

INTRODUCTION

0.1 WHAT THIS BOOK IS ABOUT

0.1.1 THE LEGAL CONCEPT OF A COMPANY

In a modern capitalist market economy, companies are a familiar part of everyday life. Companies own the supermarkets from which people buy their food; companies supply the water, gas, electricity and petroleum products we depend on; companies publish the newspapers we read and provide our Internet services. We deal with companies so often as purchasers and users of their products and services that the image which the word 'company' brings to mind is usually of an organisation concerned with marketing and collecting payment for products which the company has made (or bought in) or services it has provided. It is necessary to go behind this image to get to the company which is the subject of company law.

0.1.2 THE BIG IDEA

The company with which lawyers are concerned is the legal entity which owns the business which the organisation has been created to carry on. The remarkable thing about this entity is that it is created by process of law and exists only by virtue of the law.

The big idea of company law is the separate personality of the company as an artificial person. The separate artificial person is capable of owning property, being a party to contracts, and being a claimant or defendant in legal proceedings. This big idea is not easy to get used to. There is a further introduction to it in 0.3. It is the main theme of chapters 1, 5 and 19, and is referred to throughout the book. Chapter 5 also examines some of the arguments against the big idea of separate personality and when it can be ignored.

0.1.3 OTHER MAIN THEMES

0.1.3.1 Introduction

This book is organised to follow the life of a company roughly chronologically from formation to dissolution, but there are some main themes which keep recurring. One of them, the big idea of separate personality, has already been identified (see 0.1.2). Other recurring main themes are: ownership and control of a company and corporate governance (0.1.3.2), corporate finance (0.1.3.3), transparency and disclosure (0.1.3.4), the differences between public and private companies (0.1.3.5), and picking up the pieces after things go wrong (0.1.3.6).

0.1.3.2 Ownership and control

A company is an artificial person, which is capable of owning property. Who owns the company and benefits from the wealth which the company has, and who controls what the

company does with its assets? The basic company model is that a company has *members* (also known as shareholders) who, in effect, own it, and it has *directors* who control what the company does. Rules about ownership and control of companies and about how they are controlled, what is generally known as corporate governance, are the main theme of chapters 2, 3 and 14 to 17. In practice, it is common for a company to be owner-managed, with all its members serving as directors (see 1.5).

0.1.3.3 Corporate finance

A company as a separate person is capable of owning property, conducting a business and employing people. How does it acquire money to buy property, run a business and pay employees? Corporate finance is the main theme of chapters 6 to 13. Two principal sources of corporate finance are (a) capital contributed for shares and (b) borrowings. The concept of share capital is introduced in chapter 1 (1.3.2), and issuing and dealing in shares are the subjects of chapters 6, 7 and 8. Borrowing is the subject of chapters 11 and 12.

0.1.3.4 Transparency

A company as a separate person has members, who are effectively its owners, and it has directors, who control what it does and manage its business. But only the company as a separate person is responsible for the debts incurred in carrying on its business. Members have what is called 'limited liability', which in practice they discharge when they contribute capital for their shares (see 1.3.2 and 6.4 to 6.6). Directors of a company normally have no liability for its debts. This is a radical departure from the traditional view that the owner of a business must have unlimited liability for its debts. The price paid for limited liability for a company's debts is the obligation to make available to the public a great deal of information about the company (see chapter 4), including its accounts (see chapter 9). Rules on disclosure of information are referred to throughout this book.

0.1.3.5 Public and private companies

Public companies (plcs) are permitted to invite the general public to subscribe for their shares, whereas private companies are not. The shares of a public company may be officially listed for trading on a recognised investment exchange such as the London Stock Exchange. The shares of a private company may not. Offering shares to the public is the subject of chapter 7. Some of the rules of company law, particularly on disclosure, are more stringent or onerous for public companies than for private companies. These are noted at appropriate points in chapters 1, 6, 9 and 10. Public companies which are officially listed are subject to extra disclosure rules promulgated by the Financial Services Authority for the protection of investors.

0.1.3.6 Picking up the pieces

Much of the function of company law is to prescribe rules which should be followed to avoid disputes and conflict in running companies. Chapter 18 is about dispute resolution. The most common disputes resolved in company law are between a minority of members in a company and the majority, and the subject matter of chapter 18 is often called 'minority rights'. Chapter 20 is concerned with the legal processes for dealing with companies whose businesses fail or otherwise cease. This is often a time for examining people's responsibility for a company's failure.

0.2 WHAT IS IN THE REST OF THE INTRODUCTION

This introduction to the book begins with a short discussion of the nature of corporations in general, and companies as a particular type of corporation, and contrasts incorporated companies with two other legal forms used by businesses, the partnership and the sole proprietorship (0.4). The rest of this introduction looks at the sources of company law in statute, case law, European law and so on (0.5) and asks what purposes company law should serve (0.6). This leads to Although this review has been conducted outside the an important political question which must be faced in company law, which is introduced in 0.6 and returned to in 0.7. This question is whether company law should serve the interests only of those who contribute capital to companies or whether the activities of companies need to be controlled in the public interest.

0.3 INCORPORATION

0.3.1 THE NATURE OF INCORPORATION AND LEGAL PERSONALITY

The companies with which this book is concerned are called ‘registered companies’ because they are brought into existence by registration of documents (of which the most important is called a ‘memorandum of association’) with a public official (a registrar of companies) under the provisions of the Companies Act 1985 (CA 1985).

The most important legal characteristic of a registered company is that it is ‘incorporated’ and so has what is known as ‘legal personality’. This is provided for in CA 1985, which refers to the formation of an ‘incorporated company’ by complying with the Act’s requirements in respect of registration (s. 1(1) and (3A)). The principal requirement of the Act in respect of registration is that the persons who wish to register a company must sign a memorandum of association (s. 1(1) and (3A)) and deliver it to the registrar of companies at Companies House (s. 10(1)). By s. 13(1): ‘On the registration of a company’s memorandum, the registrar of companies shall give a certificate that the company is incorporated’.

Describing a registered company as ‘incorporated’ means that it is a corporation or ‘body corporate’ (a company is described as a ‘body corporate’ in CA 1985, s. 13(3) and (4)). The extraordinarily useful feature of a corporation is that it is an artificial entity which is treated in law as having the capacity to enter into legal relationships, such as being the owner of property, being a party to a contract or being a claimant or defendant in legal proceedings.

The law is concerned with relationships, such as contracts, ownership of property and duties of care, which are entered into by ‘persons’, who have the duties and rights attached to the relationships they enter into. The types of relationship studied in law are based on the transactions and activities of human beings, who are described as ‘natural’ or ‘real’ persons. But legal principles are concerned with the nature of a legal relationship, such as contract or the ownership of property, and can be applied not only when a human being enters into the relationship but also when any other entity does. So the law can recognise that entities other than human beings can enter into at least some legal relationships. For the purposes of the relationships in which their participation is recognised, entities other than human beings are said to have ‘legal’ personality (sometimes called ‘juristic’ or ‘juridical’ personality).

The capacity of a corporation to enter into legal relationships is limited only by two factors:

- (a) The fact that the entity is not human. For example, a corporation cannot have hurt feelings (*Collins Stewart Ltd v Financial Times Ltd* [2005] EWHC 262 (QB), LTL 25/2/

2005), or drive a lorry (*Richmond London Borough Council v Pinn and Wheeler Ltd* [1989] RTR 354).

- (b) Any limitation imposed by the process of incorporation. Following recent reforms only charitable companies suffer any limitations on capacity by being incorporated as registered companies (see 19.4).

CA 1985, s. 13(4), says that as from the date of the certificate of incorporation given by the registrar in accordance with s. 13(1) a company 'is then capable forthwith of exercising all the functions of an incorporated company'.

As well as having its own personality, a registered company is also seen as being an association of persons (natural or legal) who are called the 'members' of the company. This is why subsections (1) and (3A) of CA 1985, s. 1, require the subscription of a 'memorandum of association' and s. 13(3) provides that: 'From the date of incorporation mentioned in the certificate [given by the registrar under s. 13(1)], the subscribers of the memorandum, together with such other persons as may from time to time become members of the company, shall be a body corporate'. In nearly every company, membership is based on holding shares in the company, and so the terms 'member' and 'shareholder' are virtually synonymous.

Probably the most important legal feature of a body corporate is its dual nature as both an association of its members and a person separate from its members. The association of members may have only one member, as when a company is registered with a memorandum of association signed by only one person, as permitted by CA 1985, s. 1(3A). CA 1985 does not prohibit other members joining a company which was registered with only one member.

A corporation which is regarded as an association of members is called a 'corporation aggregate'. Its members are sometimes called 'corporators'.

Artificial entities with full legal personality are very useful (as is shown by the fact that at the end of March 2005 there were 1,980,100 registered companies in Great Britain):

- (a) Where legal relationships have to be entered into for a particular purpose those relationships can be ascribed to a separate legal person so as not to be confused with other affairs. For example, where business is conducted in the name of a registered company, the affairs of the business are kept separate from the personal affairs of the human beings who conduct it, and separate from the affairs of any other business they may conduct in the name of another registered company.
- (b) An artificial entity may continue in existence indefinitely.
- (c) Not only does an entity with full legal personality have all the legal rights, obligations, duties and liabilities arising from the legal relationships it is put into, but no other person shares any of those rights, obligations, duties or liabilities unless the entity is found to be acting as agent for some other person (*J.H. Rayner (Mincing Lane) Ltd v Department of Trade and Industry* [1990] 2 AC 418 per Lord Templeman at pp. 479–80, Lord Oliver of Aylmerton at p. 511). Furthermore, the facts that the members of a corporation exercise control over it, or that the sole objective of the corporation's legal relationships is to benefit the members, are not in themselves sufficient to constitute the corporation an agent of its members (*Salomon v A. Salomon and Co. Ltd* [1897] AC 22; *J.H. Rayner (Mincing Lane) Ltd v Department of Trade and Industry* [1989] Ch 72, CA at pp. 188–9; [1990] 2 AC 418, HL at p. 515). This is the principle of 'separate personality'. As Alderson B said in *Bligh v Brent* (1837) 2 Y & C Ex 268: 'The individual members of a corporation are quite as distinct from the metaphysical body called "the corporation", as any others of his Majesty's subjects are'. This principle confers on the members of a corporation the benefit of not being responsible for the

corporation's debts except to the extent that they are made responsible by statute or by the corporation's constitution. Lord Parker of Waddington summarised the law as follows in *Daimler Co. Ltd v Continental Tyre and Rubber Co. (Great Britain) Ltd* [1916] 2 AC 307 at p. 338:

No one can question that a corporation is a legal person distinct from its corporators; that the relation of a shareholder to a company . . . is not in itself the relation of principal and agent or the reverse; that the assets of the company belong to it and the acts of its servants and agents are its acts, while its shareholders, as such, have no property in the assets and no personal liability for those acts.

It follows that the members of a corporation cannot owe any duty of care in respect of the corporation's acts, that is, they cannot be liable in tort for the corporation's acts (*Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187).

0.3.2 TYPES OF CORPORATION

0.3.2.1 Methods of incorporation

In the law of England and Wales, a corporation may be:

- (a) Incorporated by the Crown by the grant of a royal charter.
- (b) Incorporated by Parliament by passing an Act.
- (c) Incorporated by registration with a public official who has authority to incorporate delegated by Parliament.
- (d) Incorporated by act of a person exercising authority delegated by Parliament.
- (e) Found to be incorporated by prescription.

0.3.2.2 Royal charter

The English theory of corporations was developed in relation to the powers of self-government which were possessed by certain communities (known as municipal corporations) and which were stated in royal charters.

From the 16th century onwards royal charters were granted to trading companies, especially for the purposes of overseas trading, exploration and colonisation. In the 17th and 18th centuries, and in the early 19th century, many domestic trading companies were incorporated by royal charter. Such companies are known as 'chartered companies'. The characteristic structure of the later chartered companies was that the members contributed capital to form the company's 'joint stock' which was then managed by 'governors' or 'directors' appointed by the members.

Since the mid 19th century, with a few exceptions, corporations have been created by the Crown only for non-profit-making, charitable and educational purposes, for example, the Law Society, the Institute of Chartered Accountants in England and Wales, the Chartered Institute of Management Accountants.

0.3.2.3 Act of Parliament

Parliament may create a body corporate by an enactment referring specifically to that body. Corporations established for public purposes (e.g., the Historic Buildings and Monuments Commission for England incorporated by the National Heritage Act 1983, s. 32 and sch. 3, para. 1) are incorporated by public general Act. Parliament may be petitioned to pass a private Act to establish a corporation for the petitioners' commercial purposes, especially

where powers are required to compulsorily purchase land for public utilities: corporations formed in this way are called 'statutory companies'.

0.3.2.4 Registration with a public official

The main problem with incorporation by royal charter or by private Act of Parliament is that the Crown and Parliament have been suspicious of lending their dignity and the benefits of separate personality to commercial organisations and have therefore imposed procedural and cost deterrents. In the early 19th century, legal advisers of business people were well aware that incorporation is a convenient method of conducting the affairs of a business but were usually unable to obtain a charter or an Act of Parliament. Most joint-stock companies had therefore to be organised as unincorporated associations, which was often very inconvenient. Without separate personality a joint-stock company could not own property, make contracts or be a party to legal proceedings: everything had to be done in the joint names of the shareholders of whom there might be several thousand. Legal proceedings, in particular, could collapse under the weight of paper, as in *Van Sandau v Moore* (1826) 1 Russ 441, in which there were 250 defendants. Parliament did become willing to allow selected unincorporated joint-stock companies to overcome the difficulties of taking part in legal proceedings. In the early part of the 19th century it became quite common for the members of an unincorporated joint-stock company to obtain a private Act of Parliament entitling the secretary or a director of their company to take part in legal proceedings on behalf of the company, as the company's 'public officer'. However, Parliament would pass such an Act only for an established company, and it required, as a condition, that the company had to file a list of its members in the Court of Chancery and keep the list up to date. A company which made public disclosure of its list of members in this way was known in the early 19th century as a 'public company' (see *Macintyre v Connell* (1851) 1 Sim NS 225). For the use of the term 'public company' in this old sense, see 4.6. In company law, the term is nowadays used in the sense discussed in 1.3.3.

Eventually Parliament conceded that it had been unnecessarily difficult and inconvenient for business people to obtain the benefits of incorporation. It passed the Joint Stock Companies Act 1844, which established the office of the Registrar of Joint Stock Companies and empowered the registrar to incorporate any company whose documents were duly registered with him. Under the 1844 Act, registration was a two-stage process: provisional registration (costing £5), which did not confer corporate status (*Womersley v Merritt* (1867) LR 4 Eq 695), followed by complete registration (a further £5) which did. The whole system was revised by the Joint Stock Companies Act 1856, which introduced the present system of single-stage registration (which now costs £20: SI 2004/2621, sch. 4, fee 1(b)(i)). The present statute governing registration of companies is CA 1985.

Incorporation by registration is in fact an old idea: a statute of 1597, 39 Eliz 1, c. 5 (Hospitals for the Poor), enabled individuals to incorporate hospitals by registration of a deed in the Court of Chancery. At present there are, essentially, nine provisions under which incorporation may be achieved by registering documents with a public official or body. They are (in alphabetical order) the Building Societies Act 1986, the Charities Act 1993, the Companies Act 1985, the European Economic Interest Grouping Regulations 1989 (SI 1989/638), the European Public Limited-Liability Company Regulations 2004 (SI 2004/2326), the Friendly Societies Act 1992, the Industrial and Provident Societies Act 1965, the Limited Liability Partnerships Act 2000. Of these, CA 1985 is by far the most important. The other provisions apply only to limited classes of association but, by s. 1(1) of CA 1985, 'Any two or more persons associated for a lawful purpose may . . . form an incorporated company' by registration under the Act and s. 1(3A) provides that one person may incorporate a private

limited company for a lawful purpose by registration under the Act. The Limited Liability Partnerships Act 2000 (see 0.4.1.3) is another general incorporation statute. It enables the incorporation by registration of a limited liability partnership (llp) 'for carrying on a lawful business with a view to profit' (s. 2(1)(a)). This is slightly less general than CA 1985 in that an llp can be incorporated only for a business purpose whereas a company can be registered under CA 1985 for a non-business purpose.

0.3.2.5 Incorporation by delegated authority

The Housing Act 1988, s. 62, is an example of a statutory provision enabling incorporation by ministerial act. It empowers the Secretary of State to create bodies corporate called housing action trusts by order made by statutory instrument. However, a draft of the order must be approved by a resolution of each House of Parliament.

An open-ended investment company can be incorporated by an order (called an authorisation order) made by the Financial Services Authority under the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).

Ministers and other authorities have powers to create corporations only in so far as they have been given such powers by Parliament.

0.3.2.6 Prescription

The essence of the doctrine of incorporation by prescription is that a body may be found by a court to be incorporated by a royal charter that has been lost if, for a sufficiently long time, it has been treated as though it were incorporated. Claims to incorporation by prescription have been quite common, particularly among municipal corporations, but have rarely been litigated. See *Re Company or Fraternity of Free Fishermen of Faversham* (1887) 36 ChD 329.

0.3.2.7 Corporations sole

English common law adopted a theory that certain public and ecclesiastical offices (such as the Crown, a bishop or a parson of the Church of England) had a separate legal personality, originally to provide a legal framework for ownership of church land. As only one individual could hold such an office at any one time, the incorporated offices are known as corporations 'sole'. Occasionally, Parliament creates a corporation sole, for example, the public trustee (Public Trustee Act 1906, s. 1(2)) and the Corporate Officer of each House of Parliament (Parliamentary Corporate Bodies Act 1992, ss. 1(1) and 2(1)). There is no concept of corporation sole in Scots law.

0.3.3 CORPORATION TAX

Any body corporate which is resident in the United Kingdom (see 19.8.7.2) is subject to corporation tax on its income and chargeable gains, and is not subject to income tax or capital gains tax (Income and Corporation Taxes Act 1988, ss. 6 and 832(1) (definition of 'company'); Taxation of Chargeable Gains Act 1992, s. 1(2)). The same applies to unincorporated associations (see 0.4.2), but not to partnerships (0.4.1). Rather confusingly, in tax legislation, the term 'company' is used for any entity which is subject to corporation tax (Income and Corporation Taxes Act 1988, s. 832(1) (definition of 'company')).

0.4 OTHER LEGAL FORMS FOR BUSINESSES

0.4.1 PARTNERSHIP

0.4.1.1 General partnerships

Persons (natural or legal) carrying on a business or profession in common with a view of profit, without being incorporated, are said to be in 'partnership' (Partnership Act 1890, s. 1) and their association is known as a partnership 'firm' (s. 4(1)). The law of partnership in Britain has been codified in the Partnership Act 1890. The members of a corporation aggregate, such as a company registered under CA 1985, are not in partnership (Partnership Act 1890, s. 1(2)).

Partnership is created by agreement between the partners without any action by the State. But it is not the agreement alone which creates a partnership. It is carrying on business in a particular way which creates a partnership, and a partnership comes into existence only when the partners begin to carry on business in accordance with their agreement (see *Khan v Miah* [2000] 1 WLR 2123 on what constitutes carrying on business for this purpose). This may be contrasted with a registered company, which comes into existence as soon as it is registered, regardless of whether it transacts any business.

The fundamental difference between carrying on business in partnership and being a member of an incorporated company is that being a member of a partnership imposes liability for all debts and obligations of the firm incurred during membership (Partnership Act 1890, s. 9) regardless of any agreement to the contrary between the partners, whereas a member of a body corporate is not liable for the debts of the corporation unless liability is imposed on members by the constitution of the corporation or by statute. As Cave J said in *Re Sheffield and South Yorkshire Permanent Building Society* (1889) 22 QBD 470 at p. 476:

[Counsel] argued that persons who unite together for trading or making profits in any way are, at common law, liable for all debts which are incurred during the time they are members of the association, and that, if the association has ultimately to be wound up, past members must pay their shares of the debts. As a general rule—apart from legislation—that is perfectly true with respect to partners, and with respect to associations in the nature of partnership where there is no incorporation, but with respect to corporations the case is entirely different where the legislature has not thought fit to intervene, or where the charter under which the body is incorporated does not provide otherwise. A corporation is a legal persona just as much as an individual; and, if a man trusts a corporation, he trusts that legal persona, and must look to its assets for payment: he can only call upon the individual members to contribute in case the Act or charter has so provided.

Linked to this is the further important difference that every partner in a firm may act for the purposes of the firm's business, and the acts of any one member of a partnership bind all the partners (Partnership Act 1890, s. 5); whereas in an incorporated company a board of directors must be appointed to act for the company in matters of business and no member of the company has, as a member, any authority to bind the company (see 15.1).

Sometimes partnership firms are described as 'companies'. Often the name of a firm consists of the name of one or more principal or founding partners followed by the words 'and Company' to represent the other partners.

The Law Commissions have published a joint report on partnership law, proposing that English partnerships should have separate legal personality (Law Commission, *Partnership Law* (Law Com. No. 283, Cm 6015) (London: Stationery Office, 2003)).

0.4.1.2 Limited partnerships

The general rule of partnership is that there is no limit on a partner's liability for the firm's debts and obligations. It is possible, however, under the Limited Partnerships Act 1907 to form a limited partnership consisting of (a) one or more persons called 'general partners', who are liable for all debts and obligations of the firm, and (b) one or more persons called 'limited partners', who contribute capital to the firm on entering into the partnership but are not liable to pay anything more to meet its debts and obligations (s. 4(2)). A limited partner does not have power to bind the firm (s. 6(1)). A limited partnership must be registered with the registrar of companies, otherwise the limited partner will be deemed to be a general partner with unlimited liability (ss. 5 and 15). The limited partnership form has not been popular: only 12,377 were registered at 31 March 2005. As limited partners do not take part in the management of the firm and, at one time, could not have their names included in the firm name (so as to avoid suggesting they would be liable for the firm's debts), they are sometimes called 'anonymous' partners. The idea survives in some European languages in which a public company whose members have limited liability is called an 'anonymous company' (for example, *société anonyme* in French, *sociedad anónima* in Spanish).

Limited partnerships are partnerships to which the Partnership Act 1890 and the general law of partnership apply, subject to the modifications made by the Limited Partnerships Act 1907. Many limited partnerships are formed so as to obtain favourable tax treatment for business transactions. It seems that these tax advantages may be lost in overseas jurisdictions if limited partnerships have separate personality. So the Law Commissions have recommended that separate personality should be optional for English limited partnerships (*Partnership Law* (Law Com. No. 283, Cm 6015) (London: Stationery Office, 2003)).

0.4.1.3 Limited liability partnerships

Under the Limited Liability Partnerships Act 2000 it is possible to create a new form of business association called the limited liability partnership (llp). The relationship between the members of an llp can be like that of members of a general partnership. In particular, every member of an llp is deemed to be an agent of the llp (s. 6). But, when it is registered with the registrar of companies, an llp is incorporated and so has separate personality (s. 1(2)). It follows that the members of an llp are not directly responsible for its debts and the law relating to partnerships does not apply to limited liability partnerships (s. 1(4) and (5)). At the end of March 2005 there were 11,924 limited liability partnerships.

0.4.2 UNINCORPORATED ASSOCIATIONS

The term 'unincorporated association' is usually used to refer to any association of persons (natural or legal) which has not been incorporated but which is not a partnership firm (because the members of the association are not carrying on a business or profession in common with a view of profit).

0.4.3 THE CONCESSION THEORY

The theory of English law, as set out in 0.3.2, is that (ignoring corporations sole) an entity can be incorporated with separate personality in England and Wales only by or on the authority of the Crown or Parliament. A group of people associated to pursue a business cannot effectively declare their association to have separate personality. The principle that corporations with separate personality can be created only by act of State is known as the 'concession theory'. It is true that, in contrast to the great reluctance of Crown or Parliament to grant the privileges

of incorporation before 1844 (see 0.3.2.4), the system of registration introduced by the Joint Stock Companies Act 1844 and now governed by CA 1985 offers virtually automatic incorporation. It has been said that UK companies ‘are formed by contract . . . under memorandum and articles of association to which the Registrar of Joint-Stock Companies necessarily assents if the documents are regular in form’ (per Sir Walter Phillimore in *Canada National Fire Insurance Co. v Hutchings* [1918] AC 451 at p. 456). Nevertheless, the issue of the registrar’s certificate of incorporation is an essential step in the incorporation of a registered company, and the ease with which it can be obtained does not negate the concession theory. The registrar may refuse to register a company formed for an unlawful purpose, see 1.2.1.10. As Lord Templeman said in *Arab Monetary Fund v Hashim (No. 3)* [1991] 2 AC 114 at p. 160:

When the promoters of a company enter into an agreement to incorporate a company and the agreement takes the form of a memorandum and articles of association of the company, that agreement does not create a corporation. When the memorandum and articles are registered under the Companies Act 1985, that registration does not recognise a corporation but creates a corporation.

