

SETTING UP A COMPANY AND SHAREHOLDERS' AGREEMENTS

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1. Merits of Incorporation

1.1 Introduction

If you are thinking of setting up a company, either from scratch or by way of incorporating an existing business be it a partnership or a sole trader, there are various issues to bear in mind as set out below. At the end of the day, of course, it will depend on individual circumstances and situations.

So what does running a business as a private limited company mean?

Such a business will be owned and operated by the company itself. The company is recognised in law as having a 'personality' which is separate from the person(s) who form the company and/or the directors and shareholders. The division of powers between board meetings (where, generally, directors' decisions are made) and general meetings (where generally, decisions of shareholders are made) is a fundamental aspect of company law. It imposes on a company a degree of formality, which is absent from running a business by a sole trader or as a partnership.

1.2 Liability

The company is responsible for the debts and obligations of the business, so the directors and shareholders cannot generally be required to pay anything towards the debts of the company in the event of the company's insolvency. Shareholders enjoy the benefit of limited liability, which means that their liability is limited to paying to the company the price they have agreed to pay for their shares. Once their shares have been paid for in full, the shareholder has no further liability. Note, however, that there are a few exceptional circumstances where a director or shareholder can be forced to make a contribution to the company's assets, in particular in the event of insolvency, or where a director has given a personal guarantee.

Partners and traders, on the other hand, are fully liable for all debts of the business. In the case of a partnership, if one partner does not pay then the others must pay his share.

1.3 Management Structure

The only limitation laid down by statute is that a company is obliged to have one director and, for a public company, one secretary (who may not be the same person). (**NB:** since 6 April 2008 private companies have no longer been required to have company secretaries, although they can still have one if they choose to). Otherwise the company is entitled to lay down whatever procedures and limitations on its management that it chooses, by incorporating the agreed rules in the Articles of Association (the '**Articles**'). For further advice on this area, please see paragraph 4.2 below.

The Articles would usually be drafted so as to give the directors the freedom to regulate how they manage the company. However, certain major decisions, for example, incurring borrowings over a certain limit may be reserved to the shareholders, whether this be set out in the Articles or a shareholders' agreement. For further advice on this area, please see paragraphs 4.2 and 4.3 below.

A partnership is at liberty to organise itself in such a way that certain partners exercise management functions and other partners are only consulted on major issues.

1.4 Raising Finance

The standard choice for raising finance is between debt (i.e. loans) and equity (i.e. shares). Please see the document entitled 'Raising Finance' for a fuller discussion of these alternatives. This discussion is restricted to looking at their relative advantages and disadvantages in the context of incorporation.

1.4.1 Debt

Most lenders of a business will seek security for payment of a loan. Companies, partnerships and sole traders can all create fixed charges (i.e. an interest attaching to a specific item of company property) over their assets as security, however, only a company is able to create a floating charge. A floating charge is an interest in company property created in favour of a creditor to secure an amount owing, such property being circulating assets (such as cash and stock in trade) to which it will not attach until some event causes it to become fixed. Although the floating charge is an inferior form of security compared to a fixed charge, it allows the company to use, for example, its stock-in trade and future assets as security for its borrowing. This means that a company has greater scope than a sole trader or a partnership for raising finance. Please see the document entitled 'Raising Finance' for further discussion on fixed and floating charges.

1.4.2 Capital or 'Equity'

When a person introduces capital to a limited company in return for shares, the company has the advantage of being able to offer limited liability. A partnership to which a person introduces capital and becomes a partner is asking that person to accept unlimited liability for the debts of the partnership incurred after he becomes a partner.

In the longer term, a company (provided that it is a public limited company) may also make an offer to the public and/or flotation on the London Stock Exchange or the Alternative Investment Market, a route that is denied to sole traders or partnerships. Please see the document entitled 'Listing' for further discussion on flotations.

1.5 Taxation

The company will pay corporation tax on the profits of the business; the directors and shareholders of the company cannot be made liable for payment of corporation tax. A sole trader, on the other hand, is responsible for paying income tax on all profits of the business.

1.6 Running of the Company

Unless it is dissolved a company continues in existence so that it is not affected by the death, bankruptcy, mental disorder or retirement of any of its shareholders. In the case of a partnership, on the other hand, subject to any agreement between the partners the partnership could be dissolved as regards all partners on the occurrence of such an event.

1.7 Publicity of Incorporation

The downside of a company is that it must make public a range of information about its affairs and its shareholders by filing returns and documents with the Registrar of Companies.

