



ICSA REGISTRARS GROUP GUIDANCE NOTE

PRACTICAL ISSUES AROUND ARTICLES OF ASSOCIATION RELATING TO DIVIDEND DISTRIBUTIONS

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1. Executive Summary

There has been significant focus on payment methods for dividends in recent years in terms of efficiency, cost and security. A large number of companies and businesses have taken measures to ensure that their customers, owners and partners all have access to and / or use the most relevant payment mechanisms. In addition, it is clear that new payment methods will be adopted over the short to medium term (e.g. mobile phones) and it is important that the market is prepared for such eventuality.

Historically issuers have used two distribution channels for making payments; cheques and Bacs. Some issuers now also use CREST and it is clear that more channels could be added in the future. We believe that it is sensible for issuers to ensure that their articles of association are written in a way that allows them to use different distribution channels for the payment of dividends as and when they are adopted by the market. It would also appear that over time current payment methods may be phased out, and companies should equally be prepared for this eventuality.

To manage such changes, issuers could update their articles every time a new development takes place in the area of payment distribution or they could make a one off change to their articles that gives them flexibility to adopt new developments if, and when, it is considered desirable to do so. A one off change is the most efficient and cost effective approach for both issuers and shareholders and this guidance suggests how this can be done. The proposed wording also allows an issuer to decide:

- which method is to be used;
- which method is to be the default method; and
- whether shareholders may make an election for a distribution channel other than the default or not.

2. Introduction

The Institute of Chartered Secretaries and Administrators Registrars Group (the Group) represents the main service registrars in the United Kingdom and its members are outsourced registrars for more than 99% of all quoted companies in the UK. The registrars that have contributed to this guidance note are Capita Registrars, Computershare Investor Services, Diageo and Equiniti.

The process of distributing cash to shareholders is one that is central to all companies who pay dividends or may do so in the future. Historically, companies' articles have been set up to reflect the fact that cheques were the predominant payment method within the UK and that a shareholder has to provide details to a company to receive payment by transfer to a bank account. However, payment by cheque is no longer the preferred option for many shareholders or issuers:

- A majority of shareholders now prefer electronic payment and most companies have amended their articles to allow shareholders to receive their dividends via bank transfer using the Bacs system, a service provided by Bacs Payment Schemes Limited.
- Some companies have also added CREST¹ as a possible payment medium and some institutional shareholders would like to see more use of the CREST system in this area.
- A small number of companies in the UK and Ireland have removed cheques as an option completely and only allow electronic payment methods.
- Other ways of receiving payments will become available in the future that companies may want to use for distributing funds to their shareholders (e.g. mobile phone payments).

On average, more than half of shareholders receive their dividends by electronic means and a number of companies are questioning whether their articles provide suitable flexibility to ensure they can pay dividends to their shareholders in the most efficient manner. Many companies proposing to be traded on AIM or obtain a listing in the UK also want their articles to allow them flexibility to decide which payment mechanism to use, including the power to pay all dividends via a particular payment method.

The purpose of this guidance note is to provide new model wording for articles that will allow a Board to decide which payment method to use, which is the default method and whether shareholders can make an election for a distribution channel other than the default or not, and that will allow them to use new alternative payment mechanisms as they become available in future. The Group is aware that a number of companies have already changed their articles of association in this regard and that some recently listed companies have adopted articles that allow them this flexibility but, to our knowledge, each has approached the wording for their articles in a slightly different way.

This guidance note draws on the experience of the members of the Group in managing the dividend process for their many hundreds of issuer clients across the UK and Irish markets, ranging from FTSE100 issuers to Small Cap, AIM and unlisted companies. It does not constitute legal advice.

Finally, before outlining this revised model wording we would like to take this opportunity to extend our gratitude to the members of Joint Working Party of the City of London Law Society's Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law who produced the model wording (set out below) that companies may wish to consider using as the basis for changes to their own articles of association. The wording is for guidance only and will need to be adapted to fit with a company's existing articles. It is the responsibility of the company and its legal advisers to ensure that its articles are adequate and satisfactory for its purposes.

¹ Information on the CREST dividend service and dividend payments in CREST is available from the Euroclear website via the MY Euroclear section (www.euroclear.com) and from your share registrar.

