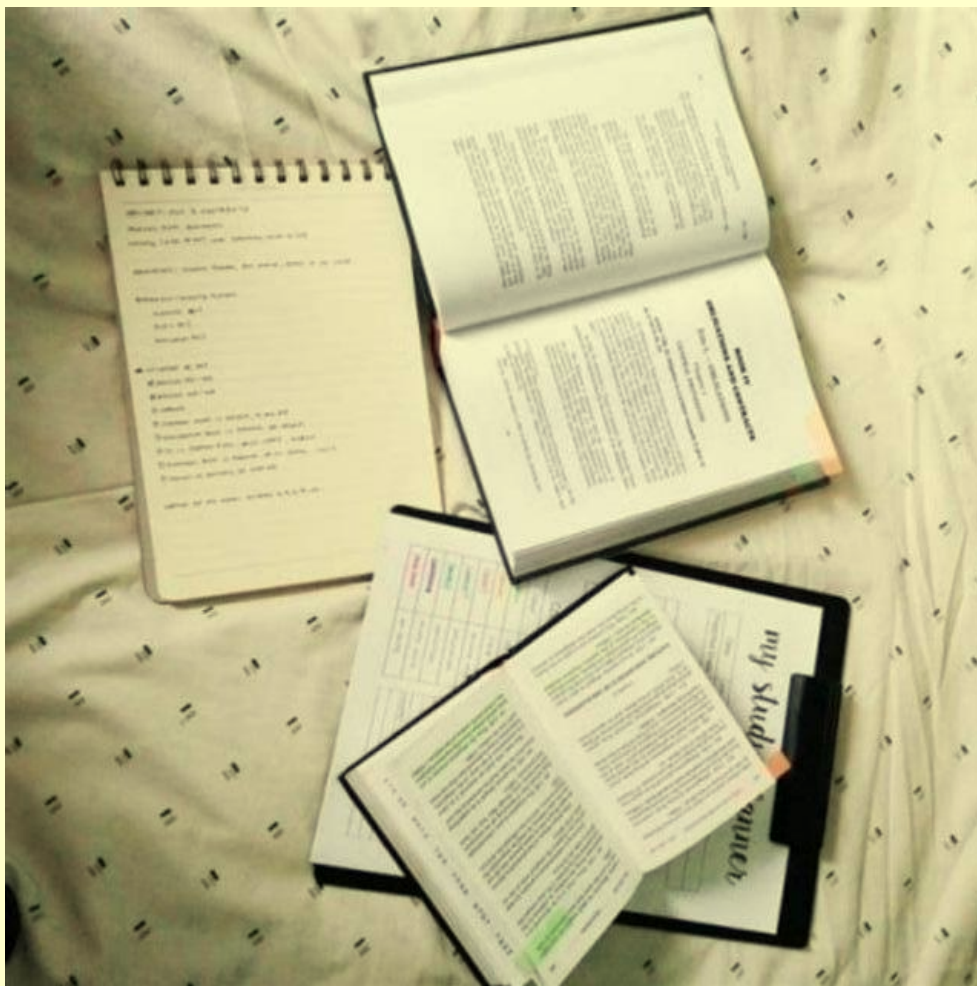


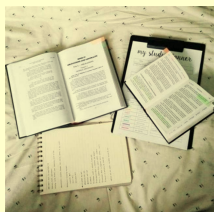
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## COMPANY LAW - LECTURE NOTES

### 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**

#### 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

"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.

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:



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.



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

(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.