

LAW SOCIETY SUBMISSION



PURCHASES AND REDEMPTIONS OF SHARES BY UNLIMITED COMPANIES – APPLICABILITY OF SECTION 105 OF THE COMPANIES ACT 2014 TO THE ULC AND PUC TYPES

DEPARTMENT OF JOBS, ENTERPRISE & INNOVATION

NOVEMBER 2015

1. Introduction and summary of the issue

- 1.1. The Law Society of Ireland (the "Law Society") wishes to raise the following concerns about Section 105 of the Companies Act 2014.
- 1.2. Under the provisions of the now-repealed Companies (Amendment) Act 1983, unlimited companies as well as limited companies were subject to the statutory rules (and the exceptions thereto) on the making of distributions by a company, and this was seen as an unnecessary restriction on the ability of an unlimited company to reduce its share capital in any way.
- 1.3. The effect of Section 1255 of the Companies Act 2014 (the 2014 Act) is that an unlimited company is not required to ensure that it has distributable profits before it makes a dividend or other distribution to members of the company. This has generally been hailed as a welcome reform of Irish company law.
- 1.4. However, Section 105 of the 2014 Act has not been disappplied to the ULC (the private unlimited company with a share capital) or the PUC (public unlimited company with a share capital). Section 105 enables a company to acquire its own shares by purchase, or in the case of redeemable shares, by redemption or purchase, but also specifies that any such acquisition is subject to payment in respect of the shares being acquired being made out of distributable profits or, where the shares acquired are to be cancelled on acquisition, the proceeds of a fresh issue made for the purposes of the acquisition.
- 1.5. As explained further below, the applicability of Sub-sections 105 (2) & (3) to the ULC and PUC types may not have been intended, as it represents a reversal of the position that applied to the PUC or ULC regarding the purchase/redemption of its own shares prior to the commencement of the 2014 Act.
- 1.6. The effect of the application of Sub-sections 105 (2) & (3) is that, while a ULC or PUC is permitted by Section 1255 to make a distribution to its members without requiring distributable profits to do so, it appears that the ULC or PUC will require distributable profits in order to redeem or purchase its shares, unless it can fund the acquisition out of the proceeds of a fresh issue.
- 1.7. It is of course true that where the ULC or PUC wishes to redeem or purchase shares, but has no distributable profits with which to do so and cannot fund the acquisition out of the proceeds of a fresh issue, it is permitted to rely on Section 1252 of the 2014 Act, which permits an unlimited company to reduce its company capital in any way it thinks expedient, including by paying off any paid-up company capital which is in excess of the wants of the company. "Company capital" is defined to include share premium (see s.64 (1) and (2) of the 2014 Act). While a special resolution to reduce the company capital of an unlimited company must not have the effect that the company no longer has any members (see s. 1252(2)), a capital reduction could achieve the same result as a redemption of shares by the unlimited company, in that the company will be able to return the par value plus any premium to the members by means of the paying off of paid-up company capital.

- 1.8. However, it is the view of the Law Society that, as it stands, the law in this respect is anomalous and may operate as a technical trap for the directors of a ULC or PUC. This can be illustrated by the following example.

Example:

A ULC or PUC has an authorised share capital of €2,000,000 and has 1,500,000 shares in issue which are fully paid up for cash at par. It is now lawful for such a company to pay a dividend of say €1 million to the members of the ULC or PUC, without requiring distributable profits to fund that dividend. Similarly, the company could return the same amount to the members, by means of a reduction of company capital pursuant to Section 1252.

However, if the company for whatever reason wants to achieve the same result by means of a straightforward purchase of 1,000,000 of its issued shares at par for €1 million, it would appear to be unsafe for the company to do so, having regard to Sub-section 105 (2), without ensuring that either there are distributable profits of at least €1 million with which to fund the purchase, or that the purchase is funded out of the proceeds of a fresh issue of shares made for the purpose.

