

Corporate Secretarial Practice

Sample paper

Suggested answers

Important notice

When reading these answers, please note that they are not intended to be viewed as a definitive 'model' answer, as in many instances there are several possible answers/approaches to a question. These answers indicate a range of appropriate content that could have been provided in answer to the questions. They may be a different length or format to the answers expected from candidates in the examination.

Case study

Trymore plc

You have just joined Trymore plc ('Trymore'), a company listed on the London Stock Exchange, as company secretary. This is the first time that a company secretary has been appointed as a separate role in Trymore, as the position had previously always been held by the finance director. Trymore manufactures and sells luxury jewellery and the business has suffered as a result of an economic downturn. Several issues have arisen with certain stakeholders of the company, including unions, shareholders, auditors and the media. The board of directors is very worried about these problems and has convened a special board meeting to discuss what to do. The chairman believes that some of the issues will require input from the company secretary, as a senior member of the company's management team. You hold a series of meetings with your senior colleagues to find out more about the problems. The matters set out below are discussed with you.

Firstly, you hold a meeting with Ms People, the director of human resources. Ms People provides you with an update on a number of matters, including staffing numbers, future wage proposals and relationships between staff, management and the Employees' Union ('the Union'). She also tells you that the Union is concerned about some of the decisions and actions taken recently by the directors and the effectiveness of the board generally. In particular, the Union:

- Has accused several directors of planning to "help themselves" to the company's assets, rather than investing the company's funds into protecting jobs.
- Is not convinced that many of the decisions taken by the directors recently have benefited the company, particularly in the short-term.

Ms People tells you that the company is keen to preserve good relations with the Union, so it will be important to fully address these issues in any dealing with them.

Several hundred staff were recently made redundant, mainly at the head office, and many of the remaining staff are fearful that they will lose their jobs. The redundancies have even spread to the company secretarial department, where 25% of the staff have been made redundant as part of cost-cutting measures. This has made the workload of the company secretarial department very heavy. You have already explained to Ms People that your staff have complained that they are finding it very difficult to cope and that you fear more staff will resign unless staffing numbers increase.

Ms People tells you that morale within the company seems particularly low. In order to expand the business, the Union understands that the company has recently acquired several overseas companies which have poor human rights records. Staff in the overseas countries are not part of the Union and are cheaper to employ, and the Union is worried that there will be further job losses among their members as a result. The Union is also concerned with the behaviour of Big Holdings plc ('Big Holdings'), the company's largest shareholder – Trymore is not a subsidiary of Big Holdings. The Union claims that Big Holdings has excessive influence over Trymore, and that Big Holdings' strategy is very similar to Trymore's regarding the investment into overseas companies. However, Ms People tells you that this approach is the most effective way to reduce the cost of employment.

Your second meeting is with Mrs Gain, the finance director and your predecessor as company secretary. She summarises the company's current financial position to you and outlines the key financial priorities for the rest of the year. She also tells you that she is worried that many of the company's shareholders will be concerned with the company's external auditors, following an alleged scandal in the press regarding several senior partners of the audit firm. Many clients of the audit firm have announced that they will no longer use them. The company is keen to preserve its reputation and is monitoring developments on this closely.

Mrs Gain shows you a copy of the recently received audit letter which refers to a number of company secretarial issues. These centre on the fact that due to the redundancies, and the resulting disorganisation in the company secretarial department, Trymore's statutory records have not been kept up-to-date, with minutes not being prepared and some statutory filings missed. She is particularly worried that there may be some consequences if the requirements for statutory filings have not been fulfilled. Nevertheless, she also tells you that she has to balance the need to control costs in the company with the need to ensure that the company adheres to its statutory requirements, and that she will need some input from you and Ms People to help her decide the best way to address this.

Your next meeting is with Mr Spin, the director of corporate communications. Mr Spin tells you that Trymore has received a lot of negative media attention recently. This includes a negative article in a newspaper which suggested that Trymore, along with other companies in its sector, was overcharging its customers. The article also attacked Trymore's environmental record.

Relationships with shareholders have also become strained recently. Due to the business suffering, the press has speculated that the company is due to make a loss for the first time. Several of the large institutional shareholders based in the City of London have told the chairman that the performance of the company needs to improve.

The business will also need to communicate to stakeholders further ways to save on costs and/or raise extra funds. In particular, Trymore has a large number of shareholders with small shareholdings and Mr Spin is keen to address their concerns. Shareholders have complained that the company has not done enough to modernise the services it provides to them. Mr Spin has been monitoring internet chat rooms and sees that several shareholders with small holdings are proposing to set up a shareholder action group which will demand improvements in performance and services. Mr Spin is keen to improve relations with shareholders, particularly during this difficult time.

Questions

1. A meeting has been planned with the chairman of Trymore and the general director of the Union. The Union is expected to make several allegations and the chairman wishes to be well prepared for the meeting.