A partnership, on the other hand, is entitled to maintain privacy with all of its affairs, except that the identity of all partners and an address for service of documents must be made public.

2. Alternative Structures and Implications

2.1 Company Limited by Shares versus Company Limited by Guarantee

2.1.1 Company limited by shares

A company limited by shares is the most common vehicle for an entity intending to make a profit and wishing to enjoy the benefits of limited liability (see paragraph 1.2 above). The liability of shareholders of a company limited by shares is restricted to the amount which they have paid or agreed to pay on their shares.

2.1.2 Company limited by guarantee

Companies limited by guarantee are usually formed for the purpose of carrying on business in which it is not intended to make a profit. The liability of shareholders is limited to the amount of the guarantee stated in the company's Memorandum of Association (the '**Memorandum**'). The figure can be as small or large as the founders of the company may wish, but commonly it is £1. Such company has no share capital.

A guarantee company will normally be used for the following purposes:

- a club or association or for some social, sporting, recreational or other purpose;
- trade and professional associations; and
- charitable bodies.

The word 'limited' can be deleted from the company provided that the Memorandum and Articles require that the company's profits, if any, or other income be applied in promoting its objects (see section 4.1 below) and prohibit the payment of dividends to shareholders.

2.1.3 Other differences between companies limited by guarantee and those limited by shares

A guarantee company differs from a company limited by shares as follows:

- each shareholder guarantees to contribute a certain sum to the company in the event of winding up. No monies are invested in or contributed to the company during its active life;
- a guarantee company may only be formed as a private company;

- the Articles and Memorandum must be in the form set out in Table C (the model articles which apply to companies limited by guarantee); and

2.2 **Single Shareholder Companies**

2.2.1 **Introduction**

A single shareholder company is a private company, limited by shares or by guarantee, which is incorporated with one shareholder, or whose membership is reduced to one person. (NB: pursuant to the 2006 Act public companies will also be able to be single shareholder companies as from 1 October 2009.)

2.2.2 **A single shareholder running the company**

A single shareholder alone cannot run a company. The company must still have at least one director. Although the 2006 Act does not replicate the 1985 Act requirement for a single shareholder company to have a secretary who cannot be the sole director (and indeed under the 2006 Act private companies no longer need to have a secretary) it will still be advisable for such companies to use the services of a secretarial services company. An experienced company secretary will be able to advise and implement many of the company procedural tasks which are a legal requirement under both the Companies Act 1985 (the '**1985 Act**') and the 2006 Act.

2.2.3 **Register of Members**

A company's Register of Members must accurately record its shareholders. If a company is incorporated with one shareholder, then the register must reflect this. If the company originally had more than one shareholder and the membership reduces, then the register must show when this happened. Similarly, the appropriate entries must be made in the Register of Members if the number of shareholders later increases.

2.2.4 **General meetings**

Regardless of any provision in the company's Articles, a single shareholder present in person or by proxy constitutes a quorum at any general meeting. If such a meeting is held, it must be recorded in the minutes.

2.2.5 **Recording decisions taken by a single shareholder**

When a single shareholder takes a decision, he must (unless the decision is made by written resolution) provide a written record of that decision. Failure to do so means the single shareholder is liable to a fine but does affect the validity of the decision.

2.2.6 **Contracts with a single shareholder who is also a director**

When a limited company enters into a contract with a single shareholder of the company who is also a director, the company must (unless the contract is in writing) ensure that the terms of the contracts are set out in a written memorandum or recorded in the first meeting of the directors after the contract was made. This does not apply to contracts entered in the ordinary course of business.

NB: another of the themes within the company law reform process has been that of making it easier to set up and run a company. To this end, the 2006 Act provides that

one person should be able to form any sort of company, including a public company. This part of the 2006 Act will be coming into force on 1 October 2009.

2.3 Limited Liability Partnerships

As from 6 April 2000, a new legal entity, a limited liability partnership (an 'LLP'), has been available. Although the name contains the word partnership, it is in fact a body corporate which has a separate legal entity from that of its shareholders (like a limited company but unlike a partnership). An LLP has unlimited capacity and can undertake the full range of partnership business activities which a partnership can undertake. As an LLP is a body corporate, partnership law does not in general apply to an LLP. *This note will not deal any further on LLP's. If you need specific advice, please contact the company commercial department of Davenport Lyons.*

2.4 As from July 2005, a new type of company, a community interest company, has been available. Broadly, this new type of company will be relevant for social enterprises, or businesses that use their profits for the benefit of the local community or the wider public.

