

Company law: fundamental changes in a company

Reading 1: Introduction to changes in companies

This text provides an overview of the area of company law dealing with the changes made to a company that generally require the involvement of lawyers.

- 1 Before you read the text, match these key terms (1–7), which all refer to types of changes in company structure, with their definitions (a–g). If necessary, consult the glossary.
 - 1 constitutional amendment
 - 2 consolidation
 - 3 acquisition of controlling shares
 - 4 voluntary liquidation
 - 5 merger
 - 6 sale of substantially all assets
 - 7 compulsory winding-up
 - a the liquidation of a company after a petition to the court, usually by a creditor
 - b the combining of two companies to form an entirely new company
 - c liquidation proceedings that are supported by a company's shareholders
 - d a change in a company's name, capital or objects
 - e the purchase of shares owned by shareholders who have a controlling interest
 - f the acquisition of one company by another, resulting in the survival of one of them and dissolution of the other
 - g a form of acquisition whereby all or almost all assets and liabilities of a company are sold

At some point in the life of a company, the owners may wish to make fundamental changes to the company. Some of these changes may merely be basically administrative, such as changing the company's name. Other changes may entail alteration of the company's structure. These changes sometimes place the rights of **creditors** and **minority shareholders** at risk and are thus subject to special statutory regulation. The main examples of the types of alterations which fall into this group are **constitutional amendments**, **mergers**, **consolidations**, **sale of substantially all assets**, **acquisition of controlling shares** and **liquidation**.

The most common constitutional alterations in a company include alteration of the company's name, capital or **objects**. According to English law, a change of name can be made by **special resolution** in a general meeting, or all the members must sign a **written resolution** that the name of the company be changed to the new name. A signed copy of the resolution containing the new name must then be submitted to the **Registrar of Companies**. If the submission is in order, **Companies House** will issue a **Certificate of Incorporation on Change of Name**.

A company may alter its **capital structure**, provided that the articles of association grant such power. Such an alteration might entail such things as an increase in share capital, a

consolidation or division of shares, a subdivision of shares or a **cancellation** of shares.

A company may only reduce its share capital following court confirmation. A company may alter its **objects clause** by special resolution. However, the court may at its discretion set aside such a resolution upon application by a small group of minority shareholders.

A **merger** takes place when one company is **absorbed** into another company. Where company X is merged into company Y, company Y is the **acquiring company** and survives, while company X is the **acquired company** and disappears. In a consolidation, both company X and company Y disappear and a new company Z is formed.

A company may also **gain control** of another company by purchasing substantially all of the other company's **assets**. At **common law**, a sale of this kind normally required unanimous shareholder approval. However, today such sales may take place upon approval by some majority of the shareholders. Acquisition of shares is another method of gaining control of another company. This is achieved by purchasing all or the controlling portion of outstanding shares in a company. Many times this is achieved through a **takeover bid**¹, whereby company Y (the acquiring company or **acquirer**) makes a public invitation to shareholders of company X (the acquired company or **target**) to sell their stock, generally at a price above the market price. There can be **hostile takeovers** and **friendly takeovers**. In the former, the takeover is opposed by the target company's management, while in the latter the action is supported by management. Various regulations apply largely to protect the target company shareholders.

Finally, **winding-up** or **liquidation** of a company is the process by which the life of a company is brought to an end. **Compulsory winding-up**² is ordered by the court when the company is **insolvent**. However, a **voluntary liquidation**³ refers to a process which may be instigated by the members of the company where the company is **solvent**.

¹ (US) tender offer

² (US) involuntary bankruptcy

³ (US) also dissolution or winding-up

Key terms: Opposing concepts in company law

- 2 The text contains several pairs of opposing concepts. Find the counterpart of each of these words.
 - 1 acquiring company
 - 2 hostile takeover
 - 3 acquirer
 - 4 compulsory winding-up
 - 5 solvent
- 3 Work in pairs. Making use of the prepositions introduced in the previous unit (*as opposed to*, *unlike*, *in contrast to*), take turns contrasting the pairs of opposing concepts listed in Exercise 2.