Required

Prepare a briefing note for the chairman, analysing the following:

- (a) (i) What are the implications of being a shadow director and what steps in general should be taken to avoid any shadow directorships arising? (6 marks)
- (ii) Why might the Union consider Big Holdings to be a shadow director? Assuming Big Holdings is a shadow director, are there any exemptions which may apply? (4 marks)
- (iii) Assuming Big Holdings is a shadow director, what steps need to be taken by Trymore, particularly if Big Holdings is going to continue its level of involvement with Trymore? (4 marks)

Suggested answer

- (i) The implications for shadow directors can be onerous. They are liable as every other director and must comply with the provisions of the Companies Act 2006 (CA 2006). Taking into account Trymore's financial difficulties, in the event of an insolvent liquidation the liquidator may claim that Big Holdings was a shadow director of the company. S214 Insolvency Act 1986 deals with wrongful trading of directors in certain circumstances where directors knew or ought to have known that there was no reasonable prospect of a company avoiding insolvency. If the liquidator is able to successfully apply to the court for a declaration that directors contribute to the company's assets, this would mean that Big Holdings could be joined with the other directors if there is any claim against the directors as part of insolvency proceedings.

Shadow directors are also amongst the class of directors that may be disqualified from being concerned in the management or direction of a company, if a finding is made under the Company Directors Disqualification Act 1986 that their conduct in relation to the company's affairs makes them unfit to be concerned in the management of a limited company. A court of summary jurisdiction may impose a disqualification order for a maximum of five years, or in the case of superior courts, 15 years. The application to the court will be made by the Secretary of State based on a report by the liquidator or the Official Receiver into the conduct of the directors of the company.

Some practical steps which can be taken to avoid potential shadow directorships arising are:

- Professional advisers should have a letter of engagement setting out their terms of reference and expressly stating that they are not to be treated as directors of the company.
- It is good practice to ensure that third parties are made aware that professional advisers are not acting as directors of the company. For Trymore, this could be done by appropriate disclosure in their Annual Report.
- It would not be appropriate for a representative of Big Holdings to attend board meetings.

- (ii) A shadow director can be described as a person in accordance with whose directions or instructions the directors of the company are accustomed to act. A key question will therefore be whether the board of Trymore is independent or whether it has been acting in accordance with Big Holdings' directions. There are some limited exceptions as to who will not be classed as a shadow director but this is generally restricted to professional advisers as their advice is usually limited to a particular part of the business. If Big Holdings has been advising Trymore in this respect of certain investment strategies only then it may well qualify as an exception. However, this seems unlikely.

As a good point of governance and disclosure, if Trymore had been reliant on Big Holdings in a way which appears to be material to the company's strategy, it may have been appropriate to disclose the relationship, for example, in Trymore's Annual Report.

- (iii) There is no requirement under the CA 2006 to register a shadow directorship at Companies House (CA 2006, s162) and under the 8th Companies Act 2006 Commencement Order, details of shadow directors should be removed from the register of directors interest of companies in existence of 1 October 2009. However, a shadow directorship is an undesirable position, particularly for a listed company. If Big Holdings is indeed a shadow director and will continue its level of involvement the most appropriate course of action would be to regularise the position. This would include the following:
- Disclosing any interests in contracts and so on.
 - Requesting Big Holdings to formalise documentation which appoints a representative to attend board meetings (ensuring appropriate induction arrangements are made if necessary for the company's representative).

- (b) On what grounds might the Union allege that the directors of Trymore have breached their statutory duties? What statutory considerations would the directors have against such allegations? How should the chairman ensure that directors are aware of their statutory duties?**

(11 marks)

Suggested answer

There are several statutory duties of directors under the CA 2006. Given the Union's concerns, the most likely allegations which may be raised are the following:

- Breach of duty to exercise reasonable care, skill and diligence (s174 CA 2006) – The Union may claim that some of the decisions made by the directors have not shown the required level of care, skill and diligence in accordance with S174. This is tested in two ways: an objective test of the general knowledge, skill and experience expected of a director, and also a subjective test of the actual general knowledge, skill and experience held by that director. Directors would, therefore, be required to demonstrate that decisions they have taken have met the standards required by s174.
- Breach of duty to promote the success of the company (s172 CA 2006) – A director is required to act in a way he or she considers in good faith and shall promote the success of the company for the benefit of its members as a whole. CA 2006 provides a non-exhaustive list of factors which directors should take into account when considering this duty. Directors would, therefore, need to show that they have taken one or more of the stipulated factors into account or any other relevant factor.

One key consideration here on which the directors may rely is the likely consequences of decisions over the long-term. It may be the case that the impact of decisions are detrimental over the short-term (such as redundancies) but are designed to be of benefit for the long-term. A further consideration is that there may be 'competing' factors which the directors need to take into account when considering which particular action or actions will promote the success of the company.

