
**BUSINESS LAW AND
PRACTICE
PRE-COURSE MATERIALS**

STUDENT INSTRUCTIONS

Introduction

- These Pre-Course Materials are designed to give you a basis upon which to build your studies on the Business Law and Practice (BLP) course. BLP is one of three 'Core Practice Areas' that you will study during Stage 1 of the Legal Practice Course (the others being Litigation & Property Law & Practice).
- The Pre-Course materials for BLP consist of these Student Instructions and the Document Bundle that follows.
- It will be helpful if you could read these materials prior to starting the BLP course, there are a few activities for you to have a go and some feedback for you to have a look at too.
- We will be teaching you business law from first principles when we see you in September- we don't expect or assume any prior knowledge in business/company law before you start the Legal Practice Course so please do not worry. However, we know that some of you may want some background in this area and we have had at least one student with a training contract as a result having been given at an assessment day a task on 'choice of business media' prior to joining us!

Aims

The aim of these pre- course materials is to:

- set in context the BLP Course on the LPC
- introduce the four main types of businesses that you will encounter on the BLP Course
- give an overview of the broad differences between these different types of businesses
- introduce you to various websites that that may be relevant to your studies of BLP- the Companies House (CH) website and the Department for Business Innovation and Skills (BIS) website and other websites

After having studied these pre- course materials, you should be able to:

- briefly describe the four different types of business structure
- briefly describe the main differences between the four types of businesses in terms of setting up the business, the ownership and management of the business and the liabilities of the business for its debts
- start to navigate the Companies House and other relevant websites to find out information to answer specific questions

- give some initial advice as to which may be the appropriate type of business to use in a simple scenario

Preparation

By way of preparation:

Read the BLP Introductory Pre-Reading (Document 1)

Activity 1

Locate the Companies House and Department for Business, Innovation and Skills and (BIS) website and navigate the sites to complete Activity 1 (Document 2)

Activity 2

Read the scenarios contained in Document 3. What initial advice would you give in each case and why?

Review and consolidation

Please read Document 4 (Feedback). Please re-read and revise your BLP Introductory Pre-Reading (Document 1).

DOCUMENT 1

INTRODUCTORY PRE-READING FOR BLP

1.1 About This Document

The purpose of this document is to help to prepare you to start the Business Law & Practice (“BLP”) course on the LPC. In particular, this document is designed to:

- illustrate the importance of BLP on the LPC and to a solicitor in practice
- give you some information on the BLP course
- provide a framework for your studies in order to put BLP into context
- provide an overview of BLP by considering some of the main principles and concepts underpinning it
- Develop your commercial awareness

Please do not worry: we will be teaching business law from first principles when we see you in September- we don't expect or assume any prior knowledge in business law before you start the Legal Practice Course (the LPC). However, we know that some of you may want some background and we have had one student directly attributed getting a training contract because of it as he had to do a task on choice of business media at an assessment day over the summer prior to joining us!

It will be useful for you to keep and re-visit these pre-course materials once you start the Course before your first Study Unit 1 and again before Study Unit 5 which is the first Study Unit in which you study Companies.

1.2 Why Business Matters to Solicitors

Some students start the LPC knowing or thinking that they have no intention or desire to deal with business or company law in practice once they qualify. You may already have a strong idea of the area of law in which you wish to practice and feel that it has nothing to do with the business world. However, it is probably best not to exclude any possibilities too early in your career, particularly in a competitive market for training contracts and jobs as newly qualified solicitors. It is also important to recognise the impact that one area of law has on other areas of practice (considered below). In any event - you never know, you might just like BLP once you have tried it!

BLP has some relevance to almost every area of practice as a solicitor not just in the company/commercial department. Here are just a few examples:

You are a wills and probate solicitor: the deceased was involved in the running of a business and owned part of the business. What will happen to the business on the death of the owner? How is the deceased's share in the business to be valued? How is that share to be realised for the benefit of the deceased's estate and beneficiaries? What are the taxation implications of the deceased owning a share of the business?

You are a matrimonial / family solicitor: one spouse owns and runs a business that is the sole source of income and the sole asset of the couple. For the purpose of settlement of maintenance and property claims, how is the spouse's ownership of the business and income from the business to be valued? Is it

practical for the other spouse to be given a share in the ownership of the business?

You are an employment law solicitor: your client was employed by a company which has got into financial trouble and has become subject to formal insolvency procedures (see below) owing your client considerable unpaid wages. What is the impact of the insolvency procedures for your client? What will be the status of your client's claim against the company?

In all of these situations (and many more) it would be very helpful, if not essential, to have an underlying knowledge of BLP.

1.3 Business Law and Practice on the LPC

Background to the BLP course

BLP is a core practice area (a compulsory subject) on the LPC. As with other subjects, the Solicitors' Regulation Authority prescribes outcomes so as to ensure that (as far as reasonably practicable) all students completing the LPC at all of the different LPC providers will have broadly similar knowledge of BLP.