Different legal systems may confer full legal personality on different entities. For example, in Scots law, unlike the law of England and Wales, a partnership firm has legal personality (Partnership Act 1890, s. 4(2)), that is, its personality arises by virtue of the private contract between the partners and not by any act of State. (Though every partner in a partnership is directly responsible for the firm’s debts in both English and Scots law.) In Hindu law, a family idol has legal personality (*Pramatha Nath Mullick v Pradyumna Kumar Mullick* (1925) LR 52 Ind App 245; see P. W. Duff, ‘The personality of an idol’ (1927) 3 CLJ 42). In *Bumper Development Corporation v Commissioner of Police of the Metropolis* [1991] 1 WLR 1362, expert evidence was accepted that a Hindu temple has legal personality in Tamil Nadu. For a proposal that natural environmental features should be given legal personality so that they can bring proceedings to prevent, or obtain compensation for, damage, see C.D. Stone, ‘Should trees have standing?—Toward legal rights for natural objects’ (1972) 45 S Cal L Rev 450 and ‘“Should trees have standing?” revisited: how far will law and morals reach? A pluralist perspective’ (1985) 59 S Cal L Rev 1.

Within a legal system, entities may be regarded as having partial legal personality, in the sense that they may be regarded as having a capacity to enter into some but not all legal relationships. For example, English rules of court procedure permit an English partnership firm to be a party to legal proceedings, and CA 1989, s. 26(2), empowers a company to appoint an English partnership firm as its auditor.

The Law Commissions have proposed that partnerships in England and Wales should be given legal personality by statute (*Partnership Law* (Law Com No. 283, Cm 6015) (London: Stationery Office, 2003)).

There has been a great deal of political debate about the concession theory. In various countries at various times, there have been fears that it may be used by governments as a means of curbing freedom to associate for political purposes. In Britain, the deliberate withholding of corporate personality from trade unions so that it would be difficult if not impossible to sue them for damage caused by industrial action was a serious political and legal issue for most of the 20th century. In the USA, controversy over the concession theory of incorporation is associated with controversy over State regulation of business activity.

0.4.4 SOLE PROPRIETORSHIP

An individual who carries on a business or profession personally without partners is said to be the ‘sole proprietor’ of the business or profession. A professional person is usually

described as a 'sole practitioner' whereas a sole proprietor of a business is usually described as a 'sole trader'.

In sole proprietorship there is no legal separation between the business and personal affairs of the proprietor, and he or she is directly responsible for all the debts incurred in carrying on the business or profession.

0.4.5 A NOTE ON TERMINOLOGY

The use in this book of the terms 'natural person' and 'legal person' for distinct categories corresponds to the way they are used in European Community documents (see *Gregg v Commissioners of Customs and Excise* (case C-216/97) [1999] ECR I-4947), and is the way in which 'legal person' was used when it was introduced into the language by the University of London's first professor of jurisprudence, John Austin (1790–1859). In French, what is here called a legal person is usually called a '*personne morale*', the adjective '*morale*' indicating that it is not a physical person but the product of human thought. In the past, this was sometimes rather inappropriately translated into English as 'moral person', but this usage seems to have died out and 'moral person' is nowadays used to refer to a person capable of moral responsibility and accountability—whether a corporation can be a moral person in this sense is an interesting philosophical and legal question: see the discussion of corporate criminal liability in 19.8.

Some writers on jurisprudence adopt a more abstract analysis. They describe any entity that has legal rights and duties as a 'legal person' and say that the rules of a legal system determine whether any particular human being or non-human entity has a legal personality. This analysis has the advantage that it allows for an entity to have more than one legal personality.

Section 5 of and sch. 1 to the Interpretation Act 1978 prescribe that in Acts of Parliament and subordinate legislation, unless the contrary intention appears, 'Person' includes a body of persons corporate or unincorporate'. This applies to Acts passed after 1889 (Interpretation Act 1978, sch. 2, para. 4(1)) though 'person' is deemed to include a body corporate in any provision of an Act, whenever passed, relating to an offence, unless the contrary intention appears (sch. 2, para. 4(5)). For example, in *R v Home Secretary, ex parte Atlantic Commercial Ltd* [1997] BCC 692 it was held that in the Criminal Justice Act 1988, s. 133 (which provides for the payment of compensation to 'a person' who has been wrongfully convicted of an offence), 'person' does not include a corporation. In all deeds, contracts, wills, orders and other instruments, unless the context otherwise requires, 'person' includes a corporation (Law of Property Act 1925, s. 61; see *Deutsche Genossenschaftsbank v Burnhope* [1995] 1 WLR 1580 discussed in 19.8.4.5). The term 'individual' is used when it is intended to exclude corporations (per Viscount Cave LC in *Whitney v Commissioners of Inland Revenue* [1926] AC 37 at p. 43). It is usual in drafting legislation to use the pronouns 'he' and 'him' for a 'person', and use of those pronouns does not show an intention to refer only to individuals (per Lord Simon of Glaisdale in *Applin v Race Relations Board* [1975] AC 259 at p. 290).

In Britain and Ireland, the word 'company' is used for corporations which are incorporated by registration under a Companies Act. And 'company' is the term used in European Community documents in English for the equivalent entities throughout the EU. In some other English-speaking countries, including the USA, Canada and Australia, the equivalent entity is called a 'business corporation' or simply a 'corporation'.

0.5 SOURCES OF COMPANY LAW

0.5.1 LEGISLATION

0.5.1.1 Importance of legislation

Because of the English concession theory of incorporation (see 0.4.3), a registered company, as an artificial person separate from its members, exists only by virtue of the Companies Act under which it was incorporated. In *Welton v Saffery* [1897] AC 299 Lord Macnaghten said, at p. 324, ‘These companies are the creature of statute’, and in *Ooregum Gold Mining Co. of India Ltd v Roper* [1892] AC 125 Lord Halsbury LC said, at p. 133: ‘. . . the whole structure of a limited company owes its existence to the Act of Parliament, and it is to the Act of Parliament one must refer to see what are its powers, and within what limits it is free to act’. The legislation on companies is therefore the primary source of company law.

0.5.1.2 History and current legislation

Incorporation of companies by registration was first legislated for in the Joint Stock Companies Act 1844. The Joint Stock Companies Act 1856 created a wholly revised system which is the basis of present-day company law. Since the 1856 Act numerous amendments have been enacted. Every now and again, Parliament consolidates the law on companies—that is, it repeals the existing statutes and re-enacts all their provisions, for convenience of reference, in a single Act. The Companies Act 1985 (CA 1985), which came into force on 1 July 1985, is the latest consolidation, and is the current principal Act governing companies. CA 1985 replaced the Companies Acts 1948 to 1983, though some provisions of those Acts were re-enacted separately in:

- (a) the Companies Consolidation (Consequential Provisions) Act 1985—known (by CA 1985, s. 744) as ‘the Consequential Provisions Act’—which contains formal and transitional provisions,
- (b) the Company Securities (Insider Dealing) Act 1985, which has in turn been replaced by part V of the Criminal Justice Act 1993—known as ‘the insider dealing legislation’ (CA 1985, s. 744)—which is considered in 13.5, and
- (c) the Business Names Act 1985.

By CA 1985, s. 744, the phrase ‘the Companies Acts’ now means CA 1985 together with the Consequential Provisions Act and the insider dealing legislation.

The provisions of CA 1985 relating to the winding up of companies and to the disqualification of company directors were extensively amended by the Insolvency Act 1985. The amended provisions were then consolidated in the Insolvency Act 1986 (IA 1986) and the Company Directors Disqualification Act 1986 (CDDA 1986). (The Insolvency Act 1986 also deals with the insolvency of individuals, known as bankruptcy.)

CA 1985 has been extensively amended by CA 1989 and by numerous regulations (see 0.5.1.6).

The legislation on the control of public markets in company shares is contained in the Financial Services and Markets Act 2000 (FSAMA 2000).

As is common the primary legislation in CA 1985 authorises the Secretary of State to fill in details by making delegated legislation in statutory instruments. One of the most significant pieces of delegated legislation is the Companies (Tables A to F) Regulations 1985 (SI 1985/805). These regulations prescribe model forms of constitutions for companies and are

referred to in nearly every chapter of this book. Other delegated legislation of great practical importance prescribes fees to be paid to Companies House and forms to be used for filing information there. Sometimes persons other than government ministers are empowered to make delegated legislation. For public companies the most significant pieces of delegated legislation are the rules which are made by the Financial Services Authority (FSA) in the FSA Handbook.

In this book, a reference to a provision of legislation is a reference to that provision as amended, unless the words 'as originally enacted' are used. The text of legislation as amended may be found in D. French, *Blackstone's Statutes: Company Law*, 10th edn. (Oxford University Press, 2006).

0.5.1.3 Company Law Reform Bill

The Company Law Reform Bill (CLRB) was introduced into the House of Lords on 1 November 2005 (HL Bill 34). It is the most extensive revision of company law since 1856. It is the product of a consultation process which was carried out from 1998 to 2005 (see 0.5.1.4). The Bill has 925 clauses and 16 schedules.

It is expected that the Bill will be enacted as the Company Law Reform Act 2006 in October or November 2006. It is likely that there will be a substantial delay before most of the provisions of the Act are brought into force. This is partly because a large quantity of delegated legislation must be produced to fill in details and partly because everyone concerned with the day-to-day operation of administration of company law needs time to adapt to the new provisions. It is likely that the Act will not be brought into force until late 2007 or spring 2008.

This edition of Mayson, French and Ryan on Company Law states the law as it is at present under CA 1985, but also notes the changes proposed by the CLRB. All references to the CLRB are to the Bill as brought from the House of Lords to the Commons, where it had its first reading on 24 May 2006 (HC Bill 190). In later prints of the Bill the numbering of clauses will be different, because of the insertion and deletion of clauses by amendment of the Bill. The proposals in the Bill which are noted in this edition may be changed and added to as the Bill progresses through the House of Commons. Where that happens, details will be given at the Online Resource Centre for this book, www.oup.com/uk/booksites/law.

In the form in which it was introduced into the House of Lords, the CLRB was not intended to replace CA 1985 completely and was not intended to be a consolidation Act. It was proposed that about one third of CA 1985 would remain, with some amendments. Nearly all speakers in the second reading debate said that the lack of consolidation would make the Act confusing. The government has said that a complete new consolidation is a very big drafting task: the 1985 consolidation took five years (Hansard HL, 25 April 2006, cols GC95–7, Lord Sainsbury of Turville). However, the government did undertake to transfer more sections from CA 1985 into the CLRB, when it is considered in the House of Commons, so as to make it 'much closer to a complete code of company law for the majority of users' (Hansard HL, 23 May 2006, col. 795, Lord Sainsbury of Turville). The CLRB does propose completely replacing the Business Names Act 1985.

0.5.1.4 The Company Law Review

The CLRB is the result of the Company Law Review, which was set up by the Department of Trade and Industry in March 1998, and made its final report in June 2001. The terms of reference for the Review were:

- (i) To consider how core company law can be modernised in order to provide a simple, efficient and cost-effective framework for carrying out business activity which:

- (a) permits the maximum amount of freedom and flexibility to those organising and directing the enterprise;
 - (b) at the same time protects, through regulation where necessary, the interests of those involved with the enterprise, including shareholders, creditors and employees; and
 - (c) is drafted in clear, concise and unambiguous language which can be readily understood by those involved in business enterprise.
- (ii) To consider whether company law, partnership law, and other legislation which establishes a legal form of business activity together provide an adequate choice of legal vehicle for business at all levels.
 - (iii) To consider the proper relationship between company law and non-statutory standards of corporate behaviour.
 - (iv) To review the extent to which foreign companies operating in Great Britain should be regulated under British company law.
 - (v) To make recommendations accordingly.

The first product of this review was a consultation document from the Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: the Strategic Framework* (URN 99/654) (London: DTI, 1999), which summarised the Review's overall approach (para. 2):

The objective is modern law supporting a competitive economy, in a coherent and accessible form, providing maximum freedom for participants to perform their proper functions, but recognising the case for high standards and for ensuring appropriate protection for all interested parties. Account needs to be taken of current change, particularly globalisation, the impact of the EU's company law harmonisation programme, modern patterns of regulation and ownership, changing asset structures and the importance of small and closely held businesses. In principle there should be presumptions:

- against interventionist legislation and in favour of facilitating markets, including provision for transparency of information, wherever possible;
- in favour of minimising complexity and maximising accessibility of the rules—complexity should only arise where the substance demands it and the law should be structured on 'think small first' principles;
- against creating criminal offences unless the subject matter demands it; and
- in favour of allocating jurisdiction to the most suitable regulatory bodies, avoiding duplication and effort.

Several working groups were established, which produced eight consultation documents:

- (a) *Modern Company Law for a Competitive Economy: Company General Meetings and Shareholder Communication* (URN 99/1144) (London: DTI, 1999);
- (b) *Modern Company Law for a Competitive Economy: Company Formation and Capital Maintenance* (URN 99/1145) (London: DTI, 1999);
- (c) *Modern Company Law for a Competitive Economy: Reforming the Law Concerning Oversea Companies* (URN 99/1146) (London: DTI, 1999);
- (d) *Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (London: DTI, 2000).
- (e) *Modern Company Law for a Competitive Economy: Capital Maintenance: Other Issues* (URN 00/880) (London: DTI, 2001).
- (f) *Modern Company Law for a Competitive Economy: Registration of Company Charges* (URN 00/1213) (London: DTI, 2000).

- (g) *Modern Company Law for a Competitive Economy: Completing the Structure* (URN 00/1335) (London: DTI, 2000).
- (h) *Modern Company Law for a Competitive Economy: Trading Disclosures* (London: Company Law Review, 2001).

All the documents may be downloaded at www.dti.gov.uk/bbf/co-law-reform-bill. Click on Company Law Review.

The Review has been ‘wholly committed to proceeding by open consultation’ (*Completing the Structure*, para. 1.5).

... the Review has sought to build consensus around its emerging conclusions, and to work towards an outcome which commands wide support; but it would be quite wrong to regard the consultative process as looking simply for some common denominator. The primary focus is on forming a view as to the best way forward in relation to the framework of company law as a whole. (*Completing the Structure*, para. 1.6.)

Consultation helped the Steering Group to refine their proposals and, in some cases, to change their position (for example, on no par value shares, see 6.1.16).

The Review’s final report was published in two volumes in July 2001 (*Modern Company Law for a Competitive Economy: Final Report* (URN 01/942 and 01/943) (London: DTI, 2001)).

On 15 July 2002 the government published a White Paper, *Modernising Company Law* (Cm 5553), in response to the Review’s final report. *Modernising Company Law* is in two volumes, the second volume (Cm 5553-II) containing an incomplete draft Bill for a new Companies Act which was intended to replace CA 1985. Much of the first volume (Cm 5553-I) of *Modernising Company Law* is devoted to comments on the draft clauses. On some topics *Modernising Company Law* indicated that the government had decided what position to take, but on many topics it invited comments and continued the process of public consultation which has been such an important feature of the Company Law Review.

The Company Law Review proceeded on the basis that it would result in a completely new Companies Act and supporting regulations. *Modernising Company Law* noted that drafting a new Companies Act is ‘a huge undertaking’ (Cm 5553-I, part I, para. 11). Rather than wait for the whole job to be completed, some reforms were made by statutory instruments and by the Companies (Audit, Investigations and Community Enterprise) Act 2004.

After nearly three years of further work, a second White Paper, *Company Law Reform* (Cm 6456, 2005), was published in March 2005, containing new draft clauses. The idea of completely replacing CA 1985 was abandoned and there are significant differences between the drafts in the two White Papers, so the earlier one should be regarded as of historical interest only.

The Company Law Reform Bill resulting from all this work was introduced in the House of Lords on 1 November 2005 (see 0.5.1.3).

0.5.1.5 Other reviews

The DTI is responsible for the development of company law and conducts consultations on proposals for reform. See its website: www.dti.gov.uk/consultations.

Some particularly difficult topics of company law reform have been referred to the Law Commission and the Scottish Law Commission for review. The Law Commissions have issued consultation papers and reports which display exceptional scholarship and examine the issues exhaustively. Their recommendations are noted at appropriate points in this book. The texts of Law Commission documents are at its website: www.lawcom.gov.uk.

0.5.1.6 Legislative process

The Companies Bills considered in the 1980s revealed problems with the legislative process. In the debate on the third reading of the Bill that became the Companies Act 1981 (which amended the 1948 Act and is now consolidated in CA 1985) Mr Stanley Clinton Davis (a practising solicitor) said (Parliamentary Debates (Hansard), Commons, 6th ser., vol. 10 (1980–81), col. 68):

Few honourable members who have served in committee on Companies Bills regard them as great examples of the efficiency of Parliamentary procedures. We are bogged down with an enormous welter of technical detail. Few of us, including myself, understand much of that detail when it is before the committee . . .

The bodies with a professional interest in such matters have a great deal to contribute—more, I fear, than honourable members when dealing with highly technical, non-contentious matters.

Companies Bills are invariably government Bills. The legislators in Parliament are required to consider Bills prepared by the civil service dealing with topics chosen by the civil service. There is a great deal of public consultation before drafting legislation. The Companies Division of the Department of Trade and Industry ‘is committed to undertaking public consultation on the development of company law’ (Department of Trade and Industry, *Companies in 1992–93* (London: HMSO, 1993), p. 2). Extensive consultation was a particular feature of the Company Law Review. But consultation consists merely of receiving views, not arguing over them as in Parliamentary debate. Obviously it is to be welcomed that proposals for changing the law are the product of careful consideration but it often seems that the system prevents Parliament fulfilling properly its representative function in arguing the causes of different groups and its role in protecting the public interest.

In what seems like an admission of defeat Parliament has, when enacting a new provision in a Companies Act, often accompanied it with the grant of a power to the Secretary of State to amend the provision by regulations. The amending power which has been used most often is CA 1985, s. 257, which permits the Secretary of State to modify the provisions of part VII (ss. 221 to 262A) of the Act concerning accounts and audit. This power has been exercised in 21 statutory instruments, most recently in SI 2005/3442. For other examples of the Secretary of State’s power to amend the primary legislation, see CA 1985, s. 179 (power not yet exercised), CA 1985, s. 210A (exercised in SI 1993/1819 and 2689, and SI 1996/1560), CA 1989, s. 117 (power not yet exercised), and CA 1989, s. 135 (exercised in SI 1991/1646).

Parliament retains some control over the delegated amendment process, because all the sections cited in the preceding paragraph authorising the Secretary of State to make amendments require that amending regulations must be laid before Parliament and cannot come into force until approved by a resolution of each House. (This is known as the ‘affirmative procedure’ for controlling delegated legislation.) In the case of CA 1985, s. 257, though, positive approval is not required if the regulations do not increase burdens on companies in the ways specified in s. 257(2). Regulations which do not increase such burdens (such as SI 1994/1935, which introduced exemptions from the audit requirements of CA 1985, part VII) can be annulled by resolution of either House (s. 257(3)) (this is the ‘negative procedure’).

The Company Law Review Steering Group recommended that there should be a permanent Company Law and Reporting Commission (*Modern Company Law for a Competitive Economy: Final Report* (URN 01/942 and 01/943) (London: DTI, 2001), vol. 1, paras 5.21 to 5.37). This would keep company law and governance under review and submit an annual report to the Secretary of State. In turn, the Secretary of State would be under a duty to consult the Commission on proposed secondary legislation. In its White Paper, *Modernising*

Company Law (Cm 5553, 2002), the government rejected this idea (Cm 5553-I, part II, paras 5.25 to 5.27). The White Paper says (part II, para. 5.26):

The government has already shown its willingness to consult intensively and inclusively through the Company Law Review. We remain committed to continuing consultation on company law, although we trust the need to consult will be less in the period following major reform; but we prefer to do so flexibly, as the need arises, rather than through a single, statutory body. The government believes it is right to be cautious about entrenching in statute arrangements which may themselves become outdated and inflexible.

The White Paper, *Company Law Reform* (Cm 6456, 2005), para. 6.1, proposed that, after the Company Law Reform Bill, future reform and restatement of company law should be made by a special form of secondary legislation, using a procedure like that for regulatory reform orders under the Regulatory Reform Act 2001. This would involve examination of proposals by committees of both Houses of Parliament and final approval by resolution of each House. The Secretary of State would be required to consult on all proposals. This proposal was originally made in *Flexibility and Accessibility: A Consultative Document* (URN 04/994) (London: DTI, 2004) and was welcomed by the House of Commons Trade and Industry Committee (*Ninth Report of Session 2003–04* (HC 1041)). However, when the CLRB was introduced in the House of Lords, the Select Committee on Delegated Powers and Regulatory Reform said that it is inappropriate for potentially large and controversial changes to the law to be made without full Parliamentary scrutiny, and recommended that the House should delete the clauses from the Bill (*Ninth Report of Session 2005–06* (HL 86)). The committee pointed out that proposed legislation may be controversial, not only because the political parties represented in Parliament disagree over it, but also because those affected by it have such significant concerns about it that full Parliamentary scrutiny and debate are required (see the Committee's *Eighteenth Report of Session 2004–05* (HL 110), para. 53). In the light of this criticism, and further objections in a letter from the chairman of the Constitution Committee, the government withdrew that Part of the Bill (Hansard HL, 30 March 2006, cols GC404–9). However, another Bill, the Legislative and Regulatory Reform Bill (HL Bill 109, 17 May 2006), proposes a general power to make orders to amend legislation so as to reduce burdens, and this power could be used to amend company law.

Parliament has responded to these difficulties in the best possible way with a high standard of legislative scrutiny in the House of Lords debates on the CLRB, in which Lord Clinton-Davis, as he now is, participated. The Liberal Democrat spokesperson, Lord Razzall (another solicitor) called it 'an absolute paradigm of how Bills should be conducted' (Hansard HL, 23 May 2006, col. 794).

0.5.1.7 Complexity

The legislation on companies forms a very large and detailed code of rules. A company as an artificial separate person exists only in writing, and there is a need for precise instructions on how this artificial entity is to be used, especially to ensure uniformity of treatment of the very large number of companies now registered in Britain. Another factor contributing to the size of the code is the detailed style of drafting customarily used in British legislation.

There is no doubt that the legislation on companies has become very much more complex during the 1980s and 90s. The most recent consolidation, the Companies Act 1985, had 747 sections and 25 schedules occupying 600 pages in the Queen's Printer's copy. The previous consolidation, the Companies Act 1948, covered the same ground in 462 sections and 18 schedules taking up 363 pages. For reviews of the changes in this period, see Lord Templeman, 'Forty years on' (1990) 11 Co Law 10; D. Milman, '1967–1987: a transformation in

company law?' (1988) 17 Anglo-Am L Rev 108; D. Milman, 'Company law in transition' (1990) 24 Law Teach 3.

With a code of this length and complexity there is a great danger that people will act in ignorance of some vital legislative provision. See, for example, *Re Bradford Investments plc (No. 2)* [1991] BCLC 688, in which four people transferred their business to a public company in return for shares in the company not knowing that CA 1985, s. 103, requires the preparation of an independent report on the value of the business (see 6.5.4). Because the statute was not complied with, they became liable to pay more than £1 million plus interest. They had relied on advice by solicitors, accountants in public practice, and the company's accountant. In *British Racing Drivers' Club Ltd v Hextall Erskine and Co.* [1996] 3 All ER 667, a solicitor, described as 'a senior commercial partner with extensive experience of the Companies Acts', wrongly advised that it was not necessary for a company to obtain the approval of its members for a substantial property transaction with one of its directors as required by CA 1985, s. 320 (see 16.6.6). Damages of more than £2.8 million were awarded for this negligent advice. For another example, see *Re Chez Nico (Restaurants) Ltd* [1992] BCLC 192 discussed by C. Mercer, 'Compulsory acquisition of minorities' (1992) 13 Co Law 139. See also *Brady v Brady* [1989] AC 755, in which the lawyers did not discover which statutory provision was relevant to the case until it reached the House of Lords.

All the cases mentioned in the preceding paragraph were concerned with changes introduced into the law during the 1980s, showing that particular problems have been caused by the extent of change in recent years. Similar problems do, however, arise in relation to rules that have been in existence for much longer. In *EIC Services Ltd v Phipps* [2004] EWCA Civ 1069, [2005] 1 WLR 1377, advisers of a company preparing for a Stock Exchange flotation failed to notice that its directors should have obtained authorisation from its existing shareholders before issuing them with bonus shares (see 10.4). The resulting claim took up 10 days of court time and produced a judgment of 226 paragraphs, which was reversed by the Court of Appeal, which heard argument only from a shareholder who did not have professional legal representation.

Beside the spectacular cases which reach the courts, there can be no doubt that in most companies, many administrative rules, relating, for example, to meetings of members and directors, are either not followed exactly or are mostly ignored. A review by the Department of Trade and Industry during the 1980s, intended to reduce burdens on business, resulted in five sections of the Companies Act 1989 (ss. 113 to 117), which were headed 'De-regulation of private companies'. These did make some valuable simplifications but at the expense of introducing yet more detailed provisions covering exceptions and special cases. Moreover they are only five out of 216 sections in yet another long and complex Companies Act.

