KEY FACTS COMPANY LAW

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HODDER EDUCATION

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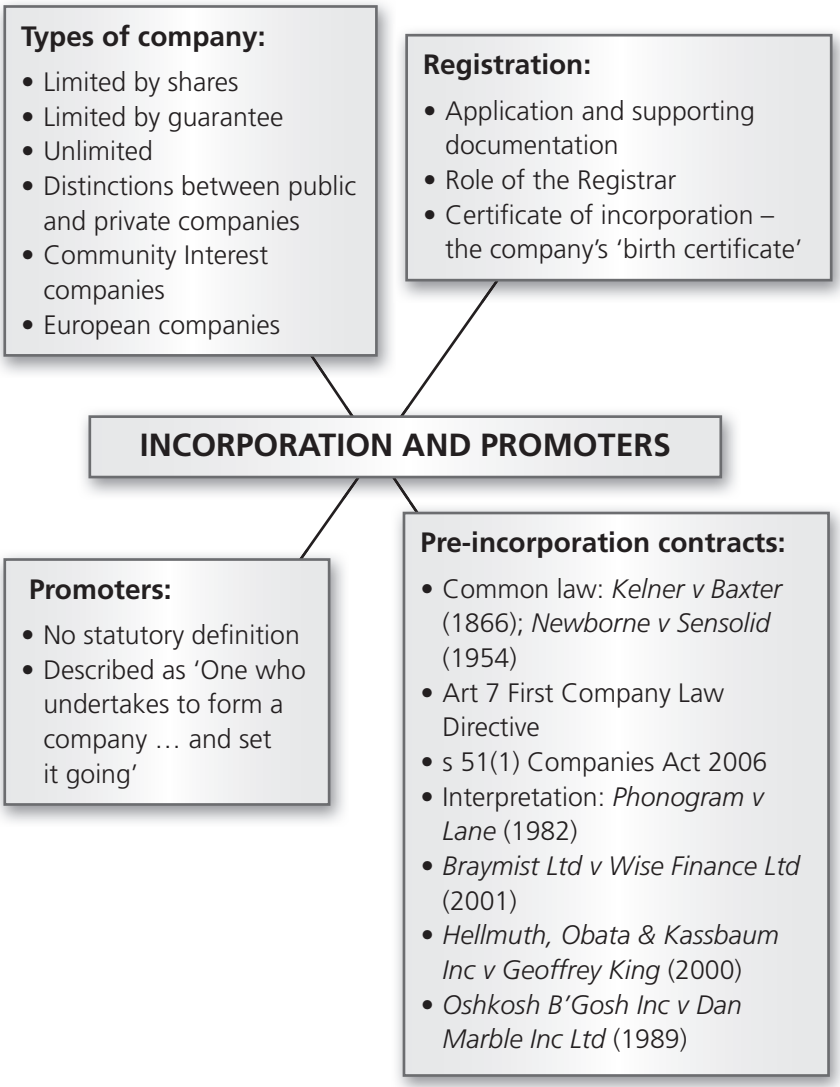
Company formation



2.1 Types of company

1. A company may be created by registration of documents with the Registrar of Companies under the Companies Act (currently CA 2006), registration with another public official or body under another act (e.g. under the Charities Act 1993), by statute or by Royal Charter. We are concerned only with the first method, that is, with 'registered companies'.

2. Companies may be registered as follows:
   - Limited by shares. This is a company with a share capital divided into shares which are issued to members. The liability of members on a winding up is limited to any amount unpaid on the shares.
   - Limited by guarantee. Section 3(3) CA 2006 provides that in such a company the liability of members is limited to the amount they agree to contribute in the event of the company being wound up. Prior to the CA 1980, a company could be limited by guarantee with a share capital. However, although a few such companies still exist, this is no longer possible.
   - Unlimited. A private company may be registered with unlimited liability, in which case the members will be liable to contribute to the whole of the company's debts on liquidation. Such companies are not subject to the disclosure requirements with respect to their accounts that apply to limited companies.

