

**EXPLANATORY MEMORANDUM TO
THE COMPANIES (MODEL ARTICLES) REGULATIONS 2008**

2008 No. 3229

1. This explanatory memorandum has been prepared by the Department for Business, Enterprise and Regulatory Reform and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 Every company formed under the Companies Acts must have articles of association which are rules, chosen by the company's members, which govern the company's internal affairs. The Companies (Model Articles) Regulations 2008, made under the Companies Act 2006 (the 2006 Act), set out model articles of association for the three main types of company – a private company limited by shares, a private company limited by guarantee, and a public company. Such companies do not have to adopt the model articles, but they will automatically be the articles for such companies which are formed under the 2006 Act on or after 1st October 2009, unless the company chooses to adopt its own tailor-made articles in place of all or part of the model articles.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The 2006 Act has substantially rewritten company law. It replaces almost all of the provisions of the Companies Act 1985 (the 1985 Act) and also introduces new provisions. Part 3 of the 2006 Act (sections 17 to 38) deals with various matters relating to a company's constitution and provides (section 18) that a company registered under the 2006 Act must have articles of association.

4.2 Section 19 of the 2006 Act enables the Secretary of State to prescribe model forms of articles for different descriptions of companies. Under section 20 these model articles will operate as default articles for limited companies formed under the 2006 Act. This replaces section 8 of the 1985 Act and goes wider than that section in extending to private companies limited by guarantee that currently have to register articles and cannot rely on model articles.

4.3 The version of the model articles that is in force at the time that a particular company is originally registered continues to apply to that company. The Companies (Tables A to F) Regulations 1985¹, and their predecessors, will continue to apply to companies formed under the 1985 Act, and previous Companies Acts². The 2006 Act model articles will apply to companies formed under the 2006 Act on or after 1st October 2009³.

4.4 The Regulations set out in three separate Schedules model articles for -

¹ S.I. 1985/805.

² See paragraph 1 of Schedule 2 to the Companies Act 2006 (Commencement No.8, Transitional Provisions and Savings) Order 2008 (S.I. 2008/2860 (C.126)).

³ See article 3(c) of S.I. 2008/2860.

- a) private companies limited by shares (Schedule 1),
- b) private companies limited by guarantee (Schedule 2), and
- c) public companies (Schedule 3).

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- *What is being done and why*

7.1 A company's articles of association are an important constitutional document and form a company's internal rulebook. For over 150 years, successive Companies Acts (and Northern Ireland Companies Orders) have provided for standardised model articles set out in legislation. No company is obliged to adopt the provisions of these model articles, but they provide useful guidance and, in some cases, a safety net. Under the 2006 Act, if limited companies do not register their own articles of association, model articles apply by default.

7.2 Section 19 of the 2006 Act gives power to the Secretary of State to prescribe model articles for different descriptions of companies. There are many different ways of describing companies, and in theory there is a wide range of different types of company for which model articles could be prescribed. The policy reflected in the Regulations is to provide model articles for the three most common types of limited company formed and registered under the 2006 Act: a private company limited by shares; a private company limited by guarantee; and a public company. Other types of company may also find the new model articles a useful guide.

7.3. The Government decided not to prepare sets of model articles for specific types of company limited by guarantee (in addition to the model articles set out in Schedule 2 to the Regulations) or for unlimited companies. While it would be possible to prescribe model articles for other types of companies, the Government took the view that these types of company either do not differ sufficiently from the types of company for which model articles are prescribed, or are too specialised and likely to need to have "bespoke" registered articles, to justify statutory model articles of their own. In addition, articles prescribed under section 19 would not operate as default articles for unlimited companies.

7.4 Before the 2006 Act, companies could divide their constitutional rules between their memorandum and articles. Under the 2006 Act the memorandum will be a simple document of purely historical significance, evidencing an intention to form a company. The model articles have therefore been drafted so as to contain matters previously found in the memorandum e.g. rules on the allocation of powers between the members and the directors and statements of limited liability.

