NEW

Nutshells

SECOND EDITION

COMPANY LAW

RANCIS ROUNDELL

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New Nutshells

Company Law in a Nutshell

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Series Introduction

New Nutshells present the essential facts of law. Written in clear, uncomplicated language, they explain basic principles and highlight key cases and statutes.

New Nutshells meet a dual need for students of law or related disciplines. They provide a concise introduction to the central issues surrounding a subject, preparing the reader for detailed complementary textbooks. Then, they act as indispensable revision aids.

Produced in a convenient pocketbook format, *New Nutshells* serve both as invaluable guides to the most important questions of law and as reassuring props for the anxious examination candidate.

The second edition of Company Law has been fully updated to incorporate the Companies Act 1981.

As in the first edition the book opens with an introduction to basic terminology before looking at promotion of companies, flotations, raising and maintenance of capital, and shares. Separate chapters are devoted to insider dealing, corporate personality, and objects and powers of a company. Other topics explained include rights of members, management, liability for officers/agents and duties of directors. Concluding chapters cover meetings, publicity, liquidations, and arrangements and reconstructions.

Contents

1 Introduction

Companies are usually formed by *registration* under the Companies Acts. The principal Act is the 1948 Act, a culmination of previous legislation and the Report of the Cohen Committee (1945). Except where the context indicates otherwise, section references in this book are to that Act. Subsequent Companies Acts were passed in 1967, 1976, 1980 and 1981, following proposals by the Jenkins Committee (1962) and, increasingly, the EEC, in its efforts to harmonise the company laws of its Member States.

Members of an *unlimited company* acquire the advantage of incorporation but their personal liability to creditors of the company is unlimited. Therefore, most companies are *limited companies*, with the liability of the members limited to the nominal value of the *shares* they hold or, less commonly, the amount they *guarantee* to contribute to the company's liability on liquidation. A registered company is a *public limited company* (which words must follow its name) if it is limited by shares or (having a share capital) by guarantee, its memorandum of association states it is a public company, and it is so registered. Remaining registered companies are *private* companies. A private limited company must not offer its securities (shares or debentures) to the public. It may re-register as a public company by passing a special resolution and, *inter alia*, if its nominal share capital is not below the *authorised minimum* (currently £50,000) and at least one quarter of the nominal value of each share allotted has been received. An unlimited company may re-register as a public company (and *vice versa*) and a public company may re-register as a private company. A member may incur unlimited liability if his company's membership falls below two.

Registration

For the registration of a company, delivery of certain documents to the Registrar of Companies is required. These include the *memorandum of association*, stating its name, situation of registered office, objects, whether it is limited or not and its initial share structure, and the *articles of association*, the terms regulating the association of the members, which will be on the terms of Table A in Schedule 1 to the 1948 Act unless otherwise excluded or modified. The memorandum of a public company must, as near as possible, follow the form in Schedule 1 to the 1980 Act and its stated share capital must not be less than the authorised minimum. A declaration of compliance with the statutory requirements and a statement of the company's first directors and secretary must accompany the application.

The Registrar must satisfy himself the statutory requirements have been fulfilled and then register the company and issue a certificate of incorporation, stating it is incorporated and (if so) that it is a limited and a public company; the certificate is conclusive evidence of compliance with the statutory requirements and of the statements it contains. A public company initially registered as such cannot commence business until section 4 of the 1980 Act is complied with and the Registrar issues a *trading certificate*. The EEC proposals to enable companies in two or more Member States, satisfying criteria to be laid down, to combine as a *European Company* and to be effective as a company in each Member State.

2 Promotion of companies

A promoter is "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." He may be anyone who participates or has an interest in setting up the company, bar someone involved in a purely professional capacity, such as a solicitor. The promoters are often the company's first directors.

Liability of promoters

A promoter may become liable to third parties for misrepresentation or perhaps as the partner of another promoter, under agency principles in partnership law. Possibly, he will be liable to the new company under contract or conceivably for deceit or negligence. The traditional area of liability to the company is for breach of the fiduciary duties he owes it during its promotion.

Equity will not permit him to take advantage of his privileged position in relation to the unborn company. He must make full disclosure to it, when formed, of his interest in any transaction and must not profit from his position without the company's free consent. Otherwise, he must account personally for profits made and hold on constructive trust any property received which came to him by virtue of his being a promoter.

The rule is strict because, whatever the entitlement to reward of a person whose enterprise results in the establishment of a company and the desirability of stimulating such enterprise, the promoter has an especial opportunity to divert to himself the benefits afforded to the company to be formed and to take advantage of potential investors.

