio of 0.20. In accepting the exchange proposal, the noteholders would also agree to vote in favour of an extraordinary resolution to vary the terms of the old 2017 Notes so as to enable the bank to redeem any outstanding 2017 Notes at a rate of €0.01 per €1,000, that is, a payment ratio of 0.00001 (the 'Resolution'). The combined effect of the exchange offer and the Resolution led to 92.03% of noteholders offering their notes for exchange and conditionally binding themselves to vote in favour of the Resolution. The Resolution was duly passed, and the bank exercised its newly acquired right to redeem the remaining 2017 Notes at the payment ratio of 0.00001. The claimant received €170 for its €17 million face value of 2017 Notes. The claimant challenged the validity of the exit consent technique as being an abuse by the majority noteholders of their power to bind the minority, albeit at the invitation of the issuer. The court allowed the claim.

BRIGGS J:

1. This [claim tests], for the first time, the legality under English law of a technique used by the issuers of corporate bonds which has acquired the label 'exit consent'. The technique may be summarised thus. The issuer wishes to persuade all the holders of a particular bond issue to accept an exchange of their bonds for replacement bonds on different terms. The holders are all invited to offer their bonds for exchange, but on terms that they are required to commit themselves irrevocably to vote at a bondholders' meeting for a resolution amending the terms of the existing bonds so as seriously to damage or, as in the present case substantially destroy, the value of the rights arising from those existing bonds. The resolution is what has become labelled the exit consent.

2. The exit consent has no adverse effect in itself upon a holder who both offers his bonds for exchange and votes for the resolution. That is either because the issuer nonetheless fails to attract the majority needed to pass the resolution (in which case both the resolution and the proposed exchange do not happen) or simply because, if the requisite majority is obtained, his bonds are exchanged for new bonds and cancelled by the issuer. By contrast, a holder who fails to offer his bonds for exchange and either votes against the resolution or abstains takes the risk, if the resolution is passed, that his bonds will be either devalued by the resolution or, as in this case, destroyed by being redeemed for a nominal consideration. This is in part because the efficacy of the technique depends upon the deadline for exchange being set before the bondholders' meeting so that, if the resolution is then passed, the dissenting holder gets no locus poenitentiae during which to exchange his bonds on the terms offered, and accepted in time, by the majority.

3. It is readily apparent, and not seriously in dispute, that the purpose of the attachment of the exit consent to the exchange proposal is to impose a dissuasive constraint upon bondholders from opposing the exchange, even if they take the view that the proffered new bonds are (ignoring the exit consent) less attractive than the existing bonds. The constraint arises from the risk facing any individual bondholder that a sufficient majority of his fellow holders will participate in the exchange and therefore (as required to do) vote for the resolution. The constraint is variously described in textbooks on both sides of the Atlantic as

encouraging, inducing, coercing or even forcing the bond-holders to accept the exchange.

4. The technique depends for its persuasive effect upon the difficulties faced by bondholders in organising themselves within the time allowed by the issuer in such a way as to find out before the deadline for accepting the exchange whether there is a sufficient number (usually more than 25% by value) determined to prevent the exchange going ahead by voting against the resolution. They were described in argument as facing a variant of the well-known prisoner's dilemma.

…

84. After some hesitation [and a review of all the relevant authorities], I have concluded that Mr Snowden [counsel for the claimant] arrived eventually at the correct question, which is whether it can be lawful for the majority to lend its aid to the coercion of a minority by voting for a resolution which expropriates the minority's rights under their bonds for a nominal consideration. In **(p. 570)** my judgment the correct answer to it is in the negative. My reasons derive essentially from my understanding of the purpose of the exit consent technique, as described at the beginning of this judgment. It is not that the issuer positively wishes to obtain securities by expropriation, rather than by the contractual exchange for value which it invites the bondholders to agree. On the contrary, the higher percentage of those accepting, generally the happier the issuer will be. Furthermore, the operation of the exit consent (here the Bank's new right to redeem for a nominal consideration) is not the method by which the issuer seeks to achieve the reconstruction constituted by the replacement of existing securities with new. The exit consent is, quite simply, a coercive threat which the issuer invites the majority to levy against the minority, nothing more or less. Its only function is the intimidation of a potential minority, based upon the fear of any individual member of the class that, by rejecting the exchange and voting against the resolution, he (or it) will be left out in the cold.

