

Chapter 3: Limited Companies - Contents

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3.1. Community interest companies - limited liability companies

There are many different types of companies, all with slightly different legal characteristics. CICs, like the vast majority of UK companies, are limited companies (meaning that their liability for the company's debts is limited, see below). They are formed, under the Companies Acts by a simple process of registration. More specifically, all CICs must be one or other of the two most common forms of company:

- ❖ A company limited by shares, or
- ❖ A company limited by guarantee.

You should consider carefully whether a company limited by shares or a company limited by guarantee is the more appropriate form for your proposed CIC, because a company limited by guarantee cannot be converted into a company limited by shares (or vice versa). The basic features of these two types of company, and the differences between them, are outlined in chapters 3.2 and 3.3. This chapter highlights some of the features that all CICs will share with ordinary companies simply by being limited companies, whether they are limited by shares or by guarantee.

As limited companies all CICs:

- Will be registered by the Registrar of Companies for England & Wales, Northern Ireland or Scotland with a unique company number and will be required to prepare and deliver accounts and other important documents and regular returns to the appropriate Registrar;
- Will be subject to general company law as set out in the Companies Act 2006 and other relevant legislation, as well as the common law of companies built up from decisions taken by the courts over many years;
- Will have constitutional documents (memorandum and articles of association) setting out key information about them, and their own internal rules, which, together with other important documents must be kept up to date on the public register kept by Companies House;
- Will have members, at least one director, and optionally a company secretary and employees. Please note a private company, does not need a secretary, but if they do appoint one, the details must be delivered to the Registrar.

Like any organisation, a company is made up of several groups of people such as members, directors, managers, and other employees. Unlike other kinds of organisation, such as clubs or partnerships, a company has its own artificial “legal personality” which is separate from any of the “natural” persons (i.e. individuals or “real people”) associated with it.

A company cannot actually do anything unless one or more of the natural persons who own, manage or work for it act on the company’s behalf. But the concept that every company is a distinct legal entity is fundamental to UK company law, and, it is the feature of companies (or, more broadly, “bodies corporate”) which most clearly sets them apart from some other common forms of business and social organisation. In particular, the fact that the company is a legal person separate from its members (although every company is an association of its members, and its members collectively constitute the company), has a number of important practical consequences.

- When a company carries on business, it does so as a separate person, rather than in any sense on behalf of its members (indeed, as noted above, it is more likely that individuals employed by the company will act on behalf of the company).
- When a company holds property, it does so in its own right as a separate person, rather than in any sense on behalf of or as a trustee for its members.
- Subject to the company’s internal rules, members can enter or leave the company relatively easily at any time after its formation, and because the company is a separate person, it “lives” independently of its members. A company’s existence will be unaffected if all its original members die or cease to be members of it, so long as it continues to have sufficient new members to allow it to function (and most companies are able to function with only a handful of members).
- A company can take legal action (or be sued) in its own name, rather than the action involving every member of the company. A company can also enter into contracts in its own name (and is therefore able to have contractual relationships with its members, which it could not otherwise do).

A further key feature of companies’ separate legal personality is that, in the absence of fraud or other exceptional circumstances, a company’s debts and liabilities are its own rather than being the debts or liabilities of its members.

Moreover, in a limited company, the liability of members to the company (e.g. any liability of members to contribute towards the satisfaction of the companies' debts) is strictly limited (in the absence of fraud or other exceptional circumstances). In the case of a company limited by shares, this generally means that the very worst that can happen to members in financial terms as a result of the company's insolvency is that they lose the value of their investment (including any part of the nominal value of their shares which they have not yet paid). In the case of a company limited by guarantee, members' liability is limited to the (usually nominal) value of the sums they have agreed to pay by way of satisfaction of the company's liabilities in the event of its being wound up.

The various forms of regulation to which companies are subject under the Companies Act 2006 and related legislation, including the obligations on companies to disclose substantial amounts of information to be made publicly available at Companies House, can all be seen as part of the "price", in terms of transparency and governance requirements, which companies and their members are required to "pay" for the benefits conferred by separate legal personality and limited liability, and as a way of trying to ensure that those benefits are not abused by unscrupulous businesses.

The last feature of limited companies which it is worth drawing attention to here is that the limited company structure facilitates separation of the ownership and ultimate oversight of a company's business from the day to day management of that business. In any limited company, the members are the ultimate decision-making body, but most companies' articles provide that the company's directors (and every company is required to have one or more directors) have delegated authority to manage the company's business and exercise all the company's powers on a day to day basis.

Of course, in a small company, it is possible that the directors and the members will be the same people, and able to meet relatively frequently, so that it is practicable for the company's day to day management to be a matter for the members, but the formalities required for decision-making by directors are generally less onerous, and as soon as a company has significantly more members than it has directors, it will usually make sense for the directors to be in control of day to day management (and indeed, the bigger the company grows, the more the directors will themselves need to delegate some matters to managers or other employees of the company).

The division of decision-making functions between a company's members and its directors is an important matter to be considered when drafting its articles of association: see further Chapter 5, and the model constitutions in Annex A, which provide a variety of different approaches in this area.

