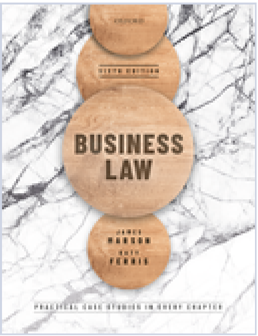

Business Law (6th edn)

James Marson and Katy Ferris

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14. Legal Requirements when Establishing a Business Enterprise

James Marson, Reader in Law and Head of Research for Law, Sheffield Hallam University and Katy Ferris, Associate Professor in Business Law, Nottingham University

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Abstract

This chapter studies the various forms of business organization that are available to those who trade. It focuses on the types of trading structures available, how they are established, and provides an overview of the implications of each form of business organization. It should be noted that there is no one model that will suit every individual or every business model. It is very much the decision of the individual—having assessed the business, what they wish to do with it, and how they see it continuing in the future—to determine the form of enterprise chosen. Being aware of the consequences for the business organization is crucial in making this decision.

Keywords: business organization, trade, trading structures, business model, form of enterprise

You are going to start your own business. What form will your business take? Will you operate as a sole trader, go into partnership with others, or form a corporation? Each of these forms of business organization will impact on the responsibilities and duties of the personnel involved, it will have tax implications, and the administration of each will vary. It is only by understanding the advantages and disadvantages of these forms of organization that an informed choice can be made.

Business Scenario 14

In 2014, Abebi established a business specializing in computer repairs and began operating as a sole trader. In January 2016, she incorporated the business and formed IT-Fixers Ltd with a share capital of 10,000 £1 shares. Abebi was issued with all 10,000 shares in consideration of the transfer to the company of her business and its assets.

Abebi continued to insure the business assets in her own name as she had done prior to the incorporation of IT-Fixers Ltd.

In January 2018, following a fire at IT-Fixers Ltd's premises, the building was substantially damaged and the equipment within it was destroyed.

Later, and following the winding up of IT-Fixers Ltd, Abebi intends to start a new business based on her experience in IT by selling biometric door locks. This, Abebi considers, will be the next big thing in home technology and security. After some initial success, Abebi speaks with a lawyer about establishing a limited company under the name Eyesecure Ltd. During this time, Gaagle plc announces the release of its latest biometric locking system with 3D retina scanning to add even more security. Abebi wants to acquire several of these systems as this latest technology will be sought after by her clients. She does not feel able to wait until her new company Eyesecure Ltd is incorporated and enters into an agreement with Gaagle plc for the purchase of 100 systems on the following terms:

This agreement is entered into on and behalf of Eyesecure Ltd

During the initial board meeting of Eyesecure Ltd, Abebi ratifies the contract with Gaagle plc. However, later, Gaagle plc refuses to supply the systems as promised as demand has been so high that Gaagle believes it can sell them for a higher price than that agreed with Eyesecure Ltd.

Learning Outcomes

- Explain how a company has its own legal personality (**14.2**)
- Identify the advantages and disadvantages of the various forms of business organization (defined throughout the chapter and in the Summary)
- p. 350 Explain the process of forming various business organizations (**14.3.1**; **14.3.2**; **14.3.3**; **14.3.7–14.3.8.7**)
- Compare and contrast a simple partnership and a limited liability partnership (**14.3.2**–**14.3.3**)
- Compare the different types of limited company and explain the implications of forming the business organization as a public and private limited company (**14.3.5–14.3.6**).

14.1 Introduction

This part of the text considers the various forms of business organization that are available to those who trade. There are many forms that organizations can take, from sole traders, to working in partnerships with others, and the organization may wish to become incorporated and operate as a limited liability partnership (LLP), private limited company, or a public limited company (PLC). Each of these provides advantages and disadvantages to the members of that organization and those who deal with it, and there are implications for a business such as taxation, succession, and regulation.

This chapter focuses on the types of trading structures available, and how they are established. This will provide an overview of the implications of each form of business organization. It will enable an initial assessment of which is most appropriate for the individual/group that wishes to begin trading or who want to vary their existing organizational structure. It should be noted that there is no one model that will suit everyone or every business model. It is very much the decision of the individual, having assessed their business, what they wish to do with the business, and how they see it continuing in the future, to determine the form of enterprise chosen. Being aware of the consequences for the business organization is crucial in making this decision.

14.2 Legal personality

The law recognizes persons having a **legal personality**, which provides them with rights and also subjects them to duties. This enables persons with the appropriate capacity to enter contracts, be subject to criminal laws, and so on. Every human has a legal personality and is known as a natural legal person. Companies, on the other hand, are artificial legal things that are known as **corporations** (when they are incorporated). When incorporated they are recognized in law as having their own legal personality and the most common example of such bodies is a limited company.

Consider

Abebi was running a business as a sole trader before establishing IT-Fixers Ltd. On incorporation, IT-Fixers Ltd becomes the legal owner of the assets of the business transferred to it. Abebi has no legal ownership to these and, as such, cannot insure the assets in her name (she has no insurable interest in the assets).

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- *Separate legal personality:* It is essential to recognize that an LLP and limited company have their own legal personality (as recognized at law). The company may enter into contracts, sue, and be sued, and these are rights and duties that are independent of the members of the company (shareholders and directors). This is despite the fact that, clearly, the directors/partners will be performing the actual duties of the corporation in its relations with the outside world. The issue of a company possessing a legal personality was established in the following seminal case.

Salomon v Salomon & Co. Ltd (1897)

Facts:

Mr Salomon had been successfully trading as a sole trader for many years as a leather merchant who produced and sold goods such as shoes and boots. It was then decided that he would change the status of the business and register as a company, and then sell the business to this newly formed company. He duly registered the business and it became incorporated, providing him with a payment of £39,000 for the sale of this business to the company. From this payment, Salomon left £10,000 in the company as his personal loan, and it was intended that this would be paid back to him, therefore he established himself as a secured creditor by taking out a mortgage debenture. Some time later the company had problems in meeting its debts and went into liquidation owing money to Salomon and other creditors. The company only had assets remaining of about £6,000 and Salomon claimed that as a secured creditor. Following an action by the liquidator as to the legality of Salomon establishing himself as a secured creditor, the House of Lords held that he was entitled to the remaining money. As the company had been correctly registered, and there was an agreement between Salomon and the company regarding the loan, as a secured creditor he was entitled to the money before unsecured creditors.

Authority for:

When correctly formed and registered (therefore in accordance with the statutory requirements) a company possesses its own legal personality. This is legally recognized and is separate from the members/directors of the company.

This case established the importance of the limited company, limiting the liability of the members of the company to the shares/money owed to the company. Whilst it may have appeared unfair, the company was correctly registered, and the creditors had been informed of the new status and hence the potential implications for trading with a limited company.

The element of the separate legal personality of the corporation, and its separation from those persons
p. 352 'running' the business, was demonstrated in *Macaura v Northern Assurance Ltd.* ↵

Macaura v Northern Assurance Ltd (1925)

Facts:

The owner of a timber mill sold his timber to a company of which he and his nominees were the only shareholders. The company owed him money, and he took it upon himself to insure the company's assets, but did so in his own name (rather than through the company). When the timber was destroyed in a fire and Macaura attempted to claim on the insurance policy, he was informed that he had no insurable interest in the company's assets and was thus ineligible to claim.

Authority for:

The company and he were separate legal entities and the insurance should have been made through the company rather than him personally.

Consider

Abebi has insured IT-Fixers Ltd's assets in her own name. Whilst Abebi as the sole proprietor of the company is allowed (*Salomon v Salomon*), the effects of the *Macura* judgment is that the insurance company would not be responsible for the losses of the assets damaged and destroyed in the fire. Abebi stopped having an insurable interest in the premises and assets when they were transferred to IT-Fixers Ltd and Abebi should have transferred the insurance to the company's name and responsibility.

Whilst it is true that companies have a separate legal personality, and this is somewhat similar to a human (a natural person) as regards the ability to form contracts, sue and be sued, and be subject to criminal offences, it does not extend to rights such as rights to vote, or to suffer human emotions (such as suffering injured feelings).