At the present time, company law is not a compulsory subject for a qualifying law degree (and is therefore not part of the PG Dip for non-law graduates). The result of this is that some students starting the LPC will have studied company law while many others have not. However, there is no need to be alarmed if you have not studied company law before because we do not spend very much time at all looking at academic theories of company law. As with the rest of the LPC, the BLP course is a practical one, concentrating on the application of the law in its practical context and how it will impact upon your clients once you go into practice. This is a very different emphasis to the study of company law at undergraduate level. Further, to the extent that you need to know legal theory, we will teach it to you.

The BLP Course Syllabus

The Solicitors' Regulation Authority's outcomes for BLP dictate the areas that we must cover (although we are to some extent free to choose our own emphasis and approach to those areas). We are required to cover the following topics:

- the different types of business media (sole traders, partnerships, limited liability partnerships ("LLPs") and companies) and how they are set up and run
- on-going operations and common transactions (entering into contracts, raising finance, drafting company documentation, taxation)
- stakeholders (directors, shareholders and creditors)
- basic business accounts.

This document aims to highlight the main concepts underpinning most of these topics and to place them in their overall context (how they inter-link with each other).

1.4 The Bigger Picture

Traditionally in this country law has been and is taught on a subject by subject basis. In other words, the whole body of law is compartmentalised into different subjects (such as contract law, torts, criminal law, land law, trusts, etc.). That is perfectly

understandable since it provides a reasonably logical and structured approach to the study of law. However, this approach has a downside in that it encourages all of us who have been through the system to think of law as being in neat and tidy compartments. Real life is not like that.

The practice of law as a solicitor is quite different. Soon you will have a real client in front of you with real problems. Those problems will not fall neatly into separate and tidy compartments. They will cross a number of subjects and require you to apply different areas of the law in order to be able to properly advise and protect your client. This is, of course, one of the reasons why you are about to embark on the LPC. It is designed to be the bridge between academic study of law and the application of law in practice. It is an inherently practical course (which is why all of us who teach it are qualified solicitors with post-qualification experience in practice).

On the LPC you will need therefore to recall and apply aspects of different subjects in order to advise fully. It is also essential that you develop a 'problem-solving' approach, drawing on all of your legal knowledge in order to solve a particular problem.

You will also need to develop **commercial awareness**. Business clients do not want to receive pure legal advice in a commercial vacuum. Clients will take it as read that you know the relevant law (that is, after all, why they are paying you) and will also expect you to understand their commercial perspective and objectives. It is, in fact, difficult to have a complete understanding of the needs and objectives of your business clients until you are in practice and are able to get to know your clients and their businesses. However, it is hoped that during the BLP course you will begin to recognise the need for solicitors to have some commercial awareness so that legal advice can be given in the appropriate context.

1.5 The Four Types of Businesses

Clients intending to set up a business must first decide what type of business they want to operate. That decision will be extremely important. It will involve weighing up a number of different factors (legal, commercial and financial) in order to determine what type of business will be most appropriate for their particular needs. This choice of business vehicle is one of the first things that we will consider on the BLP course. We shall have to look at this very broadly to begin with but bear in mind that much of the rest of the BLP course will be spent looking at the different media in detail. Your understanding should therefore increase as the course progresses.

The four choices are:

- Sole traders
- Partnerships
- Companies
- Limited Liability Partnerships ("LLPs").

Let's look at these in more detail.

2. SOLE TRADERS

2.1 Basic Concepts

The basic concept of a sole trader business is a very simple one. The individual who sets up the business owns and controls the business and is entitled to the profits (income less expenses) generated by the business.

This does not mean that the individual is necessarily the only person involved in the business. Others involved might be employees employed by the sole trader or independent contractors providing services to the sole trader. Neither type owns any part of the business. The only proprietor (owner) of the business is the sole trader.

2.2 Setting Up the Business

There are no legal formalities required to set up in business as a sole trader. No separate legal structure or entity has to be created. However, depending on the nature of the business being established, there may be a number of legal matters that need to be dealt with, including:

- Compliance with legal requirements where a sole trader chooses to trade under a name other than his or her own name.
- Obtaining planning permission for alterations to premises and/or obtaining any other specific licences necessary for the particular business (such as a liquor licence for a restaurant).
- Entering into a lease for business premises.
- Entering into contracts with employees and with suppliers of equipment, fixtures and fittings, stock, etc.
- Registering with HMRC (Her Majesty's Revenue & Customs) for tax purposes.

2.3 Assets and Liabilities, Profits and Losses

Since there is no separate legal entity that operates the business and since there is only one proprietor of the business, the position is straightforward. All of the assets used in the business (other than those leased from third parties or obtained under contracts containing reservation of title clauses) are owned by the sole trader. Likewise, all profits made from the business belong to the sole trader.

Conversely, since the sole trader directly owns and controls the business, any liabilities of the business are owed by the sole trader personally and he or she is personally responsible for any losses made by the business.

