certain resolutions and agreements listed in CA 2006, s 29. The constitutional documents must be filed at Companies House for incorporation and are public documents (CA 2006, ss 9–13).

1.16 CA 2006 introduced some important changes with respect to the **memorandum of association**[1]. This document no longer has any significance after formation and the focus is on the articles. For companies incorporated under CA 2006, the memorandum will:

- contain a statement that the founders intend to form a company; and
- give details of the subscriber shares, if relevant.

It will not, however, specify the objects of the company. Any restrictions on the objects must be set out in the articles[2].

1 Under CA 1985 the memorandum was the dominant document and prevailed in the event of conflict: *Re Duncan Gilmour & Co Ltd* [1952] 2 All ER 871. Under CA 1985 a company's memorandum had to set out the objects of the company. A company could adopt a very general objects clause under CA 1985, s 3A empowering it to carry on business as a general commercial company, that is to carry on any trade or business whatsoever. The implications of such a wide objects clause for corporate capacity and shareholders' control were significant; see para **1.32** and CA 1985, ss 35, 35A and 35B.

2 CA 2006, ss 8 and 9. The memorandum ceases to have any significance after formation. The memorandum does not need to specify the company's authorised share capital but, under CA 2006, s 10, on registration the company must file a statement of capital and shareholdings which will set out a number of features of the company's share capital, including rights attaching to any classes of shares.

1.17 The company's name is also recorded on the certificate of incorporation. For companies incorporated under CA 1985, the provisions of their memoranda which are no longer required by CA 2006 to be in the memorandum will be deemed to form part of the articles of the existing company[1].

1 CA 2006, s 28.

1.18 The **articles** are directly concerned with the internal management of the company and typically contain provisions relating to:

- the company's share capital;
- the rights and duties of shareholders;
- the transferability of shares;
- the conduct of meetings and voting;
- class rights;
- the composition, election and powers of the board of directors;
- the company's objects (if any restrictions)[1]; and
- limited liability.

1 CA 2006, s 31.

1.19 A company's articles are its internal rulebook and contain its internal management rules. The articles deal with the authority or powers of the company directors and members and the rights of members to be notified of, attend and vote at meetings and to receive dividends on their shares if declared. Companies have a degree of latitude in making their own rules in the articles, although these are always subject to the rules of general company law. To the extent that a company does not register articles at Companies House on formation, it will be subject to model articles established by Parliament. The

model articles do provide useful guidance and they apply in default of other provisions. Depending on the size and purpose of the company, the articles will be more or less complex. It is sensible to have lawyers draft a tailor-made set of articles for a particular company using the statutory model as a guide[1].

1 For companies registered under CA 1985, the Companies (Tables A to F) Regulations 1985 (SI 1985/805), Sch, Table A as amended by SI 2007/2541 and SI 2007/2826 ('Table A') apply. Companies registered under CA 2006 may adopt model articles in the form prescribed by the Secretary of State in the Companies (Model Articles) Regulations 2008 (SI 2008/3229) ('the Model Articles').

1.20 Companies registered under CA 2006 are deemed to have adopted the Model Articles prescribed by the Secretary of State to the extent these are not excluded or modified by the company's own articles[1]. If tailor-made articles are registered, the Model Articles will still constitute the company's articles to the extent that their provisions are not excluded or modified by the company's own set of articles. This is what is known as the 'default application' of the Model Articles. CA 2006 for the first time gave the Secretary of State power (under s 19) to make regulations prescribing model articles for different types of company. Rather than having just one set of model articles for all limited companies as in the past, there are now three sets:

- one for private companies limited by shares;
- one for private companies limited by guarantee; and
- one for public companies.

1 CA 2006, s 20. Under CA 1985, s 8(2) a company limited by shares could adopt Table A in full, adopt it with modifications or register its own set excluding Table A. Insofar as the articles did not modify or exclude Table A, Table A automatically applied. Companies incorporated before 1985 are governed by the Table A in force at the time of their incorporation, such as the 1980 or 1948 form of Table A (CA 2006, ss 19, 20 and 28).

1.21 Whether or not a shareholders' agreement is to be executed, it is necessary to consider what modifications to the Model Articles a company should adopt. If a shareholders' agreement is envisaged then ideally the company's articles and the shareholders' agreement should be drafted together, remembering that in general the articles will become a public document but the shareholders' agreement may not.

1.22 CA 2006 does not specify what matters must be included in the articles, and the provisions about model articles in CA 2006 may subtly change the approach to drafting articles. Companies formed under CA 1985 often registered articles adopting Table A subject to specific amendment. CA 2006, s 18(3)(a) requires that the articles be contained in a 'single' document and it has been suggested that the Model Articles will perform a gap-filling role reversing the CA 1985 approach—the articles will be silent as to the Model Articles but these will apply if gaps exist[1]. When the provisions of a relevant shareholders' agreement are also to be considered, one appreciates how important it is to draft the articles in line with the agreement and most often to exclude the Model Articles altogether to avoid duplication and potential conflict.

1 Davies, P and Worthington, S, *Gower: Principles of modern company law* (10th edn, 2016) Sweet & Maxwell, p 301, fn 47.

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THE STATUTORY CONTRACT

1.23 Previous Companies Acts created a so-called 'statutory contract' by providing that the memorandum and articles of association of a company took effect as a contract between the shareholders and the company. Despite some ambiguity in the drafting of forerunners to CA 2006, s 33, case law over the years had clarified that a 'statutory contract' was created on incorporation between the shareholders themselves and between the shareholders and the company. CA 2006, s 33 specifies that the provisions of a company's constitution bind the company and the members as if they had been signed and sealed by each member and the company, thereby removing this ambiguity and causing the old learning on the company's status under this statutory contract to lose some of its significance. A brief look at that learning is all that is required[1].

1 CA 2006, s 33 specifies:
(1) The provisions of a company's constitution, when registered, bind the company and its members to the same extent as if there were covenants, signed and sealed on the part of the company and of each member, to observe those provisions.
(2) Money payable by a member to the company under its constitution is a debt due from him to the company.
In England, Wales and Northern Ireland it is of the nature of an ordinary contract debt.

1.24 Section 16 of the Companies Act 1862 was first introduced to provide the link between the company, the members and the memorandum and articles (themselves first introduced by the Joint Stock Companies Act of 1856). The drafting of the section prescribing the so-called 'statutory contract' remained little changed in the many Companies Acts between 1862 and 1985.

1.25 CA 1985, s 14(1) did not, however, refer to a 'contract'; instead the memorandum and articles were stated to bind the 'company and its members to the same extent as if they respectively had been signed and sealed by each member'.

1.26 The drafting of CA 1985, s 14 suffered from its history (the memorandum and articles having been introduced by the Joint Stock Companies Act of 1856 to replace the deed of settlement) and left many issues unresolved. It fell to the courts to tackle these issues and every undergraduate student of company law is familiar with *Eley v Positive Government Security Life Assurance Co*[1]; *Wood v Odessa Waterworks Co*[2]; *Salmon v Quin & Axtens Ltd*[3]; *Hickman v Kent or Romney Marsh Sheep-Breeders' Association*[4]; *Beattie v E & F Beattie Ltd*[5]; and *Rayfield v Hands*[6]. These cases attempted to settle the conflicts as to the identity of the parties to the s 14 contract and the right of those parties (the company and the members) to sue on it.

1 (1876) 1 ExD 88.
2 (1889) 42 Ch D 636.
3 [1909] 1 Ch 311.
4 [1915] 1 Ch 881.
5 [1938] Ch 708.
6 [1960] Ch 1.

1.27 CA 2006, s 33 addresses the issue directly by specifying that the company is a party to the statutory contract created by the company's constitution. The language has been updated. The statutory contract is now

effectively a 'multi-party' contract. The difficulties created by CA 1985, s 14(2) in relation to limitation have also been removed in that CA 2006, s 33 specifies that debts due under the contract are 'ordinary' as opposed to 'specialty' debts[1].

1 Davies, P and Worthington, S, *Gower: Principles of modern company law* (10th edn, 2016) Sweet & Maxwell, paras 3-04 to 3-18. On limitation see Reece Thomas and Ryan, 'Section 459, Public Policy and Freedom of Contract' (2001) 22 *Company Lawyer* 177–183 and 198–206. See also Ryan and Scanlan, 'The Statutory Contract under s 33 of the Companies Act 2006: the Legal Consequences for Banks Pts I and II' (2008) 23(6)–(7) JIBFL 360. On the effect of CA 2006, s 33 see Griffin, 'Companies Act 2006 s 33—altering the contractual effect of the articles of association?', *Company Law Newsletter* (2010), and Shirazi, 'To what extent does the section 33 contract differ from an orthodox contract?' (2013) *Company Lawyer* 36.

1.28 The statutory contract has not, however, been interpreted as an 'ordinary' contract and company law imposes limitations on the usual rules applicable to contracts in this instance.

1.29 The statutory contract is a public document and no 'ordinary' contract in that:

- it can be amended without unanimous consent by virtue of the inalienable right of a company to change its articles by special resolution (CA 2006, s 21)—a special majority, that is 75 per cent of shareholders, can agree amendments leaving 25 per cent bound without their consent unless they can rely on some minority protection provision such as CA 2006, s 961[1];
- shareholders acquiring their shares after the adoption of the articles will be bound without having become a party by specifically consenting to the terms of the articles or executing a copy; their consent to the terms set out in the legislation and the company's constitutional documents is implied—they are by statute deemed to be bound by virtue of their shareholding;
- not all provisions of the articles will be enforceable at the suit of a shareholder or the company, as the common law provides that only rights held by a shareholder in the capacity of a shareholder will be personally enforceable[2]; and
- provisions in a company's constitution do not confer any rights on persons other than the company and its shareholders[3].

1 See para **1.43** and Chapters 6 and 10.
2 See paras **1.33–1.38** below.
3 Contracts (Rights of Third Parties) Act 1999, s 6(2) and see Chapter 3 paras **3.22–3.30** on privity. *DNick Holding plc, Re; Eckerle v Wickeder Westfalenstahl GmbH* [2013] EWHC 68 (Ch), [2014] Ch 196, [2013] 3 WLR 1316 confirms that those holding a beneficial interest only in shares may not rely on the statutory contract and are not shareholders for the purposes of CA 2006.

1.30 The statutory contract is a unique type of contract and this is clearly illustrated by the case *Bratton Seymour Service Co Ltd v Oxborough*[1]. This case involved an attempt to imply into the articles of association of a company which managed a residential development and whose shareholders were the owners of the residential units, a term that the shareholders should contribute to the upkeep of certain amenities associated with the development. The Court of Appeal declined to imply any such term from the surrounding circumstances since the articles were not the type of contract which was amenable to this type

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of implication. This would have involved adding a new term to the articles. The only way in which this could be done was by altering the articles of association. As Steyn LJ stated[2]:

> 'The section 14 contract is a statutory contract of a special nature with its own distinctive features. It derives its binding force not only from a bargain struck between parties but from the terms of the statute. It is binding only insofar as it affects the rights and obligations between the company and the members acting in their capacity as members. If it contains provisions conferring rights and obligations on outsiders, then those provisions do not bite as part of the contract between the company and the members, even if the outsider is coincidentally a member. Similarly, if the provisions are not truly referable to the rights and obligations of members as such it does not operate as a contract. Moreover, the contract can be altered by a special resolution without the consent of all the contracting parties. It is also, unlike an ordinary contract, not defeasible on the grounds of misrepresentation, common law mistake, mistake in equity, under influence or duress. Moreover, as Dillon LJ, has pointed out, it cannot be rectified on the grounds of mistake.'

1 [1992] BCLC 693, applied in *Towcester Racecourse Co Ltd v The Racecourse Association Ltd* [2002] EWHC 2141 (Ch), [2003] 1 BCLC 260, [2002] All ER (D) 335 (Oct), and *Dashfield and anor v Davidson and ors* [2009] 1 BCLC 220. See also Chapter 3 para **3.35** on interpretation.

2 *Bratton Seymour Service Co Ltd v Oxborough* [1992] BCLC 693 at 698. (The 'section 14 contract' referred to in this quotation has become CA 2006, s 33.)

