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Companies Act 2014

Conversion of Existing Private Companies – Opting into the New Regime

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Key points

- ***Existing companies which do nothing will default to the new model company (the "LTD") at the end of the transition period and will be deemed to have a constitution in the form applicable to the LTD***
- ***Pending the end of the transition period, or re-registration as an LTD, the governing law will be that applicable to designated activity companies (DACs)***
- ***Existing companies can opt out by re-registering as DACs or another company type and minority of members and certain creditors can force re-registration as a DAC***
- ***Members of existing companies can adopt a new constitution by special resolution***
- ***Where existing company does not re-register, directors are obliged to file a new constitution extracted from existing memorandum and articles of association***

Under the Companies Act 2014 (the "**Act**"), existing private companies limited by shares will have to decide whether to opt in to the new regime for private limited companies (referred to here as LTDs) or opt out by becoming a designated activity company (DAC) or, indeed, some other type of company. The options available for existing private limited companies and the steps in conversion are contained in Chapter 6 of Part 2 of the Act.

The default position

Section 15 of the Act provides for an 18 month transition period, beginning on the commencement of the Act (which is anticipated for 1 June 2015). On the expiry of that period, *section 55* provides that, unless it has re-registered as some other type of company, an existing private company will be *deemed* to have a one-document constitution, comprised of the provisions of its memorandum of association (except its objects clause and any non-compulsory clauses which prevent its alteration) and its articles of association, and to have become a private company limited by shares to which Parts 1 to 15 apply.

The applicable law

During the transition period (or until it re-registers as a new model private company or indeed some other type of company), the law applicable to an existing private company limited by shares will be that contained in Part 16, i.e. the law applicable to a DAC: *section 58* of the Act. This law approximates most closely to the current law applicable to private limited companies. It will mean, however, that the advantages that will accrue to the model private company under Parts 1 to 15 will be denied to companies that do not elect to opt in to the new regime. Existing companies which have adopted in whole or in part the regulations contained in Table A will continue during this transition period to be governed by those regulations notwithstanding the repeal of the Companies Act 1963.

Options on the commencement of the new provisions

There are a number of reasons for believing that most existing private companies will elect to take control of their own fate and will take action before the end of the transition period. The reasons for taking action include:

- For companies which want to opt in, having the certainty of an early application of the new regime set out in Parts 1 to 15;
- Statutory defaults and deemed constitutions are generally best avoided, especially when a new bespoke constitution can be adopted so easily;
- Directors can avoid the obligations which would otherwise arise where the members elect to do nothing, by proactively putting a new constitution to the members to adopt;
- Until such time as an existing private company "opts in", the applicable law will be the more complicated law contained in Part 16 which applies to DACs;
- For companies, such as joint ventures, which may want to opt out and retain their objects clauses and avoid re-negotiating their already bespoke articles of association, it is important to take action and opt out to prevent the application of the default form of constitution.

Converting to the new model private company

The Act provides for three ways in which an existing private company limited by shares can become a new model company. Of these, the better course of action is for members, perhaps on the directors' recommendation, to adopt a new constitution by passing a special resolution. Where this is not done, the directors are obliged to draft a one-document constitution based on the existing memorandum and articles of association; and where neither the members nor the directors (in default of their obligations) take any action before the end of the transition period, the company will default to being an LTD and its existing memorandum and articles (except its objects clause and any clauses which prevent their alteration) will be *deemed* to constitute a one-document constitution: *section 61* of the Act.

For most companies, the better course of action will be for the directors to initiate a discussion with members on the options open to the company because, where the members do nothing, obligations will be imposed on directors to take action.

Adopting a new constitution by special resolution

The Act makes it easy for existing private companies to convert to the new model private company. The most direct way in which to do this is in accordance with *section 59* of the Act and to pass a special resolution to adopt a new constitution in substitution of the existing memorandum and articles of association.

The new constitution must comply with *section 19* of the Act, i.e. it must state:

- the company's name;

- that it is a private company limited by shares and registered under Part 2:

- particulars relating to its share capital;

- the number of shares taken by its original subscribers; and

- any supplemental regulations which it is adopting.

