> of partnership requires that the partners be in business 'in common' which they obviously are not if one or more of them is deprived of a say in management. A general partner who is deprived of a say in management is, in the absence of a contrary agreement, entitled to dissolve the firm.

However, the partnership analogy would not necessarily be applied to all private companies. The analogy is most likely to be used where, as in the ***Westbourne*** case, the proprietors (members) and the managers (directors) are one and the same, as full general partners in a partnership are.

Comment

➲ See p. 312

(i) For the possibility, in more recent times, of using the more versatile remedy of 'unfair prejudice' under s 994, see Chapter 16 ➲.

➲ See p. 328

(ii) It should also be noted that the Nazars did not offer to buy Mr Ebrahimi's shares. If they had done so, e.g. at a fair price to be decided by the company's auditors, the court may not have wound the company up so that Mr Ebrahimi could get his share capital back. A pretty drastic remedy, though, to wind up a solvent company just to achieve this (see also Chapter 16 ➲).

Statutory provisions

A good starting point for the discussion of such statutory provisions is Lord Diplock's statement in ***Dimbleby & Sons Ltd*** v ***National Union of Journalists*** [1984] 1 WLR 427 when he observed: 'The corporate veil in the case of companies incorporated under the Companies Acts is drawn by statute and it can be pierced by some other statute if such statute so provides; but, in view of its raison d'etre and its constant recognition by the courts since ***Salomon*** v ***A. Salomon & Co Ltd***, one would expect that any parliamentary intention to pierce the corporate veil be expressed in clear and unequivocal language.'

(a) Section 761, Companies Act 2006

It will be recalled that by reason of s 761 a plc cannot commence trading or exercise borrowing powers unless and until it has received a s 761 certificate from the Registrar. If it does so, the transactions are enforceable against the company but if the company fails to meet its obligations within 21 days of being called upon to do so the directors are, under s 767, jointly and severally liable to indemnify a person who has suffered loss or damage by reason of the company's failure to meet its obligations. This is a further example of liability in the directors to pay, e.g. the company's debts, and no proof of fraud is required.

(b) Section 405, Companies Act 2006

This provides that where there is a holding and subsidiary relationship between companies the holding company is required, subject to certain exceptions already referred to, not only to prepare its individual accounts but also group accounts. This suggests that for financial purposes the companies within a group are one.

Finally, there are a number of examples to be found in the law relating to corporate insolvency. Thus, when a company goes into liquidation and the evidence shows that the directors have negligently struggled on for too long with an insolvent company in the hope that things would get better but which has, in the end, gone into insolvent liquidation, there are provisions in the Insolvency Act 1986 under which the directors concerned may, if the company goes into liquidation, be required by the court, on the application of the liquidator, to make such contribution to the company's assets as the court thinks proper. This means in effect that the directors will be paying or helping to pay the company's debts. Further and more detailed considerations will be given to this concept, which is called wrongful trading, and others in the chapters on directors and corporate insolvency which is where they really belong.

It is worth noting that when offering s 767 together with the insolvency situations as examples of drawing aside the veil to make the members liable for the debts of the company, these are examples of director liability. They are therefore only truly legitimate examples if the directors are also members. Since most of the problems in this area occur in private companies where the directors are normally also members, the examples can be given provided it is made clear that we assume we are dealing with director/members.

Limits on lifting the veil

It should be noted though that concepts such as 'fairness' and 'justice' do not play a leading role in the court's consideration of whether or not the corporate veil should be lifted. The prevailing attitude of the judiciary is that those individuals who adopt the corporate form should expect to take 'the 'highs with the lows'. Indeed, this has been highlighted by Browne-Wilkinson VC who observed in ***Tate Access Floors Inc*** **v** ***Boswell*** [1991] Ch 512: 'If people choose to conduct their affairs through the medium of corporations, they are taking advantage of the fact that in law those corporations are separate legal entities, whose property and actions are in law not the property or actions of their incorporators or controlling shareholders. In my judgment controlling shareholders cannot, for all purposes beneficial to them, insist on the separate identity of such corporations but then be heard to say the contrary when discovery is sought against such corporations.' Thus, as noted earlier, in ***Woolfson*** **v** ***Strathclyde Regional Council*** (1978) 38 P & CR 521 the House of Lords did not follow ***DHN Foods*** in what was a similar situation.

Companies and partnerships compared

In this chapter we are considering the nature of a company. Sometimes examiners ask students to show an understanding of that by making a comparison with another business organisation – the partnership. In this connection, it is necessary to note that there are three forms of partnership in current law. The first and the oldest form is governed by the Partnership Act 1890 and is referred to here as the ordinary partnership. There is also the limited partnership governed by the Limited Partnerships Act of 1907, and finally the limited liability partnership governed by the Limited Liability Partnerships Act 2000. Really the only sensible comparison in terms of illustrating a knowledge of the nature of a company is with the ordinary partnership, but the main points of the other two might be included in an answer. A comparison with the relevant organisations appears below.

The ordinary and limited partnership

Formation

A company is created by registration under company legislation. A partnership is created by agreement which may be express or implied from the conduct of the partners. No special form is required, though partnership articles are usually written, and, in the case of a limited partnership, must be written.

From 19 August 2010, Companies House electronic filing services have been enhanced so as to enable Limited Liability Partnerships to file their information on-line. LLPs will be able to join the PROOF Scheme (protected on-line filing). Transactions available via the filing service include annual returns, the appointment of corporate members, any changes to members' details, and the termination of appointment of members. (See: http://www.companieshouse.gov.uk/onlinefilingLLP/index.shtml)

Status at law

A company is an artificial legal person with perpetual succession. Thus a company may own property, make contracts, and sue and be sued. As we have seen, it is an entity distinct from its members. These partnerships are not legal persons though they may sue and be sued in the firm's name. Thus, the partners own the property of the firm and are liable on the contracts of the firm.

Transfer of shares

Shares in a company are freely transferable unless the company's constitution otherwise provides; restrictions may, of course, appear in the articles of a private company. A partner can transfer his share in the firm, but the assignee does not thereby become a partner and is merely entitled to the assigning partner's share of the profits.

Number of members

A company whether public or private has no upper limit of membership. For many years partnerships were, with some exceptions, limited to 20 members. The relevant provision which was in the Companies Act 1985 has now been repealed and the Companies Act 2006 carries no upper limit so there is now no contrast to be made in terms of membership requirements.

Management

Members of a company are not entitled to take part in the management of the company unless they become directors. General partners are entitled to share in the management of the firm unless the articles provide otherwise.