- 1.9. The Law Society is not aware of any legal reasons why a ULC or PUC should now be restricted by the provisions of Section 105 in this respect where it was not previously so restricted under the Companies Act 1990. Further, it is difficult to understand the rationale for the applicability of the distribution rules in Section 105 to these company types, when at the same time Section 1255 disapplies the provisions of Chapter 7 of Part 3 as well as common law rules on the making of distributions by such companies.
- 1.10. The point is not, in the Law Society's view, an academic one, as potentially there could be adverse consequences for the directors of the ULC or PUC which purchased its shares if Section 105 was not complied with and it was alleged (for example, by a disaffected member or by a creditor or liquidator in the event of a subsequent insolvency) that the directors had breached their statutory duty under Section 223 to ensure compliance by the company with the provisions of Sub-sections 105 (2) & (3), by enabling the purchase by the ULC or PUC of its shares, without having had either distributable profits or the proceeds of a fresh issue with which to fund that purchase.

2. Application of Section 105 to the ULC and PUC

- 2.1. Following the standard architecture employed throughout the 2014 Act, Part 19 provides (at Section 1230) that all the provisions of Parts 1 to 14 thereof apply to the three unlimited company types, unless disapplied or modified by Section 1230 (including the Table set out in that Section) or by any other provisions of Part 19 of the 2014 Act.
- 2.2. Section 105 is housed within Chapter 6 of Part 3, dealing with acquisitions of own shares. While the bulk of that Chapter is disapplied to the PULC by Part 3 of the Table in Section 1230, neither that Section nor the Tables therein applicable to the ULC or PUC

types, nor any other provision of Part 19 relating to unlimited companies, disapplies or modifies the application of Section 105 as regards the ULC or the PUC.

- 2.3. Section 1255 of the 2014 Act operates to disapply the provisions of Chapter 7 of Part 3, and also any rule of law on the making of distributions out of a company's capital, to an unlimited company. However as pointed out above, Section 105 is housed within Chapter 6 of Part 3, rather than Chapter 7 of that Part, and while the expression "rule of law" is not defined by the 2014 Act, based on case law it is likely that this will be interpreted by a Court as referring only to the well-known common law authorities on the making of distributions, and would not be construed by a Court as including express statutory provisions, such as Section 105, contained in other Chapters of the Act.
- 2.4. Consequently, it is the view of the Law Society that all of Section 105 applies to the ULC and PUC.

3. Comparison with previous position under Companies Act 1963 - 2013

- 3.1. Prior to June 1 2015, an unlimited company was not affected by the then applicable statutory provisions relating to the redemption or purchase of shares which required any such acquisition to be funded either out of distributable profits or, alternatively, the proceeds of a fresh issue of shares made for that purpose. This was because the restrictions in Section 207 of the Companies Act 1990 (the forerunner of Section 105 of the 2014 Act) did not apply to unlimited companies, but only applied to companies limited by shares or by guarantee and having a share capital (see subsection (1) of Section 207 of the 1990 Act).
- 3.2. The effect of Section 1230, in applying Section 105 to the ULC and PUC types, is therefore to reverse the position relating to the purchase or redemption of own shares by such companies. It is unlikely in our view that the Oireachtas deliberately intended to change the law for unlimited companies under the Companies Act 1990, relating to the redemption and purchase of shares, by applying Section 105 to the ULC and PUC types, and we are unaware of any recommendation of any body, such as the CLRG, that the law be amended in this respect.

4. Recommendation

- 4.1. In the view of the Law Society, it is anomalous, and potentially a trap for the unwary director of a ULC or PUC, that under the 2014 Act such a company need not have distributable profits before it makes a dividend or other distribution to its members, but that the same company must have such profits before it can acquire its own shares, for example by way of a straightforward purchase of those shares, where it is not possible to fund this purchase out of the proceeds of a fresh issue.
- 4.2. It is recommended that the Act be amended at the earliest possible opportunity so as to disapply Sub-sections 105 (2) & (3) and the related Sub-sections of Sections 106 to 108 inclusive to the ULC and PUC types.
- 4.3. We hope the Department will find the above comments constructive and helpful. The Law Society would be happy to engage further with the Department, if required.
- 4.4. We would also like to take this opportunity to let the Department know that we have become aware of a number of other technical issues relating to various aspects of the 2014 Act, which are currently being investigated and may merit the making of additional submissions. We will be in contact with the Department in due course in this regard.

For further information please contact:

Cormac O Culain
Public Affairs Executive
Law Society of Ireland
Blackhall Place
Dublin 7
DX 79

Tel: 353 1 6724800
Email: c.oculain@lawsociety.ie