3. Formalities and Procedure

3.1 Availability of Name

Every company must have a company name, and this must be stated in the Memorandum. Obviously a name has to be chosen when a company is first formed, but it is possible to change the name of a company if the shareholders agree to this by special resolution (i.e. a resolution which must be passed by a majority of 75% of the members present and voting in favour of it, and for which 21 clear days' notice is required).

A name cannot be used if:

- it is 'the same as' a name already on the index of names at Companies House. Therefore it is important to check the index at an early stage to ensure that the desired name is not already in use;
- it is offensive;
- its use would be a criminal offence; or
- it includes the words 'limited', 'unlimited' or 'public limited company' anywhere except at the end of the name.

It is also essential to check the Trade Mark Register to ensure the proposed name is not already registered as a trade mark in your field.

In addition, some words have been deemed to be 'sensitive' and require the approval of the Secretary of State or other relevant body before they can be registered. For example names which give the impression that the company is connected with HM Government or with a local authority. Other examples of sensitive name include those which may imply national or international pre-eminence. For example, if you use the word Scottish or Scotland you must show that the companies' main place of business will be in Scotland.

3.2 Incorporation from scratch

3.2.1 Introduction

Once it is established what sort of company is required, there are several ways of forming a suitable company. A 'tailor-made' company can be incorporated at the outset to suit individual requirements but very commonly a 'ready-made' company can be bought. The decision whether to form a new company, or purchase an existing 'ready-made' company is usually determined by cost and time.

3.2.2 Ready-Made Companies

It is possible to buy a company, which has been incorporated and therefore already exists, i.e. a 'shelf' company. The shelf company will not be trading, but will have been formed in anticipation of somebody wanting to buy it and use it as a method of running a business. Shelf companies are available from company formation agents. (Please see details of our Company Secretarial Services.)

Shelf companies are generally formed with standard Articles and an objects clause stating that the company is a general commercial company (see paragraph 4.1 below).

3.2.3 Newly Incorporated Companies

The alternative is to incorporate a new company, and the Registrar of Companies is able to provide a 'same day' incorporation service.

When a name for the company has been selected, the following duly completed and executed documents must be sent to the Registrar of Companies. (Please see details of our Company Secretarial Services)

1. Memorandum - there must be at least one subscriber to the Memorandum (there are commonly two), who must agree to take at least one share in the company; the number of shares which each has agreed to take is shown against his name in the Memorandum. One witness must also sign against each subscriber.
2. The amount of the company's authorised share capital (i.e. the nominal amount of the share capital of the company) will need to be decided.
3. Articles - which again must be signed by the subscriber(s) and witnessed.
4. The situation of the registered office of the company will have to be decided on before the formation papers are lodged at the Registrar of Companies (see below). The registered office is the address of the company to which Companies House letters and reminders will be sent.
5. The names of the first directors (and secretary, if having one) and intended place of the registered_office at the company must be submitted on Form 10. This Form must be signed by the first directors (and secretary), agreeing to act in that capacity, and must also be signed by the subscriber(s) or their agents.
6. A statutory declaration on Form 12 made by a solicitor or by one of the first directors or secretary confirming that the necessary documents have been properly prepared.

7. Where appropriate, formal justification of a 'sensitive' name must be submitted with the incorporation papers.
8. The registration fee payable (currently £20, £50 for the same day service).

If all is in order, the Registrar of Companies will issue a certificate of incorporation, bearing the date of incorporation, the company's registered number and stating that the company is a private limited company. A private limited company may commence as soon as it becomes incorporated.

NB: Continuing the theme of making it easier to set up and run a company, the 2006 Act also sets out simplified requirements for setting up a company, with, for example, the requirement for a statutory declaration being replaced with a requirement for a statement of compliance. Again this change will apply from 1 October 2009.

3.3 **Converting an existing business or partnership to a limited company**

It may be that, rather than incorporating from scratch, there is an existing business, whether it be a sole trader or a partnership, which is incorporated. There are a number of tax issues relating to the transfer, which could impact on the decision to incorporate an existing business.

3.3.1 **Income Tax**

From an income tax perspective, the business formerly carried on by the sole trader or partnership will come to an end. The impact of this needs to be taken into account and there are sometimes advantages to be had in timing the date of incorporation with care.