7.5 Model articles for private companies limited by shares have been designed with the needs of small, owner-managed companies in mind. They therefore are kept as simple and straightforward as possible, and do not cover aspects of the 2006 Act where

these are not relevant to the majority of small companies. The Government has assumed, for example, that private companies using these model articles will not wish to have alternate directors and will have fairly simple capital structures and issue no partly paid shares. This set of model articles also assumes that a small company will take advantage of the fact that under the 2006 Act it is no longer required to have a company secretary.

7.6 As well as operating as a default set of articles, the Government envisages the model articles for public companies being used as a drafting resource for particular types of provision. They may also be of use to larger and more complex private companies, taking into account that the private company model articles have been prepared with small companies in mind. The public company model articles cover all areas dealt with in the current Table A except to the extent that provisions in the 2006 Act which were not included in the 1985 Act make this unnecessary or inappropriate.

7.7 The Government's policy has been to avoid unnecessary duplication of provisions of the 2006 Act (notably Part 13 of that Act on resolutions and meetings) in an effort to keep the model articles as simple as possible. This approach will be made clear in guidance to ensure that companies are aware of their responsibility to adhere to both their articles of association and the wider law.

8. Consultation outcome

8.1 The Government consulted on the draft model articles of association on a number of occasions. An early draft of articles of association for a private company limited by shares was included as an annex to the White Paper "Company Law Reform", published for full public consultation on 17 March 2005 (Cm 6456). The first draft of model articles for a public company was published on 6 June 2006 (URN 06/1357).

8.2 On 11 August 2006, a document relating to the Companies Bill (which was nearing completion of its Parliamentary passage), 'Paper seeking views on the application of the Companies Bill to existing companies', was published for a six week consultation (URN 06/1777). This included questions on the application of the Bill's provisions to existing companies' articles of association.

8.3 Chapter 3 of the "Implementation of Companies Act 2006 Consultative Document", published on 28 February 2007 (URN 07/666), covered in detail the Government's approach to model articles. It included, as annexes, full drafts of all three sets of the draft model articles (including the first draft of model articles for a private company limited by guarantee). Over a quarter of the 65 consultation responses received included specific comments on the model articles. The majority of responses welcomed the approach taken and comments were largely related to specific points of drafting.

8.4 Further drafts of all three sets of articles were published (URN 07/1278) on 31 July 2007 with the Government response to the February 2007 consultation (URN 07/1227/GR). A further 13 formal responses were received, again supportive of the overall approach taken and only commenting specifically on technical points of drafting.

8.5 A final draft of the Regulations was published on 4 April 2008 with the Government response to the July 2007 consultation (URN 08/706 and URN 08/707). The Department responded to some points raised subsequently by stakeholders and kept

an up to date list of FAQs on the Department's website by way of more detailed response on specific points where changes to the final draft were being considered (in addition to direct responses to the stakeholders concerned).

8.6 The various published Government responses set out how the draft Regulations were developed in response to consultation. It was considered important to provide the various revised drafts of the draft model articles on the Department's website, to obtain maximum input from consultees, to allow companies and their advisers plenty of time to prepare for the changes before they come into force, and to provide updated information to other interested parties such as academics.

8.7 Most of the comments received were supportive with largely minor technical points of drafting. Some of the more substantive points raised, which the Government did not consider appropriate for amendment, covered, for example, whether bespoke articles should be prepared for unlimited and other specific types of company (see paragraph 7.3 above); and the extent to which provisions of the 2006 Act should be repeated in model articles (see paragraph 7.7 above).

8.8 The views of those who responded to consultation on the model articles were considered carefully and were particularly helpful, for example, when several respondents to the February 2007 consultation commented specifically on the question of whether or not to include new provisions regarding the exercise of members' rights by others in the model articles for public companies. Section 145 of the 2006 Act contains a new right for members to notify the company that another person is entitled to exercise some or all of the member's rights, and draft articles were initially included to cover this. However, the consensus from respondents was to remove these articles on the grounds that exercise of this right should be considered carefully by companies on a case by case basis. The Government was persuaded by these arguments and removed the draft articles.

8.9 The Government also considered long-debated factors such as whether model articles should include provisions relating to directors' indemnities and insurance. Taking a balanced view to responses to the various rounds of consultation, the Government decided that such provisions provide helpful direction, particularly to small companies, and therefore included them in the model articles but restricted these to a short permissive article which gives directors the power to indemnify and provide insurance in accordance with the 2006 Act.