2.4 Taxation

Since the business is not a separate entity from the sole trader and since all profits of the business belong to the sole trader, all of these profits are subject to income tax in the hands of the sole trader. The profits from the business will form part of the total income of the sole trader. The rates of income tax at which the business profits are taxed, and the personal reliefs which may be available to the sole trader, depend upon the total income of the sole trader from all sources and his or her personal circumstances.

If the sole trader sells an asset used in the business (or, indeed, sells the whole business), he or she will be subject to capital gains tax on any capital gain made on the sale (subject to any available reliefs or exemptions). Alternatively, if the sole trader

makes a gift of an asset used in the business or of the whole business (or sells either at an undervalue), he or she will be subject to inheritance tax on the amount by which the value of his or her estate has been reduced by the gift or sale at an undervalue (again, subject to any available reliefs or exemptions).

2.5 Failure of the Business and Insolvency

The sole trader is personally liable for any liabilities and losses of the business. If these are so substantial as to mean that the business ceases to be viable, it may have to be closed down. Any creditor of the business can claim against all of the assets of the sole trader (not just the assets used in the business).

If the business and other (personal) assets of the sole trader are insufficient to pay all of the business and other (personal) liabilities of the sole trader, the sole trader is insolvent. Whenever a legal person or business entity becomes insolvent two principal issues have to be dealt with, namely:

- What procedure will be used to administer or wind up the assets and affairs of the insolvent debtor (who will be put in charge and how will they administer the debtor's estate?)
- If, once the assets of the debtor have been sold, there is insufficient money to pay all debts in full, which creditors will get paid in full or in part (what is the order of priority to the assets in the debtor's estate?).

The principal act regulating the administration of an insolvent individual is the Insolvency Act 1986 (which has been amended in certain respects by the Enterprise Act 2002). There are two principal insolvency procedures for an insolvent individual, namely Bankruptcy and Individual Voluntary Arrangements (both regulated by the Insolvency Act 1986).

3. PARTNERSHIP

3.1 Basic Concepts

Partnership is defined by the Partnership Act 1890 (the principal act regulating partnerships) as "the relationship which subsists between persons carrying on business in common with a view to profit". It is a question of fact as to whether a partnership has been created in any given set of circumstances. The partners are the proprietors of the business and are entitled to the profits (income less expenses) generated by the business. A partnership (sometimes called a 'firm') is not a separate legal entity distinct from the partners. As a result, no separate entity has to be created.

Again, as with sole traders, this does not mean that other persons may not be involved in the business either as employees or as independent contractors (see 2.1 above).

3.2 Setting Up the Business

As with sole traders, there are no legal formalities that have to be followed in order to create a partnership. A partnership can be created informally by oral agreement or by implication as a result of the actions of the partners. There is no legal requirement for

a Partnership Agreement or Deed (although such an agreement is strongly recommended for the reasons given below.)

Depending on the nature of the business being established, the same matters will need to be dealt with as when dealing with a sole trader (see 2.2 above).

The relationship between the partners

It is necessary to consider the legal relationship between the partners themselves. In the absence of any express or implied agreement to the contrary, the rights and obligations of the partners as between themselves will be determined by the provisions of the Partnership Act 1890. This may not be desirable, and solicitors are likely to strongly recommend that clients enter into a written Partnership Agreement or Deed for the sake of clarity, certainty and for evidential reasons.

The legal relationship between partners is a special one and has the following features:

- Each partner is the agent of each of the other partners and is able to bind the firm to contracts made within the scope of the partner's authority (see 3.4 below)
- A partnership agreement (express or implied) is a contract of 'utmost good faith' imposing implied duties on the partners (as parties to the contract) that would not be implied into ordinary contracts (such as a duty to disclose to his or her fellow partners all matters relating to the partnership)
- Each partner is a 'fiduciary' of his or her fellow partners, meaning that he or she is in a position of trust and owes to his or her fellow partners the same fiduciary duties that a trustee owes to the beneficiaries under a trust. These duties include:
 - a duty not make a secret profit from his or her position as a partner
 - a duty not to be in a position where his or her personal interests conflict with those of the partnership
 - a duty to exercise any powers as a partner in good faith in the interests of the partnership as a whole and for the purpose for which the powers were given to him or her.

3.3 Ownership and Management

Since the partnership is not a separate legal entity distinct from the individual partners, the assets of the business are owned by the partners personally (see 3.4 below). In the absence of agreement to the contrary, all partners are entitled to take part in the management of the business.

3.4 Assets and Liabilities, Profits and Losses

The assets used by the partnership are owned by the partners. In the absence of agreement to the contrary, each partner will have an equal share in the assets of the partnership. Likewise, in the absence of agreement to the contrary, each partner is entitled to an equal share in the profits of the partnership.

Since the partnership is not a separate legal entity, the partners are personally liable for the liabilities and losses of the business of the partnership. In the absence of

express or implied agreement to the contrary, each partner must bear an equal share of any liabilities and losses.