The best way to ensure that the directors are aware of their duties is through a process of induction and ongoing education. The newly appointed company secretary will have a pivotal role in this. As a newly appointed company secretary, through discussion with the chairman, a “sense check” should be taken as to the directors’ awareness of their duties. The Combined Code recommends that the company secretary, in conjunction with the chairman, takes responsibility for ensuring the appropriate induction of a director. Before a director accepts an appointment, the secretary should ensure that he or she is fully aware of their responsibilities, duties and potential liabilities. This includes, in particular, their statutory duties as required by the CA 2006. The company secretary usually decides, in conjunction with the newly appointed director on the best way to deliver the induction, which may take the form of presentations, attendance at seminars or providing guidance books. Following induction, the company secretary should take responsibility for the ongoing briefing and refresher training of directors at appropriate intervals.

2. You have serious concerns about the issues regarding the statutory registers, statutory filings and auditors:

(a) (i) You discover that no action has been taken in respect of the following:

- **The Annual Return date for Trymore was two weeks ago.**
- **Your appointment as company secretary was three weeks ago.**
- **A shareholder requested minutes of the last Annual General Meeting (which was held two months ago) but no minutes have yet been prepared.**

Explain if there are any statutory or regulatory implications in respect of the above and any required timescales.

(10 marks)

(ii) Explain, in a memorandum to the finance director, why it is important for the company to promptly file all required returns with the Registrar of Companies and the implications of failing to do so.

(4 marks)

(b) The directors would like to know what the liability of the auditors to the company is, in relation to their auditing of the company’s accounts. The directors are concerned that the auditors may seek to limit their liability and wish to know whether it is permitted under company law and what procedures would be involved for this. The directors expect shareholders to be concerned about the alleged scandal regarding the auditors and have asked you if there are any provisions of the Companies Act 2006 which enable shareholders to take action in this regard. The directors also ask you if there are any disclosure issues which the company would need to take into account regarding the position of the auditor.

(11 marks)

Required

Prepare an appropriate briefing note for the directors in respect of (a) and (b) above.

(Total: 25 marks)

Suggested answer

(a) (i) Statutory filings and registers

- Annual Return date – The Annual Return must be submitted to Companies House within 28 days of the Annual Return date, together with the associated filing fee. Trymore is not, therefore, overdue and has two weeks to file the return.
- Appointment of company secretary – Public companies are required by s275 CA 2006 to maintain a register of secretaries and by s276 to notify the Registrar within 14 days upon the occurrence of any change in the particulars contained in the register. It is, therefore, good practice to update the register of secretaries without delay and a statutory requirement to notify the Registrar of Companies within 14 days of such an event. Trymore is, therefore, one week overdue. Pursuant to s276, if default is made in complying with this section, an offence is committed by every officer of the company who is in default. Furthermore, as a listed company, there is a regulatory requirement to issue an announcement via a Regulatory Information Service in respect of the appointment. This should have been done, at the latest, without delay following the appointment and is, hence, considerably overdue.
- AGM minutes – As a core function of the company secretary, it is good practice to prepare minutes promptly following a meeting. Moreover, s355 requires every company to keep minutes of all proceedings of general meetings. If the minutes have not been prepared, it is likely that any resolutions which need to be filed at Companies House have not been filed either. Such resolutions must be filed within 15 days of the meeting and, hence, are overdue. In addition, s358 entitles any member to request (subject to any applicable fee) a copy of the minutes of general meetings and such copies must be provided within 14 days of receiving the request.

The situation must, therefore, be addressed without delay in respect of writing the minutes, sending the minutes to the shareholder and making any necessary filings with the Registrar of Companies. In general, if a company fails to comply with the above requirements, an offence is committed by every officer of the company who is in default.

(ii) Filing returns with the Registrar of Companies

It is important for the company to promptly file all required returns with the Registrar of Companies for a number of reasons. Firstly, the CA 2006 makes directors of the company liable for failing to file required documents. This could damage the reputation of both the director and the company and, in extreme cases, persistent failures to file could lead to the disqualification of one or more directors. Secondly, part of the assessment of a company by stakeholders (such as credit reference agencies, suppliers and prospective customers) will include a review of documents lodged at Companies House. If it is clear that the company is not adhering to its statutory requirements, this may discourage third parties from doing business with the company. Lastly, a failure by a company to file accounts, annual returns or respond to a communication from Companies House could result in strike-off action by Companies House.

The directors would, therefore, be strongly advised to ensure that the company secretarial function is appropriately resourced to ensure that the company is able to comply with its statutory obligations.

(b) Liabilities of the auditor and shareholder concerns

Auditors are required to act honestly and with reasonable care and skill in discharging their duties. An auditor is liable to the company for any loss resulting from negligence or default in the performance of his or her duties.

