A Practical Guide to the Memorandum and Articles of Association

A Practical Guide to the Memorandum and Articles of Association

Michael Griffiths

ICSA Publishing

Published by ICSA Publishing Limited
16 Park Crescent
London W1B 1AH

© ICSA Publishing Ltd, 2005

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form, or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission, in writing, from the publisher.

Typeset in Sabon and Franklin Gothic by
Hands Fotoset, Woodthorpe, Nottingham

Printed and bound in Great Britain by
TJ International Ltd, Padstow, Cornwall

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library.

ISBN: 1-86072-153-2

Contents

Preface vii
A Note on Table A x
Table of Cases xi
List of Precedents xv

PART ONE: AN OVERVIEW OF THE MEMORANDUM AND ARTICLES 1

1 The Legal Status of the Memorandum and Articles 3
1. Introduction 3
2. Table A 4
3. The effect of the memorandum and articles 5
4. Shareholder agreements 7
5. Future developments 8

2. The Memorandum of Association 12
1. Contents of the memorandum 12
2. The name of the company 13
3. Registered office (domicile) clause 17
4. The objects clause 18
5. The limited liability clause 22
6. The capital clause 22

3. Articles of Association 23
1. The articles of association and Table A 23
2. Format of the articles 24
3. Alteration of the articles 24

PART TWO: THE 1985 TABLE A 27

Regulations for Management of a Company Limited by Shares 29
Interpretation 29
Share capital 31

Certificates 39
Lien 42
Calls on shares and forfeiture 44
Transfer of shares 51
Transmission of shares 57
Alteration of share capital 61
Purchase of own shares 62
General meetings 63
Notice of general meetings 65
Proceedings at general meetings 68
Votes of members 78
Number of directors 84
Alternate directors 85
Power of directors 87
Delegation of directors' powers 91
Appointment and retirement of directors 92
Disqualification and removal of directors 95
Remuneration of directors 97
Directors' expenses 98
Directors' appointments and interests 99
Director's gratuities and pensions 102
Proceedings of directors 103
Secretary 114
Minutes 115
The seal 116
Dividends 116
Accounts 120
Capitalisation of profits 120
Notices 121
Winding up 127
Indemnity 127

APPENDICES **129**

1. 1985 Table A: Checklist of common amendments **130**
2. The 1948 Table A **132**
3. Table of differences: 1948–1985 Table A **162**
4. Desirability of an exit clause **171**
5. Long form memorandum of association **173**

Index 179

Preface

It is a duty of directors that they are aware of the contents of the constitution of their company. This is partially stated in section 35(3) of the Companies Act 1985:

> 'It remains the duty of directors to observe any limitations on their powers flowing from the company's memorandum'.

This will be put even more strongly when the review of company law presently being undertaken by government is completed. The White Paper 'Modernising Company Law' contains a number of draft provisions which it intended should be included in a future Companies Act. Amongst these there is set out in a schedule a statement of what are termed 'general principles by which directors are bound'. The first of these principles is stated in the following terms:

> 'A director must act in accordance with:–
> (a) the company's constitution and
> (b) decisions taken under the constitution (or by the company, or any class of members, under any enactment or rule of law as to means of taking company or class decisions),
>
> and must exercise his powers for their proper purpose'.

From time to time I am asked to speak to directors about their duties. When giving such seminars in-house I always ask that each delegate has a copy of the company's memorandum and articles (and also the shareholder agreement if there is one). I then go through the constitution, highlighting any unusual special articles and other important matters. It often comes as a surprise to a board that there are restrictions on their powers and that the members as a body can take action against them should they ignore them.

Two recent experiences highlight the importance of directors knowing their powers and limitations on those powers. The first concerned a company that had been substantially under the direction of the same family for well over a

century. It had been incorporated in the early 1900s. In the late 1940s the then proprietors obviously decided that they wanted to keep the company as close as possible to its then current form in perpetuity. So they gave all of their shares to trustees on trust for various local charities while they themselves remained as the directors of the company. There was a provision that if the directors wanted to borrow more than £100 they needed the express approval of the members in general meeting. A restriction on the borrowing power of directors was a common feature of articles at the time. Indeed every Table A until that produced in 1985 contained such a restriction in some form.

Now come down another two or three generations. The same family still provides the main core of the board. When speaking to the present board I asked whether the company ever found itself in an overdraft situation. The answer was that it sometimes did. I then asked if there were ever any tensions between the shareholders (the trustees for local charities) and the board. The inevitable answer was that sometimes there were. Obviously the board members wanted to draw sufficient salaries for the needs of themselves and their families. On the other hand, the members wanted as much as they could get by way of dividends on their shares so that they could distribute as much as possible to the charity's beneficiaries. Inevitably tensions arose between ownership and management. Then came the obvious question. Did the board ever get the consent of the members before allowing an overdraft to arise? The inevitable answer was that it did not.

