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What's the value in updating my articles of association?

Contents

There is no obligation to keep your articles of association (articles) up to date but there are benefits. It would be cost effective to update your articles to reflect, and take advantage of, the current statutory regime, most notably the Companies Act 2006 (the Act) which replaced the Companies Act 1985. This guide explains why.

This guide is particularly useful for private companies, limited by shares or by guarantee, that have not changed their articles since 1 October 2009. That date was when most of the Act's provisions came into force. Companies limited by guarantee should ignore references to "shares" and read "member" instead of "shareholder".

1. Why update?

Updating your articles should enable you to:

- avoid being misled by, and perhaps even doing something unlawful because of, provisions in your articles that are inconsistent with the current law;
- take advantage of the Act's deregulatory provisions;
- no longer be subject to some administrative burdens that the Act imposes; and
- remove provisions that are no longer applicable to you and add provisions to assist the smooth operation of your company.

"**Your articles**" may incorporate by reference or by default further provisions, for example, the regulations known as "Table A". If they have not been updated they may now refer to out of date statutory provisions of the Companies Act 1985.

"**Table A**" was the previous set of statutory default articles for a company limited by shares. The current statutory default articles are called the "**Model Articles**". Up to date articles are now based on and will usually refer to the Model Articles, rather than Table A.

This guide now looks at each of the above benefits of updating articles.

2. Where might old articles be inconsistent with current law?

Procedures that follow your out of date articles, where they are inconsistent with the current law, could be challenged. This is because the Act has made some changes to areas covered by articles and, with some exceptions, it overrides whatever your articles say. Here are the most common areas where your articles may be inconsistent and misleading:

- **Article providing for the passing of a shareholders' resolution by written resolution signed by all the members now ineffective.** This article should not be used. There is now only one method for the passing of written resolutions of shareholders and that is as specified by Part 13 of the Act. Only private (not public) companies may use this method. A purported written shareholders' resolution following this provision in the articles may now be invalid.

  The statutory written resolution method only requires a 75% majority to pass a special, and a simple majority vote for an ordinary, resolution; whereas this article specified unanimous agreement from shareholders.

  In rare cases, a decision which all shareholders have agreed to by following the procedures in that article, could be effective under the **Duomatic** principle. This principle should not be relied on when planning shareholders' resolutions in advance.
- **The chairman of a shareholders' meeting is no longer given a casting vote.** Unless your articles, which were in force just before 1 October 2007, gave the chairman of a shareholders' meeting a casting vote, in general he no longer has that right. So shareholders' resolutions that are passed by the use of the chairman's casting vote

may now be invalid. In any case, we would recommend its removal and suggest other potential dispute resolution mechanisms.

- **Rights of proxies extended.** A proxy – a person appointed by a shareholder to attend a shareholders' meeting on his behalf - is now entitled to attend, speak and vote, on a show of hands as well as on a poll, at a shareholders' meeting. "Old" articles commonly state that all a proxy is allowed to do is vote on a poll. If a company were to prevent a proxy from voting on a show of hands, it could be faced with a legitimate claim that it is in breach of the Act.

- **You can communicate electronically.** The Act contains provisions for communicating electronically. These apply even if the articles don't mention or even prohibit or restrict electronic communications.

  The company could take advantage of the Act's electronic communications provisions by adding further provisions in its articles to facilitate communication via a website and alter the Act's timing for the deemed delivery of notices and documents.

- **Remove article which terminates a director's appointment automatically upon the making of a mental health court order removing his powers.** This method of terminating a director's appointment was deleted from the Model Articles on 28 April 2013. It was considered that its effect could be discriminatory. It would therefore be advisable, to avoid the risk of a discrimination claim, to consider deleting this provision if it applies to your company.

3. Where can we take advantage of the Act's deregulatory provisions?

Any company, new or old, can use the Act's provisions for electronic communications, as mentioned above. Here are some more opportunities, but they do require an old company to do something before it can take advantage:

If your company existed at the time the relevant deregulatory provision came into force, it must obtain shareholders' approval (by the passing of a shareholders' ordinary resolution) before it can adopt the deregulatory measure. As the company will need to pass a shareholders' special resolution to amend its articles (requiring a 75 per cent majority vote) any necessary shareholders' approval could be sought at the same time.

- **Remove the authorised share capital clause.** The Act has abolished the concept of authorised share capital. A company is no longer required to have an overall cap on the amount of its allotted and issued shares. A transitional provision states that this is the effect of any authorised share capital clause remaining.

  The authorised share capital clause was in the company's memorandum of association (memorandum). The Act has changed the memorandum so that as from 1 October 2009 all numbered clauses of a company's "old style" memorandum are treated as part of the articles.

  You could remove this cap by deleting this clause, and any other reference to authorised share capital in the articles.

  If you wish to set a maximum amount of allotted shares, it would be preferable to remove the old clause and all other references to "authorised share capital" and replace them with a clear statement of the maximum amount of allotted shares that the company may have at any time.

