

COMPANY LAW - LECTURE NOTES

I. INTRODUCTION TO INCORPORATION

1. Definition of a "Company"

A company is a "corporation" - an artificial person created by law.

A human being is a "natural" person.

A company is a "legal" person.

A company thus has legal rights and obligations in the same way that a natural person does.

2. Companies and Partnerships Compared

- (a) A company can be created only by certain prescribed methods - most commonly by registration under the Companies Act 1985. A partnership is created by the express or implied agreement of the parties, and requires no formalities, though it is common to have a written agreement.
- (b) A company incurs greater expenses at formation, throughout its life and on dissolution, though these need not be excessive.
- (c) A company is an artificial legal person distinct from its members. Although in Scotland a partnership has a separate legal personality by virtue of s.4(2) of the Partnership Act 1890, this is much more limited than the personality conferred on companies.
- (d) A company can have as little as one member and there is no upper limit on membership. A partnership must have at least two members and has an upper limit of 20 (with some exceptions).
- (e) Shares in a company are normally transferable (must be so in a public company). A partner cannot transfer his share of the partnership without the consent of all the other partners.
- (f) Members of a company are not entitled to take part in the management of the company unless they are also directors of it. Every partner is entitled to take

part in the management of the partnership business unless the partnership agreement provides otherwise.

(g) A member of a company who is not also a director is not regarded as an agent of the company, and cannot bind the company by his actions. A partner in a firm is an agent of the firm, which will be bound by his acts.

(h) The liability of a member of a company for the debts and obligations of the company may be limited. A partner in an ordinary partnership can be made liable without limit for the debts and obligations of the firm.

(i) The powers and duties of a company, and those who run it, are closely regulated by the Companies Acts and by its own constitution as contained in the Memorandum and Articles of Association. Partners have more freedom to alter the nature of their business by agreement and without formality, and to make their own arrangements as to the manner in which the firm will be run.

(j) A company must comply with formalities regarding the keeping of registers and the auditing of accounts which do not apply to partnerships.

(k) The affairs of a company are subject to more publicity than those of a partnership - e.g. companies must file accounts which are available for public inspection.

(l) A company can create a security over its assets called a floating charge, which permits it to raise funds without impeding its ability to deal with its assets. A partnership cannot create a floating charge.

(m) If a company owes a debt to any of its shareholders they can claim payment from its assets rateably with its other creditors. A partner who is owed money by the partnership cannot claim payment in competition with other creditors.

(n) A partnership (unless entered into for a fixed period) can be dissolved by any partner, and is automatically dissolved by the death or bankruptcy of a partner, unless the agreement provides otherwise. A company cannot normally be wound up on the will of a single member, and the death, bankruptcy or insanity of a member will not result in its being wound up.

3. History

By: Ankur Mittal

4. Types of Company

A company can be formed in a number of ways:

(a) By Royal Charter (Chartered Companies)

Formed by grant of a charter by the Crown.

Promoters of the company petition the Privy Council attaching draft of proposed charter to the petition.

Still used to incorporate learned societies and professional bodies.

No longer used to incorporate trading companies.

(b) By Act of Parliament (Statutory Companies)

Formed by private Act of Parliament.

Formerly used to incorporate public utilities such as gas, electricity and railways.

(The privatised public utilities have been incorporated as registered companies).

(c) By Registration (Registered Companies)

Formed by registration under the Companies Act 1985 (as amended) or one of the preceding Companies Acts.

Registration is the most commonly used means of forming a company and virtually the only method now used to form a trading company.

CA 1985, s.1(1): "Any two or more persons associated for a lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability."

Classification of Registered Companies

Important Note

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

"Limited Liability" - this refers to the liability of the members, not the liability of the company. The company will always be liable to the full extent of its debts.

The liability of the members, whether limited or unlimited, is to the company, not to the individual creditors of the company.

(a) Unlimited Companies

(i) Members have unlimited liability (If company is being wound up, members can be made to contribute to the company's assets without limit to enable it to pay its debts.)

(ii) Cannot be public companies.

(iii) Can be set up with or without a share capital.

(iv) Not subject to the same restrictions on alteration of capital as other types of company, and do not normally have to file annual accounts.

(b) Companies Limited by Guarantee

(i) Members agree to contribute a specified amount to the company's assets in the event of the company being wound up. (Total amount payable by all members is called the "guarantee fund")

(ii) Members do not have to pay anything as long as company is a going concern - so company has no contributed capital.

(iii) Companies limited by guarantee are not usually formed for business ventures.

(iv) Prior to 1980, a company could be registered as a company limited by guarantee, but also have a share capital - these are called "hybrid companies".

(c) Companies Limited by Shares

(i) The most common kind of registered company.

(ii) Members of the company take shares issued by the company. Each share is assigned a nominal value - the amount that must be paid to the company for the share. Members may also agree to pay an extra amount - called a premium.

(iii) When the company is registered, its memorandum must state the total nominal value of all the shares it is going to issue (called the registered capital, or nominal capital or authorised share capital).

The memorandum also states the number of shares to be issued:
e.g. 10,000 shares of £1 each = registered capital of £10,000.

(iv) Liability of a member (shareholder), when the company is wound up is limited to the amount, if any, of the nominal value of his shares which has not been paid.

(Shareholder is also contractually bound to pay any premium which has not been paid).

(v) Shares are normally partly or fully paid for when issued, so company will have a contributed capital.

Companies Limited by Shares may be Public or Private

(i) Public Companies

CA 1985, s.1(3): "a company limited by shares which has a memorandum stating that it is to be a public company and which complies with the requirements of the Act for registration as a public company."

Main requirements:

- A company cannot be registered as a public company unless it has a minimum allotted share capital of £50,000, at least one quarter of which has actually been paid.
- A public company must have at least two shareholders and at least two directors.

(ii) Private Companies

CA 1985 defines a private company as "any company that is not a public company".

Private companies have no authorised minimum share capital.

A private company is only required to have one director and, since 1992, it can be formed with only one member.

By: Ankur Mittal

Only Public Companies can have their shares listed on the Stock Exchange - but Public Companies are regulated much more strictly than Private Companies.

II. FORMATION OF A COMPANY

1. Promoters

Promotion of a company is concerned with taking the steps necessary for incorporation.

(a) Definition

"Promoter" is not defined in the Companies Act.

Some attempts at definition have been made by the courts:

Twycross v Grant (Case 1)

Whaley Bridge Printing Co v Green (Case 2)

Whether someone is acting as promoter of a company is a question of fact rather than a question of law.

(b) Duties of Promoters

In the 19th century, it was common for promoters to sell their own property to a newly formed company at an inflated price, or to acquire assets for the company and receive a commission from the seller.

The courts then began to impose a fiduciary duty on promoters similar to that imposed on agents. A promoter must disclose any profit or potential conflict of interest to either:

(i) an independent board of directors, or

(ii) existing or intended shareholders.

(c) Remedies for Breach of Promoters Duty

(i) Where promoter has sold his own property to the company, without disclosing this - the company can rescind the contract and recover the purchase price:

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Erlanger v New Sombrero Phosphate Co (Case 3)
Right of rescission is lost if restitutio in integrum is not possible.