8.10 Where comments in response to consultation made specific requests about changing the level of standard or minimum default figures in the model articles (i.e. number of days' notice for meetings, number of people required to request a poll vote) the Government has sought to adopt the majority view or has been guided by precedents set in previous articles of association. Companies are of course at liberty to set their own, different thresholds as modification to the "default" position when adopting their own articles.

9. Guidance

9.1 Non-statutory guidance on these Regulations will be published in early 2009 on the Department's website and be available in hard copy after the Regulations have been made. This will explain the differences between the approaches to default articles in the Companies (Tables A to F) Regulations 1985 and the new model articles, which may be less familiar. The guidance will primarily be aimed at small private companies.

10. Impact

10.1 The new model articles change the content and presentation of default articles prescribed by the Secretary of State to bring them up to date with the 2006 Act and to ensure that they reflect the needs of small companies. They also introduce default articles for private companies limited by guarantee. However they do not change the underlying position that all companies are required to have articles of association and that, for most companies, the model articles operate as default articles. As under the Companies Act 1985, any company may choose to adopt its own tailor-made articles.

10.2 Existing companies formed under the previous Companies Acts can choose to amend their own articles of association by special resolution to reflect new provisions in the 2006 Act, and may find the new model articles a useful guide to doing this. They are not however required to do this and no burden is imposed in this respect.

10.3 There may be some familiarisation costs for some companies associated with learning about new legal requirements or deregulatory measures that feed through to the model articles. The Government has sought to minimise the impact of these costs by providing interim amendments to existing Tables A to F when Parts of the 2006 Act have been commenced in advance of 1 October 2009. The Government also intends to publish guidance to assist companies in the introduction of the model articles, as set out above in paragraph 9.

10.4 The benefits to both new and existing companies derive from the tailoring of the model articles to particular types of company, particularly the simplification in the case of the model articles for private companies limited by shares, which have been written with small, owner-managed, companies in mind.

10.5 There is no impact on charities or voluntary bodies unless these operate as companies and are incorporated and registered at Companies House, in which case the impact is as described above.

10.6 There is no impact on the public sector.

10.7 An Impact Assessment has not been prepared for this instrument. The regulations fall within the exempt area – there is no policy change (there have been statutory model articles for the past 150 years) and there are no imposed costs on companies, which are not obliged to use them. The cost of familiarisation was picked up in the overall Companies Act 2006 impact assessment, published in January 2007.

11. Regulating small business

11.1 The legislation applies to small businesses that incorporate as companies under the Companies Act 2006.

11.2 To minimise the impact of the requirements on companies employing up to 20 people, the new model articles for private companies are specifically written with small companies in mind. The model articles are now drafted in a style that significantly simplifies default provisions for practicable use by small companies (which constitute the overwhelming majority of companies in the UK). Larger private companies can use the model articles for public companies as a guide where the model articles for smaller private companies do not meet their specific needs.

11.3 The basis for the final decision on what action to take to assist small business was the overwhelmingly supportive response to the Government's 'think small first' approach to company law reform, particularly the response to the first full sets of draft model articles as set out in the February 2007 consultation document. Most respondents agreed that the model articles for private companies limited by shares should be designed with the needs of small, owner-managed companies in mind and the Federation of Small Businesses recognised "...new model articles for private companies which streamline much of the complex regulation previously contained in Table A but which is not relevant to small companies."

11.4 The new model articles for private companies are also a useful guide for existing small companies perhaps wishing to update their own articles to reflect changes to legislation.

12. Monitoring & review

12.1 The success of these Regulations will be subject to internal review after 5 years using data readily available from Companies House as to the level of take up of the model articles by new and existing companies. Should companies submit articles that consistently and significantly deviate from the model position on a particular point, we will consider whether an amendment to the model position might be helpful. Otherwise model articles will be reviewed and amended as necessary in light of subsequent changes to company law.

13. Contact

13.1 Kathryn Waller at the Department for Business, Enterprise and Regulatory Reform Tel: 0207 215 6873 or email: kathryn.waller@berr.gsi.gov.uk can answer any queries regarding the instrument.