This case and brief introduction give you some idea of the problems which existed prior to the passing of the **Companies Act 1989** which amended this area of law.

Companies act 1989 reforms

Before we consider these, a brief point of referencing. The 1989 Act operated by modifying the Companies Act 1985. Thus references here are to the Companies Act 1985, as amended by the Companies Act 1989. You may be forgiven for thinking that the Parliamentary draftsman did not have you in mind when framing this legislation. In an attempt to help and to stop repeating the derivation of these provisions, sections which were introduced in this way will use the term 'new section' to describe them.

The 1989 Act made the following changes to the law.

1. New Section 35 states that an act done by a company cannot be called into question on the grounds of anything in its Memorandum or Articles (including the absence of any specific provision). In this context, an act would include the making of a contract. What this means is that if a company enters into a contract then it will be valid, even if not authorised by the memorandum.

2. Under new Section 35, a shareholder may take legal action to prevent a company from undertaking an *ultra vires* act as long as this is done before a contract is entered into. Once a contract exists then it cannot be stopped. Where a contract has been made which contravenes the objects clause it may be ratified by the members by means of a special resolution (explained later in this section). Ratification is a process of retrospective approval. If not ratified the directors may be sued for breach of duty and so would become personally liable for any loss the company made.

3. A company may, under new Section 3A, have the single object of being a **'general commercial company'**. This gives the company the power to carry on any trade or business and to do those things incidental to such trade or business.

Having an object such as that in (3) above effectively means that a company cannot act *ultra vires*. In other cases it is still possible for a company to undertake an *ultra vires* act but it will be valid. The directors who approved the act can however be sued for any damages suffered by the company. A member can only prevent the commission of an invalid act if he/she has sufficient notice to go to court before a legally binding contract is made.

Limited liability

ACTIVITY 11: QUESTION

We discussed earlier the way in which the concept of 'limited liability' conferred protection on shareholders. Give a brief explanation of your understanding of the term limited liability.

ACTIVITY 11: ANSWER

When a company has limited liability this means that the members are not normally required to meet the debts of the company. Their liability is limited to the value of the capital they have subscribed to the company. If shares are not fully paid up then a liquidator may compel shareholders to pay outstanding amounts.

Statement of capital

The statement of the company's capital is simply a statement of the amount of capital which the company can issue and how this is sub-divided. This may be something like; 'the capital of the company is £1,000,000 divided into £1 shares'. Note that this is the authorised capital of the company, what it is allowed to issue. It is not necessarily what has been issued.

Association clause

The association clause is a formal statement that the founders intend to be formed into a company. It will also say how many shares the founders are taking and be signed by them. It will take the following form.

We, the subscribers to this Memorandum of Association, wish to be formed into a company, pursuant to this Memorandum, and we agree to take the number of shares shown opposite our respective names.

Names and addresses of subscribers	Number of shares to be taken by each subscriber

Finally each subscriber, and at least one witness, must sign the document.

In the case of a plc there must be at least two shareholders. Large listed companies might have a share register in hundreds of thousands or even millions. Two might therefore seem a low number. Until recently the same rule applied to private companies but it is now possible to have single member private companies. This means that even sole traders can form companies. In reality they have always been able to do so. They could for example, own 1,000 shares in a new company and be taking 999 themselves and giving one to another person keep effective control and still have two shareholders.

The changes were introduced through a statutory instrument the **Companies (single member private limited companies) Regulation** 1993.

The clauses we have discussed above limited liability; domicile; capital; and association are all quite formal. This leaves us with two clauses to consider further. The name and objects are worthy of detailed discussion and we will consider them now.

SELF CHECK 5: QUESTION

Andrew, Brian, Charlotte and Diane decide to form a private limited company in Birmingham. The name of the company is to be made up of their initials. They intend to have an authorised share capital of £100,000 divided into 1,000,000 shares and will take 100 shares each. They also intend to have as wide objects as possible. Draft a Memorandum of Association for them. (There is no need to write out the association clause in full.)