1.31 It is a fundamental rule of company law derived from the separate legal personality of the company that if a wrong is done to the company, an individual shareholder has no right of action in respect of this wrong except in exceptional circumstances[1].

1 *Foss v Harbottle* (1843) 2 Hare 461; *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1, [2001] 1 All ER 481, [2001] 2 WLR 72, [2001] 1 BCLC 313; *Giles v Rhind* [2002] EWCA Civ 1428, [2003] Ch 618, [2002] 4 All ER 977, [2003] 2 WLR 237, [2003] 1 BCLC 1, (2002) Times, 23 October, [2002] All ER (D) 233 (Oct); *Gardner v Parker* [2004] EWCA Civ 781, [2005] BCC 46, [2004] 2 BCLC 554, (2004) 148 SJLB 792; and the important recent case of *Sevilleja v Marex Financial Ltd* [2020] UKSC 31, [2020] 3 WLR 255, [2020] 2 BCLC 319 in which the Supreme Court criticised the expansion of those circumstances in recent cases (distancing itself from the reflective loss principle discussed in *Giles v Rhind* [2002] EWCA Civ 1428).

1.32 This rule reflects the degree to which majority control lies at the root of company law[1]. CA 2006, s 31 removed the requirement that companies list objects in their memorandum of association. Restrictions can now be included in the articles. Objects clauses may become a thing of the past for companies incorporated under CA 2006. Companies no longer need to state any objects at all. Companies may nonetheless choose to state objects and powers in their articles and any provisions in the memoranda of companies registered under CA 1985 will automatically be transferred into their articles. This change liberates companies in theory from the restrictions of their objects. Companies incorporated before implementation of CA 2006 which do not remove the current restrictions from what will be deemed to be their articles will, however, continue to be bound by relevant *ultra vires* rules, as will companies incorporated under CA 2006 which put restrictions on objects in their articles.

1 CA 2006, ss 39–46 and see Chapter 4 paras **4.104** and **4.179** fn 1.

1.33 The so-called rule in *Foss v Harbottle*[1] will not apply where the shareholder's action relates to a personal right[2]. Personal rights common to

ordinary shareholders generally are discussed in para **1.43** but broadly they include:

- the right to proper notice of company meetings and the right to attend and vote at those meetings;
- the right to a dividend (if one is declared); and
- the right to have the company's constitution complied with by the company and the shareholders.

1 (1843) 2 Hare 461, 67 ER 189.

2 *Pender v Lushington* (1877) 6 Ch D 70, 46 LJ Ch 317 and see para **1.43** below.

1.34 The latter right has given rise to extensive judicial and academic controversy because, while the articles do give rise to a statutory contract enforceable by the shareholders, case law distinguishes between those provisions in the articles which are so enforceable and those which are not. In other words, cases have differentiated between 'insider' and 'outsider' rights or between shareholder and management rights set out in the articles[1]. In both instances, 'insider' rights are personally enforceable and 'outsider rights' are not.

1 See the cases cited at para **1.26** and fn 1 to para **1.37**.

1.35 It has been decided, for example, that an article specifying that a particular individual shareholder should be the company's solicitor for life is unenforceable by that shareholder because the statutory contract permits only the enforcement of rights in the articles that affect all shareholders in their capacity as shareholders and that article was for the benefit only of that particular shareholder[1].

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1 *Eley v Positive Government Security Life Assurance Co Ltd* (1876) 1 ExD 88.

1.36 In another case, however, an article granting one of the directors (who was also a shareholder) an effective right of veto over board decisions was upheld in the face of an ordinary resolution approving the decision in question[1]. The decision in this case turned on the court's view that the company was trying to do by ordinary resolution what the constitution required it to do by special resolution.

1 *Salmon v Quin & Axtens Ltd* [1909] 1 Ch 311, affd sub nom *Quin & Axtens Ltd v Salmon* [1909] AC 442.

1.37 Later cases have not resolved this conflict[1] but it is clear that an individual shareholder does not have the contractual right to enforce each and every provision of the articles. The statutory contract has not been judicially interpreted to allow the rule in *Foss v Harbottle*[2] to be circumvented by suits by shareholders against shareholder directors for failure to manage the company in accordance with the articles. The company alone remains capable of suing the directors in these circumstances unless an exception to the rule applies[3]. One exception would be a provision permitting suits against directors contained in a shareholders' agreement to which the company and

the directors were parties because, in that case, the suit would be for breach of the contract contained in the shareholders' agreement.

[1] See *Bratton Seymour Service Co Ltd v Oxborough* [1992] BCLC 693; *Re Compania de Electricidad de la Provincia de Buenos Aires Ltd* [1978] 3 All ER 668; and *Soden v British and Commonwealth Holdings plc* [1997] 4 All ER 353 HL which discusses the meaning of 'qua member' in the context of the Insolvency Act 1986 (IA 1986).

[2] (1843) 2 Hare 461, 67 ER 189.

[3] The exceptions include the enforcement of private rights: CA 2006, s 994. Note should also be made of the provisions in CA 2006, Pt 11 in relation to derivative actions—see Chapter 5 para 5.87 ff.

1.38 The attempted rationalisations of the cases on the statutory contract[1] are not wholly satisfactory, although the authors appear to agree that indirect enforcement of outsider matters can be achieved by suing qua member to ensure compliance with the constitution. It is because of the uncertainty surrounding the enforceability of the statutory contract that shareholders need a shareholders' agreement to govern their interrelationship and ensure they can control the company if that is the desired object[2].

[1] Wedderburn [1957] CLJ 194 and [1958] CLJ 219; Gower (1958) 21 MLR 401 and 657; Prentice, G N, (1980) 1 *Company Lawyer* 179; Gregory (1981) 44 MLR 526; Goldberg (1972) 33 MLR 362 and (1985) 48 MLR 121, and Drury [1986] CLJ 219. Wedderburn and Gregory maintain that a shareholder has the right to enforce any obligation contained in the company's memorandum and articles provided that shareholder sues qua shareholder and the obligation being enforced is more than an internal irregularity that could be corrected by an ordinary resolution. The other academics agree that a shareholder should in effect be able indirectly to enforce anything in the company's constitutional documents but only if the shareholder sues as a member *and* the right in question is essential to the proper functioning of the company or some organ of it. Drury also attempts to explain the cases on the basis of the 'long-term' relationship of company and shareholders—ie that straight contract might not or should not work. On CA 2006, s 33 see Griffin, 'Companies Act 2006 s 33—altering the contractual effect of the articles of association?', *Company Law Newsletter* (2010) where he argues Lord Wedderburn's view dominated in the House of Lords, and Shirazi, 'To what extent does the section 33 contract differ from an orthodox contract?' (2013) *Company Lawyer* 36.

[2] An interesting comparison could be made between the degree of interference with the enforceability of the statutory contract and the inability of the company to bind itself by a shareholders' agreement to fetter certain of its statutory powers. See the discussion of *Russell v Northern Bank Development Corpn Ltd* [1992] 3 All ER 161 in Chapter 4 at paras 4.15–4.25.

THE ARTICLES AND A SHAREHOLDERS' AGREEMENT

1.39 Most of the provisions likely to be included in a shareholders' agreement are matters that could be put in the company's articles of association. Articles however, once registered with Companies House, become public documents whereas a shareholders' agreement does not necessarily need to be registered. There may be commercial reasons to place the provisions in a non-public document.

1.40 If a shareholders' agreement is executed, the following need to be addressed in the context of the articles:

- the extent to which the articles need to repeat or overlap with what is in the shareholders' agreement; and

- whether the shareholders' agreement needs to be registered at Companies House along with the articles.

1.41 The relationship between the two documents needs very careful consideration, as discussed above. The safest and best practice is to draft the two documents simultaneously.

The shareholders' agreement and registration

1.42 It is often difficult to determine if a shareholders' agreement needs to be registered at Companies House along with the articles and special resolutions passed after incorporation[1]. The law on whether or not registration of the agreement is required is discussed in Chapter 4 at paras **4.26–4.40**, but if it is desired not to register the shareholders' agreement:

- the articles must deal comprehensively with all issues set out in the Model Articles—cross-referencing to the shareholders' agreement must be avoided; and
- if the shareholders' agreement and the articles conflict, the agreement should require the parties to effect a change to the articles or at the very least include a clause whereby in the event of inconsistency the shareholders' agreement is to prevail[2].

[1] As required by CA 1985, s 380(4)(c) and CA 2006, ss 29 and 30.

[2] See Chapter 4 para **4.30** which discusses registration and inconsistency clauses and **Precedent 1** (joint venture agreement), **clause 4.12** and **Precedent 4** (investment agreement), **clause 11.7** in the Appendix.

SUMMARY OF BASIC SHAREHOLDER RIGHTS WITHOUT A SHAREHOLDERS' AGREEMENT

1.43 If no shareholders' agreement exists, the terms of the statutory contract are specified in the company's constitution (the articles and any agreements and resolutions caught by CA 2006, s 29). Shareholders in addition have certain basic protections under company law which they can invoke. These include:

- the right to be properly notified of any meeting of the company[1];
- the right to attend and vote at any meeting of the company (but not a class meeting unless the shareholder is a member of that class)[2];
- the right to a dividend if one is declared by the company[3];
- the ability, if they are shareholders entitled to vote at a general meeting of the company, to request the directors[4] or the court (where it is impracticable to call or conduct a meeting as prescribed by CA 2006)[5] to order a meeting to be held;
- the ability of any shareholder with 10 per cent of the voting shares to:
  - (i) block a takeover offer[6];
  - (ii) apply to the Department for Business, Energy & Industrial Strategy (BEIS) for an investigation[7];
- the ability of a shareholder owning more than 25 per cent of the voting shares to block any special resolution including those to change the

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from the company. These devices mirror the objectives of a separately negotiated shareholders' agreement[1] and include:

- designating certain matters as reserved matters requiring unanimous decision or a higher than normal percentage of votes[2];
- providing veto rights to particular shareholders in relation to certain transactions[3];
- the incorporation of weighted voting rights[4];
- the use of class rights[5];
- the provision of golden shares (usually only found in privatisation issues)[6].

1 Where there is a separate shareholders' agreement, the articles need to be drafted to reflect this. See Chapter 5.
2 These are common minority protection devices. See Chapter 5.
3 *Quin & Axtens Ltd v Salmon* [1909] AC 442.
4 *Bushell v Faith* [1970] AC 1099 and Chapter 5 paras **5.48–5.54**. See also para **4.21** below.
5 See Chapter 5 paras **5.58–5.82** and Chapter 9 paras **9.80–9.89**.
6 See Chapter 5 paras **5.55–5.57**.

4.3 The articles can be amended to further the objectives of certain shareholders—for example, to permit the shares of a minority shareholder to be compulsorily acquired under a takeover offer (depending on what might be contained in a shareholders' agreement). Such an amendment would not in itself be unfairly prejudicial conduct under CA 2006, s 994[1].

1 See *Re Charterhouse Capital Ltd; Arbuthnott v Bonnyman* [2014] EWHC 1410 (Ch) and Chapter 5 paras **5.184–5.238**.

4.4 CA 2006 permits provisions in a company's articles to be altered by special resolution: CA 2006, s 21, or by the other resolutions or agreements specified in the Act: CA 2006, s 29. The wording of the statute is significant; it provides for the creation, registration and amendment of articles of association. In *Gunrwardena v Conron Holdings Ltd*[1] the articles in question were clearly those that had been agreed, and there was an assumption that the agreed articles would be registered. They were not. The court indicated that CA 2006 does not provide for any overriding effect of registration in the event of a conflict between what is altered, and it held that if the members resolved on an amendment by special resolution, the amended articles became the new contract and new articles and took effect immediately[2]. Their status as articles do not depend on registration. Any other conclusion would be contrary to the Act which permits only one mechanism for the amendment of articles—a special resolution. (CA 2006, s 30 requires that special resolutions are registered within 15 days; registration of an amendment mistakenly purporting to be what had been agreed by the members presumably would make the company and the directors criminally liable until the correct version was registered.)

1 [2016] EWHC 2983 (Ch).
2 See *Ho Tung v Man On Insurance Co Ltd* [1902] AC 232.