85. This form of coercion is in my judgment entirely at variance with the purposes for which majorities in a class are given power to bind minorities, and it is no answer for them to say that it is the issuer which has required or invited them to do so. True it is that, at the moment when any individual member of the class is required (by the imposition of the pre-meeting deadline) to make up his mind, there is at that point in time no defined minority against which the exit consent is aimed. But it is inevitable that there will be a defined (if any) minority by the time when the exit consent is implemented by being voted upon, and its only purpose is to prey upon the apprehension of each member of the class (aggravated by his relative inability to find out the views of his fellow class members in advance) that he will, if he decides to vote against, be part of that expropriated minority if the scheme goes ahead.

➤ Note

Note the way that Briggs J distinguished the facts of this case from *Azevedo v Imcopa Importacao Exportaacao e Industria de Oleos Ltda* [2012] EWHC 1839 (Comm) affd on appeal [2013] EWCA Civ 364:

79. In *Azevedo* the defendant issuer of notes with provisions for alteration by majority substantially similar to those here in issue proposed three successive resolutions postponing the payment of semi-annual interest payments, and in each case offering fully disclosed monetary inducements (described as consent payments) to all those voting in favour. The purpose of the postponements sought was to facilitate a restructuring of the issuer for the benefit of all its stakeholders. The claimant noteholder voted for the first two postponements and received the proffered inducements, but not for the third, which was nonetheless passed by the requisite majority, following which the underlying restructuring was approved by the Brazilian court.

…

81. Hamblen J rejected the claimant's case, concluding in particular that the open manner in which the

inducements had been offered prohibited any characterisation of them as bribery or fraud, following *Goodfellow* and *British American Nickel*. He also took comfort from the approval of 'consent payments' of a similar type by the Delaware courts and from academic comment that such payments had been a common feature of debt refinancing in the USA for some time.

82. I accept that there is, at least at first sight, some similarity between the 'consent payments' in the *Azevedo* case and the 'exit consent' technique adopted in the present case. It is just possible to characterise the offer of the New Notes as a financial inducement to vote in favour of the Resolution. Nonetheless I consider that characterisation to be flawed. The reality is the other way round. The Resolution is used as a negative inducement to deter Noteholders from refusing the proffered exchange.

83. More generally the differences between the two cases substantially outweigh their similarities. First and foremost, the resolutions to postpone the interest payments in the *Azevedo* case were the substance of that which the issuer (and in the event the majority of noteholders) wished to achieve, whereas in the present case the substance of the Bank's plan was to substitute New Notes for the Existing Notes by way of a contractual exchange. The Resolution in the present **(p. 571)** case was no more than a negative inducement to deter Noteholders from refusing the proffered exchange. Secondly it was the issuer in *Azevedo* which proffered the inducement, whereas here it is the majority of the Noteholders which (albeit at the issuer's request) wields the negative inducement constituted by the Resolution. Thirdly the postponements sought by the resolutions in *Azevedo* were plainly capable of being beneficial to noteholders, since they were designed to facilitate a reconstruction of the issuer, beneficial to all its stakeholders. Here the Resolution was designed in substance to destroy rather than to enhance the value of the Notes and was, on its own, of no conceivable benefit to Noteholders. Fourthly, no case of oppression or unfairness was advanced in *Azevedo*, only a case of bribery. Here by contrast the case is centred on alleged oppression, and bribery is not alleged at all.

➢ Questions

1. In *Assénagon*, if the majority vote had bound *all* the bondholders to accept €0.20 for each €1.00 Note, then would there have been any problem? The bondholders had agreed to majority rule, and a vote for such a proposal would not have been—at least on its face—tainted. By contrast, in *Assénagon* the dissenting minority did *not* get the deal accepted by the majority, but something far worse. Is *that* the material different between *Assénagon* and *Azevedo* ?

2. *Who* held the majority of the 2017 Notes at the time of the vote? The claimant argued, and Briggs J agreed (at [64]–[68]), that the exchange contract between the noteholders and the bank was specifically enforceable, and so the noteholders held the 2017 Notes on constructive trust for the bank.[14] Not only did this contradict the terms of the bond issue and its voting rules, but it made proof of improper purposes in the voting process still easier.

The rights of a class of shareholders are not altered, or even 'affected', by a change in the company's structure (or in the rights attached to other shares) if this change affects merely the enjoyment of such rights.

[11.08] White v Bristol Aeroplane Co [1953] Ch 65 (Court of Appeal)

Article 68 of the defendant company's articles provided that the rights attached to any class of shares might be 'affected, modified, varied, dealt with, or abrogated in any manner' with the sanction of an extraordinary resolution passed at a separate meeting of the members of that class. The plaintiff, on behalf of the preference shareholders, claimed that a proposal to increase the capital of the company by a bonus issue of new shares to the existing shareholders (to both preference and ordinary shareholders) 'affected' the voting rights attached to their shares, and therefore came within the terms of the article cited. The company's view, which was upheld by the Court of

Appeal, was that the rights themselves (as distinct from the enjoyment or the effectiveness of those rights) were not 'affected' by the proposal, so that no class meeting was required.

