CHAPTER 9

LIMITED LIABILITY COMPANIES

Objectives

At the end of this chapter students should be able to define the limited liability company, and explain the procedures for formation or incorporation of limited liability companies.

9.1 Introduction

Limited liability companies are otherwise known as Joint Stock Companies. Limited liability means that the liability of the shareholders is limited to paying to the company, the nominal amount of their shares. Once the shareholders pay the full amount of their shares to the company, they cannot be called upon again to make any further contributions to the payment of the companyâ€™s debts in the event of liquidation.

Liquidation is when a company is wound-up; such a company is asked to stop its operation. We shall mention the circumstance of wind-up or liquidation later in the next chapter.

In the case of unlimited liability, there is no limit to which a shareholder may be asked to contribute (from excess of the price of his shares, and to the extent of using his own personal fortunes) for the debts of the company in the event of liquidation. Unlimited liability companies do not need to file accounts annually with the registrar of companies.

In a limited liability company by guarantee, the liability of the shareholders are guaranteed up to a certain amount. There would have been an undertaking by the members that, in the event of liquidation, they would contribute up to a specific amount only (e.g. ₦500,000) towards the funds of the company. Usually, such companies are not necessarily for profit-making,but devoted to certain civic duties like promotion of arts and culture, science and education. Since the shareholders have not been sharing profits at all from such companies, it is fair and logical that they should not be fully liable to the debts of the companies.

Limited liability companies by both shares and guarantees - other companies are limited by both shares and guarantees i.e., in addition to paying fully for their shares, they undertake to contribute a further stated amount (e.g. ₦250,000 each) to the assets of the company in the case of liquidation.

9.2 Types of Limited Liability Companies

There are two types of limited liability companies namely: the public limited liability companies and the Private Limited Liability Companies. Each of these Companies will be explained below.

9.3 Public Limited Company

A public limited liability company is a corporation with its own legal entity which has its own name, identity, rights (including rights to perpetual succession) and duties, as distinct from those of the individual persons that form the company.

The Characteristic Features of a Public Limited Company

(i) *A legal person:* A public company is a legal person, therefore, transfer of shares does not affect the existence of the company. The company can enter into contracts on its own like a human being, and it can sue and be sued as of right. It is equally referred in law as artificial personnel.

(ii) *Shares:* The shares of a public company can be sold to the public i.e., it can raise capital in the open market.

  (a) The amount of capital that can be raised through he sales of shares is only limited by the amount of authorized capital, as contained in its memorandum of association and as approved by the registrar of companies.

  (b) Shareholders cannot withdraw their capital but are free to sell their shares to any other person, for the highest prices possible.

(iii) *Control:* Control of a public company is in the hands of the shareholders, who in turn, elect a board of directors who have responsibility for the companyâ€™s broad policy matters.

(iv) *Liability of shareholders:* The liability of the shareholders is limited to the amount owed on the shares - no more no less.

(v) *Number of members:* In a public company, there must be at least a minimum of seven (7) people. There is no legal maximum number.

(vi) *Financial reports:* A limited liability public company must file annually, with the registrar of companies, its statements of accounts in the form laid down in the company act of 1968. Such reports must show:

  (a) Profit and loss account.

  (b) Balance - sheet

  (c) Auditorsâ€™report and

  (d) Directorâ€™s report.

(vii) *Payment of dividends:* Dividend payment must be made only out of profits and not from capital, and is paid to shareholders.

9.4 The Private Company

A private company is one which by the provisions of its articles have the following guidelines:

(i) The number of its members is restricted to between 2 and 50 (excluding employees and ex-employees who have become shareholders - the managing director is regarded as an employee for the purpose).

(ii) Prohibits the offer of its shares to the public. (That is, it cannot raise capital on the capital market, e.g., on the stock exchange).

(iii) Restricts its membersâ€™ right to transfer their shares at will . (For instance, such shares must be offered first to members or the consent of the directors must be sought first.)