4.5 Companies sometimes try to make it more difficult, or impossible, for certain provisions of their constitutions to be altered by entrenching them. A provision is absolutely entrenched if it cannot be altered or removed at all and conditionally entrenched if it can be altered only by a procedure which goes beyond the relevant statutory requirement—so, for example, instead of

requiring the usual special resolution, requiring a vote of 85 per cent in favour or unanimous approval of the members to alter or remove it. Entrenchment was commonly achieved previously by putting certain matters into the memorandum which automatically entrenched them unless they were matters for which the statute provided an alteration mechanism. CA 2006 does not permit new companies to have any kind of absolute entrenchment (ie they cannot state that provisions in their articles are unalterable) but the Act does permit conditional/procedural entrenchment of any provision in a company's articles.

4.6 CA 2006, s 22 requires that if a company so wishes, its articles may contain provisions for conditional entrenchment, ie the inclusion of an article to the effect that an article or the articles may be amended or repealed only if conditions are met or procedures are complied with, which are more restrictive than a special resolution. Currently such provisions may only be included in the articles on formation of the company or by all the members at a later point in time unanimously agreeing to their inclusion by an amendment to the articles or by a court order: CA 2006, s 22.

(It should be noted that CA 2006, s 22 is only partially operative—s 22(2) is not yet in force and excluded by the Small Business, Enterprise and Employment Act 2015, ss 85(2)(b) and 164(3)(g)(ii), the reason being that the Department for Business, Energy & Industrial Strategy was uncertain whether the definition of 'provision for entrenchment' was too wide and could catch provisions sometimes attached to classes of shares, making it difficult to introduce or amend such provisions. The decision to delay the commencement of CA 2006, s 22(2) does not affect the power, as set out above, to include entrenchment provisions in a company's articles; it simply ensures that other proposed statutory restrictions on how provisions for entrenchment may be introduced do not yet apply.)

4.7 The inclusion in, or removal from, the articles of a provision for entrenchment must be notified by the company to the Registrar: CA 2006, s 23. Thus, where a company is subject to an entrenchment provision or an order restricting or excluding its power to amend its articles, it must, if it does purport to amend them, send evidence of the amendment to the Registrar. In addition, it must also deliver a statement of compliance with its articles or with the court order: CA 2006, s 24. These shareholder protection measures are discussed in Chapter 5, together with the law on minority protection.

4.8 The alternative to including these devices in the articles themselves is to use a contract outside the articles, the so-called shareholders' agreement.

SHAREHOLDERS' AGREEMENTS

4.9 As explained in Chapter 1, the purpose of a shareholders' agreement in every instance is:

- to modify, as far as possible, the legal framework provided by the companies legislation and particularly by the company's constitutional

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document(s), the articles of association and any special resolution or unanimous agreement: CA 2006, ss 17 and 29;

- to anticipate some of the problems which can arise, particularly in relation to management, constitutional and exit issues;
- to deal with matters which:
  (i) the parties do not wish to be known generally by the public (and especially not by competitors or creditors);
  (ii) are not usually included in the articles of association; and
  (iii) confer rights on shareholders in some capacity other than as members[1].

1 The aim is to avoid the decision in *Eley v Positive Life Assurance Co Ltd* (1876) 1 Ex D 88 which asserted that the articles are a contract between the company and its members and between the members inter se in relation only to membership rights. In other words, the contract created by the articles is not a contract with outsiders and is not a contract for non-membership rights. For the complex debate as to the nature of the CA 2006, s 33 statutory contract and whether or not non-membership rights can be indirectly enforced, see Chapter 1 paras **1.23–1.38**. CA 2006, s 33 now states that the company, as well as the member, is deemed to have signed and sealed the provisions in the articles so they are bound to each other by a specialty contract.

4.10 A shareholders' agreement is usually intended to be a legally binding contractual arrangement entered into between shareholders in a company[1]. Shareholders of a company may lawfully bind themselves by way of an independent shareholders' agreement[2]. Shareholders' agreements can be entered into for all sorts of purposes and matters but one of the most common reasons is to secure agreement to vote in a specific way on issues regulated by the terms of the agreement[3]. This chapter deals with matters such as:

- why a provision in a company's articles or in a shareholders' agreement which conflicts with the exercise of a statutory power is invalid[4];
- how many shareholders need to be or may be party to the agreement; and
- whether or not the company can be a party to it.

1 See Chapter 1 paras **1.1–1.8**.
2 Sometimes referred to as a 'membership agreement'.
3 In *Greenhalgh v Mallard* [1943] 2 All ER 234 Lord Greene MR said hypothetically at p 239:

> 'If the contract is such that it only imposes an obligation to vote in respect of whatever shares the contracting parties happen to have available, it follows that directly they sell their shares the contract is at an end – until possibly they acquire more shares . . . If the contract on its true construction ceases to operate when the shares are sold, then in the hands of the purchaser there can be no question of a continuing obligation which runs with the shares.'

4 *Re Peveril Gold Mines Ltd* [1898] 1 Ch 122 and *Russell v Northern Bank Development Corpn Ltd* [1992] 3 All ER 161 respectively.

4.11 The agreement is intended to regulate the shareholders' relationship as shareholders. Traditionally that relationship has been governed by the company's articles of association (which are a publicly available document). CA 2006, s 33 (the so-called 'statutory contract'[1]) and the relevant common law cases have asserted that the membership terms and conditions provided by the articles can be enforced personally by an aggrieved shareholder taking direct action, either against the company or against a fellow shareholder responsible

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for a breach of *any terms of the contract* of membership that arises from becoming a shareholder[2].

1 See Chapter 1 paras **1.23–1.38**.
2 See *Rayfield v Hands* [1960] Ch 1; see also *Pender v Lushington* (1897) 6 ChD 70.

4.12 As explained in Chapter 2 (and paras **4.1–4.8** above), there are many situations where it is commercially and legally desirable that a shareholders' agreement be entered into, and the use of shareholders' agreements is not confined to the shareholders of family, quasi-partnership companies.

4.13 Such agreements are often used where unrelated business entities come together to form a company (often referred to as 'Newco') particularly to create a joint venture, or a business venture vehicle, or for facilitating management buy-outs or buy-ins[1]. For example, in relation to a management buy-out, one of the main objects of a shareholders' agreement will be to set out the terms and conditions on which equity finance will be made available for the buy-out. It will also include warranties and indemnities from the management team in favour of the equity capital providers; impose covenants against competition by the management team; impose monitoring rights in favour of the financial institutions providing the equity capital; place restrictions on management powers and provide exit routes for the providers of the equity capital[2]. In many instances the object of a shareholders' agreement is clearly that the parties wish to be partners among themselves and a company to the outside world. Often their scheme is similar to that considered more than a century ago by the Court of Appeal in *Re Yenidje Tobacco Co Ltd*, where Cozens-Hardy MR referred to such a scheme as a quasi-partnership company, ie 'a partnership in the guise of a private company'[3]—usually a very small, more often than not, family-owned company.

1 See Chapters 2, 5, 8, 9 and 10.
2 See Chapter 9.
3 [1916] 2 Ch 426. See Chapter 10 on quasi-partnerships.

4.14 Whether a company is to be the vehicle for a joint venture or a business venture or where it is a family, quasi-partnership type company, a minority shareholder or a minority of shareholders may wish to preclude any adverse alteration of the articles of association. One way to achieve this is to include a clause in an agreement between shareholders that no alteration will be made without the consent of the minority. Where the company itself is a party to the shareholders' agreement, legal issues arise as to the enforceability of such a clause as against the company. These are dealt with in paras **4.15–4.25** below.

Leading UK shareholders' agreement case

4.15 The leading UK authority on the enforceability of covenants by a company in a shareholders' agreement is *Russell v Northern Bank Development Corpn*[1]. In the *Russell* case, a 1992 House of Lords decision, Tyrone Brick Ltd (TBL) entered into a shareholders' agreement with its four shareholders which provided, amongst other things, that:

- no further share capital was to be created or issued in the company or the rights attaching to the shares already in issue in any way altered

. . . without the written consent of each of the parties to the agreement; and

- the agreement should take precedence over the company's articles of association.

[1] [1992] 3 All ER 161.

4.16 The company gave notice to the shareholders of an extraordinary general meeting to consider resolutions to increase the company's share capital and to effect a bonus issue of shares. Mr Russell, one of the shareholders, sought an injunction to restrain the other shareholders from considering and voting on the resolutions. The trial judge and the Court of Appeal in Northern Ireland rejected the application but the plaintiff's appeal to the House of Lords was allowed. The House held that the requirement for consent contained in the agreement was invalid because it was an unlawful fetter on the company's statutory power[1] to increase its share capital by ordinary resolution of the company[2] and consequently that clause was unenforceable against the company by Mr Russell. The House of Lords, however, also held that the unenforceable part of the shareholders' agreement (ie the part which purported to take away the company's statutory rights) was independent of, and severable from, the agreement between the shareholders. Therefore the agreement between the shareholders themselves not to vote in favour of a resolution to increase the share capital was enforceable amongst and against themselves. In other words, they may make a binding agreement amongst themselves as to how they should vote in relation to alteration of the company's articles of association. The company could not be a party if by being a party it fettered its statutory power to alter its constitution. Paradoxically, the effect of their voting as agreed, against the resolution, indirectly deprived the company of its statutory right or power to increase its capital.

[1] CA 2006, s 617 (Alteration of share capital) (which was CA 1985, s 121).
[2] See CA 2006, Pt 13, ss 281–287 (Resolutions and meetings). An ordinary resolution is carried, ie becomes effective, by a simple majority of members present in person or by proxy entitled to vote and voting. An ordinary resolution is the type used whenever the law or the company's articles do not require a special or more onerous resolution. Where a section states that 'the powers conferred by this section must be exercised by the company in general meeting' it means that only an ordinary resolution is necessary.

4.17 The only reasoned speech was given by Lord Jauncey. In holding that the agreement was not binding on the company in this instance, because it was an improper fetter on the company's powers to increase its share capital, he relied on the dictum of Lord Justice Russell in *Bushell v Faith*[1] that a company could not by 'its articles or otherwise' deprive itself of the power to alter its articles. In Lord Jauncey's view, the Act ruled out the use of 'fetters on the power to alter the articles of association imposed by the statutory framework of a company' (eg by a clause in the articles), but the use of the adverb 'otherwise' also excluded other fetters to which the company was a party (such as a shareholders' agreement). He said such an undertaking by the company was 'as obnoxious as if it had been contained in the articles of association' and was unenforceable.

[1] [1969] 1 All ER 1002 at 1006. See Chapter 5 paras **5.48–5.54**.

4.18 Lord Jauncey held (without any reasoned analysis) that the company's participation in the agreement was severable from the undertakings

between the shareholders which, in his view, were enforceable as matters personal to the shareholders, citing the old case of *Welton v Saffery*[1]. In particular he approved a passage from the judgment of Lord Davey who stated[2]:

> 'Of course, individual shareholders may deal with their own interests by contract in such a way as they may think fit, but such contracts, whether made by all or some only of the shareholders, would create personal obligations, or an *exceptio personalis* against themselves only, and would not become a regulation of the company, or be binding on the transferees of the parties to it, or upon new or non-assenting shareholders.'

Curiously, despite being unenforceable, it was severable. No guidance is provided by his Lordship to explain why the company's agreement or undertaking was severable when it was already declared unenforceable, or how the courts would decide this issue in the future[3].

[1] [1897] AC 299.
[2] *Welton v Saffery* [1897] AC 299 at 331.
[3] See, however, Chapter 6 paras **6.35–6.54** on severance and para **4.125** below for the approach taken by the Canadian courts.

4.19 To sum up, the House of Lords stated in *Russell* that the shareholders' agreement:

- was separate and distinct from the company's articles and that it would have been invalid if it had been contained in the company's articles;
- was of a purely personal nature; and
- insofar as it affected the rights of the shareholders amongst themselves, was binding and independent and severable from the agreement with the company which was unenforceable against it in that instance.