- **Remove the objects clause (but not if you are a charity).** A company now has unrestricted objects unless its articles contain specific restrictions on what it has power to do. If the company still has an "old style" memorandum, its objects clause, which (as mentioned above) is now treated as part of its articles, will act as such restrictions.

  You can now delete the objects clause. However, until you file Form CC04 at Companies House, giving notice of this change, the deletion will not be effective.

If you are a charity, your powers must remain restricted, so you should not remove the objects clause. However, to simplify the company's administration procedures when producing copies of the articles (as explained below), the company would benefit from amending its articles to move the objects clause into the main provisions. And, to help the interpretation of the provisions, the new objects should be described and drafted as "restrictions", not powers.

- **Remove the 21 day notice period for shareholders' meetings.** The minimum notice period for a private company's shareholders' meeting is now 14 days or any longer period that the articles may specify. Old articles based on Table A commonly require 21 days' notice. You can amend your articles to shorten this.
- **Remove any obligation to have a company secretary.** A private company is not now required to appoint someone as company secretary (although the company secretarial jobs will still need doing). It would be rare for articles to include provisions making it compulsory for a company to appoint someone as company secretary, but you should check your articles for such provisions and, if necessary, remove them, to give the company flexibility.
- **Consider whether to remove (or add) any obligation to hold an annual general meeting (AGM).** Private company AGMs are also now optional, unless your articles require one. If your articles merely refer to an AGM, then that is not an obligation to have one. In some circumstances (for example if shareholders are not directors) shareholders may still wish to have an AGM, in which case they may wish to add an obligation that the company must have an AGM each year.
- **Insert other change of name methods.** As well as by special resolution, a company may now change its name by whatever alternative method is specified in the articles. You can choose to insert in the articles whatever alternative method best suits you; for example by a decision of the directors or even of a particular shareholder.
- **Extend directors' authority to allot shares.** The general rule remains that the directors must be authorised to allot shares.

  If the company has just one class of shares and was incorporated under the Act, then (unless the articles prohibit it) its directors are automatically authorised to allot new shares of that class, without limit. A company incorporated under any previous Companies Act can give its directors this authority by arranging for its shareholders to resolve (by ordinary resolution) that the directors should have those powers.

  If a company has more than one class of shares, there is still the requirement (which applied under the previous regime) that its directors must be authorised to allot, either by a provision of the articles or by an ordinary resolution. That authority must state the maximum amount of shares that may be allotted under it and its expiry date, which cannot be later than five years after the date of the resolution giving the authority.

  While the company has just one class of shares, the articles could impose some restrictions on the directors' wide authority to allot. Those restrictions can be more flexible than if the company has more than one class of shares. For example, the authority could be capped to a specified amount of shares that may be allotted under it, but be unlimited in time.

  There is an exemption (which applied to the previous regime) under which the directors may allot shares in pursuance of an "employees' share scheme" without having the above authorities. This could be a good reason for the shareholders wanting to include in the articles an overall cap on the amount of the company's allotted shares (as mentioned above in the explanation of the removal of the authorised share capital clause).
- **Review shareholders' statutory right of pre-emption.** The general rule remains that, when the company allots new ordinary shares wholly for cash, it must first offer them pro rata to the existing ordinary shareholders (a rights issue).

  Articles can empower the directors, within certain limits, to allot shares as if this general rule did not apply.

Private company articles can exclude this shareholders' right of pre-emption altogether and they commonly do so. But "old" articles will refer to statutory provisions that have now been repealed. So those references ought to be replaced with the up to date provisions.

It is still the case that this statutory pre-emption right does not apply to the allotment of shares in pursuance of an "employees' share scheme".

- **Include "annual limit" buy back authority.** Since 30 April 2013 a private limited company has been allowed to purchase a small amount of its own shares up to an annual limit, provided it is authorised to do so by its articles. These provisions were amended on 6 April 2015.

  A private company may like to amend its articles to include this authority in case it is needed in the future.

  In general a company must finance a purchase of its own shares out of its distributable profits, or the proceeds of a fresh issue of shares made for the purpose, or (provided it satisfies certain solvency tests) its capital. None of those financing requirements apply to a private company buying back small amounts of shares using this "annual limit" authority.

  The annual limit. The aggregate purchase price in a financial year for this type of purchase of its own shares and must be no more than the lower of:

  - £15,000; or
  - the nominal value of 5% of the company's fully paid share capital at the beginning of the financial year.

  The purchase is treated as having been made out of capital but the company is not required to comply with any of the solvency tests mentioned above.

  If you amended your articles to include this authority between 30 April 2013 and 5 April 2015 inclusive, you may wish to review them to ensure that the wording of the authority reflects the current statutory requirements.

- **Ensure your articles deal with treasury shares in the way you would like them to.** Another change, brought in on 30 April 2013, allows a company that has purchased its own shares out of distributable profits not to cancel them immediately but to hold those purchased shares in its own name. These "treasury" shares are then available for transfer or sale by the company.