Agency

A member of a company is not by virtue only of that membership an agent of the company, and he cannot bind a company by his acts. Each general partner is an agent of the firm and may bind the firm by his acts.

Liability of members

The liability of a member of a company may be limited by shares or by guarantee. The liability of a general partner is unlimited. In a limited partnership one or more of the partners may limit his liability for the firm's debts to the amount of capital he has contributed, though even a limited partnership must have at least one general partner. In this connection it should be noted that a partnership can consist entirely of limited companies in order, for example, to further a joint venture between them which stops short of merger, and a limited company can be a partner with individuals as the other partner(s). This will not in either case make the partnership a limited partnership unless the firm is registered as such under the Limited Partnerships Act 1907. The liability of a limited company for debt is unlimited in that it is liable for debt down to its last asset. It is the liability of the members which is limited.

Powers

The affairs of a company are closely controlled by company legislation and the company, if it has started objectives, can only operate within those objects as laid down in its articles of association, though these can be altered to some extent by special resolution. Partners may carry on any business they please so long as it is not illegal and make what arrangements they wish with regard to the running of the firm. This position can be taken these days by registered companies, as the Companies Act 2006 does not require them to have objects clauses, though they may have them if they so wish.

Termination

No one member of a company can wind up the company (but see exceptionally ***Ebrahimi***), and the death, bankruptcy or insanity of a member does not mean that the company must be wound up. A partnership may be dissolved by any partner giving notice to the others at any time unless the partnership is entered into for a fixed period of time. However, dissolution by notice depends upon what the partnership agreement, if any, says. If, as in ***Moss*** v ***Elphick*** [1910] 1 KB 846, the agreement says that dissolution is only to be by mutual consent of the partners, then dissolution by notice as described above does not apply. A partnership is, subject to any agreement between the partners to the contrary, dissolved by the death or bankruptcy of a partner. The partnership agreement will normally provide that the business is to continue under the remaining partner(s), so the dissolution is only a technical one, though it does leave the continuing partner(s) to deal with the paying out of the former partner's share in the business, usually in line with provisions in the partnership agreement.

Limited liability partnerships – the Act

The position is as follows.

Formation. A limited liability partnership (LLP) is created by registration of an incorporation document with the Registrar of Companies.

Status at law. An LLP is a body corporate and exists as a separate entity from its members in the same way as a limited company does. It has unlimited capacity to act and may enter into contracts and hold property. It continues in existence even though its individual members may change.

Transfer of membership. New members may be admitted by agreement with the existing members. A person ceases to be a member by following procedures agreed with the other members. Where there is no formal agreement, a person ceases to be a member by giving reasonable notice to the other members. Changes in membership must be notified to the Registrar within 14 days.

Number of members. There is no limit on the number of members in a limited liability partnership.

Management. There is no requirement for management powers to be set out in a formal document but it is usual to have one. In the absence of an agreement, the regulations made under the Act of 2000 set out default provision under which every member may take part in the management of the LLP.

Agency. Each member is an agent of the LLP and, therefore, can represent it and act on its behalf in all its business. However, the LLP will not be bound by the actions of a member where that member does not have authority to act and the person dealing with the member is aware of this or does not know or believe the member to be a member of the LLP.

Liability of members. The LLP and its assets are primarily liable for the debts and obligations of the firm, and in the ordinary course of business and in respect of debts, for example, the members will not be personally liable. However, they could lose the capital that they had invested in the LLP if its assets were exhausted in paying its debts. LLPs can be set up for any business, but there is perhaps an additional risk for partners in professional organisations such as accountants and lawyers. Here the individual member has a duty of care at common law for negligent work, and under the LLP legislation a negligent member, e.g. an accountant causing loss by negligently prepared accounts, may have his personal assets taken in a payment of damages if the LLP's assets are insufficient. The non-negligent members would not be at risk of this. However, it should be noted that this personal liability will be rare since the claimant will have to show that the member concerned was accepting personal liability. In most cases the evidence will show that he was intending only to act for the LLP, in which case only the assets of the LLP will be available to satisfy the claim.

Powers. An LLP has unlimited power to act and will not face any problems of *ultra vires* (beyond the powers) even in the restricted sense that it applies to modern companies.

Termination. An LLP can be dissolved by agreement of the members. In the situation where the LLP is insolvent, creditors can initiate a winding-up and company insolvency procedures are followed including administration and voluntary arrangements. In a winding-up past and present members are liable to contribute to the assets of the LLP to the extent that they have agreed to do so in the LLP agreement.

Limited liability partnerships – the regulations

The Limited Liability Partnerships Regulations 2001 (SI 2001/1090) came into force on 6 April 2001. They support the Act and are vital to an understanding of the operation of the law. They are quite detailed but in the end, and broadly speaking, apply company provisions to LLPs with appropriate and necessary change of wording. The regulations provide as follows.

Accounts and audit exemption

Most of the relevant provisions of the Companies Act 2006, the Company Directors Disqualification Act 1986, the Insolvency Act 1986 and the Financial Services and Markets Act 2000 are applied to LLPs with appropriate modifications. In particular, the requirements relating to the keeping and retaining of accounting records and the preparation and publication of annual accounts, the form and content of annual accounts and the audit requirement are applied to LLPs in the same way as to companies with the members of the LLP taking on the duties of directors and their responsibilities.

There is, however, no requirement to prepare the equivalent of a directors' report. A period of 10 months is given for delivery of accounts to the Registrar of Companies from the end of the financial year. Small LLPs and medium-sized LLPs will be able to take advantage of the provisions of the Companies Act 2006 applying to small and medium-sized companies, and the qualifying thresholds are the same. The usual company audit exemptions will apply as will the dormancy rules.

Financial disclosure: a disadvantage

So far as clients are concerned, one of the major disadvantages to the adoption of LLP status is the company-style financial disclosure. Even under the regime of abbreviated accounts financial disclosure may make an LLP vulnerable to commercial pressure. Furthermore, where it is necessary to disclose the income of the highest paid member of the LLP (which is where the aggregate profit exceeds £200,000) there may be repercussions from clients, creditors and staff. The government is being pressed to remove the disclosure requirements and, in general terms, the company analogy is not perfectly made out because disclosure and audit and accounting rules in a company are to a large extent to protect the shareholders against the directors. This is not the case with the members/managers of the LLP. In this connection it is worth noting that American LLPs do not need to disclose financial information at all, although some states do not permit the formation of LLPs.