EXAMPLES: In contrast to an acquiring company, which is a company that purchases another, an acquired company is one which is purchased and taken over by another company.

An acquired company is one which is purchased and taken over by another company, unlike an acquiring company, which is a company that purchases another.

Listening 1: Explaining legal aspects of an acquisition

A lawyer's involvement in the mergers and acquisitions of companies often entails communicating with the parties concerned: a lawyer may explain to the owner of a company what procedures have to be completed in the course of an acquisition or inform shareholders how the changes resulting from a merger will affect them.


In the following listening exercise, you will hear a lawyer speaking to a group of business owners. Each of these business owners is considering acquiring another business.

- 4  Listen to the first part of the presentation and choose the correct answer to each of these questions.
- 1 Which of these is the most likely entry for the talk in the programme?
 - a Mr A. Crawford of Corporate Restructuring (evening session)
 - b Mr A. Cranford of Mergers and Acquisitions (evening session)
 - c Mr A. Crawford of Mergers and Acquisitions (evening session)
 - d Mr A. Crawford of Mergers and Acquisitions (morning session)
 - 2 What is the speaker's aim?
 - a to provide the business owners with an overview of the law of mergers and acquisitions
 - b to persuade the business owners that they should use this opportunity for their businesses to grow
 - c to inform the business owners what they can expect if they decide to carry out an acquisition
 - d to tell the business owners about the process of making their businesses more attractive as potential targets
 - 3 Which of the following topics will *not* be included in the presentation?
 - a factors involved in deciding on a company to acquire
 - b staffing issues after an acquisition
 - c evaluating the prospective acquired company
 - d details of one specific deal the speaker has carried out
- 5  Listen to the second part of the presentation, in which the speaker discusses legal aspects of acquisitions. Decide whether these statements are true or false.
- 1 The important legal steps that must be carried out in the course of the acquisition process can be completed in any sequence.
 - 2 'Due diligence' refers to the process of gathering and analysing financial information and other relevant information about a business before it is acquired.
 - 3 One aspect of due diligence is verifying ownership of intellectual property.
 - 4 In the course of due diligence, the acquirer should terminate all of the target company's contracts with suppliers.
 - 5 A warranty is written statement by a party attesting that a fact relevant to the deal is true.
 - 6 The target may provide indemnities to protect the acquirer against future liabilities.

Text analysis: Beginning a presentation

In Listening 1, the lawyer began his presentation by introducing himself and his topic. Following this, he provided an overview of the points he planned to cover. He also informed his listeners about general matters related to his presentation, such as whether there would be a break or if questions were permitted.

The beginning part of any presentation, whether short or long, informal or formal, should fulfil these functions. Listeners appreciate knowing what awaits them and what they can expect to hear.

- 6  The following list provides useful phrases for the beginning of a presentation. Listen to the first part of the presentation again and complete each of the phrases using no more than three words.

- 1 Some of you may know me already, but allow me
My name's Adrian Crawford.
- 2 Mergers and Acquisitions department of our firm.
- 3 I'll acquisitions this evening.
- 4 I'm you about ...
- 5 Please feel free to at any time, should you have any questions.
- 6 At this point, I'd like to give you a short my presentation.
- 7 I'm going to start with a how to ...
- 8 Then I'll the issue of ...
- 9 After that, I'll the process of ...
- 10 I think we'll a short break at that point.
- 11 After the break, I'll the legal aspects ...
- 12 At the end, I'll a look at ...
- 13 There'll be time for at the end.

- 7 Match the phrases from Exercise 6 (1–13) with the function (a–c) they serve. The first phrase has been done for you.

- a introducing the speaker (name, affiliation) 1, ...
- b informing about points that will be covered
- c telling listeners about practical matters related to the presentation

Reading 2: Spin-offs

The text on page 52 is an excerpt from an article about spin-offs, an alteration in the structure of a company. It appeared on the website of a US firm. The primary purpose of this text is to provide information for clients. Do you think website articles are an effective way for clients to get information about complex topics?

- 8 Read through the text quickly and answer this question.

A subsidiary is a company which is controlled by another through share ownership. What exactly is a spin-off?