0.5.1.8 New styles of legislation

Finding some way to reduce the complexity of companies legislation was one of the tasks of the Company Law Review. An early consultation document introducing the Review, *Modern Company Law for a Competitive Economy* (London: DTI, 1998), said that one of the first subjects for review would be 'the structure and style of new legislation and how it might be made more accessible to non-specialists' (p. 19). In particular it noted two suggestions, which have often been made, (a) that the law on private and public companies should be in separate Acts (pp. 7 and 15) and (b) that provisions should be transferred to secondary legislation, which can be revised more easily (pp. 11 and 16), leaving a shorter principal statute which would be more readable. In *Modern Company Law for a Competitive Economy: The Strategic Framework* (URN 99/654) (London: DTI, 1999), ch. 8, the Company Law Review Steering Group examined the difficulty of the legislative process and discussed ways of legislating

without full Parliamentary debate. However, this only raises the question whether company law is so non-political and irrelevant to the public interest that it can be altered in this way. In *Modern Company Law for a Competitive Economy: Completing the Structure* (URN 00/1335) (London: DTI, 2000), the Steering Group said, 'We fully recognise the need for proper parliamentary oversight of legislation and rules made under it' (para. 12.39). Chapter 12 of *Completing the Structure* examined how best to divide company law into primary legislation, delegated legislation and codes of practice. There was further discussion of this in the *Final Report*, vol. 1, paras 5.4 to 5.12.

Several years' experience of drafting the new Companies Act showed that:

Company law does not always divide readily into 'principles' elements, which might remain in primary legislation, and more minor detail which might be appropriate for secondary. (*Flexibility and Accessibility: A Consultative Document* (URN 04/994) (London: DTI, 2004), p. 7.)

Dividing a topic between two or more legislative documents does not necessarily make it easier to find. What it has been possible to do is to recognise that nowadays more than 99 per cent of companies are private companies and so statutes on company law should be arranged to deal with them first. Historically, company law was conceived as the law of public companies. As special simpler provisions for private companies were introduced, they were drafted as exceptions to the rules on public companies. In some areas, such as accounts and meetings, the CLRБ has been drafted so as to state the law applying to private companies first, with the additional requirements for public companies given in separate sections.

One disappointment is that the government too often accepted the view that if Parliament changes the wording of a provision when re-enacting it, then it is presumed that it was intended to change its meaning. Fears were expressed that any rewording of existing provisions would create uncertainty. The result is that some very badly worded provisions have been kept unaltered, instead of replacing them with better wording which would be clearer and make the legislation more accessible. For examples, see the discussion of CA 1985, s. 14, in 3.4.1.2, and the discussion of s. 360 in 8.7.1.

0.5.1.9 Studying legislation

It is not the purpose of this book to set out for our readers every legislative provision relating to companies. We have selected for discussion what we believe to be the most important provisions relating to the creation, financing and management of companies, and their insolvency and winding up. We want to show the legislative framework of company law. We believe that having this framework in mind is the best preparation for reading the legislation itself and the large commentaries on it written for practitioners (see 0.5.5), which will provide the fine detail. See further 1.4.1.

0.5.2 CASE LAW

0.5.2.1 Types of case law studied in company law

Legal principles taken from judgments in court cases—known as case law, common law, or, simply, law, as opposed to legislation—are of great significance in company law. Three types of case law may be distinguished:

- (a) The courts are given a remarkably extensive supervisory role by the legislation relating to companies (see 0.5.2.2) and a company's affairs must be conducted in the knowledge that they may be reviewed in court proceedings.
- (b) As in any area of statute law the courts have an important role in determining the

meaning and application of the legislation and filling gaps in the legislative code (see 0.5.2.3).

- (c) There are certain types of dispute which regularly arise in relation to companies which it is appropriate to consider in a book on company law even though the principles of law involved come from other areas of law such as contract (for example, rescission of contracts of allotment of shares, see 6.7) or tort (for example, the liability of auditors for negligence, see 8.10).

0.5.2.2 Judicial supervision of companies

Parliament has relied heavily on court proceedings to control and supervise the operation of companies. But courts do not themselves seek out wrongdoing for investigation and punishment: their powers have to be invoked in proceedings brought by persons with the requisite standing.

The ultimate judicial sanction that may be invoked is the power to order a company to be wound up (Insolvency Act 1986, s. 122). The High Court has jurisdiction to order any company registered in England and Wales to be wound up (s. 117(1)). If the amount of a registered company's share capital paid up or credited as paid up does not exceed £120,000 then the county court of the district in which the company's registered office is situated has concurrent jurisdiction with the High Court to wind up the company (s. 117(2)). Under s. 117(4) and the Civil Courts Order 1983 (SI 1983/713), art. 9 and sch. 3, about half of the county courts do not have winding-up jurisdiction: the districts of those courts are attached to other county courts or, in the London area, to the High Court for the purposes of winding-up jurisdiction.

The legislation relating to companies gives many other supervisory functions to 'the court' (which means, in relation to any particular company, the court having jurisdiction to wind up the company: CA 1985, s. 744). For example:

- (a) The court has an important general power to make 'such order as it thinks fit' to give relief in respect of conduct of a company's affairs which is unfairly prejudicial to the interests of some or all of its members (CA 1985, ss. 459 to 461; see 18.6).
- (b) The court has a significant control power to disqualify a former director of a company from being a director of, or taking part in the management of, companies for a fixed period of up to 15 years (Company Directors Disqualification Act 1986; see 20.13).
- (c) If a company is, or is likely to become, unable to pay its debts, the court may make an administration order appointing an administrator to manage the company's affairs, business and property (Insolvency Act 1986, sch. B1, paras 1(1) and 2(a); see 20.3).
- (d) A company's authorised share capital cannot be reduced (except following cancellation of unissued shares) unless the reduction is confirmed by the court (CA 1985, ss. 135 to 141; see 10.2).
- (e) The court may declare that a company's annual accounts do not comply with statutory requirements and order its directors to prepare revised accounts (CA 1985, s. 245B; see 9.10).
- (f) On a number of matters a dissentient minority of members of a company may apply to the court to have a resolution adopted by the majority set aside (for a list of the matters see 14.4.1).

The success of this wide supervisory jurisdiction depends on judges and barristers who specialise in company law. The fact that for companies with registered offices in the London

area there is no alternative to using the High Court has been particularly significant in making that court and the barristers who practise there a centre of expertise in company law. All matters involving the exercise of the High Court's jurisdiction under the enactments relating to companies are assigned to the Chancery Division by the Supreme Court Act 1981, sch. 1, para. 1. The Chancery Division in London has a separate registry for company cases, which are heard by specially designated judges, with routine applications being heard by the registrar. This is an administrative arrangement which has come to be known as the Companies Court.

The main reasons why it was appropriate for Chancery lawyers to add company law to their practice when the topic developed in the 19th century were: (a) that they had always handled partnership and insolvency matters, and (b) the Chancery court was able to deal with matters which involved continuing management, such as winding up the affairs of deceased and insolvent persons, and had available remedies such as injunction and taking accounts, which are particularly suited to dealing with long-term disputes concerning business relationships.

Because of the role of Chancery lawyers, equity has always been an important component of company law and with its emphasis on conscience and fairness has provided an extra-statutory source for judicial supervision of company affairs. This is particularly noticeable in the application to company directors of the equitable concept of fiduciary duty (see chapter 16).

There are doubts about whether the amount of court time that has to be devoted to company matters is an effective use of resources. There has been repeated criticism of the length and cost of proceedings under CA 1985, ss. 459 to 461, for relief of unfairly prejudicial conduct, and the Law Commission has made recommendations for improving the situation (*Shareholder Remedies* (Law Com. No. 246, Cm 3769) (London: Stationery Office, 1997)). As from 2 April 2001 the Secretary of State has been able to accept undertakings from former directors not to take part in the management of companies in place of going to court to obtain a disqualification order (see 20.13.3). The CLRB, cl. 570, proposes that court confirmation of a reduction of capital should be optional for private companies (see 10.2.6).

The jurisdiction of the High Court and county courts under the Insolvency Act 1986, s. 117, to wind up a company registered in England and Wales is now subject to Regulation (EC) No. 1346/2000. If a company registered in England and Wales does not have an establishment within the United Kingdom and its centre of main interests is in another EU State (other than Denmark) then no court in England and Wales has jurisdiction to wind it up. Because the jurisdiction of 'the court' to deal with all other matters relating to a company is defined by CA 1985 in terms of the jurisdiction to wind up, it seems that, if the English courts do not have jurisdiction to wind up a company then they have no jurisdiction over it at all. This ought to be corrected by amending CA 1985 so that it defines jurisdiction in matters other than compulsory winding up separately from jurisdiction over winding up. The CLRB, cl. 803, simply defines 'the court', in relation to England and Wales, as the High Court or a county court, assuming that provision will be made by amendments to the Civil Procedure Rules 1998 to prescribe a basis for allocating cases to those courts.

For detailed consideration of procedure in the High Court and county courts on applications under CA 1985, IA 1986 and other legislation relating to companies see *Blackstone's Civil Practice 2006*, chapters 79, 81 and 82.

Another aspect of Parliament's reliance on the courts in company law is the vast number of criminal offences (over 100) created by the companies, insolvency and financial services legislation. Most of these, in particular those under CA 1985, consist in failing to supply information to Companies House and such offences are normally triable only summarily (i.e., by a magistrates' court) and the only penalty that may be imposed is a fine with a limit

specified in the legislation creating the offence (though, of course, it is possible to be imprisoned for failing to pay a fine). Other offences created by the legislation may be trivial or serious depending on the surrounding circumstances and are triable either way, that is, in a magistrates' court or in the Crown Court, depending on, among other things, the gravity of the particular allegation involved. Generally the Acts provide that a prison sentence may be imposed (if the court thinks it appropriate), instead of or in addition to a fine, for an offence triable either way, and the maximum term of imprisonment is usually set at two years. For a few serious offences (such as being a party to fraudulent trading) the maximum sentence may be seven years. There is no limit to the size of a fine that the Crown Court may impose (Criminal Law Act 1977, s. 32(1)).

As well as the possibility of a fine or imprisonment for contravening provisions of the companies and insolvency legislation, a person may be disqualified from acting as a director of a company (see 20.13).

In the consultation document introducing its review of company law (see 0.5.1.4) the DTI said: 'One issue for the review will be the balance between civil and criminal sanctions: it is commonly suggested that the existing Companies Act too readily invokes criminal penalties, when civil remedies would be more appropriate' (*Modern Company Law for a Competitive Economy* (London: DTI, 1998), p. 17). Despite this invitation to decriminalise, the Company Law Review Steering Group found that the existing system of criminal penalties for minor regulatory offences works well. The threat of prosecution is very effective in securing compliance:

It may be thought to bring the law into disrepute to provide so many criminal sanctions for technical offences for which prosecution is extremely rare. However, we believe that criminalising procedural requirements can underline the importance of compliance for directors and advisers. This strengthens the hand of advisers and employees responsible for ensuring compliance. Provided that such offences continue to be enforced in a sensible way, that seeks to promote maximum compliance rather than punishment, such a framework appears the most cost-effective available. It is very unlikely that an enforcement regime based on active monitoring and extensive use of reminders could operate effectively without underpinning criminal offences. (*Modern Company Law for a Competitive Economy: Completing the Structure* (URN 00/1335) (London: DTI, 2000), para. 13.48.)

The Steering Group maintained this view in their final report. Indeed, instead of considering decriminalisation the Steering Group suggested creating new offences and increasing penalties. See *Modern Company Law for a Competitive Economy: Final Report*, vol. 1 (URN 01/942) (London: DTI, 2001), ch. 15.

0.5.2.3 Interpretation and gap-filling

The legislative code governing companies is very extensive and detailed and the justification for this is that it sets out in advance the rights and duties of persons who have dealings with companies and the formalities that must be observed so that all parties know what the position is and can act accordingly. However, (a) the natural limitations of language mean that questions may arise on the interpretation and application of the provisions of a legislative code; (b) real life is complex and unpredictable and a legislative code cannot be complete, in the sense of deciding all possible questions within its scope.

The courts are often required to expound the meaning of a statutory provision by, for example, deciding whether or not it applies to a particular set of facts. For example, in *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1996] Ch 274 it was held that CA 1985, s. 317(1), which requires a director of a company who is interested in a contract with the company to declare the nature of the interest at a meeting of the company's directors, applies when the director in question is the only director of the company.

In the late 19th century the courts were called upon to fill some rather substantial gaps in the legislation as it then existed (in the CA 1862). The House of Lords decided great cases, such as *Ashbury Railway Carriage and Iron Co. Ltd v Riche* (1875) LR 7 HL 653, *Trevor v Whitworth* (1887) 12 App Cas 409 and *Ooregum Gold Mining Co. of India Ltd v Roper* [1892] AC 125. The law established in all those three cases has now been replaced by fresh legislation. The legislation has reversed the effect of the *Ashbury Railway Carriage* case (see 19.4.1), but the other two have been confirmed, though important exceptions have been created (see chapter 10). In some areas, case law still attempts to fill notable gaps in the legislation, often very cautiously. Two notable examples are the question whether a company's constitution forms a contract between the company and its members (see 3.4) and the liability of companies for crimes (see 19.8.4 to 19.8.6).

For a review of judicial interpretation of companies legislation see D. Milman, 'The courts and the Companies Acts: the judicial contribution to company law' [1990] LMCLQ 401.

0.6.2.4 Reports of cases

Reports of company law cases are found mainly in the Chancery section of the *Law Reports*, that is, Ch in the current series, ChD in the second series (1875 to 1890), and LR Eq and LR Ch App in the first series (1865 to 1874). From 1865 to about 1910, an enormous number of company law cases were reported, but as law reporters became generally more selective about what cases they published, the number of new company law cases reported annually dwindled until, during the 1960s and 70s, there seemed to be a danger that only a few specialist barristers who were aware of the unreported cases could be capable of giving advice on company matters. The situation improved greatly in the 1980s with the establishment of two specialist series of reports, *Butterworths Company Law Cases* (BCLC) and *British Company Cases* (BCC), the first five volumes of which were called *British Company Law Cases*—though the market was unable to sustain a third series, *Palmer's Company Cases* (PCC), which was published only from 1985 to 1989.

0.5.2.5 Criticism of judicial approaches

A legal system is a set of principles on which courts base reasoned judgments. Company law appears to be a particularly intricate system of both legislative and common law principles. This leads to two criticisms:

- (a) Decisions of great practical importance to business people are made to depend on insignificant legal details. Business people may, for example, wonder why the agreement of all the members of a company to a decision to reduce its capital is not considered a good enough agreement for the court to approve under CA 1985, s. 135, if the members did not hold a meeting to come to the decision, whereas a decision come to at a meeting by a three-quarters majority is good enough even if only a quorum of members (typically two) attended the meeting. This rule was arrived at in *Re Barry Artist Ltd* [1985] 1 WLR 1305 purely by construction of the legislation. Many business people would think it ridiculous that learned judges interpreting the Insolvency Act 1986, s. 123(1)(a), disagree over whether a statutory demand for a debt (which can be the first stage in a creditor's proceeding to have a company compulsorily wound up by the court) may or may not be sent by post (see 20.6.4).
- (b) When application of a legal rule produces an unwelcome result one reaction is to assert that judges should be free to disapply the rule whenever they like (usually expressed as 'whenever justice and equity require') and insistence on applying rules whatever the consequences is described as 'formalism', which is thought to be

inherently wrong. The prime example of this in company law is the long-running controversy over the circumstances in which the separate personality of a company may be ignored (see 5.3). But settled legal rules with predictable outcomes are also valued, especially when business arrangements are made relying on those rules. In the consultation document introducing its review of company law (see 0.5.1.4) the DTI says, 'The new arrangements should be based on principles of consistency, predictability and transparency' (*Modern Company Law for a Competitive Economy* (London: DTI, 1998), p. 6). The way in which a legal system should deal with a case in which the application of a rule would be unwelcome is to analyse what distinguishes the case from those in which the rule can be applied successfully and use that analysis to formulate an additional principle providing an exception to the rule. That new principle can then be followed in future cases and can be taken into account by people when planning their business transactions. See Lord Steyn, 'Does legal formalism hold sway in England?' *Current Legal Problems 1996*, part 2, pp. 43–58.

0.5.2.6 Studying case law

The number of reported cases on company law is huge. The cases up to 1999 occupy two volumes (bound in five parts) of *The Digest*, taking up 2,707 pages. As with its treatment of legislation (see 0.5.1.9), this book presents only a selection of the relevant reported cases. As with our treatment of the legislation, our aim is to provide a framework, which you can, if and when necessary, fill in with more detailed research of your own.

One of the most important skills of a lawyer is in interpreting reports of cases on reading them for the first time, and determining how they apply to a problem on which advice is sought. Teaching lawyers necessarily involves teaching how to do this. Common law subjects are sometimes taught by asking students to read leading cases and derive for themselves the principles of the law from those cases. This teaches how to interpret cases as well as teaching the principles of the subject. This book adopts the approach of setting out our statement of what the principles of law are, giving references to the cases from which we have derived those principles. This enables us to cite, and derive principles from, vastly more cases than could possibly be read during, for example, an undergraduate course on company law. It leaves it up to you to decide which cases you want to read for yourself, depending on your personal learning objectives and, if you are following a course at an educational institution, the requirements of that course.

0.5.3 EUROPEAN LAW

0.5.3.1 Harmonisation Directives

In order to establish a common market for goods and services throughout the European Union it is necessary to ensure that the laws governing the establishment of businesses are not significantly different in different parts of the Union, making business more favourable in one part than in others. The Treaty Establishing the European Community (the EC Treaty) therefore authorises the Council and the Commission to coordinate 'to the necessary extent the safeguards which, for the protection of the interests of members and others, are required of companies or firms . . . with a view to making such safeguards equivalent throughout the Community' (art. 44(2)(g)). The process of coordination required by art. 44(2)(g) is usually referred to as 'harmonisation' of company law.

A country may adopt laws restricting business within its territory conducted by companies incorporated in other jurisdictions. EU countries cannot discriminate against one another in

this way because art. 43 of the EC Treaty prohibits restrictions on the freedom of establishment of nationals of one member State in the territory of another member State, and art. 48 requires companies or firms formed in accordance with the law of a member State, and having their registered office, central administration or principal place of business within the Union, to be accorded the same rights of freedom of establishment as natural persons who are nationals of member States. See I.G.F. Cath, 'Freedom of establishment of companies: a new step towards completion of the internal market' 6 YEL 1986 247. The programme of company law harmonisation is undertaken to promote freedom of establishment (see the opening words of art. 44 and F.G. Jacobs, 'The basic freedoms of the EEC Treaty and company law' (1992) 13 Co Law 4).

Harmonisation of company law is carried out by Directives, issued by the Parliament and the Council, which set out requirements which member States must enact in their domestic legislation. A Directive is initiated by a proposal from the Commission, which must be jointly approved, with amendments if necessary, by the Council and the Parliament, following the codecision procedure of art. 251 of the EC Treaty. The harmonisation Directives are referred to as the 'First', 'Second' etc. Directives in the order in which they were proposed by the Commission. Of the 13 proposals so far, the 5th, 10th and 13th have not yet been adopted and the 9th has been withdrawn. The 11th Directive (89/666/EEC) is concerned only with registration of branches opened in any member State by companies incorporated outside that State and will not be considered in this book.

In September 2001 the European Commission set up a High Level Group of Company Law Experts to discuss the modernisation of company law in Europe. The Group has issued a report, *A Modern Regulatory Framework for Company Law in Europe*, which is available at the European Commission Internal Market website: www.europa.eu.int/com/internal_market.

If a member State has failed to implement a Directive when the time limit for implementing it expires, the terms of the Directive may be relied on, as against the State, in the State's courts, provided the terms of the Directive are unconditional and sufficiently precise, but the terms of an unimplemented Directive cannot be relied on against persons other than States (*Marshall v Southampton and South West Hampshire Area Health Authority (Teaching)* [1986] QB 401; *Duke v GEC Reliance Ltd* [1988] AC 618). In *Karella v Greek Minister of Industry, Energy and Technology* (cases C-19/90 and C-20/90) [1991] ECR I-2691 and *Sindesmos Melon tis Eleftheras Evangelikis Ekklesias v Greece* (case C-381/89) [1992] ECR I-2111 provisions of the Second Company Law Directive (77/91/EEC) were held to be sufficiently precise to be directly applicable. Because a national court is a State authority it must interpret its national law as far as possible in the light of the wording and purpose of relevant Directives (*Marleasing SA v La Comercial Internacional de Alimentación SA* (case C-106/89) [1990] ECR I-4135). In the UK it has been acknowledged that legislation enacted in order to implement a Directive must be construed so as to give full effect to the Directive, taking into account any relevant decisions of the European Court of Justice (*Litster v Forth Dry Dock and Engineering Co. Ltd* [1990] 1 AC 546). However, it has been said that legislation which was not intended to implement a Directive will not be construed so as to give effect to that Directive if to do so would distort the meaning of the legislation (*Duke v GEC Reliance Ltd*).

Information about developments in EU company law is available at the European Commission's Internal Market website, europa.eu.int/comm/internal_market.

Implementation of Directives on company law in Great Britain has usually been by Act of Parliament, but some detailed amendments have recently been made by regulations made by the Secretary of State under the European Communities Act 1972, s. 2(2) (SI 1997/2306, 1999/2770, 2003/1116, 2003/3031, 2006/1183).

0.5.3.2 *Societas europea*

As from 8 October 2004 it has been possible, under Regulation (EC) No. 2157/2001, to register, in the companies registry of any European Union country, a European public limited-liability company, or 'societas europaea' (SE). Regulation 2157/2001 is known as the Statute for a European company. It is supplemented by Directive 2001/86/EC, which governs employee involvement in SEs. There are only limited circumstances in which an SE can be formed (Regulation 2157/2001, art. 2), all of which require the cooperation of at least two existing EU companies governed by the laws of different member States (though one can be the subsidiary of the other, provided the subsidiary has been in existence for at least two years). Once established, an SE can itself cooperate in setting up another SE and can set up subsidiary SEs (art. 3).

0.5.3.3 Jurisdictional competition or cooperation?

Companies legislation is long and complex and involves both enabling provisions, which provide corporate forms for businesses to use, and mandatory provisions, which restrict how those forms may be used. Different jurisdictions which have the ability to create different forms of company law may produce laws with more or fewer mandatory provisions or with different enabling provisions. This may make some jurisdictions more attractive than others to business people wishing to form companies. There is little doubt that most business people incorporate their businesses in the jurisdictions in which they are based. This saves having to hire foreign lawyers to deal with compliance with the law of the jurisdiction of incorporation, and saves having to file documents both in the place of incorporation and the place of business. There must also be some suspicion by those dealing with a business which has deliberately been placed outside the jurisdiction in which it is dealing. Business people, like other people, have a natural affinity for their place of domicile. Nevertheless, where a choice is available some people will seek to evaluate the alternatives and choose the one that seems best.

The problems of having different companies legislation in different neighbouring jurisdictions which are closely linked economically and politically have been faced in several areas of the world. In the United Kingdom (see 0.5.3.4) and Australia (see 0.5.3.5) the answer has been to adopt a uniform code. In the USA (see 0.5.3.6) the opposite solution has been adopted and states have been allowed complete freedom to enact whatever corporations laws they want. The European Union (see 0.5.3.7 and 0.5.3.8) has compromised on a programme of harmonisation but not uniformity. Perhaps naturally, Americans have sought to show that their system would be better for the EU than the one it has chosen.

0.5.3.4 United Kingdom: uniformity of companies legislation

The United Kingdom Parliament has always enacted what is essentially a single company law code for England and Wales and for Scotland: the Companies Act 1985 applies in both jurisdictions though some of its provisions have alternative formulations adapted to the different legal systems of the two jurisdictions (see *Arthur D. Little Ltd v Ableco Finance LLC* [2002] EWHC 701 (Ch), [2003] Ch 217). The creation, operation, regulation and dissolution of types of business association are reserved matters on which the Scottish Parliament is not competent to legislate (Scotland Act 1998, ss. 29 and 30 and sch. 5, part II, s. C1). There are separate registrars of companies for England and Wales and for Scotland.

Unlike the position in Scotland, the Northern Ireland Assembly is competent to enact separate companies legislation for Northern Ireland, as was its predecessor, the Northern Ireland Parliament. However, Northern Ireland companies legislation has in practice been substantially the same as the British legislation. Legislation in Northern Ireland must now

comply with EC Directives. The CLRB proposes to end separate Northern Ireland legislation, subject to the Northern Ireland Assembly's power to make separate provision in the future. Under the CLRB proposals there will be a single legislative code for the whole of the United Kingdom. Clause 909 proposes to extend the company law provisions of the CLRB, the remaining provisions of CA 1985 and part 2 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 to Northern Ireland, and repeals the corresponding Northern Ireland legislation. Clauses 910 to 912 similarly extend to Northern Ireland the British legislation relating to SEs, limited liability partnerships, limited partnerships, open-ended investment companies and European economic interest groupings, and the provisions of the CLRB relating to business names.

Companies can be registered under separate codes in Guernsey, Jersey and the Isle of Man. The fact that the separate jurisdiction of Sark has no company law at all, and so no controls on the activities of company directors, has sometimes been seen as a way of avoiding the provisions of British company law (see *Official Receiver v Vass* [1999] BCC 516).

0.5.3.5 Australia: uniformity of companies legislation

In Australia, the Federal Parliament does not have power to legislate for the incorporation of companies (*New South Wales v The Commonwealth, The Incorporation Case* (1990) 169 CLR 482), but, since 1961, the States have agreed to adopt a uniform companies code (now called the Corporations Law). Among the reasons for preferring uniformity appear to be the convenience of professional advisers who have to learn only one code for application throughout the country (an obvious advantage given the length and complexity of modern companies legislation), and frustration under the old system of different laws in different States that when one State improved its legislation, other States could not benefit from those improvements until their own legislatures could find time to enact them (see R. McQueen, 'Why High Court judges make poor historians: the Corporations Act case and early attempts to establish a national system of company regulation in Australia' (1990) 19 Fed Law Rev 245).