3.3.2 **Capital Gains Tax Implications**

When the business is transferred to a private limited company there will be a disposal to the company by the partners (or sole trader) of any assets of the business which do not remain in their personal ownership. The Inland Revenue will treat these assets as chargeable assets for capital gains tax ('CGT') purposes. CGT may be payable on transfers even if full value is not paid for the transferred asset, or if the transferred asset is exchanged for another asset (rather than for money).

It may be possible to access relief on any resulting CGT liability. The reliefs that are most commonly claimed in these circumstances are 'business transfer (incorporation) relief' (which allows gains to be deferred when a business is transferred to a company in return for shares) and, where an asset is transferred for less than its true market value, 'gift holdover' relief.

These reliefs are subject to a number of detailed conditions and the choice between them is normally driven by other tax planning considerations.

3.3.3 **Stamp duty**

Stamp duty is chargeable on the purchase of assets, ownership of which passed to the company by document (for example a contract or conveyance); these are dutiable assets. Where ownership of assets passes by delivery (for example stock-in-trade, machinery and plant which is not fixed to the premises), the assets are not dutiable (i.e. no stamp duty is payable).

3.3.4 Value Added Tax

VAT may be chargeable on the transaction if the value of the business assets together with any other goods or services that have been supplied by the sellers exceeds the VAT registration threshold. Such VAT charge may be avoided by ensuring that the company is registered for VAT before the sale takes place so that the sale of the business can be treated as a transfer of a business as a going concern.

In addition to the tax consequences, there are a number of other consequences, such as those outlined below.

3.3.5 Consents

Now that there is a company with a separate legal entity, any licences, consents or leases which have been obtained in the name of the sole trader/partnership will need to be assigned or re-issued (as the case may be) to the company.

3.3.6 Contracts

In addition, the benefit of any contracts entered into by the sole trader/partnership will need to be assigned to the new entity or even novated. Novation is a process by which an entirely new contract is entered into in which both the third party and the new company agree that the new company will take the place of the sole trader/partnership.

3.3.7 Employees

Where an existing business is transferred into a company, the Transfer of Undertakings (Protection of Employment) Regulations 2006 will apply. The effect of this in general terms is that all employees will be employed by the newly formed company on the same terms as they were employed by the sole trader/partnership, and their period of continuous employment will run from the date on which they started working for the sole trader/partnership, rather than the date of incorporation. This has implications for unfair dismissal and redundancy claims.

4. Documentation

4.1 Memorandum of Association

This sets out the name, place of registered office (i.e. in England and Wales), share capital and objects of the company. The objects clause should set out the purpose for which the company is in business, and what it is empowered to do. Although a company's objects used to be set out in detail, in order to cover everything that a company wanted to do, it is now possible to have a main objects clause, stating simply that the company is a general commercial company. If this wording is used, the company can generally carry on any business it wishes, thereby enabling it to diversify its business without encountering problems with limitation from the objects clause. This wording also enables the company to do anything incidental or conducive to its business.

What happens if a company attempts to act outside of the objects – ie 'ultra vires'? It used to be the case that any ultra vires action taken could be challenged, and any contract entered into could be set aside. However, it is now the case that acting

'ultra vires' has no implications for the validity or enforceability of any contract entered into – in other words there are no implications for third parties, provided such third party has acted in good faith in dealing with the company. What is possible is that any shareholder can challenge a proposed ultra vires act on the basis that the company does not have the capacity to enter into the transaction concerned, and may ask the court to grant an injunction restraining the proposed action. Note however that this can only be done before the company on the contract incurs any legal obligation. After that, an aggrieved shareholder's only remedy is to claim against the directors for breach of duty (see the document entitled 'Directors').

NB: Under the 2006 Act the Memorandum be a very different document from what it is now – it will essentially be a 'snapshot' of the company, of purely historical significance, evidencing the intention of the subscribers to the memorandum to form the company and to become members on formation. In addition, the objects of the company will be unrestricted, unless the company decides to so restrict them. Once again, these changes will apply from 1 October 2009.