- 9 Decide which of these phrases (a–d) best expresses the topic of each paragraph (1–4).

- a Advantages of IRS Code Section 355
- b Reasons for creating spin-offs
- c Definition of the term *spin-off*
- d Various types of spin-offs

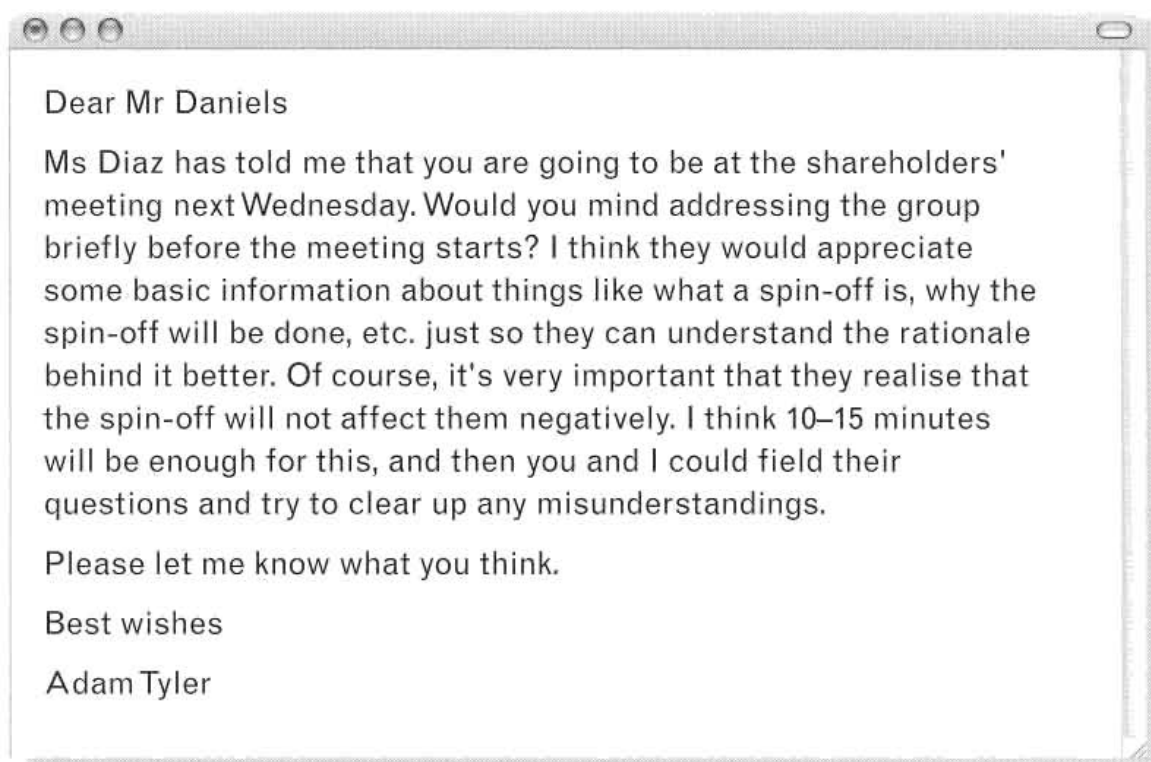
- 1** The term 'spin-off' refers to any distribution by a corporation to its shareholders of one of its two or more businesses. Sometimes the spun-off business is transferred first to a newly formed subsidiary corporation. The stock of that subsidiary is then distributed to the shareholders of the distributing corporation. Other times, the stock of a pre-existing subsidiary is distributed.
- 2** Spin-offs can include distributions on a proportional basis (i.e. pro rata), in which the receiving shareholders do not give up any of their stock in the distributing corporation when they receive the spun-off stock. Sometimes the distribution only goes to certain shareholders. In this case, the receiving shareholders give up some (or all) of their stock in the distributing corporation in exchange for the stock of the controlled subsidiary. Non-pro-rata spin-offs are sometimes referred to as 'split-offs'. A non-pro-rata spin-off that results in one group of shareholders holding all the stock of the distributing corporation and a second group holding all the stock of the former subsidiary corporation is referred to as a 'split-up'.
- 3** A spin-off is used to separate two businesses that have become incompatible. In a case where investors and lenders may want to provide capital to one but not all business operations, a spin-off can be a good solution. Spin-offs are also used to separate businesses where owner-managers have different philosophies. Spin-offs may furthermore be used by publicly held companies when the stock market would value the separate parts more highly than combined operations. The separation of business operations could also lead to a greater entrepreneurial drive for success.
- 4** The tax characteristics of a qualifying spin-off under Internal Revenue Code Section 355 make this an attractive tool for solving certain corporate challenges. Without Section 355, the distributing corporation would have to recognize a gain on the stock it distributed as if it had sold that stock. In addition, shareholders receiving the distribution would be taxed on the shares received, either as a dividend or as capital gain. This double tax usually makes spin-offs extremely expensive. Code Section 355 permits a spin-off to be accomplished without tax to either the distributing corporation or to the receiving shareholder. Any gain realized by the shareholder is deferred until the stock is sold.