4.20 The decision in *Russell* makes it absolutely clear that:

- a shareholders' agreement binds only the shareholders who are parties to it—future incoming shareholders are not bound unless they sign up to the agreement;
- a company itself may be a party to a shareholders' agreement but cannot be a party to any such agreement which purports to restrict any of its statutory powers, such as the power to alter its articles—put another way, any provision in any agreement to which a company is a party which is inconsistent with a statutory power of the company is ineffective as against the company, and if that provision is not severable from the rest of the agreement it may invalidate the entire agreement;
- no action for damages or an injunction by or against the company will lie if based on such an agreement; and
- the provisions of the agreement may still bind the shareholders, provided those offending parts purporting to restrict the company's statutory rights can be severed from the rest of the agreement, and can survive on their own despite their severance.

4.21 *Russell* held that neither future shareholders nor, in the circumstances of that case, the company were bound by the shareholders' agreement, but nevertheless that the agreement had the effect of indirectly restricting the company from acting in accordance with its statutory powers[1]. Arguably, this

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is totally contrary to the intention of the relevant provision of the companies legislation[2]. The aim of the agreement, after all, was to stop the company passing any resolution contrary to the terms of the agreement, and in doing so it effectively stopped the company exercising its statutory alteration right[3]. The effect of *Russell* is that a member who is a party to a shareholders' agreement may seek an injunction to stop other members who are parties to the agreement from acting in accordance with the company's statutory rights or powers. The shareholders' agreement in effect emasculates the statutory framework for the operation of companies and in the worst scenario the company becomes governed solely by the shareholders' agreement divorced from the intended statutory provisions. It is suggested that this is an area of law where in future the courts might, by analogy with the decisions in *Shindler v Northern Raincoat Co Ltd*[4] and *Southern Foundries Ltd v Shirlaw*[5], decide that an injunction is inappropriate and that the shareholder who breaches the shareholders' agreement should rather be penalised in damages. It might be argued, however, that such a ruling, on the other hand, would destroy one of the significant uses or purposes of shareholders' agreements.

1 A similar effect is achieved by the provision of weighted voting rights in a company's articles: see *Bushell v Faith* [1969] 1 All ER 1002 and Chapter 5 paras **5.48–5.54**.
2 CA 1985, s 9, which has become CA 2006, s 21.
3 A resolution conflicting with the terms of the shareholders' agreement could only be passed, in that case, by the consent of all the shareholders. This, however, may be achieved without any formal consent procedure because the *Duomatic* principle (*Re Duomatic Ltd* [1969] 2 Ch 365, see para **4.31–4.33**, **4.39** and **4.40**) permits all the members who are party to the agreement to informally agree that the resolution should succeed: *Euro Brokers Holdings Ltd v Monecor (London) Ltd* [2002] EWHC 1573 (Ch), [2003] 1 BCLC 338, [2002] All ER (D) 131 (May); affd [2003] EWCA Civ 105, [2003] 1 BCLC 506, [2003] All ER (D) 118 (Feb). The *Duomatic* principle did not apply to ratify any informal agreement between the unregistered claimant 'shareholder', his wife, and the first defendant that the claimant and his wife would resign as directors leaving the first defendant as the sole director, because the *Duomatic* principle is based on agreements made informally by all the registered shareholders, not by beneficial owners of shares, since companies only take notice of legal ownership as indicated by presence of shareholders on the register of members on the date when the supposed agreement was made: *Domoney v Godinho and anor* [2004] EWHC 328 (Ch), [2004] 2 BCLC 15, [2004] All ER (D) 152 (Feb). See also para **4.51** below.
4 [1960] 2 All ER 239, [1960] 1 WLR 1038. See para **4.55** below.
5 [1940] AC 701.

4.22 Some insight into the attitude of the courts can be gained from the decision in *Exeter City AFC Ltd v Football Conference Ltd*[1]. There the court held that a shareholders' agreement could not prevent a shareholder from exercising a statutory right to petition the court for relief under current CA 2006, s 994 (formerly CA 1985, s 459) for conduct unfairly prejudicial to minority membership interests, or from presenting a winding-up petition. This decision is no longer good law having been overturned at least in relation to the arbitrability of an unfair prejudice claim by the Court of Appeal in *Fulham Football Club (1978) Ltd v Richards*[2]. A provision in a shareholders' agreement purporting to preclude a member's right to present a winding up petition may not be seen by the court as a purely personal matter between the contracting parties because winding up and insolvency bring wider considerations of public policy—the protection of creditors and the public into consideration. In the latter instance a decision along the lines of that in *Exeter City AFC Ltd* is more likely. Assuming for a moment that a shareholders' agreement purports to exclude a shareholder's statutory rights, then even

though the shareholder in pursuing those rights is in breach of the agreement (the agreement would on that issue no longer be deemed ineffective or void), there seems no reason why that shareholder (whether or not those remedies are legally available) should not pay damages for breach of the terms of the agreement to the other parties to the shareholders' agreement.

1 [2004] EWHC 2304 (Ch), [2004] 4 All ER 1179, [2004] BCC 498.
2 [2011] EWCA Civ 855.

4.23 The Court of Appeal in *Union Music Ltd v Watson*[1] took a similar approach to that in the *Exeter City AFC Ltd* case in relation to the application of CA 1985, s 371 (power of the court to call a meeting, which is now CA 2006, s 306). There had been a breakdown in the relationship between the two shareholders and the terms of the shareholders' agreement had led to deadlock. The Court of Appeal held that the terms of the agreement should not be adhered to in that instance; that it was not designed to ensure power was shared equally and it could not prevent the court making an order under the then s 371 to permit the right of the majority shareholder to appoint a new director in accordance with his majority voting power[2].

1 [2003] 1 BCLC 453.
2 See also *Vectone Entertainment Holding Ltd v South Entertainment Ltd* [2004] EWHC 744 (Ch), [2004] BCLC 224, [2004] All ER (D) 52 (Apr). Note, however, that the Court of Appeal in *Union Music* [2003] 1 BCLC 453 made it clear that CA 1985, s 371 is not appropriate for breaking deadlocks between two equal shareholders as stated by an earlier decision of that court in *Ross v Telford* [1997] BCC 945. CA 1985, s 371 has been replaced, unaltered, by CA 2006, s 306.

4.24 Whether the court should use its inherent power to break the deadlock is debatable, given that all the parties had agreed their own terms. The decision in the *Fulham Football Club* case suggests courts will now be less likely to intervene. In that case the shareholders freely agreed to forego their statutory remedy. Private agreements (contracts) tend to be concerned with protecting the various interests of the contracting parties. In the *Union Music* case the freely agreed terms were to preclude the intervention under CA 2006, s 306 of the court to break a deadlock. The *Fulham Football Club* case suggests that if the shareholders freely made that choice, it should be adhered to despite endorsing the prolongation of the deadlock. What is evident, however, from the *Fulham Football Club* decision is that if a shareholders' agreement is not confined in its effect to the interests of the parties but affects third parties, creditors or the general public, public policy should dictate whether or not the terms of the agreement are enforceable[1].

1 For detailed and extensive debate of the use and extent of contractual freedom in relation to internal company regulation, see Ferran, 'The decision of the House of Lords in *Russell v Northern Bank development Corporation Ltd*' [1994] CLJ 333; Davies, 'Fulham football Club (1987) Ltd v Richards' (2011) 32 Bus LR 54; Griffiths, 'The primacy afforded to an arbitration agreement in the context of a petition against unfairly prejudicial conduct' [2011] Co LN 1; and Cheung, 'Shareholders' agreements—shareholders' contractual freedom in company law' [2012] JBL 504.

4.25 Paragraphs **4.54** and **4.55** below explain how a company can be made a party to a shareholders' agreement without falling foul of *Russell*. It is possible that, in the future, shareholders' agreements that affect the implementation of the articles rather than their content, or affect the implementation of statutory

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2 *Movitex Ltd v Bulfield* (1986) 2 BCC 99, 403.
3 *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 per Lord Porter at 159.
4 *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 per Lord MacMillan at 153.

4.135 In *Richmond Pharmacology v Chester Overseas Ltd* [2014] EWHC 3418 (Ch) the issue was whether a minority shareholder was in breach of confidentiality, owed pursuant to the terms of a shareholders' agreement, and of directors' duties under CA 2006, s 175 to avoid conflict of interest. In relation to the latter question the court held that the test for determining whether there was a breach of s 175 was objective and did not depend on whether the director was aware that what he was doing was a breach of his duty. Also, it is no defence to such a claim that the director acted reasonably, but wrongly, and thought that he was entitled to do what he had done[1].

1 Compare this to the duty to promote the best interests of the company under CA 2006, s 172—see *Re HLC Environmental Projects Ltd* [2013] EWHC 2876 (Ch). The test in *Richmond Pharmacology* may hold a director liable for a s 175 breach despite acting reasonably, but it would not preclude him from successfully seeking relief from the court under CA 2006, s 1157 on the basis his acts were honest and reasonable.

4.136 See also *Haysport Properties Ltd v Ackerman* [2016] EWHC 393 (Ch) which demonstrates the importance of fiduciary duties owed by directors to their companies when entering transactions with parties in which they also have an interest. That case also clarifies the issue of limitation and whether an action would be deemed statute-barred under the Limitation Act 1980 in relation to breach of duty. The court held there had been a breach of fiduciary duty for which there should be no limitation period and it would fall within the s 21 exemption in the Act, and the fact the defendant had a positive duty to disclose his own breaches as a fiduciary, and had not done so, meant that limitation would not be a factor until those breaches were discovered. This case also focuses on the liability of retired directors: see para **4.154** below.

4.137 The rule does cover both actual and potential conflicts (ie situations which possibly might conflict[1]) but the modern view is that *de minimis* conflicts, those that are so small they will not affect compliance with a fiduciary duty, will be ignored[2]. The current position is best summed up by Lord Upjohn (albeit in a dissenting judgment) when he said[3]:

> 'The phase "possibly may conflict" . . . means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict.'

1 *Aberdeen Rly Co v Blaikie Bros* (1854) 1 Macq 461 at 471, now embodied in CA 2006, s 175(1).
2 *Movitex Ltd v Bulfield* (1986) 2 BCC 99, 403; *Chan v Zacharia* (1983) 154 CLR 178; *Queensland Mines Ltd v Hudson* (1978) 52 ALJR 399, now embodied in CA 2006, s 175(4)(a).
3 *Boardman v Phipps* [1967] 2 AC 46 at 124.

4.138 In *Fairford Water Ski Club Ltd v Cohoon* [2020] EWHC 290 (Ch) the duties directors owe to a company and the level of detail they must provide when notifying their fellow directors of a transaction or arrangement in which they are interested were considered. The company operated a members' water skiing club. The claimant company alleged the directors were in breach of various statutory duties including CA 2006, ss 171 and 175 on the basis that they had misappropriated money and other property from the company. Also, that they had caused the company to pay unapproved management charges to a company in which they had an interest. The central issue was whether the two directors in question had properly declared the 'nature and extent' of their interest in the management company as required by CA 2006, s 177. The company argued that the directors failed to declare the 'nature' of that interest as they had not disclosed the amount of fee payable under the agreement, and that they had failed to comply with the company's articles which required each director to declare the 'nature and extent' of any interest they had in a transaction or arrangement with the company. The High Court found in favour of the company on the basis that the directors had failed to disclose 'the precise nature of the interest' or had not been able to show they had complied with the 'letter and spirit' of the disclosure requirements because of the general legal principle that directors are under a duty to make 'full' disclosure of all material pertaining to a transaction. On that basis, one director was ordered to make payments to the company; the other director escaped liability because the management agreement had already been in existence before he became a director, so he was not required to disclose his interest. It is surprising that CA 2006, s 182 (Declaration of interest in existing transaction or arrangement) was not relied on in relation to the second director.

Examples of the loyalty rules

4.139 The rules against profiting and against conflict of interest and duty are strictly applicable in relation to two categories of transactions which result in benefit to a director. In one, the transaction producing the profit involves the company, in the other it does not. In both instances the director must account to the company for any profits he has made. In the former category the transaction can be set aside (see fn 1 to para **4.104** above and the discussion of CA 2006, s 41) whereas in the latter it usually cannot be set aside but the recalcitrant director must account for any profit made and will be deemed to be a constructive trustee for the company of any other property acquired through the transaction.

4.140 To which transactions do the loyalty rules apply when the company is not a party? A director is not simply liable only if 'in earning (the) profit he has made use either of the property of the company or of some confidential information which has come to him as a director of the company'[1].