ROMER LJ: The rights attaching to the preference stockholders are those which are conferred by articles 62 and 83; and the only relevant article for present purposes is article 83. Under that article it is provided … that on a poll every member present in person or by proxy shall have one vote for every share held by him, or in the case of the preference stock, one vote for every £1 of preference stock held by him. It is suggested that, as a result of the proposed increase of capital, that right of the preference stockholders will in some way be 'affected'; but I cannot see that it will be affected in any way whatever. The position then will be precisely the same as now—namely, that the holder **(p. 572)** of preference stock will have on a poll one vote for every £1 of preference stock held by him. It is quite true that the block vote, if one may so describe the total voting power of the class, will, or may, have less force behind it, because it will pro tanto be watered down by reason of the increased total voting power of the members of the company; but no particular weight is attached to the vote, by the constitution of the company, as distinct from the right to exercise the vote, and certainly no right is conferred on the preference stockholders to preserve anything in the nature of an equilibrium between their class and the ordinary stockholders or any other class.

During the course of the discussion I asked Mr Gray [counsel] whether it would not be true to say that the logical result of his argument would be that the rights of ordinary shareholders would be affected by the issue of new ordinary capital on the ground that every one of the considerations on which he was relying would be present in such a case. The votes of the existing shareholders would be diminished in power; and they would have other people with whom to share the profits, and, on a winding up, to share the capital assets. In answer to that he was constrained, I think rightly, to say that was so. But in my opinion it cannot be said that the rights of ordinary shareholders would be affected by the issue of further ordinary capital; their rights would remain just as they were before, and the only result would be that the class of persons entitled to exercise those rights would be enlarged; and for my part I cannot help thinking that a certain amount of confusion has crept into this case between rights on the one hand, and the result of exercising those rights on the other hand. The rights, as such, are conferred by resolution or by the articles, and they cannot be affected except with the sanction of the members on whom those rights are conferred; but the results of exercising those rights are not the subject of any assurance or guarantee under the constitution of the company, and are not protected in any way. It is the rights and those alone, which are protected, and … the rights of the preference stockholders will not, in my judgment, be affected by the proposed resolutions …

EVERSHED MR delivered a concurring judgment.

DENNING LJ concurred.

[11.09] Greenhalgh v Arderne Cinemas Ltd [1946] 1 All ER 512 (Court of Appeal)

For later litigation between the same parties, see **[4.27]**. The company had issued ordinary shares of 10 *s* [50p] each and other ordinary shares of 2 *s* [10p] each (created in 1941), ranking *pari passu* for all purposes. On a poll, every member had one vote for each share held by him, which meant that Greenhalgh, who held the bulk of the 2 *s*shares, could control about 40% of the votes and so block a special resolution. The holders of the 10 *s* shares procured the passing of an ordinary resolution subdividing the 10 *s* shares into five 2 *s* shares, each ranking *pari passu* with the 1941 2 *s* shares. Greenhalgh objected unsuccessfully that the rights attaching to his 2 *s* shares were 'varied' by this manoeuvre.

LORD GREENE MR: Looking at the position of the original 2 *s* ordinary shares, one asks oneself: What are the rights in respect of voting attached to that class within the meaning of article 3 of Table A [of the 1929 Act; there is no equivalent in later Model Articles] which are to be unalterable save with the necessary consents of the holders? The only right of voting which is attached in terms to the shares of that class is the right to have one vote per share pari passu with the other ordinary shares of the company for the time

being issued. That right has not been taken away. Of course, if it had been attempted to reduce that voting right, eg by providing or attempting to provide that there should be one vote for every five of such shares, that would have been an interference with the voting rights attached to that class of shares. But nothing of the kind has been done; the right to have one vote per share is left undisturbed … I agree, the effect of this resolution is, of course, to alter the position of the 1941 2 *s* shareholders. Instead of Greenhalgh finding himself in a position of control, he finds himself in a position where the control has gone, and to that extent the rights of the 1941 2 *s* shareholders are affected, as a matter of business. As a matter of law, I am quite unable to **(p. 573)** hold that, as a result of the transaction, the rights are varied; they remain what they always were—a right to have one vote per share pari passu with the ordinary shares for the time being issued which include the new 2 *s* ordinary shares resulting from the subdivision.

In the result, the appeal must be dismissed with costs.

MORTON LJ delivered a concurring judgment.

SOMERVELL LJ concurred.