Limited liability: alternatives

For those clients who do not wish to move into LLP financial disclosure and find the unlimited liability of one partner an off-putting feature of the limited partnership, there are only the following alternatives, given the rules of company disclosure:

- to ensure heavy supervision of competent staff to avoid actionable errors;
- to negotiate with customers a contractual exclusion or limitation of liability, following careful drafting of the relevant clause and preferably a price reduction for those customers who accept the clause;
- the back-up of insurance where this can be obtained and is not prohibitive in terms of premiums, as it has become so far as professional indemnity insurance is concerned.

Other provisions

Execution of documents. Instead of the company rule of signature by the company secretary and a director, it is provided that two members of an LLP are to be signatories for valid execution.

Register of debenture holders. An LLP must keep a register of debenture holders and debenture holders have a right to inspect it.

Registered office. The Registrar will receive notice of the address of the registered office on incorporation and must be notified of changes.

Identification. The name of the LLP is to appear outside its place of business and on correspondence and on its common seal if it has one.

Annual return. The regulations provide that an LLP must deliver an annual return to the Registrar of Companies and set out the requirements as to contents.

Auditors. Subject to the applicability of the audit exemption rules, an LLP is in general required to appoint auditors. Provision is made for the Secretary of State to appoint auditors where an LLP is in default. The auditors have various rights including the right to have access to an LLP's books, accounts and information as necessary, the right to attend meetings of the LLP and certain rights in the event of being removed from office or not being re-appointed. Provision is also made for the resignation of auditors and the making of a statement by a person ceasing to hold office.

Registration of charges. An LLP is required to register charges with the Registrar of Companies (see Chapter 22 ➡).

➡ See p. 477

Arrangements and reconstructions. An LLP has power to compromise with its members and creditors.

Investigations. An investigation of an LLP may be made following its own application or that of not less than one-fifth in number of its members.

Fraudulent trading. This is punished in the case of an LLP in the same way as a company trading fraudulently.

Wrongful trading. The law relating to wrongful trading is applied with the necessary changes in nomenclature to members of an LLP who trade on with an insolvent LLP as it is to the directors of a company.

Unfair prejudice. Schedule 2 of the regulations applies the Companies Act 2006 so that in general there is a remedy for the members of an LLP who suffer unfair prejudice. The members of an LLP, however, by unanimous agreement may exclude the right set out in s 994(1) for such period as may be agreed.

Matters arising following winding-up. There are provisions dealing with the power of the court to declare a dissolution void, the striking out by the Registrar of Companies of a defunct company and Crown disclaimer of property vesting as *bona vacantia*.

Functions of the Registrar of Companies. These are set out in Sch 2 and include the keeping of records of the LLPs' filed documents on the same lines as for registered companies.

Miscellaneous provisions. These include the form of registers, the use of computers for records, the service of documents, the powers of the court to grant relief and the punishment of offences.

Disqualification. Part III of the regulations applies the provisions of the Company Directors Disqualification Act 1986 to LLPs with appropriate modifications. Under the provisions, members of an LLP will be subject to the same penalties that apply to company directors and may be disqualified from being a member of an LLP or a director of a company under those provisions.

Insolvency. Under Part IV of and Sch 3 to the regulations the insolvency provisions applied to LLPs include procedures for voluntary arrangements, administration orders, receivership and liquidation. There are two notable modifications to the company rules, namely:

(a) a new s 214A under which withdrawals made by members in the two years prior to winding-up will be subject to clawback if it is proved that, at the time of the relevant withdrawal, the member knew or had reasonable grounds to believe that the LLP was or would be made insolvent;

(b) a modified s 74 providing that in a winding-up both past and present members are liable to contribute to the assets of the LLP to the extent that they have agreed to do so with the other LLP members in the partnership agreement.

In effect, therefore, this gives members of an LLP protection in terms of limited liability. However, the matter is not straightforward. There is no obligation either in the Act of 2000 or the regulations to have a written agreement and the default provisions in Reg 7 do not deal with the extent of the liability of each member on liquidation. The position is therefore left ill-defined, there being no relation between capital contributed and liability to contribute to deficits as there is with companies. In these circumstances insolvency practitioners may find difficulty in determining the liability of members of an LLP on liquidation. This problem area underlines once again the need for a written agreement to be made in an LLP governing the maximum liability of each member on liquidation or stating that a member is to have no liability so that creditors would have to rely on the assets of the LLP alone. Unfortunately this situation would not necessarily be known to creditors since there is no requirement to file LLP agreements so that they are not open to public inspection.

It should be noted that the insolvency provisions relating to limited liability partnerships are subject to s 14 of the Insolvency Act 2000 since they follow corporate procedures. This means that if an LLP does business in other countries of the EU and becomes insolvent it may find that insolvency proceedings may be brought in regard to a place of operations in a particular EU territory.

LLPs authorised under the financial services regime. There are in corporate law special insolvency provisions for companies involved in the financial markets because of the special problems of corporate failure in that field. These provisions contained in Parts XV and XXIV of the Financial Services and Markets Act 2000 are applied to relevant LLPs.

Default provisions. Part VI of the regulations contains ‘fall-back’ provisions that apply where there is no existing limited liability partnership agreement or where the agreement does not wholly deal with a particular issue. The provisions represent a modification of s 24 of the Partnership Act 1890. There are provisions relating e.g. to profit share, remuneration, assignment of partnership share, inspection of books and records, expulsion and competition.

LLP or private limited company? – a checklist

Legal uncertainty. The company structure is a long-standing business organisation that is tried and trusted by advisers. It is set in a well-developed body of law which, over the years, has acquired a high degree of legal certainty. By contrast, the LLP is a new structure that has not been tried and tested in terms of its legal framework and legal uncertainty is often undesirable in business organisations.

Limited liability. This is, for all practical purposes, the same in the corporate and LLP organisations.

➡ See p. 94

Internal flexibility. Greater flexibility in internal matters and management is claimed for the LLP as against the private company law requirements. However, this problem is often overstated in the case of the private limited company where the Companies Act 2006 now allows a high degree of flexibility in decision making, e.g. by the calling of meetings at short notice and by using the written resolution procedure. Also, the ***Duomatic*** principle (discussed in Chapter 4 ➡) operates to validate the informal unanimous consent of all the members, even where there has been no written resolution.

The private company does not require the equivalent of an LLP agreement. The articles of association (the Model Articles) provide standard default arrangements. However, company specific articles are filed with the Registrar of Companies on incorporation, as are alterations to them, so that privacy is lost. The LLP agreement is not filed nor are any alterations that may be made to it. However, these LLP agreements have not yet been challenged by disputing parties in the courts and their operation is not certain.