0.5.3.6 United States: competition for incorporation fees

In the USA, corporations are incorporated (or 'chartered', as it is said there) under state laws and there is no system of Federal chartering. In the 19th century there was great popular suspicion of monopolistic big business, and all states imposed upper limits on the amount of capital a corporation could have. At the end of the 19th century, states one by one abandoned those limits and other restrictions as they competed with each other for the fees they could obtain from new incorporations. The history was described in *Louis K. Liggett Co. v Lee* (1933) 288 US 517 by Brandeis J, who talked of 'the traffic in charters' (at p. 557) and of a 'race' between States which 'was one not of diligence but of laxity' (at p. 559). The process has since become known as the 'race to the bottom'. It has been claimed that states have continued the race to the bottom by favouring the interests of the people who decide where to incorporate, typically those who are to be, or will control the appointment of, the directors. Delaware—the second smallest of the states—is the acknowledged winner of the race: in some years corporate fees have made up one-quarter of Delaware's state revenues. Over 40 per cent of corporations listed on the New York Stock Exchange in 1987 were incorporated in Delaware. This leadership means that Delaware lawyers benefit from the fees generated by corporate litigation. W.L. Cary, 'Federalism and corporate law: reflections upon Delaware' (1974) 83 Yale LJ 663 is a notable attack on the system. Others, however, defend Delaware: see C. Alva, 'Delaware and the market for corporate charters: history and agency' (1990) 15 Del J Corp L 885, which reveals that Delaware's statutes on corporate law are drafted by the

Delaware Bar Association and automatically adopted by the legislature, which has no members with any expertise in the subject. For further criticism and a detailed description of Delaware's legislation procedures see 'Law for sale: a study of the Delaware Corporation Law of 1967' (1969) 117 U Pa L Rev 861.

The American system is commonly defended on the ground that competition is a good thing and in a market for incorporation where State laws are a 'product', competition must result in better product. Fears that the most successful laws are those that favour a particular interest group are countered by saying that if other interest groups really felt disadvantaged they would stop dealing with companies incorporated under the disadvantageous laws, and those laws would cease to be the most successful. In particular, it is argued that if different State laws had different effects on shareholders then this would be reflected in share prices but in fact there seems to be no evidence that moving to Delaware, for example, affects a company's share price. It may be that shareholders and directors in the USA pay less attention to State corporation laws than lawyers do. The real reason for Delaware's success at attracting corporations may just be that it has become a centre of expertise in corporate law and that the lawyers advising business people tell them to incorporate in Delaware because the lawyers' future work will be made easier if they are in a legal environment with which they are familiar and can trust (see W.W. Bratton, 'Corporate law's race to nowhere in particular' (1994) 44 UTLJ 401, which is a valuable review of the debate in this area; D.G. Kaouris, 'Is Delaware still a haven for incorporation?' (1995) 20 Del J Corp L 965).

0.5.3.7 Should the EU learn from the US?

The idea of legislation as a product which is periodically redesigned to make it more attractive to consumers who may choose whether or not to adopt it is a challenge to the traditional concept of legislation as expressing inescapable basic standards for public life enacted in the public interest by the people's representatives in the legislature. It raises the question whether the public interest does require any minimum standards in company law. In Europe there is some minimum standard setting by Directives which harmonise, in the words of art. 44(2)(g) of the EC Treaty, 'the safeguards which, for the protection of the interests of members *and others*, are required of companies' (emphasis added). If there is no element of public interest in company law then it can be made by legally expert product designers and, as in Delaware, the legislators can adopt it without worrying about its effect on the people they represent. As companies are of such pervasive influence in everyday life it is unlikely that there can be no public interest in their activities or that voters would want to give up political control over them. What is in the public interest is a political question which must be determined by political institutions in which, often, conflicting interests must be reconciled. Comparing EC and US company law, W.J. Carney, 'The political economy of competition for corporate charters' (1997) 26 J Legal Stud 303 says that EC company law Directives (and hence British company law) have far more mandatory provisions than equivalent US law. He attributes this to the lack of competition among European jurisdictions allowing interest groups to obtain legislation in their favour which he claims would be removed by market forces in the competitive USA. But another way of looking at it is that European company law is produced by democratic political institutions representing a wide range of interests, whereas Delaware corporate law is not.

0.5.3.8 Current state of EC company law

At present there are no plans for a uniform company law in Europe as there is in the United Kingdom and Australia. Article 44(2)(g) of the EC Treaty requires laws to be made 'equivalent', not 'uniform'. So far the Community policy has been to create a system of minimum

standards for company law which must be observed throughout the Community. According to I.G.F. Cath, 'Freedom of establishment of companies: a new step towards completion of the internal market' 6 YEL 1986 247 at p. 255:

Though often limited in scope and having a 'compromising' character, reflecting the different schools of thought which had to be reconciled, these Directives have brought some alignment of company law and have generally raised the existing standards to a common Community level.

EC Directives have made some startling administrative changes to UK company law—for example, introducing uniform formats for the publicly available accounts of companies, introducing a new system for recognition of the qualifications of auditors and introducing single-member private limited companies. Substantive changes, altering the balance between various interest groups, are far fewer. The most significant example is the rules on security of transactions, which improve the position of persons dealing with companies and which are discussed in chapter 19, especially 19.5 and 19.6. These rules were made in the First Directive (68/151/EEC), which was adopted before the UK joined the Community, and it has been very difficult to amend British company law to comply with the rules.

There is little evidence that any EU country is bidding to become the Delaware of Europe. Incorporation fees would not be a sufficiently significant contribution to any national Treasury to influence government policy. However, there are significant differences between national laws. For example, Germany insists on employee participation in any company with more than 500 employees; in Britain there is no minimum capital requirement for a private company whereas there is in Germany. American commentators, reflecting experience in their own country, suggest that these differences will increasingly influence the choice of jurisdiction of incorporation (see A.F. Conard, 'The European alternative to uniformity in corporation laws' (1991) 89 Mich L Rev 2150; C.D. Stith, 'Federalism and company law: a "race to the bottom" in the European Community' (1991) 79 Geo LJ 1581). But the Commission has said that the prospect of companies moving within the EU to countries with less stringent company laws 'would be unacceptable to member States' (*Commission Consultation Paper on Company Law* (1997), p. 3).

In *Centros Ltd v Erhvervs- og Selskabsstyrelsen* (case C-212/97) [2000] Ch 446 two Danish citizens, Mr and Mrs Bryde, registered a company, Centros Ltd, in England and Wales, intending that it would not trade in the UK but through a branch in Denmark. Danish companies legislation required companies registered there to have a minimum paid-up capital of Dkr 200,000 (about £20,000), whereas British companies legislation does not have any minimum capital requirement for a private company such as Centros Ltd. The Danish authorities refused to register Centros Ltd's Danish branch, saying that this would enable Mr and Mrs Bryde to evade Danish law on the minimum capital of a private company, which was a law designed to protect persons dealing with companies. The European Court of Justice held that the refusal to register the branch contravened what is now art. 43 of the EC Treaty, which (when read with what is now art. 48) prohibits restrictions on freedom of establishment. The court said:

26 . . . The provisions of the Treaty on freedom of establishment are intended specifically to enable companies formed in accordance with the law of a member State and having their registered office, central administration or principal place of business within the Community to pursue activities in other member States through an agency, branch or subsidiary.

27 That being so, the fact that a national of a member State who wishes to set up a company chooses to form it in the member State whose rules of company law seem to him the least restrictive and to set up branches in other member States cannot, in itself, constitute an abuse of the right of establishment. The right to form a company in accordance with the law of a member State and to set

up branches in other member States is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty.

28 In this connection, the fact that company law is not completely harmonised in the Community is of little consequence. Moreover, it is always open to the Council, on the basis of the powers conferred upon it by [art. 44(2)(g)] of the EC Treaty, to achieve complete harmonisation.

It will be interesting to see whether dire predictions that, as a result of the *Centros* case, incorporations of private companies would cease in countries such as Austria, Denmark and Germany which impose minimum capital requirements will turn out to be true (E. Micheler, 'The impact of the *Centros* case on Europe's company laws' (2000) 21 Co Law 179).

The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: the Strategic Framework* (London: DTI, 1999), note that investment in Britain by foreign firms is of great importance to our economy and that this must be taken into account by British company law. They say (para. 2.11): 'We have to recognise that it is increasingly possible that, if we make our law unduly prescriptive, inflexible, inaccessible or onerous, businesses will choose to incorporate elsewhere'. However, they do not discuss whether choosing to incorporate in Britain has anything to do with choosing to invest in Britain.

It had been thought that greater uniformity of company law in the EU would be almost inevitable as the Single Market developed, and the Commission has long argued that companies in different European States need to unite to form companies which are large enough to compete in world markets, and this requires a uniform European company law. One aspect of this hoped-for uniform law for large companies is Regulation (EC) No. 2157/2001, the Statute for a European company (SE, see 0.5.3.2). Subject to Regulation 2157/2001, an SE is governed by the provisions of member States' laws which would apply to a public limited-liability company formed in accordance with the law of the member State in which the SE has its registered office (Regulation 2157/2001, arts 9(1) and 10). Recital 9 introducing Regulation 2157/2001 claims that:

work on the approximation of national company law has made substantial progress, so that on those points where the functioning of an SE does not need uniform Community rules reference may be made to the law governing public limited-liability companies in the member State where it has its registered office.

Member States' laws on public limited-liability companies would have been more uniform if they had been able to agree on the Commission's proposed Fifth Directive (on the structure of public limited companies) (OJ C240, 9 September 1983, p. 2; OJ C321, 12 December 1991, p. 9). The disagreement has been over mandatory provisions for employee involvement.

Compulsory employee involvement in the management of large companies (known as 'co-determination') has long been central to German society and has been adopted in a modified form in the Netherlands, but relations between employees and management have traditionally been arranged very differently elsewhere in the Union. In particular the former Conservative government in the United Kingdom was implacably opposed to any form of compulsory employee involvement. See T.E. Abeltshauser, 'Towards a European constitution of the firm: problems and perspectives' (1990) 11 Mich J Int'l L 1235; W. Kolvenbach, 'EEC company law harmonisation and worker participation' (1990) 11 U Pa J Int'l Bus L 709; J. Dine, 'Why not employee participation in the European Community context?' (1995) 16 Co Law 44. Compromise has been reached on the Statute for a European company (see 15.2.4). There has been no similar progress on the proposed Fifth Directive.

See generally, R. Drury, 'A review of the European Community's company law harmonisation programme' (1992) 24 Bracton Law J 45; M. Andenas, 'The future of EC law harmonisation' (1994) 15 Co Law 121. For an attempt to analyse why some company law rules should be

set centrally in the EU and others left to local jurisdictions see D. Charny, 'Competition among jurisdictions in formulating corporate law rules: an American perspective on the "race to the bottom" in the European Communities' (1991) 32 Harv Int'l LJ 423 (reprinted in S. Wheeler, *A Reader on the Law of Business Enterprise* (Oxford University Press, 1994)).

0.5.4 OTHER RULES

In addition to legislation and judge-made law there are carefully composed codes of rules which are of great importance in some areas of company activity, particularly for larger companies. Examples are Accounting Standards Board (ASB) standards and International Accounting Standards Board (IASB) standards (see 9.3.7.1), the City Code on Takeovers and Mergers (see 8.8.1) and the Combined Code on corporate governance (see 15.2.2). All these were originally private initiatives by non-governmental bodies to issue statements of best practice, but all have been, or will be, recognised in legislation which either requires at least larger companies to comply with the codes (IASB standards; in the future, the City Code) or requires them to explain why they have not complied (ASB standards, Combined Code). The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: the Strategic Framework* (London: DTI, 1999), ch. 5.5, discussed the range of regulations affecting companies, and they are summarised in a table in annex F to the consultation document.

0.5.5 PRACTITIONERS' BOOKS AND OTHER LITERATURE

There are three practitioners' works which deal with company law at length and in detail. *Buckley on the Companies Acts* (Butterworths) first appeared in 1873 when its author, Henry Burton Buckley, was a barrister of only four years' standing. He became Buckley J in 1900 and Buckley LJ in 1906 until he retired and became the 1st Baron Wrenbury: many of his judgments are quoted in this book as are those of his son, Sir Denys Buckley. *Palmer's Company Law* (Sweet and Maxwell) first appeared in 1898. Its author, Francis Beaufort Palmer (1845–1917), was a barrister and legal author. The work now known as *Gore-Brown on Companies* (Jordans) was originally written by Richard Jordan and first published in 1867 by Jordan and Sons Ltd, company registration agents. It was later edited by a barrister, Francis Gore-Brown (1860–1922).

The work now known as *Gower and Davies' Principles of Modern Company Law* (Sweet and Maxwell) is a university textbook rather than a comprehensive practitioners' work and can therefore be rather more argumentative and controversial. Since its first edition in 1954 it has been frequently cited and discussed in academic articles and in court.

Many academic lawyers specialise in company law. Scholarly articles and case notes will be found in the general legal journals, especially the *Cambridge Law Journal* (CLJ), the *Law Quarterly Review* (LQR) and the *Modern Law Review* (MLR). There is always much that is relevant to company law in the *Journal of Business Law* (JBL). However, probably the most important forum for academic discussion of company law is the *Company Lawyer* (Co Law), which was established in 1980. There is a similar journal published in Australia, *Company and Securities Law Journal* (C & SLJ).

Articles of a more practical nature will be found in the *Solicitors' Journal* (SJ) and the *Gazette*, and in the specialist publication *PLC: Practical Law for Companies*. All are primarily intended for solicitors.

0.6 PURPOSE OF COMPANY LAW

0.6.1 SERVICE TO BUSINESS

Incorporation of companies has been made readily available by Parliament as a service to those who wish to take advantage of artificial entities with separate legal personality which they can control and put into legal relationships without being directly responsible for them.

Legislation providing for the incorporation of companies by registration is often described as ‘enabling’ or ‘facilitative’ legislation: it enables people to use the corporate form.

Most companies are incorporated for business purposes, which Parliament has wished to encourage. Business is risky. A venture may succeed and return profits to the providers of capital, and this is an incentive for investment. There is, however, always a risk that a venture may fail. The common law principle is that those who provide the capital for a business on the basis of taking or sharing in its profits, as sole proprietors or partners, are liable for all the debts incurred in the course of the business. Parliament has considered that people are more likely to venture their capital in business if they know that their potential loss from failure of the business is limited to loss of the amount of capital they have ventured without any further liability to pay the business’s outstanding debts. CA 1985 permits the incorporation of companies with limited liability. As will be explained in more detail in 1.3.2, persons who contribute capital to a limited company, as members of the company, in return for a share in the profits made in the company’s business are not liable, if the business should fail, to lose anything more than the amount of capital they have undertaken to contribute. In its White Paper, *Modernising Company Law* (Cm 5553, 2002), the government said:

Company law has a direct impact on enterprise. It can actively promote and encourage enterprise—or hold it back. The government is strongly committed to promoting enterprise and believes that company law reform has an important part to play in making it as easy as possible to start and run companies while maintaining adequate safeguards against abuse. (Cm 5553-I, part I, para. 3.)

If business people are to be encouraged to create new businesses for which they require new companies, the creation of companies ought to be made as cheap and straightforward as possible. So one important aspect of company law which must be examined is how new companies are created (see chapters 1 to 3). Once created, the continuing operation of a company is governed by the law, and the other important aspect of company law is the operation of existing companies, which takes up most of this book. The law on existing companies is also significant for the creation of new businesses because people might be discouraged from creating new companies if they felt that the law on operating them was unsatisfactory.

0.6.2 IS COMPANY LAW SUITED TO ALL USERS?

One reason for the popularity of registered companies is that CA 1985 permits a wide measure of choice in the constitution of a company, and the company format can be adapted to many different uses. Registered companies range in size and nature from huge industrial and commercial concerns like British Telecommunications plc to associations of people following a common hobby. Many companies exist only to hold one asset such as a building or a ship. Many individuals and companies divide up their business interests into scores or even hundreds of separate companies. The separate personality which incorporation of a company provides is widely exploited in tax-saving schemes. Many companies are bound by their constitutions to follow only charitable objectives.

Nevertheless there have been complaints that the registered company is unsuitable in some circumstances. In particular it has for some time been argued that the company is not a suitable form for charities and they require a special legal form (J. Warburton, 'Charity corporations: the framework for the future?' [1990] Conv 95). A report from the Cabinet Office Strategy Unit, *Private Action, Public Benefit* (2002), suggested two new legal forms, the charitable incorporated organisation for charities generally, and the community interest company for social enterprises. It also suggested changes to the industrial and provident society legislation, renaming such societies as cooperatives and community benefit societies. The Companies (Audit, Investigations and Community Enterprise) Act 2004, part 2, makes provision for community interest companies (cics) (see 1.3.1). Legislation for registration, with the Charity Commission, of charitable incorporated organisations is proposed in the Charities Bill which the government introduced in the House of Lords on 18 May 2005.

The most persistent complaint has been that the company is an unsuitable form for small businesses. According to the Inland Revenue, at the end of March 1992 there were 2.8 million sole traders and 0.6 million partnerships compared to just over 1 million companies. This was just before incorporation of single-member private companies was first permitted. It has been argued that what is believed to be a 'simpler' legal form than a company could be used by presently unincorporated businesses and by small businesses which are presently companies but for which the company form is unsuitable. A proposal in *A New Form of Incorporation for Small Firms: a Consultative Document* (Cmnd 8171) (London: HMSO, 1981) received little support. Discussion continued. J. Freedman, 'Small businesses and the corporate form: burden or privilege?' (1994) 57 MLR 555 reports empirical research on what business people actually want. As might be expected they are in practice indifferent about legal forms, which they leave to their professional advisers (apart from some who are aware of positive or negative effects of incorporation on the image of their business). What business people are concerned about is financial matters such as the cost of complying with the accounting requirements of CA 1985 (since the survey, companies with small turnovers have been exempted from compulsory auditing of their accounts) and the tax effects of incorporation. Freedman also points out that small businesses have widely differing ownership structures, from single individuals through small or extended families to business associates with or without investors who do not participate in management. It would not be easy to decide which particular group to design a new legal form for and it is not obvious what features would make a new design attractive.

In April 1994 the Department of Trade and Industry asked the Law Commission to undertake a preliminary investigation of the problem. The Commission's report is printed in Department of Trade and Industry, *Company Law Review: the Law Applicable to Private Companies* (URN 94/529) (London: DTI, 1994). The Commission noted the difficulty of defining what a small business is and that business people do not put company law high on their list of problems. It was sympathetic to the view that creating a new legal form for small businesses would merely complicate the law and, by confining businesses to a small form, would discourage growth. It concluded that there was no need for a new legal form for small businesses.

In its White Paper, *Modernising Company Law* (Cm 5553, 2002), the government rejected the idea of a separate corporate form for small businesses, principally because it might create a barrier to small companies growing. It preferred the approach of drafting companies legislation so that it is primarily suitable for small companies, with provisions for larger companies added on as necessary (Cm 5553-I, part II, paras 1.5 and 1.6). This has been done in the CLRB to some extent (see 0.5.1.8).

Further empirical research reported by A. Hicks, R. Drury and J. Smallcombe, *Alternative*

Company Structures for the Small Business (London: Certified Accountants Educational Trust, 1995) confirms the general picture found by Freedman but makes the interesting point that most small businesses are incorporated on the advice of accountants rather than lawyers. Accountants may well emphasise the taxation effects of incorporating. Hicks et al. do support a special simple form of legal organisation for small businesses. They believe that limited liability is the cause of much of the complexity and compliance costs of the company form and their proposed 'business corporation' would have separate personality but unlimited liability and would be based on partnership concepts.

0.6.3 MANDATORY AND DEFAULT RULES

Those who register a company under CA 1985 gain the advantages of incorporating a company with artificial separate personality. In return, Parliament requires the observance of mandatory rules on the operation of the company. These include both the legislated rules (see 0.5.1) and the judge-made rules of case law described in 0.5.2.

Requiring the observance of rules in return for granting the privilege of incorporation has sometimes led to incorporation being described as a contract between Parliament and corporators. For an early example of the characterisation of incorporation as a contract see the United States Supreme Court case of *Trustees of Dartmouth College v Woodward* (1819) 17 US (4 Wheat) 518, in which it was held that the state legislature of New Hampshire could not enact laws altering Dartmouth College's charter of incorporation (which was granted by the British Crown before the independence of the USA) without the College's agreement, because the charter was a contract between the Crown and the corporators protected by the United States Constitution, art. 1, s. 10, cl. 1 (the contracts clause), which prohibits states passing laws 'impairing the obligation of contracts'.

Because the separate personality of a company is artificial, it can be put into legal relationships only by the actions of human beings who will not, however, be directly responsible for those relationships. The persons who can put a company into legal relationships are its directors and persons they have authorised. Mandatory rules of company law regulate this situation for the protection of (a) the members of companies, (b) persons who deal with companies, especially those who become creditors of companies, (c) the public interest. A related area of law is concerned with public trading in company shares on the stock market.

Some people believe that the law should never interfere with the freedom of business people to make any contracts they choose. People with these beliefs disapprove of mandatory rules of company law. Often they deny the concession theory of incorporation and say that incorporation should be recognised as arising from private contract only. However, they usually allow that it is useful to have a model set of rules which will apply in default of other rules being chosen and will save people the costs of drafting their own rules. This has been the traditional British attitude to the regulations, known as the articles of association, governing a company's internal affairs and management (sometimes called the 'governance' of the company). Legislation provides a model set of articles (Table A), which apply in default of other rules being chosen for a particular company, but any company is almost entirely free to choose any alternative regulations (see chapter 3). However, in other areas British company law has a large mandatory content, particularly with regard to disclosure of information (see chapter 4), preparation and disclosure of accounts (see chapter 9), capital maintenance (see chapter 10) and the fiduciary duties of directors (see chapter 16).

People who object to mandatory rules in company law usually believe that the rules which companies will have to adopt in order not to fail in a competitive market will be rules which will be of greatest benefit to the economy in which they operate. Market economists sometimes

use their economic theories to work out what these theoretically wealth-maximising rules would be and propose them for adoption either as default rules or as mandatory rules. These issues were debated (in the context of United States law) in a symposium issue of the *Columbia Law Review* (vol. 89, No. 7, November 1989). For the argument that there must be mandatory rules in certain areas of company law, see M.A. Eisenberg, 'The structure of corporation law' (1989) 89 *Colum L Rev* 1461 (reprinted in S. Wheeler, *A Reader on the Law of Business Enterprise* (Oxford University Press, 1994)). For the contrary view, see F.S. McChesney, 'Economics, law, and science in the corporate field: a critique of Eisenberg' (1989) 89 *Colum L Rev* 1530. The professors continued their debate in M.A. Eisenberg, 'Contractarianism without contracts: a response to Professor McChesney' (1990) 90 *Colum L Rev* 1321 and F.S. McChesney, 'Contractarianism without contracts? Yet another critique of Eisenberg' (1990) 90 *Colum L Rev* 1332. For a parting shot, see M.A. Eisenberg, 'Bad arguments in corporate law' (1990) 78 *Geo LJ* 1551.

0.6.4 THE COMPANY'S POSITION IN SOCIETY

0.6.4.1 Corporate social responsibility

Corporate social responsibility (CSR) is the responsibility of each company for its effect on the society in which it operates. The United Kingdom government has 'an ambitious vision for UK businesses to consider the economic, environmental and social impacts of their activities, wherever they operate in the world': see www.csr.gov.uk. Three reports have been issued: Department of Trade and Industry, *Business and Society: Developing Corporate Social Responsibility in the UK* (URN 01/720) (London: DTI, 2001), *Business and Society: Corporate Social Responsibility Report 2002* (URN 02/909) (London: DTI, 2002) and *Corporate Social Responsibility: A Government Update* (London: DTI, 2004).

There are sharply opposed views on the nature of a company's social responsibility and how that responsibility should be reflected in company law. British company law has traditionally paid little attention to how anyone other than the members and creditors of a company may be affected by it. Persons other than members and creditors (often referred to as 'other constituencies') are affected by the activities of companies but not, it is said, specially affected by the particular legal form of the registered company, so that their concerns are not a matter for company law: the dealings between employer and employee, for example, are the same whether the employer is a company, an individual or a partnership, and should be dealt with in employment law. Furthermore, company law is by no means just the law of companies that own large business organisations. Incorporation of companies under CA 1985 is allowed for any lawful purpose. Companies are not required to own large business organisations and to have publicly traded shares—they are not required to have any business purpose at all. British company law has to be adaptable to a wide variety of uses. Companies will always be a focus for any debate on the control of business activities because most business activity is conducted by companies. If, however, companies are singled out for regulation then incorporated businesses will be at a disadvantage compared with partnerships and sole proprietors.