The liability of each partner is said to be 'joint'. This means that any creditor of the partnership can sue any one (or more) of the partners for the full amount of the debt owed by the partnership as a whole (since the creditor is not a party to any agreement between the partners as to how the partners will share losses and liabilities).

The liability of partners is also unlimited. This means that a partner's personal liability is not limited to the amount that he or she has invested into the partnership or to his or her share of the partnership assets (see 3.6 below).

This position is altered where business is conducted through a Limited Partnership (not to be confused with a Limited Liability Partnership) set up under the Limited Partnership Act 1907. There are numerous requirements for such partnerships including a requirement that at least one partner must have unlimited liability for the debts of the firm. The liability of the other partners is limited to a stated amount of capital invested in the partnership.

The Authority of a Partner to Bind the Partnership to Contracts, etc.

As mentioned in paragraph 3.2, each partner is the agent of his or her fellow partners and so is able to bind the partnership to contracts in accordance with the usual principles of agency. Therefore, provided that a partner is acting within his or her actual authority (express or implied from the express agreement between the partners) or "apparent" authority, the partnership will be bound by the act of the partner even if it was contrary to an express agreement between the partners. This is because a third party is not bound by any private contract between the partners.

"Apparent" authority (also called "usual" or "ostensible" authority) is where a partner does not have actual authority to do a particular thing but, in circumstances known to a third party, it is reasonable for the third party to assume that the partner would usually have authority to enter into such a contract or to do such an act on behalf of the partnership. However, a third party can not rely on the apparent authority of a partner where the third party knows of an express restriction on the authority of the partner.

3.5 Taxation

At the end of each financial year, the profits of the partnership will be calculated. The profits will be divided between the partners in accordance with the profit sharing ratio (as agreed between the partners or, in the absence of agreement, in accordance with the provisions of the Partnership Act). The share of each partner will form part of his or her total income for income tax purposes. The income tax liability of each partner will depend upon that partner's other income during the year (if any) and that partner's personal circumstances as regards the rate of tax payable and the applicability of various allowances and reliefs.

If all or some of the partnership assets are sold, any gain on the sale will be apportioned between the partners in accordance with the applicable ratio for sharing capital profits (again, as agreed between the partners or, in the absence of agreement, in accordance with the provisions of the Partnership Act). Each partner may then have

a capital gains tax liability in respect of his or her share of the gain. As before, it will again be necessary to take account of each partner's personal circumstances in order to determine the rate of tax payable and the applicability of various allowances and reliefs.

If a partner makes a gift of his or her share in a partnership or sells it at an undervalue, the partner might be liable to inheritance tax on the amount by which the value of his or her estate has been reduced (subject to any reliefs or exemptions).

3.6 Failure of the Business and Insolvency

You will recall that partners have unlimited liability for the debts of the partnership. This means that if the business becomes insolvent and there are insufficient business assets to satisfy the debts of the business, the personal assets of individual partners can be used to pay the debts of the business. There is a procedure by which the partnership business can be wound up (a little like the winding up of a company, discussed below), while individual partners may become bankrupt or subject to an Individual Voluntary Arrangement.

3.7 Limited Liability Partnerships (LLPs)

Over recent years partners in large partnerships have become increasingly concerned about their potential unlimited liability for the debts of the business. This has been particularly so in the case of large national and international firms of solicitors and accountants (with hundreds, or possibly thousands, of partners around the world). There have been some high profile claims for negligence against such partnerships. Awards of more than £100 million have been made in cases where the firms' professional indemnity insurance has been insufficient to meet the claims. Partners have therefore had to make up the shortfall out of their personal assets. This led to considerable lobbying of the Government which, in turn, led to the Limited Liability Partnership Act 2000.

LLPs are a hybrid between traditional partnerships and private limited companies. They resemble limited companies in that they are separate legal entities distinct from their owners (who are called 'members', not partners). LLPs must be incorporated like limited companies and their members have limited liability for the debts of the business. The detailed rules relating to LLPs are contained in the Limited Liability Partnership Regulations 2001.

One of the ways in which LLPs resemble partnerships is that despite their being separate legal entities distinct from their members, the profits of the business are taxed not in the hands of the LLP but in the hands of the members, as for a partnership.

LLPs are available to all partnerships, not just professional partnerships. However, due to the need for incorporation and the obligation to file accounts, they are unlikely to be suitable for smaller trading partnerships.

4. COMPANIES

4.1 Basic Concepts

A company is owned by its shareholders (also known as "members") and run by its directors (known collectively as "the Board"). In smaller private companies, it is highly

likely that the shareholders and directors will be the same people. Legally, however, it is essential to recognise what actions must be carried out by shareholders and what actions may be carried out by directors.

The most important feature of a company is that it is a separate legal entity distinct from its shareholders and directors. It is a legal person in its own right and is responsible for its debts. This has important consequences for its shareholders in that they have only “limited liability” for the debts of the company. Provided that they have paid in full for their shares, they have no further liability to contribute to the assets of the company should it experience difficulties in paying its creditors.

