

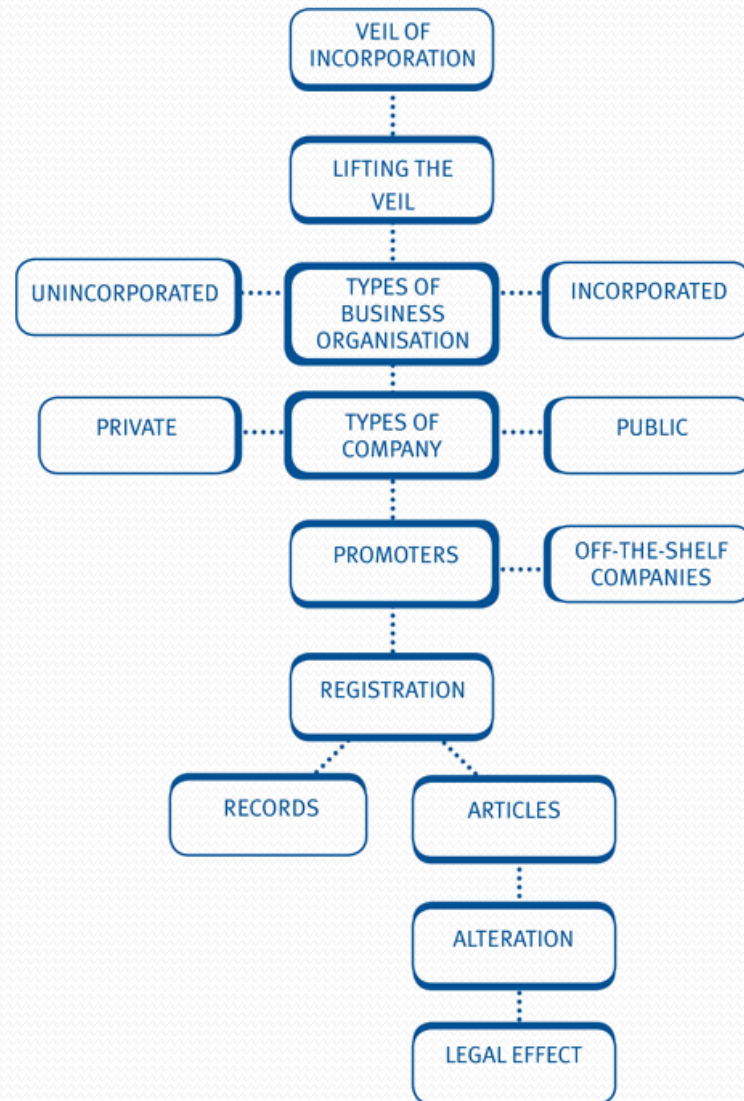
Companies

Company Formation & Legal Personality: Types, Veil,
Lifting Veil of Incorporation, MOA & AOA

Aims of the lecture

Upon completion of this chapter you will be able to:

- distinguish between **sole traders, partnerships and companies**
- explain the meaning and effect of **limited liability**
- analyse the different types of companies, especially **public and private companies**
- illustrate the effect of **separate personality**
- recognise instances where separate personality will be ignored
- explain the role and duties of **company promoters**
- describe the **procedure for registering companies**, both public and private
- describe the **statutory books, records and returns** that companies must keep or make
- describe the contents of **model articles of association**
- analyse the effect of a **company's constitutional documents**
- explain how **articles of association can be changed**.



The doctrine and veil of incorporation

Whereas English law treats a partnership as simply a group of individuals trading collectively, the effect of incorporation is that a company once formed has its own distinct legal personality, completely separate from its members.

Salomon v Salomon & Co Ltd (1897)

Facts:

- S transferred his business to a limited company. He was the majority shareholder and a secured creditor. The company went into liquidation and the other creditors tried to obtain repayment from S personally.

Held:

- S as shareholder and director had no personal liability to creditors, and he could be repaid in priority as a secured creditor. This enshrined the concepts of separate legal personality and limited liability in the law.

Consequences of incorporation

Limited liability

No one is responsible for anyone else's debts unless they agree to accept such responsibility. Unless the shareholders agree to accept liability for their company's debts. In return for this agreement, the extent of their liability is set at a fixed amount. In the case of a company limited by shares, the level of liability is the amount remaining unpaid on the nominal value of the shares held. In the case of a company limited by guarantee, it is the amount that shareholders have agreed to pay in the event of the company being wound up.