4.2 Articles of Association

These set out the rules of conduct for the company. There are three alternatives. Either a company can use the 'Table A' Articles – these are appended to the relevant Companies Act, and are the standard regulations. However, companies often wish to tailor their Articles to their specific needs. One option is to use Table A with amendments. The other is to have a completely individual set of articles (although these should follow the basic structure and headings of Table A). Most private limited companies adopt the second approach. **NB: pursuant to the 2006 Act, the Secretary of State has the power to prescribe, by secondary legislation, stand alone model articles for all different types of companies. Draft model articles have been produced for private companies limited by shares, private companies limited by guarantee, and public companies. As with Table A, the standard articles will apply by default where a company does not register its own articles at Companies House (to the extent that the company in question has not specifically excluded or modified the model articles). The new model articles will apply from 1 October 2009.**

The Articles deal with, amongst other things, the structure of the share capital (i.e. the types of classes) (see the document entitled 'Shares'), variation in share capital, rights attaching to shares (i.e. whether they are redeemable or variable, and what rights to dividend they carry) (see the document entitled 'Shares'), and variation to such rights, voting rights, notice entitlements for shareholder and board meetings, procedure at general and board meetings, and entitlements on a winding up of a company.

4.3 Shareholders' Agreements

It is also common for a shareholders' agreement to be in existence. This is a document in which the shareholders regulate the relationship between themselves and the Company. There is usually a degree of overlap between a shareholders' agreement and the Articles (see below) as well as the provisions contained in the 1985 Act. It is worth noting that whilst a shareholders' agreement is governed by the ordinary rules of contract, the Articles are a creature of company law, regulated by statute. Perhaps the most obvious distinction is that the Articles can be amended by special resolution (i.e. a resolution which must be passed by a majority of 75% of the members present and voting in favour of it, and for which 21 clear days' notice is

required), whereas on normal contractual principles, the shareholders' agreement cannot be varied without the consent of all parties. Another important distinction is that the Articles are a public document (once filed with Companies House), whereas the shareholders' agreement will not be available publicly, and indeed may contain an express provision that its contents be kept confidential. A further distinction is that the Articles will automatically bind all new shareholders, whereas new shareholders will only be bound by the terms of the shareholders agreement if they subscribe to it. Finally, note that as a shareholders' agreement tends to be specifically negotiated, often at a later stage from the setting up of the company, it is possible to find the provisions of the shareholders' agreement differing from those of the Articles. In an ideal world the two documents should be consistent, with the Articles most commonly being the document amended to ensure such consistency. However, in the event that this is not done, and the provisions of the shareholders' agreement are the ones that are to prevail, this should be expressly set out in such agreement.

A shareholders' agreement tends to deal with six key areas, although it can be expanded as necessary in a particular situation. This is a very important document and specialist advice should be sought in all instances.

The key areas are: the board of directors; shareholders; financing; transfer of shares; disputes; and restrictive covenants. In addition, a well drafted shareholders' agreement should deal with 'exit routes' for shareholders – (i.e. how they get their money out from the company), and, where relevant, what other contributions each shareholder is bringing to the party.

4.3.1 **Board of Directors**

Removal of directors: pursuant to the 2006 Act, a director can be removed by an ordinary resolution (i.e. a simple majority vote of the shareholders), subject to following the procedures set out in the such Act. Please see the document entitled 'Directors' for a more detailed discussion of the removal of directors. Consequently, it is common for the shareholders (especially a well-informed minority shareholder) to be given the right (either in the shareholders' agreement or in the Articles by creating different classes of share) to appoint and remove one or more directors. Please see the document entitled 'Shares' for a further discussion of different classes of share.

Quorum: how many directors should be present for a board meeting to be quorate? This is normally two, but in some instances the agreement will provide that board meetings cannot be held without particular individuals, or a director or directors representing a particular group of shareholders, being present.

The mechanics of the decision making process at board level: Table A provides for a simple majority vote but there may be some instances where a unanimous vote of all the directors is considered more appropriate. A frequently used compromise is to have most decisions effected by a majority but have a reserve list of those matters which require a specified majority or unanimous decision of the shareholders (see below) i.e. an entrenchment of protections at shareholder rather than board level.

Chairman: Table A (and therefore most private limited companies' Articles) provide for the Chairman to have a casting vote. However the shareholders' agreement may cover the mechanism for appointing a chairman and may state that no casting vote is available. This consideration will be particularly important in cases where simple majority decisions are required and there is an even number of directors. The position has also been recently confused by an incidental effect of the implementation of one of the provisions of the 2006 Act. If it is decided that the

chairman will not have a casting vote, it may be necessary to consider other ways of avoiding deadlock at board level. This includes referring matters in dispute to an agreed expert or arbitrator. However, leaving matters to be decided by third parties in this way is usually inappropriate for business decisions, as the arbitrator will generally not have sufficient knowledge of the particular company's business.