(ii) The promoter may have to account to the company for any profit he has made.

Gluckstein v Barnes (Case 4)

(iii) The company may be able to sue the promoter for damages for breach of fiduciary duty.

Re Leeds & Hanley Theatre of Varieties (Case 5)

(d) Payment of Promoters

A company cannot enter into a contract before incorporation - so a promoter has no legal claim against the company for fees and expenses.

In Scotland, memorandum or articles of the company can be drawn up with a provision that the company will pay fees and expenses incurred in promoting the company.

(e) Suspension of Promoters

Company Directors Disqualification Act 1986, s.2(1)

The court can make a disqualification order against a person who has been convicted of an indictable offence in connection with the promotion, formation or management of a company.

The order can be for a maximum of 15 years - a person who is disqualified is prohibited from directly or indirectly taking part in the promotion or formation of a company.

2. Pre-Incorporation Contracts

A company has no contractual capacity prior to incorporation - so contracts cannot be made on its behalf.

(a) Effect of Pre-Incorporation Contract on the Company

Company cannot be bound to the contract because it had no contractual capacity.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Company cannot ratify the contract because it was not in existence at the time the contract was made.

Company cannot sue or be sued on the contract.

(b) Effect of Pre-Incorporation Contract on Person Purporting to Contract on Behalf of the Company

At Common Law:

- if third party knew company was not yet in existence, he could make the purported agent liable on the contract. (Kelner v Baxter).

- if it appeared that the contract was with a company already in existence, the court might hold there was no contract at all, and neither the company nor the purported agent could enforce it.

Newborne v Sensolid (GB) Ltd (Case 6)

This was unsatisfactory and was first changed by legislation in 1972. Provisions are now in s.36C of the Companies Act 1985:

"A contract which 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."

This means the "agent" will always be personally liable on the contract unless there is agreement to the contrary.

Exceptions:

(i) Companies Bought "Off the Shelf"

s.36C does not apply where promoter makes contract on behalf of existing company he later buys. The company can then ratify the contract.

(ii) Companies Struck Off the Register

s.36C does not apply where a company has been in existence but has been struck off the register. The section only applies where the company has never been in existence.

Cotronic (UK) Ltd v Dezonie (Case 7)

(c) Avoiding Personal Liability

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

(i) s.36C does not apply if the parties have agreed that the promoter will not be personally liable.

This requires express agreement - courts will not infer it.

Phonogram Ltd v Lane (Case 8)

(ii) Promoter and third party could make an agreement for novation. (novation = substitution of a new obligation for an old one)

Promoter could agree with third party that promoter's liability will end when the company, once formed, enters new contract on same terms.

III. REGISTRATION OF A COMPANY

1. The Registrar of Companies

A company is registered by filing certain documents with the Registrar - he is a public official appointed by the Secretary of State. Duties include registering new companies, maintaining company files and supervising compliance with the administrative and disclosure requirements of the Companies Act. The Companies Act 1985 (Electronic Communications) Order 2000 allows most documentation to be submitted in electronic form.

2. Documents Required for Registration

These are listed in CA 1985, s.10:

(a) Memorandum of Association

(b) Articles of Association

These are the documents which make up the constitution of the company. The Companies (Tables A - F) Regulations 1985 give suggested forms for memoranda and articles for different kinds of company.

A public company's memorandum must be in accordance with Table F of the Regulations.

By: Ankur Mittal

Public and Private companies limited by shares can adopt the articles in Table A of the Regulations - Table A will also apply automatically so far as not modified or excluded by the company's own articles.

The Memorandum must be signed (subscribed) unless submitted in electronic form, and must show the number of shares each subscriber is taking.

(c) A statement giving the address of the company's registered office and the details (name, address, nationality, occupation and date of birth) of the company's first directors and secretary.

Statement must be signed by the subscribers to the memorandum and include a written consent to act signed by those named as directors/secretary.

(d) Statutory Declaration of Compliance - a statement that all the requirements of the 1985 Act with regard to registration have been complied with.

The statutory declaration must be signed by a solicitor involved in the formation of the company or by one of the persons named as director or secretary.

(e) Registration Fee - this is presently £20.

3. Certificate of Incorporation

If Registrar is satisfied that requirements of the Act have been met, he registers the documents and issues a certificate of incorporation. This is the company's "birth certificate".

The Registrar publishes the issue of the certificate in the London or Edinburgh Gazette.

Certificate is conclusive evidence that registration requirements have been met. It is also conclusive evidence as to the date of incorporation.

Registrar is entitled to refuse to register a company where it has been formed for an unlawful purpose:

R v Registrar of Joint Stock Companies, ex p Moore (Case 9)

By: Ankur Mittal

The court may also be petitioned to cancel a registration if it appears that the company has been registered for purposes which are unlawful or contrary to public policy:

R v Registrar of Companies, ex p Attorney-General (Case 10)

Trading Certificates

Private companies can begin to trade as soon as the certificate of incorporation has been issued.

Public companies require a further certificate - called a s.117 certificate or trading certificate.

Registrar will only issue s.117 certificate if satisfied that minimum capital requirements for a public company have been met.

A public company which begins to trade without a trading certificate commits a criminal offence - the company and any director responsible for the default can be convicted.

(This does not affect the validity of any contracts entered into by the company).

IV. CONSEQUENCES OF INCORPORATION

1. Separate Legal Personality

A company is a separate person in law from its members. This has several important consequences:

(a) Company is liable for its own debts

The shareholders are not liable for the debts and liabilities of the company and cannot be sued by the company's creditors. A shareholder can be a debtor or creditor of the company and can sue or be sued by the company.

Salomon v A Salomon & Co Ltd (Case 11)

Lee v Lee's Air Farming Ltd (Case 12)

(b) Limited Liability

The fact that the company is a separate person from its shareholders makes limited liability possible.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

(Remember: the company's liability is always unlimited - it is the members' liability that is limited and that liability is to the company, not to the individual creditors.)

(c) Company Property

A company owns its own property - the shareholders have no direct right to this or any share of it.

Person who no longer wishes to be a member is only entitled to whatever price he can get for his shares.

A shareholder has no legal interest in the company's property and cannot insure it against theft, damage, etc.

Macaura v Northern Assurance Co (Case 13)

(This may not apply to someone who is a secured debenture holder.)

(d) Contractual Capacity

A company has full contractual capacity - and only the company can enforce its contracts.

(Companies may also be liable in negligence - shareholder cannot be made liable for the negligence of the company, unless he was also personally negligent).

(e) Crimes

A company can be convicted of a crime, regardless of whether its directors are also convicted.

Some limitations:

- it has been held that a company cannot be convicted of a crime which requires the physical act of driving a vehicle:

Richmond on Thames Borough Council v Pinn & Wheeler (Case 14)

- a company cannot be convicted of any crime for which the only available sentence is imprisonment.