3. Background

Currently nearly all companies pay dividends by cheque or Bacs and their shareholders are allowed to choose which they prefer; if a shareholder wants to be paid by Bacs it must provide the relevant bank details to the company or its agent. Generally, if a shareholder does not specify a preference they will be sent a cheque. Over time the use of cheques has reduced and their cost increased. Furthermore cheques are higher risk and provide slower cleared funds than some alternative methods. As a result companies are considering whether they should make available alternative methods of dividend distribution to shareholders and whether they should be able to require shareholders to use a particular method of electronic payment, with payment being withheld if the relevant details have not been provided to allow that method of payment to be used and, if applicable, an election has not been made for an alternative method of payment.

Given that the distribution methods are specified in a company's articles of association, it is important that the articles provide sufficient flexibility to allow different types of distributions or defaults, to allow the company to decide which method is to be used and to allow them to treat a dividend as unclaimed if the relevant details are not provided.

The principal concepts underpinning the payment of dividends are contained in the model articles for public limited companies (article 72 of the 2006 Companies Act public company model articles). Currently, this model wording states:

“(1) Where a dividend or other sum which is a distribution is payable in respect of a share, it must be paid by one or more of the following means—

- (a) transfer to a bank or building society account specified by the distribution recipient either in writing or as the directors may otherwise decide;
- (b) sending a cheque made payable to the distribution recipient by post to the distribution recipient at the distribution recipient's registered address (if the distribution recipient is a holder of the share), or (in any other case) to an address specified by the distribution recipient either in writing or as the directors may otherwise decide;
- (c) sending a cheque made payable to such person by post to such person at such address as the distribution recipient has specified either in writing or as the directors may otherwise decide; or
- (d) any other means of payment as the directors agree with the distribution recipient either in writing or by such other means as the directors decide.”

This form of articles covers the payment of dividends through Bacs, CREST or by cheque and it allows payment by all three methods. The wording in this article is widely used by public companies as a basis for their articles. Although this wording allows payment by other means if agreed to by each individual shareholder, it does not allow a company to determine the method of payment to be used, or allow the company to introduce new methods without shareholder consent, or provide a default method –

or to decide whether shareholders are to be allowed to make an election as to how to receive payment. As a result, the articles would need to be amended if a company wanted to make electronic payments the default with cheque payment as an option, or if the company wanted to be able to treat a dividend as unclaimed if a shareholder did not provide the relevant information for electronic payment.

Consequently, if companies want directors to be able to decide which payment method to use, provide a default method and decide whether elections are to be offered or not, companies are likely to need to amend their articles. By making a general change to their articles in relation to dividends (based on the wording in this guidance note), companies can acquire increased flexibility in relation to payment distribution channels, allowing them to determine the approach used and negating the need for specific article changes (or shareholder consent) each time they change practice or adopt a changed approach in the future (for example when new payment methods become available).

4. Requirement

In order to give companies more power and flexibility to determine payment methods, the Group identified that companies' articles of association need to allow for companies to be able to:

1. specify which payment methods are to be mandatory for the payment of its dividends or interest e.g. a company can choose the default payment mechanism of dividends or interest or a company could choose a different default for CREST holders and non CREST holders.
2. determine which distribution methods will be used without the need to change their articles of association. e.g. a company can make payment of dividends or interest through any electronic method determined by either the board or the Company Secretary.

In addition, although not a matter for the articles of association, companies may wish to send tax vouchers electronically to shareholders if their dividend distribution is also electronic. Each issuer's registrar will be able to provide details of the options provided by them in this regard.

5. Action Companies may take

The Group believes that with the ongoing debate about payment methods, the drive for efficiency and the increase in payment options, companies may wish to ensure that their articles of association allow them more flexibility in relation to payment methods and the ability to determine which method is used, irrespective of whether they have any wish to alter the distribution channels they use in the short term.

Consequently, we believe that:

- All companies proposing to be admitted to listing or to be traded on AIM should adopt articles including dividend wording based on the model wording in this guidance;
- Companies that are already listed or traded on AIM should also consider amending their articles to include dividend wording based on the model wording in this guidance the next time they decide to change their articles (or, if earlier, when they wish to take advantage of the flexibility provided by the wording).

Companies proposing to adopt new articles or to amend existing articles will need to explain the proposed changes to their articles to their shareholders and how it will affect shareholders, including the fact that there would be a power for the company to specify a particular payment method, so that they can take an informed view before voting on the proposals.