As an auditor's liability is unlimited, this has led to concerns in recent years that an audit firm could go out of business were it to be found liable in a court. The CA 2006, ss534-538, introduces the possibility that the liability of auditors may be limited. However, this is not a unilateral decision by the auditor and would need to be agreed with the company. Any such attempt to limit liability would be in relation to the specific financial year and would need the approval of the company's shareholders by ordinary resolution, following approval by the board. The details of the limitation would be set out in a formal liability limitation agreement, which can reduce the extent of liability to no less than such an amount or proportion which is fair and reasonable, taking into account the auditor's responsibilities and contractual obligations and the professional standards expected of them.

In respect of likely shareholder concerns, as Trymore is a public company, it is required to propose a resolution at each Annual General Meeting (AGM) in respect of the re-appointment of the auditor. If shareholders are concerned about the suitability of the auditor, the most obvious action would be for shareholders to vote against the resolution. The appointment of the auditor would, therefore, come to an end at the end of their term.

CA 2006 s527 also gives shareholders of a quoted company the right to have a statement placed on the company's website ahead of a general meeting at which the accounts are to be considered. However, the statement must only be in relation to the audit of the accounts or any issue surrounding an auditor who has ceased to hold office. In order for the statement to be placed on the company's website, it must be requisitioned by members representing at least 5% of the total voting rights or by 100 members holding paid up shares on average sum per member of not less than £100.

As a listed company, the directors should be alert to any likely problems which could damage the company's reputation and should have a plan to deal with it. The company should, therefore, create a prepared response on the company's position in relation to the auditors which could be released if required. In addition, the Listing regime requires all circulars to shareholders to carry the necessary information to enable shareholders to make an informed choice if a voting action is required. The notice of AGM must, therefore, have a clear recommendation as to whether the directors support all of the resolutions, including the resolution on the re-appointment of the auditors.

3. You learn of some new developments with regard to the company's relationship with its shareholders:
- (a) The directors inform you that press speculation is indeed correct and that, due to a sudden change in trading, the company is expected to make a loss for the first time. They ask you what disclosure issues arise, why such issues arise and what actions should be taken. They also ask you to explain the process by which listed companies must disclose information. (12 marks)
- (b) Mr Spin notes that the company does not send Summary Financial Statements (SFSs) to its shareholders and that this could be one way in which the company modernises its shareholder services. Mr Spin asks you to prepare a note for the board explaining the following:
- (i) What SFSs are and why companies might wish to send them to shareholders. (4 marks)
- (ii) What statutory process and procedures a company must follow prior to issuing SFSs to shareholders. (3 marks)
- (iii) What key information must, at a minimum, be included in SFSs and how the SFSs should be approved. (6 marks)

Required

Prepare a briefing note for the directors in respect of (a) and a note for the board in respect of (b), above.

(Total: 25 marks)

Suggested answer

(a) Disclosure issues regarding trading conditions

Listed companies must observe various continuing obligations, as set out in Listing Rules and in the Disclosure and Transparency Rules (DTR). Continuing obligations are designed to ensure a fair market, with equal access to information by all parties and help to reinforce the importance of a properly regulated market and thus help to increase investor confidence. A cornerstone of this is the prompt release of material information to the market. Any change in the company's expected performance which is materially different from the expectation of the market must be promptly disclosed. This includes a profit warning that the company does not expect to achieve the level of profit it had previously achieved in a given financial period.

Time is of the essence, as the Financial Services Authority (FSA) are likely to investigate the time period between the directors becoming aware of the expected change in trading expectation and the release of an announcement about it. Any unwarranted delay in releasing the information is likely to lead to the creation of a false market which is contrary to the Listing Principles and, in extreme cases, could lead to accusations of market abuse. The directors would, therefore, be strongly advised to convene a board meeting without delay and to consult with its advisors on the preparation and the urgent release of an appropriate announcement to the market.

The DTRs provide guidance on the release of information to the public. Companies must submit announcements to a Regulatory Information Service (RIS), which is a primary information provider (PIP) service approved by the FSA, to disseminate regulatory information to the market. Information which needs to be notified to a RIS must be given to them before being released

elsewhere to ensure that no one person or section of the population receives the information ahead of any other.

If a RIS is closed and a company has information to disclose, the company must distribute it to at least two national newspapers and to two newswire services to ensure that there is adequate coverage. A RIS should also be informed so that it can release the news as soon as the market reopens. The underlying principle in the DTRs is that important information must be released to the market as promptly as possible and, in any event, usually by the end of the following business day. The DTRs further require that once an announcement has been released to a RIS it must also be posted on the company's internet site by the close of the business day following the day of announcement and must be kept there for at least one year.

