THE COMPANIES ACT 1980

a new business code

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Preface

This book has been written primarily for the use of those involved with company law and practice. The broad objective is to describe the major changes in the law that the 1980 Act introduces and explain the new rules and regulations, drawing together the existing legislative and common law provisions relating to the areas covered by the Act. References to 'the Act' are, unless the context otherwise requires, to the Companies Act 1980.

At this point I would like to thank Professor Campbell Burns of the Law School, Strathclyde University, for his helpful suggestions during the preparation of the book and the publishers for their kindness in supporting my work. In addition I would like to thank Her Majesty's Stationery Office for permission to reproduce the 1980 Act.

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1. Introduction

After several attempts and many recommendations and reports the process of reforming the legal framework governing companies is under way. The Companies Act 1980 represents the most significant reform of company law since the 1948 Act and, in many respects, marks a departure from the more flexible approach that legislation has taken in the past, introducing a more closely administered and prescriptive system on the continental model.

There is no doubting the need for reforming company law. The basic structure has remained largely unchanged since the first attempts were made at regulating the business association that emerged to facilitate the economic growth of the industrial revolution. Subsequent reforms have more or less remained within the parameters of the original legislation, that is, that limited liability be granted to companies subject to safeguards for shareholders and creditors, safeguards which, initially at least, were minimal. The price of limited liability was an obligation to disclose information and accounts sufficient to enable the shareholders and debenture holders to ascertain whether their money was being used to its best effect and that the corporate controllers were not abusing the privilege of limited liability.

However, the realities of contemporary business demand more effective remedies to enable shareholders to assert their proprietary rights, the recognition and protection of the legitimate rights of other groups such as the workforce, and the imposition of standards of behaviour in the conduct of business that more readily reflect society's demands for the greater control and accountability of those who are involved in the financing and management of companies. Indeed, there are signs that the courts are beginning to take a much harder line in respect of corporate irregularities,[1] reflecting the important role that companies play in our society.

At the same time, however, great care must be taken in framing new legislation on company law reform to strike the right balance between the demands for greater social control and the need to promote enterprise and efficiency. At this time there is above all a great need to promote enterprise and endeavour and not to inhibit it by adding unnecessarily to the complex net of restrictive rules and regulations that presently surround business, discouraging personal involvement and deterring the risk taker.

1.1 Factors influencing the Act

The 1980 Act owes its existence to developments in three distinct areas. First, the continuing review of company law that the Department of Trade carries out,

1. See, for example, *Industrial Development Consultants Ltd* v. *Cooley* (1972) 1 W.L.R. 447; *Dorchester Finance Co. Ltd* v. *Stebbing* (1974 No. 3538) High Court 22 July 1977; *Prudential Assurance* v. *Newman Industries Ltd, The Times*, 28 February 1980.

drawing on recommendations and representations from the professions, and inspectors' reports. In particular, the latter have been a powerful factor in highlighting areas where company law needs reforming.[2] The Conservative Government's White Paper, 'Company Law Reform',[3] and the last Labour Government's White Paper, 'The Conduct of Company Directors'[4] and the Green Paper, 'The Future of Company Reports',[5] were all the result of the Department's continuing review.

Second, the Act owes much to the European Company Law Harmonization Programme. In accordance with the broad objectives of the Community, the Harmonization Programme is aimed at the creation of common rules and regulations governing companies. Under the prevailing arrangements, companies are incorporated under the separate laws of the Member States and the considerable divergence between these different laws represents a check to economic activity within the Community as a whole. Harmonization of company law will, therefore, ultimately promote greater economic activity and facilitate achievement of the broad objectives of the Community. Thus, Art. 54(3)(g) of the Treaty of Rome provides for the progressive abolition of existing restrictions on freedom of establishment through action of the Council and the Commission:

> 'By coordinating to the necessary extent the safeguards which, for the protection of the interests of the members, are required by Member States of companies or firms within the meaning of the second paragraph of Article 58 with a view to making such safeguards equivalent throughout the Community.'