3. A major distinction is between public and private companies.
   - A public company is defined in s 4(2) CA 2006 as a company limited by shares (or by guarantee having a share capital) whose certificate of incorporation states that it is a public company in relation to which the requirements of the Act (or former Companies Acts) have been complied with.
   - A public company must have a minimum share capital, currently £50,000, of which 25% must be paid up.
   - Under s 4(1) a private company is defined as any company that is not a public company.
   - Both types of company may now be formed with one member: s 7(1) CA 2006).

4. A public company is subject to more stringent rules than a private company, especially in relation to disclosure, and throughout this book reference will be made to differences between public and private companies.

Public companies	Private companies
Defined by s 4(2) CA 2006	Defined by s 4(1) CA 2006
Limited by shares or by guarantee having a share capital	May be limited by shares or by guarantee, or unlimited
Minimum share capital requirements s 761	No minimum share capital requirement
Designated by 'plc' or Welsh equivalent	If limited, must include 'Limited' or 'Ltd' after name
Shares may be offered to the public	Shares may not be offered to the public

5. Community interest companies (CICs) were initially created by the Companies (Audit Investigations and Community Enterprise) Act 2004 for people who wanted to create social enterprises. The community interest company is recognised in s 6 CA 2006. The objects of such a company must show the intention to benefit the community and the directors must produce an annual report to show what the company has done for the benefit of the community. CICs do not have charitable status, but do enjoy lighter regulation than other companies.

6. European Companies: Regulation (EC) No 2157/2001 made it possible, from October 2004, to create a European public limited company, or *Societas Europaea*, where there is co-operation between at least two different companies in different member states.

7. The Limited Liability Partnership Act 2000 allows for incorporation by registration of a limited liability partnership (LLP). An LLP is a corporate body with a separate legal personality, while the relationship between the partners is the same as in a partnership. An LLP may only be formed for 'carrying on a lawful business with a view to profit'. Whereas an LLP must be for profit, a company can be registered for non-business purposes.

2.2 Registration

2.2.1 Documentation under the Companies Act 2006

1. To incorporate a company it is necessary to deliver an application together with the necessary documents to the Registrar of Companies for England and Wales or, for a company to be registered in Scotland, the Registrar of Companies for Scotland (s 9 CA 2006).
- Since 2001 electronic incorporation has been possible for certain users, mainly company formation agents.
- From January 2007 an online incorporation facility is available for individual users as well.

2. The application must contain the following information:
- the company's proposed name;
- the part of the United Kingdom where it is to be registered – whether in England and Wales, Scotland or Northern Ireland;
- whether the members are to have limited liability and, if so, whether by share or guarantee;
- whether the company is to be a public or private company.

3. The application must be accompanied by supporting documents:

(a) The memorandum of association, which must include a statement that the subscribers wish to form a company and, in the case of a company with a share capital, that they agree to take at least one share each. One subscriber can form a company and there is no upper limit.

(b) The company's constitution, that is the articles of association, which may be in the form of the appropriate model articles unless excluded or modified to suit the needs of the particular company.

(c) A statement of capital and the initial shareholdings. This gives details of the shares that the company will issue when it is incorporated and to whom they will be issued. The statement must be updated each time new shares are issued.

(d) A statement of the company's proposed officers, setting out details of the proposed director(s) and secretary (if applicable), together with a consent by each person to act in the proposed role. A private company may have only one director, a public company must have at least two (s 154 CA 2006). Those named will take up office on the date of incorporation.

(e) A statement of compliance, which states that the registration requirements set out in the Companies Act 2006 have been complied with.

4. The prescribed fee must be paid.

5. With respect to the articles note the following:
   - Companies registered under the Companies Act 1985 may have articles in the form of Table A, CA 1985, which were the same for public and private companies. See chapter 4 for more detail.
   - The Companies Act 2006 model articles will apply to new companies incorporated on or after 1 October 2009. There are separate model articles for public companies limited by shares, companies limited by guarantee and private companies limited by shares.
   - Under CA 2006 the articles of association comprise the main constitutional document.

6. One person can form any kind of company, including a public company: s 7(1) CA 2006. Under CA 1985 a public company had to have at least two members.