Collins Stewart Ltd v Financial Times Ltd (2005)

Facts:

Following the publication of an article regarding High Court proceedings brought against them, Collins Stewart Ltd sought damages for defamation. The losses claimed for the damage to the company's market capitalization value amounted to over £230 million.

Authority for:

The court refused to award damages on this basis. Beyond the speculative nature of a possible market capitalization value as a basis for the award of damages, the nature of the defamation claim here was regarded by the judge as misconceived and untriable.

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- *The veil of incorporation:* Separate legal personality affords a distinction between the corporation as an entity and its directors and shareholders. Further, limited companies have a particular feature: the shareholders have limited liability. The metaphor of the 'veil' identifies a cloak of secrecy/shield of the people behind it—the members of the company are protected from liability for the company's debts. Further, it transpires that due to the company's separate legal personality, the courts have often been unwilling to 'lift the veil' and find out what the directors actually did in running the business (what decisions were taken, and by whom, and so on). Due to this demarcation, it has been said that the veil of incorporation protects the members of the company. Whilst the veil is effective, to continue the metaphor, it has been 'raised' by the courts where it has been deemed relevant. The courts have been notoriously unwilling to establish clear rules as to when the veil will be lifted, and they have stated that they will not do so 'merely' in the interests of justice. Further, where one company owns shares in another (subsidiary companies), insofar as the companies are legally distinct then the courts will not seek to lift the veil.

Adams v Cape Industries Plc (1991)

Facts:

Cape Industries was an English company and the head of a group of companies which mined asbestos in South Africa. It had a subsidiary called Capasco, which itself had a marketing subsidiary based in the United States (US). Claims were brought against the US subsidiary for personal injury associated with working with asbestos and these claims were settled. Later, following a reorganization, there were no assets in the US company and the claimants sought damages from Cape in the UK courts. The Court of Appeal identified that Cape could only be subject to the US jurisdiction if the corporate veil was pierced. This would only occur if Cape was treated as a single economic unit; that it had been established as a façade; or the US subsidiary were the legal agents of Cape.

Authority for:

The rationale for the court refusing to pierce the corporate veil was that the use of corporations with independent subsidiaries to protect the remainder of the group was a legitimate use. The companies had separate boards (and were not a single economic unit); there was no evidence that the subsidiary was established as a sham or a façade; and an agency relationship could not be implied. Thus, the veil would not be lifted to see the workings of the companies.

However, the company must not be established to commit some fraud:

Jones v Lipman (1962)

Facts:

The defendant had entered into a contract for the sale of land but later changed his mind. To avoid the
p. 354 contract, he formed a company of which he was the owner and transferred ↵ the land to the company. In refusing to complete the sale, the defendant argued that the land now belonged to the company—a separate legal entity.

Authority for:

The court held the company to be a sham, having been created to avoid the contract for the sale of land. As such, specific performance was made against the owner to compel the sale to be completed.

… or to attempt to circumvent contractual agreements:

Gilford Motor Co. Ltd v Horne (1933)

Facts:

The defendant was a managing director of the claimant company and was subject to a restraint of trade clause preventing him soliciting Gilford's customers on leaving the business. When his employment was terminated, Horne formed a company and he stated this company employed him, and he began soliciting the customers of Gilford in breach of the restraining clause. He argued the clause was binding upon him rather than the company, but the Court of Appeal granted an injunction to restrain him from breaching the clause. It lifted the veil to identify the true nature of Horne's role in the company. The court considered the formation of the company to be a sham.

Authority for:

The veil of incorporation separating the company from its members (with regard to the company's separate legal personality) will be lifted by the courts where the company's formation is a device/stratagem to evade the effects of a contractual term. The veil may be lifted where the company is a 'sham' or has been established to perpetrate a fraud.

… or the veil will be lifted to identify the true nature of the undertaking (e.g. a 'sham' company).

A recent case from the Court of Justice of the European Union may reduce the protection of separate legal personality in certain circumstances and it would be wise to remain vigilant to developments in this area:

Vantaan kaupunki v Skanska Industrial Solutions Oy, NCC Industry Oy, Asfaltmix Oy (2019)

Facts:

The case was heard by the Court of Justice of the European Union following a reference from the Finnish Supreme Administrative Court. Seven companies had formed a cartel and were in breach of national and EU competition laws. When another company p. 355 ↵ acquired three of those companies, it was fined for the conduct of the companies even though it had not participated in the anti-competitive activities. The argument of the separate legal personality of the subsidiary companies did not prevent the parent company being subject to the fine. The Court of Justice considered that to allow this would enable corporations to evade liability for infringements of competition laws through restructurings or sales.

Authority for:

This is a potentially very significant ruling. The Court of Justice has identified that a parent company may be held jointly and severally with its subsidiary. Here the situation involved fines where the parent company did not participate in the activity. It further applies to anti-competitive activities (which breached EU law) and extends to several different groups of legal persons as the ruling applied to the EU concept of an 'undertaking'. Also, by implication, it may result in the acquirer of a company unknowingly acquiring liability in damages when buying a company, where that company has not participated in an infringement of the law yet its subsidiary has. Further case law is needed to provide certainty in the area.

14.3 Types of business organization

Consider

Abebi has initially established a business as a sole trader. What is the extent of her personal liabilities and what risks are present when operating this trading structure?

14.3.1 Sole Traders

A sole trader is the simplest business organization due to the ease of establishing and dissolving the business. The person carries on their business as an individual; they personally own the property and assets; they generally perform the work, unless they employ others or subcontracts; and, very importantly, they have unlimited liability for any acts or omissions of the business. They may have a business name, but this does not create a separate legal person as it does for a limited company.

They must conform to the Companies Act (CA) 2006, Part 41, which prohibits, for example, a business name suggesting a connection with central or local government or its agencies without the approval of the Secretary of State (CA 2006, s. 1193).

The sole trader is merely responsible to their customers and the State (such as registration with Her Majesty's Revenue and Customs (HMRC), and registration for Value Added Tax (if applicable)). This ensures the appropriate taxes are paid and the business can be regulated in conformity with the law (such as that presented in this text regarding employment, torts, contract, relevant insurance coverage, and so on). Therefore, there is relatively little external regulation of the business. The sole trader, as a self-employed person, is responsible for their end-of-year taxes being prepared on the basis of a self-assessment form p. 356 submitted in arrears at the end of January each year (unless otherwise agreed). The ↵ taxation of earnings is subject to the provisions of the Income Tax (Earnings and Pensions) Act 2003, whilst the taxation of trading income is subject to the Income Tax (Trading and Other Income) Act 2005.

- *Forming the sole trader business:* As stated above, there are no formal rules regarding the steps to be taken to form such a business enterprise. Insofar as no regulatory requirements exist (such as in professions, including lawyers and accountants) the sole trader may begin to trade immediately. The sole trader may also operate the business in whatever way they wish, as they do not have to ask the permission of partners or seek to change the nature of the business that may have been included in a memorandum of association (as with a corporation).
- *Bringing the sole trader business to an end:* There are very few formalities when ending the sole trader business. Assuming that tasks as contracted to undertake have been completed, and creditors have been paid (along with any associated taxes/duties owed), the sole trader need only inform the relevant authorities of their action to cease trading. Clearly, where the sole trader cannot pay debts associated with the business, there are formalities to do with bankruptcy proceedings (but these are not discussed in this text).

14.3.2 Partnerships

A person may wish to form a business enterprise, and may seek to achieve this by forming a partnership with others. There may be many reasons why a partnership may be sought. The partners may complement each other by each offering expertise in some area, they could establish new markets (such as a builder, plumber, and electrician forming a partnership to build houses), new partners may be brought in to introduce capital without obtaining a bank loan, or partners may be able to offer additional help in running the business. As such, they may decide to establish a 'simple' partnership. The most common type of partnership is an unlimited partnership, where the partners are responsible for the debts/liabilities of the firm and must satisfy these from their own assets if required. The partners simply have to agree to form the partnership (hence it need not be in writing (although this may be wise) and it may be formed through verbal agreements or implied through conduct).

