

Setting up a company and a director's duties

This FAQ sheet forms part of a series prepared by postgraduate students from the University of Manchester's School of Law, in conjunction with the Legal Advice Centre. They are intended as an introductory guide to commonly asked questions by those approaching the Manchester Enterprise Centre when seeking advice on starting up new businesses.

These guides provide only a basic overview on key issues to be considered and do not constitute legal advice. Further detailed advice should be sought as necessary from appropriate professionals such as a solicitor or accountant.

This FAQ sheet looks at some options you have in terms of setting up a business specifically looking at setting up a private limited company and a partnership. It also outlines what obligations you have as a function of the role you have within the company, e.g. your duties as a director. Specifically the FAQ sheet sets out to answer the following questions:

1. What are some of the popular legal forms your business can take?
2. What is the process for setting up a private limited company?
3. What are the legal requirements for governance and management of a company?
4. What obligations does a director have and what are the legal differences between different types of leadership roles, e.g. chairman, CEO, COO, CFO?
5. How are partnerships structured and what issues are specific to a partnership?

Q1: What are some of the popular legal forms your business can take?

There are a number of legal forms your business will take. Three forms are described in table 1 along with some of the key advantages and disadvantages. More specific information on sole-traders and on social enterprises is given in the 'gov.uk' links listed at the end of this FAQ sheet.

Table 1: Pros & Cons of different legal structures

Sole Trader		
Definition	Advantages	Disadvantages
A sole trader is a business started and run by one individual. It is not a separate legal entity as there is no legal distinction between the owner and the business.	<p>The main advantage of a sole trader is that it is easy to start up, subject to fewer regulations relative to other types of businesses, has full autonomy with regard to business decisions, and is easy to discontinue.</p> <p>Another advantage is that the owner takes all the profits of the business.</p>	As a business becomes successful, the risks accompanying the business tend to grow. Protection through limitation of liability is therefore attractive by setting up a limited company. Financing of a limited company can also be easier than a sole trader.
Private Limited Company		
Definition	Advantages	Disadvantages
A private limited company is a separate legal entity where the liability of the shareholders is limited to the amount unpaid on their shares. Its constitution is set out in the Memorandum and Articles of Association.	<p>The company's shareholders will only be liable for the amount unpaid on their shares and no more, unless personal guarantees are given.</p> <p>A limited company is a separate legal entity from its owners.</p> <p>Limited companies are only taxed on their profits and as such are not subject to the higher (personal) tax rates placed on sole traders or partnerships.</p>	<p>There are more complex and restrictive rules for limited companies than sole traders.</p> <p>Shares cannot be offered to the public.</p> <p>Sale of shares to increase company funds will further dilute the management, as more and more people have a say in how the company is run. There is also a risk (since other companies can buy shares) that a takeover might occur this way.</p>
Partnership		
Definition	Advantages	Disadvantages
<p>Partnership is the relationship which subsists between two or more persons carrying on business in common with a view to profit. Partnerships are governed in the UK by the Partnership Act 1890. A partnership is not a separate legal entity. Partners generally have unlimited liability.</p> <p>Other forms of partnership may be possible –see paragraph 5 below.</p>	<p>The more partners there are, the more money they can put into the business.</p> <p>Without interference by shareholders, they are far more flexible in terms of management, as long as all the partners can agree.</p> <p>Partners can share the responsibility of the running of the business. Partners share the decision making and can help each other out when they need to.</p>	<p>There is a danger of disagreements between the partners.</p> <p>Because the partnership is jointly run, it is necessary that all the partners agree with things that are being done. This means that in some circumstances there are fewer freedoms with regards to the management of the business.</p> <p>Ordinary (general) partnerships are subject to unlimited liability. Partners are jointly and severally liable for debts meaning that one partner can be sued for the entire partnerships debts.</p> <p>The current laws can mean that if the partnership (and the partners) bring in more than a certain level, then they may be subject to greater levels of personal taxation than they would be in a limited company.</p>

Q2: What is the process for setting up a private limited company?

Registering a company as a private limited company in the UK is done through the office of Companies House, which receives application through different ways, notably:

- Registering online if the company is limited by shares and has 'model articles' as its articles of association. The service currently costs £12 and registration is done within 24 hours. This is relatively the simplest and cheapest way.
- Registering through postal application (by post) which takes between 8 to 10 days and costs £40.

- Submitting the application at Companies House where registration is done on the same day, costing £100.

Alternatively, one can register a company through an agent or third-party as well. Once a company is registered, it will need to register for corporation tax within 3 months of starting to do business.

It is worth noting that before registering a company, you need to have all required details, such as a suitable company name (to which restrictions can apply), registered office address, at least one director, share capital and memorandum and articles of association.