In conclusion, the number of LLP registrations continues to be small compared with the private limited company registrations. Business, in general, would seem to prefer the corporate route, although LLPs have found favour with organisations of professionals because they provide for a form of limited liability within the partnership ethos.

Reform – an ordinary partnership with legal personality

The Law Commission has issued a Consultation Paper on Partnership Law in response to a request from the DTI. There are also proposals regarding partnerships in Scotland made by the Scottish Law Commission that are not considered here. The review is being conducted in respect of the provisions of the Partnership Act 1890, many but not all of which operate as default provisions in the absence of a contrary agreement of the partners, and the Limited Partnerships Act 1907. The Limited Liability Partnerships Act 2000 (see above) is not involved. The reforms would however, if implemented, narrow the present distinction between ordinary partnerships and the new limited liability partnership.

Main reform proposals

The three main proposals are:

1 Proposals to introduce separate legal personality. There are two sub-proposals here:
   (a) to confer legal personality on all partnerships without registration. There would be a transitional period to allow the parties to a partnership agreement to organise their affairs or to opt out of the continuing aspect of separate personality of the firm.
   (b) to make legal personality depend on registration. Under this sub-proposal only a registered partnership would have legal personality capable of continuing regardless of changes in the membership of the firm. Under this option non-registered partnerships would not have legal personality.

   The Commission feels that having a system of registration would create a more complex situation in which there would be a legal environment for registered partnerships and another for non-registered firms. The Commission also feels that many small firms would not register and so lose the benefits of legal personality.

On balance therefore the provisional view of the Commission is the first option, i.e. continuity of legal personality without registration, and views are invited on this. The creation of a registered partnership regime would bring partnership law in the UK closer to those legal systems in Europe in which legal personality is conferred by registration.

2 Proposals to avoid the unnecessary discontinuance of business caused by the dissolution of the firm under the 1890 Act default rules when one person ceases to be a partner.

3 Proposals to provide a more efficient and cheaper mechanism for the dissolution of a solvent partnership.

Other reform proposals

The following suggestions for reform are according to the Commission intended to clarify some of the uncertainties in the 1890 Act; to update provisions which are outdated or spent and to propose adaptations of existing provisions if in the event consultees support the separate and continuing legal personality of the firm.

(a) *Partnership and agency*. With the concept of legal entity the partners would be agents of the firm but not each other.

(b) *Ownership of property*. With separate personality the firm would be able to hold property in its own name. It would not be necessary, as now, to use the device of the trust. Also, the firm and not the partners would have an insurable interest in partnership property.

(c) *Partners' liability for the obligations of the firm*. As a result of separate personality, the firm would be primarily liable. A partner's liability would be subsidiary but unlimited. Creditors would normally need to get a judgment against the firm before enforcing the claim against the assets of the firm or the partners. The liability of partners would be joint and several for the debts and obligations of the firm.

(d) *Partners' duties*. Partners have a duty to act in good faith in equity already. The Commission proposes to include the duty in a reformed statute and possibly also a duty of skill and care in negligence. There is a suggestion that partners be relieved of the duty of good faith when, on the break-up of a firm, they are competing for its client base provided they act honestly and reasonably.

(e) *Litigation*. A partnership with a separate legal personality would be sued in its own name and the partners could be sued in the same action.

(f) *Information about the firm including former partners who may have subsidiary liability at the time of a claim would be available if the partnership was registered*. If this is not so, the Commission proposes an extension to the Business Names Act 1985 requiring display of such information by the firm administratively.

(g) *Floating charges*. Currently, partnerships cannot grant floating charges over the firm's assets. The Commission makes no proposals on this but invites views.

Advantages and disadvantages of incorporation

The main advantages put forward by professional advisers for the conversion of a business into a limited company for those who do not wish to incorporate as an LLP can be summarised as follows:

1. Perpetual succession of the company despite the retirement, bankruptcy, mental disorder or death of members.
2. Liability of the members for the company's debts limited to the amount of their respective shareholding.
3. Contractual liability of the company for all contracts made in its name.
4. Ownership of property vested in the company is not affected by a change in shareholders.
5. The company may obtain finance by creating a floating charge (see Chapter 22 ➡) with its undertaking or property as security yet may realise assets within that property without the consent of the lenders during the normal course of business until crystallisation (see Chapter 22 ➡) occurs. As we shall see, no other form of business organisation except an LLP can sensibly use such a charge.

➡ See p. 477

➡ See p. 477

It is generally thought that the above advantages outweigh the suggested disadvantages of incorporation which are:

1. Public inspection of accounts (with exceptions in the case of some unlimited companies and abbreviated or modified disclosure in the case of small and medium companies).
2. Administrative expenses in terms, for example, of filing fees for documents.
3. Cost of compulsory annual audit (unless the company is a dormant company or in a position to opt out).

Companies and human rights

The Human Rights Act 1998 came into force on 2 October 2000. It implements the European Convention on Human Rights into UK law. The Convention is available to companies in terms of their dealings with emanations of the state, e.g. government and local authorities. This is because the initial effect of the Act is vertical. Whether the Convention will be extended by the courts horizontally into areas of private business remains to be seen, though s 6 of the 1998 Act provides that the courts and tribunals of the UK must not act contrary to the Convention. Problems have arisen in connection with the lack of independence in UK courts and tribunals in that Crown Court recorders were appointed part time and paid by the state and removable by the state with no security of tenure. The same was true of appointments to employment tribunals in cases involving the state as an employer or an emanation of the state, such as a local authority. The solution here has been to give these part-time judicial officers fixed-term contracts of, say, five years during which time they are not dismissible except for misconduct, and this gives some security of tenure. That a company can complain about the infringements of its human rights in this context (and others no doubt) is illustrated by ***County Properties Ltd* v *Scottish Ministers*** (2000) *The Times*, 19 September, which, although a Scottish case, is applicable in the rest of the UK. The company, in effect, had been refused permission by the Crown to obtain the release of the listed building restrictions on one of its properties and the matter was referred for decision to an inspector appointed by the Crown. The company objected to this procedure because it infringed Art 6 of the Convention that provides: 'In the determination of his civil rights and obligations [. . .] everyone is entitled to a [. . .] hearing [. . .] by an independent and impartial tribunal.' The Court of Session held that this was an infringement of the company's rights. That part of the procedure was invalid and the matter would have to be dealt with by appeal to the courts as the relevant legislation allowed. The case was overturned on appeal (***County Properties Ltd*** v ***Scottish Ministers*** 2002 SC 79) the court following the same line as in the Barnes case.