A partnership may also trade as a limited partnership under the Limited Partnerships Act 1907. This simply requires one of the partners to agree to accept full liability for any debts if the partnership is unable to satisfy its obligations (while the other partners' loss is restricted to any capital/property invested). The 'limited' partner must also not have any part in the management of the firm or they will lose the 'limited' status and be liable with the other partners for any debts or liabilities. These types of partnerships are not often used as a form of business organization but are more likely to be seen in the formation of collective investment schemes. Since 2000, a firm can be established as a Limited Liability Partnership (LLP):

- *Types of partner:* Generally, there are four types of partner in a partnership:
  - Under the Partnership Act 1890, s. 24 the 'typical' partner is one who has the right to take part in the management of the firm (unless specifically agreed to the contrary).
  - A 'silent'/dormant partner may come into the firm who, by their nature, invests money into the partnership but who does not take an active role in the management.
  - p. 357 A firm may usually require a partner to join in the partnership by making some investment and 'buying into' the firm. However, it is possible, and used by some professional firms such as lawyers and accountants, for a person to join the partnership as a salaried partner. They do not have the rights and obligations of the other partners, and is essentially treated as an employee, but appears on the firm's letterheads.
  - Where the partner allows their name to be used by the partnership, such as on the letterhead of the firm to add to its credibility with outside bodies, the partner may be a partner by estoppel. The Partnership Act 1890, s. 14 provides that where a person, through their words (spoken or written) or conduct, either represents themselves as, or knowingly allows themselves to be represented as a partner of the firm, they are liable as if they were a partner of the firm to anyone who contracted with the firm (such as providing credit/money).

Similarly with sole trader business organizations, a partnership is simple to create and to dissolve (there are no specific formalities or registration), there is little external regulation (although HMRC must be informed that the self-employed person is a partner rather than a sole trader) other than that already identified for sole traders, and partnerships can commence trading immediately. The partnership is restricted in the choice of business name, and whilst a partnership may use the word 'company' in its business name, it must not identify itself as a limited company or use the initials 'Ltd' and 'Plc' as these are restricted to those organizations that have followed the appropriate registration requirements. The tort of passing-off is also applicable to the business name of the partnership.

Partnerships are two or more persons who come together, and act in common, to form (or with a view to form) a business 'with a view of profit'.

Khan v Miah (2001)

Facts:

The individuals involved agreed to set up a restaurant business. They engaged in preparatory activities including opening a joint bank account, they obtained a loan, bought premises and equipment, and advertised the new venture. However, before they began trading, one individual no longer wished to continue with the business. The other continued and when they obtained profits, the first individual attempted to obtain a share in the business capital and profits. The question for the court was whether there was a partnership in existence?

Authority for:

The House of Lords concluded that parties to a joint venture became partners in the firm when it engaged in activities that were part and parcel of what the parties had agreed to do. It did not have to actually begin trading for the partnership to become effective.

This is of crucial importance in that whilst the Act states that the partner joins with a view to a profit, this
p. 358 does not mean that having not shared in any profits they do not qualify as a partner. ↵

M Young Legal Associates Ltd v Zahid (2006)

Facts:

A solicitor in a law firm was paid a fixed amount, but had no entitlement to share in the firm's profits. A question was raised as to his status as a partner.

Authority for:

The solicitor was a partner of the firm. There was no minimum threshold as to a person's rights to receive profits or their involvement in management before they can be considered a partner. The test is whether, in accordance with their actions, the parties had meant a partnership was to be created.

- *Identification of partners:* The names of the partners must be shown on the letterheads (and when a business name is used which is different from the true surnames of the partners). This is a requirement identified in CA 2006, and applies in the same way as to all business organizations with regard to the choice of business name, and the correct identification of the partners/members.

- *Partnership property:* When a partnership is formed the partners each own the property of the partnership. The Partnership Act 1890, ss. 20 and 21, identifies that, in the absence of any agreement between the partners to the contrary, property will be considered partnership property where it had been purchased with partnership money, the partner who brought property into the firm had been credited with its value, or where it is treated as an essential part of the firm's property. Hence, when the business is dissolved, the partners will take back the property they brought to the firm. However, if the firm is dissolved owing money to creditors, the creditors have the right to realize partnership assets before the partners can 'take back' property introduced into the business.
- *Partnership ratio:* It is worthy of note that where, for example, two people are intending to join together to form a partnership, it is wise not to arrange it on a 50/50 ratio split. Where the two partners have an equal share of, and right to manage, the firm, inevitably a situation will arise where one of the partners wishes to follow a route (e.g. expanding the business), whilst the other partner is more cautious and does not agree with the strategy (and potential risks). As neither partner has the power to force the decision, the partnership may come to an end with such a disagreement (with the consequent problems entailed).
- *Partners as agents:* Partners are considered agents of the organization under s. 5 of the Partnership Act 1890 for the purpose of the partnership's business (this means that the organization is bound by the actions of the partner if the partner has acted in a way that is consistent with the kind of business normally carried out by the organization). This enables the partners to manage the organization, contract on behalf of the firm, and obligate the other partners as a result of this action (as agents). Such authority enables a partner to obligate the firm in the sale of the firm's goods, to purchase goods that would normally be purchased on behalf of the firm, to pay the debts of the firm, and to hire workers. They, therefore, will bind the other partners and the firm in (lawful) agreements that they have concluded. This means that even if a partner does not have the actual authority to perform such actions, p. 359 they may still bind the partnership under 'apparent' authority (see **18.3.2**). The reason why partners may be held liable for the actions of another partner is to protect the public, who may not be aware of the internal power relations within the organization. It is generally accepted that partners can buy and sell goods, take money on behalf of the firm, and issue receipts for transactions in the name of the partnership. These rights regarding transactions of this type are more 'securely' granted on partners in a firm that trades as its object, rather than professional firms (such as accountants) whose partners may not readily exercise such authority.
- *Liability of partners:* A crucial aspect of partnerships is of joint and several liability. Section 9 of the Partnership Act 1890 includes such liability for debts or contracts (as extended under the Civil Liability (Contributions) Act 1978), and s. 10 applies the liability for torts committed in the normal course of business (outside of the normal course of business the individual partner is held responsible (*Hamlyn v Houston and Co.*)).

Hamlyn v Houston and Co. (1905)

Facts:

An aspect of the defendant's business was to obtain commercial information relating to its competitors. Houston, a partner of the firm, obtained confidential information on Hamlyn by bribing one of its employees. The activities associated with obtaining this information were contrary to the defendant's instructions. In a claim for damages for the losses sustained by Hamlyn, it sued the company rather than the partner at fault.

Authority for:

The defendant company was held jointly vicariously liable for Houston's actions. The obtaining of information through lawful means was part of Houston's role at the firm and thus, accordingly, gathering the information through unlawful means was also within this scope of his authority.

This means that if one partner commits a tort or crime in the course of the business, the partnership will be liable (including each partner) if this was within the offending partner's actual or apparent authority.

Dubai Aluminium Co. Ltd v Salaam (2003)

Facts:

A solicitor was alleged to have been involved in dishonest practice in the drafting of documents. As a result, damages were sought not only from him but his fellow partners.

Authority for:

It was held that as the (dishonest) actions of the solicitor were so closely connected with those he would be expected to undertake in his ordinary role, they must be considered to have been undertaken in the ordinary course of his business. The other partners were thus jointly liable. Nothing in the Partnership Act 1890 excluded liability for acts in torts or deceit.

p. 360 ↵ This results in the partners being held responsible for any losses incurred whilst they are partners. If the partnership owes a debt to a creditor and there are no resources of the organization to pay this, then under the concept of unlimited liability, the partners have to satisfy the shortfall from their own resources. This liability will be shared equally between the partners based on their respective percentage ownership. However, if one partner has resources and the other partner(s) does not have the resources to satisfy the debt, the partner with funds is responsible for the full debt (Partnership Act 1890, s. 9). They then have the responsibility/option to seek the money owed from the defaulting partner(s). This liability cannot be imposed on a partner for acts that occurred before they entered the partnership (Partnership Act 1890, s. 17). However, the liability continues even when the partner has left the partnership for acts conducted whilst they were a partner. It is therefore important to be aware of the person(s) who may become partners and there are several express and implied terms (obligations) on partners as to information they must disclose to potential partners.