Perpetual existence

As the corporation exists in its own right, changes in its membership have no effect on its status or existence. Members may die, be declared bankrupt or insane, or transfer their shares, all without any effect on the company. As an abstract legal person the company cannot die, although its existence can be brought to an end through the winding-up procedure.

Business property is owned by the company

Any business assets are owned by the company itself and not the shareholders.

Legal capacity

The company has contractual capacity in its own right and can sue and be sued in its own name. The extent of the company's liability, as opposed to the members, is unlimited and all its assets may be used to pay off debts. The company may also be liable in tort for any injuries sustained as a consequence of the negligence of its agents or employees.

Sue and be sued in court - **Foss v Harbottle (1843)**

This states that where a company suffers an injury, **it is for the company**, acting through the majority of the members, **to take the appropriate remedial action**. Perhaps of more importance is the corollary of the rule, which is that an individual cannot raise a legal action in response to a wrong suffered by the company

Lifting veil of incorporation - Statute

- Under **s767 CA06** if a **public company** starts to trade without first obtaining a **trading certificate**,
 - the directors can be made personally liable for any loss or damage suffered by a third party
- Under the **Company Directors Disqualification Act 1986**, if a **director who is disqualified** participates in the management of a company,
 - that director will be jointly or severally liable for the company's debts.
- Under the **Insolvency Act 1986**,
 - members and/or directors held liable for **wrongful or fraudulent trading** may be made personally liable for losses arising as a result.

Lifting veil of incorporation – Case law

- **Sham companies.**

The courts will not permit the corporate form to be used for a clearly fraudulent purpose or to evade a legal duty.

- Thus in **Gilford Motor Co Ltd v Horne (1933)** an employee had covenanted not to solicit his former employer's customers. After he left their employment he formed a company to solicit those customers and it was held that the company was a sham and the court would not permit it to be used to avoid the contract.
- **Jones v Lipman (1962)** – The veil was lifted in order to prevent the seller of a house evading specific performance.

- **Nationality.**

The courts are prepared to ignore separate personality in times of war in order to defeat the activity of shareholders who might be enemy aliens.

- See **Daimler Co Ltd v Continental Tyre and Rubber Co (GB) Ltd (1916)**.

- **Groups.**

Where groups of companies have been set up for particular business purposes, the courts will usually not ignore the separate existence of the various companies, unless they are being used for fraud.

- Although there is authority for treating separate companies as a single group (as in **DHN Food Distributors Ltd v London Borough of Tower Hamlets (1976)**) later authorities have cast extreme doubt on this decision (see **Woolfson v Strathclyde Regional Council (1978)**). More recent cases would appear to suggest that the courts are now more reluctant to ignore separate personality where the company has been properly established (**Adams v Cape Industries plc (1990)**).