1 Per Lord Blanesburgh in *Bell v Lever Bros Ltd* [1932] AC 161 at 194. Clearly a director will be liable for the profit he makes in these circumstances but the ambit of the law on this point is wider, as shown by the dicta in the leading case *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134. (See also *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704, [2001] All ER (D) 294 (May) and paras **4.141–4.162**.)

4.141 The current, wider ambit of judicial thinking is contained in the leading case of *Regal (Hastings) Ltd v Gulliver*[1]. Their Lordships took the view that a director must account for any profit from a transaction to which the company is not a party if the profit arises by reason of and in the course of the director's fiduciary relationship. Of all the judges involved the dicta of Lord Wright is the most precise. He stated that a director must account for profit arising 'by reason of (the director's) fiduciary position, and by reason of the

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opportunity and the knowledge, or either, resulting from it'[2]. That case also makes it clear that it is irrelevant whether or not:

- the company was capable of making the profit;
- there was any fraud or absence of *bona fides* involved;
- the profiteer was under a duty to obtain the source of the profit for the plaintiff;
- the profiteer took a risk or acted as he did for the benefit of the plaintiff; or
- the plaintiff had in fact been damaged or benefited by the profiteer's action[3].

1 [1967] 2 AC 134.
2 [1967] 2 AC 134 at 154.
3 [1967] 2 AC 134 per Lord Russell of Killowan at 144–145.

4.142 The liability to account arises from the mere fact that a profit was made 'by reason, and only by reason of the fact that' (the profiteer) was a director of the company and 'in the course of (his) exercise of that office'[1]. This is the strict equitable principle and it was strictly applied in *Towers v Premier Waste Management Ltd*[2] where Mr Towers, who was a director of Premier, borrowed equipment/machinery from one of the company's customers to help with work he was carrying out on one of his personal properties. He was not charge a fee for borrowing the equipment. He clearly derived a personal benefit from the position he held as a director of the company. He had not disclosed his interest to the board. The High Court had held that he put himself in a position of conflict once he took the benefit from a customer of the company. The Court of Appeal rejected the argument that there was no conflict because there was no corrupt motive and because the value of the breach was small—approximately £5,000. He was held to be in breach of CA 2006, s 175 (conflict of interest) and also s 176 (because he had accepted a benefit from a third party). He was ordered to pay the rental costs of the equipment for the relevant period. In *Anthony Kleanthous v Theodoros Paphitis and ors*[3] the alleged conflict of interest arose from the use of information acquired during the course of negotiations by the company of which Mr Paphitis and others were board members, to purchase a business. The company took the decision not to proceed. Mr Paphitis and the other defendants incorporated a new company and proceeded with the acquisition and subsequently sold it for a large profit. A derivative claim alleging breach of CA 2006, s 175 failed because:

- the defendants had disclosed their interest;
- it was discussed at a number of board meetings; and
- most important of all, Mr Paphitis' proposal for him and others to make the acquisition for their new company was properly approved by the board.

1 [1967] 2 AC 134 at 147. See also *Murad v Al-Saraj* [2006] EWHC 2404 (Ch), [2006] All ER (D) 131 (Mar).
2 [2011] EWCA Civ 923.
3 [2011] EWHC 2287 (Ch), [2011] All ER (D) 33 (Sep).

Specific interest limitation

4.143 The application of the loyalty rules is confined, however, to transactions in which the company has a specific interest but is not a party. This is well illustrated by the cases involving usurpation by a director of business opportunities of his company[1].

1 *Regal (Hastings) Ltd v Gulliver (1942)* [1967] 2 AC 134 per Viscount Sankey at 137.

4.144 The leading cases indicate that a director will be forced to give up or 'regurgitate' any profit that has been made by competing with or undertaking the same kind of business as that of his company while he is a director, and it is irrelevant whether or not he resigned his directorship before or after undertaking that profit-making business[1]. In the most clear instances a director will have diverted to himself business which should 'properly belong to the company he represents'. He has become aware of the opportunity, the transaction, the contract from which he subsequently profited, because of his position as a director of that particular company. In most instances the profiteer resigns his office of director and sets up his own new company in which he has the sole or predominant interest in order to take up, exploit, develop and take advantage of the knowledge or opportunity which he gained while an officer of the former company[2]. In *Goldtrail Travel Ltd (in liq) v Aydin (Abdulkadir) and Black Pearl Investments Ltd*[3], a company in liquidation brought claims against its former sole director and shareholder for breach of fiduciary duties owed under CA 2006, s 175. The claim was that the director had misapplied the company's money by entering into deals with third parties to purchase airline seats for the company's customers. Large sums were paid by the third parties to the director rather than the company, consequently he was able to make a personal profit. The liquidator, interestingly, also claimed against the third parties, who were joined as defendants for dishonest assistance, both in relation to the misapplication of the company's money and the breach of the director's duties. (This claim against the third parties is instructive not only in relation to breaches of s 175 but also s 176). The defendants sought to strike out the claims. The High Court, however, permitted it to proceed on the basis that once the company went into liquidation, the director could not approve the misapplication of the company's funds as the sole shareholder because by that stage the director owed duties to the creditors and not just to the company. The court held Goldtrail could claim against both the director and the third-party defendants. The director was in breach of fiduciary duty and there was sufficient evidence that the third parties had assisted him knowing his transactions were dishonest and in breach of duty.

1 *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443; *Canadian Aero Service Ltd v O'Malley* (1973) 40 DLR (3rd) 371.
2 See for example *Cook v Deeks* [1916] 1 AC 554 and *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443. Applied in *Kingsley IT Consulting Ltd v McIntosh* [2006] All ER (D) 237, where the director in question had also breached the shareholders' agreement by imparting confidential information to the new company which he had formed to wrongfully take up an opportunity.
3 [2014] EWHC 1587 (Ch).

4.145 In *CMS Dolphin Ltd v Simonet*[1] two colleagues formed an advertising agency (CMS). One resigned and set up a new business and was then joined by

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all the staff of the original agency and the major clients that he had introduced to the original agency. CMS claimed breach of fiduciary duty and fidelity duty by diverting part of the CMs's business and some of its opportunities to the new business. The judge, however, began by stating that a director is entitled to resign despite the adverse effect this might have on the company as long as he honours the provisions of his contract of employment.

1 [2001] 2 BCLC 704, [2001] All ER (D) 294 (May).

4.146 A director who does resign can subsequently make use of his general skills and knowledge and personal connections to compete against his former company for new opportunities and new clients. The director's fiduciary duties continue, however, to prevent him diverting existing corporate opportunities or misusing information (trade secrets) obtained while a director of that former company. Those business opportunities are the company's property and any appropriation of them would make the director personally liable to account for the profits whether he exploited them himself or through a company controlled by him. In this instance the judge held that the new company, its directors and the ex-CMS director were jointly liable to account to CMS. CA 2006, s 170(2) states that a person who ceases to be a director continues to be subject to the duty in s 175, to avoid conflicts of interest, as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director. He is also subject to the duty in CA 2006, s 176 not to accept benefits from third parties, as regards things done or omitted by him before he ceased to be a director[1]. In *Foster Bryant Surveying Ltd v Bryant*[2], Rix LJ took the view that in relation to alleged post-resignation infidelity, there needs to be evidence of a lack of good faith with which the future exploitation was planned while still a director and that the subsequent resignation was part of that dishonest plan. If there is no disloyalty, there should be no liability.

1 See also *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch).
2 [2007] EWCA Civ 200, [2007] 2 BCLC 239.

4.147 A way of avoiding issues relating to a director's breach of equitable statutory duties would be to include in a company's articles of association, a director's contract of employment and/or a shareholders' agreement restrictive covenants that govern confidentiality, non-disclosure, non-compete and non-solicitation. In relation to confidentiality and what 'confidential information' includes, see *P14 Medical Ltd v Edward Mahon* [2020] EWHC 1823 (QB).

4.148 Non-solicitation and non-compete clauses are common in employment contracts and are usually strictly construed because of the limitations they place on future employability of departing employees, but additional effect may be achieved by including such clauses (ie restrictive covenants) in a shareholders' agreement, thus providing the company with more protection than would ordinarily be acquired using just an employment contract. This is illustrated in *Guest Services Worldwide Limited v David Shelmerdine*[1], in which the Court of Appeal considered a shareholders' agreement which contained clauses prohibiting employee shareholders from competing with the company's business and from soliciting customers, employees and suppliers

both during their employment and for a period of twelve months after they ceased to be shareholders.

1 [2020] EWCA Civ 85, [2020] 2 All ER (Comm) 455. See also *Nekrews and anor v PMAC Scientific Limited* [2018] ScotSAC Civ 29.

4.149 The issue in this case was whether on proper construction of the restrictive covenants included in the shareholders' agreement they were unenforceable because of their duration and/or their nature and extent. The High Court had found that:

- the proper construction of the specific clauses in the shareholders' agreement was that the restrictions would only bind an employee shareholder for so long as he was both an employee and a shareholder of the company—if a person ceased to be an employee but continued to be a shareholder, the restrictions would cease to apply to that person; and
- even if the above construction were wrong and the restrictions applied to a former employee who continued to be a shareholder until twelve months after that person ceased to be a shareholder, the restrictions would be unenforceable because the duration was longer than reasonably necessary for the protection of the company's legitimate business interests.

The Court of Appeal overturned the High Court decision. It found that it was clear that the purpose of the restrictions was to protect the company, its goodwill and the value of its shares and that it would make 'no commercial sense at all . . . if the restrictions [in the shareholders' agreement] can be avoided altogether and with immediate effect, by terminating one's employment, agency or directorship'[1].

1 *Guest Services Worldwide Limited v David Shelmerdine* [2020] EWCA Civ 85 at [33].

4.150 Accordingly, having considered the objective meaning of the restrictions when read in their factual and commercial context, the Court of Appeal held that Mr Shelmerdine remained bound by the restrictions (and, in particular, the non-compete clause) for as long as he remained a shareholder in the company and for twelve months thereafter. This was despite Mr Shelmerdine's argument that this would mean he could remain subject to the restrictions for a potentially indefinite period whilst he remained a shareholder of the company before he could be bought out, if indeed he could be bought out at all. The Court of Appeal rejected this argument on the basis that (given the compulsory transfer provisions included in the company's articles of association) in all likelihood the cessation of employment, agency or directorship and ceasing to be a shareholder would be co-terminous or, at least, there would be only a limited lapse of time between the cessation of employment and the disposal of the individual's shares.

4.151 With regard to the duration issue, the Court of Appeal noted that whilst all restrictions in restraint of trade are unenforceable unless they are reasonable, the courts should be 'less vigilant' where restrictions are contained in a shareholders' agreement or similar agreement rather than in an employment contract. On this basis, the Court of Appeal did not accept that a period of twelve months was unreasonable. The court noted in particular that it was

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JOINT VENTURE: STRUCTURAL ISSUES

Definitions

8.5 The term 'joint venture' is not a term of art in English law. It is not defined as such in the Companies Act 2006 (CA 2006). It has been said judicially[1]:

> 'In English law a "joint venture" has no settled legal meaning. It is a business, not a legal, term.'

[1] *Excalibur Ventures LLC v Texas Keystone Inc* [2013] EWHC 2767 (Comm), [2013] All ER (D) 211 (Dec)—see para **8.47** below. The term is not defined in the Insolvency Acts 1986 and 2000, nor the Corporate Insolvency and Governance Act 2020, the Company Directors Disqualification Act 1986, the Financial Services and Markets Act 2000 (FSMA 2000), the Limited Liability Partnerships Act 2000 (LLPA 2000), the Limited Liability Partnerships (Amendment etc) Regulations 2020 (SI 2020/643), the Partnership Act 1890 or the Enterprise Act 2002 (as amended by the Enterprise and Regulatory Reform Act 2013). See in connection with real estate trusts for tax purposes section 584 of the Corporation Tax Act 2010 which defines 'joint venture company' and 'joint venture group'.

8.6 The term is used in both English and European competition laws but without strict legal definition. Competition laws regulate certain joint ventures because of the potentially anti-competitive effects of their activities, not because of the legal structure adopted[1].