- *Forming a partnership:* Establishing a partnership is very simple and can amount to an agreement between like-minded people to form a business with a common goal. It is always preferable, however, when forming an agreement that has the potential implications for the partners as identified above, to create a contractually binding agreement. This is referred to as the 'partnership agreement' and identifies for what purpose the partnership is being established, for how long (if a time is identified) the partnership should remain in existence, the names of the partners, the business address where official documentation is to be sent, the percentage ownership and distribution of profits of each partner, the authority for participating in the management of the partnership (if sleeping partners are included), and the responsibilities of each partner.

If new partners are to be included in the partnership (to increase expertise, introduce money, and so on), there has to be agreement between the existing partners for this to take effect (s. 24(7) and (8)). This right does not apply to partners who are retiring and its aim is simply to ensure that due to the unlimited liability nature of the business, and the need for the firm to work to a common goal (not to mention the duties on partners that will affect the working relationships of the partners), the new partners are accepted by all other partners who may be affected by their actions.

14.3.2.1 Duties on partners

There exists in partnerships a fiduciary duty for the partners to act with loyalty to the partnership and in 'good faith'. The Partnership Act 1890 also creates duties on the partners in the following ways:

- *Duty of disclosure:* Section 28 obligates partners to submit full information to the other partners or their legal representatives in matters affecting the organization and to submit true accounts.
- *Duty to account:* Section 29 obligates partners to account for any benefit they have obtained without consent from any transaction on behalf of the firm.
- *Duty not to enter into competition with the organization:* Section 30 obligates a partner, who is competing with the partnership without the consent of the other partners, to account to those partners for any profits or benefit produced in the course of that business.

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- *Relationship based on good faith:* The partnership agreement is a contract based on the utmost good faith. As such, partners must disclose relevant details to other partners (and prospective partners) that could affect the partnership. Therefore, a person's silence can amount to a misrepresentation.

Bentley v Craven (1853)

Facts:

Mr Craven was a partner along with three others in a sugar refinery business. He was responsible for purchasing and, on his own account, bought sugar which he later sold to the partnership at the market price. He failed to declare his interest in the contract to the other partners.

Authority for:

Craven was liable to account to the other partners for the profits made on the contract.

14.3.2.2 The rights of partners

The Partnership Act 1890 provides the following rights (unless expressed to the contrary in the partnership agreement):

- the right to share equally in the capital and profits of the firm;
- the right to be indemnified by the firm for any liabilities or losses made in the normal course of business;
- the right to take a role in the management of the firm (but not ‘sleeping partners’);
- an entitlement to inspect the partnership’s accounts and to have these available when requested;
- the right to veto the entry of a new partner to the partnership or to change the partnership’s business.

14.3.2.3 Bringing the partnership to an end

The partnership may be dissolved on the agreement of the partners (s. 32(c)), or on lapse of time (s. 32(a)), or when a specific task for which the partnership was created has been completed (s. 32(b)). It may also be dissolved on the death or bankruptcy (s. 33(1)) of any partner or where there has been illegality on behalf of the partnership (s. 34). Illegality can occur where the nature of the business was unlawful (such as *Everet v Williams*); and where the partners cannot form a partnership to conduct an otherwise lawful action (such as the case of a solicitor allowing their practice certificate to lapse).

Everet v Williams (1725)

Facts:

The parties were highwaymen who entered into a partnership to share the proceeds from their criminal activities. An argument arose between the two regarding the share of the proceeds and this led Everet to bring a claim for damages against Williams.

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Authority for:

Here the action for damages was dismissed due to its basis being on the criminal activities of the parties. Further, the court fined the lawyers representing the parties and required them to pay the court costs for having brought such a case.

The Partnership Act 1890 continues to identify events affecting the partners that lead to the partnership being brought to an end. These include if a partner becomes a patient under the Mental Capacity Act 2005, if they suffer some permanent form of incapacity (s. 35(b)), if the partner wilfully or persistently breaches the partnership agreement (s. 35(d)), where the business can only be continued at a loss (s. 35(e)), and where it is just and equitable to end the partnership (s. 35(f)). When the business has been brought to an end and the property owned by the partnership is realized, the resources are used to first pay any liabilities, then the partners who have loaned money to the firm are paid back, the capital contribution of the partners is paid, and the remainder is shared on the basis of the percentage of the partnership which each partner 'owned'.

If a partner decides to leave a solvent partnership that intends to continue trading, upon their leaving, the partner will be entitled to their share of the partnership, and the remaining partner(s) will have to generate the money to provide the settlement. This is often a key concern and disadvantage of partnerships as partners may die, and they often disagree about the business and might feel compelled to leave.

14.3.3 Limited Liability Partnerships

As noted, the partners in simple partnerships (unless in limited partnerships) have unlimited liability for the debts of the firm. The enactment of the Limited Liability Partnerships Act 2000 changed this situation, and a partnership created under the Act will be considered a separate legal entity, with its own legal personality. The LLP must be registered with the Registrar of Companies and whilst it has unlimited liability for any debts and liabilities, the individual partners of the LLP have limited liability. This will result in the partners losing any investment into the LLP if it is wound up and insolvent, but they will not be liable for losses beyond this contribution.

As the LLP has its own legal personality, contracts and obligations will be created with the LLP rather than the individual partners. The property of the LLP will also belong to the partnership instead of to the partners. This situation has further advantages over the simple partnership model. As partnerships have to contain at least two individuals, if, in a simple partnership of two partners, one was to die, then the partnership would come to an end (or a new partner(s) has to be found). With LLPs, the partnership will continue despite changes to its internal membership and it will continue until formally wound up. Typically, professional firms have taken the opportunity to become LLPs where the nature of their profession involves the risk of liability claims (such as negligence) that may expose the partners to risk, if the partnership could not settle any award.

The LLP is required to file its audited accounts and tax returns to the Registrar of Companies and the incorporation document must identify 'designated members' who will administer these and other matters on behalf of the LLP. The taxation of the partners will be based on the simple partnership model, and the individual partners are responsible for their 'share' of the tax due, rather than this being placed on the LLP itself. The partners ↵ will have to disclose their proportion of the profits in the annual returns to the Registrar (Limited Liability Partnerships Regulations 2001).

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- *Forming an LLP:* To form an LLP, the incorporation document and a statement of compliance must be filed with the Registrar of Companies, who will then issue a certificate of incorporation if the documentary requirements have been satisfied. Having received this certificate, the LLP can begin to trade, although, to do so before the certificate is issued may result in the partners being held liable as they would under the Partnership Act 1890. The Registrar must be informed of the members of the LLP, who will maintain a register, and the Registrar must also be informed when new members join and others leave.

It is imperative when forming the LLP that the partners establish an agreement that incorporates issues regarding the purpose of the business, the capital in the firm and how profit and losses are to be distributed between the members, the requirements of meetings and voting rights, how new members will be allowed to join, the procedures for the retirement of members, and so on. The requirement for an agreement is even more prominent when it is remembered that LLPs are regulated somewhat similarly to companies, only there is no default standard set of 'model articles' that exist for companies under CA 2006.

This document is private, is not subject to public scrutiny, and does not need to be sent to the Registrar of Companies. Hence, those who are trading with the LLP have no actual mechanism (beyond asking to see the agreement) to identify the internal structure of the members' responsibilities and rights.

- *Bringing the LLP to an end:* The LLP continues in existence until it is formally dissolved, as it possesses its own legal personality irrespective of its members. LLPs can be wound up through their insolvency and, as such, procedures may be established for voluntary arrangements, administration orders, receivership, and liquidation. Section 214A of the Insolvency Act 1986 has been beneficial to creditors to the LLP in that members who have made withdrawals in the previous two years before the winding-up may be requested to return these sums if during that period the member knew, or ought reasonably to have known, that the LLP would become insolvent. Section 74 of the Act ensures that members of the LLP and those members that have left, and who had established an agreement to contribute to the LLP upon **dissolution**, will contribute to the assets of the firm.