Clearly there was a problem here to be addressed.

The second experience arose when I was asked to speak to the board of a housing association. The board consisted of twelve members. Four were appointed by a local authority. Four were local business people. The housing tenants appointed four. So the three factions of the board came from three totally different constituencies. As would be expected, the quorum at a board meeting was fairly complex. There had to be at least five members present, of which at least one should come from each of the three constituencies. No decision could be taken by the board in the absence of a quorum. There then followed a rather unusual article. A director had physically to remove himself from the room if a matter was being considered in which he had a personal interest. Thus when his own rent was being considered by the board, a tenant director would have to withdraw thereby rendering the board inquorate. Any decisions taken in respect of such rent were technically improperly made.

The message to any board must be: 'Know your company's constitution'.

Using this Guide

This Guide is a practical resource for companies and their advisors who have a responsibility for creating and maintaining a company's core constitutional documents: the memorandum and articles of association.

Part One sets the context by looking at the legal status of the memorandum and articles, what they should comprise and how, when and why they should be reviewed and, if necessary, updated.

Part Two provides a detailed commentary on every Article of the 1985 Table A, cross-referenced to the corresponding 1948 Table A and relevant case law. Where appropriate, precedents for common amendments or enhancements are also given. These are numbered consecutively by Article, for example, Precedent Reg. 2.2 refers to the second precedent relating to Article 2 of Table A. All precedents in the book are included in the List of Precedents, and, for ease of customisation, are also available on the CD that accompanies the book.

The 1948 Table A in full is included as an Appendix, alongside a table outlining the main differences between this and the 1985 version. The Appendices also include a checklist of common amendments to Table A and a sample long form memorandum of association.

M J Griffiths
March 2005

A Note on Table A

There have, to date, been seven versions of the model set of articles known now as Table A: in 1856, 1862, 1906, 1908, 1929, 1948 and 1985. Part Two of this Guide deals almost exclusively with the 1985 Table A, which applies to companies formed on or after 1 July 1985. However, since many companies were incorporated under the Companies Act 1948, the 1948 Table A has been reproduced in Appendix 2. The relevant provisions are cross-referenced in the commentary on the 1985 Table A. The 1948 Table A was itself amended on not less than seven occasions, and the form in which we have reproduced it is its latest version. The 1948 Table A applies to companies formed under that Act.

The 1948 Table A was, in its original form, in two parts, Part I being a model set of articles for a public company and Part II incorporating most of Part I and future provisions necessary for private companies. The Companies Act 1980 made public companies the definitive category of company, and so the restrictions for private companies were omitted for companies incorporated on or after 22 December 1980. Part II was replaced as from this date. However, it continues to apply to companies incorporated before 22 December 1980 as long as the company's own articles incorporated it by reference.

The 1985 Table A was itself amended by the Companies Act (Electronic Communications) Order 2000 (SI 2000/3373) as from 22 December 2000.

Table A only applies insofar as the company concerned does not have its own special article on a particular matter, and the first reference point must always be to the company's own articles. If these are silent on the point of enquiry, the relevant Table A regulation should be taken into account.

PART

1

An Overview of the Memorandum and Articles

CHAPTER 1

The Legal Status of the Memorandum and Articles

1. Introduction

Every company incorporated by registration with the Registrar of Companies must have a memorandum. By section 1(1) of the Companies Act 1985 this must be subscribed (i.e. signed at the end) by those persons wishing to form the company. The form of the memorandum is to be found in the Companies (Tables A to F) Regulations 1985 (SI 1985/805). A model memorandum for a private company limited by shares is to be found in Table B and for a public company limited by shares in Table F. By section 3 of the Companies Act 1985, the memorandum must be in this form.

Under the Companies (Single Member Private Limited Companies) Regulations 1992 (SI 1992/1699), private companies may be incorporated with only one member, which allows the single member to subscribe alone to the memorandum.

The memorandum constitutes the company's charter with the outside world and contains a number of statutory clauses (s. 2). These are outlined in more detail in Chapter 2.

The articles of association are the regulations governing the company's internal management. A company limited by shares and being incorporated by registration does not have to file specific articles, this being made discretionary by section 7 of the Companies Act 1985. By section 8(2), where a company limited by shares has no registered articles or, if articles are registered, in so far as they do not exclude or modify Table A, that Table (so far as applicable, and in force at the date of the company's registration) constitutes the company's articles, in the same manner and to the same extent as if articles in the form of that Table had been duly registered.