[1] See Chapter 7 paras **7.40–7.42** which explain how UK law to date is now closer to European law in regulating effects not form.

8.7 The accountants, on the other hand, do define the term 'joint venture' and Section 15 of FRS 102[1] (known as the new UK GAAP) is devoted to investments in joint ventures and states:

> 'A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities.'

FRS 102 makes a distinction between jointly controlled entities, jointly controlled assets and jointly controlled operations. Previously UK GAAP classified joint ventures by looking at the substance of the arrangement. Under FRS 102, classification as a jointly controlled entity is driven by whether there is the creation of a **separate legal entity**[2].

[1] FRS 102 is the Financial Reporting Standard applicable in the UK and Republic of Ireland published by the Financial Reporting Council—see www.frc.org.uk/accountants/accounting-and-reporting-policy/uk-accounting-standards/standards-in-issue.

[2] See paras **8.166–8.174** on accounting below. Equity accounting is used to account for both associates and jointly controlled entities. Regular 'net' equity accounting will be required for jointly controlled entities under FRS 102.

8.8 English law does not therefore recognise a joint venture as a distinct legal concept. The joint venture is simply the mechanism by which two or more parties can accomplish an intended project by pooling resources. The concept of a joint venture covers many different types of situations, ranging from structural arrangements that create or change the economic control of a legal entity, which can involve joint venture companies, partnerships or just changes to shareholder control, to non-structural joint ventures such as contractual

joint projects or informal (undocumented) collaborations. A joint venture can be formed for one specific project, a specific period or a continuing business relationship.

8.9 Joint venturers have to choose the structure that best fits their project. The choice of structure will depend on the circumstances of the parties. The most common structures used include:

- a corporate joint venture—establishing a separate limited company of which each party is a shareholder;
- a joint venture partnership—establishing a new partnership; or
- a contractual or commercial joint venture—setting out all the details of the joint venture relationship in a contract.

8.10 It is explained in Chapter 2 that a shareholders' agreement will commonly be used when the joint venture takes the form of a body corporate, when, that is, the joint venturers, those investing in the venture, use a corporate entity whose shares will be divided between them and which will thus be jointly controlled as required by FRS 102[1].

[1] See also in connection with Brexit the Companies, Limited Liability Partnerships and Partnerships (Amendment etc) (EU Exit) Regulations 2019 (SI 2019/348).

8.11 Tax and commercial considerations are often determinative of the choice of entity employed to give effect to a joint venture. The non-corporate forms are analysed below before the legal and practical issues associated with the incorporation of a joint venture company and negotiation of a shareholders' agreement are explored later in the chapter.

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NON-CORPORATE JOINT VENTURES

Limited liability partnerships/limited partnerships/partnerships

8.12 English law recognises three types of partnership:

- the unlimited partnership;
- the limited liability partnership; and
- the limited partnership.

The unlimited partnership

8.13 While there may be tax and confidentiality advantages in using a partnership to effect a joint venture, the partnership route is unattractive to many joint venturers principally because partners' liability is not limited and one partner can legally commit the others without needing their consent.

8.14 English law defines an **unlimited partnership** as 'the relation between persons carrying on a business in common with a view to profit'[1] and imposes no structural requirements on the partners or the partnership. Whether a partnership exists is a mixed question of law and fact. The Partnership Act 1890 (PA 1890) sets out the law governing the partnership relationship, its liability to third parties and what happens on dissolution. While the parties can

by a partnership deed or agreement derogate from the Act, those provisions in the Act dealing with third party rights, both during the life of the partnership and on termination, are mandatory[2].

1 PA 1890, s 1(1). For a detailed analysis of PA 1890 see 79 Halsbury's Laws (2020 reissue) PARTNERSHIP. Other legislation affecting unlimited partnerships includes the Insolvent Partnerships Order 1994 (SI 1994/2421) (IPO 1994), the Insolvent Partnerships (Amendment) Order 2005 (SI 2005/1516) (IPAO 2005), and the Insolvent Partnerships (Amendment) Order 2006 (SI 2006/622) (IPAO 2006)—which apply administration to partnerships; and the Company Directors Disqualification Act 1986 (CDDA 1986), as modified—which applies to partnerships which are wound up as unregistered companies.

2 PA 1890, ss 2–18 and 32–50.

8.15 A partnership is not a separate legal entity in English law[1], it does not have personality and the partners are personally liable for the debts of the partnership to the extent that these exceed the value of the partnership assets. Each partner is deemed to be the agent of the partners for the purposes of the business of the partnership and in most cases their acts will bind the partnership[2].

1 A Scottish partnership is not a body corporate but nevertheless is recognised in Scotland as a legal person distinct from the partners of whom it is composed (PA 1890, s 4(2)).

2 PA 1890, s 5.

8.16 Partnerships hold property as set out in the relevant partnership agreement, which can be oral, or in the form of a written deed. All assets contributed by the partners at the outset of the venture and all property acquired during the life of the partnership in the course of its business will be partnership property to be held and applied exclusively for its purposes[1] and subject to the agreement or deed. It is common for partnership property to be held on trust for sale in agreed shares[2]. On dissolution all partnership property will be applied to outstanding liabilities and any surplus will be distributed in accordance with the shares set out in the deed or in accordance with PA 1890, ss 40–44.

1 PA 1890, s 20(1). Also, unless the contrary intention appears, property bought with money belonging to the firm is deemed to have been bought on account of the firm (PA 1890, s 21).

2 PA 1890, s 20(2).

8.17 The partnership agreement or deed will similarly set out the profit-sharing arrangements agreed between the partners and if it does not the division will occur as provided in the Act[1].

1 PA 1890, s 24.

8.18 PA 1890 provides rules for the dissolution of partnerships and allows one partner to apply for a court order dissolving the partnership in a number of instances including when 'circumstances have arisen, which, in the opinion of the court render it just and equitable that the partnership be dissolved'[1].

1 PA 1890, s 35(f). Compare with the just and equitable ground under s 122(1)(g) of the Insolvency Act 1986 (IA 1986). See Chapter 5.

8.19 The deed or agreement may specify rules on the assignability of partnership shares which are necessary because PA 1890, s 31 otherwise renders those partnership shares non-assignable.

8.20 Individuals and bodies corporate may be partners. Joint venturers may avoid the problems of unlimited liability for partnership debts, associated with a joint venture formed by partnership, by incorporating limited liability companies and using them as the partners. This can give rise to problems of its own, such as adverse publicity, and removes one of the important advantages of the use of the partnership approach to a joint venture: tax transparency. Partners themselves and not the partnership are taxed on the profits and losses of the partnership. This is of course a function of the lack of legal personality and may be advantageous to the joint venture partner seeking to use the losses of a start-up joint venture to offset profits or gains in other areas or, conversely, offset joint venture profits or capital gains against losses generated by other activities.

8.21 Partnerships must submit accounts to HM Revenue and Customs (HMRC) but do not need to file details of their business on any public register. It may thus be easier to keep the details of a joint venture partnership out of the public domain than it is to maintain confidentiality with an incorporated joint venture company which has to register its articles of association at Companies House[1]. Partnerships are required to notify changes in the composition of the partnership in the relevant *Gazette* (London or Edinburgh) and thus some public disclosure is necessary[2]. Partnerships may not grant security in the form of a floating charge as only limited liability partnerships and incorporated companies can create these charges[3].

1 CA 2006, ss 7–10 and see Chapter 1 para **1.9**.

2 PA 1890, ss 36 and 37.

3 LLPA 2000, s 15.

8.22 A joint venture partnership may be difficult to manage as it will not have its own board of directors. Not having a separate entity with its own board of directors means the management of each of the joint venturers has to become actively involved in the day-to-day running of the joint venture partnership. This can be addressed by using a jointly owned management company as agent for the partnership and to make decisions, or by creating a management committee. Each of these can create problems of their own and take up management time.

8.23 In summary, while there may be tax and confidentiality advantages in using a partnership to effect a joint venture, it is the lack of limited liability and the ability of one partner to bind the others without consent that makes the partnership route unattractive to many joint venturers.

Limited liability partnerships

8.24 After much debate and calls from professional bodies for a right to limited liability, English law recognised a form of limited liability for partnerships with the enactment of the Limited Liability Partnerships Act 2000 (LLPA 2000). The Act permitted the creation of limited liability partnerships (LLPs) which are to be distinguished from limited partnerships formed under the Limited Partnerships Act 1907 (LPA 1907) and discussed below at paras **8.28–8.34**.

8.25 Essentially an **LLP**:

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- is a body corporate;
- has separate legal personality;
- provides for limited liability for its members;
- can grant floating charges;
- is taxed as a partnership;
- preserves confidentiality;
- is treated broadly as a company for accounting purposes; and
- retains some of the flexibility of an unlimited partnership[1].

1 The relevant instruments governing LLPs are: the Limited Liability Partnerships Act 2000 (LLPA 2000); the Limited Liability Partnerships Regulations 2001 (SI 2001/1090) (LLPR 2001) (as amended by the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 (SI 2009/1804)) (LLPR 2009); the LLPR 2009, as amended by the Limited Liability Partnerships (Amendment) Regulations 2009 (SI 2009/1833); the Companies Act 2006 and Limited Liability Partnerships (Transitional Provisions and Savings) (Amendment) Regulations 2009 (SI 2009/2476); and the Limited Liability Partnerships (Amendment) (No 2) Regulations 2009 (SI 2009/2995). The LLPR 2009 applied modified provisions of the Companies Act 2006 (CA 2006) to LLPs. The Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 (SI 2008/1911) (LLPR 2008) apply CA 2006, Pts 15, 16 and 42 on accounts and audit to LLPs. In addition, the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913) specify the form and content of accounts for large and medium-sized LLPs, and the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912) specify the form and content of accounts for small LLPs. See also the Limited Liability Partnerships (Register of People with Significant Control) Regulations 2016 (SI 2016/340) and the Companies and Limited Liability Partnerships (Filing Requirements) Regulations 2016 (SI 2016/599) on filing requirements.
As part of its response to the Coronavirus pandemic, the government enacted the Corporate Insolvency and Governance Act 2020 (CIGA 2020) which received Royal Assent on 25 June 2020. This provides some relief for directors of entities from some of the wrongful trading provisions, and various sections refer to limited liability partnerships—notably CIGA 2020, s 15. See Chapter 6. See also the Companies, Limited Liability Partnerships and Partnerships (Amendment etc) (EU Exit) Regulations 2019 (SI 2019/348).

8.26 The members of the LLP act as its agents and their liability is limited to their contribution to the LLP. The LLP itself has legal personality and thus the capacities of a natural person. It can own property, make contracts and sue and be sued. It has no share capital. For tax purposes it is treated as a partnership and the members are taxed on their share of the LLP's profit and losses. An LLP must have at least two members and the LLP agreement governs membership admission and withdrawal. Members may be individuals or corporate bodies.

8.27 An LLP is an attractive vehicle for professional partnerships of accountants and lawyers but it is not particularly suitable for joint ventures between corporate entities. The agency of the members and lack of an autonomous management together with the non-transferability of membership make an LLP unhelpful as a choice of vehicle for most corporate joint ventures. There may also be tax disadvantages. In May 2016 there were approximately 59,000 LLPs registered at Companies House[1]. The original legislation on LLPs has been amended to allow LLPs to benefit from some of the reforms of company law introduced by CA 2006[2].

1 Companies House, 'Statistical Release: Incorporated companies in the United Kingdom' (April 2016)—available at www.gov.uk/government/statistics/incorporated-companies-in-the-united-kingdom-april-2016. On LLP accounts see the Companies House guidance at www.gov.uk/government/publications/limited-liability-partnership-accounts-guidance. Also note the regime for small LLPs—see the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); the Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016 (SI 2016/575); and the Statutory Auditors Regulations 2017 (SI 2017/1164).
2 See para **8.25** fn 1 above and the Companies House guidance on the confirmation statement that replaced the annual return—available at www.gov.uk/government/publications/confirmation-statement-guidance-for-llps.