Thus, a promoter who owns property before the promotion begins which he later sells to the company at a profit may retain the proceeds if he discloses all the facts. But, once promotion has begun, any property he acquires while in his fiduciary position will be held on trust for the company (subject to reimbursing him for the price) unless he clearly proves that he obtained the property solely in his personal capacity, for resale to the company on disclosing the full facts, although such proof might well fail if he should have obtained the property for the company directly.

He must disclose fully the nature and extent of his interest and profit. The duty cannot be avoided by setting up a company with a board of directors which cannot and does not "exercise an independent and intelligent judgment on the transaction" and disclosing merely to that board (*Erlanger* v. *New Sombrero*, 1878). The directors should not contribute to disadvantaging the shareholders. Disclosure to the members would be effective if they acquiesced (*Lagunas Nitrate* v. *Lagunas Syndicate*, 1899) but not if an undue advantage over potential investors remained, *e.g.* if the original members comprised or were otherwise under the influence of the promoters (*Gluckstein* v. *Barnes*, 1900).

Remedies

The company may be able to *rescind* a contract entered into consequent upon non-disclosure or misrepresentation by a promoter unless one of the bars to rescission has become operative, *i.e.* affirmation; lapse of time; intervening third party rights; inability to make *restitutio in integrum*; and the court's discretion to award damages in lieu of rescission (Misrepresentation Act 1967, s. 2 (2)).

Breach of fiduciary duty may result in liability to *account* and/or imposition of a *constructive trust*. But promoters should be able to retain expenses incurred in acquiring property in such cases.

A slender thread of authority suggests that *damages* (a common law remedy) may be awarded for breach of fiduciary (equitable) duties (*Re Leeds & Hanley Theatres*, 1902; *Jacobus Marler* v. *Marler*, 1913). In principle, this is misconceived but the cases might be supported on the ground that promoters must refrain from deceit or negligence, the remedy for which is damages.

Remuneration and expenses

The promoter does his work and incurs expenses, by the very nature of his position, at a time before the company has become legally capable of acting. Hence, it cannot enter into a binding agreement with him to remunerate him (or even to indemnify him for expenses) nor can the company, when formed, validly ratify (*i.e.* retrospectively validate) such an agreement made when it did not exist (*Kelner* v. *Baxter*, 1866). It cannot even enter into a new contract with him after formation (except under seal), for the consideration he provides will be past.

The practical solution is for promoters to secure the insertion in the articles of a provision enabling the directors (amongst whom will often be numbered willing promoters) to pay promoters expenses plus reasonable remuneration, which provision will be valid if full disclosure is made.

Pre-incorporation contracts

Similar difficulties arise with contracts purporting to be made between the company and third parties before incorporation. The company will not normally be bound by preliminary contracts. Nor will the promoter be liable for breach of implied warranty of authority (for acting as the agent of a then non-existent principal) if no implication can be made, the third party knowing the true facts. The company may be liable apart from contract, to pay a reasonable amount for benefits actually received, or for conversion, for refusing to permit the third party to retake goods delivered.

Rather than attempting to bind the company, a promoter might contract personally with a third party and forward benefits received to the company when formed, under a separate contract. He might make the company liable on his original contract by assignment. In practice he often stipulates for his liability to cease if the company enters into an identical contract after incorporation: this is possible because if, as usual, the third party has outstanding obligations, he will not be providing merely past consideration (*Natal Land Co.* v. *Pauline Colliery*, 1904).

Under section 9 (2) of the European Communities Act 1972 (hereafter, E.C.A.):

> "Where a contract purports to be made by a company, or by a person as agent for a company, at a time when the company has not been formed, then subject to any agreement to the contrary the contract shall have effect as a contract entered into by the person purporting to act for the company or as agent for it, and he shall be personally liable on the contract accordingly."

It is unnecessary, for such liability, that both parties to the purported contract know that the company has not yet been formed. And the company's agent will be personally liable whether he purports to act "on behalf of" the company or signs the contract in the company's name alone (*Phonogram* v. *Lane*, 1981).

3 Flotations

A company may issue shares by various methods. It could invite tenders or subscriptions directly from the public (usually through the agency of an *issuing house*, of known standing). It might sell them to the issuing house, for it to resell them to the public, by issuing a prospectus or inviting subscriptions, or it might *place* them with the issuing house, either for sale and resale to selected clients of the issuing house or for inviting clients to subscribe. The issuing house is rewarded, where it buys shares, by its profit on resale, and otherwise by commission, especially where it underwrites an issue, by taking up itself any shares not otherwise disposed of. Any commission for underwriting an issue must not exceed 10 per cent., must be authorised by the articles and must be disclosed in the prospectus or alternative document.

