CHAPTER 16: COMPANY I – FORMATION AND FINANCE

QUESTION 1

Explain the options available for financing a company.

Answer:

- In order to carry out business a company will need to raise a certain amount of capital which can be obtained by selling shares in the company, (share capital) or by taking out loans (loan capital).
- Buyers of shares in a company become shareholders and are members of the company.
- A share is a form of property which carries rights and obligations. Subject to any restrictions in the articles it is transferable.
- A company may create different types of shares which have different rights as regards
 payments of dividends, voting at meetings, and return of capital on liquidation of the
 company or reduction of share capital.
- Shareholders receive a return on their capital investment by way of dividends.
- Where loans are made to a company the lenders do not become members but are creditors of the company.
- When a loan is made to a company the document setting out the terms of the loan is called a
 debenture. There are 3 main types of debenture, a single debenture, debentures issued as a
 series and debenture stock.
- Loans may be unsecured or secured on company property.
- The return creditors receive from the money invested in the company is by interest on the loan.

QUESTION 2

Discuss the general content and effect of a company's articles.

Answer:

- Companies set up under the Companies Act 2006 have one major constitutional document, the Articles of Association which are constitutional document of the company.
- Where companies have been set up under previous legislation and have an old style memorandum then its provisions are generally treated as part of its Articles.
- The Articles state all the rules necessary for the conduct of the company's business and contain information relating to such matters as, the company name the appointment and powers of its directors, and secretary, proceedings at meetings, voting rights of members, payment of dividends, issue and transfer of shares.
- The Articles bind the company and its members to the same extent as if there were covenants on the part of the company and each of the members to observe those provisions (CA s33), Pender v Lushington (1877), Rayfield v Hands (1960), Hickman v Romney Marsh Sheep Breeders Association (1915).



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• Articles can usually be amended by special resolution. But any alteration must comply with company legislation and be made in good faith for the benefit of the company as a whole.

QUESTION 3

Shreena and Gita wish to run a business buying and selling organic vegetables. They have decided to set up a private company limited by shares and are thinking of calling their company 'VegRus'. They will be the subscribers and the first directors of the company. They have already found premises but the owner is insisting that a contract to lease the premises is signed immediately, despite the fact the company will not be registered for about four weeks.

Advise Shreena and Gita what documents will have to be delivered to the Registrar of Companies before a certificate of incorporation of the company is issued, any restrictions on choice of name of the company, and any liabilities they may personally incur if the lease is signed before the company is incorporated.

Answer:

- Shreena and Gita are promoters and have a general duty to exercise reasonable care and skill and a fiduciary duty towards the company. They are responsible for registering the necessary documents with the Registrar of Companies.
- The documents that must be registered with the Registrar of Companies are: a memorandum of association, an application for registration (together with copies of documents required in the application), and the appropriate fee, (Companies Act 2006 (CA) s9).
- Registration of companies and filing of company documents can be completed electronically.
- The company must not have the same name that is already on the register (CA s162)) and the name must end with "limited" or "Ltd." There are restrictions on certain names such as those that are offensive, sensitive or suggest connection with central or local government or other bodies.
- If Shreena and Gita chose a name that is very similar to the name of another established business. The established business can apply to a court for an order to prevent the new company trading it its registered name. The action is the tort of passing off.
- Where a contract is made by persons purporting to act on behalf of, or as agents of, a
 company not yet formed it is not binding on the Company, but those persons are personally
 liable for the contract. Therefore a lease entered into by Shreena and Gita before the
 company is formed even if supposedly made on behalf of company, is not binding on the
 company but Shreena and Gita (promoters) are personally liable (CA s51).

QUESTION 4

Fabrics Ltd currently supplies soft furnishings to wholesalers, largely on credit terms. Its share capital comprises 100,000 £1 ordinary shares. The company has recently decided to raise more capital as it wants to extend its business via an internet site selling mail order curtains to non-trade customers.



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Fabrics Ltd seeks your advice on the following points:

- a) In the event that it issues preference shares instead of ordinary shares, what are the differences -between the two?
- **b)** If it issues secured debentures, what are the differences between a floating charge and a fixed charge?

Answer:

a)

- Ordinary shares are issued without any special rights being attached to them. The majority (and sometimes all) of a company's share capital usually consists of ordinary shares.
- Ordinary shares generally have the most voting rights and shareholders with ordinary shares have greater control of the company.
- The amount of the dividend payable on ordinary shares depends on the profits made by the company, and the dividends vary according to the company's performance.
- Preference shares carry rights in preference to other shares. They have the right to receive an annual dividend of a fixed amount before a dividend is paid on ordinary shares.
- The rights of preference shares depend on what is expressly stated of them in their terms of
 issue, except a preferential dividend is deemed to be cumulative unless expressly described
 as non-cumulative.
- Dividends on preference shares are paid before the dividends on ordinary shares.
- Usually preference shares have a priority right to the return of capital if the company is wound up.

b)

- A fixed charge relates to specific assets of a company and attaches to those assets as soon as it is created. It is possible to have more than one fixed charge on any one asset.
- Assets subject to a fixed charge cannot be disposed of without repayment of the charge.
- If the company defaults in payment of the interest of loan the holder of the charge will be entitled to apply to court for the sale of the asset to recover monies owing.
- A floating charge does not attach to any particular property but is taken on a type of or all of a company's assets, both present and future.
- The type of assets that a floating charge will generally be made on are those that constantly changing such as stock or debts owing to the company.
- Where a floating charge has been created a company can carry on business selling and trading with the assets charged until the charge crystallises.
- On crystallisation the charge converts to a fixed charge on the asset secured by the floating charge that the company has at that moment in time.