This concept was developed over many years and was finally confirmed by the House of Lords in possibly the most famous case in company law, *Saloman v Saloman* [1897]. It is worth considering the reason why this concept developed. As enterprise developed (particularly during the industrial revolution) it became clear that one of the main factors hindering entrepreneurial risk-taking by wealthy individuals was the risk of the business failing. If it did so, the whole of the individual’s wealth was at risk of being used to meet the debts of the failed business. Wealthy people were not prepared to risk their entire fortunes, but they were prepared to risk a certain, limited amount. It was (and still is) perceived that it is important to encourage new enterprises (which inevitably involve an element of risk) for the benefit of the economy and of society generally. New businesses create jobs and new jobs create revenue and so on.

However, a balance must be struck between protecting the personal assets of those who set up a new business and protecting those people who go on to have dealings with it, such as customers, creditors and employees. On the BLP course we will consider ways in which the law tries to strike a balance between these two competing objectives.

Types of Companies

There are several different types of companies but the most prevalent is the private limited company, which is what we shall be considering on the BLP course. Private limited companies differ from public limited companies in that the former may not offer their shares for sale to the public generally. The vast majority of companies in the UK are private companies limited by shares. Students who are interested in studying public limited companies (which are much more heavily regulated) should consider taking the Corporate Finance Law elective.

Relevant Legislation

Company law has undergone major changes as a result of the implementation of the Companies Act 2006 which came into force fully on 1st October 2009. This has been the first major reform of company law since the enactment of the Companies Act 1985. The purpose of the 2006 Act was to simplify the law and switch the emphasis of regulation from larger companies to smaller ones so that the legislation is drafted primarily with small companies in mind, reducing the burden of regulation of unnecessary paperwork and red tape for small companies, with additional or different provisions for larger companies being brought in as necessary. The Act has been successful in that to a large part as is now well bedded in but it is the longest piece of legislation ever laid before Parliament and an Act containing 1,300 sections and 16 schedules!

The principal act regulating the administration of an insolvent company is the Insolvency Act 1986 (as amended by the Enterprise Act 2002).

4.2 Setting Up the Company

The company, as a separate legal entity, has to be created or 'incorporated'. The procedure for incorporating a company involves delivering a number of documents and a fee to the Registrar of Companies (an officer at the Department of Trade and Industry with primary governmental responsibility for the public control of companies) at the Companies Registration Office at 'Companies House' in Cardiff.

When the Registrar of Companies has received all of the information required to incorporate a company, he will issue a Certificate of Incorporation. This is effectively the birth certificate of the company that will come into existence on the date stated on the Certificate of Incorporation.

Constitution

Companies incorporated before the 2006 Act came into force had a two-part constitution, comprising a Memorandum and Articles of Association. However, following implementation of the 2006 Act, a company's constitution is now to be found in the Articles of Association only. The Memorandum has been down-graded to one of the incorporation documents, showing a "snapshot" of the position at the time the company was incorporated. If the Memorandum of a pre-2006 Act company contained any restrictions on the company's powers, these are now deemed to be incorporated in the Articles.

The Articles of Association deal with the day to day operation of the company and will, for example, set out:

- procedures for calling and holding meetings of the directors of the company, known as Board Meetings
- procedures for calling and holding meetings of the shareholders of the company, known as General Meetings, and the voting rights of shareholders
- any restrictions on and the procedure for the transfer of shares previously issued by the company and to be transferred by the existing owner to a proposed new owner.

Historically, legislation has provided a set of model Articles of Association for different types of companies. On incorporation, a company may:

- adopt the Model Articles in full without alteration
- adopt some of the Model Articles together with additional Articles suitable for the company in question, or
- adopt unique Articles not including the Model Articles.

The second of these options is the most common. When setting up a company it is extremely important to ensure that the Articles of Association are in a form that is appropriate for the particular circumstances of the client.

On the course, we shall be considering two different sets of model Articles for private companies. These are the **Model Articles** provided in connection with the 2006 Act, and their predecessor, the model Articles provided under the Companies Act 1985 and known as "Table A". Table A has not been repealed by the 2006 Act and will continue to apply to pre-2006 Act companies for many years to come. You will therefore need to be familiar with both sets of model Articles in practice.

A Company's name

There are certain requirements for and restrictions on the name which a company might adopt or trade under. We shall be considering these rules and regulations on the course. We shall also see that it is possible for a company to have two names – the name with which it is registered at Companies House, and the name under which it trades.

4.3 Ownership and Management

Ownership

As mentioned above, the company is owned by its shareholders. Shares are units of ownership of the company. A company needs money in order to acquire assets and carry on its business activities and issuing shares in return for money is one of the main ways for a company to raise funds. This is sometimes known as “equity finance”. The other main method of raising finance is by borrowing it (known as “debt finance”) which is considered in 4.7 below.