Parts I, II and III of the Act seek to implement the Second Directive on company law reform of December 1976. This Directive seeks to regulate the formation of public companies and the maintenance and alteration of their capital, and was at an advanced stage of preparation when the United Kingdom acceded to the Treaty of Rome.[6]

It was followed by the adoption of two further Directives in 1978, the Third Directive, which is concerned with mergers, and the Fourth Directive, which deals with company accounts. Legislation is promised in the autumn of 1980 to implement the Fourth Directive.[7]

It was considered preferable to implement the Second Directive by means of a Bill rather than the order-making procedure provided in s. 2(2) of the European Communities Act 1972, because the Directive necessitates a complete reformulation of the definition of public and private companies. Subordinate legislation would, therefore, be an unsuitable way of implementing such a major change. In addition, the Government considered that many of the provisions of this Directive aimed at public companies could be applied to the private

2. See, for example, the Department of Trade Inspectors' Report on the London and Counties Securities Group.
3. 1973 Cmnd. 5391.
4. 1977 Cmnd. 7037.
5. 1977 Cmnd. 6888.
6. See 'Implementation of the Second E.E.C. Directive on Company Law. An Explanatory and Consultative Note'. Department of Trade 1977.
7. See 'Company Accounting and Disclosure: A Consultative Document'. 1979 Cmnd. 7654.

company. The opportunity has, therefore, been taken to introduce equivalent provisions dealing with private companies.

The third and potentially most significant influence on the 1980 Act is the impact of wider economic and social developments which are affecting the public's expectations about the role, function and responsibilities of the modern corporate enterprise. Company law in the United Kingdom has resisted adapting to a view of the company as an institution with desirable social and economic responsibilities to groups other than the shareholders. There has been no significant change in the legal definition of a company's responsibilities since the limited liability company was conceived. However, the traditional framework setting the priority of company operations towards the interests of the owners has tended to mask the reality of corporate activity in the United Kingdom. Most company boards would today consider their primary function to strike a balance between the often competing interests of the shareholders, employees and the community. The 1980 Act enshrines this view, albeit in a modest manner. It lays the foundation for future reforms aimed at making companies and those that are responsible for running them, more accountable for their actions. In this context, of particular interest is the growth of voluntary codes through the system of self-regulation by the city institutions, the problem of accountancy standards and the need to consider whether aspects of these should be converted into law or given legal support.

1.2 Operation of the Act

The 1980 Act will not come into operation all at once. Different parts will become operational on an appointed day as and when the Secretary of State decides, by means of a statutory instrument. Reference is frequently made in the text to the 'transitional period'. This refers to a period of 18 months from the date when the particular provision comes into operation.

2. Classification of companies

Under the 1948 Act every company was regarded as a public company unless it satisfied the requirements of a private company. These requirements were set out in s. 28 of the 1948 Act and defined a private company solely by reference to its articles. Thus a company was private if its articles:

(a) restricted the right to transfer its shares;
(b) limited the number of its members to 50; and
(c) prohibited the company from making any invitation to the public to subscribe for its shares or debentures.

If the article contained no such restrictions, the company would be a public company.

2.1 Public companies

Following the Second Directive, the Act radically changes the position by defining public companies, private companies thus forming the residual category.

Section 1(1) defines a public company as one:

(a) which is limited by shares or by guarantee and having a share capital;
(b) which states in its memorandum and articles that it is to be a public company; and
(c) in relation to which the provisions of the Companies Acts as to the registration and re-registration[1] as a public company have been complied with.

Registration of companies limited by guarantee with a share capital will no longer be permitted (s. 1(2)).

The minimum number of subscribers to the memorandum of association of a company to be incorporated as a public company is reduced from seven to two and in future the names of all public companies will have to end with the suffix, 'public limited company' rather than 'limited'. In the case of a company whose registered office is in Wales, the Welsh equivalent may be used, 'Cwni Cyfyngedig Cyhoeddas'. The Act does, however, permit the use of the abbreviations 'PLC' or 'CCC' (s. 2(2)).

The memorandum will state the name of the company, ending with the new suffix and must be broadly in the form set out in Part I of Sch. 1 to the Act; or if it is a company limited by guarantee and having a share capital in the form set out in Part II of that Schedule. In the case of public companies, these forms will supersede the forms of memorandum set out in Sch. 1 of the 1948 Act (Tables B and D).