(b) Summary Financial Statements

- (i) SFSs are, as the name suggests, a summary version of the full accounts of a company. All companies may choose to issue SFSs to shareholders instead of the full accounts (CA 2006, s426). In addition to sending SFSs in hard copy, SFSs may be made available electronically, for example, on a website or sent by email to those who have requested it. This would meet some of the concerns of shareholders that the company has not modernised its services to them.

SFSs are a useful tool in promoting effective shareholder relations. SFSs avoid overwhelming private investors with detailed and complex annual accounts. It also saves companies with large shareholder bases substantial costs in printing and posting annual accounts. This is useful as Trymore is looking for ways in which to save costs.

- (ii) Before a company may send SFSs to its shareholders, it must ascertain the wishes of members regarding the receipt of full accounts. The company must have ascertained that the shareholder does not want to receive the full accounts. This may be accomplished by sending the shareholder a reply-paid card which requests the shareholder to opt-in to receive the full accounts. If the shareholder fails to reply, it is assumed that the shareholder is willing to receive the SFSs.
- (iii) The SFS to be prepared for the financial year for Trymore must include the following (as stipulated in the CA 2006, ss427-428 and regulations made under those sections):
- A summary balance sheet (statement of financial position).
 - A summary directors' report.
 - Paid or proposed dividends.
 - A report by the auditors.
 - A report on directors' remuneration.

The SFS must also contain a statement that it is only a summary of the full accounts and that the summary accounts do not contain sufficient information to allow a full understanding of the company. It must also provide shareholders with details of where the full accounts may be obtained (free of charge). In addition, to provide additional comfort for shareholders, the SFS must contain a statement by the company's auditors of their opinion that the SFS is consistent with the full accounts and complies with the CA 2006.

As with the full accounts, for good governance, the SFS must be approved by the board. The SFS is signed on the board's behalf by a director whose name must be stated on the copies issued to shareholders. In seeking the board's approval, the board will need to confirm that the SFS is indeed a true summary of the full accounts.

4. The directors strenuously deny that they are planning to “help themselves” to the company’s funds. The following transactions are intended to take place between the directors and the company:

(a) The company plans to provide loans and credit transactions to two directors. Firstly, Mrs Gain, the finance director, will receive a loan of £8,000 for the purposes of buying a new car and separately will receive a loan of £18,000 (repayable next year) so she can buy jewellery from the company at market price. Secondly, Mr Sell, the marketing director, will receive a loan of £40,000 which he will use to clear personal debts as he was in severe financial difficulty.

(12 marks)

(b) The company also has plans to participate in property transactions with the directors. The company intends to purchase Mrs Gain’s old car for £4,000. Mrs Gain has pointed out that the car is registered in her husband’s name, and he is not a director of the company. The company also plans to purchase, for development, a plot of land owned by Mr Sell in exchange for £115,000, plus the allotment of 20,000 shares in the company. Each transaction is intended to be at market value.

(13 marks)

The chairman has asked you to provide advice as to whether each of the above transactions are permitted under the Companies Act 2006 and, if so, what approvals, procedures and disclosures need to be made. The chairman has also asked you if Mr Sell’s financial difficulties raise any issues under statute or the company’s Articles of Association.

Required

Prepare the responses required in (a) and (b) above.

(Total: 25 marks)

Suggested answer

(a) Loans and credit transactions

Under the CA 2006, companies may make loans or credit transactions to directors. This is provided there has been prior approval by ordinary resolution of the members. In order for approval to be given in general meeting, there needs to be full disclosure in advance by including the following information in a memorandum:

- The purpose of the loan or transaction.
- The amount of the loan or value of the transaction.
- The liability to which the company may be exposed under the loan or transaction.

Where the resolution is to be passed in a general meeting, the memorandum must be available for inspection at the registered office for at least 15 days ending with the date of the meeting. It must also be available for inspection at the place of the general meeting.

Shareholder approval is not required where loans or transactions are in respect of small amounts. The relevant exceptions where shareholder approval is not required are:

- Loans or quasi-loans up to £10,000.
- Up to £15,000 for credit transactions under which the director acquires goods from the company on deferred payment terms.
- To enable a director to meet expenditure incurred for the purpose of the company’s business to enable him to perform his duties. The aggregate amounts outstanding must not exceed £50,000.

Taking the above into account, the loan to Mrs Gain does not require approval by shareholders, approval by the board is sufficient. Mrs Gain should declare an interest and should be excluded from the quorum and the voting in respect of the board's approval of the loan.

However, the £18,000 loan to Mrs Gain and the loan to Mr Sell require shareholder approval before they can be made. This is because the £18,000 loan is a credit transaction above £15,000 in exchange for goods by the company and the £40,000 loan is above the exemption allowed under the CA 2006. If the directors concerned also hold shares they should refrain from voting in a general meeting on any approval as each is a conflicted related party.