10 Read the text again and answer these questions.

- 1** Under which circumstances would a company typically decide to make a spin-off?
- 2** What benefits for the corporation and for the shareholders result from Internal Revenue Code Section 355?

Speaking: Presenting a spin-off

One of your corporate clients is planning to carry out a spin-off. He has written you the following email.





- 11** Using the presentation in Listening 1 as a model and the information from Reading 2, prepare the beginning of such a presentation.
- 12** Take turns presenting your beginning to a partner. Check that your partner has:
- ☐ introduced him/herself
 - ☐ informed you about what points will be covered
 - ☐ mentioned any practical matters (questions, timing, etc.)

Listening 2: A checklist

Lawyers play an important role in the processes involved in altering the structure of a company. For example, they review the documents connected with such changes to ensure that all the relevant statutes have been complied with.

Checklists are useful tools for making sure that the proper procedures have been followed and the necessary documents drawn up. Once an issue has been addressed, a lawyer will tick the box to confirm that he has considered the particular matter listed. You will hear two lawyers discussing such a checklist. A more experienced lawyer guides his younger colleague through the list of actions to be taken and documents to be filed.

- 13**  Listen to the dialogue and answer these questions.
- 1** What kind of change are they discussing?
 - 2** What two meetings need to be held?
 - 3** How many documents need to be filed at Companies House?

- 14  Listen again and complete the missing items (1–10) in the left-hand column of the checklist, using up to three words for each space.

Checklist on increasing a company's share capital	Matter considered
<ul style="list-style-type: none"> • Check the memorandum of association to identify the company's 1) See also <i>authority to increase capital</i> under Articles. Consider whether creation of new shares will involve variation of class rights. If so, appropriate consents may be required. 	
<ul style="list-style-type: none"> • Has the company issued all its share capital? 	
<ul style="list-style-type: none"> • 2) of increase of share capital. 	
<ul style="list-style-type: none"> • Convene 3) at reasonable notice: Normal procedure or consider using written resolution procedure. 	
<ul style="list-style-type: none"> • Ensure a quorum of 4) is present at the board meeting. 	
<ul style="list-style-type: none"> • Directors have to 5) that they will put the increase of share capital to vote at an extraordinary general meeting (EGM). 	
<ul style="list-style-type: none"> • Convene an EGM by notice or use written resolution procedure. 	
<ul style="list-style-type: none"> • If written resolution procedure is not used, notice to shareholders must state: <ul style="list-style-type: none"> a date b time c place d proxy e ordinary resolution f consent to 6) 	
<ul style="list-style-type: none"> • Ensure the 7) presides at the EGM and that a quorum of shareholders is present. 	
<ul style="list-style-type: none"> • Pass the ordinary resolution by 8) on a show of hands or by poll. 	
<ul style="list-style-type: none"> • Draw up board and EGM minutes. 	
<ul style="list-style-type: none"> • Lodge at Companies House 9) days: <ul style="list-style-type: none"> a ordinary resolution; b notice of increase of 10) (Form 123); c amended memorandum and (if necessary) articles of association. 	