When a private company fails to comply with any of the three requirements above, it loses all its privileges as set out below, although, it still remains a private company. A private company can convert to a public company (when its members increase to seven) by (a) a special resolution, and (b) issue of a prospectus or a statement in lieu. In the same manner, a public company can turn private, if its members fall to 50 or below and by a special resolution to alter the articles.

The Privileges and the Characteristic Features of a Private Company

The best way to appreciate the privileges and the features of a private company is to make some comparisons between a private company and public company. The privileges of the private company can be viewed from the point that, although, both types of companies are subject to the same requirements of the Company Acts, the private company has some exemptions.

(i) **Membership**: A private company requires only two members to carry on as a company while a public company requires at least seven.

(ii) **Officers:** A private company may have only one director and a secretary while a public company must have at least 2 directors and a secretary. Two or more directors may be appointed by a single resolution *(known as omnibus resolution)* in a private company, while in a public company, there must be separate resolutions for electing each of the directors.

On application for incorporation, because there is a public offer of shares by public company, points (iii) - (viii) below apply:

(iii) **Issue of Prospectus:** A private company has no need for a prospectus or a statement in lieu of prospectus, but a public company must produce either of the two.

(iv) **Minimum Subscription:** There is no need for a private company to meet the minimum subscription requirements as in the case of the public company.

(v) **Commencement of Business:** A private company can commence business on receipt of certificate of incorporation i.e., unlike a public company, it does not have to wait for a trading certificate.

(vi) **Directors List:** A private company, unlike a public one, does not need to file a list of persons who have agreed to become directors, nor their written undertakings to take up their qualification shares.

(vii) **Directorsâ€™ Age Limit:** The stipulation that a director in a public company should be below seventy years of age does not apply in a private company. There is no age limit at all in a private company.

(viii) **Statutory General Meeting:** For a private company, there is no compulsion for a statutory general meeting or the filing of an annual report with registrar.

(ix) **A Register of Members:** It is not compulsory for a private company to keep an index of members like a public company. However, a register of members should be kept.

(x) **Quorum and Proxy:** Two members form a quorum in the general meetings of a private company as against seven who must personally attend in a public company. In a private company, proxies might speak and vote on a poll (not on show of hands) unless otherwise provided by the articles.

9.5 Procedures for Formation or Incorporation of Companies and Document (Legal Requirements)

All companies that wish to be formed under the Company Act of 1968 must be registered with the registrar of companies. In doing so, the following documents must be submitted to the registrar of companies:

(i) **Methods of formation:** There are three methods of forming a company:

(a) *By Acts of Parliament or Decrees* (in a military regime): Government corporations are formed in this way. They are, therefore, referred to as â€˜statutory corporationsâ€™. Examples are the Nigeria Railway Corporation, etc.

(b) *By Royal Charter:* This was the practice in the past when parliaments and kings or queens granted charter (rights) of operation to some companies. The practice was common in the United Kingdom, where the East India company is an example of a company by royal charter.

(c) *By registration under the company act 1968:* This is the most popular method, and we shall be concerned here with this type of registration.

(ii) **The Memorandum of Association:** This is the chapter of the company. It indicates the powers and states the objects of the company. Regulates the relationship between the company and those dealing with it from the outside world. The following are the contents of the memorandum of association of a company (limited by shares):

(a) The name of the company with â€˜limitedâ€™ added as the last word. Charitable organizations could omit the word â€˜limitedâ€™. The clauses of the business name registration act mentioned under partnership are relevant here.

(b) The registered office of the company.

(c) The objects of the company - this is the objective for which the company is formed. Such objectives must be legal and the company cannot operate outside its objectives otherwise such actions are â€˜Ultra Viresâ€™ and are not enforceable in law. However, such objectives are usually expressed in such ways that they allow future necessary developments.

(d) A statement as to the limitation of the liability of members, i.e. limited by shares, by guarantees or both.

(e) A statement of the amount of the nominal or registered capital, and division of such capital into shares - for instance, â€˜one million Naira capital divided into one million shares of one Naira per shareâ€™. The nominal or registered capital cannot be exceeded without the prior consent of the registrar of companies. The nominal capital may be issued as needs arise and not necessarily at a stretch.