The House of Lords took a different view in an appeal from the Divisional Court of Queen's Bench in England. Their Lordships felt that the hearing of planning matters by a government-appointed inspector did not flout Art 6 of the Convention because the inspector's decision could always be brought before the ordinary courts by means of a procedure called judicial review (see ***R*** v ***Secretary of State for the Environment, etc., ex parte Holding and Barnes plc*** (2001), *The Times*, 10 May). Nevertheless, the cases show that companies can argue human rights matters before our courts.

Action against companies based on human rights

Implementation of the Human Rights Act 1998 on 2 October 2000 raised the spectre of the litigation floodgates opening since it made the European Convention on Human Rights available to litigants in UK courts, thus avoiding the need to take the matter to the European Court of Human Rights at Strasbourg, previously the only option. It has already been noted that the initial effect is against public authorities with the possibility of some expansion into the private sector through s 6 of the 1998 Act. In this connection, a statement by the Lord Chief Justice in ***Daniels*** v ***Walker*** [2000] 1 WLR 1382, CA is of interest. He expressed the hope that judges would be robust in resisting attempts to allow inappropriate arguments on human rights. These he defined as arguments that lead the court down blind alleys. There has also been the suggestion that adverse costs may be awarded against those who raise spurious questions and points on human rights. Furthermore, the Court of Appeal observed in ***Barclays Bank plc*** v ***Ellis*** (2000) *The Times*, 24 October that legal representatives seeking to rely on the Human Rights Act 1998 should supply the court with any decisions of the European Court of Human Rights on which they intend to rely or which might assist the court. This should operate as a deterrent to those lawyers who may think of raising human rights issues unless, where possible, supported by authority.

The specific effect of the Convention on directors is considered, in terms of their functions as individuals and managers, in Chapter 17 ➲.

➲ See p. 334

Essay questions

1 (a) In the celebrated case of ***Salomon*** v ***Salomon & Co Ltd*** [1897] AC 22, Lord Halsbury LC observed: 'Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr Salomon. If it was not, there was no person and no thing to be an agent at all and it is impossible to say at the same time that there is a company and there is not.'

Comment.

(b) Tiedeman was the owner of a large bulk-carrier called *Ocean-Star*. The ship was valued at £1 million and was insured for that sum with Lloyd's in Tiedeman's name. Subsequently, Tiedeman incorporated Tiedeman Ltd in which he held all the shares but one which was held by his wife as his nominee. *Ocean-Star* was then sold to Tiedeman Ltd and the purchase price was secured by a debenture issued in favour of Tiedeman giving as a security a fixed charge on the only asset of the company *Ocean-Star*. While carrying a valuable cargo on charter to a Kuwait company the *Ocean-Star* was attacked by Iranian gun-boats and sunk.

Consider whether Tiedeman or in the alternative Tiedeman Ltd could claim to be indemnified by Lloyd's for the loss of the bulk-carrier. (*University of Plymouth*)

2 The principle of law set out in ***Salomon* v *Salomon & Co Ltd*** is not always applied. Give the facts of this case and give its principle of law, and discuss when the judiciary or statutory provisions will not take account of that principle. (*University of Paisley*)

3 '. . . a fundamental attribute of corporate personality . . . is that the corporation is a legal entity distinct from its members' – Gower.

Which do you consider are the two outstanding advantages of incorporation? Give reasons for your choice and explain their dependence upon this fundamental attribute. (*The Institute of Chartered Accountants in England and Wales*)

4 Explain by reference to statutory and common law examples what is meant by the term 'lifting the veil of incorporation'. (*The Chartered Institute of Management Accountants*)

5 John, who runs Trent Ltd, a small manufacturing company, has heard that he may not have to appoint auditors in regard to future accounts and is keen to save the audit fees. Advise John as to the relevant law. (*Authors' question*)

6 Thomas Taylor-Wright is a sole trader, based in Saville Row in London, where he has a very lucrative business making men's exclusive formal suits. Thomas has decided that he would like to expand his business and is having discussions with a fellow tailor, Terry Thimble, about possibly going into business together and renting larger premises in Saville Row. Thomas comes to you for advice as he cannot decide whether he and Terry should set up as a partnership or a limited company.

Answer ALL PARTS.

- Advise Thomas and Terry which type of business medium you would recommend and why.
- Thomas and Terry have decided to set up as a limited company, but they have no idea how they should go about doing so. Advise them of the procedure for incorporating as a limited company.
- They would like to use the name Saville Row Tailors Ltd. Advise them on their suggested choice of name. (*University of Hertfordshire*)

Test your knowledge

Four alternative answers are given. Select ONE only. Circle the letter beside the answer which you consider to be correct. Check your answers by referring back to the information given in the chapter and against the answers at the back of the book.

1 The members of a social club wish to form a legal entity. There is no commercial risk but they do not want too much disclosure of their affairs to the public. What type of company should they form?

A A company limited by guarantee.
B An unincorporated association.
C A private company limited by shares.
D A private unlimited company.

2 Fred has been allotted 200 £1 ordinary shares in Ark Ltd with a nominal value of £1 and a premium of 0.40 pence. Fred has paid 0.85 pence. What is Fred's maximum liability if the company is wound up?

A £30 B £110 C £2,000 D £280

3 To what extent is a member of a company which is limited by guarantee personally liable for the company's debts?

A He is personally liable for all the company's debts at any time.
B He is personally liable for all the company's debts if the company is wound up.
C His personal liability is limited to the amount set out in the memorandum on a winding-up.
D His personal liability is limited to the amount set out in the memorandum at any time.

4 Three friends own and are also directors of a limited company carrying on the family business. They have it in mind to change the organisation to an ordinary partnership. What aspect of the business would be affected if this change were carried out?

A The right to sue in the business name.
B The right to mortgage the business assets.
C The right of the partners to examine the firm's accounts.
D The ability to create a floating charge over the business assets.

The answers to test your knowledge questions appear on p. 616.