1. See 2.1.1—'Registration and re-registration of companies'.

2.1.1 Registration and re-registration of companies

Where any memorandum is delivered for registration under s. 12 of the 1948 Act, the registrar cannot register the memorandum unless he is satisfied that all the requirements of the Acts in respect of registration and of matters precedent and incident thereto have been complied with (s. 3(1)). In particular, in the case of a public company, the amount of the share capital must not be less than the authorized minimum, that is, £50,000. The certificate of incorporation must contain a statement to that effect as well as recognition that the company is a public company.

Such certificate in respect of any company represents conclusive evidence that:

(a) the formalities have been complied with; and
(b) in the case of a public company, that the company is incorporated as a public company.

A statutory declaration in the prescribed form must be delivered to the registrar, to the effect that the provisions of s. 3(1) have been complied with. This declaration is made by the solicitor engaged in the formation of the company or by a person named as director or secretary of the company in the statement delivered under s. 21 of the 1976 Act in respect of the first directors and secretary of the company. The registrar is permitted to accept the declaration as sufficient evidence of compliance with s. 5(1).

2.1.2 Public companies not to do business

A company registered as a public company on its original incorporation is not permitted to commence business or exercise any borrowing powers unless the registrar has issued a certificate under s. 4. The certificate will be issued on an application in the prescribed form by the company if the registrar is satisfied that the nominal value of the company's allotted share capital is not less than the authorized minimum and a statutory declaration is delivered to him. The declaration under this section is required to be signed by a director or secretary and state the following:

(a) that the nominal value of the company's allotted share capital is not less than the authorized minimum;[2]
(b) the amount paid up at the time of the application on the allotted share capital of the company;
(c) the amount or estimated amount of the preliminary expenses of the company and the persons by whom any of those expenses have been paid or are payable; and
(d) any amount or benefit paid or given or intended to be paid or given to any promoter and the consideration for the payment or benefit.

The registrar may accept the declaration as sufficient evidence of the matters

2. In respect of the authorized minimum share capital, the company cannot count shares allotted under an employee share scheme unless the shares are paid up at least to 25 per cent of their nominal value and the whole of any premium on the share. See s. 4(4).

stated in it and the certificate issued by the registrar will be conclusive evidence that the company is entitled to do business and exercise borrowing powers.

If a company carries on business or exercises any borrowing powers in contravention of s. 4, it and any officer in default will be liable to criminal penalties. Although these provisions do not affect the validity of any transaction entered into by the company, if a company does enter into a transaction without carrying out the formalities of the provisions and fails to comply with its contractual obligations thereunder within 21 days of being called upon to do so, the directors shall be jointly and severally liable to indemnify the other party to the transaction. This indemnity covers any loss or damage suffered by the other party to the transaction by reason of the company's failure to comply with its obligations (s. 4(8)).

2.2 Re-registration of companies

Consequent upon the new definition of a public company, s. 28 of the 1948 Act is repealed. Articles will still, however, contain similar restrictions on the right to transfer shares, indeed s. 15 of the Act makes it an offence for a private company to offer shares or debentures to the public.

Doubtless the usual practice of forming a private company and then 'going public' will persist and initial formation as a public company will remain a rare practice. The Act does remove a number of the advantages of the practice whereby a company intending to go public straight away is registered as private and immediately converts into a public company by passing a special resolution to change its articles. Such a practice avoided s. 130 (need for a statutory report and statutory meeting), s. 109 (restrictions on the conduct of business) and s. 48 (publishing a statement in lieu of prospectus) of the 1948 Act; these sections have now been repealed.

Section 5 of the Act sets out the new procedure for re-registering private companies as public companies. A private company, other than a company not having a share capital or an old public company,[3] qualifies to re-register as a public company if it passes a special resolution altering its memorandum to state that it is to be a public company. In addition, its name must be changed to include the appropriate suffix and any other alterations made to the memorandum and articles as are required by the Act and the circumstances of the change.

