The Private Company – No longer a legislative afterthought but the New Model for Irish Company Law

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Introduction

The draft Companies Consolidation and Reform Bill 2007 ("the Bill") presented by the Review Group (CLRG) represents a major overhaul of Irish Company Law and is an attempt to consolidate the thirteen Companies Acts and various Statutory Instruments into a single and more simplified piece of legislation. The new draft Bill is the result of the first comprehensive review of Irish Company Law since the report of the Company Law Review Committee (1958) and when enacted will radically reform the substance and structure of Company Law.

The Heads of the Bill are currently being discussed at Parliamentary Counsel and the following important changes and major areas of reform are proposed:

- the private company limited by shares becoming the model company (rather than the public company, as is currently the case)
- the abolition of the doctrine of "ultra vires"
- the codification of directors' duties
- new registration and priority of charges rules
- a requirement for liquidators to have appropriate qualifications

In this Article, the significant provisions will be discussed and some of the major implications for Irish companies following enactment of the Bill. An analysis of certain comparable provisions in UK Companies Act, 2006 which replaces the Companies Act, 1985 will also be highlighted.

Background and Structure of the Bill

Current Company Law was mainly written with the large company in mind. However over 90% of the companies in the State are small to medium sized private companies limited by shares. This is in contrast to public limited companies ("PLCs") which are few in number and account for approximately 0.7. % of companies registered with the Companies Registration

Office ("CRO"). Historically, there was no distinction between the law applicable to private and public companies and this has resulted in smaller companies being obliged to comply with a significant Company Law code, a considerable amount of which may have no application to their business.

In keeping with the modernisation and simplification agenda of Company Law the Heads of the Bill propose to divide the law pertaining to companies into two separate pillars – Pillar A and Pillar B. The former is exclusively concerned with the private company limited by shares and the latter will govern other corporate entities including PLCs and Designated Activity Companies ("DACs") amongst other corporate types.

The law applicable to private companies limited by shares will be ring fenced from the law applicable to all other types of company with the "private company" to be established as the model type company in Irish Company Law.

Pillar A – The Private Company

Part A2: Incorporation, Constitutional Documentation and the abolition of the Doctrine of 'Ultra Vires'

The private company incorporation process will be simplified and the current requirement for a memorandum and articles of association will be replaced by a single document 'constitution'. This document will govern the company's relations with outsiders and insiders and will in effect define the company.

The memorandum of association of a private company currently contains the objects clause which outlines the parameters of permitted corporate activity and typically contains a lengthy list of core and ancillary objects. There is an obligation on parties dealing with a company to verify whether or not a transaction is within the corporate capacity of a company. Contracts entered into by companies that are ""ultra vires" (or beyond their powers) may be unenforceable to the obvious detriment of a party seeking to rely on it.

The Bill proposes a radical change in this area in line with other jurisdictions where the doctrine will have no application to the private company and it will be given the contractual capacity of a natural person. Part A2 Head 20 (1) states that "A company shall have, whether acting inside or outside of the State the full and unlimited capacity to carry on and undertake any business or activity, do any act or enter into any transaction". The abolition of

the ‘ultra vires’ principle will allow for greater protection for persons entering into business transactions with companies.

A private company will continue to be subject to a limit of 99 members, subject to a new exception, whereby property management companies that are formed as private companies may have an unlimited number of members, provided they are all co-owners in the same development. Private companies will be permitted to have only one member.

Part A3: Process of Share Capital reduction

It is proposed in the Bill that the strict rules governing the preservation of share capital on the balance sheet should be relaxed in situations where the solvency of private company is not in doubt. It will now be possible for a private company to reduce its share capital without the requirement to make an application to the High Court by means of a validation procedure i.e. a directors’ statutory declaration of solvency and a special resolution of members.

In addition, the Bill proposes a simplification of the corporate restructuring procedure whereby private companies will be permitted to enter into a three-party shares-for-undertaking transaction, that is, where a company transfers an asset to a new company it will now be able to issue consideration shares to the transferring company’s shareholders rather than the transferring company.

Part A4: Corporate Governance

One Director

The Bill proposes that a private company should be permitted to have only one director but must have a separate company secretary. A review of case law would indicate that the requirement to have two directors serves no meaningful propose (see for example decision in Re. Hunting Lodges Ltd (1985) IRLM 75 as cited in The Law of Private Companies (2002), T.B.Courtney, para.10.091 at p.559). In particular recent decisions would appear to indicate that the appointment of a second director (which in many cases is the spouse of the director) in order to meet the statutory requirement may result in him/her facing legal action for breaches of the Companies Acts or being personally liable for losses incurred despite in many instances playing no active role in the management of the company.

Age Restriction

The present law does not dictate at what age a person may become a company director. Therefore in theory a minor may become a director of a company and have liability imposed on him/her for breaches of Company Law. The Bill provides that there will be a prohibition on a minor being a director or secretary of a company unless he has attained the age of 18 years. This Head is substantially based on Part 10 of the UK Companies Act, 2006 where they have provided that 16 years will be the minimum age for a director.

Annual General Meeting (AGM)

It is a mandatory requirement that every multi-member company convenes an annual general meeting. However, in many private companies, in particular those where the directors and members are one and the same, it is difficult to support this. It is recommended in the Bill that private companies may dispense with an AGM (with the exception of PLC's) where the members unanimously agree to do so.