Types of Business Organisations

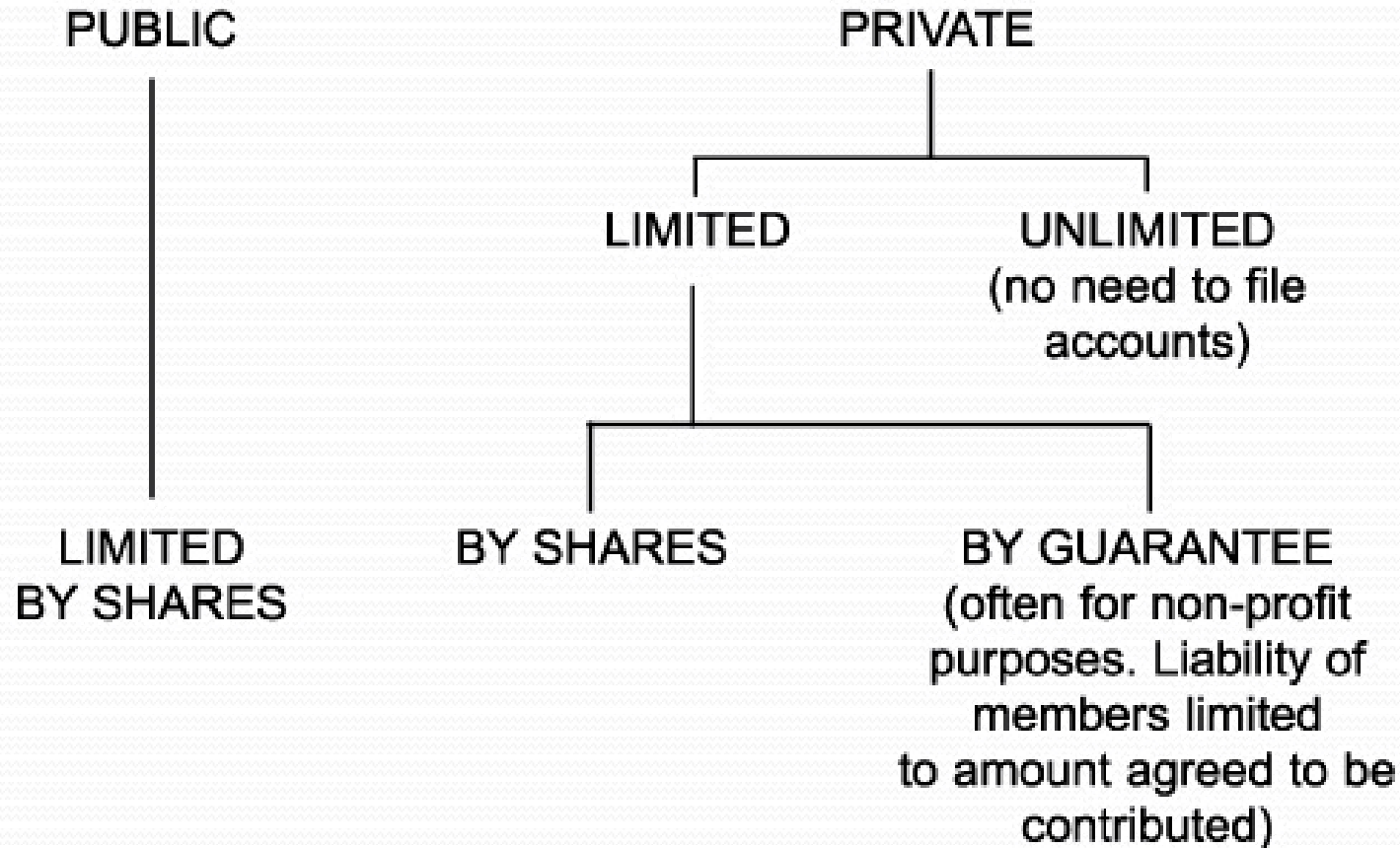
Unincorporated:

- Sole trader (self-employed): The owner 'is' the business – owns the assets and is liable for all the debts. No legal formalities are required to set up a sole trader business. This form of business is inappropriate for large businesses or those involving a degree of risk.
- Partnership: the relationship which subsists between persons carrying on a business in common with a view of profit
 - General
 - Limited

Types of Business Organisations

Incorporated:

- Limited Liability Partnerships ([Partnership Act 2000](#))
 - An artificial legal entity with perpetual succession. It can hold property in its own right, enter into contracts in its own name, create floating charges, sue and be sued
 - The liability of the members of an LLP is limited to the amount of capital they have agreed to contribute.
 - The LLP must file annual accounts and an annual report with Companies House.
- Private unlimited companies ([Companies Act 2006](#))
 - May or may not have a share capital and there is no limit to the members' liability.
- Private limited companies ([Companies Act 2006](#))
 - **By shares**
 - **By guarantee** - members do not make any contribution to the capital during its lifetime as they do not purchase shares. The members' liability is limited to the amount that they each agree to contribute to the company's assets if it is wound up.
- Public limited companies ([Companies Act 2006](#))
- Community Interest Companies ([S6 Companies Act 2006](#))



Private v Public

	Public companies	Private (limited) companies
Definition	Registered as a public company.	Any company that is not a public company.
Members	At least two members.	Can have a single member.
Name	Ends with plc or public limited company.	Ends with Ltd or limited.
Capital	Must not be less than the authorised minimum (currently £50,000) and, in order to trade, must have allotted shares of at least that amount.	No minimum (or maximum) requirements.
Raising capital	May raise capital by advertising its securities (shares and debentures) as available for public subscription.	Prohibited from offering its securities to the public.
Start of trading	Must obtain trading certificate from registrar before commencing trading.	Can begin from date of incorporation.

