



The small print for BIG IDEAS

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Client Reference Number: [Confidential]

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### **Privileged & Confidential**

By email to: [Confidential]

Dear [Confidential]

**Re: Your appointment with qLegal on 2<sup>nd</sup> November 2021.**

### **How we work**

Thank you for attending your appointment with us and for using the services of qLegal at Queen Mary University of London. Although we cannot provide you with representation in any proceedings and do not hold ourselves out to be a firm of solicitors or patent attorneys, our advice is free and we aim to provide the same high standard of service expected in the practice of law. Please note that the legal advice provided is in relation to the laws of England and Wales only. If you require advice outside of this jurisdiction, please contact us.

### **Case summary**

[Confidential] (“the Business”) is a platform that connects those who wish to let out their [Confidential] items on a short-term basis and users wanting to hire such items for a fee. You plan to advertise the Business on multiple online platforms including Facebook, Instagram and the Business website ([Confidential]). The Business currently operates through you acting as a sole trader and was established in January 2021. If the Business appears to be successful long term, you will expand its commercial activities to the repairing and cleaning of the interior goods. Affordability and sustainability are key values in its operations.

The Business is currently conducting a trial on Instagram. This trial is only open to a limited number of users. Due to its positive reviews and potential growth, you want to incorporate the Business as a private limited company in the United Kingdom. It is envisaged that on incorporation, you will be the sole subscriber of shares and sole director of the limited company.

Once incorporated, you intend to hire a Chief Technical Officer whose remuneration shall consist of a salary and potentially equity in the Business. You are also considering seeking investment in the Business and you are currently in talks with [Confidential] ([Confidential]). Attracting angel investors is another option that you might explore.

You indicated that you would ideally raise 150,000 GBP through angel investment or 250,000 GBP through [Confidential]. At the date of our meeting, you had injected around 1,000 GBP of your own money in the Business.

We have been provided with the following documents:

- [Confidential] Terms & Conditions

### **Scope of our advice**

You want to understand the practical steps you need to take in order to incorporate a private limited company in the United Kingdom. Our advice on this covers:

- The process of incorporating private company limited by shares; and
- Important documents for filing.

Additionally, you want to understand the key considerations when working with investors. Our advice on this covers:

- Important agreements;
- Amendments to the Model Articles;
- Introduction to a shareholders' agreements; and
- A brief overview of employee share schemes.

### **Summary of advice**

Following our appointment, we would advise you to set up a private company limited by shares. To do this, you need to file articles of association, memorandum of association and Form IN01 at Companies House. You will also need to pay a fee.

When seeking funding, it is important to consider how much equity and control you are prepared to give up to an additional shareholder. Before engaging with investors or any other party, we recommend you enter into a non-disclosure agreement so that any confidential information is protected. You may also want to set out the terms of investment in a term sheet. Depending on the nature of the investment, it may be necessary to amend the articles of association (once a private limited company has been incorporated) to reflect the new equity and control rights the investor has been given.

We recommend that you seek further legal advice on how to prepare the legal documents you need.

## **1. Incorporation and registration of a private limited company**

### **a. What is a private limited company?**

A private limited company is a company that is limited by shares or limited by guarantee. Private limited companies limited by guarantee are usually not for profit and so the appropriate private limited company for the Business would be a private limited company limited by shares.

A private company limited by shares:

- Has shares and shareholders;
- Is legally separate from the people who run it (this means that the company can have its own property, enter into contracts, employ people and survive its directors and shareholders);
- Has limitation of liability of shareholders (this prevents individual shareholders from being held personally responsible for a company's debts or financial losses);
- Has separate finances from your personal ones; and
- Can serve as a vehicle for intellectual property to be pooled and protected.

Any choice of business structure should always be considered from a tax perspective too and you should consult a tax advisor in case of uncertainty. qNomics (<https://www.qmul.ac.uk/qnomics/>) offers free financial advice to start-ups and entrepreneurs.

b. How does a private limited company differ from a sole trader?

A sole trader runs a business independently and he/she is self-employed. Usually, sole traders will have complete control over their businesses' commercial activities. They decide how the business is run without having to consult others and the owner does not have to share any profit. Sole traders are taxed personally on business income.

Unlike shareholders in private companies who will only be responsible for losses in relation to their shareholder stake, a sole trader is personally responsible for all the losses of the business.

Whilst sole traders are easy to set up (there is no public registration), guarantee privacy and have low costs, many start-ups ultimately incorporate as a private limited company, as limited liability is attractive and the structure of a private limited company enables future external investment.

c. Incorporation process of a private limited company (constitution)

In order for a company to be registered, you must file the necessary documents (detailed below) with Companies House and pay a fee. The company is brought into existence when Companies House issues a certificate of incorporation. Once you have received this certificate, the company will have an official company number.

Companies House web incorporation service enables applicants to set up a simple private limited company, online. Model Articles will be provided for a fee of £12. You can access the service via <https://www.gov.uk/limited-company-formation/register-your-company>. The service is available 24 hours a day, seven days a week. Your online application will be submitted directly to Companies House.