Language use 1: Explaining a procedure

When explaining how a procedure is carried out, the order of the steps to be taken can be indicated using sequencing words. Look at the following examples from the listening text:

Well, **the first thing** you have to do is check the memorandum of association ...

Then you have to find out whether they've issued all their share capital already or not.

The next step would be to determine the amount of increase of share capital. But **before** the EGM can take place, the shareholders have to be informed by notice about the EGM.

Finally, within 15 days, the following documents have to be filed at Companies House ...

Here are some more sequencing words:

After that, Afterward(s), At this point, Following this, Once you have done that, Subsequently

Another feature of such an explanation is the use of words and expressions indicating necessity, such as *to have to, must, to be required* and *to be necessary*:

*The first thing you **have to** do is ...*

*Tell your client that they **have to** call a board meeting ...*

*This notice **must** state the following things ...*

*The chairperson **is required to** preside at the EGM, and **it's necessary that** a quorum is present.*

*Minutes of the two meetings ... **have to** be drawn up.*

- 15** Think about a complicated legal procedure you have to deal with in the course of your work or which you have studied. Make a checklist to identify what you have to do to complete this procedure. Explain the procedure carefully to your partner. He/She should make notes. When you have finished, ask your partner to repeat back to you the stages of the procedure.

Reading 3: The minutes of a meeting

When fundamental changes are made to a company, meetings of the directors and/or shareholders must be convened so that the proposed changes can be voted on. The official record of the proceedings of such a meeting is called the **minutes**.

- 16** Discuss these questions.

- 1** Who writes the minutes of a meeting?
- 2** When would a lawyer have to read such a text?

- 17** The text on page 56 is the minutes of a meeting held by board members of a small company. Read through the minutes quickly. Why was the board meeting called? Why was the EGM called?

Longfellow Ltd

Minutes of a meeting of the Board of Directors held at Company premises, Langdon Building, Sherwood Road, Manchester

On: 10 September, 2005, at 3 p.m.

Present: Debra Smith (Chairperson)
Anna Bean (Director)
Claire Thurman (Secretary)

- 1 The Chairperson confirmed that notice of the meeting had been given to all the Directors of the Company and that a quorum of the Board of Directors was present at the meeting.
- 2 Applications were presented to the meeting from Debra Smith, Anna Bean and Allison Sharp for the allotment of 10,000, 20,000 and 20,000 shares respectively by the Company, and it was resolved that their applications be approved subject to the approval of the extraordinary general meeting.
- 3 It was noted that Debra Smith and Anna Bean had declared their interests in the shares pursuant to s317 Companies Act 1985.
- 4 The Chairperson reported that it was proposed to increase the authorised share capital of the Company by 50,000.
- 5 The Chairperson reported that the directors required authority to allot shares, as there was no power in the Company's articles of association.
- 6 The Chairperson also informed the members that the Company would need to disapply s89 Companies Act 1985 in relation to pre-emption rights.
- 7 There was presented to the meeting a notice of an extraordinary general meeting at which resolutions would be proposed to implement the above proposals to increase the Company's share capital; to authorise directors to allot the new shares; and to disapply the requirements of s89 Companies Act 1985. It was resolved that the notice be approved, that the Secretary be instructed to send it to all the members and the auditors of the Company, and, subject to all the members agreeing to short notice, that the meeting be held immediately.
- 8 The meeting was adjourned to enable the extraordinary general meeting to be held.
- 9 The meeting resumed at 8 p.m. and the Chairperson reported that the resolutions set out in the notice of an EGM had been duly passed.
- 10 It was resolved that the application by Debra Smith, Anna Bean and Allison Sharp for 10,000, 20,000 and 20,000 shares respectively be accepted and that the capital of the Company be allotted to the applicants on the terms of the application.
- 11 The Secretary was instructed to enter the names of the applicants in the register of members of the Company as the holders of the shares allotted.
- 12 The Secretary was instructed to prepare share certificates in respect of the shares allotted and to arrange for the common seal to be affixed to them and to deliver the share certificates to the applicants.
- 13 The Secretary was instructed to prepare and file with the Registrar of Companies: Form 88(2) (return of allotments) in respect of the allotment just made; Form 123 (increase of capital); and the special and ordinary resolutions in connection with raising capital for the Company.
- 14 There being no further business, the meeting was closed.