Private v Public

	Public companies	Private (limited) companies
Directors	Minimum two.	Minimum one.
Secretary	Must be qualified.	Need not have one.
Accounts	Must file accounts within six months.	Need not lay accounts before general meeting. Must file within nine months.
Audit	Accounts must be audited.	Audit not required if turnover below £5.6m.
AGM	Must be held each year.	Need not hold an AGM.
Resolutions	Cannot pass written resolutions.	Can pass written resolutions.

Promoters - Definition

- There is no statutory definition of a promoter.
- According to case law, a promoter is a person who **‘undertakes to form a company and who takes the necessary steps to accomplish that purpose’**:
Twycross v Grant (1878).
- The definition excludes people acting in a professional capacity.

Promoters – Fiduciary Duties

- disclose any **interest** in transactions to the company and not to make a **secret profit**
- disclose any **benefit acquired** to an independent board and/or to the shareholders.

If a promoter does make a secret profit, the company may:

- **Rescind the contract** – but this is not always possible, e.g. if a third party has acquired rights under the contract
 - Example of third party rights: A sells his business to B on the terms that B will pay A £1000 a month for the rest of his life and will pay A's wife, T, £500 a month if A predeceases her. A dies. B refuses to pay T anything.
- **Obtain damages** – but this requires the company to prove loss
- **Recover the profit** – the company must prove that the promoter has failed to disclose his profit from a transaction.

Pre-incorporation contracts

- A pre-incorporation contract is a **contract made by a person acting on behalf of an unformed company**.
- The position at common law is that a **company**, prior to its incorporation, **does not have contractual capacity** and the **promoter is therefore personally liable**. (This is because a company does not legally exist until it is incorporated.)

Kelner v Baxter (1866)

- **Facts:** A, B and C entered into a contract with the claimant to purchase goods on behalf of the proposed Gravesend Royal Alexandra Hotel Co. The goods were supplied and used in the business. Shortly after incorporation the company collapsed.
- **Held:** As the Gravesend Royal Alexandra Hotel Co was not in existence when the contract was made it was not bound by the contract and could not be sued for the price of the goods. Neither could it ratify the contract after incorporation.

Pre-incorporation contracts

- **S51 CA06** reinforces the common law position by providing that, subject to any agreement to the contrary, the **person making the contract is personally liable**. Clear and express words are needed in order to negate liability: **Phonogram Ltd v Lane (1981)**.
- The promoter can protect his position by:
 - including a term in the contract **giving the company the right to sue** under the **Contracts (Rights of Third Parties) Act 1999**
 - **postponing** finalising contracts until the company is formed
 - entering into an agreement of **novation** (this involves discharging the original contract and replacing it with a new one) or **assigning** (transferring) the contract
 - agreeing with the company that **there is no personal liability** for the promoter
 - buying an '**off-the-shelf** company, so it is ready to contract.

Off-the-shelf companies

An 'off-the-shelf' company is one that **has already been formed**.

- Advantages:
 - cheap and simple
 - can trade immediately
 - no problem of pre-incorporation contracts.
- Disadvantage:
 - The articles of association may be unsuitable. They can be altered, but that entails cost and administrative inconvenience.

Registration Documents (S9 CA06)

- **Memorandum of association**

- Signed by all subscribers and stating that they wish to form a company and agree to become members of the company.

- **Application** – it must include:

1. the proposed **name** of the company
2. whether the members will have limited **liability** (by shares or guarantee)
3. whether the company is to be **private or public**
4. details of the **registered office**
5. statement of capital and initial **shareholdings**

- **Articles of Association**

- the model articles ([Tables A-F](#)) apply if no articles are supplied.
- The [new model articles](#) will apply to new companies formed on or after 1 October 2009

Registration Documents (S9 CA06)