While most of what was contained in the company's articles of association will now apply by statute unless the constitution otherwise provides, companies would be well advised to review their articles of association and ensure that tailored provisions, such as those dealing with pre-emption on transfer, are included in the new constitution. Upon delivery of the new constitution so passed by special resolution to the Registrar of Companies in the Companies Registration Office (CRO), the company will become the new model private company, a new certificate of incorporation will issue and Parts 1 to 15 of the Act will apply to it.

Obligations on the directors

Unless the shareholders have adopted a new constitution, or the company is going to re-register as a DAC or other type of company, the directors of an existing private company are required to prepare a constitution for the company, deliver a copy to each member and deliver a copy of it to the CRO. This must be done before the expiry of the transition period: *section 60* of the Act.

So what are the directors to put into the constitution? In fact, there is no room for ambiguity because it is provided that the directors must only include the company's existing memorandum of association (excluding its objects clause and any clause that prohibits the alteration of the memorandum and articles of association) and the company's articles of association. This is, in reality, a secretarial exercise whereby the two-document constitution is rewritten as a one-document constitution. Although there are likely to be many unnecessary provisions in the resulting one-document constitution (because so many of the regulations currently found in Table A will have been adopted in the Act as statute law and will apply unless a constitution provides otherwise), shareholders' existing rights will be preserved and the form of the constitution will be that applicable to a new model private company.

Deemed constitution

The Act also makes provision, in *section 61*, for cases where neither the members, nor the directors (in breach of their obligations) take any action – whether to adopt a new constitution or, indeed, to opt out by re-registering as a DAC or some other type of company. In such an event, upon the expiry of the transition period the existing private company shall be deemed to have, instead of its existing memorandum and articles of association, a constitution comprising of its existing memorandum of association (excluding its objects clause and any clause that prohibits the alteration of the memorandum and articles of association) and its existing articles of association. It will also be deemed to have become a new LTD to which Parts 1 to 15 apply and the CRO will issue it with a new certificate of incorporation, attesting to its status as such.

Electing to re-register as a DAC

An existing private company limited by shares may *opt out* of the new regime quite easily. While it will be more attractive for most existing private companies to "opt in", joint venture companies with bespoke articles of association which reflect negotiated rights of the parties thereto will most likely opt out so as to preserve the negotiated position. For certain companies, there will be no choice: for example, a company which lists debt securities cannot remain an LTD and must re-register as a DAC or another type of company.

Opting out is easy and whether an existing company wishes to become a DAC or, indeed, some other type of company, it is proposed that that choice can be facilitated by Part 2 of the Act. So, members can pass a special resolution and convert to any other type of company provided the requirements applicable to such companies set out in Part 20 of the Act are satisfied: *section 56(4)* of the Act.

Up to 3 months prior to the expiry of the transition period, there are two re-registration options:

- First, an existing private company may re-register as a DAC by passing an ordinary resolution: *section 56(1)* of the Act. Where the directors and members are of like mind, this method of converting to a DAC will be the most suitable.

- Alternatively, where the directors are unwilling to convene an EGM to put an ordinary resolution to the members, a member or members holding more than 25% of the voting rights can serve a notice in writing on the company requiring it to re-register as a DAC: *section 56(2)* of the Act.

Additionally, where an existing company does not re-register as a DAC before the end of the transition period, (whether it is obliged to do so or not) one or more of its members holding not less than 15% of its issued share capital, or one or more creditors holding not less than 15% of its debentures entitling them to object to alterations in its objects clause, may apply to court for an order directing the company to re-register as a DAC.

The mechanics of re-registration as a DAC

Where an ordinary resolution is passed by the members to re-register as a DAC or where the directors resolve to re-register as a DAC (whether because a notice is served by qualifying members, because the company must re-register as a DAC or because such is ordered by the court) the effect is to alter the company's memorandum of association so that it states that the company is to be a DAC: *section 63(2)* of the Act. The company must file the resolution, the new memorandum and articles of association, a declaration of compliance and the prescribed form with the CRO.

Protecting members and creditors

Without limiting the provisions concerning minority shareholder oppression (*section 212* of the Act) if any member considers that his rights or obligations have been prejudiced by the exercise or non-exercise of any power under the Chapter dealing with conversion or its exercise in a particular manner, by the company or its directors, the member may apply to court for an order under *section 212*.

For more information, including a quotation for re-registering your company, contact:

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