FURTHER COMMENTARY AND PROPOSALS FOR AMENDMENTS TO THE COMPANIES ACT 2014 (SUBMISSION NO. 4)

DEPARTMENT OF BUSINESS, ENTERPRISE AND INNOVATION

OCTOBER 2017
ABOUT THE LAW SOCIETY OF IRELAND

The Law Society of Ireland is the educational, representative and regulatory body of the solicitors' profession in Ireland.

The Law Society exercises statutory functions under the Solicitors Acts 1954 to 2011 in relation to the education, admission, enrolment, discipline and regulation of the solicitors' profession. It is the professional body for its solicitor members, to whom it also provides services and support.

The headquarters of the organisation are in Blackhall Place, Dublin 7.
1. Introduction

1.1 The Law Society of Ireland (the “Law Society”) wishes to make the following submissions in the interests of clarifying some of the provisions, and removing technical anomalies, in the Companies Act 2014 (‘the Act’).

1.2 Recommendations and issues covered within this submission include:

- Domestic mergers – section 462.
- Mergers by absorption – section 463.
- Acquisition of own shares – Part 3 of Chapter 6.
- Variation in class rights – section 88.
- Definition of ‘relevant sum’ – section 126.

2. Domestic Mergers – Section 462

2.1 Section 462(b) of the Act provides that Chapter 3 of the Act (which provides for domestic mergers) only applies if at least one of the merging companies is a private company limited by shares. This seems to be an unnecessary restriction which can require re-registration of companies just to acquire eligibility to implement a domestic merger.

Recommendation

2.2 The Law Society believes that section 462 should be amended by the deletion of section 462(b).

3. Mergers by Absorption – Section 463(2)

3.1 Section 463(2) of the Act defines a merger by absorption as “an operation whereby……a company transfers all of its assets and liabilities to a company that is the holder of all of the shares representing the capital of the first-named company..” and the subsidiary company is then dissolved without going into liquidation. This appears to require that only one company can transfer its assets and liabilities to another company by way of merger by absorption.

3.2 This creates a burden in a group restructuring scenario where a company wishes to acquire the assets and liabilities of a number of its wholly owned subsidiaries in a court approved merger by absorption. Each wholly owned subsidiary will need to have its merger with the successor company approved separately as opposed to them being approved together. This could prove costly where the court approval procedure is used and there are a large number of companies involved.
3.3 In the only merger to date that has used the court procedure, the court agreed to treat the companies’ applications as one composite application but this was a concession specific to the circumstances because of the charitable status of the particular companies involved and was by no means a precedent.

Recommendation

3.3 The Law Society is not aware of any policy reason why a group of subsidiary companies wholly owned by the same parent company could not take part in the application for the approval of a merger by absorption and would ask the Department to consider an amendment to section 463(2) to include more than one subsidiary company.

4. Acquisition of Own Shares Under Part 3 of Chapter 6

4.1 Clarification is required on the status of own shares acquired by a company pursuant to a merger or division under Chapter 3 or 4 of Part 9 (as permitted by section 102 of the Companies Act 2014) such as what rights attach to them (if any), how they should be categorised in the accounts of Successor Company, and whether they can be re-issued or cancelled. The definition of “Treasury Shares” in section 106(1) appears to cover shares acquired by a company under section 105, or otherwise acquired by it under section 102(1)(a)” but nothing else.

Recommendation

4.2 The Act should be amended to provide that, where a company acquires its own shares pursuant to a merger or division under Chapter 3 or 4 of Part 9, those shares can be either cancelled or categorised as Treasury Shares.

5. Section 88 - Variation in Class Rights

5.1 In drafting section 88, each reference to "memorandum of association" and "articles of association" was replaced with a single reference to "constitution" which had unintended consequences in relation to variation of class rights.

5.2 This creates an issue for a company which has shares with different classes but the constitution of which does not provide for a variation of class rights. The effect of section 88 is that such rights may only be amended with the approval of all shareholders which is unlikely to have been the intention of the Company Law Reform Group or the legislature. For DACs (under section 982), unanimous approval is only required if the rights attaching to a class of shares are contained in a company's memorandum of association. This approach follows the provisions from the "old"
legislation. In effect, rights which were included in articles of association of a company prior to its re-registration as a private company limited by shares (LTD), or rights included in a constitution on incorporation as an LTD are “entrenched” in the same way as if they had been included in a memorandum of association.

5.3 The drafting of Section 88 also gives rise to an issue if the provision for variation in class rights is not included at the time of incorporation of the company. At the time of incorporation a company may have only one class of shares so it may not be relevant then, but may subsequently become relevant.

Section 88(4) — variation of rights not connected with an allotment or reduction in capital

5.4 Under Section 88(4), where the rights are attached to a class of shares by the constitution or otherwise and

(a) where they are attached by the constitution, it contains provisions which were included at the time of incorporation; or
(b) where attached otherwise, the constitution contains such provision (whenever first so included)

and in either case the variation does not concern allotment or capital reduction, those rights may be varied in accordance with the constitution.