Suggested further reading

Drury, R, 'The Delaware Syndrome: European Fears and Reactions', (2005) JBL, 709

Gallagher and Zieger, 'Lifting the Corporate Veil in the Pursuit of Justice', (1990) JBL 292

Keay, A, 'Ascertaining the Corporate Objective: An Entity Maximinsation and Sustainability Model', (2008) 71 MLR 663

Lowry, 'Lifting the Corporate Veil', [1993] JBL 41

Moore, 'A Temple Built on Faulty Foundations: Piercing the Corporate veil and the Legacy of Salomon v Salomon', (2006) JBL 180

Ottolenghi, 'From Peeping Behind the Corporate Veil to Ignoring It Completely', (1990) 53 MLR 338

Rixon, 'Lifting the Veil between Holding and Subsidiary Companies', (1986) 102 LQR 415

Samuels, A, 'Lifting the Veil', [1964] JBL, 107

Schmitthoff, 'Salomon in the Shadow', [1976] JBL, 305

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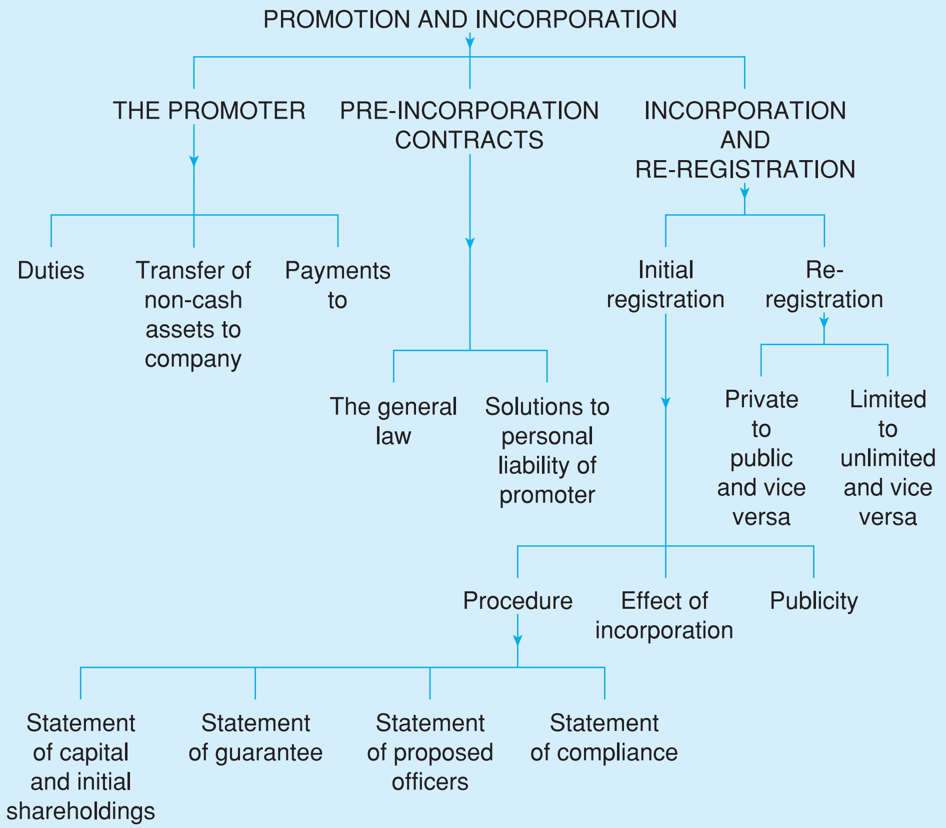
2 Promotion and incorporation


PROMOTION AND INCORPORATION
THE PROMOTER
PRE-INCORPORATION CONTRACTS
INCORPORATION AND RE-REGISTRATION
Duties
Transfer of non-cash assets to company
Payments to
The general law
Solutions to personal liability of promoter
Initial registration
Re-registration
Private to public and vice versa
Limited to unlimited and vice versa
Procedure
Effect of incorporation
Publicity
Statement of capital and initial shareholdings
Statement of guarantee
Statement of proposed officers
Statement of compliance

The promotion of a company consists in taking the necessary steps to incorporate it by registration under the Companies Act, to see that it has share and loan capital, and to acquire the business or property which the company is formed to control.

The promoter

There is no general definition of a promoter in the Companies Act 1985. However, Treasury regulations under the Financial Services and Markets Act 2000 exempt from liability for false statements in listing particulars, or a prospectus, those who merely give advice in a professional capacity but do not give specific reports for inclusion as experts. Thus, a solicitor or accountant who merely advises the promoters on legal and financial matters respectively will not be considered as a promoter in respect of misrepresentations which appear in any prospectus issued to raise capital. Nevertheless, accountants, in particular, may be liable as experts if any of their financial statements are included with their consent in a prospectus and turn out to be false (see further Chapter 10 ➡).

➡ See p. 212

In addition, the courts have not given the expression 'promoter' a precise definition although Cockburn CJ, in ***Twycross* v *Grant*** (1877) 2 CPD 469, called a promoter 'one who undertakes to form a company with reference to a given project, and to set it going, and who takes the necessary steps to accomplish that purpose'. In addition, Bowen J in ***Whaley Bridge Printing Co* v *Green*** (1880) 5 QBD 109 said:

> The term promoter is a term not of law, but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence.

Thus, it can be said that whether a person is a promoter or not is a matter of fact and not of law. However, a promoter will usually be in some sort of controlling position with regard to the company's affairs, both before it is formed and during the early stages of its existence and will be in a position analogous to that of a director during that period. Basically a promoter is a person who promotes a business project through the medium of a company.

Those who would normally be regarded as promoters would include persons who authorise the drafting of legal documents such as the articles of association, and who nominate directors, solicitors, bankers and other agents, together with those who arrange for the placing of shares and who purchase property for the proposed company. The purchaser of a ready-made company is a promoter because such a person is promoting a company through the medium of a company.

During the nineteenth century there was in existence a class of professional company promoters whose methods of raising capital from the investing public were often unscrupulous and thus it was necessary for the legislature and the courts to impose rigorous duties upon such persons to protect the public from fraud.

Those days have gone and in modern times most companies are promoted as private companies by persons with an interest in the business who become directors and remain so. Obviously, some protection is still required because such persons could defraud the company by, for example, selling property to it at exorbitant rates. However, they are not likely to do so because in the modern situation the promoter retains an interest in the company and would merely be defrauding himself, whereas the old professional promoter either did not take any shares in the company at all or if he did unloaded them to others shortly after its incorporation.

If, after incorporation as a private company, there is a need to raise capital from the public then there would be a conversion to a public company. In such a situation there is no need for a promoter but there would be a need for the services of a specialist organisation such as a merchant bank to raise the necessary capital from the public.