There are particular problems with crimes which require *mens rea* ("a guilty mind") - most common law crimes require *mens rea*, while many statutory offences involve strict criminal liability.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

In order to convict companies of common law crimes, courts may regard the *mens rea* of those individuals who control the company to be the *mens rea* of the company.

However, the courts have been very restrictive in their use of this approach:

Tesco Supermarkets v Nattrass (Case 15)
R v P&O European Ferries (Dover) Ltd (Case 16)
R v Kite and OLL Ltd (Case 17)
Transco plc v HM Advocate (No 1) (Case 18)

Crimes Against the Company

A company can be the victim of crime.

It is theft to steal from a company, even if those accused of the theft are also the company's only shareholders:

R v Philippou (Case 19)
(f) Perpetual Succession

Separate personality means that the existence of a company does not depend on the existence of its members. Membership may change or members may die - the company continues in existence until wound up.

(g) Borrowing

A company can borrow money and grant a security for a debt. Only a company can create a floating charge.

Floating charge = a kind of security for a loan. The charge "floats" because it does not attach to any particular asset, but floats over the company's assets as they exist from time to time. Certain events cause the charge to "crystallise" and attach to whatever assets the company has at the time.

2. Veil of Incorporation

Separate legal personality of company operates as a shield - the courts will not normally look beyond the façade of the company to the shareholders who comprise it.

The screen separating the company from its individual shareholders and directors is commonly referred to as "the veil of incorporation".

e-mail:mittal.ankur1988@gmail.com

3. Piercing the Corporate Veil

Sometimes the law is prepared to examine the reality which lies behind the company façade - this is described as "lifting" or "piercing" the corporate veil.

(a) Statute

Some statutory provisions have the effect of piercing the corporate veil to make directors personally liable.

Presumption is in favour of separate personality and courts will not normally infer that legislation is intended to pierce the corporate veil.

Dimbleby & Sons Ltd v NUJ (Case 20)
Situations where "veil is lifted" by Statute

(i) Companies Act 1985 s.24 - where membership of a company falls below two for more than six months. Member who knows he is the sole member but continues to trade will be jointly and severally liable with the company for company debts contracted after the six month period has elapsed. (s.24 no longer applies to private limited companies)

(ii) Companies Act 1985, s.117(8) - where public company trades without obtaining a trading certificate. If the company fails to comply with any obligations under a transaction within 21 days of being called on to do so, the directors of the company are jointly and severally liable to indemnify the third party against any loss.

(iii) Companies Act 1985, s.349 - if person acting on behalf of a company signs or authorises the signing of a bill of exchange, cheque, order for goods or similar document in which the company's name is not correctly stated, the person signing will be personally liable if the company fails to pay.

This provision is rigidly enforced:

Durham Fancy Goods v Michael Jackson (Fancy Goods) Ltd (Case 21)
(iv) Insolvency Act 1986, ss.213 & 214

s.213 applies where company is being wound up and it appears that business has been carried on with intent to defraud creditors.

s.214 applies where company is in insolvent liquidation and the director(s) should have known this, but did not take sufficient steps to minimise losses to creditors.

By: Ankur Mittal

In either case, the court can order that those involved make a contribution to the companies assets for the benefit of creditors.

(v) Insolvency Act 1986, s.216 & 217

The director of a company which has gone into insolvent liquidation cannot become a director of another company with the same name within a five year period. If he does he can be made personally liable for all the debts of the new company.

(vi) Company Directors Disqualification Act 1986, s.15

A person will be jointly and severally liable with the company for all the company's debts if he takes part in the management of the company while he is under a disqualification order.

NB: For the purposes of these provisions, "person" includes legal as well as natural persons.

(b) Common Law

The courts are willing to pierce the veil of incorporation in some circumstances:

(i) Fraud, Façade or Sham

Courts will examine the reality behind the company where the company was set up purely to evade a legal obligation, or to allow someone to do something he would not be allowed to do as an individual:

Gilford Motor Co v Horne (Case 22)

Jones v Lipman (Case 23)

Re Bugle Press Ltd (Case 24)

(ii) Agency

Court may lift the veil on the basis that one company is merely carrying on business as the agent of another - so that transactions entered into by the subsidiary can be regarded as transactions of the holding company:

Smith, Stone & Knight v Birmingham Corporation (Case 25)

Firestone Tyre & Rubber Co v Lewellin (Case 26)

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

But see: Adams v Cape Industries Ltd (Case 27)

(iii) Single Economic Unit

In the past, courts have been willing to lift the veil on the basis that a group of companies was not a group of separate persons, but a single economic unit:

DHN Food Distributors v Tower Hamlets (Case 28)

Later cases have doubted this principle:

Woolfson v Strathclyde Regional Council (Case 29)

Adams v Cape Industries Ltd (Case 27)

(iv) State of Hostility

In times of war, courts may regard a British company as an enemy alien if the company is controlled by nationals of an enemy country:

Daimler Co Ltd v Continental Tyre and Rubber Co (GB) Ltd (Case 30)

(v) Justice and Equity

Courts have sometimes been prepared to pierce the corporate veil where they feel this is in the interests of justice:

Re a Company (Case 31)

Creasey v Breachwood Motors Ltd (Case 32)

But see: Adams v Cape Industries Ltd (Case 27)

Ord v Belhaven Pubs Ltd (Case 33)

Yukong Lines Ltd v Rendsburg Investment Corp (Case 34)

V. THE CORPORATE CONSTITUTION

The constitution of a company consists of its memorandum of association and its articles of association.

1. The Memorandum of Association

For a company limited by shares, the memorandum must contain the following:

By: Ankur Mittal

(a) Name Clause

CA 1985, s.25 - the name of a public limited company must end with the words "public limited company", the name of a private limited company must end with the word "Limited". Abbreviations may be used instead: "plc" or "Ltd".

It is an offence to carry on business under a name which uses these words or abbreviations when not entitled to do so - the penalty is a fine.

Under CA s.26, it is not possible to register a company name which includes the words "public limited company", "limited", "unlimited" or their abbreviations anywhere except at the end of the name.

There are also other restrictions on the use of names:

(i) Under s.26, a company cannot be registered under a name which is identical to a name already registered.

(ii) A company cannot be registered under a name which is regarded as offensive or where the use of the name would constitute a criminal offence.

(iii) A company cannot be registered under a name which suggests that the company is connected with the government or a local authority - or under any name including a word listed in the Company and Business Names Regulations 1981 - unless the Secretary of State gives permission for the name to be used.

(iv) s.26 does not prevent the registration of a name very similar to that of another company - but if the similarity is deceptive and likely to lead to confusion, the established business may bring an action to restrain the new company from using the name. This is called a "passing-off" action.

Court will take into account:

- scope of pursuer's reputation

- similarity of kind of business

Ewing v Buttercup Margarine Co Ltd (Case 35)

Dunlop Pneumatic Tyre v Dunlop Motor Co (Case 36)

Aerators Ltd v Tollitt (Case 37)

Exxon Corp v Exxon Insurance (Case 38)

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

(v) A company must have its name printed on all business documents and it must be displayed at the registered office and all business premises.