  If a company is likely to have treasury shares, it should review its current articles (and even any shareholders' agreement) to ensure that they do not produce unintended consequences.

  For example, it is often appropriate to treat a transfer of treasury shares by the company as if it were an issue of new shares. If you wish your articles to follow that treatment and they contain restrictions on transfers of shares, you may wish specifically to exclude transfers of treasury shares from those restrictions. And if the articles have restrictions on issues of shares – for example, they may include non-statutory pre-emption rights on allotments of shares – you may wish to add a direction that those provisions apply also to transfers of treasury shares by the company.

4. How can we remove administrative burdens imposed by the Act?

- **Remove the other outstanding clauses from the memorandum.** As mentioned above, the numbered clauses in the company's "old style" memorandum of association are now treated as part of the articles. Apart from the authorised share capital and objects clauses discussed above, those clauses concern: limited liability; the company name; location of the registered office; and any additional provisions particular to your company.

  An administrative burden is that each time you produce a copy of the articles, you must now include copies of those clauses from the "old style" memorandum, annexed to the articles, and there are statutory requirements as to how those annexed clauses are labelled. Those rules will cease to apply if you delete the additional clauses and add in to the main body of the articles the provisions you want to keep.

You do not have to specify the company name and registered office in your articles, so those clauses can be deleted completely. But the company must have a limited liability clause in its articles, so you should add that clause back in, or ensure that the articles include that provision already.

- **Update definitions and references to the Act.** Out of date statutory references will not usually present a major legal problem. This is because statutory transitional provisions and the small print within your articles will generally treat the up to date statutory references as substituted. However it would significantly reduce the legal work entailed, each time those references need to be considered and their interpretation analysed, if they were updated.
- **Delete "extraordinary" from "extraordinary general meeting" and "extraordinary resolution".** These terms are no longer used in the Act or the Model Articles. Even though there are statutory saving provisions that retain the effectiveness of any existing articles that use them, it would remove the need to check those saving provisions if "extraordinary general meeting" or "EGM" were changed to "general meeting", and "extraordinary resolution" to "special resolution".
- **Base your article on the Model Articles instead of Table A.** Table A is now out of date. It has been replaced by three sets of "Model Articles". These are for a private company limited by shares, a private company limited by guarantee and a public company respectively.

  We recommend that your articles are based on whichever set of Model Articles is applicable to your company, since they will be consistent with current company law and practice.

5. What provisions could be removed or added?

- **Removing directors' retirement by rotation.** These provisions are now generally excluded from private company articles. If you are one of the few companies that still has these, is it time to remove them?
- **Do your articles allow telephone board meetings?** It is generally considered that articles must expressly allow these; otherwise meetings can only be held face to face and meetings held over the phone will not be valid.

  Table A does not include provision for these, but the Model Articles do. It is rare to find a set of "old" articles that does not include a specific provision allowing telephone board meetings, but it would be as well to check.
- **Provisions to facilitate how directors' conflicts are dealt with.** The issues to consider in relation to a director's duties to avoid a conflict situation are: (1) disclosure and/or prior authorisation (by the directors or a shareholders resolution or a provision of the articles) of a situation where a Director has a conflict of interest or duty; and (2) whether a director can take part in directors' decisions that involve his conflict situation.

  If the company was incorporated on or after 1 October 2008, authorisation of a director's conflict situation may be given by the other directors, as long as there is nothing in the articles to invalidate such authorisation. The directors of a company incorporated before 1 October 2008 have that power if its shareholders resolve (by ordinary resolution) that the other directors may give that authorisation. This ordinary resolution may be passed at the time of the updating of the articles.

  We would recommend that, in the interests of good corporate governance, your articles supplement both the Model Articles and the Act in this area, since certain additional detailed provisions (such as in relation to duties of confidentiality) would streamline the procedures.

6. Amend or adopt new articles?

If you decide to implement the changes recommended in this guide, it is usually preferable, in the long run, to adopt an entirely new set of articles, rather than make piecemeal changes to your current articles.

7. Long form or short form?

Most private company articles used to be adopted in "**short form**". This meant that Table A was incorporated by reference. This is not a very user friendly method as most of the provisions are not immediately visible, but it does keep the document shorter.

It is generally now more common for articles to be in "**long form**" which means that they contain the wording of the relevant Model Articles in full with necessary amendments and additions. Companies see the benefits of having all their constitutional provisions in one document.

It should be noted that the Act would still be referred to for certain constitutional aspects.

8. Are your articles still appropriate for you?

There may be reasons why your articles could do with a review in any case. For example, they may contain rights attaching to shares that the company no longer has in issue. Or, if your company is now a wholly-owned subsidiary within a group, and has articles that differ from the rest of the group, it would simplify group company secretarial work enormously if each company in the group had the same form of articles.

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