Section 88(5) — variation of rights where constitution is silent on variation

5.5 Under Section 88(5), where the rights are attached to a class of shares by the constitution and the constitution is silent on variation of rights, then they may only be varied if all the members of the company agree.

5.6 If a company’s constitution is silent on variation of class rights or if in certain circumstances a provision or variation of class rights was not included at the time of its incorporation, minority shareholder(s) would have an effective veto over a corporate transaction by the company involving the variation of class rights (including for example the creation or issue of new shares carrying preferential rights).

Recommendations

5.7 It is proposed that section 88 be simplified so that class rights can be varied with the consent of 75% of the class or, if the constitution includes provision for their variation, in accordance with such provision. This is not inconsistent with section 982 for DACs as it applies to class rights included in articles of association. It is also the approach adopted in the UK in relation to variation of class rights as provided for in section 630 of the UK Companies Act 2006.
5.8 The drafting of Section 88 is somewhat complicated and is not in line with overall aims of simplification of legislation in its application to LTDs.

5.9 It is proposed that section 88 be replaced with a section similar to section 630 of the UK Companies Act 2006 as follows:

**Section 88**

(1) This section is concerned with the variation of the rights attached to a class of shares in a private company limited by shares.

(2) Rights attached to a class of a company's shares may only be varied—

(a) in accordance with a provision in the company’s constitution for the variation of those rights, or

(b) where the company’s constitution contain no such provision, if the holders of shares of that class consent to the variation in accordance with this section.

(c) This is without prejudice to any other restrictions on the variation of the rights.

(3) The consent required for the purposes of this section on the part of the holders of a class of a company's shares is—

(a) consent in writing from the holders of at least three-quarters in nominal value of the issued shares of that class (excluding any shares held as treasury shares), or

(b) a special resolution passed at a separate general meeting of the holders of that class sanctioning the variation.

(4) Any amendment of a provision contained in a company's constitution for the variation of the rights attached to a class of shares, or the insertion of any such provision into the constitution, is itself to be treated as a variation of those rights.

(5) In this section, and (except where the context otherwise requires) in any provision in a company's constitution for the variation of the rights attached to a class of shares, references to the variation of those rights include references to their abrogation.

In adopting the above approach, there will be no distinction between variation of rights arising on the giving, variation, revocation or renewal of a Section 69 authority or reduction in capital from a variation arising otherwise, which is appropriate for LTDs. An LTD need not have an authorised share capital and as directors’ authority to allot shares need not be limited in time, it is possible to have an allotment of shares that is not in connection with the giving, variation, revocation or renewal of a Section 69(1) authority.
5.10 Alternatively section 88 could be amended as follows:

88. (1) This section shall have effect with respect to the variation of the rights attached to any class of shares in a company whose share capital is divided into shares of different classes, whether or not the company is being wound up.

(2) Where the rights are attached to a class of shares in the company otherwise than by the constitution, and the constitution does not contain provisions with respect to the variation of the rights, those rights may be varied if, but only if-
   (a) the holders of 75 per cent, in nominal value, of the issued shares of that class, consent in writing to the variation; or
   (b) a special resolution, passed at a separate general meeting of the holders of that class, sanctions the variation,
and any requirement (however it is imposed) in relation to the variation of those rights is complied with, to the extent that it is not comprised in the requirements in paragraphs (a) and (b).

(3) Where—
   (a) the rights are attached to a class of shares in the company by the constitution or otherwise; and
   (b) the constitution contains a provision for the variation of those rights; those rights shall not be varied unless—
      (i) the requirement in subsection (2)(a) or (b) is satisfied; and
      (ii) any requirement of the constitution in relation to the variation of rights of that class is complied with to the extent that it is not comprised in the requirement in subsection (2)(a) or (b).

(4) Where the rights are attached to a class of shares in the company by the constitution and it does not contain provisions with respect to the variation of the rights, those rights may be varied if the requirements in 2(a)or (b) is satisfied.

(5) Where a resolution referred to in any of the preceding subsections is to be proposed at a meeting of members holding a particular class of shares—
   (a) the necessary quorum at any such meeting, other than an adjourned meeting, shall be 2 persons holding or representing by proxy at least one-third in nominal value of the issued shares of the class in question and at an adjourned meeting one person holding shares of the class in question or his or her proxy;
   (b) any holder of shares of the class in question present in person or by proxy may demand a poll.

(6) Any amendment of a provision contained in the constitution of a company for the variation of the rights attached to a class of shares or the insertion of any such provision into the company’s constitution shall itself be treated as a variation of those rights.
(7) References to the variation of the rights attached to a class of shares in—
(a) this section; and
(b) except where the context otherwise requires, in any provision for the
variation of the rights attached to a class of shares contained in the
company's constitution,
shall include references to their abrogation.

(8) Nothing in subsections (2) shall be read as derogating from the powers of
the court under sections 212, 451 and 455.

(9) Save where the company's constitution provides otherwise, the rights
conferred upon the holders of the shares of any class issued by a
company with preferred or other rights shall not, unless otherwise
expressly provided by the terms of issue of the shares of that class, be
deemed to be varied by the creation or issue of further shares ranking pari
passu therewith.