Where there is a conflict between the memorandum and the Articles, the memorandum prevails (s. 17).

2. Table A

Table A is a model set of Articles for both private and public companies limited by shares.

Usually when there is a consolidation of company law a new Table A is produced. Thus there are different and separate Tables for 1856, 1862, 1906, 1908, 1929, 1948 and 1985. When reading a company's articles of association which incorporate Table A, it is essential to identify the date of registration of the company to establish which edition of Table A applies to it. It is also essential to check whether there have been any modifications to these specific articles either by statute or by the members of the company in general meeting.

Each Table A is different. When a particular provision appears in one Table A and not in another, this is relatively easy to identify. For example, Article 79 of the 1948 Table A requires the directors to obtain the consent of the members in general meeting if they wish the company's borrowing to exceed the nominal amount of the share capital for the time being issued. There is no such restriction in the 1985 Table A. Similarly, in the 1985 Table A, alternate directors are permitted by Articles 65–69; such directors are not mentioned in earlier Tables. By section 159 of the Companies Act 1985, a company limited by shares or limited by guarantee and having a share capital may, if authorised to do so by its Articles, issue redeemable shares. This only became possible under the Companies Act 1981, so while Article 3 of the 1985 Table A permits a company to issue redeemable shares there is generally no such provision in earlier Tables. (The 1948 Table A was modified on 3 December 1981 to accommodate the change brought about by the Companies Act 1981.)

It is more difficult to identify instances where there are slight amendments to the detail of specific articles. For example, Article 50 of the 1948 Table A states that, in summoning an annual general meeting, the notice must specify, in the case of special business, the general nature of that business. Article 52 then defines special business as being anything other than the declaring of dividend, the consideration of the accounts, balance sheets, and the reports of the Directors and Auditors, the re-election of directors in the place of those retiring and the appointment of, and the fixing of the remuneration for, the auditors. The 1985 Table A draws no distinction between special and ordinary business and Article 38 states that the notice calling any meeting must specify the general nature of any business to be transacted. Another example of a fine distinction is in the disqualification of directors. Article 88 of the 1948 Table A disqualifies a director from holding office if he becomes of unsound mind. Article 81 of the 1985 Table A disqualifies a director who is suffering from a mental disorder only if a court order has been made in respect of such infirmity.

3. The effect of the memorandum and articles

3.1 The statutory contract

Section 14(1) of the Companies Act 1985 states that:

> ‘subject to the provisions of this Act, the memorandum and articles, when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all provisions of the memorandum and of the articles’.

This, on the face of it, appears absolutely straightforward: the memorandum and articles are a contract between the company and the members and also between the members themselves. Thus a company can enforce an article giving it the right to make calls on unpaid shares against a member, a member can enforce an article giving him voting rights against the company, and a member can enforce an article giving pre-emption rights on a sale of his shares against another member.

This is usually referred to as the statutory contract or the section 14 contract.

3.2 Testing the statutory contract

The starting point is the case of *Eley* v. *Positive Government Life Security Assurance Co* (1876) 1ExD 88. The articles of the company provided as follows:

> ‘Mr William Eley, of 27, New Broad Street in the City of London, shall be the Solicitor to the company, and shall transact all the legal business of the company, including parliamentary business, for the usual and accustomed fees and charges, and shall not be removed from this office except for misconduct’.

The articles had been drafted by Eley himself when preparations were being made for the registration of the company. Doubtless taking the view that a company with such excellent legal advice was well worth investing in, he subsequently bought some shares in the company. The company then started to instruct another solicitor and Eley brought an action for breach of contract. The action was dismissed at first instance and this was confirmed by the Court of Appeal.

Lord Cairns LC said:

> 'Articles of association, as is well known, follow the memorandum, which states the objects of the company, while the articles state the arrangement between the members. They are an agreement *inter socios*, and in that view, if the introductory words are applied to [the article], it becomes a covenant between the parties to it that they will employ the plaintiff. Now, so far as that is concerned, it is *res inter alios acta*, the plaintiff is no party to it. No doubt he thought that by inserting it he was making his employment safe as against the company; but his relying on that view of the law does not alter the legal effect of the articles. The article is either a stipulation which would bind the members, or else a mandate to the directors. In either case it is a matter between the directors and the shareholders, and not between them and the plaintiff'.

In other words, Eley lost his case because he had sued in the wrong capacity: as solicitor to the company rather than as a shareholder. Indeed the judgments never addressed the specific point that Eley was a shareholder in the company and was, as such, entitled to enforce the article by virtue of his being a member.

