

COMPANIES ACT 2006

EXPLANATORY NOTES

COMMENTARY

Part 17: a Company's Share Capital

Chapter 10: Reduction of Share Capital

948. Section 135 of the 1985 Act lays down a statutory procedure under which a limited company may, if authorised by its articles, reduce its share capital. This requires a special resolution of the company's members and the reduction must be confirmed by the court. Companies limited by shares may also reduce their share capital under section 171 (private company redemption or purchase of own shares out of capital) and sections 146 to 147 of the 1985 Act (which require a public company which acquires shares in any of the specified ways, for example, through forfeiture for failure to pay up, to cancel those shares within a specified period), the provisions of both of which are carried forward by the Act. A reduction of capital may also occur as a result of the court making an order for the purchase by a company of its members' shares.
949. A company may wish to reduce its share capital for a variety of reasons, for example, where its capital is in excess of the company's wants or where the value of the company's net assets has fallen below the amount of its capital (as stated in the company's accounts) and the position is likely to be permanent.

Section 641: Circumstances in which a company may reduce its share capital

950. This section replaces section 135(1) and (2) of the 1985 Act. It sets out the circumstances and manner in which a company limited by shares may reduce its share capital. As recommended by the CLR (Final Report, paragraph 10.6), in future a private company limited by shares will be able to reduce its share capital using a new solvency statement procedure for capital reductions (see section 642).
951. A company may only reduce its share capital under section 135 of the 1985 Act if it is authorised to do so by its articles. In line with the recommendations of the CLR (Completing the Structure, paragraph 2.15), the requirement for prior authorisation in the articles has not been retained but, if it wishes, a company may restrict or prohibit a reduction of capital by making provision to this effect in its articles (see *subsection (6)*).
952. *Subsection (1)(a)* contains a signpost to a new provision, which will enable a private company limited by shares to reduce its share capital using the new solvency statement procedure (see above). In addition, private companies and public companies alike will continue to be able to use the current court approved procedure for capital reductions – which is retained in *subsection (1)(b)*.
953. In the case of a private company limited by shares which is proposing to use the new solvency statement procedure to effect a reduction of capital, the company may only reduce its share capital under *subsection (1)(a)* if it will have at least one member remaining after the proposed reduction (see *subsection (2)*). That member need only hold one share in the company but that share must not be a redeemable share. The

principle behind this requirement is that a private company limited by shares should not be capable of reducing its share capital to zero unless the reduction of capital is sanctioned by the court. This mirrors the existing equivalent provision in section 162(3) of the 1985 Act – which applies to a purchase of own shares.

954. Both the solvency statement procedure for capital reductions and the court-approved procedure require a special resolution of the company's members. Under *subsection (5)* a special resolution to reduce a company's share capital may not provide for the proposed reduction to take effect on a date later than the date on which the resolution to reduce capital takes effect. Under the solvency statement procedure a resolution to reduce capital will take effect when the documents referred to in section 644 have been registered by the registrar (see section 644(4)). This would operate to prevent a company passing a resolution on, say, 1st January stating that the reduction is to take effect on 1st October. Under the court approved procedure, the resolution will take effect on the registration of the court order and statement of capital or, in the context of a reduction forming part of a compromise or arrangement under Part 26, on delivery of those documents to the registrar (unless the court orders otherwise) (see section 649).

Section 642: Reduction of capital supported by solvency statement

955. This section sets out the conditions that must be satisfied in order for a private company limited by shares to reduce its share capital using the new solvency statement procedure.
956. The procedural requirements that the directors must follow when they propose a capital reduction using the solvency statement route are set out in *subsections (1) to (3)* which provides that the solvency statement made in connection with a reduction of capital by a private company cannot be made more than 15 days before the date on which the resolution to reduce capital is passed. It also provides that both the resolution and the solvency statement must be filed with the registrar in accordance with the provisions of section 644.
957. The solvency statement must also be made available to the company's members when they vote on the resolution to reduce capital and the procedure for providing a copy of the solvency statement to the members varies according to whether the resolution to reduce capital is proposed as a written resolution or at a meeting of the company's members (see *subsections (2) and (3)*). Whilst a failure to observe these procedural requirements will not affect the validity of the resolution to reduce capital, if a solvency statement which has not been provided to the company's members in accordance with the provision of this section is subsequently filed with the registrar, every officer of the company who is in default commits an offence (see section 644).

Section 643: Solvency statement

958. A solvency statement made under section 643 must be made by all of the directors. If one or more of the directors is unable or unwilling to make this statement, the company will not be able to use the solvency statement procedure to effect a reduction of capital unless the dissenting director or directors resign (in which case the solvency statement must be made by all of the remaining directors).
959. The solvency statement must be in the "prescribed form" and "prescribed" in this context means prescribed by the Secretary of State in regulations or by order made under the Act.
960. The solvency statement must state the date on which it is made and the name of each director of the company but there is no requirement that the directors must all be in the same location when they make this statement. The registrar will be able to make rules under section 1068 as to the form of the solvency statement.
961. In forming their opinions, the directors must take account of all the company's liabilities including contingent and prospective liabilities (see *subsection (2)*). So, in

circumstances where a company holds redeemable preference shares which, for the purposes of the accounting standards that applied to the company on the date that the directors made the solvency statement, are treated as liabilities, a proposed redemption or purchase of these shares in the relevant period should be treated as a contingent or prospective liability.