Duties of a promoter

In equity a promoter stands in a fiduciary relationship towards the company he is promoting but is not a trustee. Thus he is not absolutely forbidden to make a profit out of the promotion so long as he has disclosed his interest in the transaction out of which the profit arose and the company consents to the retention of the profit. As a general rule, any profits which he makes on the promotion and fails to disclose must be surrendered to the company. This is illustrated by the following case.

Gluckstein v Barnes [1900] AC 240

In 1893 the National Agricultural Hall Co Ltd owned a place of entertainment called the Olympia Company which was being wound up. A syndicate was formed to raise funds to buy Olympia and resell it, either to a company registered under the Companies Act for the purpose, or to another purchaser. If a company was formed, the appellant Gluckstein and three other persons, Lyons, Hart and Hartley, who were members of the syndicate, had agreed to become its first directors and to promote it. In the event a company was formed, called the Olympia Company Ltd, and the promoters issued a prospectus stating that the syndicate which was promoting the company had purchased Olympia for £140,000 and was selling it to the company for £180,000 thus quite properly disclosing a profit of £40,000. What they did not disclose but referred to vaguely as 'interim investments', was the fact that they had purchased certain mortgage debentures in the old Olympia Company for less than their face value, and that these mortgage debentures were to be redeemed at their face value out of the proceeds of the issue of shares. This meant that the syndicate made a further £20,000 on the promotion. The company afterwards went into liquidation, Barnes being the liquidator, and he sought to recover the undisclosed secret profit.

Held – the profit of £20,000 should have been disclosed and the appellant was bound to account to the liquidator for it.

Comment

The following points of interest arise from this case:

(i) There had been disclosure by the promoters in regard to the £40,000 and £20,000 profit to themselves as directors but of course this was useless because disclosure must be to an independent board (see below).

(ii) The prospectus said that the £40,000 profit did not include profits on 'interim investments' but the court held that this was not a disclosure of the profit of £20,000.

(iii) The case also illustrates that liability of promoters is joint and several for recovery of profit because Mr Gluckstein tried to defend himself by saying he was only liable for a proportion of the profits. The House of Lords held him liable to account for it all with a right of contribution against his fellow promoters.

In ***Erlanger*** v ***New Sombrero Phosphate Co*** (1878) 3 App Cas 1218, the House of Lords took the view that the disclosure mentioned above had to be made to an independent board of directors. This view was, however, too strict. The boards of private companies, for example, are unlikely to be entirely independent of the promoter of the company and since Salomon, where it was held that the liquidator of the company could not complain of the sale to it at an obvious over-valuation of Mr Salomon's business, all the members having acquiesced therein, it has been accepted that disclosure to the members is equally effective. Thus, if the company issues a prospectus disclosure to the shareholders may be made in it and the shareholders give their consent by conduct when they apply for the shares being issued under the prospectus. Disclosure by a person, in his capacity as promoter, to himself, in his capacity as director, is not enough (***Gluckstein*** v ***Barnes***, 1900, above).

A promoter will perhaps most often make a secret profit by selling his own property to the company at an enhanced price and this is further considered below. However, other forms of profit are possible, e.g. where the promoter takes a commission from the person who is selling property to the company (and see also ***Gluckstein*** v ***Barnes***, 1900). All such profits are subject to the rules of disclosure. The liability of promoters as vendors of property may be considered under two headings:

(a) Where the property was purchased by the promoter before he began to act as a promoter

If the promoter does not disclose his interest in the sale, the company may rescind the contract, i.e. return the property to the promoter and recover the purchase price. If the company wishes to keep the property it may do so, but cannot recover the profit as such (***Re Cape Breton*** (1887) 12 App Cas 652). The remedy is to sue the promoter for damages in tort at common law for negligence if damage has been suffered, as where the company has paid a price in excess of the market price. That this can be done follows from the decision of the court in ***Jacobus Marler Estates Ltd*** v ***Marler*** (1913) 114 LT 640n, and in ***Re Leeds and Hanley Theatres of Varieties Ltd*** [1902] 2 Ch 809.

There may be, according to circumstances, an action for fraud, or under s 2 of the Misrepresentation Act 1967 where the promoter's misstatements, e.g. as to value, are made negligently. Therefore, if P acquired some land in 2008 for £10,000 and became the promoter of X Co in 2009, selling the land to the company for £20,000 through a nominee and without disclosing his interest, then the company may:

(a) rescind the contract; or
(b) keep the property and recover damages for P's breach of duty of skill and care.

If the property was worth only £18,000 in 2009, the company could recover £2,000, but in no circumstances could it recover the £10,000 profit.

(b) Where the property was purchased by the promoter after he began to act as a promoter

Here, again, the remedy of rescission is available, but if the company does not wish to rescind it is possible to regard the promoter as agent for the company when he purchased the property, and the company can recover the profit made by the promoter. Thus, in the example given above, if P had been the promoter of X Co when he purchased the land, the company could have recovered the profit made, i.e. £10,000.

One of the first acts in promotion is normally to negotiate for the purchase of property. However, the courts have been reluctant to hold that the promoter's contract to buy property is the start of his promotion and this has deprived the rule about secret profits of much of its practical value. Obviously, if the public has been invited to subscribe for shares when the property is purchased, the courts will regard the promotion as having commenced, but things rarely happen in this way.

The remedy of rescission is not, in general, available against the promoter if it is not possible to restore the company and the promoter to the position they were in before the contract was made, as where the company has resold the property to a third party. In such a case the company must go on with the contract and sue the promoter for the profit made, depending on the promoter's position when he bought the property which he later sold to the company. However, where the property has been merely used and not sold, as where the company has worked a mine purchased from a promoter, the rule of full restoration to the former position does not appear to operate as any real restriction on rescission in view of the wide powers now exercised by the courts to make financial adjustments when granting rescission. This is particularly true where the promoter has been fraudulent.

The duties of a promoter to the company are derived from common law and have not yet been fully developed by the judiciary. They are not contractual duties because the company is not incorporated and cannot contract with the promoter. Nevertheless, a promoter can be regarded as a quasi-agent working without a contract and as such would at common law owe a general duty in negligence to exercise reasonable skill and care in the promotion, i.e. to show reasonable business acumen in regard to transactions entered into.

Thus, if he allows the company to buy property – including his own – for more than it is worth, he may be liable to the company in damages for negligence (***Re Leeds and Hanley Theatres of Varieties Ltd*** [1902] 2 Ch 809).