We do not consider there to be a one size fits all standard for dividend distribution channels and/or default payment method. Each company needs to address the needs of its shareholders and each of our members will be happy to work with their clients to progress the right options for them should they wish to debate the matter.

In relation to the requirement in LR 13.2.2 for circulars to be approved by the FCA if a circular explaining an amendment to a company's constitution has "unusual features", we have requested guidance from UKLA to confirm that the changes to the articles referred to in this note would not be treated as unusual. Pending any such confirmation, companies and their advisers are free to take their own view on this issue.

6. Model Wording drafted by the Joint Working Party of the City of London Law Society's Company Law Sub-Committee and the Law Society of England and Wales' Standing Committee on Company Law

The model below is based on the wording in the Companies Act 2006 model articles for public companies. The wording replicates the wording in articles 70 to 77 of the model articles for public companies, except that new wording is provided in article 72 to meet the aims described in this guidance note. The wording is for guidance only and neither ICSA nor the Joint Working Party take any responsibility for it or are providing any advice on it. It is the responsibility of the company and its legal advisers to ensure that its articles are adequate and satisfactory for its purposes.

Wording in articles to provide flexibility for electronic dividends

DISTRIBUTIONS

Procedure for declaring dividends

- 70.** (1) The company may by ordinary resolution declare dividends, and the directors may decide to pay interim dividends.
- (2) A dividend must not be declared unless the directors have made a recommendation as to its amount. Such a dividend must not exceed the amount recommended by the directors.
- (3) No dividend may be declared or paid unless it is in accordance with members' respective rights.
- (4) Unless the members' resolution to declare or directors' decision to pay a dividend, or the terms on which shares are issued, specify otherwise, it must be paid by reference to each member's holding of shares on the date of the resolution or decision to declare or pay it.
- (5) If the company's share capital is divided into different classes, no interim dividend may be paid on shares carrying deferred or non-preferred rights if, at the time of payment, any preferential dividend is in arrear.
- (6) The directors may pay at intervals any dividend payable at a fixed rate if it appears to them that the profits available for distribution justify the payment.
- (7) If the directors act in good faith, they do not incur any liability to the holders of shares conferring preferred rights for any loss they may suffer by the lawful payment of an interim dividend on shares with deferred or non-preferred rights.

Calculation of dividends

- 71.** (1) Except as otherwise provided by the articles or the rights attached to shares, all dividends must be—
- (a) declared and paid according to the amounts paid up on the shares on which the dividend is paid, and
- (b) apportioned and paid proportionately to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid.
- (2) If any share is issued on terms providing that it ranks for dividend as from a particular date, that share ranks for dividend accordingly.
- (3) For the purposes of calculating dividends, no account is to be taken of any amount which has been paid up on a share in advance of the due date for payment of that amount.

Payment of dividends and other distributions

72. (1) Where a dividend or other sum which is a distribution is payable in respect of a share, it may, subject to article 72(2), be paid by one or more of the following means—

(a) transfer to a bank or building society account specified by the distribution recipient either in writing or as the directors may otherwise decide;

(b) sending a cheque made payable to the distribution recipient by post to the distribution recipient at the distribution recipient's registered address (if the distribution recipient is a holder of the share), or (in any other case) to an address specified by the distribution recipient either in writing or as the directors may otherwise decide;

(c) sending a cheque made payable to such person by post to such person at such address as the distribution recipient has specified either in writing or as the directors may otherwise decide;

(d) by means of a relevant system [*assumes articles incorporate definitions from USRs*] in respect of shares in uncertificated form in such manner as may be consistent with the facilities and requirements of the relevant system or as the directors may otherwise decide; or

(e) by any electronic or other means as the directors may decide, to an account, or in accordance with the details, specified by the distribution recipient either in writing or as the directors may otherwise decide.

(2) In respect of the payment of any dividend or other sum which is a distribution, the directors may decide, and notify distribution recipients, that:

(a) one or more of the means described in paragraph (1) will be used for payment and a distribution recipient may elect to receive the payment by one of the means so notified in the manner prescribed by the directors;

(b) one or more of such means will be used for the payment unless a distribution recipient elects otherwise in the manner prescribed by the directors; or

(c) one or more of such means will be used for the payment and that distribution recipients will not be able to elect otherwise.

The directors may for this purpose decide that different methods of payment may apply to different distribution recipients or groups of distribution recipients.