14.3.4 Formation of a Company

This section considers the types of companies and the methods of formation (or incorporation) that have to be satisfied. Due to the complexity of the topic, this introductory chapter identifies some important features that will be considered in greater depth in **Chapters 15–17**.

- *The Registrar of Companies and Companies House:* The Department for Business, Innovation & Skills is the department where most of the laws relating to businesses generally will be considered, consulted upon, and advanced through Parliament. It has a section dealing with the registration of companies and it ensures compliance with the requirements established under legislation, including CA 2006, and is called Companies House. This is where the public can find out information regarding companies and their directors (details are available for public inspection), and the 'Registrar of Companies' heads this
p. 364 department. The Registrar is responsible for the issuing of certificates of incorporation when a company is registered, when the company's name is changed, and where the company is re-registered. It lists the details of all registered companies, limited partnerships, and LLPs; holds the annual returns and accounts submitted by companies as required by law; and maintains the details of charges over company property. It may strike companies off the register when dissolved, holds the register of a company's special and extraordinary resolutions, and publishes details of the companies and the receipt of documents in the **London Gazette** (this is the weekly supplement of the publication of The Stationery Office that identifies public notices such as bankruptcies and liquidations of corporations).
- *Unlimited companies:* Very few companies are registered as unlimited companies as the members of the company have unlimited liability, and this significant protection for the members through incorporation is lost. An advantage of trading as an unlimited company is that its accounts are not made public and do not have to be submitted to the Registrar of Companies. However, these are somewhat weak reasons to establish the corporation on this basis, particularly in respect of the deregulation of limited companies through CA 2006. The liability of members exists in situations where the company is wound up, rather than to the company's creditors. Clearly though, where the company does not have sufficient funds to satisfy its debts, the company will be wound up and the members of the company are liable on the basis of the nominal value of the shares held. If no share capital is held, then the members will be liable on an equal basis, and held jointly and severally liable.
- *Limited companies:* This is a very popular form of business enterprise and the changes introduced in CA 2006 remove many of the administrative procedures that were required under the Companies Act 1985. The two main types of limited companies are private limited companies and public limited companies, and this will be identified upon registration through the memorandum of association. It may be thought that only large organizations are corporations, but of course the majority are small and medium-sized enterprises, with just a few shareholders. The majority of companies formed are limited by shares and this identifies that the members of the company (the shareholders) are responsible for the nominal/par value of the shares they own if the company is wound up. The second example of a limited company is one that is limited by guarantee (usually a method chosen by charitable institutions rather than 'businesses'). The 'guarantee' in this respect is a determined amount, established in the memorandum (and possibly in the articles as well), which is to be paid when the company is wound up. Upon being wound up, the sums guaranteed have to be paid to satisfy the company's debts, and where

this amount is insufficient in relation to the debt, those members that left within a year of the company's winding-up can be requested to contribute their guarantee in relation to the debts that occurred whilst they were members.

- *Corporations sole:* The very nature of a company, when compared to a sole trader for example, is that it conjures images of a number of persons joining together to run a business. Whilst this may be the case, a corporation may involve just one person (member). This was typically seen where the bishop or vicar of a parish had a vested interest in the church land, but when he died, the land technically had no owner until the clergyman's successor was found. In response to this, it was established by common law that the office of the bishop/vicar was a corporation with the present incumbent the sole member. Consequently, when the clergyman died, this did not affect the status of the corporation; the land still belonged to the corporation, and the next bishop/vicar simply became the new 'sole member'.

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Consider

Abebi has not incorporated her second business before entering a contract with Gaagle plc. Is it possible to trade under the company name prior to its incorporation? Are directors allowed to ratify an agreement made prior to the company's existence?

14.3.5 Features of a Limited Company

When determining the form of business organization, a corporation, being a separate entity from its members, provides advantages to those members, and also empowers the company to take actions, accept liabilities, and so on, that other business organizations may not. Therefore, some of its more important features are identified below:

- *Limited liability:* Always remember that the 'limited' element of this type of organization refers to the potential liability of members of the company—the shareholders. The company itself has unlimited liability and therefore must satisfy any debts to creditors. If there are insufficient funds and assets to pay the creditors when the debts are called in, the money that is available in the company (its money, property, stock, and so on) will be made available to creditors depending upon their status. The shareholders have their liability for any debts of the company limited to the value they paid for the shares (which will become worthless as the company will be wound up) or the money they owe on any shares (shares do not necessarily have to be fully paid for when issued). It provides protection for the shareholders as to the liability they are exposing themselves to, but also imposes a risk for those trading with the limited company that they may not be able to seek owed money from those who ran or owned the business.
- *Perpetual succession:* One of the drawbacks with trading as a sole trader is that when the sole trader dies, the business may die with them. With a partnership of two people, where one dies another partner has to be found or the firm wound up or run as a sole trader/registered as a corporation. The advantage to the limited company is that once established, it will remain in existence until it is legally wound up,

regardless of who owns or runs the company. Therefore, when shareholders leave the company, a director dies/leaves the organization, and so on, this has no effect on the company's assets or ability to continue trading. As businesses invest time and resources establishing a reputation (trustworthy image, reputation for a quality service/products, and so on), the ability to continue this 'brand image' when the company is sold or other directors take charge of its operation and direction is a significant advantage.

- *Raising finance:* It has been argued that a limited company may be able to raise capital investment and finance more easily than can a sole trader and a partnership. The sole trader and partnership will generally have to secure loans from a lending institution through a charge over the assets (providing collateral). Due to the increased regulation and reporting duties imposed on limited companies, and the controlled use of funds, lenders may be more willing to make loans to improve a business. There is the further benefit of being able to transfer/sell shares to generate income that may be used, and, unlike a loan, this does not have to be paid back.

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- *Contractual capacity:* (Due to its separate legal personality) the company may establish contracts in its own right and enforce contracts when the other party is in breach, although a director of the company must physically undertake this.
- *Taxation:* Taxation of companies' profits may be more beneficial than personal income tax. This, evidently, is a simplification of a very complex area, and requires greater detailed examination than can be provided in this text, but tax has to be paid on taxable profits. Income tax (applicable to sole traders and partnerships) is charged (for 2017/18) at 20 per cent (the starting rate after exceeding the 'personal allowance'), rising to 40 per cent (the higher rate) where the person's income is in the band £33,500–150,000, and 45 per cent (the additional rate) for incomes over £150,000. The main corporation tax is charged at 19 per cent. Hence, it may prove advantageous to trade as a limited company to benefit from the levels of taxation.
- *Administration:* Whereas the sole trader and partnership are largely accountable to themselves, their partners (where relevant), the client/customer, and HMRC, the limited company has much greater administrative burdens that are required through CA 2006. This may include submitting company accounts to Companies House as required and holding an Annual General Meeting (AGM) (although this is not required for private companies). These are not applicable to sole traders/partnerships and as such they are a more 'simple' way of trading.
- *The ability to own property:* A company has the ability to own property irrespective of the composition of the shareholders. The person who forms the company may introduce property to it (e.g. houses in a property rental business). If the person owns this property in their own right, and then 'gives' it to the company, they are owed the money of the value of the property passed over to the company and, whilst stamp duty may be applicable, the person who formed the company will be able to receive the value of the property back from the company. However, the property is no longer owned by the person who gave/sold it to the company; rather it legally belongs to the company. Such assets may be used to raise finance.
- *Commit criminal offences:* It is possible for a company to commit a criminal offence (through the criminal intent (*mens rea*) of the directors).

R v ICR Haulage Ltd (1944)

Facts:

The managing director and the haulage company had committed offences and were convicted of conspiracy to defraud. However, the defendants had argued that the company should not be convicted of an offence which required *mens rea*.

Authority for:

That the actions in the case emanated from the company's managing director, as he was effectively the company's 'directing mind', the company was equally responsible with its managing director.

This has particularly been effective in cases of the manslaughter of persons, where the directors of companies may be convicted and imprisoned on the basis of their actions (health and safety laws are instrumental in this p. 367 aspect of the law). See the online resources ↵ for a discussion of the Corporate Manslaughter and Corporate Homicide Act 2007 regarding the criminal actions of directors and organizations.

