Re-denominating UK company capital: a hidden euro cost

Kevin McGuinness and Stephen Copp discuss the cost implications of the euro in the realm of company capitalisation.

In January, the Department of Trade and Industry published a consultative document dealing with the re-denomination into euros of the share capital of UK companies. Though there has been much media comment on the single currency issue, stressing the desire of many business leaders to see the UK adopt the euro, previously the practical ramifications of such adoption on UK corporate governance and financing have not received sufficient attention. The DTI consultative document moves discussion on the subject away from the realm of theory and ideology towards more practical considerations of the steps that would or should be taken if the UK were to join the single currency.

On initial reading the consultative document would seem to deal with a minor aspect of the adoption debate. Thus it was surprising to find that it identifies an extensive range of technical questions which raise significant cumulative cost implications for UK companies. For instance, at least some amendments to the memoranda and share terms of all UK companies will be required if the UK itself ever adopts the euro. Without some change to the law, the aggregate cost to the UK economy of effecting such amendments would be very high indeed.

Broadly speaking, the consultative document considers issues arising as a result of the re-denomination of share capital into the euro in two distinct contexts: (a) voluntarily, in anticipation of the UK joining the single currency; and (b) compulsory conversion should the UK actually join. The costs that UK companies will incur as a result of re-denomination vary, depending upon which of these contexts applies and the extent of the changes made to company law to facilitate re-denomination. Because of the EU's regulations governing conversion to the euro, companies with very low par value shares may well have greater legal obstacles to overcome, and as a result may incur greater cost than other companies.

The consultative document is notable more for the questions that it raises than the specific proposals that it puts forward. The DTI is clearly interested in receiving public input from the corporate sector, so that the law can be changed to minimise the costs resulting from re-denomination of share capital into the euro.

Even if the UK never adopts the euro, the DTI recognises that at least some UK companies may wish to re-denominate their capital into euros as the EU member states with which those companies do most of their business convert to that currency. A company may, for instance, wish to match the currency of its capital base to the currency in which it carries on business. Some companies may also perceive that euro-denominated capital will have a lower cost of funds. The DTI raises the question of whether companies legislation is necessary to facilitate such voluntary re-denomination. Aside from these cost-related questions, there are many other technical matters that much be tackled in the legislation, such as the manner of dealing with shares having a very low par value.

New legislation?

UK company law has long permitted a company both to issue foreign currency denominated shares and to re-denominate its existing share capital into foreign currency. However, the DTI draws attention to the surprising fact that current legal provisions for the reorganisation of a company's share capital (such as consolidation or subdivision) do not permit direct re-denomination of existing issued capital into another currency. Re-denomination normally involves a company temporarily 'reducing' its share capital by way of the archaic and cumbersome procedure of a special resolution of the company's shareholders followed by confirmation by the court. New capital (denominated in foreign currency) is then issued in place of the old. These steps greatly increase the cost and time involved in re-denomination. Accordingly, the DTI has suggested that new legislation could attempt to contain the costs associated with voluntary re-denomination (whether into euros or other foreign currencies) by adopting a simplified procedure. Some of the options under consideration include (or might include) the following:

- Allowing re-denomination into euros to proceed without court confirmation, and with shareholder approval limited to an ordinary resolution;
- A more extreme option permitting re-denomination to be sanctioned by a simple board resolution, giving the shareholders only a right of revocation by ordinary resolution;

- Specifying the mechanical procedures to be employed in effecting re-denomination, such as the conversion rate, the rounding rules that should apply; and perhaps the method of calculating dividends payable where conversion occurs during a given financial year;
- Exempting companies from the obligation to issue new share certificates to reflect re-denomination;
- Permitting the minimum share capital of a plc to be denominated in euros as well as in sterling.

Conversion risks

It is not entirely clear, however, that the voluntary re-denomination of share capital should be simplified. If the UK does not adopt the euro, the voluntary re-denomination of the share capital of a UK company into the euro may expose existing shareholders to foreign currency conversion risks that they do not wish to assume. It cannot be guaranteed that the euro will be less prone to devaluation than Sterling. Euro-denominated securities may well be less marketable in the UK than sterling-denominated securities. Much has been done to attempt to transform the UK into a shareholding democracy. The particular exposure of small shareholders must also be considered: although institutional shareholders may dominate the membership of listed companies, private shareholders remain significant.

On a broader level, the consultative document raises the question of whether a move should be made towards 'no par value' shares - a proposal long mooted as a company law reform measure as a way of side-stepping some of the above issues. Unfortunately, the tight legislative timetable might rule out the abolition of par value shares as a curative measure, since such a step could necessitate wide changes to the general framework of company law. It appears that the earliest legislative time could be made available would be the 1998/9 session of Parliament. It is clear from the consultative document that the DTI itself still has not finalised its thinking on many of the points raised by the re-denomination issue. Time is clearly running out if the DTI wishes to amend company law prior to the date when the euro comes into use.

Insofar as re-denomination of currency pertains to public limited companies, some methods of facilitating re-denomination appear to be complicated by the present wording of the Second Company Law Directive, which was of course adopted many years before any real thought was given to the creation of a single European currency. Even a casual read of the consultative document is sufficient to convince that some amendment of the Second Directive is likely to be required.

The consultative document earnestly requests public input into the DTI both as to the extent of the need to facilitate voluntary re-denomination and the steps to take in this regard. The solicitation of widespread public input early in the law reform process should be applauded and taken advantage of. Chartered secretaries and other senior officers of management would be well advised to obtain a copy of this document, in order to consider whether voluntary re-denomination would be of benefit, and also to evaluate the various options identified by the DTI in the event of mandatory re-denomination as a consequence of the UK joining the single currency.

Conclusion

Based upon our own review of the document, we would suggest the following:

- There is no justification for the retention of archaic or cumbersome regulation in company law whether the UK joins the euro or not. The consultative document has thrown a spotlight on a number of difficulties posed to companies rushing to re-denominate their share capital, such as the need to involve the court. If this procedure provides a valid protection for shareholders and creditors then it should be retained; if not it should be abolished. The euro has nothing to do with the matter it will simply be another overseas currency.
- The problems raised by the Second Company Law Directive beg the question whether this Directive imposes more in the way of cost than it affords in the way of benefit. It should be re-examined, with a view to considering whether it should be amended or perhaps even repealed.
- It is a fair question whether the costs of re-denomination are merely symptomatic of a wide range of hidden costs associated with the proposed single currency. If so, these costs need to be identified now and considered by the government in greater depth before a decision is made whether it is in the UK's interests to join. Much has been made of the euro's potential benefits to commerce. Costs require at least equal consideration. In a global economy UK companies should not be handicapped by being subjected to costs which non-EU competitors will not face.
- Consideration needs to be given to a number of ancillary questions not really dealt with in the consultative document, such as the currency in which dividends are to be paid and class rights.
- If the UK ultimately converts to the euro so that re-denomination becomes mandatory, a highly simplified, low-cost procedure should be put in place to effect an automatic re-denomination of existing capital. Such procedure should be geared towards the probable requirements of the vast majority of companies, as determined by precisely the sort of public consultation that the DTI is now seeking to conduct. The law should be sufficiently flexible to accommodate the requirements of an individual company where its circumstances render the ordinary approach impractical. Since corporate circumstances and requirements differ greatly, iron-clad rules should be avoided. ■

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