

Private company reduction of capital supported by solvency statement.

From 1 October 2008 a private company limited by shares will be able to reduce its share capital without going to court. Instead the company will be able to reduce its share capital if its directors make a solvency statement not more than 15 days before the resolution to reduce share capital is passed. The solvency statement is a statement that each of the directors:

- (a) has formed the opinion, as regards the company's situation at the date of the statement, that there is no ground on which the company could then be found to be unable to pay (or otherwise discharge) its debts; and
- (b) has also formed the opinion:-
 - (i) if it is intended to commence the winding up of the company within twelve months of the date of the statement, that the company will be able to pay (or otherwise discharge) its debts in full within twelve months of the commencement of the winding up; or
 - (ii) in any other case that the company will be able to pay (or otherwise discharge) its debts as they fall due for one year after the date of the statement.

In forming those opinions, the directors must take into account all of the company's liabilities (including any contingent or prospective liabilities). The solvency statement must be in the prescribed form and must state the date when it is made and each director's name.

If the directors make a solvency statement without having reasonable grounds for the opinions expressed in it and the statement is delivered to the Registrar of Companies, every director in default commits an offence and is liable to imprisonment of up to two years or a fine or both.

The relevant sections in the Companies Act 2006 and related requirements are sections 641 to 644.

Purpose of this memorandum

The purpose of this memorandum, which has been approved by the Company Law Committee of the Law Society, is to record some consensus views of members of the Committee as to practical steps that directors can take before making a solvency statement (as referred to in section 643 Companies Act 2006) to reduce the risk of committing an offence under section 643(4). This memorandum does not address other aspects which may be relevant to any reduction of capital supported by a solvency statement.

First it should be noted that the directors must have reasonable grounds for the opinions they are proposing to express in the solvency statement and that they will be expected to exercise reasonable care, skill and diligence in forming those opinions. It will therefore be helpful for directors to keep a record of the information they

considered in reaching their opinion. The information should be sufficient to enable the directors to form a reasonable opinion on the following two matters:

- (a) whether the company can pay or discharge its debts at the date of the statement; and
- (b) whether the company will be able to pay or discharge its debts as they fall due for one year after the date of the statement or, if the company will be wound up in that period, in full within twelve months of commencing the winding up.

The directors should use information which enables them to identify the company's existing debts and debts to be discharged over the next twelve months and the resources available to the company (or reasonably expected to be available to it) to enable it to meet those debts. If there are any uncertainties, both as regards contingent and prospective liabilities or as regards the resources available to meet the debts, the directors should consider these uncertainties and satisfy themselves that there is a reasonable basis for their conclusions.

What the directors need to consider may differ considerably depending on the company's circumstances. For example, the position of a non-trading company is likely to be very different from the position of a trading company. The directors will also wish to consider other potential threats to the company's business model (based on the facts and circumstances known to them when they make the statement, or which would be known to them if they had exercised reasonable care, skill and diligence) including, for example, what the effect on the company would be of events such as the insolvency of a supplier or the loss of a major customer and the likelihood of such events occurring.

There is no requirement in the sections for a report by any independent third party on the directors' conclusions. This contrasts with other provisions in the Companies Act 2006, for example where a private company redeems or purchases its own shares out of capital, when the directors' statement (which also relates to the ability to pay debts) must have a report by the company's auditor annexed to it (see section 714).

In some cases, the directors may wish to obtain advice to reach their opinion or seek comfort on the processes they have gone through (or propose to go through) to help satisfy themselves that their opinion is soundly based. Whether or not the directors decide to do so is likely to depend on their assessment of the difficulties of forming their opinion on the basis of the information they have and the potential benefits of seeking comfort on the processes or taking advice on the things to be taken into account or the reasonableness of any judgements they have to make. Where directors give proper instructions and take account of the advice or comfort received that is likely to be helpful in showing that the directors had reasonable grounds for their opinions. The Company Law Committee believes that if the directors do not obtain a report from an independent third party or advice or comfort on process, this will not necessarily prevent the directors from demonstrating that they have reasonable grounds for the opinions expressed.