14.3.6 Distinctions Between Public and Private Companies

A Public Limited Company (PLC) is entitled to offer its shares and debentures for sale to the public and it may be listed on the London Stock Market (although due to the rules in which companies may be listed this is only applicable to the largest organizations). A private company is prohibited from offering its shares to the public (CA 2006, s. 755). Shares do not have to be paid for in full on allocation but, with a PLC, the shares must be paid for when requested (such as upon its winding-up). This must be in the form of money or assets, but when assets are provided, the value must be independently assessed by an auditor to ensure they represent the value of the owed amount and that a fraud is not being committed on the business. **Table 14.1** sets out the advantages and disadvantages of the various trading structures and **Table 14.2** shows a comparison between private and public companies.

Table 14.1 The advantages/disadvantages of the trading structures

Business organization	Advantages	Disadvantages
Sole trader	It is simple to establish	The sole trader has unlimited liability
	The sole trader is responsible to their customers	Succession. The sole trader often trades under their own name; however, when the sole trader dies, their business may also die

Business organization	Advantages	Disadvantages
	The sole trader has autonomy in how they run the business, when they work, and how profits are disposed of (subject to HMRC rules)	They have complete responsibility for the business—to fulfil contracts, to invest money into the business, to employee replacement if they are ill or on holiday, and so on
	They can begin trading immediately	
Partnership	Partners often 'buy into' a partnership, therefore capital is often introduced	Partnerships have unlimited liability and the partners' personal assets may be at risk for debts/losses
	Partners may offer expertise in an area or provide the ability to enter into new markets	Partners may create liabilities for the other partners and the firm
	Partners may share the work of the business and share the liabilities	Partners share in the profits of the firm, therefore the individual partner's share may be reduced
	Partners have several legal advantages including the ease of formation and it can be quickly dissolved, and it may provide tax advantages in certain circumstances	Partners may be jointly and severally liable for losses
p. 368 ↵ Limited Liability Partnership	The LLP has its own legal personality and limits the liability of its members	It is subject to registration procedures with the Registrar of Companies
	The partnership continues despite changes in the internal membership of the firm	It must file accounts and tax returns to the Registrar It has many features in common with limited companies, some of these are positive to the members and many have negative implications
Limited companies	Limited liability for the members	It has much greater administration requirements than other forms of business organizations
	It has perpetual succession and only 'dies' when formally wound up	It is subject to external and internal regulation
	It is generally easier to raise finance than through a sole trader/partnership business organization	There is no automatic right to participate in the management of the company

Business organization	Advantages	Disadvantages
	It can make contracts in its own right Tax benefits are available for corporations compared to other business organizations	
	The company may offer fixed/floating charges over property	
	Companies may be formed in the belief that the 'status' of a limited company provides an advantage over operating as a sole trader	

Table 14.2 Comparison of private and public companies

Private company	Public company
Its name must end with the words 'Ltd' or 'Limited'	Its name must end with the words 'Public Limited Company' or 'PLC'
A private company is prohibited from offering its shares to the public (CA 2006, s. 755)	A PLC is entitled to offer its shares and debentures for sale to the public and it may be listed on the London Stock Exchange (although due to the Exchange's rules about which companies may be listed this is only applicable to the largest organizations)
A private company is not required to have a secretary (and if a private company chooses to have one they do not have to be qualified)	A PLC requires a secretary and they must be qualified for the position
There is no necessity to hold an AGM	The PLC must hold an AGM each calendar year
'No minimum share capital is prescribed'	The PLC must have an allotted share capital of £50,000 (one quarter of the value of which must have been paid up)
Only one director is required	At least two directors are required
It can pass written resolutions	It cannot pass written resolutions

The private company has become much less regulated and hence more favourable to those who run businesses than before. For example, there is no statutory requirement for a private company to hold any general meeting; there is no limit on the private company's share capital; and it need only have one shareholder, with no need for a company secretary. Private companies may also pass written resolutions without the need to hold a meeting. A PLC also only requires one member, but it does require a secretary and they must be qualified for the position (a solicitor, accountant, or someone who has three years' experience of being a public company secretary). The PLC may not be unlimited and must have an allotted share capital of

£50,000 (one-quarter of the value of which must have been paid up—most shares are paid for in full as soon as they are bought but this is not always required, although on winding-up, any outstanding money must be paid) and this information has to be sent to the Registrar. Without this information a trading certificate will not be issued and if one is not requested within one year of incorporation, an application may be made for its compulsory winding-up. Without a trading certificate, the company may not trade, but if it does, the directors
p. 369 of the company may be held liable ↵ (on the same basis as with a partnership) for any debts/liabilities incurred. The PLC must hold an AGM each calendar year.

- *Size of the company:* Companies are identified on their size and this has implications for the documents to be submitted to the Registrar. Companies identified as small have to satisfy two or more of the following requirements in a financial year (as amended by S.I. 2008/393):
  - a turnover of not more than £10.2 million;
  - a balance sheet total of not more than £5.1 million;
  - not more than 50 employees (as a weekly/monthly average).

However, the small companies regime does not apply to PLCs or a company that is an authorized insurance company, a banking company, an e-money issuer, a MiFID (S.I. 2007/2932) investment firm, an UCTIS management company, or a member of an ineligible group. The small company regime allows for abridged accounts to be submitted to the Registrar (although members have the right to be provided with full accounts but may agree to be sent 'summary of financial statements' instead (s. 426)). The advantage of this provision is that sensitive information, such as the salaries of directors, the directors' report, and a profit and loss account, need not be submitted.

A medium-sized company has similar rights to submit abridged accounts where it satisfies two of the three following requirements in a financial year:

- a turnover of not more than £36 million;
- a balance sheet total of not more than £18 million;
- not more than 250 employees (as a weekly/monthly average).

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14.3.7 Establishing the Limited Company

There are three methods of establishing the limited company—either through Royal Charter, statute, or (most commonly and applicable to this text) through registration.

- *Royal Charter:* This is a mechanism for establishing companies, but as one can imagine, it will not be established for the means of trading (where registration under the Companies Act is more relevant). Examples of the Royal Charter being used to establish a company can be seen in the British Broadcasting Corporation, and universities such as Oxford and Cambridge. The Privy Council is the body that would establish a company in this manner.

- *Statute:* Statutes have been used to create corporations, such as the utilities, where, upon privatization, their status had to be altered as they were no longer owned by the State and did not possess the powers that the State did in relation to the purchase of land and so on. As such, these bodies were registered as PLCs. Statute has also been used to establish bodies such as the Health and Safety Executive, which regulates health and safety inspections and was established through the Health and Safety at Work etc. Act 1974.
- *Registration:* The most common and, in relation to the three forms available, the simplest way to form a company is through registration with the Registrar of Companies.

14.3.8 Procedures of Registration

When a company is formed in the UK, the Registrar of Companies must be sent the memorandum of association, the articles of association, and a completed Form IN01, along with the appropriate registration fee (£12 for online applications and £40 for paper-based applications), by the founding member(s) (also known as the **subscribers**). If the Registrar is satisfied the documents are correct, a certificate of incorporation is issued, identifying the company with its registered number, and the new company will be noted in the *London Gazette*. If the registrar is not satisfied that the documents are correct, or suspects the company is being established for some unlawful means, they can refuse to register the company, and the subscribers have an opportunity to appeal the decision.