A company issues shares in return for an investment in the capital of the company. The shares will confer certain rights and expectations on the shareholders, such as:

- right to vote at general meetings of the company
- an expectation of sharing in the profits made by the company in the form of dividends
- on the winding up of the company, a share in any surplus assets after all debts of the company have been paid in full (including the return of the original share capital invested).

However, the precise rights attaching to any shares issued by a company will be set out in the company’s Articles of Association. A company can have more than one type of shares at any time, each with different rights attached. However, most private companies have just one class of shares known as “ordinary shares”.

There are three ways in which to acquire shares in a company:

- by agreeing to take shares on incorporation as one of the original ‘subscribers’
- by applying for (‘subscribing’) new shares after incorporation
- by accepting a transfer of existing shares that have previously been issued to or acquired by another person.

We shall consider each of these methods on the course.

Involvement of shareholders in decision-making

Whilst the day to day running of the company is a matter for the directors, the 2006 Act provides that certain important decisions must be taken by shareholders. These decisions include:

- changing the Articles
- changing the name of the company
- allowing shares to be issued for cash to new shareholders

- winding-up the company (bringing it to an end).

Shareholders take decisions by passing resolutions. There are two types of resolution:

- ordinary resolutions, which must be passed by a bare majority of votes cast (a fraction over 50%)
- special resolutions, which must be passed by 75% of votes cast.

The 2006 Act specifies whether an ordinary or special resolution is required. Resolutions can be passed in writing or at meetings of shareholders. We shall look at the relevant procedures on the course and draft the documents required.

Management

As a company is an artificial legal entity it can only act through the agency of human beings. Every act or decision of a company must be done or taken on its behalf by people. These people are usually the directors although, as was stated above, the 2006 Act provides that certain important decisions must be taken by shareholders.

Directors are agents of the company to whom power is delegated (by the Articles) to manage the company's business on a day-to-day basis. In the absence of any specific reservation of power to the shareholders, the directors have the authority to exercise all of the powers of the company. Typically, these powers include authority to:

- buy and sell property
- borrow money and create mortgages and charges over the assets of the company to secure repayment of the borrowings
- employ and dismiss employees
- decide whether the company should start or defend legal proceedings
- enter into contracts on behalf of the company
- delegate all or any of their powers as a Board to a sub-committee of directors or a single director (such as a managing director).

Power is delegated by the shareholders to the directors. The directors have one vote each at Board Meetings (and the Articles might provide that the chairman has a second or casting vote in the event of an equality of votes for and against (known as "deadlock")). Decisions are made by simple majority of those directors attending and voting at the Board Meeting. Accordingly, decisions of directors are not classified as ordinary or special resolutions. These terms apply only to shareholders' decisions. As is the case for shareholders, directors may pass written resolutions instead of holding a meeting, but only if they are all in favour of a proposal.

Historically, directors have been subject to many duties. These have included both fiduciary and common law duties. These duties have now been included in the 2006 Act. The seven duties are:

- to act within their powers
- to promote the success of the company
- to exercise independent judgment
- to exercise reasonable care, skill and diligence
- to avoid conflicts of interest

- not to accept benefits from third parties
- to declare interests in proposed transactions or arrangements

In certain circumstances directors can be made personally liable for the debts of an insolvent company. For example, if it is established that the directors deliberately or recklessly financially mis-managed the affairs of the company without trying to protect creditors, they might be liable for fraudulent trading or wrongful trading under the Insolvency Act 1986. Further, directors who have behaved in such a way might also be disqualified from being involved in the management of any company for up to 15 years under the Company Directors Disqualification Act 1986.

The CA 2006 provides that certain transactions involving directors require approval from the shareholders. We shall look at examples of such transactions on the course. We shall also look at the procedures for appointing and removing directors.

When considering the procedures to be followed by directors, it is also important to check the Articles of a particular company to see whether there are any specific limitations on the powers of directors. For example, both Table A and the new Model Articles provide that a director cannot vote at a Board Meeting on any decision in respect of which he or she has a personal interest.

4.4 Assets and Liabilities, Profits and Losses

Since a company is a separate legal entity, it is able to own its assets and is responsible for any liabilities and losses of its business. You will recall that the liability of shareholders to contribute to the funds of the company is limited to any amounts unpaid on their shares. As most shares are issued 'fully paid' (meaning that the full amount due is paid on subscription), in most cases shareholders will have nothing further to pay should the company become insolvent.

In the first instance, the profits of the business also belong to the company itself. The directors may or may not decide to distribute some or all of those profits to shareholders in the form of dividends. As we shall see on the BLP course, in most cases shareholders have no right to compel the directors to declare a dividend, even if the company is very profitable.

4.5 Taxation

The Company

A company pays corporation tax on the aggregate of its income profits (generally calculated in the same way as income of individuals for income tax purposes) and its capital gains (generally calculated in the same way as capital gains of individuals for capital gains tax purposes).

Directors and Shareholders

A director usually receives remuneration or fees from a company. These sums will be subject to income tax in the hands of the individual director. The company will be able to deduct amounts paid out to directors in calculating its income profits for corporation tax purposes.