6. Definition of “relevant sum” in section 126 of the Act.

6.1 Section 126 of the Act deals with the extent to which a company may utilise reserves
to pay up and issue bonus shares. When compared to the corresponding provisions in
Table A at Regulation 130A of the Companies Act, 1963, this provision is more
restrictive in terms of the definition of reserves which may be applied in this way.
Furthermore, the manner in which a company’s constitution can provide for a less
restrictive application of reserves in this way is unclear.

6.2 The Law Society recommends that a clarifying amendment be made to bring Section
126 into line with the corresponding provision in Table A to the 1963 Act or in the
alternative to more clearly set out the manner in which a company’s constitution may
contain provisions which qualify the effect of section 126.

Ability to capitalize reserves

6.3 Pursuant to section 126 of the Act, a company in general meeting may, on the
recommendation of the directors, resolve that it is desirable to capitalise any part of a
relevant sum which is not available for distribution, by applying such sum in paying up
in full unissued shares to be allotted as fully paid bonus shares, to those members of
the company who would have been entitled to that sum if it were distributed by way of
dividend (and in the same proportions).

6.4 “relevant sum” is defined in section 126 (2) as meaning:

a) Any sum for the time being standing to the credit of the company’s
undenominated capital;
b) Any of the company’s profits available for distribution; or
c) Any sum representing unrealised revaluation reserves.

6.5 Under the Companies Act 1963 (as amended), Regulation 130A of Table A provided that the company in general meeting could capitalise any part of the amount for the time being standing to the credit of any (emphasis added) of the company’s reserve accounts by allotting bonus shares. Section 126 appears to be narrower, in that certain reserves cannot be capitalised, as they fall outside the definition of “relevant sum”.

6.6 A reserve which arises on a capital contribution to a company of a non-cash asset could not be capitalised, for example, as it does not appear to fall within the definition of “relevant sum”, even though such a reserve could have been capitalised under previous legislation.

6.7 The Law Society understands that section 126 had initially been drafted to provide for a broader definition of “relevant sum” and to provide that any sum for the time being standing to the company’s reserves was capable of being capitalised. The definition was however amended to its current form by Government Amendment at Dáil Report Stage without explanation or parliamentary debate.

6.8 There does not appear to be a convincing public policy reason or a capital maintenance principle which underpins a requirement that Section 126 should be more restrictive than the regime permitted under the 1963 Act. While it is possible that some components of reserves may fluctuate in value, the directors in setting the valuation of reserves in its accounts must do so on a true and fair basis and, even if a reserve has been capitalised by a bonus issue, where the underlying asset decreases in value, this must be reflected by a provision in the company’s profit and loss account, thereby diminishing the ability to make distributions.

6.9 Furthermore, the capitalisation of a reserve which is or is not characterised as undistributable (such as a capital contribution designated as such) into bonus shares has the effect of making a distribution less likely. For example, it would prevent a reserve created by a capital contribution which has been designated as undistributable from being redesignated as distributable and being distributed. Also, reserves which are undistributable without a summary approval procedure under Section 118 of the Act might, absent the restriction in section 126, be capitalised by a bonus issue, again resulting in a decreased likelihood of distributions. We do not consider that if a company wishes to treat its undistributable reserves in this way, that it is the interests of any stakeholder in a company that it should be prevented from doing so.

Clarification required regarding the phrase “save where the company’s constitution provides otherwise”?
6.9 Section 126 of the Act is stated to apply “save where the company’s constitution provides otherwise”. This suggests that it should be possible for the company’s constitution to explicitly permit the capitalisation of reserves which do not fall within the definition of “relevant sum”. However, we are aware of a view which suggests that the phrase “save where the company’s constitution provides otherwise” means that the constitution may take away the power to capitalise “relevant sums”, rather than suggesting that the constitution could confer an even wider power, such as a power for the company to capitalise undistributable reserves which do not come within the definition of “relevant sum”. The Law Society is of the view that official guidance would be useful in this respect.

6.10 The Law Society considers that it would provide certainty (and enable a consistent approach) if it were clarified that the phrase “save where the company’s constitution provides otherwise” confers a wide power on companies to explicitly permit the capitalisation of reserves which do not fall within the definition of “relevant sum”. We consider this to be a possible alternative to an amendment to section 126 as described at paragraph 6.9 so that, if it is regarded as desirable to reserve to shareholders the power to permit the board to capitalise certain undistributable reserves, this can be clearly reflected in section 126.

Recommendation

6.11 The Law Society recommends that consideration be given to two possible amendments to section 126 of the 2014 Act, by:

(i) Expanding the definition of “relevant sum” to include any of a company’s undistributable reserves or, as an alternative;

(ii) Clarifying the meaning of the phrase “save where the company’s constitution provides otherwise”, so that there is no doubt that a constitution can confer a broader or wider power on the company to capitalise all undistributable reserves.

We hope that the Department will find the above comments constructive and helpful. The Law Society will be happy to engage further with the Department if required.
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