A company which wishes to trade under a name other than its registered name comes within the provisions of the Business Names Act 1985.

(vi) Insolvency Act 1986, s.216 prevents the director of a company which has gone into insolvent liquidation from taking part in the management of any business trading under the same name as the insolvent company.

(vii) A company can change its name by special resolution (requires approval of holders of 75% of the company's shares).

The Secretary of State can order a compulsory name change within 12 months of registration if he discovers the name is the same as or too like one previously registered.

The Secretary of State can order a compulsory name change at any time if he discovers that the name gives a misleading impression of the activities of the company.

(b) Registered Office Clause

CA 1985 s.2 - the memorandum states whether registered office is to be in England and Wales or in Scotland.

This establishes company's nationality and its domicile, but not its residence. Registered office is important because:

- it determines the jurisdiction in which the company can be sued.
- it is the address at which notices and documents must be served on the company.
- it is the address at which the company's registers and records must be kept and made available for inspection by the public.

Address of registered office can be changed by ordinary resolution (simple majority vote of shareholders), provided this does not also change the domicile.

(c) Objects Clause

By: Ankur Mittal

Company's memorandum must contain an objects clause - a clause which states the purpose or purposes for which the company was incorporated.

(i) The *Ultra Vires* Rule

If the company does something beyond the scope of its objects clause, this is said to be *ultra vires* (beyond the powers of the company).

Previously this was of great importance - transaction entered into beyond the company's powers was void and could not be enforced by or against the company, and it could not be ratified. This was called the *ultra vires* rule.

Ashbury Carriage and Iron Co v Riche (Case 39)

(ii) Abolition of the Rule

The Rule has been abolished by statute as far as third parties are concerned.

s.35(1) CA 1985 - the validity of an act done by a company shall not be called into question on the grounds of lack of capacity by anything in the company's memorandum.

The rule still operates internally of the company - a shareholder can bring an action to restrain the company from carrying out an *ultra vires* act.

(The court will not restrain the company from doing anything it is already under a legal obligation to do)

A director may be liable to the company for any costs incurred by the company on an *ultra vires* transaction.

Potential problems can be avoided: CA 1985 s.3A allows a company to state in its memorandum that its object is to carry on business as a general commercial company. It can then carry on any trade or business whatsoever.

(iii) Change of Objects Clause

Under CA 1985, s.4 a company can change its objects clause by special resolution.

Members (holding at least 15% of the nominal issued share capital) who did not consent to the change can apply to the court to have the alteration set aside. (s.5)

Application must be made within 21 days of the resolution being passed. The alteration will not then come into effect unless it is confirmed by the court.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

(d) Limitation of Liability Clause

If members' liability is to be limited, memorandum must have a clause to this effect.

(e) Capital Clause

Limited company with share capital must have a clause stating the total amount of share capital with which it proposes to be registered and the division of that capital into shares of a fixed amount.

No minimum capital for private companies; £50,000 minimum for public companies.

(f) Association Clause

This is a clause stating that the subscribers are desirous of being formed into a company in pursuance of the memorandum. This is followed by signatures of subscribers (attested by one witness) and the number of shares each has agreed to take.

(g) Other Clauses

Public company must have clause stating it is to be a public company.

No other clauses are necessary but it is possible to have others.

(h) Alteration of Memorandum

CA 1985, s.2(7) - a company cannot change its memorandum except in the circumstances and manner expressly provided for in the Act.

Memorandum can be altered to change company from public to private and vice versa - requires special resolution of shareholders.

Company can be changed from unlimited company to limited by special resolution - change from limited to unlimited requires written consent of all the members.

Reduction of share capital requires special resolution.

CA 1985, s.17 - any provision in the memorandum which could have been contained in the articles can be altered by special resolution.

By: Ankur Mittal

CA 1985, s.16 - no member of a company can be bound to an alteration which makes him liable to take more shares or which increases his liability in any other way unless he consents in writing.

When company resolves to alter its memorandum, a copy of the resolution, and the amended memorandum, must be sent to the Registrar within 15 days - failure to do this is a criminal offence punishable by a fine.

2. Articles of Association

(a) Articles Generally

The articles govern the internal management and organisation of the company.

The articles are secondary to the memorandum - if there is conflict between the articles and the memorandum, the memorandum prevails.

Re Duncan Gilmore & Co Ltd (Case 40)

Companies (Tables A - F) Regulations 1985 provides a model set of articles for a company limited by shares.

A company has three options:

- (i) It may adopt Table A in full.
- (ii) It may adopt Table A with modifications.
- (iii) It can exclude Table A entirely and write its own articles.

(Table A has existed in various forms since 1862 - a company which adopts Table A will be bound by the Table A existing at the time it was incorporated, not a later version).

Articles must be: (i) Printed
(ii) Set out in numbered paragraphs
(iii) Signed by the subscribers to the
memorandum

(b) Alteration of Articles

CA 1985, s.9 - articles can be altered by special resolution, which must be notified to the Registrar of Companies within 15 days.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Any provision in the articles which would have the effect of making them unalterable is void.

There are certain restrictions on the company's power to alter its articles:

(i) Express Statutory Restrictions

s.16 - cannot alter articles to increase a member's liability without his consent.

s.369(1) sets out notice periods for calling meetings and states this cannot be shortened by a provision in the articles.

(ii) General Law and Public Policy

A provision in the articles which is contrary to public policy is void.

St Johnstone Football Club Ltd v SFA (Case 41)

The same would apply to any provision which was inconsistent with the companies legislation.

(iii) Court Order

Certain sections of the 1985 Act give the court power to order that no alteration be made to the articles.

(iv) Memorandum

An alteration to the articles which conflicts with the memorandum would be effectively void.

(v) Improper Use of Power to Alter Articles

The Power to alter the articles must be exercised bona fide for the benefit of the company as a whole.

A member cannot challenge an alteration carried out in good faith for the benefit of the company, even if the alteration adversely affects his own rights.

Allen v Gold Reefs of West Africa Ltd (Case 42)

Greenhalgh v Arderne Cinemas Ltd (Case 43)

By: Ankur Mittal

The courts will usually allow the alteration, but have sometimes found that it is not bona fide for the benefit of the company as a whole:

Brown v British Abrasive Wheel (Case 44)

Dafen Tinplate Co Ltd v Llanelly Steel Co (Case 45)

3. Legal Effect of Memorandum and Articles

The legal effect is described in s.14 CA 1985. The memorandum and articles operate as a contract between the company and its members, which both parties are bound to honour.

The effect of this is:

(a) Each member, in his capacity as a member, is bound to the company as if he personally had signed the memorandum and articles.

Hickman v Kent or Romney Marsh Sheep Breeders Association (Case 46)

(b) The company is bound to each member in his capacity as a member.

Wood v Odessa Waterworks Co (Case 47)

(c) The memorandum and articles do not constitute a contract binding the company or any member to an outsider - or to a shareholder in any other capacity than as a member.