SELF CHECK 5: ANSWER

Your answer should look something like this:

MEMORANDUM OF ASSOCIATION

1. The company's name is 'ABCD Limited'.
2. The company's registered office is to be situated in England and Wales.
3. The object of the company is to be a general commercial company.
4. The liability of the members is limited.
5. The company's share capital is £100,000 divided into 1,000,000 shares of 10p.

We, the subscribers to this Memorandum of Association, wish to be formed into a company, pursuant to this Memorandum, and we agree to take the number of shares shown opposite our respective names.

Names and addresses of subscribers	Number of shares to be taken by each subscriber
Andrew	100
Brian	100
Charlotte	100
Diane	100
Total number of shares taken	400

Witness signature (and name and address)
Date

If the company had been a plc, the only difference would have been the inclusion of a clause to this effect. This states simply that 'The company is a public company'.

The Articles of Association

We stated earlier that the Articles dealt with 'internal' matters. By this we mean those issues which regulate the relationship between the shareholder and company. Matters covered by the Articles includes: convening meetings; voting; appointment of directors; shares; and payment of dividends. In Self-check 5 you were asked to draft a Memorandum. This is a relatively easy job and the answer given at the end of this section would be workable in practice. This is not the case for the Articles. They will need to cover a wide variety of situations and detailed rules will be needed to provide that problems which arise can be dealt with.

Drafting Articles is therefore a major job and most company founders will not be able to do it. To help them there are standard sets of Articles which can be adopted instead. For limited companies the model set is referred to as **Table A**. This is updated periodically, the last time in 1985. It is published in a statutory instrument after consultation and as such represents over a century's experience of company regulation. Larger, listed companies are much more likely to draft their own Articles. It is also possible to have a hybrid position. This is adopting **Table A** with appropriate amendments.

Q SELF CHECK 6: QUESTION

A new company drafts its Memorandum but fails to create any Articles. What is the consequence of this as regards the company's constitution?

A SELF CHECK 6: ANSWER

The position is that the company has a set of Articles. It is deemed to adopt Table A except insofar as this is excluded either in whole or in part.

Changing the Constitution

The memorandum

Of the clauses in the Memorandum, all but one can be changed. The odd one out is the domicile clause which is fixed. The authorised share capital clause can be altered by means of an ordinary resolution. The rest, with one exception, by means of a special resolution. Changes to confer unlimited liability on a private limited company need unanimous consent. A plc cannot be unlimited. Note that as the association clause is simply a statement then it is never necessary to change this. The fact that the founders give up their shares is not relevant.

We need to define the two types of resolution which we have mentioned.

Special resolution

This is a resolution passed by three-quarters of the members attending a general meeting in person or by proxy at which notice to move the resolution has been given at least twenty-one days earlier.

Note that votes are usually one per share. Thus a person who holds seventy-five percent of the shares in a company could always pass a special resolution. The three-quarters figure relates to the shares actually voted and not the total number in circulation.

Ordinary resolution

This is passed by a simple majority. Strictly no notice is needed but as a general meeting requires at least fourteen days notice this will be usually given for ordinary resolutions.

There is one final type of resolution to consider here. The **extraordinary resolution** is similar to a special resolution but requires only fourteen days notice.

In some cases it is possible to have less than the required notice but this normally requires the consent of the holders of at least 95% of the shares in the company.

SELF CHECK 7: QUESTION

List the clauses of the Memorandum and state alongside each the type of resolution which can be used to alter it.

SELF CHECK 7: ANSWER

1.	Name	Special
2.	Domicile	Not alterable
3.	Objects	Special
4.	Liability	
	Limited to unlimited	Unanimous consent
	Unlimited to limited	Special
5.	Share capital	Ordinary
6.	PLC	Special

For changes to the name the rules which applied to the original selection must still be met. Changes to the objects can be subject to a challenge in the courts by shareholders who opposed the measure provided that they hold at least fifteen per cent of the company's shares and apply within twenty-one days. The court would then decide whether or not the change should come into effect. Where a plc re-registers as a private company then the holders of five per cent of the shares may object to the court within twenty-eight days.

Where changes are made they must be notified to the Registrar within fifteen days and a copy of the altered Memorandum enclosed.