0.6.4.2 Shareholder primacy

What is special about a company is that decisions about its activities are taken by its directors. Sole proprietors and partners can, if they wish, operate their businesses in the interests of any objectives they choose, and so can be persuaded to act as good citizens and operate their businesses for the public good, but directors of a company are actually forbidden from

considering any interests other than those expressly allowed by company law (see 16.4), which does not, at present, allow consideration of the public good. Traditionally the only interests which the law permitted the directors of a company to work for were the interests of the company, and for a business company this probably means only the financial interests of the company's shareholders (see 16.4.3.3). Statute now requires directors to have regard to the interests of the company's employees in general (CA 1985, s. 309; see 16.4.5) and, when the company is insolvent or near to insolvency, the interests of creditors (see 16.4.6.2). But neither employees nor creditors can take legal proceedings to force directors to have regard to their interests, whereas members with a simple majority of votes have a statutory right to dismiss directors (CA 1985, s. 303; see 15.6.3) and even a minority of members may petition the court for relief if the conduct of the company's affairs is unfairly prejudicial to their interests (CA 1985, s. 459; see 18.6). Company law is often described as 'shareholder-centred' or based on a principle of shareholder primacy.

Shareholder primacy is the subject of considerable political debate. On one side it is claimed that incorporation is made available to encourage business for the good of society generally and not simply for the private profit of shareholders:

. . . business is permitted and encouraged by the law primarily because it is of service to the community rather than because it is a source of profit to its owners. (E.M. Dodd Jr, 'For whom are corporate managers trustees?' (1932) 45 Harv L Rev 1145 at p. 1149.)

One must remember that the corporation is a legal fiction—a creature of the law—and the benefits of participation in enterprise with limited liability are provided for the benefit of society, not of the shareholders themselves. (T.S. Norwitz, "The metaphysics of *Time*": a radical corporate vision' (1991) 46 Bus Law 377 at p. 387.)

It is pointed out that requiring people working for companies to restrict the purpose of their working lives to maximising shareholder wealth is unhealthy, demeaning and morally corrupting (L.E. Mitchell, 'Groundwork of the metaphysics of corporate law' (1993) 50 Wash and Lee L Rev 1477; A. Wolfe, 'The modern corporation: private agent or public actor?' (1993) 50 Wash and Lee L Rev 1673; L.E. Mitchell, 'Cooperation and constraint in the modern corporation: an inquiry into the causes of corporate immorality' (1995) 73 Tex L Rev 477).

On the other side, it is claimed that restricting company management to the single objective of maximising shareholder wealth is the most efficient means of using companies to increase the wealth of society as a whole:

. . . maximising profits for equity investors assists the other 'constituencies' automatically. The participants in the venture play complementary rather than antagonistic roles. In a market economy each party to a transaction is better off. A successful firm provides jobs for workers and goods and services for consumers. The more appealing the goods to consumers, the more profits (and jobs). Prosperity for stockholders, workers, and communities goes hand in glove with better products for consumers. . . .

Frequently the harmony of interest between profit maximisation and other objectives escapes attention. (F.H. Easterbrook and D.R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991), p. 38.)

For another expression of this view see M.E. DeBow and D.R. Lee, 'Shareholders, nonshareholders and corporate law: communitarianism and resource allocation' (1993) 18 Del J Corp L 393. Easterbrook and Fischel believe that if difficult moral and social questions were priced and expressed as costs to the company, they could be taken into account in corporate decision-making:

Far better to alter incentives by establishing rules that attach prices to acts (such as pollution and layoffs) while leaving managers free to maximise the wealth of the residual claimants [i.e., the shareholders—see 15.1.2] subject to the social constraints. (Op. cit., loc. cit.)

Treating corporate managers as capable only of profit-making but incapable of taking moral and social decisions is regarded by Mitchell as unnatural and objectionable. Requiring managers to take moral and social factors into account is characterised by followers of Easterbrook and Fischel as unnatural and objectionable ‘social engineering’ (DeBow and Lee, op. cit. at p. 404).

These issues are explored at length and in detail in J.E. Parkinson, *Corporate Power and Responsibility* (Oxford: Clarendon Press, 1993), which argues in favour of the thesis that ‘. . . every large corporation should be thought of as a social enterprise; that is, as an entity whose existence and decisions can be justified only in so far as they serve public or social purposes’ (p. 23, quoting R.A. Dahl, ‘A prelude to corporate reform’ in R.L. Heilbroner and P. London (eds), *Corporate Social Policy* (Reading Mass: Addison-Wesley, 1975), pp. 18–24 at p. 18). For the opposing point of view see A. Alcock, ‘Corporate governance: a defence of the status quo’ (1995) 58 MLR 898. The description of large American corporations as more nearly social institutions than private enterprise was made by A.A. Berle Jr and G.C. Means in *The Modern Corporation and Private Property* (New York, 1932), p. 46.

The political debate in Britain was encapsulated by John Kay in his column in *The Daily Telegraph*, 11 September 1995 (reprinted in *The Business of Economics* (Oxford University Press, 1996), p. 86):

Is the purpose of a large public company to maximize its profits? Or to develop its business, in the interests of customers, employees, suppliers, investors, and the wider community? Like most people, I think the right answer is the second, but when I said so a few weeks ago institutions like the Institute of Directors denounced the prescription as wet, woolly, and vacuous.

Recognition by a company of the other interests listed by Kay is often seen as an element of the political idea of the stakeholding society (see J. Plender, *A Stake in the Future: The Stakeholding Solution* (London: Nicholas Brealey, 1997); P. Goldenberg, ‘IALS Company Law Lecture—shareholders v stakeholders: the bogus argument’ (1998) 19 Co Law 34). For a discussion of arguments for and against the stakeholder analysis of companies, see T.L. Beauchamp and N.E. Bowie (eds), *Ethical Theory and Business*, 5th edn. (Upper Saddle River NJ: Prentice Hall, 1997), ch. 2.

0.6.4.3 Enlightened shareholder value

In their first consultation document the Company Law Review Steering Group (see 0.5.1.4), whose 12 members included both Kay and Parkinson, declared their preference for shareholder primacy, adopting the Easterbrook and Fischel line that ‘. . . the ultimate objective of companies as currently enshrined in law—i.e. to generate maximum value for shareholders—is in principle the best means of securing overall prosperity and welfare’ (*Modern Company Law for a Competitive Economy: the Strategic Framework* (London: DTI, 1999), para. 5.1.12). Responses to that 1999 consultation document prompted a slight modification of this line. In *Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (London: DTI, 2000) the group said, at para. 2.11:

A very substantial majority of responses (in number and in weight) favoured retaining the basic rule that directors should operate companies for the benefit of members (i.e., normally shareholders). However, there was also very strong support for the view that this needed to be framed in an ‘inclusive’ way. There was concern that in many companies there was not sufficient appreciation (either by directors or by shareholders) of the importance of running businesses with a strategic

balanced view of the implications of decisions over time, with proper emphasis on the long term. Due recognition was also needed of the importance in modern business of fostering effective relationships over time, with employees, customers and suppliers, and in the community more widely. If companies failed to address these interests effectively, then neither their own success, nor the overall competitiveness of the economy, which is the object of the Review, could be secured. Many favoured reform to reflect these imperatives, both in framing duties of directors and in the form in which companies account publicly for their achievement, prospects and intentions.

This is known as the ‘enlightened shareholder value’ (ESV) approach to directors’ responsibilities. The CLRB, cl. 158(1), proposes to incorporate the ESV approach into United Kingdom company law (see 16.4.8).

The then Secretary of State for Trade and Industry, Patricia Hewitt, said in her foreword to *Draft Regulations on the Operating and Financial Review and Directors’ Report: A Consultative Document* (URN 04/1003) (London: DTI, 2004):

What are companies for? The primary goal is to make a profit for their shareholders, certainly. But the days when that was the whole answer are long gone. We all have higher expectations of companies in the modern economy.

We expect companies not simply to perform well in the short term, but to have an effective strategy for delivering long-term profitability. This is essential to the millions of us who invest our savings in companies through pension funds, life assurance, unit trusts and other forms of investment. We save for the years ahead, not the months ahead, and we need the companies in which we invest to share our own horizons.

We expect companies to generate the wealth that provides good public services and a decent standard of living for everyone. We need continuing recognition that wealth-creation demands honest and fair dealings with employees, customers, suppliers and creditors. Good working conditions, good products and services and successful relationships with a wide range of other stakeholders are important assets, crucial to stable, long-term performance and shareholder value.

We expect companies to create wealth while respecting the environment and exercising responsibility towards the society and the local communities in which they operate. The reputation and performance of companies which fail to do these things will suffer.

The people who invest in companies are the same people who are employed by them, buy their products, live in the communities around them, and are concerned about their effect on the environment. So, we have multiple reasons for wanting to see good companies.

0.6.4.4 Legitimacy of corporate power

Because most economic activity is conducted by companies, company law has a large potential impact on people’s lives. People are naturally concerned by the power that companies have to affect their lives and wish to be assured that corporate power is legitimate and is properly controlled, just as they wish to see proper controls on the power of other institutions, such as national and local government, trade unions and educational institutions. People naturally look to the law to provide the framework for legitimation and control of power. For some people, the power of a company will be legitimate only if it is exercised in the interest of all those whom it affects. They want the law to require companies to give due consideration to all relevant interests. Other people believe that corporate power is legitimised by the contribution that companies make to the economy and that the market provides adequate control of economic activity so that legal controls are either superfluous or produce damaging distortions of the market.

0.6.4.5 Social, environmental and ethical considerations

The CLRB, cl. 399, proposes that companies whose shares are traded on the London Stock Exchange and some other exchanges will in future have to give information in a directors’

report about the following matters to the extent necessary for an understanding of the development, performance or position of the company's business:

- (a) environmental matters, including the impact of the company's business on the environment;
- (b) the company's employees; and
- (c) social and community issues.

The information will have to include information about any policies of the company in relation to those matters and the effectiveness of those policies. See 9.9.4.

Pension funds are very significant as shareholders of companies whose shares are traded on the London Stock Exchange. The trustees of occupational pension schemes are required by the Pensions Act 1995, s. 35, to produce a statement of their investment principles. As from 3 July 2000 this must state the extent to which (if at all) social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments (SI 1996/3127, reg. 11A(a)). This may, at least, require companies to explain to those of their shareholders who are trustees of pension funds what effect they think that social, environmental and ethical (SEE) considerations may have on them, and may require them to reflect on the long-term effect of ignoring SEE considerations (see 16.4.3.3).

0.6.4.6 Other styles of capitalism

The shareholder-centred vision of the company is not universally held among advanced economies. In Germany companies are seen as serving both shareholders and employees, and in German company law this is reflected in the 'co-determination' principle that both shareholders and workers should take part in the governance of large companies. The conflict between the German and British views of the company has caused significant difficulties in the harmonisation of EC company law. In Japan a company is seen as a long-term coalition of investors, employees and trading partners, who are all concerned with the company's continuing prosperity. Japan's company law is modelled on Germany's, and the concern in both countries with the position of the company in society has been heavily influenced by the thinking of the German industrialist and statesman, Walther Rathenau (1867–1922), whose writings are cited by and clearly influenced Berle and Means. See M. Yoshimori, 'Whose company is it? The concept of the corporation in Japan and the West' (1995) 28 (4) *Long Range Planning* 33; J. Groenewegen, 'Institutions of capitalisms: American, European, and Japanese systems compared' (1997) 31 *J Economic Issues* 333; M. Yavasi, 'Shareholding and board structures of German and UK companies' (2001) 22 *Co Law* 47. The German and Japanese experience has influenced the development of the idea of the stakeholding society. For discussions of differing forms of capitalism in different national cultures see Groenewegen, *op. cit.*; C. Crouch and W. Streeck (eds), *Political Economy of Modern Capitalism* (London: Sage, 1997).

0.6.4.7 International standards of corporate behaviour

In many parts of the world, businesses are seen to benefit from repressive governments which create a compliant and cheap workforce, while government personnel benefit from bribes paid by businesses.

Attempts have been made to require multinational (or transnational) companies to adopt higher standards than those of the governments of the countries in which they operate.

The United Kingdom, together with the other members of the Organisation for Economic Cooperation and Development (OECD), has recommended the OECD Guidelines for

Multinational Enterprises to multinational enterprises operating in or from its territory. The first general policy set out in these Guidelines is that enterprises should contribute to economic, social and environmental progress with a view to achieving sustainable development. As ch. 1, para. 4, of the Guidelines points out:

The Guidelines are not aimed at introducing differences of treatment between multinational and domestic enterprises; they reflect good practice for all. Accordingly, multinational and domestic enterprises are subject to the same expectations in respect of their conduct wherever the Guidelines are relevant to both.

The Guidelines do not have the force of law, but are a statement of internationally recognised good practice. For more information see www.dti.gov.uk/europeandtrade/trade-policy/oecd-multinat-guidelines/page10203.html.

A United Nations initiative launched in 2000, the Global Compact, is a voluntary network which seeks to promote responsible corporate citizenship. The Global Compact has 10 principles in the areas of human rights, labour, the environment and anti-corruption, which it invites companies to adopt. See www.unglobalcompact.org.

Attempts to create a United Nations statement of companies' obligations to observe human rights have foundered, because it would have gone far beyond the current principle that legal responsibility for observance of human rights rests on governments alone. The statement was to be of 'norms on the responsibilities of transnational corporations and other business enterprises with regard to human rights'. A final draft (E/CN.4/Sub2/2003/12/Rev.2) was adopted by a sub-commission of the United Nations Commission on Human Rights in August 2003. It became clear that governments would not adopt the norms, which were expressed as positive obligations of enterprises. Instead the Secretary-General has been asked to appoint a special representative mandated, among other things, to identify and clarify standards of corporate responsibility and accountability and compile a compendium of best practices (Commission on Human Rights Resolution 2005/69, endorsed by the Economic and Social Council, see Press Release ECOSOC/6174).

0.7 MORALITY, ECONOMICS, DEMOCRACY AND COMPANY LAW

The principal object of this book is to provide an introductory description of the current rules of English company law. Those rules are intended to support and serve the country's economic system, and different views are possible on how law should do this. Some of these differences of opinion reflect differences about the function of law generally.

Law influences human behaviour (a) by prescribing the limits of acceptable behaviour (for example, insider dealing is an offence—see 13.2; using one's position as a company director to make a profit that is not permitted by the company is a breach of fiduciary duty—see 16.5) and (b) by providing for sanctions to punish or deter unacceptable behaviour (a court may fine or imprison an insider dealer; may require a profit made in breach of fiduciary duty to be handed over to the company). Human behaviour is also influenced by moral judgment (which may, for example, limit actions by a human that harm other humans, the actor, or other animals). It is natural to regard moral judgment as a precursor of law. So a Law Lord can say that: 'The law and morality are inextricably interwoven. To a large extent the law is simply formulated and declared morality' (Lord Steyn in *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254 at p. 280). Certainly laws command greatest respect when they reflect moral judgments held almost universally and without substantial objection (for

example, laws punishing murder). But laws are often controversial in areas where a variety of moral views exist, and where the variety continues despite extensive public discussion, for example, on the subjects of abortion, drug use, euthanasia, sexual activity and the uses humans make of other animals. The relationship of morality to law has been particularly illuminated by the work of the legal philosopher H.L.A. Hart, who argued for the autonomy of law and that there are some moral judgments which it is not appropriate to translate into laws. See N. MacCormick, *H.L.A. Hart* (London: Edward Arnold, 1981). In the United Kingdom the theory of Parliamentary sovereignty over law means that we look to the political forum to decide what laws to make in the knowledge of conflicting moral views.

Some legal philosophers have hoped to find a natural law, which would be a law that is a universal requirement of human societal life and which might be found by examining that life and, for some, by revelation from a deity.

Other jurists claim to have found a different underlying principle for law in the neoclassical economics of the Chicago school (so-called because its leading exponents, including Milton Friedman, George Stigler and Ronald Coase, taught at the University of Chicago). Jurists taking that view are usually known as the Chicago law and economics movement. A detailed and sympathetic account of the history of this movement, which nevertheless gives room to the criticism that has been made of it, is in N. Duxbury, *Patterns of American Jurisprudence* (Oxford: Clarendon Press, 1995), ch. 5. The best-known presentation of the movement's views is R.A. Posner, *Economic Analysis of Law*, 6th ed. (New York: Aspen Publishers, 2002).

Chicago neoclassical economics is founded on the assumption that those who undertake economic activity do so for the sole purpose of maximising their wealth and they have both complete knowledge of what has to be done to achieve that and unfettered ability to do it—they are described as rational economic actors. If they undertake their economic activity by freely contracting in a market whose other participants also have the same knowledge and ability (known as a perfect market), it is predicted that productive resources will be acquired by those who use them to produce the greatest wealth, and so the overall wealth of the economy is maximised. It is assumed that freely contracting in markets is the best way of conducting economic activity. To the extent that law and other forms of State regulation are found to distort free contracting in a perfect market (which it is assumed they will do), they are wrong. As Milton Friedman put it in 1974 (quoted in Duxbury, *op. cit.*, p. 366):

In discussions of economic policy, 'Chicago' stands for belief in the efficacy of the free market as a means of organising resources, for scepticism about government intervention into economic affairs, and for emphasis on the quantity of money as a key factor in producing inflation.

The fact that real people do not have the knowledge and ability assumed in the theory (they have what is called bounded rationality) is not thought to affect the value of the theory. It is assumed that real people will want to become more and more like rational economic actors in perfect markets so that they can maximise their wealth. Many who disagree with the law and economics movement are content not to be rational economic actors in perfect markets, which is a profound difference in world views that may explain why supporters and opponents of the theory often do not take each other seriously (D. Millon, 'Communitarians, contractarians and the crisis in corporate law' (1993) 50 Wash and Lee L Rev 1373 at p. 1382). As Posner points out (*Economic Analysis of Law*, 3rd ed. at p. 22), 'The most frequent criticism is that the normative underpinnings of the economic approach are so repulsive that it is inconceivable that the legal system would (let alone should) embrace them'.

Promotion of collective wealth maximisation is proposed in Chicago law and economics apparently despite individual casualties. This is counter to the view of the law as the upholder of each subject's individual rights (see G.J. Stigler, 'Law or economics?' (1992) 35 J Law &

Econ 455). For example, neoclassical economists assert that laws to prevent wage discrimination between workers of different gender or ethnicity prevent wealth maximisation (H. Demsetz, 'Minorities in the market place' (1965) 43 NC L Rev 271, reprinted in *Ownership, Control and the Firm*, vol. 1 (Oxford: Blackwell, 1988), pp. 82–103; R.A. Posner, 'An economic analysis of sex discrimination laws' (1989) 56 U Chi L Rev 1311) and that the economy's wealth would be increased if women could sell their babies (E.M. Landes and R.A. Posner, 'The economics of the baby shortage' (1978) 7 J Legal Stud 323). A theory that leads to these results may look like the antithesis of law rather than a basis for it. Discrimination and baby-selling are illegal because they are disapproved of morally, not because of the effects they are predicted to have by a theory of economics. Proposing that they should be made legal because of a theory of economics supposes that the theory is superior to national moral judgment. Choosing whether to base a nation's laws on moral judgment or economic theory is a political choice.

Part of the problem is that, like much of economics, neoclassical theory is about static equilibrium states, not dynamic changing states: it predicts the ideal final state, but is not much concerned with getting there, or who might get hurt on the way (a point made by, among others, Guido Calabresi in, for example, 'The pointlessness of Pareto: carrying Coase further' (1991) 100 Yale LJ 1211). The most common criticism of the theory is that it maximises the wealth of an economy only for a given distribution of wealth within that economy, which it is not concerned to change. But in reality the present distribution of wealth gives some persons—particularly large companies—overwhelming power over others, so that there is no possibility of free contracting between them, and it is the underprivileged in this situation who require the protection of the law. For discussion of wealth maximisation as a guiding principle of public life see R.M. Dworkin, 'Is wealth a value?' (1980) 9 J Legal Stud 191, J.L. Coleman, 'Efficiency, utility and wealth maximisation' (1980) 8 Hofstra L Rev 509 and R.A. Posner, 'The value of wealth: a comment on Dworkin and Kronman' (1980) 9 J Legal Stud 243.

Supporters of the law and economics movement meet the controversy over its conclusions by claiming that they are arrived at scientifically. They say that their arguments are derived from scientific economics and they claim to have demonstrated the truth of their theory because it correctly predicts rules of common law arrived at before the theory was invented. The congruence of law and economics with common law is a central thesis of Posner. It has been elaborated in the company law context by B.S. Black, 'Is corporate law trivial? A political and economic analysis' (1990) 84 Nw U L Rev 542 and in relation to equity, which is of great significance to company law, by A.J. Duggan, 'Is equity efficient?' (1997) 113 LQR 601. However, in reality there seems to be only a coincidental overlap of common law and Chicago law and economics. There are common law doctrines of which Chicago law and economics disapproves and much of the law desired by Chicago law and economics does not exist. That the overlap is fortuitous is hardly surprising: both the common law and Chicago law and economics arrive at their results by systematic reasoning, but from different premises. Whether the common law should adopt the same premises as Chicago law and economics, and so produce exactly the same results, is an essentially political question. For more on the scientific status of law and economics see G.S. Crespi, 'The mid-life crisis of the law and economics movement: confronting the problems of nonfalsifiability and normative bias' (1991) 67 Notre Dame L Rev 231 (which, incidentally, suggests that law and economics is best characterised as a literary genre); R.C. Downs, 'Law and economics: nexus of science and belief' (1995) 27 Pac LJ 1 (which, incidentally, notes the quasi-religious tone of much of law and economics: a tone that is particularly apparent in the more fundamentalist writings on American corporate law and which is discussed in M.A. Eisenberg, 'New modes of discourse

in the corporate law literature' (1984) 52 *Geo Wash L Rev* 582); G. De Geest, 'The debate on the scientific status of law and economics' (1996) 40 *European Economic Review* 999 (which responds that law and economics is scientific if it is judged by weaker criteria than other sciences).

The fact that some predictions of Chicago law and economics are so obviously controversial shows that the theory cannot be relied on to produce laws to which there will be almost universal agreement and no substantial opposition. There are undoubtedly people who believe in it as a source of law, but equally there are many who do not. In a democratic society the law that will be made in the light of these conflicts of opinion will be the result of a political solution of the conflicts.

Many in the American law and economics movement extend their scepticism of government to scepticism about the political process of legislation, which they see as merely favouring interest groups whose aims they disapprove of, rather than achieving political solutions to the conflict between their aims and those of others. For example, Delaware's success in attracting incorporations is attributed by one author to the fact that its tiny legislature accepts the proposals of the Delaware Bar Association: 'Many of the legislative pressures, which could disrupt the development of corporate law, from environmental groups, unions, and local communities, are not present in Delaware' (D.G. Kaouris, 'Is Delaware still a haven for incorporation?' (1995) 20 *Del J Corp L* 965 at p. 1005).

As companies are so important in economic life the Chicago law and economics movement has paid much attention to company law. The leading text in America is F.H. Easterbrook and D.R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991). This is by two convinced believers in the neoclassical economics of Chicago (where Fischel teaches). As they say in their Preface: '... we take a few economic principles and preach to legislatures and judges about what the law ought to be if it is to promote social welfare' (p. viii). The theory is applied in the context of English company law in B.R. Cheffins, *Company Law: Theory, Structure and Operation* (Oxford: Clarendon Press, 1997). Critics who argue that corporate law should not be captured by Easterbrook and Fischel include L. Johnson, 'Individual and collective sovereignty in the corporate enterprise' (1992) 92 *Colum L Rev* 2215 at p. 2217 and L.E. Mitchell, 'The cult of efficiency' (1992) 71 *Tex L Rev* 217 at p. 219.

In the USA many of the legal scholars who apply Chicago law and economics to company law have adopted from economists the description of a company as a 'nexus of contracts' (see 5.4.3), and such scholars are often called 'contractarians'. The following quotation from H.N. Butler, 'The contractual theory of the corporation' (1989) 11 *Geo Mason U L Rev* 99 at p. 100, explains the contractarian position that corporations should be regarded as created by private contract with which the State must not interfere:

The contractual theory of the corporation is in stark contrast to the legal concept of the corporation as an entity created by the State. The entity theory of the corporation supports State intervention—in the form of either direct regulation or the facilitation of shareholder litigation—in the corporation on the ground that the State created the corporation by granting it a charter. The contractual theory views the corporation as founded in private contract, where the role of the State is limited to enforcing contracts. In this regard, a State charter merely recognises the existence of a 'nexus of contracts' called a corporation. Each contract in the 'nexus of contracts' warrants the same legal and constitutional protections as other legally enforceable contracts. Moreover freedom of contract requires that parties to the 'nexus of contracts' must be allowed to structure their relations as they please.

As explained in 0.3 our view is that the most significant legal feature of incorporation is the creation of an artificial separate personality, and, in English law, this can only be done by grant from the State.

People who have disagreed with the conclusions of the Chicago law and economics analysis of company law have, in the USA, been called 'communitarians' (M.E. DeBow and D.R. Lee, 'Shareholders, nonshareholders and corporate law: communitarianism and resource allocation' (1993) 18 Del J Corp L 393). This has been accepted by a leading critic of that analysis (D. Millon, 'Communitarians, contractarians and the crisis in corporate law' (1993) 50 Wash and Lee L Rev 1373 at p. 1378), but it implies (and was perhaps intended to imply) that the only people who disagree with the analysis are those who adopt the political philosophy of communitarianism, which is not the case. Two articles which place arguments over the economic approach to company law into the context of a very long history of opposed political values are F.R. Kaen, A. Kaufman and L. Zacharias, 'American political values and agency theory: a perspective' (1988) 7 J Bus Ethics 805; P.N. Cox 'The public, the private and the corporation' (1997) 80 Marq L Rev 391.