962. If the directors make a solvency statement without having reasonable grounds for the opinions expressed in it, and that statement is subsequently delivered to the registrar, every director who is in default commits an offence (see *subsection (4)*). The penalty for this offence is set out in *subsection (5)*.

Section 644: Registration of resolution and supporting documents

963. This section sets out the requirements as to delivery of the solvency statement and other key documents to the registrar. The resolution to reduce capital itself must be filed with the registrar within the same time period as currently applies – that is, within 15 days of the date that it is passed (see section 30) and it will not take effect until the solvency statement and statement of capital (see *subsections (1)* and *(2)*) are registered by the registrar. As with all circumstances where the company makes an alteration to its subscribed capital, the company is required to deliver a statement of capital to the registrar (see note on section 619).
964. In addition to making a solvency statement in accordance with section 643, the directors must also make a statement confirming that the solvency statement was made not more than 15 days before the date on which the resolution to reduce capital was passed and that this statement was provided to the company's members in accordance with section 642 – see *subsection (5)*.
965. In addition to the new offences which are set out in sections 643(4) (directors making solvency statement without reasonable grounds for the opinion expressed in it) and *subsection (7)* (company delivering solvency statement that was not provided to members to registrar), where a company fails to comply with any of the filing requirements under section 644, an offence is committed by the company and every officer of the company who is in default (see *subsection (8)*). The penalty for this offence is set out *subsection (9)*.

Sections 645 to 649: Reduction of capital confirmed by the court

966. These sections replace or restate various provisions in the 1985 Act that are concerned with reductions of capital confirmed by order of the court.
967. *Sections 645* and *646* restate section 136 of the 1985 Act which is concerned with the procedure for making an application to court to confirm a reduction of capital (including the creditors' right to object). If, on such an application, an officer of the company intentionally or recklessly conceals a creditor or misrepresents the nature or amount of a debt owed by the company, or is knowingly concerned in any such concealment or misrepresentation he commits an offence (see section 647). As now the court may make an order confirming the reduction of capital on such terms and conditions as it thinks fit (see section 648 which restates section 137 of the 1985 Act).
968. *Section 649* replaces section 138(1) to (4) of the 1985 Act. Under section 138 of that Act, a resolution to reduce capital using the existing court approved scheme takes effect when the court order confirming the reduction and minute of the reduction are registered by the registrar. The minute (which must be approved by the court) sets out key information regarding the company's share capital immediately after the reduction. Section 649 updates the 1985 Act provisions by replacing the current requirement for a minute of the reduction with a statement of capital (see note on section 619). Like the minute confirming the reduction, this statement must be approved by the court.

969. In line with the CLR's recommendations (Final Report, paragraph 13.11), *subsection (3)(a)(i)* of this section provides that a reduction of capital that forms part of a compromise or arrangement under Part 26 of the Act will take effect at the same time as other aspects of that compromise or arrangement: namely on delivery of the court order confirming the reduction (and statement of capital approved by the court) to the registrar (unless the court orders that it should take effect on the registration of these documents) (see new *subsection (3)(a)(ii)*).
970. In all other cases, that is, where the reduction of capital does not form part of a compromise or scheme of arrangement under Part 26, where a company reduces its share capital using the court approved procedure the reduction will, as now, take effect on registration of the court order confirming the reduction (and statement of capital) by the registrar. *Subsection (5)* requires the registrar to certify the registration of the order and statement of capital. *Subsection (6)* restates section 138(4) of the 1985 Act in relation to such certificate.

Section 651: Expedited procedure for re-registration as a private company

971. This section, together with section 650, substantially restates section 139 of the 1985 Act and provides for the consequences where the court confirms the reduction by a public company of its share capital below the authorised minimum (defined in section 763): in particular they facilitate the re-registration of the company as private.
972. *Subsection (3)* replaces section 139(4) of the 1985 Act. It introduces a requirement to send a copy of the court's order (that is, the order authorising the company to be so re-registered without its having passed a special resolution) to the registrar, together with an application for re-registration. The current requirement for the application to be signed by a director (or secretary) has not been retained.

Sections 652 and 653: Effect of reduction of capital

973. These sections restate section 140 of the 1985 Act (with the exception of references to the "minute" being replaced with references to the statement of capital) which is concerned with the liability of a company's members in respect of any amounts unpaid on its shares following a reduction of capital. As now, there are special rules where a creditor was omitted from the list of creditors settled by the court.