➢ Notes

1. See also *Re Saltdean Estate Co Ltd* **[10.03]** and *House of Fraser plc v ACGE Investments Ltd* (Note 1 following *Re Saltdean Estate Co Ltd* **[10.03]**, p 518), where it was held that no variation of rights was involved in the *cancellation* of a class of shares on a reduction of capital, this being consistent with the terms of issue of the shares in question.

Reference may also be made to *Re Hellenic and General Trust Ltd* **[15.05]**, where Templeman J ruled that, for the purposes of a scheme of arrangement under CA 1985 ss 425–427A [CA 2006 ss 895ff], ordinary shares owned by the intending purchaser's subsidiary constituted a different 'class' from ordinary shares owned by outsiders, although the terms of issue of all these shares were identical. This approach, taking account (as it does) of matters peculiar to the holder rather than to the shares themselves, is in strong contrast with that in the two cases last cited. However, it may be justified by reference to the wording of s 425, which refers to classes *of members* rather than classes *of shares* (CA 2006 s 895 is the same).

2. These cases deal with the *rights* of the different classes of shareholder as a matter of formal law. But an act which is within the rights of the controlling shareholders in this sense may nevertheless sometimes justify the grant of relief to minority members under CA 2006 s 994 (see 'Unfairly prejudicial conduct of the company's affairs', pp 681ff) or IA 1986 s 122(1)(g) (see 'Compulsory winding up on the "just and equitable" ground', pp 796ff).

Transfer of shares

This section examines the transfer of shares, but most of the remarks apply also to dealings in other company securities, such as loan stock or debenture stock. A number of general points can be made.

Shares in a company are in principle freely transferable, subject to any restrictions imposed by the company's articles of association (CA 2006 s 544). However, the articles of nearly all (if not all) private companies restrict their members' rights to transfer their shares. This is done to ensure control over the management and direction of the company.

Although a share is a chose in action, the transfer of shares is not governed solely by the ordinary rules of assignment of choses in action. The *legal* title to shares is transferred only by registration of the new holder's name in the company's register of members.[15] Oddly, it is not possible to find any categorical statement to this effect in the Companies Act, although it is perhaps implicit from a reading of ss 540ff. The rule goes back to the

days when shares normally had a substantial element of unpaid liability, and the act of registration established beyond argument the contractual bond of the new member to the company, so that his or her liability for calls could be enforced. (There was also probably some analogy with the transfer of government stock, where the requirement of registration is statutory.)

(p. 574) CA 2006 s 770 provides that a transfer of shares (or of company debentures[16]) cannot be registered (unless the transfer occurs by operation of law) unless: (i) a proper instrument of transfer has been delivered to the company; (ii) it is an exempt transfer within the Stock Transfer Act 1982; or (iii) it is a transfer undertaken in accordance with CA 2006 Pt 21, Ch 2, dealing with uncertificated transfers.

On ordinary contract law principles, specific performance will be ordered of contracts for the sale of company shares unless there is a ready market for the purchase of substitute shares, when a damage award will suffice (*Re Schwabacher* (1907) 98 LT 127).

Share certificates, uncertificated shares and dematerialised securities

The primary record of the ownership of company shares is the register of members (CA 2006 s 112). Companies may also provide their shareholders with share certificates, which provide evidence of ownership. Until 1996, every sale of shares had to be accompanied by the relevant share certificate. Since 1996, the London Stock Exchange has developed a centralised securities depository, called CREST,[17] which is a computer-based system that records title to shares and enables title to be transferred. When the title to a share is recorded in CREST, no share certificate is issued, and the share is said to be '*uncertificated*' or '*dematerialised*'. At present, only listed companies need to have uncertificated shares. In all other companies, shares are certificated.

Transfer of certificated securities

The holder of fully paid certificated shares transfers them by completing and signing a share-transfer form which indicates the name of the company, the details of the shares being transferred (number, nominal value, class), the consideration for the transfer (nil if by way of gift) and the name and address of both the transferor and the transferee.[18]

In the simplest case of a sale of all the shares represented on one share certificate, the transferor sends the completed transfer form, plus the share certificate,[19] to the transferee, who pays the price and the relevant stamp duty, and requests the company to register the transfer. The transfer is recorded by the company in the register of members and a new certificate, made out in the transferee's name, is issued to him. This procedure (prescribed by the Stock Transfer Act 1982) may be used for all fully paid securities even though the company's articles provide otherwise. Further practical steps are added if the transferor wants to sell only part of a holding denominated on one share certificate, or if the transferee wants the shares to be converted to uncertificated securities.

