

company structure

Getting the right company structure in place is key to the success of the business. The company's articles of association and shareholders' agreement determine how you manage the critical relationships between shareholders, directors and the company.

Setting up a company

A company is incorporated by filing certain documentation at Companies House together with an incorporation fee. Companies House then checks the documentation, registers the company and issues a certificate of incorporation. Companies are usually limited by shares or by guarantee, ie, the members' liability is limited to the amount of share capital introduced or the amount of the guarantee. Companies limited by shares are the most common form. Companies limited by guarantee are, for example, commonly used for charitable and other not for profit companies.

A common way to set up a company is to buy one "off the shelf". These are companies that have already been incorporated and which can be tailor-made to the business' specific requirements by changing the name of the company, registered office, directors and shareholders as well as making any required changes to the share capital and articles. Mills & Reeve can provide shelf companies for a small fee. In addition, Mills & Reeve can incorporate new companies tailored to your needs online (including same day incorporation).

A private company needs at least one member or shareholder and at least one director. There is a minimum age requirement of 16 years for directors and a requirement for companies to have a least one director who is a natural person. Since 6 April 2008 private companies are no longer required to appoint a company secretary. (If the directors decide to dispense with one, they should be aware that the tasks that a company secretary commonly deals with will remain and need to be dealt with either by themselves or by a person appointed by them.) The company must have a registered office at which legal documentation can be served.

Directors have day to day control of the activities of the company although key constitutional rights, rights to profits and abilities to change directors are vested in the company's shareholders.

Decisions of private company shareholders can either be made by written resolution or by voting at a general meeting of shareholders. General meetings are normally convened by directors but they may also be requisitioned by shareholders holding 10 per cent of the voting rights (or 5 per cent in certain circumstances). Directors are appointed either by other directors or by shareholder vote. Directors may be removed by shareholders in general meeting passing an ordinary resolution (requiring a simple majority, ie, greater than 50 per cent of shareholders voting).

Shareholders acquire shares either by subscribing for new shares or by buying shares from existing shareholders.

Shareholder/board control

Day to day control of the company is delegated to the directors and therefore the composition and control of the board of directors is of fundamental importance. Care should be taken to consider which, or what combinations of, directors have control of the board and who, if anyone, is to have a casting vote in the event of a stalemate.

Shareholders do not under general law run the business. This is the responsibility of the directors. While the shareholders can change the directors, their voting rights are generally restricted to constitutional issues such as changes to share capital, changes to the articles of association, approval of accounts and payments of dividends. A simple majority of those persons present at a shareholders' meeting is sufficient for many decisions. However, at least a 75 per cent majority is needed for certain decisions including resolutions to wind up the company, change the articles, buy back the company's shares out of capital or re-register the company as a public limited company. Therefore, a shareholding of greater than 25 per cent gives an important blocking power.

Shareholdings of less than 25 per cent have some restricted benefits eg, 10 per cent or more enables shareholders to requisition a shareholders' meeting and to demand that a vote is by poll rather than on a show of hands (ie, votes are based on the number of shares held rather than one vote per shareholder).

Articles of association

The articles of association are the company's internal "rule book" and usually deal with how shares are issued or transferred, how meetings are held and resolutions passed, as well as the powers, obligations and proceedings of directors.

The Model Articles contain default articles that can be adopted wholesale, although it is more common to modify the Model Articles to tailor the articles to the specific requirements of the company.

Why would you want to amend the standard articles?

Common changes to the Model Articles are, for example:

- o to create different classes of shares. The Model Articles assume all shares will be ordinary shares. Different classes of shares are useful if you want to have, for example, differing voting rights or rights to dividends, veto rights over key decisions or preferred rights on a winding up of the company. In an early stage company with only founder shareholders it is usually simpler and more cost effective to stick with ordinary shares.
- o to give the directors power to allot shares for up to five years. Unless a general power is given in the articles or by resolution of shareholders, directors must specifically be given the power to allot shares by the shareholders on an allotment by allotment basis. As each time this is done a general meeting will need to be convened (or a written resolution circulated to eligible members), the expense and inconvenience of this may be avoided if a blanket five year power is set out in the articles and remains valid.
- o to remove or modify statutory pre-emption rights. These are the rights of existing shareholders to be offered any new shares being issued for cash in proportion to their shareholdings before any (other) existing shareholders or outside investors may purchase them.
- o to enable the directors to vote at board meetings on issues in which they have a personal interest. Normally, if a director has a personal interest on a matter he/she cannot vote. This restriction can be inconvenient and is often removed particularly in the case of smaller companies where the directors are also shareholders of the company.
- o to restrict the members' rights to transfer shares. This is often important in a small company where the founders want to retain control over membership.
 - (i) Rights of first refusal for existing shareholders can be included together with a mechanism for valuing the price of the shares to be sold.
 - (ii) "Tag-along"/"drag-along" provisions are also common (particularly where a venture capital investor is involved) where a sale by a shareholder or shareholders would result in a change of control. Shareholders wishing to sell their shares can only accept an offer to sell if it is made to all the shareholders on the same terms (tag-along). Shareholders may alternatively or in addition provide that if a certain majority percentage of shareholders wish to accept an offer of sale then the