Limited partnerships including Private Fund Limited Partnerships

8.28 In certain jurisdictions, notably in certain US states, partnerships where some at least of the partners have limited liability are popular, partly because liability is limited but also because tax transparency is preserved. In England, LPA 1907 regulates this form of partnership and provides that:

- at least one partner (the general partner) assumes unlimited liability;
- the liability of the other partners (the limited partners) can be limited to the amount of their capital contribution; and
- capital contributions once made by a limited partner cannot be withdrawn until dissolution of the limited partnership.

LPA 1907 further establishes that limited partners do not have the power to bind the partnership and are prevented by the legislation from participating in the management of the limited partnership which is the responsibility of the general partner[1].

1 LPA 1907, ss 1–6. If they do participate, the limited partners lose their limited liability status. See Berry, E, 'Limited Partnership Law in the United States and the United Kingdom: teaching an old dog new tricks?' [2013] JBL 160.

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8.29 Limited partnerships must be registered with the Registrar of Companies and provide a statement of particulars including the firm name, the general nature of the business, the principal place of business, the name of all partners and the term of the partnership. Disclosure must also be made to the registrar of the amount and form of each partner's capital contribution[1].

1 LPA 1907, s 8.

8.30 Neither unlimited nor limited partnerships are any longer prohibited from having more than 20 partners[1]. In accounting terms no statutory accounts are required for limited partnerships[2].

1 LPA 1907, s 4(2) as amended by the Regulatory Reform (Removal of Twenty Member Limit in Partnerships etc) Order 2002 (SI 2002/3203).
2 FRS 102 definition of entity; see paras **8.5–8.11** and paras **8.166–8.174** on accounting generally. See the Companies House guidance at www.gov.uk/government/publications/limited-liability-partnership-accounts-guidance.

8.31 Limited partnerships are likely to be collective investment schemes for the purposes of the Financial Services and Markets Act 2000 (FSMA 2000), which means that the general partner will need to be authorised under that Act by the Financial Conduct Authority[1]. Since 2017 it has been possible to set up a Private Fund Limited Partnership (PFLP) under the Legislative Reform (Private Fund Limited Partnerships) Order 2017 (SI 2017/514). The PFLP is an alternative to a traditional limited partnership, available only to partnerships that qualify as 'collective investment schemes'. Existing limited partnerships

authorised will be entitled to exercise the same powers on behalf of the corporation which he represents as that corporation could exercise if it were an individual member.

9.6 A resolution put to the vote of a meeting will be decided on a show of hands unless, before or on the declaration of the result of the show of hands, a poll is demanded. Subject to the provisions of the Act, a poll may be demanded at any general meeting by the chairman, or by any member present in person or by proxy and entitled to vote or by a duly authorised representative of a corporation which is a member and entitled to vote.

9.7 In the case of an equality of votes, whether on a show of hands or on a poll, the chairman will not have a second or casting vote.

9.8 In the case of a corporation, a resolution in writing may be signed on its behalf by a director **[or the secretary of that corporation]**[1] or by its duly appointed attorney or its duly authorised representative.

9.9 A general meeting or a meeting of any class of members of the Company may consist of a conference between members some or all of whom are in different places if each member who participates is able to hear each of the other participating members addressing the meeting and to address all of the other participating members simultaneously, whether directly, by conference telephone or by any other form of communications equipment or by a combination of them. A quorum will be deemed to be present if those conditions are satisfied for at least the number of members required to form a quorum. A meeting held in this way is deemed to take place at the place where the largest group of participating members is assembled or, if no group is readily identifiable, at the place from where the chairman of the meeting participates.

9.10 A resolution put to the vote of a meeting will be decided by each member indicating to the chairman (in a manner directed by the chairman) whether the member votes in favour of or against the resolution or abstains.

9.11 References in this Article 9 to members include their duly appointed proxies and, in the case of corporate members, their duly authorised representatives.

1 Under CA 2006, s 270(1), private companies are no longer required to have company secretaries. Indirect references (such as this), however, are not to be taken as a binding obligation to retain a company secretary.

10 VOTES OF MEMBERS

10.1 Subject to any rights or restrictions attached to any Share, on a show of hands every member who is an individual and is present in person or by proxy, or is a corporation and is present by a duly authorised representative, or by proxy, unless the proxy (in either case) or the representative is himself a member entitled to vote,[2] has one vote, and on a poll every member has one vote for every Share of which he is the holder.

10.2 No Share of either class will confer any right to vote on a resolution for the removal from office of a director appointed or deemed to have been appointed by holders of Shares of the other class.

10.3 If at any meeting, a member is not present in person or by proxy or by a representative, the votes exercisable on a poll for the Shares of the same class held by members present in person or by proxy or by a representative will be pro tanto increased (fractions of a vote being permitted) so that those shares together entitle those members to the same aggregate number of votes that could be cast for all the Shares of that class if all the holders had been present.

10.4 An instrument appointing a proxy (and, where it is signed on behalf of the appointor by an attorney, the letter or power of attorney or a certified copy) will either be delivered to the place specified for that purpose in the notice convening the meeting (or, if no place is specified, at the registered office) at least one hour before the time appointed for the meeting or adjourned meeting or (in the case of a poll taken otherwise than at or on the same day as the meeting or adjourned meeting) for the taking of the poll at which it is to be used or delivered to **[the secretary] [(or]** the chairman of the meeting **[)]** on the day and at the place of, but before the time appointed for holding the meeting or adjourned meeting or poll. An instrument of proxy will not be treated as valid until it is so delivered.

2 This reflects the proxy rights to vote on a show of hands (CA 2006, ss 284(2) and 324(1)).

11 NUMBER OF DIRECTORS

The maximum number of Directors will be **[ ]** or another even number determined by special resolution of the Company and the minimum number of Directors will be **[ ]**. **[ ]** will be A Directors and **[ ]** will be B Directors. Article 11(3)(a) of the Model Articles is deleted.

12 ALTERNATE DIRECTORS

12.1 Any Director (other than an alternate director) may appoint any other Director or any other person willing to act to be an alternate director and may remove from office any alternate director so appointed by him. The alternate need not be approved by resolution of the Directors.

12.2 The same person may be appointed as the alternate director of more than one Director, and his voting rights will be cumulative in addition to his own vote (if any) as a Director, but he will count as only one for the purpose of determining whether a quorum is present.

12.3 An alternate director will not be entitled to receive any remuneration from the Company, but he may be paid by the Company out of the remuneration otherwise payable to his appointor.

12.4 An alternate director who is absent from the United Kingdom **[will/will not be entitled to receive notice of all meetings of Directors and meetings of committees of Directors]**.

13 POWERS OF DIRECTORS

No Director, alternate director or any other person has any authority (whether express or implied) to bind the Company in any way or to act on its behalf or to execute or sign any document or instrument on behalf of the Company unless expressly authorised by resolution of the Directors.

14 APPOINTMENT AND RETIREMENT OF DIRECTORS

14.1 The holders from time to time of a majority of the issued A Ordinary Shares may from time to time appoint up to **[ ]** persons (or, if greater, the number that is one half of the maximum number of Directors authorised from time to time) to be Directors and to remove from office any person so appointed and to appoint another person in his place. The holders from time to time of a majority issued of the B Ordinary Shares may from time to time appoint up to **[ ]** persons (or, if greater,

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the number that is one half of the maximum number of Directors authorised from time to time) to be Directors and to remove from office any person so appointed and to appoint another person in his place.

14.2 Any appointment or removal of a Director under this Article 14 shall be in writing served on the Company at its registered office and signed by or on behalf of the person or persons together holding a majority in nominal value of the issued A Ordinary Shares or issued B Ordinary Shares (as the case may be). In the case of a corporation, any document may be signed on its behalf by a director **[or the secretary]** or by its duly appointed attorney or duly authorised representative.

14.3 The Directors are not required to retire by rotation.

14.4 The office of a Director will be vacated if:

(a) he resigns his office by notice in writing to the Company and the Directors resolve to accept his resignation;

(b) all the other Directors unanimously resolve that he is incapable by reason of illness (including, without limitation, mental disorder) or injury of discharging his duties as a director; or

(c) he is removed by the holders of a majority of the relevant class of share under this Article 14,

and Article 18 of the Model Articles is amended accordingly.

15 REMUNERATION OF DIRECTORS

Any Director who serves on any committee or who otherwise performs services which in the opinion of the Directors are outside the scope of the ordinary duties of a Director may be paid (by way of salary, commission or otherwise) extra remuneration or may receive other benefits as the Directors may resolve.

16 PROCEEDINGS OF DIRECTORS

16.1 A Director who is absent from the United Kingdom is entitled to receive notice of all meetings of Directors and meetings of committees of Directors.

16.2 All business arising at any meeting of the Directors or of any committee of the Directors must be determined only by resolution and no resolution will be effective unless carried by a majority including at least one A Director and at least one B Director. In the case of an equality of votes, the chairman will not have a second or casting vote and Article 13(1) of the Model Articles is deleted.

16.3 The quorum for a meeting of the Directors throughout the meeting must be at least one A Director and one B Director.

16.4 No Director may be appointed otherwise than as provided in these Articles. Article 11(3) of the Model Articles is modified accordingly.

16.5 A committee of the Directors must include at least one A Director and one B Director and the quorum for a meeting of any committee throughout the meeting must be at least one A Director and one B Director.

16.6 A meeting of the Directors may consist of a conference between Directors some or all of whom are in different places provided that each Director who participates is able to hear each of the other participating Directors addressing the meeting to address all of the other participating Directors simultaneously, whether directly, by conference telephone or by any other form of communications equipment or by a combination of them. A quorum will be deemed to be present if those conditions are satisfied for at least the number of Directors required to form a quorum under Article 16.3. A meeting held in this way is deemed to take place where the largest group of participating Directors is assembled or, if no group is readily identifiable, at the place where the chairman of the meeting participates.

16.7 Subject to the required disclosure being made in accordance with the Act, a Director may vote as a Director on a resolution concerning any matter in which he has, directly or indirectly, an interest or duty, and if he votes it will be counted and he will also be counted in the quorum when that resolution or matter is under consideration.

17 NOTICES

17.1 Any notice to be given under these Articles must be in writing.

17.2 Any notice or other document to be served or given under these Articles may be delivered or sent by first class recorded delivery post or facsimile process or email.

17.3 Any notice or document will be deemed to have been served:

(a) if delivered, at the time of delivery; or

(b) if posted, at 10 am on the second business day after the time of despatch, if despatched before 3 pm on any business day, and in any other case at 10 am on the business day following the date of despatch; or

(c) if sent by facsimile transmission, on receipt of telephone or other transmission confirmation of its receipt; or

(d) if sent by email, on confirmation of receipt from the server or on receipt of an automated delivery receipt.

17.4 In proving service it is sufficient to prove that delivery was made or that the envelope containing the notice or document was properly addressed and posted as a prepaid first class recorded delivery letter or that the facsimile message or email was properly addressed and despatched (as the case may be).

17.5 The Company may give any notice to a member either personally, by sending it through by post in a prepaid envelope addressed to the member at his registered address, by leaving it at that address or by facsimile process or email. A member whose registered address is not within the United Kingdom and who gives to the Company an address within the United Kingdom at which notices may be given to him is entitled to have notices sent to him at that address, but otherwise no member whose registered address is outside the United Kingdom is entitled to receive any notice from the Company.

17.6 A member present, either in person or by proxy, at any meeting of the Company or of the holders of any class of shares in the Company is deemed to have received notice of the meeting and, where requisite, of the purposes for which it was called.

17.7 Every person who becomes entitled to a share is bound by any notice concerning that share which, before his name is entered in the register of members, has been duly given to a person from whom he derives his title.

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(a) defer Completion to a date not more than twenty eight days after that date (and so that the provision of this clause 3.3 shall apply to Completion as so deferred);

(b) proceed to Completion so far as practicable (without prejudice to their rights under this agreement); or

(c) rescind the contract of sale arising by virtue of the acceptance or deemed acceptance of the Offer contained in the Termination Notice, following which that contract and this agreement shall immediately terminate.

4 DURATION OF OBLIGATIONS

4.1 This agreement will terminate on [ ] if no Termination Notice has been served on or prior to that date.

4.2 If any Termination Notice has been served on or prior to [ ] this agreement will terminate on the fulfilment of all of the Parties' respective obligations under the Termination Notice.