Again, if a promoter issues a prospectus which he knows to be false so that the company is liable to be sued by subscribers, the company may sue him at common law for damages. In the ***Leeds*** case the court proceeded on the basis of fraud but since the company does not itself act upon the fraud by subscribing for shares, the decision is felt to be based on negligence.

In other areas, e.g. the purchase by a promoter of a business which loses money, the standard required presumably depends upon the experience and/or qualifications of the promoter in business fields. A higher standard would be expected of a promoter who was, for example, an experienced and/or qualified accountant, than would be of a person of no great experience or qualification in the field of business. The duty may well be analogous to that of directors (see Chapter 19 ➡).

➡ See p. 378

The equitable and common law duties of a promoter are owed to the company, which may enforce them by a claim form served by the company on the promoter. Also, by s 212 of the Insolvency Act 1986, the court may in a liquidation, on the petition of the liquidator or a creditor, or a member, order a promoter to repay or restore property obtained by breach of duty.

A claim by a member of the company under ss 994–996 (unfair prejudice) is, in modern company law, the way to proceed. Under these sections a member may, regardless of the size of his shareholding, ask the court to authorise a claim to be brought by the company against a person who has caused loss to the generality of its members.

The duties are not owed to shareholders who are unable to bring a personal action unless this relates to false statements made by the promoter in a prospectus.

Trade creditors and debenture holders cannot sue for breach of duty. There was, for example, no action by trade creditors in ***Salomon*** although he did not disclose to them his interest in the promotion. However, secret profits or damages recovered by the liquidator in a winding-up are used to pay the company's debts.

The duties of disclosure and skill and care upon promoters do not end on the incorporation of the company, nor indeed on the appointment of a board of directors. However, once the company has acquired the property and/or business which it was formed to manage, the initial capital has been raised and the board of directors has effectively taken over management from the promoters, the latter's duties will terminate. Thus, in ***Re British Seamless Paper Box Co*** (1881) 17 Ch D 467, a promoter disclosed a profit which he had made out of the company's promotion to those who provided it with share capital when it commenced business. It was held that he was under no duty to disclose that profit to those who were invited to subscribe further capital some 12 months later and in these circumstances the company could not recover the profit from him by reason of his failure to do so.

Promoters' dealings with the prospective company: rules of capital maintenance

Although a promoter is not bound to be a subscriber to the memorandum on incorporation of a public company, it is very likely that he will be. In these circumstances certain provisions of the Companies Act 2006 relating to capital maintenance apply.

Section 598 provides that for two years following the date of issue of the certificate that a company registered as a public company is entitled to commence business, the company may not acquire (whether for cash or shares) non-cash assets from subscribers to the memorandum having an aggregate value equal to one-tenth or more of the nominal value of the issued share capital unless:

(a) the valuation rules set out in s 600 are complied with. This means that the asset must have been valued by an independent accountant who must state that the value of the consideration to be received by the company is not less than the value of the consideration to be given by it; and
(b) the acquisition of the asset and the terms of the acquisition have been approved by an ordinary resolution of the company.

Under s 603, the above provisions also apply when a private company converts to a public company and the non-cash asset is acquired from a person who is a member of the private company on the date of conversion, i.e. re-registration. The period is two years beginning with that date. Such members are also, in a way, promoters of the public company.

The above matters are considered in more detail in Chapter 8 but it will be appreciated that they do operate as a form of control on promoters/subscribers/members, as the case may be, off-loading property on a public company at above its real value, since if the transaction has gone through in breach of s 598 the company can recover what it has paid for the asset and, if it has not gone through, it is not enforceable against the company.

Payment to promoters

Since a company cannot make a valid contract before incorporation, a promoter cannot legally claim any remuneration for his services, or an indemnity for the expenses incurred in floating the company.

Re National Motor Mail Coach Co Ltd, Clinton's Claim [1908] 2 Ch 515

A company, called the Motor Mail Coach Syndicate Ltd, promoted another company, called the National Motor Mail Coach Co Ltd, to acquire the business of a motor mail contractor named Harris. The promoters paid out £416 2s 0d in promotion fees. The two companies were subsequently wound up and Clinton, who was the liquidator of the syndicate, proved in the liquidation of the National Motor Mail Coach Co Ltd for the promotion fees.

Held – Clinton's claim on behalf of the syndicate could not be allowed because the company was not in existence when the payments were made, and could not have requested that they be made. The syndicate was not acting as the company's agent or at its request, and the fact that the company had obtained a benefit because the syndicate had performed its promotion duties was not enough.

However, since the promoters or their nominees are likely to be the first directors, the payment will usually be made by the director under their general management powers.

Pre-incorporation contracts: generally

Another consequence of the company having no legal existence and therefore no capacity to make contracts is that if a promoter, or some other person purporting to act as its agent, makes a contract for the company before its incorporation then:

(a) the company when formed is not bound by it even if it has taken some benefit under it (see ***Re National Motor Mail Coach***, etc., above);

(b) the company is unable to sue the third party on the agreement unless the promoter and the third party have given the company rights of action under the Contracts (Rights of Third Parties) Act 1999 (see below);

(c) the company cannot ratify the agreement even after its incorporation (***Kelner*** v ***Baxter*** (1866) LR 2 CP 174);

(d) unless the agreement has been made specifically to the contrary, it will take effect as one made personally by the promoter or other purported agent and the third party (s 51 CA 2006). This is illustrated by the following case.

Phonogram Ltd v ***Lane*** [1981] 3 All ER 182

In 1973, a group of pop artists decided that they would perform under the name of 'Cheap Mean and Nasty'. A company, Fragile Management Ltd (Fragile), was to be formed to run the group.

Before the company was formed, there were negotiations regarding the financing of the group. Phonogram Ltd, a subsidiary of the Hemdale Group, agreed to provide £12,000, and the first instalment of £6,000, being the initial payment for the group's first album, was paid. Fragile was never formed; the group never performed under it; but the £6,000 was not repaid.

The Court of Appeal was asked who was liable to repay it. It appeared that a Brian Lane had negotiated on behalf of Fragile and a Roland Rennie on behalf of Phonogram Ltd.

A letter of 4 July 1973 from Mr Rennie to Mr Lane was crucial. It read:

> In regard to the contract now being completed between Phonogram Ltd and Fragile Management Ltd concerning recordings of a group [. . .] with a provisional title of 'Cheap Mean and Nasty', and further to our conversation of this morning, I send you herewith our cheque for £6,000 in anticipation of a contract signing, this being the initial payment for initial LP called for in the contract. In the unlikely