14.3.8.1 The memorandum

The memorandum is a document available for public inspection and its aim is to identify the features of the company. It is not intended to form part of the company's constitution as it previously had, but rather to identify the company when it was formed. Essentially, this was an attempt to simplify the provision of company law and to provide the details of the constitution of companies in one document. Hence, the memorandum is almost supplementary to the articles of association (s. 28) and unless the company specifically restricts the remit of the objects of the company, its objects are unrestricted (s. 31(1)). The elements that establish the memorandum include:

- *Its name:* There are restrictions on the choice of business name that a company may use, and the use of words and symbols in the name (CA 2006 provides in s. 57 for the Secretary of State to prohibit the use of words that may make the tracing of a company difficult), and guidance is provided through Companies House. From 1 September 2011, Companies House will no longer accept company names on documents that contain minor variations and/or typographical errors. A list of acceptable abbreviations
p. 371 is provided on its website. Evidently, a company may not choose the same name as another company (a directory exists for the purposes of checking); nor may a name be used that is likely to cause offence, or one that infers a connection with local or central government. When a name is selected, it is registered on a 'first come, first served' basis and therefore names cannot be saved (as such it is recommended that electronic copies of forms be submitted to speed up the process). The name must end in Ltd or Limited where it refers to a private limited company (or its Welsh equivalent if the company is based there) or PLC (or the Welsh equivalent) in relation to a public limited company, and this must be published on company documents. This name must be displayed outside of the registered office, and placed on all

company stationary, invoices, receipts, and so on (these materials must also include the company's registration number). The name of the company may be changed through a special resolution, or through a written resolution of a private company, or other means provided for in the articles (CA 2006, s. 77). The Registrar must be informed of such changes and will then issue a new certificate of incorporation.

- *The registered office:* The company must identify an address where correspondence from the Registrar and from Companies House may be sent. There is no requirement over the use of an address insofar as it is based in England or Wales, and the address is effective for delivering documents, to ensure that unnecessary delays can be avoided.

The memorandum and articles may be obtained from a company formation agent or a law stationer. Companies House will supply the new-style memorandum and a limited company will be able to use the relevant model articles where it wishes (CA 2006, s. 20).

14.3.8.2 The articles

The articles refer to the constitution of the company and how it may run its affairs. This is the contractual agreement between the parties and the company, and may be established on the basis of a bespoke set of articles, or the company will use the default model articles included in CA 2006. The articles of a company may be altered at a later date through a special resolution (s. 21) and s. 22 allows for the entrenchment of articles to enable the amendment or repeal of specified provisions in the articles where conditions are met, or procedures are complied with that are more restrictive than those applicable in cases of a special resolution.

14.3.8.3 Form IN01

'Form IN01' identifies (among others) the first director(s) and their personal details including their age, occupation, and details of previous directorships held in the previous five years; the secretary of the company, who can be both a director and secretary where there are two or more members of the company (where there is only one member, they must have another person to act as secretary); the company's registered office, and must again be authenticated by the subscribers.

The Registrar of Companies maintains the documents and makes them available for public inspection.

14.3.8.4 The certificate of incorporation

The company is established when the Registrar of Companies issues the certificate of incorporation. This document formally establishes the existence of the company and it will only 'die' when it is formally wound up. The certificate provides the company with its legal status and personality that will enable it to trade and
p. 372 establish the contracts that enable the 'business' to begin. ↵

Consider

Abebi has established the contract with Gaagle before the company is incorporated. As such, the company cannot enforce the contract, but she will have the rights under it to seek fulfilment. Further, given the nature of the product, which remedy would be most suited to her claim (see **Chapter 10**)?

If the promoters of the company establish contracts on behalf of the company before the certificate is provided, they may be held personally liable and they will not obtain the protection from the limited liability status of the organization (s. 51(1)). However, the individual will be in a position to enforce the contract on their own behalf, in the case of a breach. This is where the promoter of the company has not informed the other party of the lack of incorporated status.

Braymist Ltd v Wise Finance Co. Ltd (2002)

Facts:

The claimant was establishing a company whilst at the same time selling land. The contract for the sale was signed by solicitors of the purported company but which, at the time, had not been incorporated. The respondent was unaware of the non-incorporation of the company.

Authority for:

The solicitors were personally liable for the contract as it was made in their name and could not be in the name of a company which, at the time, did not exist. It did also, however, give rights to the solicitors to enforce the contract.

Section 51(1) provides that the person is liable 'subject to any agreement to the contrary' and therefore if this is specifically identified to the other party and this party accepts that upon the certificate being provided the company will ratify the agreement, then the company may be subsequently bound (assuming the other party could be convinced to agree to this!).

14.3.8.5 Re-registration of the company

The private company and PLC may choose to re-register between the two statuses, and once completed a new certificate of incorporation is issued. The company will thereafter be subject to the rules applicable to the newly formed business. For the private company to re-register as a PLC, a special resolution must be passed through s. 90 to enable a change in the articles and memorandum to comply with the requirement to incorporate to a PLC. The documents outlined earlier have to be submitted to the Registrar, with the request for the change in status, and a report by the private company's auditors that the amounts of capital are as required under CA 2006.

A PLC may re-register as a private company through a special resolution. Section 97 of CA 2006 requires that p. 373 all of the company's members have assented to its being so ↵ re-registered. Due to the nature of the PLC and the requirement for protection of the minority shareholders, s. 98 provides that shareholders with a minimum of 5 per cent of the nominal value of the issued share capital, or if the company is not limited by shares, by a minimum of 5 per cent of its members, or a minimum of 50 members, may apply within 28 days of the resolution, to a court to have the special resolution terminated and become unenforceable as they were not in favour. It is for the court to determine whether the resolution should be enforced or not.

14.3.8.6 Buying an off-the-shelf company

Due to the perceived problems that some people may have in completing the relevant forms and keeping up to date with the changes in company law and submitting the required documents, a simpler option may be to purchase a company from an agent. Such agencies are quite common and their service is to issue a company that has already been registered and they may also (for additional costs) act as company secretary for a given period of time to ensure all the necessary paperwork and documents are filed with Companies House. The agent that has established the company will sell this company to the purchaser and then resign as director/secretary and inform Companies House of this matter (having appointed the purchaser as the new director/secretary). This is undoubtedly a quick method of establishing the company, but there are issues to be considered. This may be a 'recycled' company and if the company has previously traded, any bad credit and so on will be passed on to the purchaser (as the company number originally issued will remain). This could have serious implications for future credit and financial matters. Hence, they should be used with caution.

Consider

Had Abebi purchased an off-the-shelf company and established the agreement with Gaagle plc it would have been enforceable by Eyesecure Ltd. As seen above, contracts may only be established and/or retrospectively ratified by the company where the company exists at the time of the agreement. It is not possible for Eyesecure Ltd to ratify Abebi's contract with Gaagle plc even if the board of directors agree—any contract, and its enforcement, would be between Abebi and Gaagle plc (CA 2006, s. 51).

14.3.8.7 Passing-off

This is an important issue to recognize when determining the implications of a company's name (for general information regarding this tort see **24.5.5**). The tort occurs where the company is given a name that is very similar to an existing business and it gives the (misleading) impression that the two companies are connected. As noted earlier, businesses often rely on their name and brand image to promote confidence to customers and retain and win new customers, therefore a company that is formed to take (unfair) advantage of this name may have to change its name (and be faced with a possible tort action for damages). An objection can be raised with the Registrar regarding the names of the companies and only the Registrar can decide whether the name should be changed (this is not a decision of the courts). ↵

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Halifax Plc v Halifax Repossessions Ltd (2004)

Facts:

The respondent company had been using a name similar to that of the claimant. In an action to prevent the respondent from infringing their trademark, the claimant was successful. The court ordered the respondent to refrain from using the trademark name, which it did, but the respondent did not change its company name. The claimant attempted to enforce the ruling, which was granted by the court, through an order to the Registrar of Companies to make the respondent remove the word 'Halifax' from its name.

Authority for:

The court did not have the authority to make such an order. The Registrar may only act within the confines of the statute (now the CA 2006) and, were a court allowed to make this order, it may have more serious and widespread consequences than those addressed in the issue heard before that court.

Whilst the motive of the subscriber of the company is not the primary concern in the issue of whether the company name should be changed, if they have acted to deliberately mislead customers into thinking the company is linked with another with a similar name, this will be negatively viewed by the courts.

Croft v Day (1843)

Facts:

A very famous firm that made boot polish (Day & Martin) had been established and named after the founders (who by the time of this case were deceased). Their business was bought by Mr Croft, who continued trading under the same name. Soon after, a Mr Day and Mr Martin started a business in the same profession and established the same business name on the basis of convincing (and misleading) potential buyers that the company was the same as the original. The court held that the new entrants to the market had attempted to pass the business off as the original, and granted Croft an injunction to prohibit the use of the new business's name.