Eley v Positive Government Life Assurance Co Ltd (Case 48)

Beattie v E & F Beattie Ltd (Case 49)

(d) Provisions of the memorandum or articles can sometimes form part of an extrinsic contract between the company and an outsider. This can happen in one of three ways:

(i) Where provisions of the memorandum or articles are expressly incorporated into an express contract between the company and the outsider.

(ii) Where there is no express contract but a provision in the memorandum/articles is incorporated by implication from the conduct of the parties.

(iii) Where there is an express contract which is silent on a particular matter, and relevant provisions in the articles or memorandum are used to fill in any gaps.

The company is not actually liable to the outsider on the basis of the articles, but under the extrinsic contract.

Re New British Iron Co, ex parte Beckwith (Case 50)

(e) A member has a right to compel the company to act according to the articles even if not enforcing a right which is personal to himself as a member.

Salmon v Quinn & Axtens Ltd (Case 51)

(f) The memorandum and articles constitute a contract between each member and every other member.

Rayfield v Hands (Case 52)

VI. CAPITAL AND SHARES

1. Nature of Shares and Share Capital

(a) What is a Share?

A share is the unit of measure for determining a member's interest in the company.

The memorandum states the nominal value for each share - members must contribute at least this amount.

(b) Share Capital

There are different aspects to this:

Authorised Share Capital

By: Ankur Mittal

Total value of shares the company is allowed to allot - also known as nominal or registered capital.

Allotted Share Capital

Value of shares the company has actually allotted to members.

Paid-up Share Capital

Amount that members have paid on their shares, excluding any premium.

Called-up Share Capital

Paid-up capital + any amount members have been called on to pay.

Uncalled Capital and Reserve Capital

Uncalled capital is the amount owing on partly paid shares which members have not yet been called on to pay.

Reserve capital is uncalled capital the company has resolved not to call unless the company is wound up.

2. Classes of Shares

(a) Typical Rights of Shareholders

Member's rights are detailed in the Articles, but the following are typical:

- right to control company through voting at meetings
- right to participate in distribution of profits
- right to participate in surplus assets in a winding up.

(b) Preference Shares

Give preferential right to a dividend of fixed amount or fixed percentage per share - this dividend is paid before anything is paid to ordinary shareholders. Right to dividend is normally cumulative.

Preference shares usually give a preferential right to repayment of capital on a winding up.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Preference shareholders normally have restrictions placed on their power to vote at general meetings.

(c) Ordinary Shares

Dividend depends on company profits and there is no automatic right to a dividend.

3. Issue and Allotment of Shares

Issuing is the process by which members take shares in the company.

A share is allotted when someone acquires an unconditional right to be entered in the register of members.

(a) Allotment Contracts

Usual rules of contract apply. There must be an offer met by an acceptance. A prospectus is not an offer to sell shares, it is an invitation to treat.

It is possible to have a conditional contract which gives an option to demand the allotment of shares at a later date. These option can be traded like shares.

(b) Authorisation of Allotment

CA 1985, s.80 - Directors cannot allot shares without authority given by the existing shareholders or the articles.

The authority must state the maximum number of shares to be allotted. It is a criminal offence to allot shares without proper authorisation, but the allotment remains valid.

(c) Pre-emption Rights

CA 1985, s.89 - existing shareholders must be offered the opportunity to buy any new issue of shares before they are offered elsewhere. Shareholder must be given 21 days to decide whether to buy. Private companies can avoid pre-emption rights.

4. Transfer of Shares

CA 1985, s.182 - shares must be transferable.

Private companies usually restrict members' rights to transfer shares.

(a) Transfer of Unlisted Shares

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

- transferor signs stock transfer form
- form is given to transferee with share certificate.
- if only part of shareholding is being transferred, form and certificate are sent to the company instead, for certification.
- transferee sends form and certificate to company, which enters him on register of members. New share certificate is issued after two months.

(b) Transfer of Listed Shares

- can be done as for unlisted shares.
- companies that support CREST can transfer listed shares electronically - records are computerised and no share certificate is issued.

(c) Transmission of Shares

Transmission is the automatic transfer of shares by operation of law. It takes place in a number of circumstances.

(i) Death of Shareholder

Shares of deceased shareholder transmit to his executor to deal with as directed by the will or the rules of intestacy.

(ii) Insanity of Shareholder

If shareholder becomes a patient under the Mental Health Acts and a public guardian is appointed, the shares transmit to the public guardian.

(iii) Bankruptcy of Shareholder

Shares held by a bankrupt transmit to his trustee in bankruptcy.

Holder of shares through transmission has the same rights and benefits as a member even if not registered as a member - but he cannot vote. He can choose to be registered and can then vote.

5. Capital Maintenance

Members are entitled to a dividend out of profits. A company cannot return capital to the members. This provision operates to protect creditors.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

CA 1985 sets out some legal methods by which the capital of a company can be returned to the members.

(a) Reduction of Capital

CA 1985 ss.135-141

A company can reduce its capital if this is authorised by the articles and the reduction is confirmed by the court. It also requires alteration of the share capital as stated in the memorandum - this needs a special resolution.

The court will only confirm the reduction if satisfied that the company's creditors have been paid or have consented to the reduction.

(b) Redeemable Shares

CA 1985 s.159(1)

A company can issue redeemable shares if power to do so is given by the articles.

The shares give a temporary membership of the company - the nominal value (and sometimes a premium) is paid to the shareholder at the end of the period.

When shares are redeemed they must be cancelled by the company. The company must make up its capital by issuing new shares or transferring funds from the profit and loss account to the capital redemption reserve account.

Any premium payable on redemption must be paid out of profits.

Private companies can pay for redemption completely out of capital - this needs a special resolution and a declaration from the directors that the assets will exceed liabilities after the payment is made.

(c) Company Purchasing its own Shares

Generally this is prohibited by s.143(1), but s.162 allows a company to buy its own shares in the circumstances provided by the Act and if authority is given in the company's articles.

(i) Market Purchase

By: Ankur Mittal

Must be authorised by ordinary resolution, which must state maximum number of shares to be purchased and minimum and maximum price to be paid. The authority cannot last more than 18 months.

(ii) **Off-Market Purchase**

This requires a special resolution approving the specific purchase contract. If the company is a public company, the authority to buy must expire within 18 months.

When a company has bought its own shares it must cancel them and compensate for lost capital by a new share issue or a transfer of profits to the capital redemption reserve.

VII. MEETINGS AND RESOLUTIONS

1. Shareholders and Shares

Day to day management of a company is in the hands of the directors, not the shareholders - but the shareholders retain some important powers - many decisions require a resolution of the shareholders and cannot be decided by the directors alone.

(a) Who is a "Member"

(i) Anyone who subscribes the memorandum.

(ii) Any other person who agrees to become a member and whose name is entered on the register of members.

(b) Register of Members

CA 1985, s.352 requires every company to keep a register of its members. The register must show:

- name and address of each member.
- date person became a member and, where applicable, the date he ceased to be a member.
- the number of shares held by each member and the amount paid on them.

2. Kinds of Meetings

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

(a) Annual General Meeting

Most companies must hold an AGM.