If a share transfer is made as a result of fraudulently forged share certificates, then anyone who suffers loss as a result can sue the fraudster in deceit (see 'Forged and fraudulent transfers', p 577). The same measure of remedy (ie as in deceit) is available against a company that makes a negligent false certification (CA 2006 s 775(3)), and the certification is taken to have been made by the company if it was issued and signed by the person authorised to issue certifications (s 775(4)(b)) (see *Balkis Consolidated Co v Tomkinson* **[11.12]**).

Under the Model Articles for private companies, art 25, and the Model Articles for public companies, art 49, a member will be supplied with a replacement for a certificate that is damaged or defaced, or which is said to be lost, stolen or destroyed.

(p. 575) Transfer of uncertificated shares

The rules noted previously apply in the main to shares (or other securities) not traded on a public market. Although the rules could apply in a wider context, most purchasers of publicly traded shares use a different process. For shares traded on a public market, the Listing Rules do not permit any restrictions on transferability; the buyers and sellers deal through the Exchange, via a broker, not face-to-face; and the transfer is effected in uncertificated form, through CREST, on the basis of real-time delivery against payment. This electronic system of transfer reduces

costs and risks.

As mentioned earlier, CREST is a computer-based securities transfer settlement system which enables securities to be transferred electronically without a written instrument, and title to be evidenced without a certificate. CREST came into operation in July 1996. It is operated by a company called CRESTCo Ltd, authorised for the purpose by the Financial Conduct Authority under powers delegated by the Treasury. Securities held on CREST are recorded in electronic form and are transferred by means of electronic instructions received from participating members (primarily brokers), subject to elaborate provisions for security. Participation in the CREST scheme is optional, in the sense that a company may choose to have some or all of its securities held in uncertificated form, and there is also an option for any individual holder of the securities to hold his or her securities in one form or the other.

Until 2001, CREST did not itself maintain any register of holders, but merely provided a settlement system, and an instruction to the company to amend its share register accordingly. An entry in the company's register remained evidence of title in the same way as if the entry related to certificated securities. Since 2001, CRESTCo has maintained an Operator register (separate from the company's own register), and registers the transfers immediately they occur. The Operator register is prima facie evidence of the title to uncertificated shares (just as the company's register is for certificated shares).

Restrictions on transfer: directors' approval and pre-emption rights

Listed companies are not permitted to impose restrictions on transfer. Private companies typically do, however. The two provisions most commonly found are: (i) an article giving the directors a discretion to refuse to register any transfer (see Model Articles art 26(5)[20]), and (ii) some form of pre-emptive right for existing members. A transfer of certificated shares is not complete until the transfer is registered in the company's register of members. After paying for the shares and before registration, the transferee only has an equitable interest in the shares.

If the directors are given absolute discretion to refuse to transfer the shares, they must, as directors, exercise this power bona fide and for proper purposes: see 'Duty to act within powers: CA 2006 s 171', pp 331ff, and *Re Smith and Fawcett Ltd* **[11.10]**. CA 2006 s 771(1) requires the directors to consider the matter and either register the transfer or give the transferee notice of and reasons for refusal as soon as practicable and, in any event, within two months. The reasons for refusal must be such as may reasonably be requested, but need not extend to the minutes of board meetings at which the matter was considered.

If transfers are subject to pre-emption rights (requiring the shares to be offered first to the existing shareholders), then directors must refuse to register transfers to outsiders until this is done. Absent this, the existing shareholders' equitable interest in the shares takes priority over the transferee's equitable interest under the sale: *Tett v Phoenix Property and Investments Co Ltd* [1984] BCLC 599.

(p. 576) ***Where the articles confer on the directors a discretion to refuse to register a transfer of shares, they must exercise their power bona fide and for proper purposes; but, subject to this qualification, they may be given an absolute discretion.***

[11.10] Re Smith and Fawcett Ltd [1942] Ch 304 (Court of Appeal)

Article 10 of the company's articles provided that the directors might in their absolute and uncontrolled discretion refuse to register any transfer of shares. There were only two directors and shareholders, Smith and Fawcett, who held 4,001 shares each. After Fawcett's death, Smith and a co-opted director refused to register a transfer of his shares into the names of his executors, or one of them; but Smith offered instead to register 2,001 shares and to buy the remaining 2,000 shares at a price fixed by himself. The court refused to intervene in the exercise of this discretion without evidence of *mala fides*.

> LORD GREENE MR: The principles to be applied in cases where the articles of a company confer a discretion on directors with regard to the acceptance of transfer of shares are, for the present purposes, free from doubt. They must exercise their discretion bona fide in what they consider—not what a court may consider—is in the interests of the company, and not for any collateral purpose. They must have regard to those considerations, and those considerations only, which the articles on their true construction permit