(b) Property transactions and Mr Sell's financial difficulties

The CA 2006, ss190-196, sets out the provisions in respect of substantial property transactions between a company and a director. The term "director", for the purposes of substantial property transactions, includes connected persons to the director and this would include Mrs Gain's husband. Hence, the transaction in respect of the car needs to be considered. Generally, a company may not transfer to a director, or a director to a company, a non-cash asset (for example, property) if its value exceeds 10% of the company's net assets and is more than £5,000, or if the value exceeds £100,000, unless approved by the company in general meeting. No shareholder approval is required if the value is less than £5,000.

Taking the above into account, the purchase of the car is a property transaction as it is with a connected person to the director. However, as it is for less than £5,000, no shareholder approval is required. As with the loan for £8,000, board approval is all that is required and Mrs Gain should declare an interest and should be excluded from the quorum and the voting in respect of the transaction. However, the purchase of land does require shareholder approval as the value exceeds £100,000. If the director concerned also holds shares, he should refrain from voting in a general meeting on any approval as he is a conflicted related party.

It is noted that the company intends to acquire the plot of land for cash and shares. The CA 2006, ss593-597, provides that a public company may not allot shares either fully or partly paid up for a payment other than cash, unless the consideration has been valued by an appointed valuer within the six months prior to the allotment, and a copy of the valuation sent to the proposed allottee. The valuation report must be made by an independent person who would be qualified to be an auditor of the company.

The valuer's report must state:

- The nominal value of the shares being allotted for a consideration other than cash.
- The amount of any premium payable on the shares.
- The consideration which has been valued and the method used to value it.
- The amount of the nominal value of the shares and any premium treated as paid up for a consideration other than cash.

A copy of the report should be sent to the Registrar of Companies when the return of allotments form SH01 is filed (CA 2006, s597) together with a formal contract for the transfer of the plot of land. As the transaction is with a director and requires shareholder approval, adequate disclosure must be made in the circular sent to shareholders and documents must be made available for inspection in a similar way as for the arrangements for loans, as described above. Mr Sell should also refrain from participating in any board approval on this matter.

Questions need to be asked about Mr Sell's personal financial position as this may impact his ability to continue to serve as a director. Public company Model Article 22 provides that a director would cease to be a director as soon as a bankruptcy order is made against that person or if a composition is made with that person's creditors generally in satisfaction of that person's debts. In addition, if a director becomes bankrupt after appointment, section 11 of the Company Directors Disqualification Act 1986 provides that his position will be resigned unless the courts give permission for him to continue.

5. You are a Chartered Secretary in private practice. John Smith is a shareholder in Pots plc ('Pots'), a company listed on the London Stock Exchange. Mr Smith tells you that he and many other shareholders of Pots, who hold between them 7% of the issued share capital, are unhappy with the way the company is being run and wish to put forward some proposals of their own for consideration. Mr Smith asks you to prepare a report giving your professional advice on the following:

(a) How can shareholders of a company: (i) assert their rights by requisitioning a general meeting; and (ii) add a resolution to the agenda of the next Annual General Meeting (AGM) of Pots? Mr Smith would like to know the applicable statutory procedures and timescales, what documents would need to be produced and in what format, any related costs, and what information would be circulated and disclosed.

(16 marks)

(b) Once the general meeting/AGM has been held, how will Mr Smith and his associates know the result of their proposed resolution? What steps are available to Mr Smith and his associates if they are not satisfied with the way any vote at a general meeting/AGM has been conducted?

(9 marks)

Required

Prepare the report required in (a) and (b) above.

(Total: 25 marks)

Suggested answer

Advice for Mr John Smith – Pots plc

I refer to our recent discussion regarding Pots plc and I provide below the information that you requested.

(a) Requisition of business at general meetings

(i) Requisition of a general meeting

Under s303 of the CA 2006, members holding not less than 10% of the paid-up capital may requisition the directors to hold a general meeting. As you and your colleagues only hold 7% of the capital, you do not have sufficient shares to requisition a meeting. You must, therefore, either find further shareholders who are willing to support your requisition (holding at least 3% of the share capital) or you may wish to consider waiting until the next AGM and add a members' resolution at that time (see below).

The requisition may be in hard copy or electronic form and must be authenticated by the persons requesting it. On receipt of the requisition, the directors of Pots plc must convene the meeting within 21 days, and the meeting must be held not more than 28 days after the date of the notice of the meeting (CA 2006, s304(1)). The cost of convening the general meeting is met by the company.

In practice, if convening a meeting, the directors would circulate the notice to the members with a letter explaining the circumstances in which the meeting was being called and state whether or not they supported the proposals to be considered. This is good practice generally for shareholder relations. Also, it is particularly relevant for listed companies as the Listing Rules require any circular sent to shareholders of a listed company to contain a clear and adequate explanation of its subject matter, including enough information for shareholders to be sufficiently informed when voting or taking other actions. As Pots plc is a listed company, it will be required to issue a regulatory announcement without delay disclosing that shareholders have

requisitioned a general meeting. This is necessary as the public are potential investors and need to be informed of all material events affecting Pots plc.