(i) CA 1985 s.366 provides that an AGM must be held every calendar year with not more than 15 months between meetings. A newly incorporated company must hold its first AGM within 18 months of incorporation.

(ii) CA 1985 s.367 - if a company does not hold an AGM as required, any member can apply to the Secretary of State to call or to direct the calling of the meeting.

(iii) CA 1985 s.366A - members of a private company can choose to dispense with the holding of an AGM by elective resolution - but any member of such a company can require that an AGM be held in a particular year by giving notice at least 3 months before the end of the year.

(iv) CA 1985 s.371 - if it is impracticable to call a meeting or conduct a meeting in the manner prescribed by the company's articles, any member or director who would be entitled to vote can apply to the court which can order the meeting to be called or held.

Re Sticky Fingers Restaurant Ltd (Case 53)

(b) Usual Business of an AGM

(i) Directors lay before the company annual accounts and reports for the most recent financial period.

(ii) Auditor's term of office ends at AGM, so they must be re-appointed or new auditors must be appointed.

(iii) Director's recommendation for the dividend to be paid to shareholders will be voted on.

(iv) The Articles may provide that directors are to retire in rotation. Some directors will retire at the AGM and must be re-appointed or replaced.

(v) Resolutions may be required to pay directors' and auditors' fees. (Now normally fixed by contract).

(vi) Shareholders may have their own resolutions placed on the agenda.

(c) Extraordinary General Meetings

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Any meeting which is not an AGM. Table A provides that only directors can call an EGM, unless there are too few directors in the UK to make up a quorum - then any member can call one.

CA 1985, s.368 - directors must call an EGM if requisitioned by holders of 10% of the paid up capital of the company.

CA 1985, s.371 - power of the court to order the holding of an AGM also applies to EGMs.

CA 1985, s.142 - public company must hold an EGM if the company's net assets have fallen to less than half of its called up capital. Meeting must be called within 28 days of the directors becoming aware of the loss of capital, and must be held within 56 days of that date.

CA 1985, s.392A - where auditor has resigned and has made a statement of circumstances he thinks should be brought to the attention of creditors and shareholders - the auditor can requisition the directors to hold an EGM so that he can explain the circumstances of his resignation.

3. Convening Meetings

(a) Notice of Meetings

(i) Authority to Call a Meeting

Authority normally rests with the directors.

If person without authority issues notice of a meeting the notice is void.

(ii) Who must be notified?

Depends on the Articles. Table A provides that notice must be given to all shareholders, directors and auditors.

Failure to notify someone entitled to notice will invalidate the meeting unless the failure was purely accidental:

Young v Ladies Imperial Club (Case 54)

Re West Canadian Collieries Ltd (Case 55)

(iii) Method of Service

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Articles can provide for any method - Table A requires written notice to be delivered personally or by post.

Bradman v Trinity Estates Ltd (Case 56)

The Companies Act 1985 (Electronic Communications) Order 2000 allows notice to be given by electronic means such as via a website provided the member agrees to being given notice in this way.

(iv) Length of Notice

Articles can set any length of notice, but by s.369, notice must be at least 21 days for an AGM, or 14 days for an EGM - unless all members agree shorter notice period.

(v) Contents of Notice

Set out by articles. Table A requires notice to specify date, time and place of meeting and a general indication of business to be dealt with. Notice must state if meeting is an AGM.

If meeting is being convened to pass a special or extraordinary resolution, or a resolution for which special notice is required, these resolutions must be set out in full in the notice.

Notice will be invalid unless it contains enough detail to allow a reasonable shareholder to judge whether he needs to attend the meeting.

Baillie v Oriental Telephone & Electric Co Ltd (Case 57)

(vi) Special Notice

Some kinds of resolution require special notice to be given:

- resolution to dismiss a director
- resolution to appoint replacement director at same meeting as dismissal.
- appointment or retention of public company director aged 70 or over.
- resolutions concerning dismissal or appointment of auditors.

Special notice = at least 28 days notice to the company of the intention to move the resolution. The company must then give the members at least 21 days notice of the meeting.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

4. Conduct of Meetings

(a) Quorum

"Quorum" = the minimum number of persons who must be present before the meeting will be valid.

Articles can provide for any quorum:

Table A requires two members entitled to vote, or their proxies.

If Table A has been excluded without providing an alternative, CA 1985 s.370 requires two members personally present.

Single Member Private Companies - one member will form a quorum, notwithstanding anything in the articles.

A meeting held without a quorum cannot validly transact any business:

Sharp v Dawes (Case 58)

(b) Chairman

Usual to have a chairman to preside over a meeting - Table A provides this should be the chairman of the board or another director nominated by the board.

Chairman's role is to keep order - he/she has no power to adjourn or dismiss a meeting unless this is specified in the articles.

Chairman has no casting vote unless given one by the articles. (Table A gives a casting vote.)

(c) Minutes

Companies must keep minutes of general meetings at the registered office for inspection by members.

Chairman signs the minutes - they then become prima facie evidence of what occurred at the meeting.

(d) Voting and Proxies

CA 1985 s.372 - all companies must allow a member who cannot attend a meeting to allow a proxy to vote in his place.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Appointment of proxy must be in writing and lodged with company at least 48 hours before meeting.

There are two methods of voting at company meetings:

(i) Show of Hands

Voting can be by show of hands unless articles provide otherwise.

Each member has just one vote regardless of number of shares he has - hands are counted and the result declared by the chairman. Result is conclusive once recorded in the minutes.

Proxies cannot vote on a show of hands unless the Articles allow this.

(ii) Voting by Poll

A company cannot refuse a demand for a poll made by:

- at least 5 members having the right to vote, or
- any member/members representing one-tenth or more of the total voting rights.

Members normally have one vote per share in a poll.

Members are entitled to exercise their votes according to their own interests.

Northern Counties Securities Ltd v Jackson & Steeple (Case 59)

5. Resolutions

(a) Special Resolutions

Requires vote of 75% of members present in person or by proxy, who are entitled to vote and do vote.

Meeting at which resolution is proposed must have had at least 21 days notice, unless shorter period was agreed by majority in number of members holding at least 95% of the shares.

Certain matters can only be decided by special resolution and the articles cannot provide to the contrary.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Printed copy of special resolution must be sent to Registrar within 15 days of it being passed.

(b) Extraordinary Resolutions

Same requirements as for special resolution except for notice period required, which depends on type of meeting. (21 days for AGM, 14 days for EGM - shorter notice possible by agreement).

Extraordinary resolution must be used:

- for voluntary winding up when company cannot pay its debts (IA 1986 s.84(1))
- to authorise a liquidator to make an arrangement with creditors in members' voluntary winding up (IA 1986 s.165(2))

(c) Elective Resolutions

Apply only to private companies. s.379A CA 1985 lists circumstances - e.g. election to dispense with AGM.

Requires 21 days notice of meeting - resolution must be supported by all members entitled to attend and vote.

Must be filed with Registrar within 15 days of being passed.

An elective resolution can be revoked by an ordinary resolution - which must also be filed with the Registrar within 15 days.