- **Statement of capital and initial shareholdings (S10 CAo6)**
 - the number of shares
 - their aggregate nominal value
 - how much has been paid up
- **Statement of guarantee (S11 CAo6)**
 - (if applicable) - maximum amount each member undertakes to contribute
- **Statement of proposed officers Form 10 (S12 CAo6)**
- **Statement of compliance Form 12 (S12 CAo6)**
- **Registration fee**
 - standard registration £20 paper/£15 online
 - same day incorporation £50 paper /£30 online

Registrar's duties

- **Inspect the documents** and ensure that Companies Act requirements are fulfilled.
- **Issue certificate of incorporation** which is conclusive evidence that Companies Act requirements have been fulfilled: **s15 CA06**. The company exists from the date on the certificate of incorporation.
- **Issue a trading certificate** (PLC only)

Trading certificate - plc only

- A plc **cannot commence trading** until the Registrar has issued a trading certificate.
- In order to obtain a trading certificate, an **application** must be made to the registrar which **states**:
 - The nominal value of allotted **share capital** \geq **£50,000**.
 - That **at least a quarter** of the nominal value and all of the premium have been **paid up**.
 - The amount of **preliminary expenses** and who has paid or is to pay them.
 - Any **benefits given** or to be given to **promoters**.

Trading certificate - plc only

If a plc trades before the certificate is issued:

- The company and any officers in default are liable to a fine.
- It is a criminal offence to carry on business, but any contracts are still binding on the company.
- The directors are personally liable if the company defaults within 21 days of due date.
- There are grounds for winding up if not obtained within one year:
s122 IA 1986.

Company name

- It must have limited (**Ltd**) or public limited company (**plc**) at the end as applicable.
- It cannot be the **same as another** in the index of names.
- It cannot use certain **words which are illegal or offensive**.
- It must have the **Secretary of State's consent** to use certain words (e.g. England, Chartered, Royal, National, University, Insurance, etc.) or any name suggesting a connection with the **government or any local authority**.
- It must avoid the **tort of passing off**: ELSA & ELSA.

Company's internal constitution

1. Memorandum of Association

- Sets out the company's **name**,
- the proposed **location** of its registered office (i.e. 'England and Wales', 'Wales' or 'Scotland') in the UK,
- the **objects** of the company,
- a statement regarding the **liability** of its members and
- details of its **share capital**, if any, (or in the case of a UK company limited by guarantee, the amount which members will contribute in a winding up).
- Also, in the case of a UK company having a share capital, the memorandum must show the **name of each initial member/shareholder** (also called 'subscribers') and the number of shares each takes.

2. Articles of Association

- set out the manner in which the company is to be governed, and
- regulate the relationship between the company and its shareholders

Articles of Association - Model articles

- For companies incorporated under Companies Act 2006, **model articles will be prescribed by the Secretary of State.**
- These model articles will apply where a company is formed **without registering articles** or where the **articles registered do not exclude or modify the model articles.**
- A company:
 - may adopt the model articles in full or in part
 - is deemed to have adopted the model articles if there is no express or implied provision to exclude them, or
 - may draft its own unique articles.

Articles of Association - Alteration

Procedure

- By a **special resolution** (75% majority)
- Copies of the amended articles must be **sent to the Registrar within 15 days.**
- It is possible to **entrench** some of the articles. This means that a specified procedure (e.g. unanimous consent) may be required to change them.
- **S25 CA06** prevents a member being bound by any alteration made after he becomes a member that requires him to increase his liability or contribute further to the company.

Articles of Association - Alteration

Common law restriction

- Any change to the articles must be (benefit) '**bona fide in interests of the company as a whole**': **Allen v Gold Reefs of Africa (1900)**.
 - **Subjective element**: members deciding an alteration must actually believe they are acting in the interest of a company
 - **Objective element**: any alteration must be in the interest of the 'individual hypothetical member'. It depends on the facts of a case.

Articles of Association - Alteration

- It is for the members to decide whether the change is bona fide in the interests of the company as a whole.
- The court will not interfere unless no reasonable person would consider the change to be bona fide.
- If the change is bona fide, it is immaterial if that happens to inflict hardship or has retrospective operation.
- The change will be void if actual fraud or oppression takes place.
- An alteration is not invalid merely because it causes a breach of contract - but that does not excuse breach.

Articles of Association - Alteration

Brown v British Abrasive Wheel Co (1919) – INVALID

- By providing an **unlimited power of expropriation over a minority interest**, the alteration could not be held as ‘bona fide’ interest of the company as a whole. Minority shareholder can challenge such a decision.