4.3.2 Shareholders

As mentioned above, it may be preferable to provide that certain matters cannot be effected without a specified percentage majority or unanimous decision of the shareholders. Commonly included are:

- any alteration of the Memorandum or Articles;
- a change in the nature of the business carried on by the company;
- a change in the capital structure of the company, the issue of further shares, or the creation of any options to subscribe for or acquire shares;
- the issue of any debenture or loan stock or the creation of a mortgage, charge, or other third party right over any of the company's assets;
- the giving of any guarantee or indemnity;
- the approval or amendment of annual operating plans or budgets or any activity outside the scope of the annual budget or business plan;
- the sale of all or a substantial part of the company, the winding up of the company or any merger with it;
- making a loan, providing credit, or creating, renewing or extending any borrowings;
- the appointment of any employee whose salary will be over a certain threshold; and
- making any capital expenditure over and above a certain threshold.

4.3.3 Financing the Company

It is common to specify in a shareholders' agreement any agreed arrangements for initial funding and funding on a continuing basis, including working capital requirements and any development and expansion costs. For example, will each shareholder be required, or entitled, to contribute to any continuing calls for funding, pro-rata to his/its original investment or otherwise? Alternatively, will funding be secured only on the assets of the company?

4.3.4 Transfer of Shares

Parties entering into a shareholders' agreement do not normally expect the other parties to have the right to dispose freely of their shareholdings to a third party since the result could well be that two or more incompatible parties are thrown together. It is common to provide that a shareholder cannot transfer shares (other than in certain permitted circumstances, such as a transfer to existing shareholders, or to a member

of the same group of companies) without first offering them to the other shareholders at a fair value.

It is also common to provide for mandatory transfer provisions in certain specified circumstances. Typically, in the case of an individual shareholder his bankruptcy, death or breach of a service agreement may give rise to an obligation on that shareholder to sell his shares.

It may be prudent to consider the situation where a third party offer is received by a majority shareholder and consider whether that majority shareholder ought to be obliged to bring along the other shareholders by procuring the third party offer extends to them ('tag along rights') and/or should the other shareholders be obliged to sell their shares if the majority shareholder receives a third party offer ('drag along rights'). This mechanism is favourable because that a business is far more saleable in its entirety.

4.3.5 Disputes

Although shareholders will usually be approaching the negotiations of a shareholders' agreement with optimistic hopes for the company, a well-prepared shareholders' agreement should provide for the possibility of a dispute. Where the traditional mechanism in a shareholders' agreement is used – i.e. a list of matters requiring a specified percentage majority or unanimous decision then it is usually considered unsatisfactory where the percentage is not achieved to continue with the status quo. In such a situation, commonly referred to as 'deadlock', the following might be considered:

- a reference to a third party arbitrator as referred to in Section 4.3.1 above;
- the right to require the liquidation of the company;
- 'Russian Roulette' – under this mechanism, any party may serve a notice on the other, either requiring the receiving party to purchase its entire holding from it, or for the receiving party to sell its entire holding to the initiating party, at the price set out in the notice.

However, an alternative school of thought is that almost by providing a deadlock resolution mechanism, this can encourage deadlocks to occur. If no such mechanism is provided for, then the parties just have to thrash out a conclusion to the particular matter.

4.3.6 Restrictive Covenants

Parties to the shareholders' agreement will also need to consider whether each shareholder should be prohibited from competing with the company both during and after their involvement. These restrictions are additional to those commonly found in employee shareholder's service contracts.

4.3.7 Exit Routes

It is also common for a shareholders' agreement to deal with the intentions with regard to exit routes i.e. ways in which the shareholders can get the benefits of their investments. For example, it might provide that dividends will be payable after the first two or so years (to allow for stability) and even that certain shareholders will

have preferential rights upon payment of such dividends. Alternatively, the shareholders might agree in the shareholders' agreement that they are aiming to sell the company in so many years' time, and that all should work towards that common goal.

4.3.8 Contributions

In addition to providing cash by way of subscription monies, shareholders might also be providing services to the company. For example, a telecommunications company which invests in a 'start up' might also be providing platform and other telecommunication services to the company often on favourable terms. This should be dealt with in the shareholders' agreement.