(d) Ordinary Resolutions

Most matters can be decided by ordinary resolution and some must be (e.g. decision to remove a director).

Ordinary resolution requires simple majority - 50% + 1 vote of members present in person or by proxy.

(e) Written Resolutions

CA 1985 s.381A - allows private company to pass resolutions without holding meetings.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Written resolution is passed by being signed by or on behalf of all members who would be entitled to attend and vote at a meeting.

Companies cannot be restricted from using s.381A procedure by anything in the articles.

Resolutions to remove a director or an auditor before his term of office has expired cannot be taken by written resolution.

VIII. DIRECTORS

1. Appointment of Directors

CA 1985 s.282 - public companies must have at least two directors, private companies at least one.

(a) First Directors

Persons named in the statement of first directors and secretary submitted on registration are deemed to be appointed as directors as soon as company is incorporated.

(b) Subsequent Directors

Appointed in manner laid down by Articles - usually ordinary resolution.

(c) Persons Who cannot be Appointed Directors

(i) Share Qualification

If the articles provide for a share qualification, director must obtain this within two months.

(ii) Over-age Persons

No upper age limit for private company unless articles so provide. Person cannot be appointed as director of a public company if he has reached the age of 70 (CA 1985 s.293)

(iii) Undischarged Bankrupts

CDDA 1986, s.11 - criminal offence unless permission given by the court.

Applications for Permission are usually refused:

Re Altim Pty Ltd (Case 60)

Acting in contravention of s.11 is a strict liability offence:

R v Brockley (Case 61)

(iv) Persons Disqualified by the Court

CDDA 1986 - it is a criminal offence to act as director of a company while under a disqualification order.

Court may make a disqualification order where:

- Where a person is convicted of an indictable offence in relation to the company (Maximum period - 15 years).

- Person has been in persistent default in filing returns or documents with the Registrar (Maximum 5 years).

- Company is being wound up and person has apparently committed fraud in relation to the company (Maximum period - 15 years.)

- DTI requests a disqualification order in the public interest after and investigation. (Maximum 15 years.)

- Person has been found liable for wrongful trading under s.214 Insolvency Act (Maximum 15 years)

The court must make a disqualification order where:

- a person is director of a company which has become insolvent and that person's conduct makes him unfit to be concerned in the management of a company.

(Minimum 2 years, Maximum 15 years)

R v Austen (Case 62)

Re Sevenoaks Stationers (Retail) Ltd (Case 63)

Re Firedart Ltd (Case 64)

(v) Auditors and Secretaries

- Auditor of a company cannot also be a director of it.

- Secretary of a company cannot also be the sole director of it.

2. Proceedings of Directors

(a) Meetings

By: Ankur Mittal

(i) Notice

No prescribed notice period - directors are entitled to reasonable notice of board meetings.

Re Homer District Gold Mines (Case 65)

Browne v La Trinidad (Case 66)

Bentley Stephens v Jones (Case 67)

Shaw v Tati Concessions Ltd (Case 68)

(ii) Quorum for Board Meetings

Whatever the articles provide. A director with a personal interest in the matter being discussed does not count toward the quorum:

Re North Eastern Insurance Co Ltd (Case 69)

(iii) Minutes

Minutes must be recorded, but shareholders have no right to inspect them.

3. Powers of Directors

Directors have sole power to manage the business of the company, but power vests in the shareholders if the directors are unable or unwilling to act:

Barron v Potter (Case 71)

A director who exceeds his powers may be liable for any loss the company suffers, unless the shareholders ratify his actions:

Bamford v Bamford (Case 72)

Shareholders can now also ratify ultra vires transactions, unless this amounts to a fraud on the minority.

Third parties are protected by CA ss.35A and 35B - can enforce transactions even if directors exceed their powers.

4. Duties of Directors

(a) Fiduciary Duties

By: Ankur Mittal

Director's fiduciary duties are owed only to the company, not to the individual shareholders.

Percival v Wright (Case 73)

Allan v Hyatt (Case 74)

The Fiduciary Duties are:

(i) A duty to act bona fide for the benefit of the company as a whole:
Re W & M Roith Ltd (Case 75)

(ii) A duty to use powers only for the purpose for which they were conferred:

Howard Smith v Ampol Petroleum (Case 70)

(iii) A duty to avoid a conflict between his own interests and those of the company.

Aberdeen Railway Co v Blaikie Bros (Case 76)

A director cannot vote on any matter in which he has a personal interest, and, by CA s.317 a director with any interest in a proposed contract must disclose this to the board:

Guinness plc v Saunders (Case 77)

Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (Case 78)

(iv) A duty not to make a personal profit out of his connection with the company.

If he does he must account for the profit to the company:

Boston Deep Sea Fishing Ltd v Ansell (Case 79)

Regal (Hastings) Ltd v Gulliver (Case 80)

IDC Ltd v Cooley (Case 81)

The shareholders can vote to permit the director to keep the profit
- unless there is a fraud on the minority:

Cook v Deeks (Case 82)

(b) Duty of Care and Skill

By: Ankur Mittal

Relates to director's competence in managing the company. Traditionally, the duty has been minimal - director is judged according to his own knowledge and experience:

Re City Equitable Fire Insurance Co Ltd (Case 83)

Re Brazilian Rubber Plantations & Estates (Case 84)

Dorchester Finance Co Ltd v Stebbing (Case 85)

More recent cases suggest a move to a tougher standard - the level of skill reasonably to be expected from a person undertaking the same duties.

Norman v Theodore Goddard (Case 86)

Re D'Jan of London Ltd (Case 87)

5. Vacation of Office by Directors

(a) Age

A director of a public company must normally retire when he reaches the age of 70, unless:

- Articles of the company provide otherwise, or
- Shareholders approve his continued appointment.

(b) Retirement under the Articles

Table A, Art 81 - a director must vacate office if:

- he becomes bankrupt or insane
- he becomes disqualified
- he is absent from board meetings for more than six months without permission.

Director can also resign by giving notice.

(c) Dismissal

By: Ankur Mittal

CA 1985, s.303 - a director can be dismissed at any time by an ordinary resolution of the company - this cannot be overridden by the articles or director's service contract.

Special notice must be given of a resolution to remove a director and the director has the right to make representations at the meeting.

The articles may give a director's shares special voting rights - this may defeat the operation of s.303:

Bushell v Faith (Case 88)

IX. MAJORITY RULE AND MINORITY PROTECTION

The general rule in company law is that the wishes of the majority will prevail.

1. The Rule in Foss v Harbottle

Foss v Harbottle (Case 89)

When a wrong is done to a company, it is for the company to decide what action to take.

The courts will not usually hear an action brought by a member or members of the company.

(a) Reasons for the Rule

(i) The Proper Plaintiff Principle

The company is the proper plaintiff (pursuer) in any action to right a wrong against it.

(ii) The Internal Management Principle

The courts will not interfere with the internal management of a company. It is for the company to decide whether it is being properly managed.

(iii) Irregularity Principle

A member cannot sue to rectify a mere informality where the act would be within the company's powers if done properly and the wishes of the majority are clear.