You should note that the directors of Pots plc cannot simply ignore the requisition. CA 2006 s305 provides that if the directors do not comply with the requisition, the requisitionists, or a group representing more than 50 per cent of the voting rights of all of them, may convene the meeting at any time within three months from the date of deposit of the requisition. As far as possible, the meeting should be convened in the same manner as would be done by the directors. This will also be at the expense of the company.

(ii) Adding an item of business to the next AGM

In addition to the ability of shareholders to requisition a general meeting, shareholders as owners of a company have the right to add their own items of business to the agenda of a forthcoming AGM. As you and your associates do not hold 10% of the share capital of Pots plc, this may provide an alternative route for you. CA 2006, s338 provides that one or more shareholders holding at least 5% of the fully paid up voting capital may requisition an item of business at the next AGM. Hence, you and your associates hold sufficient shares to take this course of action. However, you will have to wait until the time of the AGM.

In respect of timescales, the requisition must be lodged not less than six weeks before the date set for the meeting, but if the meeting is subsequently set for sooner, the requisition is deemed as being validly served. The procedure is to deposit the signed requisition(s) (stating the object(s) or including any supporting statement) at the registered office. This may be in hard copy or electronic form. As with requisitioning a general meeting, the board is likely set out in the notice the circumstances in which the resolution has been added and whether or not they support the proposals.

Timing is critical in this matter. In respect of costs, if the request is received before the end of the financial year preceding the meeting, the costs of circulation must be met by the company (CA 2006 s340(1)). If the request is received later, it must be accompanied by an amount to cover the expenses of circulation. If not, the directors are not obliged to circulate details of the resolution or any accompanying statement. CA 2006, s314 allows members to request circulation of a statement of up to 1,000 words which relates to a resolution to be proposed at any general meeting or to other business to be dealt with at the meeting. The number of members required is the same as for requesting a resolution to be put to an AGM. However, the request under this section need only be received one week before the meeting.

(b) Voting results of a general meeting

All shareholders will be able to find out the result of the resolutions passed at a general meeting. You should note that the Listing Rules provide that the result of any resolutions passed at general meetings must be released via a regulatory information service. In addition, the Combined Code (which is the corporate governance code which applies to listed companies) requires that where a resolution has been passed on a show of hands, the chairman of the meeting should inform the meeting of the proxy votes lodged, even if a poll vote has not been called and that the proxy votes lodged should be published on the company's website.

Shareholders have the right to ensure that any poll vote taken at a general meeting has been conducted appropriately. CA 2006, ss342-351 has provisions to allow shareholders to require an independent report on a poll vote taken at any general meeting. Members holding 5% of the voting rights may require the report, so the shares held by you and your associates will be sufficient to make this demand. The requisition must be received by the company no later than one week after the poll has been held. On receiving such a request, the directors have to appoint an independent assessor within one week. The assessor's report must state whether, in his opinion:

- The procedures for the poll were adequate.

- The votes cast were fairly and accurately counted and recorded.
- The validity of proxy appointments was fairly assessed.
- The company complied with legal requirements regarding the appointment of proxies.

Again, open disclosure is key and all shareholders will be able to find out the result of the independent assessor's report. Under s351 CA 2006, the company must publish on its website the fact that an independent assessor has been appointed and who the assessor is. Once the report is produced, this must also be put on the website.

6. **You are the board secretary to Westshire University ('the university'). Dr Smart informs you that the science department has produced an invention which has the potential to earn revenue for the university. You note that it is against University policy to operate public limited companies.**

Professor Witty has told you that an old student of the school has made a large donation and wishes this to be used for charitable purposes or to benefit the local area through community enterprises.

Both Dr Smart and Professor Witty are keen for these ideas to be carried out by companies which are separate entities from the university but they wish the university to retain some control.

- (a) **Prepare a report for the next board meeting of the university, setting out the steps, procedures, documentation and other matters to consider which are required to incorporate a company. Professor Witty and Dr Smart's considerations, as set out above, should be taken into account.**

(15 marks)

- (b) **Prepare a report for the next board meeting, setting out the reasons why both a company limited by guarantee or a community interest company may be suitable for Dr Smart and Professor Witty's proposal. The report should include any additional relevant information on the formation, purpose, liability or winding up of each type of company and any board approvals which may be appropriate.**

(10 marks)

Required

Prepare the responses required in (a) and (b) above.

(Total: 25 marks)

Suggested answer

Westshire University

To: The board
 From: The secretary
 Re: Formation of new companies

I refer to the recent discussions with Dr Smart and Professor Witty and, as promised, I provide further advice below on the discussions.