- remaining shareholders will be bound to sell on the same terms (drag-along).
- (iii) Compulsory transfer obligations requiring employee shareholders to transfer their shares, for example where key director shareholders cease to be employed by the company, are also common.
 - o to prevent the removal of directors. An article may be added to give directors who are also shareholders extra votes on any ordinary resolution of the shareholders to remove them from office.
 - o to remove the chairman's casting vote at proceedings of directors. This may be relevant if there are an even number of directors. Alternatively the directors may prefer to refer matters upon which they cannot agree to the shareholders for decision.

Why have a shareholders' agreement?

The articles of association form part of the company's constitutional documentation and govern the rights of the shareholders, the directors and the company. The articles of association is a public document, which is filed at Companies House. Changes to the articles generally require at least 75 per cent of the members to consent to the change either in general meeting or by way of written special resolution. By contrast a shareholders' agreement governs the rights and obligations of shareholders to each other and the company. The shareholders' agreement is a private document, which is not filed at Companies House. Generally it needs unanimous consent to be changed.

Shareholders' agreements are therefore commonly used to deal with matters relating to the company and rights of shareholders that the parties do not want to be a matter of public record, rights between shareholders and more administrative matters relating to the running of the company.

Areas commonly covered by shareholders' agreements

The following matters are commonly addressed in a shareholders' agreement, often in conjunction with the articles of association:

- o Directors' powers: most decisions relating to the running of the company may be taken by the directors without any recourse to the shareholders. The shareholders' agreement can regulate this discretion, for instance by placing a limit on the value of contracts, borrowing or capital expenditure which directors can enter into or incur. Also, the shareholders' agreement can require that any proposed new ventures or expansion of the business must first be approved by the shareholders.
- o Regularity and quorum for board meetings.
- o Veto rights over key decisions: a shareholders' agreement can enhance the position of minority interests by including a list of issues for which a minority shareholder's consent is needed. These could include the appointment of key staff, changes to the board, changes to the nature of the business, borrowing or granting security or (importantly) changes to the articles. Protections may need to be replicated in the articles too.
- o Appointing/removing directors: the shareholders can agree how to deal with appointing future directors (for instance, you might want to have the option to appoint a particular person at some time in the future) or not to remove a director from office unless a particular shareholder agrees. The shareholders might agree to place certain restrictions on directors who are also shareholders, such as preventing them from setting up a competing business if they leave the company.
- o Transfer of shares – pre-emption rights: often shareholders wish to place limits on who can hold shares in the company, to stop shares being transferred to external investors if an existing shareholder wants to sell. Future shareholders will also usually be required to agree to be bound by the terms of the shareholders' agreement. Again these rights could also be included in the articles.
- o If agreements have been reached, for example for particular shareholders to contribute to working capital, these arrangements would usually be documented in the shareholders' agreement.
- o Dividends: shareholders may wish to require payment of a dividend of a minimum percentage of available profits each year.

Simplified procedures

Recent changes in company law have reduced the administrative burden on private companies. When setting up your company it is worthwhile considering whether to take advantage of these simplified procedures, in particular:

- o Whether your company should hold annual general meetings (AGMs) as a private company is no longer required to hold one unless its articles require it to do so (NB: even if you choose to hold an AGM, there is no longer a requirement to lay annual accounts and reports in general meeting (although members must still be sent a copy) and your auditor need not be re-appointed in general meeting).
- o Whether your company needs to have a company secretary as private companies are no longer required to appoint a company secretary, although they may do so if they wish (or their articles require it). (NB: Even if a secretary is not appointed, the directors will still have to allocate responsibility for carrying out company secretarial functions).

Contact

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