(f) The association clause: A statement that, the seven signatories attached have undertaken to be formed into a company. The seven signatories have, therefore, constituted themselves into promoters.

(g) A statement of subscription: The witnessed signatures of the seven promoters indicating the number of shares they have agreed to take.

(h) Alteration of the memorandum: Condition must be stated for alteration of the memorandum, and this must be for the benefit of the company.

(iii) **Articles of Association:** The articles of association embody the set of rules and regulations binding members of the company, and governing the running of the affairs of the company. It can be said that, the memorandum of association sets the external relations while the articles of association sets the internal organization of the company. By practice, the paragraphs of the articles are inconsecutively numbered.

The contents are:

(a) Appointments, powers, duties and rights of directors.

(b) The manner of calling meetings and the procedures during the meetings, including voting rights.

(c) The rights attached to different classes of shares.

(d) Presentation of accounts and audits, and declaration of dividends.

(e) The articles must carry the signature of the subscribers of the memorandum and must be witnessed.

N.B. Table A of the Company Acts determines all matters that are not covered by a companyâ€™s own articles. It is assumed to be governed by Table A, which is a model Article of Association as contained in the Company Acts of 1968.

(iv) **Certificate of incorporation:** Once the documents in (ii) above are accepted by the registrar of companies, he will issue a Certificate of Registration or Incorporation which has the following implications:

(a) If a private company, it can commence trading immediately, but as a limited liability company, it must await its certificate of trading.

(b) It can now raise capital and borrow money.

(c) It can make contracts provisionally, pending the issue of a certificate of trading if the contracts will be binding.

(v) **Certificate of trading:** This is issued once the following conditions are fulfilled:

(a) When a prospectus or a statement in lieu thereof, has been issued. (See prospectus later on in this chapter.)

(b) When the shares to be paid for in cash, have been allotted to an amount not less than the minimum subscription stated in the prospectus. A minimum subscription must be enough to cover preliminary expenses and the required initial working capital.

(c) When each director has paid the same amount just as the public on application and allotment of the shares he has agreed to take.

(d) When there has been compliance with all the requirements of the company act.

The issuing of the certificate of trading has the following implications:

(a) The company could commence trading activities immediately.

(b) The provisional contracts already made become binding automatically.

Other documents include:

(iii) A statement of nominal capital (if limited by share capital). This is for the purpose of assessing capital duty (about 50 kobo in ₦1 00.00).

(iv) A statutory declaration of compliance with all the requirements of the company act. Such declaration must be signed by a solicitor or director or secretary already named in the articles.

The following are additional requirements for a public company with share capital:

(v) A list of persons who have consented to be directors.

(vi) A written undertaking consent to be directors.

(vii) The written undertaking of the directors to take up and pay for their qualification shares.

He who undertakes to form a company and files these documents with the Register of Companies is a Promoter.

9.6 The Promoter

Definition: The company act does not include the definition of a promoter, but from law cases, an accepted definition has emerged thus: One who undertakes to form a company with reference to a given project and to set it going; and who takes the necessary steps to accomplish that purpose.â€™

The responsibilities of the promoter are as follows:

(i) He is responsible for the preparation of the memorandum and the articles of association.

(ii) Towards (i) above, he decides on the object, name place of business, each membersâ€™s liability in cash of losses and the required capital.

(iii) He negotiates the initial contract, even on provisional basis at first.

(iv) He raises the working capital.

(v) He appoints directors for the proposed company.

(vi) Finally, he registers the new company.

The Promoterâ€™s Right to Remuneration and Profit Making

(i) The promoter is not entitled to remuneration for his services, including repayment of formation expenses, unless such is agreed to after incorporation. But even then, since the consideration is past, the agreement must be under seal.

(ii) If a promoter makes a profit in the process of company formation, he must disclose it in a prospectus; otherwise, the profit must be surrendered.

(iii) If a promoter makes an undisclosed profit, and the company gets to know, the company is free to repudiate or rescind the contract of purchase. The alternative step open to the company is: if the promoter had made the contract or purchase before acting as promoter, then the company might sue for damages for breach of duty.