(a) Process for incorporating a company

The CA 2006 provides the process by which a company may be formed. This will allow the ventures proposed by Dr Smart and Professor Witty to form a separate entity to that of the University. As such, it will also have its own obligations, for example, disclosure obligations and a requirement to comply with all applicable statutes.

In order to form a new company, there must be at least one person or company which agrees to its formation. This is known as the subscriber who agrees to take at least one share in the company or, for a company limited by guarantee, acts as the guarantor. For governance purposes, the board should, therefore, resolve that the new companies be formed.

All companies are required to have a set of Articles of Association, which are rules to govern the internal affairs of the company. It is usual to adopt the Model Articles, which are default Articles which apply to the running of most companies. To the extent that these are suitable, we can make any specified modifications. Again, for good governance, the board should approve the Articles.

Each company needs a unique name which is appropriate for the business. This can be done by checking the proposed name of the companies against the index of company names held by the Registrar of Companies. Any proposed company name which is the same as, or 'too like', the name of any existing company, or otherwise objectionable (see below), will be rejected by the Registrar of Companies. In addition, there are also some "sensitive" words which, if included in a name, require approval to be obtained in advance before we are able to use it and this should be factored into the timescale for forming the company.

There are a number of forms which must be completed in order to complete the company formation. Completing these forms will also assist in determining what other steps and actions are required as part of the formation. Form IN01 is the main incorporation document required. It contains all the details to enable the incorporation of a company.

Key considerations for the board to approve include the following:

- What will be the address of the registered office and respective jurisdiction (for example, England and Wales)? The registered office address must be within the respective jurisdiction.
- Who will be the first director(s) and secretary(ies)? The board will need to consider the most appropriate person given the required responsibilities of the directors. In addition, for good governance and to retain some control, the board may wish to appoint someone from the University to ensure good governance and a reporting line into the University. A company secretary is not required. However, this may well be useful to ensure that statutory compliance is being fully observed.
- The board will need to decide to what extent the company will be capitalised and who will own the shares, if it is limited by shares. For example, the company could be a subsidiary of the University in order to retain some control of the company. The details of the initial shareholders must be disclosed as part of the formation process.
- Form IN01 contains a Memorandum of Association, which is the request by one or more person to form a company. Every subscriber to the Memorandum of Association must sign a statement of compliance which is contained within the form. The statement confirms that the subscriber has complied with the requirements of the CA 2006 in respect of registration.

The registration documents must be accompanied by the applicable registration fee. If all is in order, the Registrar of Companies will issue a certificate of incorporation. This is effectively the 'birth certificate' of a company. Details of the company are disclosed and made available to the public via the Registrar of Companies' website.

(b) Companies limited by guarantee and Community Interest Companies (CICs)

In a company limited by guarantee, the liability of the members is limited to the amount that they undertake to contribute to the assets of the company if it is wound up. Companies limited by

guarantee are usually low risk entities such as charitable or not-for-profit organisations and would, therefore, be appropriate for the separate entity required to administer donations from former students.

In a company limited by guarantee, members are not required to provide funds on becoming a member. However, upon incorporation, it will be required to submit a statement of guarantee that it is to be limited by guarantee. The statement must contain such information as required so that the subscribers to the Memorandum of Association can be identified (CA 2006, s11). It must also state that each member undertakes that, if the company is wound up while he is a member, or within one year after he ceases to be a member, he will contribute the specified amount towards the debts and liabilities of the company. The liability of the members in the event of insolvent liquidation is limited to the guarantee, usually fixed at some low nominal value, such as £1 per member. As there is little commercial risk to the business, a company limited by guarantee would, therefore, be an appropriate vehicle for the University.

The Companies (Audit, Investigations and Community Enterprise) Act 2004 introduced the Community Interest Company (CIC). The purpose of a CIC is to encourage the provision of products and services which benefit the social and environmental regeneration of wide sections of local communities. Any profits generated from CICs must, therefore, be used for the public good. Companies wishing to qualify for CIC status are required to satisfy the community interest test that 'a reasonable person might consider that its activities are being carried on for the benefit of the community'. The expectation is that the CIC will help to meet the need for a transparent, flexible model, clearly defined and easily recognised. The surplus assets of a CIC on transfer or winding up must be applied only to similar organisations or for charitable purposes.

A CIC may be incorporated as a company limited by shares or limited by guarantee. In addition to the usual incorporation documents, directors are required to sign a statement which confirms that the CIC will only be used for public good purposes.

Given that there will be some risk in forming any company, for good governance and to show acknowledgement of a required decision, the board should pass a formal resolution to approve the incorporation of either a company limited by guarantee or a CIC.

The scenarios included here are entirely fictional. Any resemblance of the information in the scenarios to real persons or organisations, actual or perceived, is purely coincidental.