Whatever arrangements are chosen, it is important to remember that both directors and members should exercise their powers in good faith in what they believe to be the best interests of the company (including, in the case of CICs, the community which the company exists to serve, as well as its members as a whole).

3.2. Community interest companies - limited by guarantee

A CIC may be incorporated as a company limited by guarantee or an existing guarantee company can be converted to a CIC.

In this company format members guarantee to meet the debts of the company up to a specific limit in the event of its failure. They have no further liability for the debts of the company (as a member) beyond their guarantee. The company's constitution sets out how people can become or cease to be members (see Companies Act 2006 s.3).

In practice each of the guarantors usually guarantees a nominal sum such as £1 but there is no reason why a principal supporter of the CIC should not in effect underwrite its activities by guaranteeing a larger sum.

This has been the traditional form of companies operating without the motive of making a profit for distribution to the members. In this context it is worth noting two points.

- Adopting the ordinary, non-CIC company limited by guarantee form does not, in itself, give any assurance of operating on a "not for profit" basis. If you want to ensure that your company is "not for profit", either in the sense that it does not aim to make a profit, or in the sense that its profits will not be distributed to its employees or members, you will need to make appropriate provision in the company's articles. Incorporating as a CIC company limited by guarantee will achieve this result, because of the asset lock rules (see Chapter 6.1).
- It is certainly true that if you do want investors to be paid a return, and enjoy decision-making powers, which are proportionate to amount of their financial commitment to the company, you should adopt the form of a company limited by shares. Likewise, if you want all members to be equal in terms of decision-making at general meetings, and / or they are not to invest capital in the company, a company limited by guarantee is probably a sensible choice.

Guarantee companies have most of the other characteristics and obligations of other forms of limited companies including the ability to pay directors.

Until the Companies Act 1980 (or the Companies (Northern Ireland) Order 1981) there was provision to incorporate a hybrid form of company limited by both shares and guarantee. Although such companies cannot now be incorporated a few still exist and these may be converted to a CIC.

3.3. Community interest companies - limited by shares

This is the most common form of capital structure for ordinary companies. The company has a stated capital divided into a number of shares; for example a company may have a share capital of £1,000 divided into 1,000 shares of £1 each. Once the full nominal value of a share has been paid to the company the member has no further liability for the debts of the company (as a member). Where shares are only partly paid members may be required to pay the balance if called upon to do so by the company or liquidator (see Companies Act 2006 s.3).

The company raises capital by selling its shares to people wishing to become members (usually called shareholders). Potential members may also purchase shares from existing shareholders; the price paid may be more or less than the nominal value depending on the market for the shares at the time.

The first important question for people wishing to form a CIC with share capital is whether or not they will want to pay dividends on the shares. Having made that decision they must ensure that they adopt the appropriate form of memorandum and articles of association.

The more detailed rights of members (such as voting at meetings and restrictions on transfer of shares and appointment of directors) will vary from company to company and will also be set out in the articles of association (see Chapter 5.1.).

The extent to which dividends can be paid is subject to a cap (see Chapter 6.2, and the CIC regulations 2005 part 7.). The members must approve the declaration of a dividend by a CIC.

The extent to which shares may be bought and sold is governed by general company law, including the rules on public offers of shares, and by the company's specific articles of association (see Chapters 5 and 7 and the Companies House booklet, "Share and Capital Prospectuses").

The next important question you will need to decide is whether you want your CIC to be a public or private company.

The differences between public and private companies are mainly about capital structure and transferability and other rights attached to shares. They are not about size or status; some very large organisations are run as private companies and some public companies are fairly small operations. Public companies are subject to additional or different rules of general company law in various respects.

A public company is established as such by its application for registration and articles of association and subject to compliance with the appropriate law and regulations can make public offers of shares and its members can buy and sell the shares freely. Shares in a “listed” or “quoted” company may be traded on the Stock Exchange or other markets. Not all public companies are listed or quoted: some organisations, for example, see being a public company as a convenient way of managing a large number of members and involving them in their activities. Detailed consideration of the rules governing public companies is a wide and sometimes complex subject beyond the scope of these notes and upon which professional advice is essential.

The vast majority of companies are private companies; this means in particular the articles of association restrict the public sale and transfer of shares. In general, public companies are more heavily regulated than private companies. Unless you want to raise fairly large sums of money to pursue the CIC’s community purpose by a public offer of shares or possibly are looking for a large membership who can transfer shares freely a private company is probably the best structure for your purposes.

A company can convert from being a public to a private company and vice versa (see Chapter 5.).

If a normal company goes into liquidation any surplus assets after payment of its debts and costs of the liquidation are usually paid to the members in proportion to their shareholdings. With a CIC such returns to members are restricted to repayment of the paid up value of the shares i.e. the amount paid to the company for the shares including any premium. Any further surplus has to be transferred to another asset locked body such as another CIC or charity (see Chapter 10, and Community Interest Company Regulations 2005 Part 2 & regulation 23).

CICs are also subject to restrictions on the redemption or purchase of their own shares and the reduction of share capital (see Chapter 6.4.).