Q3: What are the legal requirements for governance and management of a company?

- Directors can be executive (involved day to day) or non-executive (strategic management).
- They run the company on behalf of the shareholders.
- Directors can also sometimes be trustees appointed under a separate trust document.

The Companies Act 2006 sets out the general statutory duties of a director. These are listed below:

- To act within powers.
- To promote the success of the company.
- To exercise independent judgment.
- To exercise reasonable care, skill and diligence
- To avoid conflicts of interest.
- Not to accept benefits from third parties.
- To declare interests in proposed transactions.

In addition to these duties, a director has duties:

- To consider or act in the interests of creditors (particularly in times of threatened insolvency)
- To maintain confidentiality of the company's affairs (a duty which to a large extent follows from the general duties outlined above).

Directors can be paid or unpaid. They are responsible to the shareholders for the day to day running of the company. A private limited company must have at least one director and one shareholder.

In general, shareholders have little power over the directors and how they run the company. However under the Companies Act 2006, major business decisions which would affect shareholders' rights must be approved by the shareholders at a general meeting called by the directors of the company, by way of special resolution. You also have certain obligations towards your shareholder which in some areas are dependent on the percentage of shares they hold. This is described in more detail in Start-up Brief: Getting investment for your business and obligations to your shareholders.

Q4: What obligations does a director have and what are the legal differences between different types of leadership roles, e.g. chairman, CEO, COO, CFO?

Only directors registered at Companies House are the true statutory directors. A statutory director and in certain circumstances people deemed to be acting as 'shadow' directors have certain liabilities set out at law if wrongdoing is proven.

Titles such as CEO, chairman, COO and CFO not prescribed by the legislation but there are certain expectations, e.g.

Chief Executive Officer (CEO): The CEO or in some cases the COO, Chief Operating Officer tends to occupy a role similar to that of Managing Director, being responsible for the operation of the company to the Chairman. He or she may or may not be a board member.

Chair: Often still referred to in business as the chairman or more increasingly as the chairperson. The chair as the head of the company and along with the board regulates the company setting its agenda ensuring it is an effective working group. The chairman must promote a culture of openness and debate and is responsible for effective communication with shareholders. The chairman must ensure that all board members receive accurate, timely and clear information. The chairman may not always be a part-time non-executive: many are full time and describe themselves as executive chairman, but the roles of chairman and the CEO are distinct.

Chief Financial Officer (CFO): Often on the board but there is no statutory requirement for this.

Company secretary: The company secretary is responsible for the efficient administration of a company, particularly with regard to ensuring compliance with statutory and regulatory requirements and for ensuring that decisions of the board of directors are implemented. There is no longer any statutory requirement for a private company to have a company secretary.

Advisory boards: Corporate advisory boards are not required by statute in the UK. However, some European countries have them. Generally such boards do not have authority in the management of the company, but rather they are there to help the management in provision of outside technical expertise and skills on a certain matter the directors may need to accomplish their duty.

Q5: How are partnerships structured and what issues are specific to a partnership?

This is unlikely to be an issue for you as you start up a business. But you do need to be aware that partnerships are a typical model in certain sectors, particularly in professions such as law or accountancy. So this may be an option in some circumstances.

Partnerships under the Partnership Act 1890, as with sole traders, generally have unlimited liability. However, limited liability may be possible either through setting up a Limited Liability Partnership (LLP) under the Limited Liability Partnerships Act 2000 or through creating a limited partnership under the Limited Partnership Act 1907.

LLPs are a separate legal entity and can have a company as a member (corporate member). Here, although each member pays tax on their share of the profits, members are not personally liable for any debts the business cannot pay.

In limited partnerships, you must have at least one 'general partner' and one 'limited partner', with different responsibilities and levels of liability for debts when the business is unable to pay. However, all partners pay tax on their share of profits.

Partnerships do not need to have a memorandum or articles of association as do companies. However, it is recommended that all partnerships have a partnership agreement regulating their relationships, responsibilities of those involved, dispute resolution and exit strategies. This does not need to be filed with the Registrar of Companies (Companies House). Limited liability partnerships do need to file certain forms at Companies House. Charters are generally non-legally binding and have no statutory standing save for organisations formed by Royal Charter such as universities. The expression 'partnership' is often used in business simply to describe working together rather than in any legal sense. Where it is used as such in business, a 'partnership' charter acts as a tool devised for the collaborators which provides for underlying principles that guide their working together, to give general guidance in doing their business and avoid likely pitfalls.

Useful links:

<https://www.gov.uk/set-up-sole-trader>

<https://www.gov.uk/set-up-business-partnership>

<https://www.gov.uk/limited-company-formation>

<https://www.gov.uk/government/publications/legal-forms-for-social-enterprise-a-guide>