Sidebottom v Kershaw, Leese & Co (1920) – VALID

- Alteration to the articles to give the **directors the power to require any shareholder**, who entered into **competition** with the company, **to sell their shares** to nominees of the directors at a fair price

Greenhalgh v Arderne Cinemas Ltd (1950)

Allen v Gold Reefs of West Africa Ltd (1900)

Southern Foundries (1926) Ltd and Federated Foundries Ltd v Shirlaw (1940)

Company's internal constitution – legal effect

- The provisions of a company's constitution **bind the company and its members** to the same extent as if there were covenants on the part of the company and of each member to observe those provisions (**S33 CA06**). This means that the articles form a **contract between the company and its members**, and the members between themselves, even if they do not sign them.
- The articles are in all respects **enforceable by the company against its members**.
- The articles also operate as a **contract between individual members in their capacity as members**.

Company's internal constitution – legal effect

- The articles **do not bind the company to non-members.**
 - **Hickman v Kent or Romney Marsh Sheepbreeders' Association (1920)**
 - **Eley v Positive Government Security Life Assurance Co (1876)**
- The articles are **enforceable by the shareholders against the company.**
 - **Pender v Lushington (1877)**
 - **Rayfield v Hands (1958)**
- The articles **do not bind the members in any other capacity.**
 - **Beattie v EF Beattie (1938)**

Company's internal constitution – legal effect

- Even where the articles are not a relevant contract for this purpose they may be **evidence of another contract made independently**.
 - **New British Iron Co, ex parte Beckwith (1898)**

EXAM TIP: check the capacity in which the person is claiming. Is it as a member, or in some other capacity, such as a director or an accountant? In Eley's case above, Eley's membership was irrelevant to his claim; as solicitor he had no claim – he was attempting to enforce a non-member's right.

Statutory books, returns and records

Registers

Register	Contents
Members	Names, addresses, date became/ceased, number of shares, type, amount paid up.
Directors and company secretary	Name, address, occupation, nationality, other directorships within the last five years and date of birth.
Charges	Name of chargee, type of charge, property charged, amount and date created.
Other documents	Minutes of general meetings.
Resolutions and meetings	Records must be kept for a minimum period of ten years.

- Depending on the nature and situation of the company it may be obliged to keep **up to 13 possible registers**.
- These registers must either be held at the **Registered Office Address (ROA)**, or at a **Single Alternative Inspection Location (SAIL)**.
- The registers must be **available for public inspection**.

Statutory books, returns and records

- **Requests for inspection** must provide
 - details about the person seeking the information,
 - the purpose of the request and
 - whether the information will be disclosed to others.
 - The company may apply to the court for an order that it need not comply with the request.
- **The register of directors' addresses should now contain service addresses** rather than details of the directors' residential addresses. The service address can be simply 'the company's registered office'.
- The company must also keep a **separate register of the directors' residential addresses**. Both the service and the residential addresses will need to be supplied to the Registrar of Companies.
 - The residential addresses will be withheld from the public register.
 - However, they will generally remain available to the Registrar and certain specified public bodies and credit reference agencies.

Statutory books, returns and records

Annual return - is a record of key company information

- must be filed with the Registrar annually **within 28 days of the return date** (which is the anniversary of incorporation).
- It contains:
 - address of registered office
 - type of company
 - principal business activities
 - details of officers
 - details of issued shares and their holders
 - details of private company elections to dispense with holding AGMs/laying accounts.

Statutory books, returns and records

Accounting records - records which are sufficient to show and explain a company's transactions and to disclose (with reasonable accuracy) its financial position at any time. In particular the records must show:

- details of all money received and spent
- a record of assets and liabilities
- statement of stocks at end of year
- statements of all goods sold and purchased, showing the goods and the buyers and sellers (except in the retail trade).

Statutory books, returns and records

Annual financial statements

- **Contents:** companies are required to produce annual financial statements including:
 - **balance sheet and profit and loss account** showing true and fair view
 - **directors' report** stating the amount of any dividend and likely future developments.
- **Form:** the annual financial statements must be
 - **approved and signed on behalf of the board of directors** and
 - **a copy filed with Registrar.**