As you will be the sole shareholder and director of the company, you should follow the rules for a single member company when you register the company. Single member companies are governed by the same formalities as any other private limited company. However, you must record this fact in the register of members of the company, together with your name and address. If this changes, you will have to register this accordingly with Companies House.

d. Documentation required (memorandum of association, articles of association, form IN01)

Every company has its own constitution, which sets out the characteristics of the business and explains its purpose in detail. The memorandum of association, articles of association and IN01 are integral to the incorporation of the Business.

First, you will have to submit a **memorandum of association**, which is a snapshot of the company at the point of registration. It has no continuing relevance, but states that subscribers wish to form a company and have agreed to become members. Since you will be the first and only subscriber, you should issue at least one share.

Next, you will be required to submit the **articles of association**. The articles of association is a public document that generally sets out the company's internal rules. Since you are planning on incorporating a private company limited by shares, you can initially use the Model Articles. You will need to amend these at a later date (for example when there is further clarity on your funding plans and potential shareholders) and we would advise that you seek legal advice when doing so.

Finally, you will have to submit a **Form IN01** with Companies House. This form includes:

- *The company name (likely to be the proposed Business name); and*
- *The type of company structure and its intended principal business activities*

Make sure to use general descriptions. Since you are planning on extending the Businesses activities in the long-term, make sure to include cleaning and repairing services. You are better off being too general than restricting your activities by not covering everything. We would also advise you to seek separate intellectual property advice from qLegal to ensure that the name of your Business does not infringe any trade marks. Be aware that registering a company name will not give you trade mark protection.

- *Details of the registered office*

You must state your registered office (for example, your address in London, England if this is the case). You may of course change this information on a later date.

- *Details of directors and secretary*

A private limited company must have at least one director, but is not required to have a company secretary. You should provide your personal information, as you will be managing the company.

- *Statement of capital and of initial shareholdings*

This should mention the class and number of shares taken by potential subscribers on formation, including the nominal value of each share as well as the amount to be unpaid and paid up on each share.

It also sets out the total number of shares to be taken on formation by subscribers, aggregate nominal value and the aggregate amount to be paid on those shares.

Additionally, it should contain the details of the rights attached to each class of shares. For a simple start-up, a typical amount would be 100 ordinary shares of GBP 1 each (selecting “ordinary” in the “class of share” box and 100 in the “number of shares” box).

- *Statement of compliance*

This statement includes the signatures from each initial member of the company (this will only be you as the sole shareholder of the company). Members represent the shareholders of the company.

- *Significant control*

Confirm whether a person or persons will have significant control of the company. This would be you as the sole shareholder (as you will hold at least 25% of the share capital).

You should also bear in mind that there are annual and event-driven filings that must be made at Companies House (either online or by post) after you have registered your company. Detailed information on this can be found here: <https://www.gov.uk/government/collections/companies-house-guidance-for-limited-companies-partnerships-and-other-company-types#annual-filings>.

Once you have successfully registered your company, it will have legal personality. You can then use the company’s legal name to enter into contracts and to open bank accounts, on behalf of the company.

## 2. Key investment considerations

### a. Introduction

You should carefully consider how much equity and control you want to give away to any additional shareholder(s) as this may have a significant impact when you seek further investment. It shall also impact the ability to retain control of major decisions in the company. In practice, founders are likely to want to retain as much equity and control in the company as possible.

You explained to us during our appointment that you may potentially seek funding from [Confidential] or an angel investor.

[Confidential] helps founders and start-ups by guiding their business from an early stage. The studio provides the entrepreneur with an investment up to 100,000 GBP once the idea is validated for the purposes of building out the product. Once the concept is proven and the product is ready to launch, you could get another 150,000 GBP. We understand that [Confidential] is a potential investor willing to inject capital up to 250,000 GBP.

Angel investors are high-net-worth individuals that hold equity as an investment, directly out of their own resources. Angel investment tends to occur earlier in a company's life than venture capital investment.

In this section we explain some of the key considerations when seeking funding, including what changes may be required to the articles of association and what exactly a shareholders’ agreement is. Some of these points will also apply to other shareholders joining the company in a later stage (e.g., a co-founder who also wants to become a shareholder in the Business). This is more of a general overview of key considerations, as you are still deciding

whether to move forward with the investment and because you have not received any offers for investment at this point.

b. Non-disclosure agreement

Before engaging with investors or any other party, we recommend you enter into a non-disclosure agreement so that any confidential information is protected. Its form, including the safeguards on confidential information, will depend on the nature of the information, who you share it with and why. An example of a mutual NDA (both parties disclosing confidential information) can be found at <https://www.cooleygo.com/documents/mutual-non-disclosure-agreement-uk/>.