Chairperson

- 18** Read the minutes again and answer these questions.
- Which resolutions were passed at the meeting?
 - What steps must be undertaken by the Secretary subsequent to the meeting?
- 19** As a record of what occurred at a meeting, the minutes include an account of what the participants said. Verbs referring to speech acts, such as *to state* or *to propose*, are commonly used. Which verbs of this kind can be found in the minutes?

Language use 2: Collocations

- 20** The minutes on page 56 contain examples of verbs that often appear together with the nouns *meeting* and *resolution*. Find and underline them.
- 21** Complete the table below to show which of the verbs in the box can be used with *meeting* and *resolution*. You may need to consult a dictionary.

adopt	arrange	attend	authorise	call	cancel	convene
draft	endorse	introduce	oppose	pass	preside at	
schedule	summon	table				

meeting	resolution

Reading 4: Shareholder rights

The letter on page 58 has been written by an American lawyer in response to a query concerning the rights of a shareholder.

- 22** Read the letter and discuss these questions.
- What kind of letter is it?
 - What exactly is the query it responds to?
- 23** Read the letter again and decide whether these statements are true or false.
- The shareholder seeks to set aside the transaction on the grounds that he was not able to vote at the shareholders meeting.
 - The lawyer states that in a true merger, the statutes do not provide appraisal rights to the shareholder.
 - The lawyer points out that looking at the substance rather than the form of the transaction might appear at first to help the shareholder's case.
 - The lawyer believes that it is likely that the courts in the jurisdiction in question will decide along the lines of *Heil v. Star Chemical*.

Re: Shareholder Rights in Stock for Assets Transaction

Dear Mr. Fitzwilliam

You have requested advice regarding your rights as stockholder in Alca Corporation (the "Target Corporation") which entered into a stock-for-assets agreement with Losal Corporation (the "Purchasing Corporation").

The advice and statements set forth below are based on the facts you presented to me in our telephone conference of January 27. This advice should be viewed in light thereof and remains subject to future discovery and research.

The facts are as follows: you are a stockholder in the Target Corporation. On or about October 1 last year, the Target Corporation and the Purchasing Corporation entered into a Reorganization Agreement by which the Target Corporation agreed to sell all its assets to the Purchasing Corporation in consideration for 550,000 shares of the Purchasing Corporation's stock. The Target Corporation called a stockholders' meeting to approve the Reorganization Agreement and the voluntary dissolution of the Target Corporation upon distribution of the shares to the Target Corporation's stockholders. As I understand it, the stockholders meeting approved the plan, 70% of all stockholders voting. You did not vote at the meeting. Your query to me is whether it is possible to set aside the transaction based on your rights as a stockholder.

Generally, a stockholder's rights in a merger situation are twofold. First, the stockholder has the right to approve or disapprove the agreement. Second, the stockholder holds an appraisal right, which means that he is entitled to have an independent appraiser determine what his shares are worth. The aforesaid provides the stockholder with assurance that the Purchasing Corporation is not getting a discount on the shares. As I understand it, you were not afforded any appraisal rights.

The difficulty in the *instant* case is that the transaction is not a "true" merger but rather a sale of assets in exchange for shares. In the latter case, strictly speaking, the statutes do not provide the shareholder appraisal rights. However, it might be argued that, due to the fact that the transaction at issue achieved the same results as a merger, the court should look at the substance of the transaction rather than its form in order to protect your rights as a shareholder. *In essence*, the argument is that a "de facto" merger has taken place and that you should be entitled to the same rights as if a "true" merger had taken place. If the court finds in your favor, the transaction could then be set aside as being in violation of the applicable statutes.