1

REGISTRATION

1.1 INTRODUCTION

The Companies Act 1985 provides for the incorporation of companies by a simple process of registration which is described in this chapter. The companies thus incorporated are known as ‘registered companies’. Registration under the Companies Act 1985 makes readily available the benefits of separate corporate personality which were described in 0.3.1. However, it does not confer on the members of a registered company the benefit of not being liable for the company’s debts. Instead the Act offers the choice of unlimited liability (adopted by very few companies) or limited liability (adopted by nearly all companies)—see 1.3.2.

1.2 PROCEDURE

For the effect of the CLRB on the law discussed in 1.2 see 1.2.4.

1.2.1 FORMATION AND REGISTRATION UNDER THE COMPANIES ACT 1985

1.2.1.1 Delivery of documents to Companies House

To create a new registered company it is necessary to prepare and sign a set of documents and deliver them to a registrar of companies. If a new company is to be governed by the law of England and Wales then the documents must be delivered to the registrar of companies in England and Wales, whose office is at Crown Way, Cardiff CF14 3UZ. The registrar is chief executive of a government agency called Companies House. The documents for a new company which is to be governed by the law of Scotland must be delivered to the registrar of companies for Scotland, whose office is at 37 Castle Terrace, Edinburgh EH1 2EB.

Companies House is an executive agency of the Department of Trade Industry. An executive agency is a distinct part of a government department with its own budget. Companies House is funded entirely by the fees it charges, which include fees for registering new companies (see 1.2.1.7), changes of companies’ names (see 2.4.2), annual returns (see 4.6) and charges on companies’ property (see 11.7.2), and fees for allowing inspection of all this information and providing copies (see 4.2.2.1). Information about Companies House, including details of the procedure for registering new companies, is available at its website, www.companieshouse.gov.uk, and in its magazine, *Register*.

As will be explained in 1.3, several different types of company can be registered. The contents of the documents that have to be delivered for registration depend on the type of company being registered. The two most important types are the public company limited by

shares (the plc) and the private company limited by shares. (The public can be invited to invest in the shares of a public company but not in the shares of a private company.)

The documents which are required to be filed in order to register a new company provide the following basic information:

- (a) The company's name and the location of a place (called the registered office) where documents can be served on the company.
- (b) The type of company (public or private, limited or unlimited, with or without a share capital—see 1.3).
- (c) The objects which the company is formed to pursue.
- (d) The company's constitution.
- (e) The names of the company's first member(s), director(s) and secretary.
- (f) The proposed capital of the company (no capital need be contributed at the time of registration).

The required documents are:

- (a) The company's constitution contained in two documents called the memorandum of association (see 1.2.1.2) and the articles of association (see 1.2.1.4).
- (b) A statement naming, and giving other details of, the company's first director (or directors) and secretary, and giving the address of its registered office.
- (c) A statement that all requirements of the CA 1985 in respect of registration have been complied with.

1.2.1.2 Memorandum of association and subscribers

The memorandum of association of a company states what the company's name will be (it may be necessary to check before registering that there will be no objection to the name: see 2.3.3.6), states the objects which the company has been formed to pursue, names the company's first member or members, and gives some other basic details depending on the type of company being registered. The contents of the memorandum will be considered in depth in chapter 2.

A company's memorandum must be signed by one or more persons who are called 'subscribers'. If the company is to be a private company limited by shares (or a private company limited by guarantee, a comparatively little used type of company which will be described in 1.3), only one subscriber is required. The memorandum of a public company limited by shares or any other type of company must have at least two subscribers. There is no upper limit to the number of subscribers.

The subscribers of a company's memorandum will be the company's first members when it is registered (CA 1985, s. 22(1)). They are the persons who wish to be associated together as members of the company, which is why the document they sign is called a memorandum of association, though it is possible for the association to have only one member.

Each subscriber must sign the memorandum in the presence of at least one witness, who must attest the signature (s. 2(6)). An alternative form of authentication is used in electronic incorporation (s. 2(6A)).

The fundamental principle that a company can be created by registration of a memorandum of association is enshrined in the first section of the CA 1985 as amended by SI 1992/1699:

- (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. . . .

(3A) Notwithstanding subsection (1), one person may, for a lawful purpose, by subscribing his name to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company being a private company limited by shares or by guarantee.

1.2.1.3 Who may be a subscriber

The subscribers of a memorandum of association may be foreigners: there is no requirement that the subscribers be domiciled in the part of Great Britain in which the company is to be registered (*Princess of Reuss v Bos* (1871) LR 5 HL 176). But an association which is already completely constituted as a partnership or a corporation under another legal system cannot be registered as a company under CA 1985 (*Bulkeley v Schutz* (1871) LR 3 PC 764). In particular, a company already registered in Scotland cannot register in England and Wales or vice versa (see *Bateman v Service* (1881) 6 App Cas 386 on the inability of a company registered in one state of Australia to register in another).

Signature of a memorandum by a minor is valid unless the minor has repudiated the signature before registration (*Re Nassau Phosphate Co.* (1876) 2 ChD 610; *Re Laxon and Co.* (No. 2) [1892] 3 Ch 555).

1.2.1.4 Articles of association

Articles of association set out the internal regulations of a company (see chapter 3).

When registering a private or public company limited by shares, articles of association need not be registered if the company is to use the standard set of articles known as Table A which has been promulgated by the Secretary of State—see 3.2.1—but in practice it is usual to register articles drawn up specifically for the company. If articles are registered, each subscriber of the memorandum must sign them in the presence of at least one witness, who must attest the signature (s. 7(3)(c)). An alternative form of authentication is used in electronic incorporation (s. 7(3A)).

1.2.1.5 Statement of first directors and secretary

When registering a new company, Companies House must be given a statement naming the company's first directors, and giving their addresses and other details about them (CA 1985, s. 10(2) and sch. 1; see 15.7.2), naming, and giving the address of, the company's first secretary (s. 10(2) and sch. 1; see 17.3.2), and stating the intended situation of the company's registered office (s. 10(6); see 2.3.4). This statement must be signed by or on behalf of the subscribers and must contain a consent to act by each of the persons named as director or secretary (s. 10(3)), which must be signed by each of them (SI 1995/736, sch. 2, form 10).

1.2.1.6 Declaration of compliance

When registering a new company, Companies House must be given a statutory declaration that all the requirements of CA 1985 in respect of registration, and all matters precedent and incidental to it, have been complied with (s. 12(3)). The declaration must be made by either (a) a solicitor engaged in the formation of the company, or (b) a person named as a director or secretary of the company in the statement delivered under s. 10(2) (see 1.2.1.5). The requirements of CA 1985 in respect of registration appear to be the requirements in s. 10 to deliver the memorandum, articles, and statement of first directors and secretary, and the requirements concerning the form, content and signature of those documents. The reference to 'matters precedent and incidental' seems to superfluous. In an electronic incorporation

(see 1.2.1.8) only an electronic statement of compliance is required, without a statutory declaration (s. 12(3A)).

1.2.1.7 Fee

A fee of £20 is payable for the registration of a company non-electronically (SI 2004/2621, sch. 4, fee 1(b)(i)). Registration normally takes five working days. For £50 registration will be completed on the same day if documents are presented before 3 p.m. and there is no problem with the company's name (SI 2004/2621, sch. 4, fee 1(b)(ii)). For electronic filing see 1.2.1.8.

1.2.1.8 Electronic incorporation

It is possible to incorporate a company by electronic filing. Currently electronic incorporation can be carried out only by bulk users (see 1.2.2) who have specialist software. It is expected that an Internet incorporation facility will be generally available from January 2007. The registrar may direct the method of authentication to be used, in place of attested signatures, for memoranda and articles delivered for electronic incorporation (CA 1985, ss. 2(6A) and 7(3A)). The registrar may direct the method of authentication to be used, in place of attested signatures, for a memorandum delivered for electronic incorporation (CA 1985, s. 2(6A)). In an electronic incorporation a statutory declaration of compliance with the requirements of CA 1985 may be replaced by a statement delivered using electronic communications (s. 12(3A), see 14.6.5) and s. 12(3B) provides that it is an offence to make a false statement. The fee for electronic registration is £15 (SI 2004/2621, sch. 4, fee 1(a)(i)) or £30 for same-day service (fee 1(a)(ii)).

1.2.1.9 Registration; certificate of incorporation

Companies House must retain and register the memorandum and articles, if any, if the registrar is satisfied that 'all the requirements of [CA 1985] in respect of registration and of matters precedent and incidental to it have been complied with' (s. 12(1) and (2)), though the registrar is entitled to rely on the statutory declaration that all these requirements have been met (s. 12(3)).

On registering a company's memorandum, Companies House must allocate to the company a number, called its 'registered number' (s. 705), and must give a certificate that the company is incorporated (s. 13(1)). Such a certificate of incorporation is conclusive evidence that all the requirements of registration have been complied with, and that the company is duly registered (s. 13(7)). The certificate of incorporation of a limited company must state that it is limited (s. 13(1)). The certificate of incorporation of a public company must state that it is public (s. 13(6)) and if it does so, it is conclusive evidence of that fact (s. 13(7)).

Companies House will publish in the *Gazette* a notice of the issue of a certificate of incorporation (s. 711(1)(a)). It puts on the certificate the company's date of incorporation and the company is a body corporate from that date (s. 13(3)), which means from the first moment of that day (*Jubilee Cotton Mills Ltd v Lewis* [1924] AC 958). A registered company exists as from the date of its incorporation as recorded on its certificate of incorporation without any further formalities and regardless of whether it undertakes any business. There is no need for a meeting of members or directors to ratify its incorporation.

1.2.1.10 Lawful purpose of registration

CA 1985 only provides for the registration of companies formed 'for a lawful purpose' (s. 1(1) and (3A)) so Companies House is entitled to refuse to register a company formed for a purpose that is not lawful. In addition, a trade union must not be registered as a company (Trade Union and Labour Relations (Consolidation) Act 1992, s. 10(3), repeating provisions

made in earlier trade union legislation). The latter provision has caused problems: see M.A. Hickling, 'Trade unions in disguise' (1964) 27 MLR 625; R.R. Drury, 'Nullity of companies in English law' (1985) 48 MLR 644.

A refusal by Companies House to register a company is subject to judicial review. For example, in *R v Registrar of Joint Stock Companies, ex parte More* [1931] 2 KB 197 the registrar refused to register a company because its main object was stated to be to sell in Great Britain tickets in a lottery (popularly known as the Irish Sweep) run in what was then the Irish Free State. The promoters of the company sought judicial review of this decision. The Court of Appeal held that selling such tickets in England would have been an offence under statutes then in force (it would now be an offence under the Lotteries and Amusements Act 1976, s. 2) so that the registrar was right to refuse to register the company, which was not formed 'for a lawful purpose'. (The Irish Sweep has been discontinued.)

In *R v Registrar of Companies, ex parte Bowen* [1914] 3 KB 1161 the court held that the registrar's refusal to register a company had been wrong: the registrar had doubted that the company's name, 'The United Dental Service Ltd', was legal because of statutory restrictions on advertising oneself as a qualified dental practitioner; however, the court held that the name was legal. There is now a procedure for vetting some company names before registration and if Mr Bowen were registering The United Dental Service Ltd today he would have to go through that procedure—see 2.3.3.6. Since 1914, further controls on dentistry have been enacted. Mr Bowen formed his company to carry on the business of dentistry. It would not now be lawful to form a company for that purpose because of the Dentists Act 1984, s. 42.

Requiring something to be 'lawful' gives the courts the opportunity to exclude things not only because they constitute criminal offences or civil wrongs, but also because they offend against a wider moral code, especially in sexual matters. So, although trading as a prostitute is not a criminal offence, and the profits of the trade are subject to income tax (*Commissioners of Inland Revenue v Aken* [1990] 1 WLR 1374), to carry on the business of prostitution is not a lawful purpose for which a company may be registered (*R v Registrar of Companies, ex parte Attorney-General* [1991] BCLC 476).

A positive decision by Companies House to register a company is less amenable to judicial review than a refusal to register, because the applicant in the review proceedings would have to present evidence to the court that the provisions of CA 1985 in respect of registration had not been complied with, whereas the certificate of incorporation is conclusive evidence that they have been complied with (CA 1985, s. 13(7)). Accordingly the court cannot hear any application for review of a decision to register a company unless the applicant is the Attorney-General, whose evidence the court must hear because s. 13(7) does not bind the Crown (per Lord Parker of Waddington in *Bowman v Secular Society Ltd* [1917] AC 406 at pp. 438–40 and in *Cotman v Brougham* [1918] AC 514 at p. 519; *R v Registrar of Companies, ex parte Central Bank of India* [1986] QB 1114). It is important for persons who deal with a company to be confident that the company's existence cannot easily be challenged. The Attorney-General's power to ask for reversal of a decision to register a company was used in *R v Registrar of Companies, ex parte Attorney-General* [1991] BCLC 476.

Provided the fact of its incorporation is not questioned, the legality of the objects of a company may be questioned in legal proceedings and its certificate of incorporation is not conclusive that they are legal (*Bowman v Secular Society Ltd*).

1.2.2 COMPANIES OFF THE SHELF

The preparation of documents for the registration of a new company requires careful consideration and specialist knowledge of company law and procedures. Enterprises exist

which specialise in company formation. It has been estimated that they are responsible for approximately 60 per cent of company registrations (Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (London: DTI, 2000), para. 11.32). As well as registering companies in response to specific customer requirements, company registration agents register a large number of companies and hold them ready for sale to anyone who wants a new company. This kind of company is called an 'off-the-shelf' or a 'shelf' or a 'ready-made' company. A shelf company is registered with persons associated with the company-formation enterprise as its subscribers (i.e., first members), its first director and first secretary. The subscribers take one share each. The company can then be sold to a customer of the enterprise by transferring its two shares to two persons nominated by the customer, at which point the first director and secretary resign and report their resignations to Companies House.

British shelf companies are remarkably cheap (as low as £45) and buying one is a very simple and quick process. According to A. Hicks, R. Drury and J. Smallcombe, *Alternative Company Structures for the Small Business* (London: Certified Accountants Educational Trust, 1995), in other European countries shelf companies are not available and persons wishing to incorporate have to employ legal advisers at about 10 times the cost of a British company. An important disadvantage of a shelf company is that its constitution will not be specially designed for the needs of its purchasers who will be unlikely to care about the deficiencies until it is too late. This is a shame because one of the great advantages of the company form is that members can have whatever constitution suits them best, if they are willing to spend time (and money) finding out what they need. Hicks et al. also think that cheap shelf companies make limited liability too freely available.

1.2.3 COMPANIES FORMED AND REGISTERED UNDER THE FORMER COMPANIES ACTS

Before 1 July 1985, companies were registered under the Companies Act 1948, which came into force on 1 July 1948.

From 1 November 1929 to 30 June 1948, companies could be registered under the Companies Act 1929.

From 1 April 1909 to 31 October 1929, companies could be registered under the Companies (Consolidation) Act 1908.

From 2 November 1862 to 31 March 1909, companies could be registered under the Companies Act 1862.

From 14 July 1856 to 1 November 1862, companies could be registered under the Joint Stock Companies Act 1856, though, by virtue of s. 2 of the 1856 Act, banking companies could not register until the Joint Stock Banking Companies Act 1857 came into force, and insurance companies never could register under the 1856 Act (they were allowed to register under the Companies Act 1862 and subsequent Acts). Insurance companies were excluded from the 1856 Act so as to prevent them being registered with limited liability (see 1.3.2.6).

The Acts from 1856 to 1948 are referred to in CA 1985 as 'the former Companies Acts'. A company formed and registered in England and Wales or Scotland under any of these earlier Acts, and not since dissolved, is called an 'existing company' and is governed by CA 1985 as if registered under that Act (CA 1985, s. 675). However, companies registered in Ireland under the 1908 Act or any of its predecessors are not 'existing companies' for the purposes of CA 1985 and so are not governed by it (CA 1985, s. 735(1)(b); similarly CA 1929 and CA 1948 did not apply to Irish companies).

The first Act enabling incorporation of companies by registration was the Joint Stock

Companies Act 1844, which permitted registration as from 1 November 1844 (though it did not apply in Scotland). The system under the 1844 Act was very different from that under the 1856 Act and its successors. Accordingly, all companies registered under the 1844 Act were required to re-register under the 1856 Act on or before 3 November 1856 (Joint Stock Companies Act 1856, s. 110), though this was later extended to 2 November 1857 by the Joint Stock Companies Act 1857, ss. 25 to 27. Insurance companies registered under the 1844 Act were excluded from re-registering under the 1856 Act but were required to re-register under the 1862 Act. Banking companies were not allowed to register under the 1844 Act, and the Joint Stock Banks Act 1844 prevented any association of more than six persons setting up a banking business without obtaining a royal charter of incorporation under the Act.

1.2.4 EFFECT OF THE CLRB

The changes in the registration process proposed by the CLRB result mainly from the proposal that the constitution of a company should be contained in a single document, the articles of association, instead of being split into two (memorandum and articles) (see 1.2.1.1). Some of the information currently required to be in the memorandum (the company's objects and authorised capital) will not be required to be given in the constitution at all. Other information which is currently given in the memorandum is very important for understanding what kind of company is being created, so the CLRB proposes that the information should instead be given in a new document to be filed on incorporation, called an application for registration, and in statements to be filed with the application.

A company's memorandum of association will no longer be a part of its constitution (CLRB, cl. 17). It will merely be a statement that the subscribers intend to form a company and be its first members and take at least one share each (if the company is to have a share capital) (cl. 8(1)). The constitutional provisions presently required to be in the memorandum will instead be in the articles of association. There will no longer be an obligation to state the objects of a company, but the ban on registering a company for an unlawful purpose (see 1.2.1.10) will continue (cl. 7(2)).

Only one founder member will be required for any type of company and so only one subscriber is required for any memorandum of association (cl. 7(1); see 1.2.1.2).

A new filing document will be required, called an application for registration (cl. 9). This will give some of the information presently required to be in the memorandum of association:

- (a) the company's proposed name;
- (b) the part of the United Kingdom in which its registered office is to be situated (see 2.3.4);
- (c) whether members are to have limited liability and, if they are, whether it is to be limited by shares or by guarantee (see 1.3.1 and 1.3.2);
- (d) whether the company is to be a public or a private company (see 1.3.3).

If the company is to have a share capital, a statement of capital and initial shareholdings (cl. 10) will have to be filed with the application for registration (cl. 9(4)(a)).

The statement of capital section of the statement of capital and initial shareholdings will have to give the following details of the share capital to be taken on formation by the subscribers to the memorandum (cl. 10(2)):

- (a) the total number of shares of the company to be taken on formation by the subscribers,

- (b) the aggregate nominal value of those shares,
- (c) for each class of shares:
 - (i) prescribed particulars of the rights attached to the shares,
 - (ii) the total number of shares of that class, and
 - (iii) the aggregate nominal value of shares of that class, and
- (d) the amount to be paid up and the amount (if any) to be unpaid on each share (whether on account of the nominal value of the share or by way of premium).

A limited company will have to file a new statement of capital updating this information every time it allots shares (cl. 545; see 6.2.7).

The statement of initial shareholdings section will state:

- (a) such information as may be prescribed for the purpose of identifying each of the subscribers to the memorandum (cl. 10(3));
- (b) the number, nominal value and class of the shares each subscriber will take on formation of the company (cl. 10(4)(a))—as at present (CA 1985, s. 2(5)(b)), each subscriber must take at least one share (CLRB, cl. 8(1)(b));
- (c) the amount to be paid up and the amount, if any, to be unpaid on each share (whether on account of nominal value or by way of premium) (cl. 10(4)(b)).

When applying for the registration of a company limited by guarantee a statement of guarantee will have to be filed (ccl. 9(4)(b) and 11).

Only public companies will be required to appoint a secretary and so only a public company will be required to state the name of its first secretary (cl. 12(1)(b)).

The declaration of compliance (see 1.2.1.6) will be renamed ‘statement of compliance’ and will not be required to be a statutory declaration, whether or not the company is being registered electronically (cl. 13). It will no longer be required to state compliance with matters precedent and incidental to registration.

In addition to the information currently given by a certificate of incorporation (see 1.2.1.9), CLRB, cl. 15(2), will require it to state whether the company’s registered office is to be situated in England and Wales, Wales, Scotland or Northern Ireland, and, for a limited company, whether the limitation is by shares or by guarantee. This information will be taken from the application for registration.

A company whose articles of association, on formation, contain a provision for entrenchment (see 3.6.3) will have to give notice to Companies House (cl. 23(1)). When this notice has to be given is not specified, but it cannot be given on application for registration, because it has to be given by ‘the company’ and the company does not exist until it has been registered.

1.3 CLASSIFICATION OF COMPANIES

1.3.1 INTRODUCTION

CA 1985 provides for the registration of five different types of company. The wording of the documents which have to be delivered to Companies House on the registration of a company depends on which type of company it is and so it is necessary to choose which type a company is to be before registering it. There are provisions for re-registration so that a company can be changed from one type to another, though there are certain changes that are not possible by re-registration—see 1.4.

There are three characteristics of a company which determine which type it is:

- (a) Whether the members have limited or unlimited liability (see 1.3.2).
- (b) Whether the company is public or private (see 1.3.3). The classification of companies into public and private was altered on 22 December 1980. Companies whose members have unlimited liability can now only be private companies.
- (c) Whether the company does or does not have a share capital (see 1.3.2). A company without a share capital must be a private company.

This means that the following kinds of new company may now be registered:

- (a) Public limited company (plc) with share capital.
- (b) Private limited company with share capital (by far the most numerous type).
- (c) Private limited company without share capital (called a 'company limited by guarantee' or 'guarantee company').
- (d) Private unlimited company with share capital.
- (e) Private unlimited company without share capital.

The features which have proved most popular have been limited liability and the capacity to have a share capital—see 1.3.2. Both features are particularly attractive to business enterprises. The share capital of a company is capital contributed by members (shareholders) for use in the company's operations. The distinction between public and private companies is that a public company may invite the public generally to contribute to its share capital whereas a private company cannot (see 1.3.3.1).

Guarantee and unlimited companies have been found appropriate for some specialised uses but the limited company with share capital is by far the most common form of company and this book will hardly mention other kinds of company.

Under part 2 (ss. 26 to 63) of the Companies (Audit, Investigations and Community Enterprise) Act 2004 (which came into force on 1 July 2005), it is possible to register any type of limited company as a community interest company (cic). The registration of a cic cannot go ahead until approved by the Regulator of Community Interest Companies (s. 36), who must be satisfied that the company will satisfy the 'community interest test' and is not an excluded company (s. 36(5)(b)). A company satisfies the community interest test if a reasonable person might consider that its activities are being carried on for the benefit of the community (s. 35(2)). Excluded companies, which cannot be registered as cics, are companies which are, or would be when formed, a political party or political campaigning organisation, or a subsidiary of such a party or organisation (SI 2005/1788, reg. 6). Cics are subject to limitations on the dividends which they may pay their members. The 100th cic was registered on 27 January 2006. See www.cicregulator.gov.uk.

1.3.2 LIMITED OR UNLIMITED COMPANIES AND SHARE CAPITAL

For the effect of the CLRB on the law discussed in 1.3.2 see 1.3.2.10.

1.3.2.1 Liability of company members

The opening provision of the CA 1985 (s. 1(1)) allows incorporation 'with or without limited liability'. Almost all registered companies are incorporated with limited liability. A registered company with limited liability is called a 'limited company' and a registered company without limited liability is called an 'unlimited company'.

The principle of separate personality of a body corporate such as a registered company means that its members are not responsible for its debts unless they are made responsible by statute or by the constitution of the corporation (*Re Sheffield and South Yorkshire Permanent Building Society* (1889) 22 QBD 470 per Cave J at p. 476).

Liability for the debts of a registered company is imposed on its members by statute. However, except in the rare circumstances in which CA 1985, s. 24, applies (see 1.3.2.7), the statutory provisions do not make the members directly responsible to the company's creditors, that is, a creditor cannot sue the members personally: as Lord Cranworth said in *Oakes v Turquand and Harding* (1867) LR 2 HL 325 at p. 357:

There is no doubt that the direct remedy of a creditor is solely against the incorporated company. He has no dealing with any individual shareholder, and if he is driven to bring any action to enforce any right he may have acquired, he must sue the company, and not any of the members of whom it is composed.

Instead of being made directly liable to creditors of the company, the members are made liable by statute if, but only if, the company is wound up (CA 1985, s. 13(4)), and their liability then is *to the company as a separate person*, and is a liability to contribute money for the payment of the company's debts and liabilities, and settling its affairs (Insolvency Act 1986, s. 74(1)).

In an unlimited company, the liability of members at this point is unlimited. Only a very small proportion of registered companies are unlimited companies and they will be almost completely ignored in this book.