(3) Payment of any dividend or other sum which is a distribution is made at the risk of the distribution recipient. The company is not responsible for a payment which is lost or delayed. Payment, in accordance with these articles, of any cheque by the bank upon which it is drawn, or the transfer of funds by any means, or (in respect of shares in uncertificated form) the making of payment by means of a relevant system, shall be a good discharge to the company.

- (4) In the event that:
- (a) a distribution recipient does not specify an address, or does not specify an account of a type prescribed by the directors, or other details necessary in order to make a payment of a dividend or other distribution by the means by which the directors have decided in accordance with this article that a payment is to be made, or by which the distribution recipient has elected to receive payment, and such address or details are necessary in order for the company to make the relevant payment in accordance with such decision or election; or
 - (b) if payment cannot be made by the company using the details provided by the distribution recipient, then the dividend or other distribution shall be treated as unclaimed for the purposes of these articles.
- (5) In the articles, “the distribution recipient” means, in respect of a share in respect of which a dividend or other sum is payable—
- (a) the holder of the share; or
 - (b) if the share has two or more joint holders, whichever of them is named first in the register of members²; or
 - (c) if the holder is no longer entitled to the share by reason of death or bankruptcy, or otherwise by operation of law, the transmittee.

Deductions from distributions in respect of sums owed to the company

- 73.** (1) If—
- (a) a share is subject to the company’s lien, and
 - (b) the directors are entitled to issue a lien enforcement notice in respect of it,
- they may, instead of issuing a lien enforcement notice, deduct from any dividend or other sum payable in respect of the share any sum of money which is payable to the company in respect of that share to the extent that they are entitled to require payment under a lien enforcement notice.
- (2) Money so deducted must be used to pay any of the sums payable in respect of that share.

² This wording is taken from the 2006 Act model articles for private companies. In the case of listed companies, although the first named holder is normally classified as the senior holder, the practice that may be followed is that instructions need to be received from all joint holders in relation to instructions and elections for payment of dividends. Companies will need to discuss this with their registrars and ensure that the wording in their articles reflects how instructions are received and payments are made in practice to joint holders, for each type of payment and each type of election, or that the wording provides the directors with discretion as to whom instructions can be received from.

- (3) The company must notify the distribution recipient in writing of—
- (a) the fact and amount of any such deduction;
 - (b) any non-payment of a dividend or other sum payable in respect of a share resulting from any such deduction; and
 - (c) how the money deducted has been applied.

No interest on distributions

74. The company may not pay interest on any dividend or other sum payable in respect of a share unless otherwise provided by—
- (a) the terms on which the share was issued, or
 - (b) the provisions of another agreement between the holder of that share and the company.

Unclaimed distributions

75. (1) All dividends or other sums which are—
- (a) payable in respect of shares, and
 - (b) unclaimed after having been declared or become payable,
- may be invested or otherwise made use of by the directors for the benefit of the company until claimed.
- (2) The payment of any such dividend or other sum into a separate account does not make the company a trustee in respect of it.
- (3) If—
- (a) twelve years have passed from the date on which a dividend or other sum became due for payment, and
 - (b) the distribution recipient has not claimed it,

the distribution recipient is no longer entitled to that dividend or other sum and it ceases to remain owing by the company.

Non-cash distributions

76. (1) Subject to the terms of issue of the share in question, the company may, by ordinary resolution on the recommendation of the directors, decide to pay all or part of a dividend or other distribution payable in respect of a share by transferring non-cash assets of equivalent value (including, without limitation, shares or other securities in any company).
- (2) If the shares in respect of which such a non-cash distribution is paid are uncertificated, any shares in the company which are issued as a non-cash distribution in respect of them must be uncertificated.

(3) For the purposes of paying a non-cash distribution, the directors may make whatever arrangements they think fit, including, where any difficulty arises regarding the distribution—

- (a) fixing the value of any assets;
- (b) paying cash to any distribution recipient on the basis of that value in order to adjust the rights of recipients; and
- (c) vesting any assets in trustees.

Waiver of distributions

77. Distribution recipients may waive their entitlement to a dividend or other distribution payable in respect of a share by giving the company notice in writing to that effect, but if—

- (a) the share has more than one holder, or
- (b) more than one person is entitled to the share, whether by reason of the death or bankruptcy of one or more joint holders, or otherwise,

the notice is not effective unless it is expressed to be given, and signed, by all the holders or persons otherwise entitled to the share.

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