4.3.9 'Quasi Partnership'

A shareholders' agreement can also be important in ensuring that the relationship between the parties is not viewed as a 'quasi partnership.' Case law has established that where a private company is a 'quasi partnership', a winding up order can be made on the just and equitable ground where the facts would enable the dissolution of a partnership. This route gives a minority shareholder further protection, in addition to the more usual remedies of a derivative action and an 'unfair prejudice' petition, and could be a nasty surprise for a majority shareholder. For this reason, it is common to see included in the shareholders' agreement a declaration that the parties are not partners, although note that this is not sufficient in itself to prevent a 'quasi partnership' being found.

5. Immediate Obligations and Practicalities

5.1 Statutory Books

These include the Register of Members, Register of Directors, Register of Company Secretaries, Register of Charges, and minutes of meetings and should be kept together in a coherent format. Most newly-formed companies come with a binder containing all the necessary registers. The books must be written up on incorporation and amended from time to time to reflect any changes – for example, any new issues of shares. If this is not done, then any director or other officer of the company in default may be liable to a fine. Please see paragraph 6 below and the document entitled 'Directors' for further discussion in this area.

5.2 Bank Account

Although not a legal requirement, from a practical point of view this must be set up as soon as possible. Bank mandate forms will require the signatures of the directors, and instructions as to who can sign for cheques and whether there is any monetary limit. These decisions are commonly dealt with at the first board meeting (see paragraph 5.10 below).

5.3 Stationery

All stationery used by a company must bear its name, place of registration, registration number, address of the registered office, and either the names of all the directors, or the names of none of them. E-mails are also caught within these requirements, as are order forms and websites.

5.4 **VAT registration**

If the value of a company's taxable supplies is expected to exceed £61,000 in the ensuing 30 days, then the company must register for VAT with H.M Customs and Excise. In any case, once turnover has reached £64,000 within a period not exceeding twelve months, registration for VAT becomes necessary. This figure will rise to £67,000 for the tax year 2008/9. The company will be allocated a VAT number, and must make returns every three months. Note that if the company's taxable turnover is under £1.35million, it can join the 'annual accounting scheme' and send in just one return a year. However, members of the scheme are still required to make regular payments throughout the year.

5.5 **Corporation Tax notification**

When a company comes into charge to corporation tax it must notify the Inland Revenue within three months of the event. A company comes into charge to corporation tax when it commences a trade, or when it obtains its first source of income, for example cash in a bank account or acquires investments.

5.6 **Licences required**

Depending on the nature of the business, certain licences may need to be obtained. These can range from the more usual types (such as software licences), to more industry specific ones.

5.7 **Data Protection**

Although there is an exemption for companies which only process data for: staff administration; advertising, marketing and public relations; and accounts and records, in reality, this exemption is difficult to meet. Therefore most companies who process personal data (including obtaining it, holding it and amending it) on living individuals will need to make a notification with the Data Protection Commissioner, and thereby be added to the data protection register. Failure to register when necessary is a criminal offence. Registration can be done fairly simply, either through the Internet, or by contacting the Information Commissioner's office by telephone (on 01625 545700), and will last for one year, costing £35. For further information on this area please see the section on Intellectual Property.

5.8 **Domain Name**

A domain name is something which identifies the address of a website on the Internet. In today's world, registration of a domain name is a vital first step, not only to facilitate access to the company's website, but also in order to build up and protect the goodwill of a company and to prevent others from registering your name for themselves in order to divert traffic rightfully intended for your site. A search will need to be done to ensure the domain name's availability, and it is worth registering similar names in order to protect goodwill.

5.9 **Insurance**

Insurance should be taken out in the company's name, including employer's liability insurance, insurance for vehicles, if relevant, and occupier's liability insurance.

5.10 **Employees**

Both the local tax inspector and the Department for Work and Pensions will need to be contacted, in order to arrange for the PAYE system and national insurance contribution payments to be put in place. Employment contracts (including the particulars of employment required by statute) should be entered into with all employment staff. Please see the document entitled 'Statements of Employment Particulars' in the section on Dealing with Your Staff for further information in this area.

5.11 First Board Meeting

A board meeting will need to be held soon after incorporation to enable the directors to make the necessary decisions to take the business forward. These will include opening a bank account (see above), appointing an auditor (although technically this need not be done before the first annual general meeting), fixing an accounting reference date, possibly appointing a new secretary and new directors, possibly appointing the Chairman of the board, using a business/trading name, and allotting shares.