The vast majority of companies are limited companies. In a limited company the members' liability when the company is wound up is limited to a fixed amount agreed with the company when they became members: the fixed amount being either an amount payable on shares or an amount payable by guarantee (Insolvency Act 1986, s. 74(2)(d) and (3)). When drawing up the memorandum of association of a limited company for registration, a choice must be made between making the members liable on shares (CA 1985, s. 1(2)(a); Insolvency Act 1986, s. 74(2)(d)) or by guarantee (CA 1985, s. 1(2)(b); Insolvency Act 1986, s. 74(3)). Almost all limited companies are limited by shares.

The memorandum of a company limited by shares or by guarantee must state that the liability of its members is limited (CA 1985, s. 2(3)). The certificate of incorporation of a limited company must state that it is limited (s. 13(1)).

The difference between limitation by guarantee and limitation by shares is that in a guarantee company, the limited amount that the members are liable to pay is payable only on the winding up of the company (s. 2(4)) whereas in a company limited by shares it is expected that part at least of the payment will be made while the company is a going concern and will form the contributed capital of the company (known as its 'share capital'). In practice, nowadays, in a company limited by shares, the whole amount that the members are liable to pay is paid as contributed capital while the company is a going concern so that the members have no further liability on winding up. The creditors of a company limited by shares have to bear the risk that its capital contributed while it is a going concern may be lost in trading before it is wound up.

The position is, then, that in the statute permitting incorporation of companies by registration, Parliament has insisted that members of a registered company must be liable to contribute to its assets, but it permits that liability to be limited.

In relation to companies the terms 'limited' and 'unlimited' refer to the liability of the companies' members, not the liability of the companies as separate persons. Saying that a person has liability for an obligation does not mean that the person will actually meet the

obligation in practice: a person who has run out of money cannot meet any liabilities. A limited company as a separate person has unlimited liability to pay all its debts and can be forced to pay them until it runs out of money: but if it is wound up, its members have only limited liability to contribute further money for the payment of those debts—they cannot be required to pay more than the limit on their liability.

1.3.2.2 Companies limited by shares

The liability of members of a company limited by shares is based on the company having a 'share capital' and the members taking 'shares' issued to them by the company. Each share is assigned a 'nominal value' or 'par value' and is described in CA 1985, s. 2(5)(a), as a share 'of a fixed amount'. The nominal value of a share in a company is a sum of money that must be paid on it to the company (though, when a share is issued, the company and the person to whom it is issued may agree that an additional amount, called a 'share premium', is to be paid).

The memorandum of a company limited by shares must state a total nominal value for the shares it may issue: this is described as 'the amount of the share capital with which the company proposes to be registered' (s. 2(5)(a)) and so is known as the 'registered capital' (it is also known as the 'authorised share capital' or the 'nominal capital'). The memorandum must also state the number of shares and the nominal value of each share.

For example, Textbook Examples Co. Ltd could state in its memorandum of association, 'The company's share capital is £10,000 divided into 20,000 shares of 50p each'. Its registered capital would be £10,000; the nominal value of each share would be 50p.

The Insolvency Act 1986, s. 74(2)(d), provides that 'in the case of a company limited by shares, no contribution is required [when the company is wound up] from any member exceeding the amount (if any) unpaid on the shares in respect of which he is liable'. This means the amount of the *nominal value* of the shares that has not been paid (*Ooregum Gold Mining Co. of India Ltd v Roper* [1892] AC 125 per Lord Watson at p. 136), and a limited company cannot agree with its members that they may pay less than the nominal value of their shares (*Ooregum Gold Mining Co. of India Ltd v Roper*; CA 1985, s. 100). The liability of a member under the Insolvency Act 1986, s. 74(2)(d), to pay whatever is unpaid of the nominal value of shares is a statutory liability (*Hansraj Gupta v Asthana* (1932) LR 60 Ind App 1) but it does not extend to share premium, which is a matter for contract between the member and the company (*Niemann v Smedley* [1973] VR 769; *Re Vedelago* (1992) 8 ACSR 135).

A member of Textbook Examples Co. Ltd would have to contribute to the company's capital at least 50p for each of its shares. There could be a separate agreement between the company and a member that the member would pay, say, an extra £1 for each share, which would be a share premium and would reflect the investment value of the shares at the time of taking them. If when Textbook Examples Co. Ltd is wound up a member has contributed, say, only 30p for each 50p share held, the member can be required to pay the remaining 20p per share in order to pay the company's debts and liabilities.

It is usual nowadays for an undertaking to contribute capital for shares to be fulfilled at the time when the shares are issued. When all the capital represented by a share has been contributed the share is said to be fully paid. In the 19th century it was common for only part of the nominal value of a share to be contributed on issue, leaving the company with the right to make a call for the remainder when it required more capital. Shares for which some of the capital has not been contributed are said to be partly paid.

For the first 20 years or so after registration of companies was introduced in 1844, it was thought to be essential to a company's creditworthiness that its shares should be partly paid.

Shareholders were usually wealthy individuals who were known in the commercial world. The list of members of a company is available for public inspection and the presence on the list of well-known individuals of substantial means who still had a large liability to contribute to the assets of the company was thought to be a good way of encouraging traders to grant it credit. Accordingly companies typically had shares with nominal values of £10 to £100 on which only a small amount was paid up, leaving a potentially huge liability for some shareholders. More than 30 companies in this period had shares of £1,000 or more.

The disadvantage for companies of partly paid shares was that there were very few investors wealthy enough to be able to meet the liabilities on their shares and they would only invest in companies if they knew the directors personally and could keep a close watch on the companies they were liable for.

Investors became alarmed at the large amounts they had to pay up during the financial crisis of 1866–7 and the depression years of 1873–86. They realised that, in effect, they were not benefiting from limited liability. Equally, companies realised that there were many middle-class, small-scale investors who would be willing to invest in company shares if they could have effective limited liability. Accordingly, during the 1880s it became normal for company shares to be fully paid £1 shares. For a more detailed history see J.B. Jefferys, 'The denomination and character of shares, 1855–1885' in *Essays in Economic History*, ed. E.M. Carus-Wilson (London: Edward Arnold, 1954), pp. 344–57.

The Companies Act 1985, s. 1(2)(a), describes a company limited by shares as being 'a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them'. In practice it is unnecessary for the memorandum to make this statement explicitly (see the prescribed forms of memorandum discussed in 2.3.2). It is sufficient that the memorandum contains both the statement that the liability of members is limited, which is required by s. 2(3), and the statement of the registered capital required by s. 2(5). The limitation is achieved by the operation of the Insolvency Act 1986, s. 74(2)(d).

Each subscriber of the memorandum of a company limited by shares must take at least one share (CA 1985, s. 2(5)(b)) and the number of shares to be taken by each subscriber must be stated in the memorandum (s. 2(5)(c)). There must be at least one subscriber (s. 1(1) and (3A)), who is deemed to be a member of the company on its registration (s. 22(1)). These rules ensure that in any company limited by shares there is at least one share on which a payment must be made to the company by a member.

A person holding shares in a company limited by shares knows that liability to contribute to the assets of the company in respect of the shares is limited to a certain amount which the member has agreed with the company. Parliament has not put any restrictions on what that amount must be, apart from a rule that in a *public limited company* the *total liability of all the members* must be at least the 'authorised minimum' (s. 11), which is currently £50,000 (s. 118). In private limited companies, it is common for the total liability of members to be a trivial amount, typically £1.

Nominal values of shares and authorised share capitals have to be stated in monetary terms but not necessarily in sterling (*Re Scandinavian Bank Group plc* [1988] Ch 87; *Re Anglo-American Insurance Co. Ltd* [1991] BCLC 564). The nominal value of a share may be an amount such as $\frac{1}{2}$ p which cannot be paid in legal tender (*Re Scandinavian Bank Group plc* at pp. 99–100; *Re Australian Pacific Technology Ltd* [1995] 1 VR 457, in which the court approved the issue of shares with a nominal value of 0.01 cent each).

Almost all registered companies are companies limited by shares and in the rest of this book the term 'company' without further qualification will be used to mean a registered company limited by shares.

1.3.2.3 Companies limited by guarantee

The liability of a member of a company limited by guarantee is based on an undertaking stated in the memorandum (CA 1985, s. 2(4)) to contribute, on the winding up of the company, an amount not exceeding a sum specified in the memorandum. The contribution is to be made for the payment of the debts and liabilities of the company, and of the costs, charges and expenses of winding up and for the adjustment of the rights of the contributories among themselves. The Insolvency Act 1986, s. 74(3), confirms that in the case of a guarantee company, 'no contribution is required [when the company is wound up] from any member exceeding the amount undertaken to be contributed by him to the company's assets in the event of its being wound up'. CA 1985, s. 1(2)(b), describes a company limited by guarantee as being 'a company having the liability of its members limited by the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up'. This statement has to be made explicitly in a 'guarantee clause' in the company's memorandum (s. 2(4)).

The limit on the liability of a member of a company limited by guarantee is the amount specified in the guarantee clause of the memorandum.

The total amount that members of a guarantee company are liable to contribute under its guarantee clause is sometimes called the company's 'guarantee fund'. A guarantee company does not have any contributed capital while it is a going concern—the guarantee fund comes into existence only when the company is wound up—and this is usually considered inappropriate for a business enterprise. Accordingly, guarantee companies are usually formed only to undertake charitable objects or to carry on some non-commercial undertaking. Only a very small proportion of registered companies are guarantee companies and so, like unlimited companies, they will hardly ever be mentioned again in this book.

A member of a company limited by guarantee knows that liability to contribute to the assets of the company under the guarantee is limited to a certain amount which the member has agreed with the company. Parliament has not put any restrictions on what that amount must be, and in practice it is usually nominal—typically it is £1.

1.3.2.4 Collateral liability

Parliament has insisted that every limited company must require each of its members to pay up to a fixed amount to the company on shares or under guarantee, but there must be a certain maximum amount—a company may be able to obtain a share premium when a member joins (see 1.3.2.2) but it cannot make the amount payable on its shares or under guarantee variable at its option: this is the essence of limited liability. This is emphasised by CA 1985, s. 16, which provides that a member of a company is not bound by any change in the company's memorandum or articles which requires the member to take or subscribe for more shares or in any way increases the member's liability to contribute to the company's share capital or otherwise pay money to the company, unless (by s. 16(2)) the member gives express written agreement to be bound.

In some English cases the court has accepted that it is possible for the memorandum or articles of association of a limited company to impose on its members a collateral liability to pay money to the company otherwise than on shares held or under guarantee. Examples are *Peninsular Co. Ltd v Fleming* (1872) 27 LT 93, in which the collateral liability was to lend money to the company; and *Lion Mutual Marine Insurance Association Ltd v Tucker* (1883) 12 QBD 176 and *Re Bangor and North Wales Mutual Marine Protection Association, Baird's Case* [1899] 2 Ch 593, in both of which the collateral liability was to contribute to a fund for insuring the marine losses of members of the company. In *Galloway v Hallé Concerts Society*

[1915] 2 Ch 233, each member had a collateral liability to contribute to the society (which was a guarantee company) such sum as the committee (equivalent to a board of directors) might determine, not exceeding in the aggregate £100: it was held that the directors could not call for different contributions from different members because of a general rule of law that members of a company must be treated equally.

In some cases in the Commonwealth it has been asserted that even a collateral liability offends against the principle of limited liability and so cannot be imposed (for example, Salmond J in *Shalfoon v Cheddar Valley Cooperative Dairy Co. Ltd* [1924] NZLR 561 at p. 577; *Edmonton Country Club Ltd v Case* (1974) 44 DLR (3d) 554). In England, the question has been debated in the somewhat obscure context of societies incorporated by registration under the industrial and provident societies legislation. Members of such societies have limited liability (limited by shares) in the same form as members of limited registered companies. In *Dibble v Wilts and Somerset Farmers Ltd* [1923] 1 Ch 342, P.O. Lawrence J held that such a society could not impose a collateral liability (and Salmond J in *Shalfoon v Cheddar Valley Cooperative Dairy Co. Ltd* cited that case in support of his view). However, in *Agricultural Wholesale Society Ltd v Biddulph and District Agricultural Society Ltd* [1925] Ch 769, the Court of Appeal held that P.O. Lawrence J had been wrong, and the Court of Appeal's view was confirmed by the House of Lords in *Hole v Garnsey* [1930] AC 472; see especially the speech of Viscount Dunedin.

1.3.2.5 Hybrid companies

It was possible before 22 December 1980 to register a company limited by guarantee with a share capital (known as a 'hybrid' company). Hybrid companies in existence on that date continue in existence as hybrids but no new hybrid company may be registered (CA 1985, s. 1(4)).

1.3.2.6 History of limited liability

When incorporation of companies by registration was first introduced by the Joint Stock Companies Act 1844, the most significant political dispute was about limited liability, which many saw as contrary to the established business ethic that a trader should be personally responsible, to the full extent of his or her fortune, for debts incurred in trading: unlimited liability was thought to be the best way of ensuring the standards of behaviour in business sought by the community.

Accordingly, the Joint Stock Companies Act 1844 imposed on the members of a company a form of direct and unlimited liability for its debts: a judgment creditor of a company registered under the Act was permitted to levy execution on individual members of the company if the judgment debt was not paid by the company itself (see *Re Sea Fire and Life Assurance Co., Greenwood's Case* (1854) 3 De G M & G 459).

The argument in favour of limited liability in joint-stock companies was that normally members were only investors who did not take part in the management of the company and so should not be held responsible for it. It was for the good of the community that capital in the hands of private investors should be made available to set up new businesses; such investment would be encouraged by removing the possibility of complete disaster if the business invested in should fail.

This argument was eventually won when the Limited Liability Act 1855 allowed any registered company (other than an insurance company) with at least 25 members to limit the liability of its members to the amounts unpaid on their shares, provided it put 'limited' as the last word of its name. Shortly afterwards, the Joint Stock Companies Act 1856 reduced the minimum number of members to seven (it is now one).

Insurance companies were not permitted to register with limited liability until CA 1862 came into force. In practice, though, a company incorporated under the Joint Stock Companies Act 1844 carrying on insurance business would include in every policy a provision precluding the levying of execution against the members of the company personally for any money payable under the policy—an insurance company's deed of settlement (equivalent to a present-day company's memorandum and articles, see 2.2) would usually forbid its directors from issuing policies without such a provision, and this was the basis on which members took shares in the company. The effectiveness of such a policy provision as a method of contracting out of the personal liability imposed by the 1844 Act was confirmed in *Halket v Merchant Traders' Ship Loan and Insurance Association* (1849) 13 QB 960 and *Hassell v Merchant Traders' Ship Loan and Insurance Association* (1849) 4 Ex 525. The device was also effective when used by unincorporated insurance companies (*Hallett v Dowdall* (1852) 18 QB 2).

Under the 1855 Act, the liability of members was still direct to creditors but the 1856 Act introduced the principle that the liability of members of a registered company should be to the company only and should be enforced for the benefit of creditors on the winding up of the company. Guarantee companies were first allowed for in CA 1862. For more detail of the history up to 1862 see H.A. Shannon, 'The coming of general limited liability' in E.M. Carus-Wilson (ed.), *Essays in Economic History*, vol. 1 (London: Edward Arnold, 1954), pp. 358–79 (reprinted from *Economic History*, vol. 2 (1931), pp. 267–91); J. Saville, 'Sleeping partnership and limited liability, 1850–1856', *Economic History Review*, 2nd ser., vol. 8 (1956), pp. 418–33; C.E. Amsler, R.L. Bartlett and C.J. Bolton, 'Thoughts of some British economists on early limited liability and corporate legislation', *History of Political Economy*, vol. 13 (1981), pp. 774–93. Saville's article reveals the wide variety of arguments for and against wider availability of limited liability that were advanced by various interest groups.

During the second half of the 19th century, believers in the moral superiority of unlimited liability who nevertheless recognised that it was not appropriate to make mere investors in an enterprise liable for its debts to an unlimited extent promoted the compromise of limited liability for investors but unlimited liability for the directors or managers who actually conducted the enterprise's business. Their model was the French partnership *en commandite*. A business may be conducted on these lines in two ways: as a limited partnership (introduced in 1907; see 0.4.1.2) or as a limited company with directors or managers who have unlimited liability (introduced in 1867; see 2.3.6). See M. Lobban, 'Corporate identity and limited liability in France and England 1825–67' (1996) 25 *Anglo-Am L Rev* 397.

As will be explained in 1.3.3.2, in the late 19th century it was realised that although limited liability encouraged capitalists to invest money in companies which they did not manage, nothing in the law required a limited liability company to have members who did not take part in management. It became increasingly popular for small businesses to be carried on by companies whose only members were the people who operated the business. Thus business people could obtain limited liability for their own trading.

Limited liability became the dominant business ethic in the European Community when the Council adopted its 12th Company Law Directive (89/667/EEC) in 1989. This required member States to provide a legal form for *individuals* to trade with limited liability, finally abandoning the view that limited liability is only appropriate for people who merely invest in a business without taking part in its management. In Britain the 12th Directive was implemented by SI 1992/1699, permitting the registration of single-member private limited companies. For background to the 12th Directive see V. Edwards, 'The EU Twelfth Company Law Directive' (1998) 19 *Co Law* 211.

The justification for making limited liability freely available is that it encourages people to set up in business by making it less risky. However, making it easier to carry on businesses that

become insolvent makes economic activity more risky for the community generally if it becomes more likely that money will be lost dealing with insolvent limited liability companies. Any creditor of a small company in a strong enough negotiating position (such as a bank or a landlord) usually requires personal guarantees from the individuals controlling the company and this makes limited liability meaningless for them. In the recent long economic recession, ordinary trade creditors and customers who cannot negotiate special protection for themselves have become increasingly discontented with limited liability and this has led to suggestions that it is necessary to return to the concept that limited liability should be available only for non-managing investors. See, for example, A. Hicks, R. Drury and J. Smallcombe, *Alternative Company Structures for the Small Business* (London: Certified Accountants Educational Trust, 1995). A policy of restricting the availability of limited liability was rejected by the Company Law Review (*Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (London: DTI, 2000), paras 9.61 to 9.71).

Merely imposing unlimited liability on a company's shareholders does not make dealing with the company free of risk for creditors. They still have the risk that their debts will exceed the shareholders' assets.

So far the main legislative response to discontent with freely available limited liability has been that business people need to be made responsible for their dishonest business practices not their economic misfortunes. Accordingly, in contrast to the limited liability of members of companies, statute has increasingly exposed directors to liability if they fail to meet publicly required standards of behaviour in business—see the Insolvency Act 1986, s. 214 (wrongful trading) discussed in 20.12, and s. 217 discussed in 20.14 and the provisions on disqualification of directors discussed in 20.13.

For a discussion of many issues related to limited liability, see Tony Orhnlial (ed.), *Limited Liability and the Corporation* (London: Croom Helm, 1982). There have been some discussions in terms of economic theory of the possible advantages of limited liability. See, for example, R.E. Meiners, J.S. Mofsky and R.D. Tollison, 'Piercing the veil of limited liability' (1979) 4 Delaware J Corp L 351; P. Halpern, M. Trebilcock and S. Turnbull, 'An economic analysis of limited liability in corporation law' (1980) 30 UTLJ 117; and F.H. Easterbrook and D.R. Fischel, 'Limited liability and the corporation' (1985) 52 U Chi L Rev 89.

Halpern et al. suggest that, as far as public companies are concerned, if they could not offer members limited liability then the market for their shares would be hampered. Shareholding would be concentrated in a few wealthy investors who were able to monitor closely the companies they invested in. Small investors would refuse to buy shares that could lead to catastrophic liability unless they could buy insurance against losses. (Insurers would depend on the effectiveness of the close monitoring by the large shareholders.) The poor experience of the English stock market with partly paid shares of high nominal value (which impose a liability that is practically unlimited), described in 1.3.2.2, shows that this analysis is probably correct, at least in times of economic uncertainty. If, however, investors are confident that a company is sound and the risk of catastrophe is negligible then they will buy and trade in unlimited liability shares as though they had limited liability, as they did with the American Express Company in the 1950s (P.Z. Grossman, 'The market for shares of companies with unlimited liability: the case of American Express' (1995) 24 J Legal Stud 63).

In relation to private companies, Halpern et al. support the criticism that if limited liability is too readily available then it encourages the setting up of too many businesses that will fail.

If a company's members have unlimited liability, or a high liability on partly paid shares, the company's creditors will want to check the wealth of its members, which is why it has always been considered important that a list of a company's members should be available for public inspection. If a company's members have limited liability, its creditors must turn to

monitoring the company's own financial health, which is why accounting and auditing requirements are such an important feature of company law, and why limited, but not unlimited, companies must file their annual accounts with the registrar.

In the USA it has been suggested that although limited liability for contract debts may be an acceptable price for the business community, as creditors, to pay for giving enterprises the ability to raise capital easily, it is not acceptable that shareholders should have limited liability for tort when the activities of companies can do massive harm to the environment (for example, oil spills, explosions at chemical plants) and can cause serious personal injury to large numbers of consumers (for example, product negligence in vehicle and pharmaceutical manufacture, use of harmful materials such as asbestos). Clearly there is a qualitative difference between hardship caused because trading debts are not paid and hardship caused by personal injury or environmental damage. See H. Hansmann and R. Kraakman, 'Toward unlimited shareholder liability for corporate torts' (1991) 100 Yale LJ 1879. J.A. Grundfest, 'The limited future of unlimited liability: a capital markets perspective' (1992) 102 Yale LJ 387 suggests that the financial markets could invent ways of avoiding the imposition of unlimited liability but see the response by Hansmann and Kraakman (1992) 102 Yale LJ 427 and the article by Grossman cited above.

1.3.2.7 Reduction in members

A member of a registered company which has separate personality is not directly liable to the company's creditors for its debts. A member is liable only to the company, and that liability may be limited or unlimited, depending on the type of company. Apart from private companies limited by shares or guarantee, the benefit of incorporation under CA 1985 is allowed only to *two or more persons* who associate for a lawful purpose (s. 1(1)). Accordingly, s. 24(1) provides:

If a company, other than a private company limited by shares or by guarantee, carries on business without having at least two members and does so for more than six months, a person who, for the whole or any part of the period that it so carries on business after those six months—

- (a) is a member of the company, and
- (b) knows that it is carrying on business with only one member,

shall be liable (jointly and severally with the company) for the payment of the company's debts contracted during the period or, as the case may be, that part of it.

When counting the number of members a company has for the purposes of s. 24(1), the fact that the company is itself registered as a member in respect of treasury shares—see 10.6.5—must be ignored (s. 24(2)).

Liability under s. 24 is imposed only on the remaining member (and the company) and not on the member whose departure from the company leads to the application of the section. Indeed where no members remain in the company only the company itself is liable. The section can be easily avoided by having one share registered in the name of a person who holds it only as nominee and accordingly it may be thought to be a useless provision which only traps unlucky persons who do not know about it (see per Hoffmann LJ in *Nisbet v Shepherd* [1994] 1 BCLC 300 at p. 305).

1.3.2.8 Share capital of unlimited companies

An unlimited company may have a share capital, which will be capital contributed for the company's day-to-day operations. Instead of stating its authorised share capital (the total nominal value of shares which it may issue) in its memorandum, as a company limited by shares must (CA 1985, s. 2(5)(a)), an unlimited company's capital has to be stated in its

articles of association (s. 7(2)). Putting the statement in the articles instead of the memorandum makes it easier for an unlimited company to alter its authorised capital (see 6.1.13).

1.3.2.9 No liability companies

In Britain, the constitution of a registered company must impose liability on at least some of its members to contribute capital, either unlimited liability or liability limited by shares or by guarantee. In Australia, it is possible to register a no liability (NL) company, in which there is no obligation to pay calls on shares. However, a company can be registered with no liability only if its objects are confined to mining. In a no liability mining company, shareholders pay an initial small part of the nominal value of their shares to pay for investigation of a new mine, and further instalments to fund development and eventually operation of the mine if it appears to be worth going further. At any stage, shareholders can refuse to pay anything more on their shares, which will then be forfeited.

1.3.2.10 Effect of the CLRB

The CLRB proposes to define a limited company (see 1.3.2.1) as a company whose members' liability is limited by its constitution (cl. 3(1)), which, at the time of its registration, will be contained wholly in its articles of association (cl. 17). The constitution can specify that liability is limited either by shares or by guarantee (cl. 3(1), (2) and (3)). If there is no limit on the liability of a company's members, it is an unlimited company (cl. 3(4)). An application for registration of a company must state whether it is to be a limited company and, if it is, whether the limitation is by shares or by guarantee (cl. 9(2)(c)). Information about limitation of liability will no longer be included in the memorandum of association.

The need to state the registered or authorised capital of a company in its memorandum of association (see 1.3.2.2), or, in the case of an unlimited company, in its articles of association (see 1.3.2.8), will be abolished. Instead a statement of capital and initial shareholdings, stating the shares to be issued to the subscribers to the memorandum on formation of the company (cl. 10) must be filed with the application for its registration (cl. 9(4)(a)).

A company limited by guarantee (see 1.3.2.3) is defined in cl. 3(3) as a company whose members' liability is limited to such amount as they guarantee to contribute to its assets in the event of its being wound up. This limitation must be stated in the articles of association (cl. 3(1)) and no guarantee clause will be required in the memorandum.

When applying for the registration of a company limited by guarantee a statement of guarantee will have to be filed (ccl. 9(4)(b) and 11).