9.7 Methods of Raising Finance for a Company

The methods of raising finance capital for a company are the same for both new and old companies.

(A) **Private method:** Capital can be raised privately by seeking loans from private individuals and from the banks.

(B) **Public subscription:** This is by inviting the public to subscribe to shares. This in turn can take different forms:

(i) *By the issue of a prospectus (or SIL):* This would be discussed later in this chapter.

(ii) *By sale of shares to an issuing house:* This in turn offers them for sale to the public.

(iii) *By â€˜placingâ€™* the shares with stock exchange brokers who in turn offer them to their clients. This is known as â€˜stock exchange placingâ€™

(iv) *By right issue:* This is an offer to existing members who are invited to take up, for instance, one more new share for five shares already held. The members can accept or refuse the offer and then sell on the public market.

A rights issue is the cheapest form of raising capital since it does not need a prospectus, but only printing and postage cost plus a stock exchange stamp, since the rights issues are usually below the market value. An existing member, thus, has the advantage of cheaper additional shares. He would, therefore, make a profit if he decides to sell his rights.

(C) **Loan-capital:** This is otherwise called debentures.

(i) *Creditors not owners of the company:* This is money borrowed at a fixed interest rate - hence the reference to debentures (loans) as 5% or 6% on the loan. Unlike the shareholders, the debenture holders (those who lend money to the company) are not the owners of the company. They are merely creditors of the company, and their fixed income in form of interest rate first, before shareholders are given their share of the profit.

(ii) *Mortgage secured debenture:* A debenture may be secured or unsecured. It is secured when the loan is effected on the provision of companyâ€™s assets like building or machinery which act as securities for the loan. Mortgage debentures must be registered with the registrar of companies. Consequently, until such loans are repaid, the securities can not be disposed off. In the event of failure to repay the loans, the debenture holders can appeal to the court of law to sell such securities for payment of their loans (or debentures).

Mortgage debentures may be a fixed charge, i.e. it is secured by specific assets, e.g. building or it can be a floating charges i.e. it is secured by the assets generally - not by a specific asset. In the latter case, such general assets can be disposed of before repayment of the loans; but there can be disposal in the case of a fixed charge before loan repayment.

(iii) *Unsecured loans or dentures:* These are not borrowed on attachment to any of the companyâ€™s assets, they are, therefore, otherwise known as naked debentures.

However, naked debenture holders can still sue a refund of their loans in the event of a default by the company.

(iv) *Redeemable loans:* They are repayable at, or before a fixed date.

(v) *Irredeemable loans:* These are left in the business indefinitely. Hence, like shares, they can be sold on the stock exchange.

(D) **The Prospectus:** This is a document primarily concerned with the raising of capital for a company. Its essential features are as follows:

(a) It is an invitation to the public at large to subscribe to the shares of a new company. In the company acts of 1968, it is described as â€˜Any prospectus, advertisement, notice, invitation, circular or other invitation (its mnemonic is â€˜PANICâ€™), offering to the public for subscription or purchase, any shares or debentures of a company - unless it can properly be regarded as a matter of private concern, not likely to result in the shares or debentures becoming available to other than those receiving the offerâ€™.

(b) A prospectus usually indicates that permission is being asked for a stock exchange to deal in the shares being offered, after they have been issued. Should the permission be refused, application fee must be refunded and any allotments made are void.

(c) A copy of the prospectus most be signed by every directors or proposed director named in it, and it must be deposited with the registrar of companies.

The following are some of the essential contents of a prospectus:

* Detailed information about the promoters and directors, such as number and class of shares held, and their interests in any property.

* Particulars of shares issued other than for cash - for instance, in exchange for goodwill, property, service of experts, etc.

* In the case of a new company, the amount of minimum subscription necessary to commence business operations.

* Details of the shares offered - such as their voting rights, payment on application and allotments, etc.

* Reports of the valuers of the company property.

* Arrangements made with underwriters.