As already mentioned, a shareholder is likely to expect to share in the profits of the company by receiving dividends on his or her shares. Again, as already stated, a shareholder has no right to compel the directors to declare a dividend, and it is also true that a company can only pay a dividend if it has sufficient distributable profits. If dividends are paid, individual shareholders may have to pay income tax. We shall look at this on the course. From the company's point of view, dividends are not a deductible expense in computing its income profits for corporation tax purposes. Instead, they are regarded as an allocation of profits.

Where an individual sells shares in a company, he or she may be liable to capital gains tax on any capital gain made on the sale (subject to any available reliefs or exemptions). The purchaser of the shares will be liable to stamp duty on the transfer.

If an individual gives shares away (or sells them at an undervalue), he or she may have to pay inheritance tax on the amount by which the value of his or her estate has been reduced by the gift or sale at an undervalue (again, subject to any available reliefs or exemptions).

4.6 Failure of the Business and Insolvency

You will recall that a company has unlimited liability for its debts, and that shareholders are only liable to contribute any amounts unpaid on their shares. What, then, will happen when a company is unable to pay its debts?

Ultimately, an insolvent company is at risk of going into liquidation. Where a company is unable to pay its debts as they fall due, or where it is shown to the satisfaction of the court that the assets of the company are less than its liabilities, certain people (most probably its creditors) may petition the court for an order that the company be compulsorily wound-up (brought to an end). If an order is granted, a liquidator will be appointed and he or she has a duty to sell off the assets of the company in order to pay its debts in the statutory order of priority. Once the liquidator has completed these tasks, he or she must file a report at Companies House and the company will subsequently be removed from ("struck off") the Register of Companies. It is then "dissolved" and ceases to exist.

The rules relating to liquidation are contained in the Insolvency Act 1986 (as amended by the Enterprise Act 2002). This act also provides for alternative insolvency procedures for companies such as Administration and Company Voluntary Arrangements. We shall consider the various procedures on the BLP course. In particular, we shall discover that Administration is often entered into with a view to saving the business of the company and the company itself. This procedure has been significantly altered by the Enterprise Act with the intention of making it more effective in achieving this aim.

Whereas holders of fully paid shares have nothing to fear in the event of a company becoming insolvent, the same may not be true for its directors. We have discovered that in certain circumstances directors might be found liable for wrongful trading if they continue to allow a company to trade when they know that it is insolvent. If so, they may be required to contribute to the funds of the insolvent company from their own personal assets. In this respect, directors are not protected from the creditors of a company by the notion of limited liability. It is also likely that creditors such as banks might not have been willing to lend money to a newly formed insubstantial private company without the added security of personal guarantees from the directors. Again, the personal assets of the directors can be called upon if the company itself is unable to repay the bank in full.

4.7 Borrowing by a Company (debt finance)

As mentioned at 4.3, a company may raise additional finance by borrowing funds, usually (but not always) from a bank, instead of by issuing further shares. If so, a commercial lender is likely to charge interest on the loan and require security in the form of charges granted over the company's assets. These charges are likely to be contained in a document known as a "debenture". We shall consider debentures on the course. One advantage that companies have in this area over sole traders and partnerships is the ability to create 'floating' charges over their assets. A floating charge is a charge over a class of assets which are constantly being acquired and disposed of by the company, such as trading stock. Floating charges can be granted in addition to fixed charges over specific assets such as land. If a commercial lender is making a loan to a company that has little in the way of assets to offer as security, it might also require personal guarantees from the directors.

DOCUMENT 2

ACTIVITY 1

Locate the Companies House Website and the website for the Department for Business, Innovation and Skills (BIS). Navigate the sites to complete the following tasks. You may also need to refer back to your Introductory Pre-Reading:

1. What is the main statute that governs the way companies are run in the U.K?
2. List any three key features of a private limited company.
3. Locate the “FAQs” on the Companies House website.
4. Describe how you would go about finding out some information about a company (webcheck) on the Companies House website.
5. Describe how you would go about finding one of the statutory forms that a company may need to file.
6. What is a partnership?
7. List any three key features of a partnership.
8. What is the legislation that governs LLPs in the U.K?
9. Why was the LLP Act 2000 introduced?
10. List three key features of a LLP.
11. On the BIS website, click on the link “What we Do” and the link “Business & Enterprise” and read both to get a feel for what BIS does and what current the topics of focus are.

DOCUMENT 3

CHOICE OF BUSINESS VEHICLE – SCENARIOS

Scenario A

Andrew and John together run a successful landscape gardening business. They have been working together for about a year and have not entered into any formal legal agreement as so far they have not needed to (they both spend the same amount of time working in the business and split the profits equally). They have come to see you because they are thinking about taking on someone else.

Scenario B

Phoebe and Jane have together been running a hairdressing business for about three years. They have a formal partnership agreement. They are worried about the position should the business run into financial difficulties in the current economic downturn.