6. Maintenance of Internal Books and Records

6.1 Introduction

The statutory books (more commonly known as the company books) consist of records, which every company is required to keep which reflect the history of the company. The 1985 Act and the 2006 Act (until 1 October 2009 both have relevance in this area) make it compulsory to keep at least four 'statutory registers', namely Register of Members; Register of Directors; Register of Company Secretaries (for those companies who have a company secretary) and Register of Charges. In addition minutes of board meetings and of general meetings, accounting records, and copies of directors' service contracts should be kept with the statutory books. These must be written up on incorporation, and amended from time to time to reflect any changes so that they are always up-to-date. The records of meetings, decisions and resolutions must be kept for at least 10 years.

Traditionally these registers have been kept in hard form, and have been updated by hand, by the company secretary or director. However, many companies now keep their registers in computerised form. If the requirements are not met, any Director or other officer of the company in default maybe liable to a fine. The statutory books must be kept at the registered office (or, as from 1 October 2009, at a place specified by regulations under Section 1136 of the 2006 Act) and available for inspection by the general public.

6.2 Register of Members

The Register of Members must contain the following information:

- the name and addresses of the shareholders;
- the date at which each person was registered as a shareholder;
- the date at which any person ceased to a shareholder; and

- The number of shares held by each shareholder, distinguishing each share by its number (if any) and, where the company has more than one class of issued shares, by its class.

6.3 Register of Directors (and Secretaries if relevant)

In relation to directors the following information must be completed in the Register:

- the present and any former first names/forenames or surname of an individual, as well as any name by which the individual was formerly known for business purposes;
- their usual residential address (although as from 1 October 2009 only a service address will be included in the Register for each director, rather than their usual residential address)
- their nationality;
- their business occupation; and
- their date of birth.

As to the Secretary details of their present and any former Christian names (forenames or surname) and their usual residential address must be included.

6.4 Register of charges

A Register of Charges should be kept by every company, even if there are no charges to be entered in the Register, since the person having the right to inspect the Register will wish to know whether or not a company has any charges specifically affecting the property of the company or any floating charges (see paragraph 1.4.1 above) or undertaking on any of its property. The Register must contain particulars of all charges on any property of the company. In addition, companies are under the obligation to keep copies of instruments creating charges. Please see the document entitled 'Raising Finance' for further information on floating and fixed charges.

6.5 Directors' service contracts

Copies of Directors' service contracts, which are not terminable by the company (within 12 months) without payment of compensation, must be made available for inspection without charge by any shareholder of the company.

6.6 Minutes and written resolutions

Minutes of general meetings (and copies of written resolutions) must be kept at the registered office (or at a place specified by regulations under Section 1136 of the 2006 Act as from 1 October 2009). There is no requirement for other minutes to be kept at a specified place. Only records in relation to shareholder decisions are to be available for inspection by the shareholders.

6.7 Inspection of the Statutory Books

The statutory registers must be available for inspection by the shareholders free of charge and any other person (members of the public) for a fee during business

hours. Shareholders and any other person are also entitled to request copies of these registers at a fee, which the company must supply generally within ten days.

Note that some of the 2006 Act provisions on access to the register of members are being implemented in a tapered fashion: companies who file an annual return with a made up date after 30 September 2007 will be able to avail themselves of the tighter restrictions provided by the 2006 Act, which state that anyone wanting to access the register must give prescribed information such as their name and address, and the request must be made for a 'proper purpose.' The company must comply with any request within five days, or apply to the court for directions that they need not supply the relevant information as it is not being sought for a 'proper purpose'.

7. Recent Company Housekeeping Changes

As can be seen from paragraph 5 above, and the document entitled 'Directors', as well as maintaining internal books and records, companies also need to make filings with the Registrar of Companies. In addition, companies at various times need to communicate with shareholders (i.e. in order to give them notice of a general meeting, or to send them a copy of the annual accounts). It is now possible in some instances to communicate with shareholders electronically. Companies therefore no longer have to rely solely on information being sent by post. Indeed, this has been facilitated by the bringing forward to January 2007 of the provisions in the 2006 Act allowing for electronic communications with shareholders.

In addition, some of the requisite filings at Companies House can now be made electronically, including annual returns, Forms 288a and 288b (dealing with the appointment and resignation of directors and Form 287 (dealing with a change of registered office) (note that the names of these various forms will be changing in due course) The aim for the future is to widen this flexibility for incorporation, and more general filing. Indeed, the Act will allow in due course for companies to be formed on-line, and provisions that came into force on 31 December 2006 as a result of the First Company Law Amendment Directive have made electronic filing of documents even easier.

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