The CLRB proposes to repeal CA 1985, s. 24 (see 1.3.2.7), without making any equivalent new provision.

1.3.3 PUBLIC OR PRIVATE COMPANIES

1.3.3.1 Definitions

A limited company with a share capital is a public company if its memorandum states that it is to be a public company and it was registered or re-registered as a public company on or after 22 December 1980 (CA 1985, s. 1(3)). (Re-registration is dealt with in 1.4.) In addition the name of a public company must end with the words 'public limited company' or the abbreviation 'plc' (ss. 25(1) and 27) or, if its memorandum requires its registered office to be in Wales, the equivalent in Welsh (ss. 25(1) and 27). If Companies House registers a memorandum which states that the company is to be a public company, the certificate of incorporation must say so (s. 13(6)) and is conclusive evidence of that fact (s. 13(7)(b)).

The class of public companies includes hybrid companies (see 1.3.2.5) which were in existence on 22 December 1980 and which have re-registered as public companies.

A company that is not a public company is called a 'private' company (s. 1(3)).

The shares of a private company cannot be officially listed for trading on the London Stock Exchange's Main Market (Financial Services and Markets Act 2000, s. 75(3); SI 2001/2956, reg. 3), and it is an offence to offer a private company's unlisted shares to the public (CA 1985, s. 81; see 7.4.7 for the effect of the CLRB). A public company's shares can be listed and the principal practical difference between public and private companies is that a public company can, if it is large enough and satisfies the conditions for listing, obtain large amounts of low-cost capital through public issues of shares on the London Stock Exchange. Although a company must have the legal form of a plc if it is to have its shares listed, the listing process is entirely independent of the company registration process, and it is not unusual for a plc to have no publicly traded shares.

A public company must have at least two members whereas a private company (other than an unlimited company or a hybrid company) may have only one member. Under the CLRB, one member will be sufficient for any type of company (cl. 7(1)).

A further difference between a public company and a private company is that whereas a private company may have only a trivial amount of contributed capital (such as £1), the legislation sets a comparatively substantial minimum requirement for the contributed capital of a public company, and several tediously detailed provisions of CA 1985 are devoted to ensuring that no public company goes into the world without its minimum contributed capital. The requirement that a public company must have a minimum contributed capital is imposed throughout the European Union by the Second Company Law Directive (77/91/EEC), art. 6, which sets the minimum at 25,000 euro. In Britain the minimum is expressed in terms of the 'authorised minimum', which is £50,000 or such other sum as the Secretary of State may by order prescribe (CA 1985, s. 118). However, a public company is not actually required to have contributed capital of £50,000. The requirement is that a public company must allot to its members shares with a nominal value of at least £50,000 but it is permissible for the members to pay up only one-quarter of the nominal value of each share allotted. Thus the amount of contributed capital of a public company may be as little as £12,500 with a right to call on members for a further £37,500. In the memorandum of a company that is to be registered as a public company its authorised share capital must not be less than £50,000 (CA 1985, s. 11; to be repealed by the CLRB).

If a company is registered as a public company when it is first incorporated then CA 1985 ensures that it satisfies the minimum capital requirements by forbidding the company from doing any business or borrowing any money until it has received from the registrar a certificate to commence business issued under s. 117. Failure of the company to obtain a certificate within a year of registration is a ground for petitioning the court to wind it up (Insolvency Act 1986, s. 122(1)(b)). The main condition for the issue of a certificate is the allotment by the company of shares with a nominal value of at least £50,000 (CA 1985, s. 117(2)), for each of which the company must have received at least one-quarter of the nominal value (ss. 101(1) and (2) and 117(4)). For further details, see 6.6.1.

The High Level Group of Company Law Experts appointed by the European Commission has noted that 25,000 euro 'is not enough to ensure that companies have sufficient financial means to carry out substantial economic activities' (*A Modern Regulatory Framework for Company Law in Europe*, para. 3.3.7). The only function of the minimum requirement seems to be to deter people from setting up a public company light-heartedly.

Under Council Regulation (EC) No. 2157/2001, art. 4, the capital of a European public company (an SE) must be at least 120,000 euro.

1.3.3.2 History of the distinction between public and private companies

When incorporation of companies by registration was first introduced in 1844, it was assumed that the typical registered company would have a large membership of investors who would entrust the management of the company's affairs to its directors. It was also presumed that there would be public dealings in the shares of registered companies.

The Joint Stock Companies Act 1856 set the minimum number of members of a registered company at seven. Within 20 years or so it was realised that it was unnecessary for a company to have a large membership. The practice grew of incorporating what were informally known as 'private' companies, as described in Francis Palmer's book, *Private Companies; or, How To Convert Your Business into a Private Company, and the Benefit of So Doing*, first published in 1877. An individual in business on his or her own (a 'sole trader') would find six nominees to make up the required minimum of seven subscribers and incorporate a company to take over the business, thus achieving a separation of business and private affairs and, most importantly, limited liability. In *Salomon v A. Salomon and Co. Ltd* [1897] AC 22 the House of Lords confirmed that this was permitted by CA 1862 and that the members of such a company had limited liability. The popularity of the 'private' company was recognised by Parliament, which in CA 1907 created a statutory category of 'private companies' for which the minimum membership was two. From 1908, it was possible to register a company as a private company but such a company was forbidden to offer its shares to the public and was required to restrict the right to transfer its shares and limit its membership to 50 persons (excluding employees). This definition of 'private company' was last re-enacted in CA 1948, s. 28. (In some Commonwealth countries in which similar legislation was introduced, private companies were called 'proprietary' companies, and their names included the abbreviation 'Pty'.) By 1979 nearly 98 per cent of British registered companies were private companies. See further P. W. Ireland, 'The rise of the limited liability company' (1984) 12 Int J Sociol Law 239.

The system was changed by CA 1980 so that now every registered company is defined to be a private company *unless* it is registered or re-registered as a public company (CA 1985, s. 1(3)). CA 1980 removed the requirement that a private company must limit the number of its members and reduced the minimum number of members of a public company from seven to two.

A limited company with a share capital existing on 22 December 1980 which was not a private company as that term was defined by CA 1948, s. 28, is called an 'old public company' (Companies Consolidation (Consequential Provisions) Act 1985, s. 1(1)). This term is also used for a limited company with a share capital in respect of which an application for registration was pending at 22 December 1980 if the application was not for registration as a private company as defined by the 1948 Act (*ibid.*). Old public companies could be either companies limited by shares or hybrid companies.

All old public companies were required to apply for re-registration as private companies or as public companies (plcs) by 21 March 1982. Many old public companies opted to become private companies and at the end of March 2005, 99.4 per cent of British companies were private companies.

In 1992, the minimum number of members of a private limited company (other than a hybrid company) was reduced to one by SI 1992/1699, implementing the EC 12th Company Law Directive (89/667/EEC). Research carried out for the Company Law Review shows that about 90 per cent of companies have four or fewer members (*Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (London: DTI, 2000), para. 11.6).

British company law traditionally regards private and public companies as two variants of

the same basic form of legal organisation, unlike legal systems in Continental Europe which tend to treat them as different forms of organisation. Since joining the European Community, British law has made more differences between public and private companies. Before 1980 people dealing with companies did not usually know, or care, whether they were public or private. Now, the use of the two different terminations to names—plc for a public company, Ltd for a private company—makes it obvious. This is in accord with Continental practice, for example, in France the name of a public company (*société anonyme*) ends SA while that of a private company (*société à responsabilité limitée*) ends Sàrl.

Law and economics analysts, who are much concerned with companies as the subject of stock-market trading, draw a sharp distinction between companies whose shares are publicly traded and those which are not—see, for example, H.G. Manne, ‘Our two corporation systems: law and economics’ (1967) 53 Va L Rev 259.

1.4 RE-REGISTRATION TO CHANGE THE CLASSIFICATION OF A COMPANY

1.4.1 INTRODUCTION

CA 1985 provides procedures for a company to change its classification by re-registering. When a company changes classification from public to private or vice versa, or from limited to unlimited, or vice versa, a new certificate of registration must be issued because the certificate is required to state if a company is limited (s. 13(1)) and if it is a public company (s. 13(6)). Curiously, although a new certificate must be issued when a company changes its name (see 2.4.2), the procedure for changing a company’s name is not referred to as ‘re-registration’.

The re-registration provisions are a very good example of the way in which the British companies legislation attempts to prescribe every detail of a procedure, even if the procedure (like that for re-registering an unlimited company as a limited one) is hardly ever used. We will spend about three pages outlining the re-registration procedures in what we believe is enough detail for an introductory textbook like this. The legislation itself, with all its detailed provisions, in the same type size and book format, occupies over seven pages—plus nine A4 pages of prescribed forms in SI 1995/736.

The specific procedures set out in CA 1985 do not cover all the possible changes of status though some changes for which there is no direct procedure can be achieved by two successive re-registrations. For example, a public company can be re-registered as an unlimited company by two re-registrations (see 1.4.2) but there is no procedure at all by which a guarantee company can be re-registered as a company limited by shares (see 1.4.4). In Australia there has been controversy over whether a court-sanctioned arrangement with members (the British provisions for which are in CA 1985, ss. 425 to 430) can be used to effect a change of status for which there is no specific statutory procedure. In *Windsor v National Mutual Life Association of Australasia* (1992) 106 ALR 282 a full court of the Federal Court said that the specific procedures are the only ways of changing status; in *Australian Securities Commission v Marlborough Gold Mines Ltd* (1993) 177 CLR 485, the High Court of Australia would not go that far but held that there was a legislative intention that the particular change of status desired by the company—from limited to no liability—should not be carried out at all. The Company Law Review Steering Group recommended creating procedures for three further changes of status—public to unlimited, private company limited by shares to guarantee, limited by guarantee to limited by shares (*Modern Company Law for a*

Competitive Economy: Final Report, vol. 1 (URN 01/942) (London: DTI, 2001), paras 11.11 to 11.15). The CLRB has provided a procedure for the first of these (cll. 108 to 110), but the government decided there was insufficient need for the other two.

1.4.2 CHANGE FROM BEING A PUBLIC COMPANY

A public company (including a hybrid public company) may re-register as a private limited company under CA 1985, s. 53. This is a common form of re-registration. It is used, for example, when a public company is taken over by, and becomes a subsidiary of, another company. The section can be used to re-register a public company only as a private company limited by shares or limited by guarantee (s. 53(3)). There is no provision for re-registration as a private hybrid company. In order for a public company to be re-registered as a private company, the members must adopt a special resolution (which requires a majority of three-quarters of those voting, see 14.8.3) that it should be so re-registered (s. 53(1)).

A change from public to private status may be very unwelcome to a minority who object to the change if their shares lose their marketability. Provision is therefore made for accommodating a dissentient minority who object to re-registration as a private company.

The holders of 5 per cent or more of the nominal value of a public company's issued share capital or of any class thereof (not counting shares held by the company as treasury shares—see 10.6.5: s. 54(2A)), or 50 or more of its members, may apply to the court for the cancellation of a special resolution to request re-registration as a private company, provided that the applicants did not consent to or vote in favour of the resolution (s. 54(1) and (2)). The application must be made within 28 days of the passing of the resolution (s. 54(3)). On the hearing of a s. 54 application the court may either cancel or confirm the resolution, and in any event may make its order on such terms and conditions as it thinks fit, adjourn the proceedings to enable an arrangement to be made which it finds satisfactory for the purchase of the applicants' interests in the company, and give any directions or orders which are expedient for facilitating or carrying the arrangement into effect (s. 54(5)). The court's order may provide for the purchase by the company of the shares of any members (s. 54(6)).

Once satisfied that the company is entitled to be re-registered as a private company the registrar must issue a new certificate of incorporation appropriate to a private company (s. 55(1)). The company becomes a private company on the issue of the certificate (s. 55(2)) and the certificate is conclusive evidence that the re-registration requirements have been complied with and that the company is a private company (s. 55(3)). The registrar notifies issue of the certificate in the *Gazette* (s. 711(1)(a)).

A public company cannot be directly re-registered as an unlimited company (s. 49(3)): it must first re-register as private under s. 53 and then re-register as unlimited under s. 49 (see 1.4.3). The CLRB proposes a procedure for direct re-registration of a public limited company as a private unlimited company (cll. 108 to 110).

A public company limited by guarantee with a share capital (a public hybrid company) may be re-registered as a private company either limited by shares or limited by guarantee (without a share capital) under s. 53. However, there is no express provision for a public hybrid company to alter its memorandum so as to become a public company limited by shares (in principle this could be achieved by first re-registering as a private company limited by shares and then re-registering again as a public company under s. 43 (see 1.4.3), but this is unlikely to be a practical possibility because shareholders would lose the marketability of their shares in the interval between re-registrations without being certain that a special resolution for the second re-registration would be adopted).

1.4.3 CHANGE FROM BEING A PRIVATE COMPANY LIMITED BY SHARES

A private company limited by shares or a hybrid private company may be re-registered as a public company under CA 1985, s. 43. This is a common form of re-registration. It may be used, for example, when a private company decides to 'go public' in order to obtain more capital for growth by inviting the public to subscribe for its shares.

In order for a private company to be re-registered as a public company, the members must adopt a special resolution (which requires a majority of three-quarters of those voting, see 14.8.3) that it should be so re-registered (s. 43(1)). An application by a private company to re-register as public must be delivered to the registrar (s. 43(1)) and be accompanied by a statutory declaration, or equivalent statement using electronic communications, by a director or secretary of the company that the requisite special resolution has been passed and that various requirements relating to minimum capital are satisfied (s. 43(3)(e), (3A) and (3B)). The registrar may accept this as sufficient evidence that the conditions for re-registration have been satisfied (s. 47(2)). Other documents which must accompany the application are specified in s. 43(a) to (d). The registrar will issue the company with a certificate of incorporation stating that it is a public company (s. 47(1)), which is conclusive evidence that the requirements of the Act relating to re-registration have been complied with and that the company is a public company (s. 47(5)). The registrar notifies issue of the certificate in the *Gazette* (s. 711(1)(a)). A company re-registered as a public company does not need a certificate to commence business.

When this edition went to press Companies House had not yet made arrangements for receiving electronic communications for the purposes of s. 43.

Subject to various conditions and restrictions which will not be discussed here, a private limited company may, with the consent of all its members, lodge an application with the registrar for re-registration as an unlimited company (either with or without a share capital): see CA 1985, s. 49. Having changed from limited to unlimited, a company cannot change back again (s. 43(1) (forbidding a second re-registration as a public company) and s. 51(2) (forbidding a second re-registration as a private limited company, whether limited by shares or by guarantee)).

Although a public company limited by shares may be re-registered as a company limited by guarantee (though it must be as a guarantee company without a share capital: s. 53(3)), there is no express provision under which a private company limited by shares can alter its memorandum so as to become a company limited by guarantee: however, it seems that this change can be achieved by first re-registering the private company as a public company under s. 43 (see 1.4.2) and then re-registering again as a private company limited by guarantee.

1.4.4 CHANGE FROM BEING A PRIVATE COMPANY LIMITED BY GUARANTEE

A private guarantee company may be re-registered as an unlimited company under CA 1985, s. 49 (see 1.3.4.3).

There is no provision for a guarantee company without a share capital to alter its memorandum so as to become a company limited by shares. It cannot alter its memorandum to provide that it shall have a share capital and so become a hybrid company (s. 1(4)) and it is forbidden from re-registering as a public company (s. 43(1)). It could re-register as an unlimited company but could not then re-register again as a limited company (ss. 43(1) and 51(2)).

1.4.5 CHANGE FROM BEING A HYBRID PRIVATE COMPANY

A private hybrid company can be re-registered as a public company under CA 1985, s. 43 or as an unlimited company under s. 49 (see 1.3.4.3) but there is no express provision for a private hybrid company to alter its memorandum so as to become a private company limited by shares (though this could be achieved by first re-registering as public and then re-registering again as a private company limited by shares). A private hybrid company could become a pure guarantee company by reducing its share capital to zero under the procedure described in 10.2.

1.4.6 CHANGE FROM BEING AN UNLIMITED COMPANY

An unlimited company with a share capital may, if its members adopt a special resolution (which requires a majority of three-quarters of those voting, see 14.8.3), re-register as a public limited company under CA 1985, ss. 43 to 48 (this must be a company limited by shares: s. 48(2)(a)). An unlimited company, with or without a share capital, may, following a special resolution, re-register as a private limited company (either limited by shares or by guarantee) under ss. 51 and 52. Having changed from unlimited to limited, a company cannot change back again (s. 49(2)). An unlimited company cannot be re-registered as a hybrid company (s. 1(4)).

1.5 QUASI-PARTNERSHIP COMPANIES

The Companies Act classifications of companies do not necessarily reflect the varieties of relationships between members and especially between members and directors. The roles assigned by the law to members and directors are that members are investors who do not wish to be involved in day-to-day management, which is the province of the directors. Members are expected to see each other only at annual general meetings. In the case of a plc members are expected to have taken their shares as a result of a public advertisement. (Before 1908 this was expected of the members of any company.) Nevertheless, it is common for members to be directors, and soon after incorporation of companies by registration was first allowed it was found that, contrary to expectation, many companies were formed with very small numbers of members. This trend increased when the statutory minimum number of members was reduced from seven to two in 1908.

The courts have paid particular attention to companies formed on the basis of a personal relationship between members involving mutual confidence and the understanding that certain members will be directors. Such companies are known as 'quasi-partnership' companies and the courts are willing to take into consideration the mutual understandings between members of quasi-partnership companies even if they have not been stated in the company's memorandum and articles or in separate contracts between the members.

The leading case on this topic is *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, in which a member of a quasi-partnership company successfully invoked a provision which is now the Insolvency Act 1986, s. 122(1)(g), under which the court can order a company to be wound up if it is 'just and equitable' to do so. Commenting on the phrase 'just and equitable', Lord Wilberforce said, at p. 379:

The words are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations *inter se* which

are not necessarily submerged in the company structure. That structure is defined by the Companies Act and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The 'just and equitable' provision does not . . . entitle one party to disregard the obligation he assumes by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.

In *Ebrahimi v Westbourne Galleries Ltd* the majority shareholders in a company (who were also directors of it) had the legal right, under what is now CA 1985, s. 303 (see 15.6.3), to dismiss Mr Ebrahimi, the minority shareholder, from his position as a full-time working director of the company. This dismissal in effect deprived him of his livelihood, because the company's profits were always distributed as directors' fees, not as share dividends. But the company had been formed on the basis that Mr Ebrahimi would be a full-time working director. The House of Lords found that the exercise of the legal right to dismiss Mr Ebrahimi breached this mutual understanding and was unjust and inequitable. So the House affirmed that the company should be wound up by the court, meaning that its business and assets would be sold and the surplus after paying its debts would be shared by all the members, including Mr Ebrahimi. (The law has subsequently been developed so that the normal remedy provided by the court in cases like this is that the majority shareholders must buy out the minority member at an independently fixed fair valuation of the minority member's share of the value of the company—see 18.6.)

By asking the court to find that it is 'just and equitable' for a company to be wound up, IA 1986, s. 122(1)(g), is expressly inviting the court to 'subject the exercise of legal rights to equitable considerations' (in the words of Lord Wilberforce quoted above). Similarly, when CA 1985, s. 459(1), asks the court to provide relief when a company's affairs have been conducted in a manner that is 'unfairly prejudicial' to a member's interests (see 18.6) the court may give relief on finding that legal rights have been exercised by some members contrary to the legitimate expectations of others (*Re a Company (No. 00477 of 1986)* [1986] BCLC 376) because 'what is unjust and inequitable is obviously also unfairly prejudicial' (per Fulton J in *Diligenti v RWMD Operations Kelowna Ltd* (1976) 1 BCLR 36 at p. 46). See also *Caratti Holding Co. Pty Ltd v Zampatti* (1978) 52 ALJR 732, discussed in 3.4.3.

In cases like *Ebrahimi v Westbourne Galleries Ltd*, what has been enforced by the courts is a mutual understanding by all the members of a company, not expressed in its constitution, that its affairs will be conducted in a particular way. This kind of mutual understanding will not exist in many companies. For example, it would be practically impossible for it to exist in a listed public company. The conventional way of approaching the cases is to say that it must be shown that a company satisfies certain conditions before a court will enforce mutual understandings not expressed in its constitution. Companies that satisfy these conditions are called quasi-partnership companies. Defining a quasi-partnership company depends on identifying what conditions must be satisfied before mutual understandings about it will be enforced.

The term 'quasi-partnership' is used because the recognition that it is unjust and inequitable to breach mutual understandings not expressed in the constitution developed from cases in which it was considered just and equitable to wind up a company in circumstances which would justify the dissolution of a partnership. It was considered appropriate to apply this partnership analogy to a company if, in the words of Lord Cozens-Hardy MR in *Re Yenidje Tobacco Co. Ltd* [1916] 2 Ch 426 at p. 432, ' . . . in substance it is a partnership in the form or the guise of a private company'. This will clearly be so if the company was incorporated to

carry on the business of a pre-existing partnership (as happened in *Ebrahimi v Westbourne Galleries Ltd*) and the members of the company are the members of the former partnership.

In *Ebrahimi v Westbourne Galleries Ltd* Lord Wilberforce widened the scope of the law by saying that the test of whether a company is a quasi-partnership company is whether it is appropriate to subject the legal rights of the members of the company to equitable considerations. In many companies it is not appropriate to look beyond the legal rights of members. Lord Wilberforce said ([1973] AC 360 at p. 379) that it was impossible, and wholly undesirable, to define the circumstances in which it is appropriate. His lordship went on to say:

Certainly the fact that a company is a small one, or a private company, is not enough. There are very many of these where the association is a purely commercial one, of which it can safely be said that the basis of association is adequately and exhaustively laid down in the articles. The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence—this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be ‘sleeping’ members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members’ interest in the company—so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.

Without the ‘something more’ mentioned by Lord Wilberforce there is no basis for a legitimate expectation that limits not expressed in the company’s constitution will apply to the exercise by the board and the company in general meeting of whatever powers they are given by that constitution (*Re Saul D. Harrison and Sons plc* [1995] 1 BCLC 14 per Hoffmann LJ at p. 20).

However, it may well be that the essential question in the cases is whether it can be shown that the particular mutual understandings alleged to have been breached actually existed. It may be that the only purpose of showing that a company fits into a defined category of quasi-partnership companies is that the court can readily infer that in any company of that type such mutual understandings must have existed.

Just as many people would think that a company is not truly a ‘public company’ unless it is listed on the London Stock Exchange, but not all companies registered as plcs are listed, so the concept of the quasi-partnership company, with its emphasis on personal rather than financial association, may be thought to contain the essence of the truly ‘private’ company. See C.M. Schmitthoff, ‘How the English discovered the private company’, in *Quo vadis ius societatum*, ed. P. Zonderland (Deventer: Kluwer, 1972), pp. 183–93.

That company law may not exhaustively define the relationship between members of a company has been recognised in other contexts. For example, in *Lion Mutual Marine Insurance Association Ltd v Tucker* (1883) 12 QBD 176, the relationship between the members of a guarantee company was that of a mutual marine insurance association and the Court of Appeal held that the company law limitation on liability of members under CA 1985, s. 2(4), did not apply to their liability among themselves to insure each other’s marine losses. For other examples, see *Trebanog Working Men’s Club and Institute Ltd v Macdonald* [1940] 1 KB 576 discussed in 5.3.9 and *Elliott v Wheeldon* [1993] BCLC 53 discussed in 16.3.2.

1.6 NUMBERS OF COMPANIES

According to the Department of Trade and Industry’s report, *Companies in 2004–2005* (London: Stationery Office, 2005), at the end of March 2005 there were 1,980,100 companies

registered in Great Britain, of which 1,873,900 were registered in England and Wales (figures are to the nearest 100 and exclude companies in the course of liquidation). Of the total number of companies in Great Britain, 0.6 per cent are public companies.

These figures give a slightly misleading impression because many companies are members of groups controlled by holding companies. Research carried out for the Company Law Review shows that about 87 per cent of companies are not in groups (*Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (London: DTI, 2000), para. 11.6).

1.7 EUROPEAN PUBLIC LIMITED-LIABILITY COMPANIES

A European public limited-liability company (*societas europaea* or SE) may be registered in any EU State under Regulation (EC) No. 2157/2001. It must be registered in the member State in which it has its registered office (art. 12(1)). An SE must be treated in every member State as if it were a public limited-liability company formed in accordance with the law of the member State in which it has its registered office (art. 10).

The formation of an SE is governed by law applicable to public limited-liability companies in the State in which it establishes its registered office, subject to the provisions of Regulation (EC) No. 2157/2001 (art. 15(1)). Registration of an SE in Great Britain is performed by the registrar of companies under SI 2004/2326. (SR 2004/417 makes equivalent provision in Northern Ireland.) The provisions of Regulation (EC) No. 2157/2001 mean that an SE, unlike a domestic public company, cannot be formed by the agreement of the subscribers to its memorandum (called the instrument of incorporation in the Regulation). Instead an SE can be formed only by an existing SE (which may form an SE as a subsidiary) or by existing companies, at least two of which must be governed by the law of different member States. This considerably limits the circumstances in which SEs may be formed, when compared with companies formed under national law. The SE is conceived as a form into which companies can grow, rather than a form to be used when establishing a new business.