DOCUMENT 4

FEEDBACK

Introduction

These Pre- Course Materials will hopefully have given you a framework that will help you when you start your Business Law and Practice Course on the Legal Practice Course. *Please don't worry if you did not get all of the right answers; it does not mean that you will not do well on the course!* In terms of the legal theory, we will be teaching you from first principles anyway. If there is anything that you are not sure about, your BLP tutor will be happy to answer any questions that you have.

Activity 1

Activity 1 required you to answer various questions and to locate the Companies House Website - www.companieshouse.org.uk and the website for the Department for Business, Innovation & Skills (BISD) www.bis.gov.uk You then had to navigate the sites to complete the questions (this is less about answering the questions and more about getting you familiar with the sites).

1. What is the main statute that governs the way companies are run in the U.K?

The Companies Act 2006 replaces the 1985 Act which is no longer in force.

2. List any three key features of a private limited company.

From your pre-reading, you should identify three of the following:

- A company is a separate legal entity distinct from its shareholders and directors. You may have considered the case of *Saloman v Saloman* referred to in your Introductory Pre-Reading
- Shareholders (i.e the owners) only have limited liability for the debts of the company – their personal assets are protected
- A company is owned by its shareholders (also known as its members)
- A company is run by its directors (known collectively as the Board). In smaller private companies the directors and the shareholders are often the same people
- Legally certain actions must be taken by shareholders and certain actions may be taken by directors

3. Locate the “FAQs” on the Companies House website.

Go to the blue menu on the top of the screen, then click on “Companies Act FAQs”.

4. Describe how you would find out some basic information about a company on the Companies House website.

Go to “Find Company Information” located on the top right hand side of the screen then follow instructions, filling in the name of the company.

5. Describe how you would go about finding one of the statutory forms that a company may need to file.

Again on the Companies House website, right at the top of the web home page is a link to “forms”. Click on that and it gives you a list of forms that can be filed online (WebFiling). For all other forms you will need to print off and send a paper copy. To do this, scroll down to the link that says “Download Paper Forms Here”. This comes up with a list and a brief description of the form.

6. What is a partnership?

From your pre-reading you will have learned that the legal definition of a partnership (as defined by the Partnership Act (1890)) is “the relationship which subsists between persons carrying on business in common with a view to profit”. It is a question of fact as to whether a partnership exists. Do not confuse with a limited liability partnership (see below).

7. List three key features of a partnership.

From your pre-reading, you should identify three of the following:

- The legal definition (see 2.6 above)
- No legal formalities required – it can be an implied agreement (although an express agreement it is strongly recommended as we shall see in your first Study Unit of BLP)
- Each partner is an agent and is able to bind the firm to contracts made within the scope of the partners authority
- A partnership agreement (express or implied) is a contract of ‘utmost good faith’
- Each partner is a fiduciary of his fellow partner(s) and owes special duties including the duty not to make a secret profit, no conflicts and duty to exercise powers in good faith.

8. What is the legislation that governs Limited Liability Partnerships (LLP) in the U.K?

The primary legislation is the Limited Liability Partnership Act 2000. However, the Limited Liability Partnership Regulations, the Companies Act 2006, the Insolvency Act 1986, the Financial Services and Markets Act 2000 and the Company Directors Disqualification Act 1986 may also be relevant. You will come across all of these in your BLP studies.

9. Why was the LLP Act 2000 introduced?

The LLP is a new form of legal entity introduced following years of intensive lobbying by major accountancy firms. It is a new business vehicle that is designed to protect a partner's personal assets.

10. List three key features of a LLP.

- It is a hybrid between a company and a partnership
- It is a separate legal entity like a company
- LLPs must be incorporated
- Members have limited liability for debts
- Taxed like a partnership

11. Read the sections on the BIS website "What we do" and Regulatory Business & Enterprise"

Activity 3

You were asked to read the scenarios contained in Document 4 of your Document Bundle and then to explain what initial advice you would give.

Scenario A

Andrew and John have not entered into any formal legal agreement but would be likely to be working in partnership. Under the Partnership Act 1890 a partnership exists where there are two or more persons carrying on a business in common with a view to making a profit. All of these elements appear to be satisfied. As they do not have an express written partnership agreement, the provisions of the Partnership Act 1890 would apply. It would be desirable for them to enter into a Partnership Agreement (and this is even more important if a new partner is to be admitted). We shall explore why this is the case further in BLP Study Unit 1.

Scenario B

Here Phoebe and Jane could consider setting up a limited liability company. As a company is a separate legal identity, it would be the company that would be liable for its debts and not the shareholders. Their personal assets would therefore be protected in the event of the Company's insolvency.

5. Conclusion

We hope that you have found this document useful and that you now have an idea of what to expect from the BLP course. **Please remember to re-read this once you start the course and at regular intervals throughout the course – it will help you put into wider context what you are learning in each study Unit on BLP.**

We hope that you will enjoy the BLP course and, indeed, the LPC as a whole. We really look forward to meeting you.

Best wishes

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