4.3 This agreement will automatically terminate if:

(a) the Company enters into liquidation or compounds or makes any voluntary arrangement with its creditors or has a receiver, administrative receiver, administrator or other similar officer or encumbrancer appointed of it or over all or any part of its assets or takes or suffers and similar action in consequence of debt or becomes unable to pay its debts as and when they fall due;

(b) **[there is a Change of Control of any one or more of the Shareholders][; or**

(c) ***Insert other termination events*]**.

4.4 On the termination for whatever reason of this agreement the rights and obligations of the Parties to this agreement will immediately cease and determine except for any prior breach of this agreement.

5 CROSS NOTICES

Any Termination Notice served during the period of any operative prior Termination Notice will be void and of no effect.

6 COMPANY'S OBLIGATIONS

The Company undertakes with each of the other Parties to this agreement to be bound by and comply with the terms of this agreement insofar as they relate to the Company and to act in all respects as contemplated by this agreement insofar as it is able by law to do so.

7 NOTICES

7.1 Any notice given under this agreement must be in writing.

7.2 Any notice or other document to be served or given under this agreement may be delivered or sent by first class recorded delivery post, facsimile process or email to the relevant party at his or its address appearing below or at another address as that party may have notified to the other Parties in accordance with this clause.

7.3 The addresses for service of the Parties are as follows:

(a) [ ];

(b) [ ];

(c) [ ]; and

(d) the Company at its registered office set out on page 1 of this agreement.

7.4 Any notice or document will be deemed to have been served:

(a) if delivered, at the time of delivery; or

(b) if posted, at 10 am on the second business day after the time of despatch, if despatched before 3 pm on any business day, and in any other case at 10 am on the business day following the date of despatch; **[or]**

(c) if sent by facsimile transmission, on receipt of telephone or other transmission confirmation of its receipt **[; or**

(d) if sent by email, on confirmation of receipt from the server or on receipt of an automated delivery receipt].

7.5 In proving service it is sufficient to prove that delivery was made or that the envelope containing the notice or document was properly addressed and posted as a prepaid first class recorded delivery letter or that the facsimile message was properly addressed and despatched (as the case may be) and that a hard copy of all faxed documents was sent by first class post on the day of despatch of the facsimile message to the relevant address set out in clause 7.3 above.

8 INTEREST

If any sum payable under this agreement is not paid on the due date (otherwise than as a result of the default of the Party or any of the Parties entitled to payment) the unpaid sum will carry interest calculated on a daily basis (after as well as before judgment) at the Prescribed Rate from the due date until the date of actual payment (both dates inclusive).

9 GENERAL

9.1 A notice served under any term, condition or provision of this agreement may not be withdrawn except with the written consent of the recipients of that notice.

9.2 If any of the terms, conditions or provisions of this agreement conflict or are inconsistent with the Articles, the terms, conditions and provisions of this agreement will prevail. Each Shareholder undertakes, if so requested by the other Shareholders, to exercise all rights available to him as a Shareholder of the Company to approve any necessary amendments to the Articles to remove that conflict.

9.3 The benefit of this agreement may not be assigned by any Party without the prior written consent of the other Parties to this agreement.

9.4 This agreement supersedes any previous agreement between the Parties in relation to the matters contained in it. No variation of this agreement will be effective unless made by an instrument executed as a deed by all the Parties.

9.5 The failure by any Party at any time to require performance by any other Party of this agreement or the failure to claim a breach of any term, condition or provision of this agreement will not be deemed to be a waiver of any right under this agreement by that Party.

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1.6 References to persons include associations or bodies, whether or not incorporated.

1.7 References to clauses, recitals and schedules are references to clauses, recitals and schedules to this agreement and references to Articles, unless the context otherwise requires, are references to the articles contained in the Articles.

1.8 References to **writing** and **written** include any electronic form of transmission of words.

1.9 The terms **subsidiary**, **subsidiary undertaking**, **parent undertaking**, **holding company** and **financial year** have the meanings respectively attributed to them by the Act.

2 SUBSCRIPTION

2.1 In consideration of the mutual undertakings and covenants and other due and valuable consideration contained in this agreement, and on and subject to the terms, conditions and provisions of this agreement and in particular (but without limitation) to the satisfaction of the conditions precedent set out in Schedule 9, the Investor will on Completion subscribe for the following B Ordinary Shares and Redeemable Preference Shares for the following cash amounts:

Number of Redeemable Preference Shares	Number of B Ordinary Shares	Amount £
Total:	**Total:**	**Total:**

2.2 The Executives irrevocably waive all rights of pre-emption whether under the Act, the Articles or otherwise in connection with the allotment and issue of those B Ordinary Shares and the Redeemable Preference Shares referred to in clause 2.1.

2.3 The shareholders in the Company and their respective shareholdings immediately following Completion are set out in Schedule 4.

3 WARRANTIES

[Note: When acting for management consider further limitations to liability.]

3.1 The Warrantors **[separately and not]** jointly and severally represent and warrant **[on an indemnity measure of loss]** to the Investor in the terms of the Warranties.

3.2 Any information supplied by or on behalf of any Group Company to the Executives or their respective advisers in connection with the Warranties or the Disclosure Letter in relation to any Group Company does not constitute a representation or warranty or a guarantee as to the accuracy of that information and the Executives irrevocably waive any and all claims which they might otherwise have against each Group Company and its respective officers and employees (other than for any right of contribution which any of the Executives may have from any of the other Executives for any liability under the Warranties).

3.3 The Warranties are given subject to matters fully, fairly and accurately disclosed in the Disclosure Letter.

3.4 The Warrantors (excluding the Company) undertake to pay to the Investor within [ ] days of a written request to do so all reasonable costs and expenses incurred by the Investor as a result of pursuing a successful claim for a breach of the Warranties.

3.5 The Warranties continue in full force and effect notwithstanding Completion and notwithstanding any of the Warrantors ceasing to be a shareholder in the Company.

3.6 Each of the Warranties is separate and independent and is not limited by reference to any other Warranty or any other term, condition or provision of this agreement.

3.7 Where any statement in the Warranties is qualified by the expression 'to the best of the knowledge, information and belief of the Warrantors' or 'so far as the Warrantors are aware' or any similar expression, each Warrantor is deemed to have knowledge of:

(a) anything of which the other Warrantors have knowledge or are deemed by sub-clause 3.7(b) or 3.7(c) to have knowledge;

(b) anything of which he ought reasonably to have knowledge given his particular position in and responsibilities to the Company; and

(c) anything of which he would have had knowledge if he had made due and careful enquiry immediately before giving the Warranties.

3.8 The Warrantors undertake **[separately and not]** jointly and severally to the Investor to disclose to each of them in writing immediately on becoming aware of any fact or circumstance which may render untrue or misleading any of the Warranties or constitute a breach of any term, condition or provision of this agreement.

3.9 The Warrantors irrevocably undertake not to exercise any right of set-off or counterclaim or any other claim or right of recovery against any Group Company or any of its officers, employees, auditors or advisers in relation to any claim which may be made for a breach of any of the Warranties.

3.10 Each of the Warrantors acknowledges that representations have been made by each of them in the terms of the Warranties with the intention of inducing the Investor to enter into this agreement and that the Investor has been induced to enter into this agreement on the basis of and in reliance on the accuracy of each of the Warranties (save as disclosed in the Disclosure Letter), but not on the basis of any other representations or warranties (express or implied).

3.11 Save in the case of fraud or wilful non-disclosure on the part of the Warrantors, or any of them:

(a) the liability of each of the Warrantors in relation to any claim for breach of the Warranties ceases on the Expiry Date (except to the extent of and in relation to any claim of which written notice specifying the grounds of the claim has previously been given to all of the Warrantors by or on behalf of the Investor prior to the Expiry Date); and

(b) no claim or claims can be made for a breach or breaches of any of the Warranties unless and until the aggregate amount of that claim or those claims, together with all other claims, exceeds £[ ] but so that once this aggregate amount has been exceeded the Investor is entitled to make a claim for the whole of the aggregate amount and not just the excess over that amount.

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3.12 The aggregate liability of the Warrantors **[(excluding the Company)]** for breach of the Warranties is limited to £[ ] **[exclusive/inclusive]** of all costs and expenses payable pursuant to clause 3.4.

3.13 The Warrantors have no liability under the Warranties to the extent that any liability would, in the absence of this clause, arise solely as a result of any change in legislation after Completion.

3.14 Each of the Warranties is construed separately and independently from the others so that the Investor has a separate claim and right of action for every breach of each Warranty.

3.15 The Disclosure Letter does not qualify or limit any Warranty given in relation to the Business Plan and the Warrantors confirm that they have prepared and finalised the Business Plan having taken due account of the contents of the Disclosure Letter.

3.16 Payment in full of any claim under the Warranties, to the extent of the payment, pro tanto satisfies and discharges any other claim under the Warranties which is capable of being made concerning the same subject matter.

3.17 The Investor may assign the benefit of the Warranties on the transfer of all or any of its Shares in accordance with this agreement or the Articles.

4 COVENANTS

4.1 The Company covenants with the Investor in the terms of the covenants set out in Schedule 5 Part A relating to the Company.

4.2 Each of the Executives separately (and not jointly and severally) covenants with the Investor in the terms of the covenants set out in Schedule 5 Part B.

4.3 The covenants set out in Schedule 5 Part B bind each Executive for so long as he is the registered holder or beneficial owner of any A Ordinary Shares, except for covenant 2 in Schedule 5 Part B which expires twelve months after the date that the Executive ceases to be so registered or ceases to be the beneficial owner. The covenants set out in Schedule 5 Part A bind the Company for so long as the Investor is the registered holder or beneficial owner of any B Ordinary Shares or Redeemable Preference Shares.

4.4 Each of the covenants is construed separately and independently of each of the others.

4.5 If one or more of the covenants is deemed to be invalid but would have been held valid if some part of it were deleted, the covenants in question apply with any modifications as may be necessary to make the Covenant valid and enforceable.

5 COMPLETION

5.1 Completion will take place at the offices of [ ] on the Completion Date.

5.2 At Completion the Investor will subscribe for those B Ordinary Shares and Redeemable Preference Shares set out in clause 2 and pay the subscription moneys to the Company by [ ] to [ ] account [ ].

5.3 The Executives undertake to procure that the Company:

(a) passes the Resolutions;

(b) allots and issues to the Investor the B Ordinary Shares and Redeemable Preference Shares, executes and delivers to the Investor the share certificates for the B Ordinary Shares and the Redeemable Preference Shares and enters the Investor (or its nominees) in the register of members as the holders of the B Ordinary Shares and Redeemable Preference Shares;

(c) pays the Fees;

(d) takes or (as the case may be) procures all matters, acts, deeds, documents and things to enable the Bank Facilities to be drawn down; and

(e) appoints [ ] as Investor Directors of the Company.

5.4 The Executives must:

(a) deliver the Disclosure Letter to the Investor; and

(b) execute **[and deliver]** the Service Agreements.

5.5 The Investor must countersign the Disclosure Letter.

5.6 The Company must execute [and deliver] the Service Agreements.

5.7 The subscription moneys must be applied in the following order of priority:

(a) to complete the Acquisition Agreement;

(b) to the extent permitted by law, to pay the Fees; and

(c) to apply any balance towards working capital for the Company and the Group.

6 INVESTOR'S RIGHTS

6.1 The Investor may appoint up to [ ] Investor Directors to the Board of the Company and may remove an Investor Director so appointed and appoint someone else in his place.

6.2 An Investor Director must at the request of the Investor be appointed a director of any other Group Company or Group Companies.

6.3 The appointment or removal of an Investor Director takes effect automatically on receipt of a notice by the Company from the Investor to that effect.

6.4 An Investor Director may attend and address all meetings (of the Board and of members) of the Company and any Group Company. The Executives undertake that the Investor and the Investor Directors are given (except in the case of any emergency) not less than [ ] Business Days' prior notice of any meeting and together with a written agenda for the relevant meeting.

6.5 **[During the period of an Investor Director's appointment, the Company must pay the Investor for each of the Investor Directors appointed by it, an annual fee of £[ ] plus value added tax and reasonable expenses. The fee accrues from day to day and is paid annually in arrears on [ ] in each year]**.

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