(b) Problems with the Rule

By: Ankur Mittal

The majority of shares often belong to directors. The majority are in the best position to prejudice the company - then decide that the company will not bring an action against them.

There is thus a need for minority protection - enforcement of minority rights falls into three main categories.

2. Exceptions to the Rule in Foss v Harbottle

(a) Preliminary Points

A number of matters must be established first:

- (i) The company is entitled to the remedy - shareholder cannot have a wider right to bring an action than the company itself would have had.
- (ii) It is not possible to petition under CA s.459 or IA 1986 s.122(1)(g) (these will usually be easier).
- (iii) The action falls within one of the recognised exceptions to the Rule in Foss v Harbottle.
- (iv) It is not possible to obtain authority to bring an action in the company's name (i.e. must show the company has decided not to sue).

(b) The Recognised Exceptions

Edwards v Halliwell (Case 90) identified four exceptions:

- Fraud on the minority by wrongdoers in control
- Invasion of members personal rights
- Ultra vires acts
- Material procedural irregularities

In reality, only the first of these is a true exception to Foss - the others are cases where the Rule has no application.

(i) Fraud on the Minority by Wrongdoers in Control

By: Ankur Mittal

"Control" = voting control (50% + 1 vote) - but some suggestion that de facto control is enough:

Prudential Assurance v Newman Industries (Case 91)

"Fraud" = unconscionable use of majority power resulting in loss to or discrimination against the minority.

Negligence is not enough to amount to fraud:

Pavlides v Jensen (Case 92)

But "self-serving" negligence might be:

Daniels v Daniels (Case 93)

Oppression of the minority will be regarded as fraud:

Menier v Hooper's Telegraph Works (Case 94)

Cook v Deeks (Case 82)

Also conduct which is an abuse of majority powers:

Estmanco v GLC (Case 95)

(ii) Invasion of Personal Rights

Invasion of the shareholder's personal rights is not really an exception to the rule in Foss v Harbottle - because the shareholder would be the proper person to bring the action:

Wood v Odessa Waterworks Co (Case 47)

Salmon v Quinn & Axtens Ltd (Case 51)

(iii) Illegal or Ultra Vires Acts

Any shareholder is entitled to bring an action to restrain the company from doing something which is outside the company's objects.

(iv) Material Procedural Irregularities

General rule that the courts will not interfere with the internal management of a company when an action is brought by a shareholder does not apply if the act done by the company was one which required a special majority which was not obtained.

If this exception did not exist, the company would be able to act in breach of its own constitution.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Edwards v Halliwell (Case 90)

3. Unfairly Prejudicial Conduct

(a) Companies Act 1985 s.459

This allows a shareholder to petition the court where the company is being managed in a way that is unfairly prejudicial to the interests of some of the members. (but only to his interests in his capacity as a member).

(b) Meaning of "Unfairly Prejudicial"

The Act does not define this, but:

(i) Test is concerned with effect of conduct, not motive:

Re Bovey Hotel Ventures Ltd (Case 96)

(ii) The conduct must be both unfair and prejudicial.

Re Saul Harrison & Sons plc (Case 97)

(iii) The words are flexible in meaning.

(c) Clean Hands

No bar to petition that the pursuer's own conduct has not been beyond reproach - no requirement for "clean hands".

Re London School of Electronics (Case 98)

(d) Irregularity Principle

The court will not hear a petition under s.459 brought on the basis of a procedural irregularity that could easily be rectified. (As in Browne v La Trinidad (Case 66) and Bentley Stephens v Jones (Case 67))

(e) Grounds for a s.459 Petition

(i) Exclusion from Management

Dismissing a member of a quasi-partnership from the office of director may amount to unfairly prejudicial conduct:

Re a Company (Case 99)

Re Ghyll Beck Driving Range Ltd (Case 100)

(ii) Diversion of Business

Where majority diverts business of the company elsewhere to benefit the majority but prejudice the minority.

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

Re London School of Electronics Ltd (Case 98)

(iii) Non-Payment of Dividends

Majority pay themselves high directors' salaries but the company pays no or very low dividends.

Re Sam Weller & Sons Ltd (Case 101)

(iv) Dilution of Minority

Majority allots shares to dilute percentage of shares and thus voting power held by minority.

Re D & R Chemicals Ltd (Case 102)

(v) Serious Mismanagement

Bad management would not normally be grounds for a s.459 petition - but there is some suggestion that it might be if serious enough:

Re Elgindata Ltd (Case 103)

Limits to the s.459 petition:

The concept that members have a legitimate expectation that the company will be run in a way that differs from the articles of association will not normally apply to a public company:

Re Astec BSR plc (Case 104)

The concept that breach of a legitimate expectation could give rise to a petition based on s.459 was given a more restricted interpretation by the House of Lords in:

O'Neill v Phillips (Case 105)

(f) Remedies

The court has wide discretion - it can grant any order it thinks fitting in the circumstances. In particular, it can:

- regulate the future affairs of the company.
- order the company to bring civil proceedings.
- order the purchase of the aggrieved shareholder's shares. (The most common remedy).

4. **Just and Equitable Winding Up**

By: Ankur Mittal

Insolvency Act 1986, s.122(1)(g) - a company may be wound up by the court if the court is of the opinion that this would be just and equitable.

(a) Locus standii (Who can petition)

Any shareholder provided he has had his shares for at least 6 months during the eighteen months prior to bringing the petition, or have inherited them, or have obtained them by direct allotment from the company.

(b) "Just and Equitable"

This is not defined by the Act - the courts have described it as a broad and flexible concept. "Clean hands" are essential for a s.122(1)(g) petition.

(c) Grounds for Granting the Petition

(i) Breakdown of Mutual Trust and Confidence

Most s.122(1)(g) petitions are brought by members of quasi-partnerships. Court will probably grant the petition if it is evident that the members have lost confidence in each other and can no longer work together:

Re Yenidje Tobacco Co Ltd (Case 106)

(ii) Exclusion from Management

This also applies only to quasi-partnership companies, where the members have a legitimate expectation of taking part in the management of the company.

Ebrahimi v Westbourne Galleries Ltd (Case 107)

(iii) Lack of Probity of Directors

Where shareholders have joined a small family company or quasi-partnership on the basis that it will be managed in a certain way and this has not been done, the petition may be granted where the shareholders have lost confidence in the management.

Loch v John Blackwood (Case 108)

Jesner v Jarrad Properties Ltd (Case 109)

The court is unlikely to grant a winding up order if the petitioner could have had an equally viable remedy under s.459. Winding up is a drastic remedy.

(d) Effect of Presentation of Petition

e-mail:mittal.ankur1988@gmail.com

By: Ankur Mittal

(i) Presentation of the petition freezes the companies affairs while the matter is decided.

(ii) The company can apply for a validating order, which will allow it to carry in business pending a decision.

(iii) The company can take out a cross-undertaking for damages against the petitioner - the petitioner would then be liable for any loss suffered by the company because of the petition if the petition eventually fails.