At the time that the special resolution is passed, the following conditions must prevail:

(a) the nominal value of the company's allotted share capital must be not less than the authorized minimum;
(b) each of its allotted shares must be paid up to the extent of one-quarter of its nominal value and the whole of any premium;
(c) where any share in the company or premium payable on it has been fully or partly paid up by an undertaking by any person that he or another

3. See 2.4—'Old public companies'.

should do work or perform services for the company or another, such undertaking must be performed or discharged; and

(d) in the case of shares allotted and any premium payable, in full or in part for a consideration consisting of or including an undertaking (apart from (c) above) to the company, the undertaking must be performed or discharged or there must be a contract under which the undertaking will be performed within five years from the time of the resolution.

For the purposes of determining whether the last three conditions are complied with, the following shares are disregarded:

(i) those allotted before the end of the transitional period. If, however, the aggregate in nominal value of that share and the others which it is proposed to disregard are more than one-tenth of the issued capital it may not be so disregarded;

(ii) shares allotted under an employee's share scheme and by reason of which the company would be precluded under the second condition from being registered as a public company.

Although these shares may be disregarded for the purpose of conditions (b) to (d), they may not be regarded as part of the issued share capital of the company for the purposes of determining the authorized minimum (s. 6(2)).

An application for re-registration must be accompanied by a printed copy of the memorandum and articles as amended, a copy of a written statement by the auditors that in their opinion the last balance sheet (it must be no more than seven months old) shows that the company had net assets not less than the aggregate of its called-up capital and undistributed reserves, together with a copy of the balance sheet and an unqualified report of the auditors in respect of that balance sheet.[4]

Where between the balance sheet date and passing the special resolution the company allots shares as fully or partly paid up as to their nominal value and any premium on them otherwise than in cash, it will be prevented from making an application for re-registration unless the consideration has been valued. Such valuation must be made in accordance with the valuation provisions of s. 24 and a report on its value must be prepared in accordance with the rules of s. 24 and made to the company during the six months preceding the allotment of shares.

A copy of the valuation report must also accompany the application for re-registration in addition to a statutory declaration by a director or secretary of the company to the effect that the special resolution has been passed and requisite conditions complied with. The declaration must also contain an assurance that between the balance sheet date and the application for re-registration, there has been no change in the company's financial position resulting in the net assets becoming less than the total of called up capital and undistributed reserves (s. 5(3)).

4. A qualified report may still be used if the auditor states that the thing giving rise to the qualification is not material for the purpose of s. 5. See 5.9.

Provided that the registrar is satisfied that the formalities have been complied with he may then proceed to issue the certificate of incorporation stating that the company is a public company whereupon the alterations to the memorandum and articles take effect and the company enjoys the status of public limited company. If it transpires that a court has made an order confirming a reduction of capital which brings the nominal value of the company's allotted share capital below the minimum, then the registrar cannot issue the certificate (s. 5(7)).

2.3 Unlimited companies

The Act makes provision for re-registration of unlimited companies as public companies under the same terms as private companies but subject to certain modifications. In effect, such a company will have to become limited in addition to meeting the requirements in s. 5 in respect of public status. Thus the special resolution must additionally state that the liability of the members is to be limited by shares and what the share capital is to be. The company must also make such alterations to the memorandum as are necessary to bring it, in substance and form, into conformity with the requirements of the Act with respect to the memorandum of a company limited by shares. The certificate of incorporation must also state that the company has incorporated as a company, limited by shares.

Certain of the provisions of s. 44 of the 1967 Act will apply to re-registration as a public company by an unlimited company. In particular in the case of a winding up within three years from the date of re-registration, past members may be liable to contribute to the assets of the company in respect of debts and liabilities contracted prior to re-registration.[5]

2.4 Old public companies

Inevitably, the Act makes detailed provisions for the change by existing public companies into the new form of public company. These are contained in s. 8 and in effect they mean that a company may choose to be re-registered as a new public company or become a private company. The expression 'old public company' is taken to mean a company limited by shares or a company limited by guarantee having a share capital and satisfying three conditions:

(a) it existed on the appointed day or was incorporated after that day under an application made prior to that date;
(b) it was not a private company within the meaning of s. 28 of the 1948 Act; and
(c) the company has not subsequently been re-registered as a public company or become a private company.

Either before or after the end of the transitional period such a company may be re-registered as a public company. The directors must first pass a resolution that the company be so re-registered, altering the memorandum to state that the

5. See s 44(6) and (7) of the 1967 Act.