It is always recommended to seek legal advice before entering into any agreements. If you require further advice on drafting an NDA or any other agreements, please contact qLegal.

c. Term sheet

This is a preliminary document that often includes the key terms of an investment in a company, including an agreed valuation, key financial and legal terms and both parties' rights. Once more, you should get further legal advice before you agree to a term sheet.

d. Articles of association

As we have outlined above, when you incorporate your company you will use the Model Articles. However, these are unlikely to be fit for purpose once your company starts growing (for e.g., if you bring a co-founder onboard and they request shares in the company and/or the Business begins to attract investment). You will therefore need to amend the company's articles of association. We have outlined some of these areas below. This is not an exhaustive list. When you are ready to amend the articles of association, we would advise that you seek further legal advice from a corporate Solicitor. He/she will be able to tailor the articles to the specific needs of the Business.

<p>Different share classes</p>	<p>You will incorporate your company with one class of share. However, the share capital of companies often consists of more than one class of share (for example when there is investment or a company has an employee share option scheme). Linked to these different classes are different rights such as voting rights, dividend rights and rights to capital on a winding up. We have explained these in more detail below.</p> <p>A <b>voting right</b> is the right of a shareholder to vote on matters of corporate policy, including decisions on the makeup of the board of directors, issuing new securities, initiating corporate actions like mergers or acquisitions, approving dividends, and making substantial changes in the corporation's operations.</p> <p>A <b>dividend right</b> means the right to receive in cash or shares, an amount equal to the dividends paid with respect to a specified number of shares.</p>
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	<b>Capital rights</b> are the rights shareholders have to a portion of surplus capital in relation to their percentage of ownership if/when the business is wound up.
Alternate director right	The right for a director to appoint an alternate director, or any other person approved by the directors.
Governance	Changes to the articles of association reflect how the Business will be governed and sets out the management of board meetings and general meetings, including voting mechanisms and how to deal with conflicts of interest.
Share transfers	Determines how the transfer of shares is managed. For example, you might want to include pre-emption rights that obliges shareholders to offer their shares to you before any other party. You might also want to prohibit the transfer of shares.
Allotment of new shares	The rules on who can allot new shares in the company and what type of shares can be allotted.

e. Shareholders' agreement

Another important document alongside the articles of association, is a shareholders' agreement. Whilst a company has to have articles by law in order to incorporate a company, a shareholders' agreement isn't a mandatory requirement.

However, a shareholders' agreement is useful as it records commercial arrangements between the parties, defines shareholder rights and obligations, includes details of share subscription and explains other key terms of investment. It's also private and confidential.

As you will be the sole shareholder of your company to begin with, it is not necessary to put a shareholders' agreement in place from the start. You might however consider including one once the Business starts growing and when you are no longer going to be the sole shareholder. We recommend you seek further legal advice from a corporate Solicitor to help with the drafting of a shareholders' agreement.

We have outlined some of the key provisions of a shareholders' agreement below:

- **Governance and management.**
- **Veto rights** that limit the management of the Business.
- **Pre-emption rights.** This gives 'pre-emption' to existing shareholders where new shares are issued or shares are transferred. (i.e., a right of first refusal to existing shareholders).
- **Right to appoint directors and determine their activities.**
- **Drag-along rights.** If someone that holds more than 75% of the ordinary shares (or whatever percentage is decided (generally, more than 50% but less than 90%)) wishes to transfer all of their shares to a third-

party purchaser, then that third-party can require the remaining shareholders to sell their ordinary shares to them. This prevents minority shareholders from hindering the sale of the company.

- **Mandatory share transfers.** For example, where a shareholder fails to comply with their obligations under the shareholders' agreement.
- **Dividends.** For example, a policy detailing how much profit is available for distribution to shareholders each financial year.
- **What happens if there is a liquidation of a company.** For example, preferential rights for some shareholders.
- **Non-complete, non-disclosure and confidentiality clauses.**
- **Managing disputes.** Setting out a procedure on how to resolve disputes between shareholders.

### 3. Employee Share Scheme

We understand that the company may also want to offer shares to the Chief Technical Officer and other employees as means of remuneration.

The main reason for using employee share incentive plans is to recruit, retain and motivate employees. They are also used to help align the interests of employees, particularly senior executives, with those of shareholders. The aim of this alignment is to encourage employees to consider the best interests of shareholders in their management of the business. A useful overview of employee share schemes can be found at <https://www.cooleygo.com/share-incentives-employees-private-uk-companies/>.

When you are further along in your company's development and ready to hire employees and look at potential share schemes, we would advise you to seek further advice at that time to help with amending company documentation and deciding on a share incentive scheme that is right for your Business.

We hope that our advice provides you with a comprehensive understanding of the legal questions you asked us to address. Should you require any assistance in any future matters, please do not hesitate to contact us.

We would be extremely grateful if you could take a few moments to complete this short form <https://qmul.onlinesurveys.ac.uk/client-feedback-on-qLegal-2021-22>, as your feedback is important to our educational development and the development of our services.

Yours sincerely,

[Confidential]

**Student Adviser**

[Confidential]

**Student Adviser**

**On behalf of qLegal**