Part A5: Directors' Duties and other Officers

The diverse sources of directors' duties contained in common law, in equity and in statute can in practice be a "*disincentive to compliance or a ready excuse to the indolent who have no wish to comply with such duties*" (CLRG First Report (2000-2001), para 11.3.1 at p.238). One of the most significant changes proposed in the Bill is the codification of directors' fiduciary duties. Part A5 Head (9) lists a non-exhaustive list of fiduciary duties which a director owes to a company. In addition a statutory definition of "de facto" director is included for the first time and is defined as a person who "occupies the position of director but who has not been formally appointed". He/she will be responsible to the company and will be treated for the purposes of Part 5 as if they had formally been appointed.

There is a new provision which requires directors to account to their companies for any gain made by them directly or indirectly and a requirement to indemnify the company for any loss or damage caused as a result of their breach of duty.

However, the requirement for a director to declare all his interests in the company will be relaxed whereby disclosure of interests in shares held that amount to less that 1 per cent of the share capital of the company, or where the shares or debentures in question do not carry a right to vote at general meetings, will no longer need to be declared.

Director's Compliance and Related Statement

A diluted version of Section 45 of the Companies (Auditing and Accounting) Act, 2003 is incorporated into Part A5 Head 7 (2) of the Bill. Directors of companies to whom the legislation will apply will be required to ensure that there is material compliance with the company's "relevant obligations" which will extend only to Irish tax law as defined in Part A5 Head 7 (1) and indictable offences under Irish Company Law.

A private limited company will not be obliged to prepare a compliance statement unless (a) it has a balance sheet of more than €12.5 million euros per annum and (b) an annual turnover of €25 million euros. This will ensure that only large private companies will come within the parameters of the proposed compliance statement regime.

A company will be able to rely on internal or external advisors in putting appropriate structures in place to secure compliance with its relevant obligations. The provision is permissive rather than mandatory and there is no implication that company directors should seek such advice. Nevertheless, where directors do not have the necessary expertise, it may be appropriate to seek such professional advice. The provision will also allow directors to take account of any reliance that the company has placed upon such advisors who have the requisite knowledge to advise the company on its compliance regime.

Part A6 of the Bill details the requirements in respect of financial statements, audit and annual returns with Head (38) outlining directors' obligations in respect of their financial end of year report and requisite content of compliance and related statements.

Part A13 deals with the disqualification and restriction of directors and other officers. Although there are no radical changes proposed in this section, the comparable Part 40 of the UK Companies Act, 2006 proposes significant reforms. This section provides for the disqualification of directors of UK companies where they are subject to "foreign restrictions"- a term given a broad definition. Potentially Part 40 would catch within its scope persons subject to A13 provisions (previous Section 150 or Section 160(2) orders under the Companies Act, 1990 as amended). While the precise scope of Part 40 will only become clear when the statutory instruments are published, this provision may extend to Irish directors that hold UK directorships where he/she is subject to a disqualification or restriction order and there has been a finding of misconduct or unfitness in an Irish court of law.

Part A7: Debentures and Charges

The Register of Charges

The most significant and welcome change in respect of the registration of charges is that priority in company charges will now be determined by the date of registration rather than the date of their creation. Therefore priority will be given to the creditor who files first in time which is the system that has been applied in other jurisdictions such as the U.S., Canada and New Zealand for many years. A shift to the date of registration dictating priority will end the existing built in three week time lag and will create an incentive to publicise an interest as soon as possible to the benefit of creditors.

Part A7 Head 7 (5) gives effect to ruling in *Re Castlemahon Poultry Products Ltd* (13th December 1985, unreported) and provides that registration with the CRO relieves the company of the obligation to register a second time in the chattel mortgage register as provided in the Agricultural Credit Act , 1978.

Part A 11: Winding up

The most significant reform proposed is in respect of placing court-ordered windings-up as far as possible on the same footing as creditors' voluntary winding ups and reducing the courts' role by transferring power to the appointed liquidator. At present Irish Company Law does not impose any positive qualification requirements on liquidators. New provisions include the requirement that a liquidator must be qualified to act in such a capacity and be appropriately insured. The practical benefits of these proposals will include a reduction in the significant costs associated with compulsory liquidations and potentially lead to an increase in the funds available for distribution among creditors.

Pillar B

The legal provisions applicable to private companies limited by shares (Pillar A) are modified and expressly applied to other forms of public companies listed in Pillar B, subject to the disapplication of certain sections in Pillar A that are not relevant or inappropriate. Additional provisions unique to public type companies including PLCs, DACs, the European Company ("Societas Europae") and other corporate forms set out in Pillar B are outside the scope of this Article.

Conclusion

The consolidation and reform of Irish Company Law as proposed in the Bill is a radical reappraisal of and reverses the emphasis in the current Companies Acts by establishing the private company as the model company (as opposed to the public company). The streamlining of the establishment and operation of the private company by removing the doctrine of ultra vires, having a one-document constitution and codifying directors' fiduciary duties, amongst other provisions outlined above, is a welcome and arguably long overdue change.

The proposed legislative changes will simplify the operation of the Companies Acts and lead to an improved corporate governance and compliance culture. In addition, it is hoped that the new streamlined regime will support enterprise creation in Ireland making it a more competitive and attractive place to do business for both indigenous and international companies.

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