



Articles of Association: Table A and the New Model Articles



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1. Introduction – What are Articles of Association?

Articles of Association are, simply put, the rules which dictate how a company is run and define the sometimes complex relationships between the company, its shareholders and directors. What is in the Articles can decide who wins a power struggle or control of the Board or whether a former Director or employee must sell their shares when they leave.

The enactment of the 2006 Companies Act has led to an overhaul of the standard form 'Table A' Articles and these have been superseded (for new companies) by the new 'Model Articles'.

So what are the practical implications of all of this for the busy entrepreneur and his advisers? In this Fact Sheet we explain the key issues and what to look for when you read a company's Articles.

2. Some Background Explained

Before making a start we must first set out some background.

Long Form or Short Form?

Articles of Association can either be long form or short form. Until recently, short form Articles were by far and away the norm for private companies. The short form Articles would typically be no more than 5 or 6 pages; they set out key issues (for which see below) and incorporated the statutory boilerplate which was known as "Table A", a set of standard Articles set down by law as the default version.

In fact there were a number of slightly different versions of Table A which had been enacted over the years reflecting changes in company law. Which of those versions is relevant to a particular company will depend on when the company was incorporated. This is because the newer version does not affect an existing company: it keeps the constitution with which it was incorporated unless the company takes active steps to change its Articles.

The decision of the government to overhaul company law led to the Companies Act 2006. This was intended to simplify company law particularly for small private companies.

It was also decided that for private companies a simpler default constitution would be more appropriate. This took effect from 1 October 2009 when the new Model Articles replaced the old Table A Articles for newly incorporated companies.

Since this date, a new practice has now developed with Company Formation Agents using long form Articles of Association. These set out in full a modified version of the Model Articles incorporating the changes that the draftsman considered were an improvement to the standard. The key issues lie buried in the Agents' own "standard" that have now typically grown to 30 pages plus.

This Fact Sheet attempts to highlight the key issues for most companies in these new long form articles.

Before covering these we must first, though, give a brief overview of the principal practical points on company law that must be borne in mind as the backdrop to the Articles.

3. Key Points of Company Law

A company is controlled and managed by its Board of Directors: so who decides on the appointment or removal of Directors is fundamental. It is often said that the only job of a Venture Capitalist is to decide when to sack the Chief Executive!

The holders of a majority of the issued ordinary share capital (50.1%) can hire and fire the Directors. Before the Company Act 2006 took effect the Chairman (unless the Articles said otherwise) would have a casting (or second) vote at shareholders' meetings. This meant a 50/50 Company was effectively controlled by the Chairman.

That still applies to companies incorporated before 1 October 2008 (unless they have Articles which say otherwise). For companies formed since that date the Chairman of the Board cannot have a casting vote at meetings of shareholders: so a 50% shareholder cannot remove Directors as officers of the company if opposed by the other 50% holder. However, the Chairman still can have a casting vote

at Board Meetings so irrespective of the company's date of incorporation, the Chairman can exercise a casting vote (if the Board is deadlocked) to terminate the employment contract of a Director.

The next key threshold is 75% of the voting rights at a shareholders' meeting. This percentage is required to change the Articles, to authorise a buy-back of shares or to resolve to wind-up the company.

A key power of the Board is to issue new share capital. The Companies Act 2006 has now removed the need for a private company with just one class of share to have shareholders' authority to issue new shares.

However, unless the Articles say otherwise if shares are to be issued for cash they must first be offered to the members for 21 days in proportion to their existing shareholdings. An exception to this is shares issued under an employees' share scheme.

From the above it will be apparent that:

1. holding a chairman's casting vote can be key;
2. holding 50.1% of the voting shares can be key;
3. the ability to pass a special resolution with 75% of the votes can be very important.

The other important threshold is 90% of the issued shares in the context of a company sale. Buyers of private companies almost invariably want to acquire 100% of the shares. There is a procedure under company law that allows the buyer of 90% of the shares in a company to compulsorily acquire the remaining shares. However, the procedure may be costly to implement and there is a statutory right of appeal.

To overcome these issues Articles sometimes include a "Drag Along" article. This allows a purchaser of a specified percentage of the shares in the company (often 75%) to acquire the remaining shares without invoking the

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statutory procedure.