Although I consider the argument above to be *persuasive*, I doubt whether the courts of this jurisdiction will accept it. The doctrine of de facto merger is widely accepted in many other jurisdictions for the reasons I have set forth above. However, in this jurisdiction, the courts have been *hesitant* to take a position. In addition, in one particular case, *Heil v. Star Chemical*, the court, although not addressing exactly the same situation as in this case, referred to the fact that the provisions governing merger and the sale of all the assets in a corporation are separate and should be treated as such. The *mere* fact that they overlap does not change the legislative intent.

In summary, you have an argument, but in my opinion your chances are slim. It will most likely take an appeal to win, as I suspect the trial court will not stray from the reasoning established in the *Heil* case. Hence, as your attorney, I would suggest that you take a look at your options from a financial perspective and make a determination as to whether it is worth it.

As always, I remain at your disposal should you wish to discuss your options. I look forward to hearing from you and answering any further questions you may have.

Yours truly

Mark Sanders

- 24 Match these words and phrases from the letter (1–5) with their synonyms (a–e).
The words are in *italics* in the letter.

- | | |
|--------------|--------------|
| 1 instant | a basically |
| 2 in essence | b simple |
| 3 persuasive | c reluctant |
| 4 hesitant | d convincing |
| 5 mere | e present |

- 25 According to the letter of advice on page 58, there is a good reason why a court might rule in favour of the shareholder, but also a good reason why it would not. Discuss these reasons with a partner and decide how you would advise your client in this situation.

Writing: Standard phrases for opening and closing letters and emails

Referring to previous contact

*With reference to your letter of 15 February ...
In response to your query concerning ...
Further to our (telephone) conversation of ...
Thank you for your email of 15 February.*

Stating the reason for writing

I am writing to inform you that ...

Closing, offering further assistance

*Please contact me again if I can help in any way.
Should you have any further questions, do not
hesitate to contact me.*

Referring to future contact

*I look forward to your reply / to meeting you / to
hearing from you.*

- 26 The letter of advice on page 58 has been written in response to a query.

- 1 How does the lawyer make reference to this query?
- 2 How is the previous conversation between lawyer and client referred to?
- 3 At the end of the letter, which sentences are used to indicate willingness to provide further help and to invite further contact?

- 27 As the associate for corporate counsel to Longfellow Ltd, you have received an email from a shareholder requesting information about what happened at the board meeting and the EGM documented in the minutes in Reading 3 on page 56. Respond to the request of the shareholder. In your email, you should:

- ☐ refer to the email sent by the shareholder;
- ☐ state the reason for writing;
- ☐ explain the circumstances under which the meetings were held;
- ☐ summarise the content of the resolutions passed;
- ☐ offer to provide further assistance if necessary.

SAMPLE
ANSWER
>> p. 288



Unit 4

To improve your web-based research skills, visit www.cambridge.org/elt/legalenglish, click on Research Tasks and choose Task 4.

Language Focus

- 1 Vocabulary: distinguishing meaning** Which word in each group is the odd one out? You may need to consult a dictionary to distinguish the differences in meaning.

- 1 pause suspend cancel adjourn
- 2 according to related to pursuant to in conformity with
- 3 exempt liable freed released
- 4 convoke call contend convene
- 5 continue resume pick up add on
- 6 said relevant aforementioned aforesaid

- 2 Vocabulary: definitions** Match these words and expressions in italics (1–8) with their definitions (a–h). They are all taken from the Reading sections in this unit.

- | | |
|--------------------------------------------------|----------------|
| 1 <i>pro-rata</i> distribution | a before |
| 2 <i>under</i> Internal Revenue Code Section 355 | b enter into |
| 3 <i>prior to</i> distribution | c determining |
| 4 <i>become a party to</i> a transaction | d according to |
| 5 <i>no consideration</i> is paid | e actual |
| 6 <i>de facto</i> merger | f relevant |
| 7 <i>applicable</i> statutes | g payment |
| 8 provisions <i>governing</i> merger | h proportional |

- 3 Word formation** Complete this table by filling in the correct verb or noun form. Underline the stressed syllable in each word that has more than one syllable.

Verb	Abstract noun
dist <u>ri</u> bute, <u>dis</u> tribute	<u>distri</u> bution
	merger
	regulation
submit	
	approval
consolidate	
acquire	
	liquidation
cancel	
	alteration