The Stock Exchange imposes rigorous requirements for securities to be listed. Parliament has generally contented itself with requirements for disclosure. The Prevention of Fraud (Investments) Act 1958, section 14 generally prohibits the distribution of a document containing an offer to dispose of or acquire securities without the consent of the Department of Trade except in certain cases (which cover most practical situations).

Prospectuses

A prospectus is any document offering securities to the public for subscription or purchase, which includes offers for sale or placings. An offer calculated to result in shares becoming available other than to those receiving the offer or invitation is made to the public.

An application form for securities issued to the public must generally be issued only with a prospectus and any prospectus issued must set out auditors' and accountants' reports and state details of the number and price of shares, class rights, company property, material contracts, directors and their interests, promoters, commissions and expenses (s. 38). These details are unnecessary where shares are issued to existing members or are uniform with existing listed shares or where an application for listing is made and the Stock Exchange issues a certificate of exemption. If a prospectus contains an expert's report, his consent must be given and recorded. A copy of the prospectus must be delivered to the Registrar.

The prospectus requirements are inapplicable to the allotment or sale of shares for a non-cash consideration (*Government Stock* v. *Christopher*, 1956) or to subsequent dealings.

The practice of issuing shares using issuing house facilities and of obtaining Stock Exchange quotations for certain shares, with the corresponding necessity to comply in advances with the rules of the Issuing Houses Association and the Stock Exchange Requirements, restricts the potential liability of persons responsible for issuing shares, although the sanctions provide no legal redress. Criminal or civil liability may however arise.

Criminal penalties

The 1948 Act creates offences, punishable by fine and possibly imprisonment, for breach of certain of its provisions, *e.g.* issuing an application for securities without a prospectus (s. 38 (3)) or authorising the issue of a prospectus containing an untrue statement (s. 44). The Prevention of Fraud (Investments) Act 1958, s. 13 makes it an offence to induce a person to invest money if the inducement is fraudulent or reckless (negligence is insufficient). It is similarly an offence fraudulently or recklessly (dishonestly or otherwise) to induce someone to deposit money with a company (Banking Act 1979, s. 39). Under the Theft Act 1968, s. 19, a company officer causing or contributing to publication of a statement knowing it to be false or misleading, with intent to deceive members or creditors, may be imprisoned. Those publishing false statements may also be convicted of common law conspiracy to defraud.

Civil liability

Whether on the first issue of or a subsequent dealing with shares, a person relying on a false statement may have a remedy against the company or the individual responsible (who may have to indemnify the company for liability arising from his misconduct).

A person subscribing for or purchasing shares on the basis of a misrepresentation may *rescind* the contract. Rescission is available against the company if it has knowledge that the contract is made on the basis of the representation, the misrepresentation is made in a prospectus deemed to be issued by the company and it is made within the authority of an agent of the company. The remedy is subject to the usual bars and to the court's discretion to award damages in lieu. Damages for breach of contract are unlikely to be available against the company, mainly because of the rules governing the maintenance of capital and equal rights of membership, but such damages might be claimed from a transferor of shares.

A person intended to rely and actually relying on a false representation made knowingly, or without belief in its truth, or recklessly (careless of whether it be true or false) may sue for damages for deceit (*Derry* v. *Peek*, 1889). But a purchaser of shares in the market cannot sue if the representation is made as an inducement only to original subscribers (*Peek* v. *Gurney*, 1873) unless it is also meant to mislead subsequent purchasers or is re-activated by a later statement (*Andrews* v. *Mockford*, 1896). It was held in

Houldsworth v. *City of Glasgow Bank* (1880) that a shareholder cannot claim damages from the company while he remains a member (*i.e.* without terminating his membership or after rescission becomes impossible) as this would, apparently, result in an impermissible return of capital to a member (see Chap. 4). Is the decision sound?

A subscriber for shares on the faith of an untrue statement in a prospectus may claim compensation from persons authorising its issue, subject to defences of reasonable belief, ignorance or disclaimer (s. 43). He is, therefore, in a better position than a subsequent purchaser, who may be confined to damages for negligent misstatement under *Hedley Byrne* v. *Heller* (1964) or (so long as the defendant has contracted with him) under the Misrepresentation Act 1967, s. 2 (1).