2.2.2 Registrar's role

1. If all the documentation is in order, the Registrar issues a certificate of incorporation, which is conclusive evidence:
   - that the requirements of the Act in respect of registration and of matters precedent and incidental to it have been complied with, and that the association is a company authorised to be registered, and is duly registered under the Act; and
   - that if the certificate contains a statement that the company is a public company, it is in fact such a company.

2. Public notice must be given that the memorandum and articles of association have been received by Companies House.

3. Section 7(2) CA 2006 provides that a company may not be formed for an unlawful purpose. The Registrar may refuse registration if he considers this to be the case.

4. Under previous companies legislation, every company's memorandum of association contained an objects clause which, in theory, set out the purpose for which the company was being set up. This allowed the Registrar, in certain cases, to determine that the purpose was unlawful:

R v Registrar of Companies, ex parte Bowen (1914); *R v Registrar of Companies, ex parte AG* (1980) reported (1991).

5. Under the CA 2006 a company is not required to have an objects clause (see chapter 5).
6. If the Registrar is satisfied that the requirements of the Act have been complied with, he must register the company (s 14 CA 2006). A company comes into existence on the date stated on the certificate of incorporation.
7. A refusal by the Registrar to register a company is subject to judicial review.
8. A public company cannot start trading until a trading certificate has been issued under s 761 CA 2006, whereas a private company can trade immediately on incorporation.

2.2.3 Off the shelf companies

It is also possible to buy a company 'off the shelf'. Such companies are incorporated by registration agents and are available for purchase relatively cheaply. When the ready-made company is sold, its shares are transferred to nominees of the purchaser. The original directors and secretary resign and new directors and secretary are appointed by the purchaser.

2.2.4 Company names

1. The CA 2006, and associated statutory instruments, contain a number of provisions relating to company names, including:
   - the name of a private company limited by shares must end with 'ltd' or 'limited', or in the case of company registered in Wales, the Welsh equivalent;
   - a public company's name must end with 'public limited company', 'plc' or the Welsh equivalent;
   - a company may not be registered with a name which is illegal or which the Registrar considers to be offensive or misleading;
   - permission is needed to use certain words, for example anything that suggests that the company is connected with government or a local authority;
   - under s 66 CA 2006 a company may not register a name that is the same or too like one already registered on the Registrar's index

of names. There are exceptions to this and ss 67 and 68 contain provisions dealing with situations where such names are registered in error.

2. If a company's name is deceptively similar to that of another business to the extent that damage may be caused to the reputation or goodwill of the other business, an action in the tort of passing off may provide a remedy.

2.3 Promoters

2.3.1 Introduction

1. During the nineteenth century it was common for people setting up a new company to raise money by offering shares to the public. This provided an opportunity for abuse and the principles described below were developed in response to this.
2. As a result of legal regulation and the Stock Exchange Listing Rules, the law relating to duties of promoters is now of little practical importance as far as public companies are concerned. It may still have some relevance to private companies.

2.3.2 Who is a promoter?

1. The term *promoter* is one of fact, not of law. A promoter has been described as: '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' (Cockburn CJ, *Twycross v Grant* (1877)).
2. People who act in a purely administrative capacity (e.g. solicitors and accountants) do not become promoters simply by carrying out a professional service.
3. Promoters working together to set up a company are not necessarily partners (*Keith Spicer v Mansell* (1970)).
4. In each case the courts will look to the surrounding facts to establish whether a person is a promoter.

2.3.3 Duties of a promoter

1. As the early cases show, there is often the opportunity for a promoter to abuse his position and take a profit from deals made in the course of

promotion. For example, they may purchase property which they later sell to the company: *Erlanger v New Sombrero Phosphate Co* (1878).