Authority for:

Where a business name is already in existence, the use of the same/very similar name by others in an attempt to confuse or mislead the public as to believing they are dealing with the original will be considered a breach of 'passing off'. (This is the rule insofar as the requirements for breach of that tort are satisfied.)

In relation to a misleading registered company name, a complaint may be made by a person who possesses the goodwill in a name, adversely affected by the misleading company name, to the Company Names
p. 375 Adjudicator, who can order that the name be changed ↵ (CA 2006, s. 69. This has been supplemented by the Company Names Adjudicator Rules 2008 (S.I. 1738/2008)).

14.3.8.8 Bringing the company to an end

As the text continues with issues such as the winding-up of the company and the methods that may be adopted to achieve this, bringing the company to an end is considered in **15.7**.

Conclusion

This chapter has begun the process of considering the forms of business organization available and the implications of trading as each. The sole trader and partnerships are relatively simple organizations and hence they will not be investigated further. However, as corporations are complex, with detailed rules regarding how they are administered and governed, this will form the majority of the consideration of the remainder of this part of the text. This has been a deliberately introductory chapter and the text continues to detail the internal structures of companies, and how they operate.

Summary of main points

Legal personality

- Natural persons and businesses established as corporations possess their own legal personality.
- The legal personality of a company exists irrespective of the members or directors who carry out its functions.
- The legal personality of a company separates the company from those who own it. However, the courts may lift this 'veil' (reluctantly) to identify the true nature of the business.

Sole traders

- There is no legal distinction between the sole trader as an individual and the person running the business.
- The sole trader is a very simple business organization with very little internal or external regulation.
- The sole trader business can be formed and dissolved easily, and it does not require any special formalities other than informing the relevant government departments.

Partnerships

- A partnership involves two or more people coming together to establish a business.
- A partnership can be 'simple', 'limited', or a 'Limited Liability Partnership'.
- Partners may be 'typical/general', 'salaried', or a partner by estoppel.
- Many rights and obligations exist for partners in simple and limited partnerships including good faith, disclosure, and to account.
- Partners generally have the right to participate in the management of the firm and may bind the partnership through the exercise of actual or apparent authority.
- Bringing a partnership to an end is a relatively simple procedure, and the Partnership Act 1890 identifies specific reasons for its dissolution.

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Limited liability partnerships

- Unlike sole traders and simple partnerships, LLPs have a separate legal personality and limited liability for members.
- They are regulated in similar ways to a company and are subject to some aspects of CA 2006.

Companies

- Companies are artificial things that have their own legal personality.
- Companies may be limited or unlimited.
- PLCs require a minimum of £50,000 allotted share capital on registration.
- There are exemptions from certain administrative duties for small/medium-sized companies.
- Limited companies may be formed by Royal Charter, statute, but most commonly through registration.
- The subscribers to a limited company must submit the memorandum, articles, and Form IN01 to the Registrar of Companies.

- Companies can be re-registered to reflect changes in their circumstances.
- Rather than forming the limited company, one may be bought ‘off-the-shelf’ through an agency.
- Regulations exist regarding the choice of business name.
- Businesses must ensure the name of the company is not too similar/the same as another company or they may be guilty of the tort of ‘passing-off’.

Summary questions

Essay questions

1. ‘*Salomon v Salomon* was wrongly decided. Its implications have allowed corporations to defraud innocent customers and suppliers, and it has facilitated the creation of sham companies with the protection afforded by the veil of incorporation. Corporations should not possess a legal personality distinct from those who subscribe to it.’

Critically assess the above statement.

2. Identify the rights and duties imposed on partners, and assess how effective they are in maintaining trust and good faith.

Problem questions

1. Delia Smythe runs a small catering service from her home, providing hot lunches for the management of three firms in Sheffield. She has two employees—a driver and an assistant cook. She would like to bid for catering contracts at more firms and possibly expand into catering for private dinner parties, but could not do all this from her home. She is worried about how she would manage the operation. One of her worries is that she has no experience beyond institutional catering.

Advise Ms Smythe about alternative forms of business organization available to her, explaining the advantages and disadvantages as they apply to her situation. Which form of business would you advise her to adopt? (Visit the online p. 377 resources where a completed IN01 form is provided if Ms Smythe intended to form a private limited company.) ↵

2. Paula has been approached by Jackson and Taylor Estates to join the partnership operating a property development and rental business. Jeffrey (Jackson), one of the partners, speaks with Paula about the offer and Paula agrees. She does not invest money into the business, but rather she says that she has expertise of negotiating good deals with builders, and has ‘contacts’ in the local Council which will assist on development applications, and advance knowledge of policies and plans likely to be adopted by the Council. Both existing partners—Jeffrey and Barbara (Taylor)—welcome Paula to the partnership and amend the partnership agreement to account for her addition to the business.

Sometime after her arrival, Paula approaches her fellow partners with a business opportunity. There is a somewhat dilapidated building which would be prime for development and she has heard from her contacts that once developed, the Council would provide permission to convert its use to residential accommodation. This would dramatically increase its value, but a quick sale was essential to obtain the premises for fear the owner could decide against selling. The partners agree and the property is purchased. It transpires that the property is in very poor repair, to such an extent that it is dangerous. It contains a structural fault so severe that no valuation expert will provide a quote as to its insurable value. Further, unknown to Jeffrey or Barbara, Paula owns the property, she knew of its condition, and had been trying (unsuccessfully) to sell it for years.

When approached, the Council refuse permission to convert the building to residential accommodation. This has nothing to do with its condition or repair, but simply that any such application in that area would be refused. Paula had essentially misled the partners as to her 'contacts'—which is actually a receptionist on the front desk who occasionally hears gossip (usually about members of staff rather than secret plans or policies).

Finally, when the partnership applies for a loan to fund the purchase of the property, they are refused due to failing a credit check. They had never experienced this before Paula's introduction, and upon further investigation, they discover Paula has County Court Judgments against her and some quite serious criminal convictions. Paula never disclosed this information because 'she was never asked'.

Advise the parties as to their legal rights and duties under partnership law.

You can find guidance on how to answer these questions **here** *<https://oup-arc.com/access/content/marson6e-student-resources/marson6e-chapter-14-indicative-answers-to-end-of-chapter-questions?options=name>*.

Further Reading

Books and articles

Bourne, N. (2016) Bourne on Company Law (7th Edition) Routledge-Cavendish: London.

Hawkey, J. (2005) Sale or Succession? How to Plan for a Successful Business Exit How to Books: Oxford.

Whittaker, J. and Machell, J. (2016) The Law of Limited Liability Partnerships (4th Edition) Bloomsbury Professional: Haywards Heath.

Websites, Twitter links, and YouTube channels

https://www.gov.uk/government/organisations/companies-house *<https://www.gov.uk/government/organisations/companies-house>*

@CompaniesHouse

p. 378 ↵ https://www.youtube.com/user/TheCompaniesHouse *<https://www.youtube.com/user/TheCompaniesHouse>*

Information regarding the establishing of business organizations, forms to speed up the process, and general company advice.

http://legislation.gov.uk/ukpga/Vict/53-54/39/contents *<http://legislation.gov.uk/ukpga/Vict/53-54/39/contents>*

The Partnership Act 1890.

http://www.legislation.gov.uk/ukpga/2006/46/contents *<http://www.legislation.gov.uk/ukpga/2006/46/contents>*

The Companies Act 2006.

http://www.legislation.gov.uk/ukpga/2000/12/contents *<http://www.legislation.gov.uk/ukpga/2000/12/contents>*

The Limited Liability Partnerships Act 2000.

Online Resources

Visit the online resources *<https://oup-arc.com/access/marson6e-student-resources#tag_chapter-14>* for further resources relating to this chapter, including self-test questions, an interactive glossary, and key case flashcards.

Related Links

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Test yourself: Multiple choice questions with instant feedback *<https://learninglink.oup.com/access/content/marson-and-ferris-concentrate4e-resources/marson-and-ferris-concentrate4e-diagnostic-test>*

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