* Particulars of important contracts entered into in the ordinary course of business.

* In the case of an old company, the auditorâ€™s reports on company profits for the previous ten years, if less than ten years, since incorporation.

* Names and addresses of bankers to whom cash and application forms must be forwarded.

* Period (of time) that subscription lists are open to the public, including the compulsory three days (at least notice of opening).

9.8 Underwriters

(i) Underwriters are banks, insurance companies, and other finance houses who undertake in return for a commission, up to a certain amount, any shares not taken up by the public. It is important that what the underwriters undertake to buy must be less than the required minimum subscription; so that with the proceeds of underwriting business, operation can at least start.

(ii) The underwriting commission is always paid from profits only, but in certain circumstances it is paid from capital.

Such circumstances include:

(a) When payment of commission is allowed by the articles.

(b) Such amount or rate must have been indicated in the prospectus or Statement in Lieu (SIL).

(c) The commission not being more than 10% of the issue price of the shares, or such amount specified in the articles.

(d) The number of shares that the underwriter wishes to take firmly, not simply to guarantee, must be disclosed in the prospectus or SIL.

Summary

Limited liability could be by shares, or guarantee. A limited liability company is a seperate legal entity from its shareholders. There are some statutory documents required for its incorporation i.e.,

Memorandum of Association;
Articles of associationsâ€™
Statutory declaration of compliance;
List of persons who consented to be directors.

Revision Questions

A. Essay Questions

1. (a) What is a public company?

   (b) Explain the terms â€˜limited liabilityâ€™ and â€˜unlimited liabilityâ€™.

(c) State four essential features of a Public limited liability company.

2. Explain the following terms:

(a) Nominal capital.
(b) Uncalled-up capital.
(c) Oversubscribed shares.
(d) Minimum subscriptions.
(e) Prospectus.

3. Specify all the statutory books that a public limited company must keep.

4. State five documents that must accompany an application for the registration of a company to the registrar.

5. Distinguish between:
(a) Certificate of incorporation and certificate of trading.
(b) The memorandum of association and articles of association.

B. Objective Questions

1. Which of the following organisations is often referred to as an â€œartificial personâ€ in law?
A. Sole proprietorship
B. Partnership
C. Public limited liability company
D. Co-operative society
E. A consortium *NECO 2001*

2. When a private company is issued with the certificate of incorporation, it is allowed to:
A. acquire premises
B. come into existence
C. commence trading
D. rouse capital
E. recover its debts

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3. The people who undertake the setting-up of a public limited company are referred to as
A. Promoters
B. Orbitrators
C. Speculators
D. Trustees

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4. One of these is not a true feature of a public limited company.
A. cannot sell shares to the public.

B. shareholders can withdraw capital from a company.
C. it can sue and be sued.
D. can law freely sell their shares

5. A public company can be formed in all these ways except one:
   A. by registration under the company and allied matters act 1999.
   B. by registration under partnership act of 1940.
   C. by act of parliament or decrees.
   D. by royal charter.

6. A public limited liability company can take any of these forms except one
   A. Limited liability by shares.
   B. Limited by guarantee
   C. Limited by security.
   D. Limited by both shares and guarantee.

7. One of these is not in the Articles of Association.
   A. Appointments, power, duties and rights of directors.
   B. Manner of calling meetings and meetings procedures.
   C. The qualifications and status of shareholders
   D. Signatories to the memorandum of association
   E. Presentation of accounts.

8. Some categories of loan-capital are these except one
   A. Mortgage secured debenture
   B. Equity capital
   C. Unsecured loans
   D. Redeemable loan

9. The most significant implication of issue of trading certificate is to
   A. Commence immediately
   B. Start borrowing
   C. Declaring dividends
   D. Paying corporation tax

10. The following are sources of fund to a public company - by
    A. Public subscription
    B. Loans
    C. Rights issue
    D. Liquidation

Project

1. Give a list of ten private limited liability companies in your locality.

2. Make a visit to a public limited liability company and ask for permission to make a sketch drawing of the certificate of incorporation of that company.