The *Eley* decision is quoted in most legal reference books as authority for the proposition that articles can only give rights to a member in his capacity as a member. However, that reasoning formed no part of the judgment. It was not until a later case, *Hickman* v. *Kent or Romney Marsh Sheep-Breeders' Association* [1915] 1 Ch 881 that this interpretation was put upon the case by Astbury J:

> 'that no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, as, for instance, as solicitor, promoter, director, can be enforced against the company'.

In other words, a member can enforce an article which gives him a right in his capacity as a member, for example the right to receive a specified dividend, the right to vote or the right to receive a return of capital on a winding up, but that he cannot enforce a right given to him in any other capacity.

Although this interpretation has now been widely accepted, it could be disputed for a number of reasons:

1. It reads into section 14 words that are not there. Section 14 states that the memorandum and articles upon registration bind a company and its members. There are no caveats contained in the provision. The statutory provision is clear and unqualified. It is therefore unacceptable to read caveats into it.

2. The decision misinterprets the *Eley* decision. Eley lost because he had sued in the wrong capacity. He had not sued as a member.
3. Astbury J disregarded the decision in *Salmon* v. *Quin and Axtens Limited* [1909] 1 Ch 311. In this case, the articles of a company gave the general powers of management to the directors. There was a provision that no resolution of the directors regarding certain matters was to be valid if either of the two managing directors dissented from such resolution. One of the managing directors, the plaintiff in the case, dissented from a resolution. The question which the court had to consider was whether the dissent prevented the passing of the resolution. In the Court of Appeal, Farwell LJ said 'The articles forming this contract, under which the business of the company shall be managed by the board, contain a most usual and proper requirement, because a business does require a head to look after it, and a head that shall not be interfered with unnecessarily'. This decision was subsequently affirmed by the House of Lords at [1909] AC 442. Thus there is authority at the highest level that an article can confer a right upon a member in some capacity other than as a member – in this case as managing director.

3.3 Is this just an academic question?

This case law is relevant because it may well have practical implications for the drafting or altering of a company's articles. Suppose a joint venture company were formed in which one of the shareholders was an insurance company. The purpose of the joint venture is to construct a shop and office development. The insurance company investor wants all the insurance to come its way. Accordingly an article is inserted in the company's constitution that all insurance shall be placed through the insurance company. Suppose now that management starts to use another insurer. Could the insurance company enforce the article? If the judgment of Astbury J were followed, then it could not. On the other hand, if section 14 was read literally, the article could be enforced.

4. Shareholder agreements

Increasingly, companies are putting some rules of internal management into shareholder agreements rather than into articles. Such agreements are simple contracts. As such they are completely distinct from articles. Articles are automatically a contract between the company and the members. Upon becoming a member of a company that incomer is automatically bound in to the section 14 contract. However, a shareholder agreement is merely a contract between those persons who are parties to it. It is therefore essential that any

person joining the company as a member agrees to become a party to the shareholder agreement, because failure to do so will mean that he is neither bound by the agreement nor can he enforce it against a party to it.

While articles of association constitute a public document, shareholder agreements are generally viewed as being confidential. Sometimes there is academic argument as to whether certain provisions of a shareholder agreement (such as anything which purports to vary a provision stated in the company's articles) should be filed at Companies House. There is no judicial authority on this point, so it is probably safe for shareholder agreements to be treated as purely private documents.

Under section 9 of the Companies Act 1985, articles can always be changed by a special resolution (see Chapter 3 below). A shareholder agreement, being a contract, can only be changed either as the contract itself provides or, failing such provision, by the unanimous consent of all the parties to it. In *Russell* v. *Northern Bank Development Corporation Limited* [1992] BCC 578, the House of Lords had to consider a shareholder agreement made between the members of a company incorporated in Northern Ireland. The company, which had been formed for the merger of two brick manufacturing businesses, had an issued share capital of 200 £1 shares. Four executives each held 20 shares and an investment bank held the remaining 120. There was a shareholder agreement to the effect that there should be no increase in the share capital without the written consent of each of the parties to the shareholders agreement. It was held that this was a binding contract and a declaration to this effect was made by the court.

5. Future developments

5.1 Community interest companies

The Companies (Audit, Investigations and Community Enterprise) Act 2004 anticipates the introduction of community interest companies. These entities, which are due to become possible on 1 July 2005, will occupy an area somewhere midway between charities and commercial companies. They will not be charities, and so will not enjoy the tax breaks from which charities benefit. They will be formed as companies, with the usual documentation going to the Registrar of Companies. It is intended that community interest companies will attract grants from local, central and European government, and so there will be strict controls as to what benefits can come out of such companies for their shareholders. One such control will be reflected in the contents of their articles. Certain specifc articles must be included. These will be set out in forthcoming secondary legislation.