4. Key Issues in the Articles of Association

1) Transfer of Shares

The simplest provision is one under which the Directors can veto any transfer of shares by a member.

Whilst this may not prevent circumvention by a declaration of trust very few buyers would accept such an elaborate arrangement.

The Model Articles follow the old Table A in having a default provision giving the Directors a veto on share transfers (clause 26 (5)).

The entrepreneur and his advisers will want to check that this is included. If, instead, the Articles include pre-emption rights on share transfers (i.e. rights of first refusal for existing shareholders before a transfer can be made) then these must be checked carefully. A common "add-on" are leaver provisions, which require an employee leaving the company to offer his shares for sale (sometimes at a below market value). Whilst the entrepreneur may want these included to apply to other team members, these will rarely be appropriate for the entrepreneur's own shareholding.

2) Quorum for Shareholders' Meetings

Unhelpfully the Model Articles do not themselves specify a quorum (i.e. the minimum number of shareholders that must attend for the meeting to be able to make decisions). The default position is instead set out in the Companies Act 2006 (section 318): this is one for a single member company and 2 for all others.

The Articles should be checked to see if this default provision has been amended.

More important is what happens if a quorum is not present. The Model Articles state that the meeting to be adjourned.

The entrepreneur will want this

qualified (and this was invariably done with Table A) so that at the reconvened meeting a single member can be a quorum.

This prevents a minority shareholder, perhaps a Director-shareholder, failing to attend meetings and thereby frustrating important business.

3) Quorum for Directors' Meetings

The Model Articles (like the old Table A) specify a quorum of 2 as the default position. However, Article 7(2) allows for a sole Director to have full authority to manage the company.

The entrepreneur will want to check that this applies in case the company has just one Director.

4) Directors' Conflicts of Interest in Company Transactions

The starting point in the Model Articles is that if a Director is interested in the business to be transacted at a board meeting he is disqualified from voting and indeed cannot count in the quorum.

There are "permitted causes" where an interested Director can vote, for example the giving of a guarantee by a Director, a share subscription, or schemes for employees where Directors participate on the same terms. However, the entrepreneur and his advisers will want to replace the Model Article provision to allow interested Directors full rights to vote and count in the quorum on matters in which they are interested. This is because it is likely to be their personal interests that become an issue not those of fellow Directors.

5) Situational Conflicts (Section 175 Companies Act 2006)

The 2006 Act introduced a new provision (section 175) dealing with the *situation* where a Director may have a conflict: so this is not transactions (see paragraph 4 above) but general *situations* of conflict. An example would be a Director with directorships of other companies which may be competitors of the company. The section was introduced as part of the codification and tightening up of Directors' duties.

The purpose of the section was to allow a company to give its Directors authority to permit such *situational* conflicts. Under old company law it was the shareholders only who could permit such conflicts.

The new provisions allow the Board to sanction a *situational* conflict. The statute specifies, however, that conflicted Directors cannot vote or count in the quorum.

Recognising the difficulty this may create it is now common practice in private company Articles to reduce the quorum for Directors' meetings down to one if there is only one non-conflicted Director..

The Articles should be checked to see if this is covered.

6) Restriction on Share Issues

Before the Companies Act 2006 the Directors had to be given authority by the members to allot shares. Furthermore the Memorandum of Association included a share capital clause. If the company wanted to issue more shares than specified in its Memorandum it had to increase its authorised share capital.

The authorised capital requirement has been abolished so post 2006 Act companies have no capital clause. For a company incorporated before 1 October 2008 the restriction in the Memorandum is imported into the Articles as a "hidden restriction". Many formation agents choose to adopt a cap in the Articles on the number of shares that can be issued. This should be checked.

The entrepreneur may wish to ensure that there is a restriction in the Articles that would prevent a board that he may not control resolving to issue shares without his consent.

5. Free Review

Everyman Legal offers a free 15 minute discussion and review of your company's Articles of Association. If this is of interest, please do not hesitate to contact us on 0845 868 0960.

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For more information contact:

James Hunt on 0845 868 0962

james.hunt@everymanlegal.com

Stephen Evans on 07963 931 830

stephen.evans@everymanlegal.com

Ed Burrell on 0845 868 0965

ed.burrell@everymanlegal.com



Everyman Legal Limited

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www.everymanlegal.com