2. In equity a promoter owes a fiduciary duty to the company when it is incorporated. The fiduciary relationship begins as soon as the promoter starts to take steps to set up the company.
3. The essence of this duty is in 'good faith, fair dealing and full disclosure'. The most important aspect of the duty is that the promoter may not make a secret profit and must declare an interest or profit in any transaction that involves the company.
4. Some problems arise as to how and to whom disclosure should be made. Disclosure to, and approval by, a board of directors who are independent of the promoters is sufficient, as is disclosure in a prospectus inviting prospective shareholders to invest in the company. Disclosure to the members as a whole has long been recognised as effective (*Erlanger v New Sombrero Phosphate Co* (1878); *Lagunas Nitrate Co v Lagunas Syndicate* (1899)).
5. Partial disclosure is insufficient – promoters must declare the whole profit: *Gluckstein v Barnes* (1900).
6. Remedies of the company for breach of fiduciary duty include:
   - rescission of any contract entered into as a result of non-disclosure or misrepresentation;
   - recovery of any secret profit;
   - imposition of a constructive trust;
   - damages for breach of fiduciary duty (*Re Leeds & Hanley Theatres* (1902)) – however, the scope of this remedy is somewhat uncertain;
   - damages for deceit.
7. At common law a promoter may be liable in tort for loss caused by fraud or negligence.

2.4 Pre-incorporation contracts

1. The company, once incorporated, is recognised by the law as a separate legal person. As such it can act only through agents (see chapter 5). Agency problems arise when a person purports to make a contract for a company prior to incorporation because the principal (the company) does not yet exist.

2. A contract made on behalf of a company before its incorporation does not bind the company, nor can it be enforced or ratified by the company after incorporation. However, there may be a remedy against the person purportedly acting for the company.
3. Early cases distinguished between contracts made 'for and on behalf of' the company (*Kelner v Baxter* (1866), where it was held that the person who purported to act as agent was personally liable in place of the non-existent principal), and those where the promoter signed his own name to authenticate the name of the company (*Newborne v Sensolid* (1954), where it was held that because the company did not exist there was no contract). The fine distinctions suggested by these and other cases made the position at common law quite complex. This has, however, been superseded by statute.
4. Article 7 of the First Company Law Directive provides: 'If, before a company being formed has acquired legal personality, action has been carried out in its name and the company does not assume the obligations arising from such action, the persons who acted shall, without limit, be jointly and severally liable therefore unless otherwise agreed'.
5. This was implemented by the European Communities Act 1972 and is now re-enacted as s 51(1) CA 2006 which provides: 'A contract that purports to be made by or on behalf of a company at a time when the company has not been formed has effect, subject to any agreement to the contrary, as one made with the person purporting to act for the company or as agent for it, and he is personally liable on the contract accordingly'.
6. The section was interpreted in *Phonogram v Lane* (1982) in which it was held:
   - in applying this section the subtle distinctions developed by the courts will not be made;
   - the section applies whether the process of incorporation has been started or not (i.e. it is not necessary for the company to be in the course of being formed);
   - the section applies whether or not the company is eventually incorporated;
   - it applies to a contract purportedly made on behalf of a company intended to be incorporated outside Great Britain as long as the contract is governed by the law of England and Wales or of Scotland: *Hellmuth, Obata & Kassbaum Inc v Geoffrey King* (2000).

7. Section 51(1) CA 2006 makes it clear that a purported agent will be liable under a pre-incorporation contract (unless the parties have agreed otherwise).

8. Until recently it was unclear whether an agent would be able to enforce such a contract. This issue was addressed in *Braymist Ltd v Wise Finance Ltd* (2001) and it was held that where s 51(1) applies, a fully effective contract is deemed to have been concluded between the purported agent and the contracting party, conferring both liability and a right of action on the purported agent.

9. Section 51(2) CA 2006 provides that the same provisions apply to a deed.

10. A pre-incorporation contract cannot be ratified by the company after incorporation. The company did not exist when the contract was purportedly made on its behalf and the purported agent cannot retrospectively be given authority to act on behalf of a non-existent entity. The only way that the company can assume liability on the contract is by way of novation – that is by entering into a new contract with the contractor.

11. The section has limitations:

(a) it will not apply when a company has been bought off the shelf and is in the process of changing its name. In this situation the company does not comply with the requirement in s 51(1) that it 'has not been formed' (*Oshkosh B'Gosh Inc v Dan Marbel Inc Ltd* (1989));

(b) the agent must purport to make the contract on behalf of a new company, so the section will not apply in a situation where the parties are unaware that the company has been dissolved (*Cotronic (UK) Ltd v Dezonie* (1991)).