
LEGAL BASICS TO COMPANY FORMATION

and

COMPANY STATUTORY OBLIGATIONS

*Prepared by: **BROWNE GIBSON HARVEY P.C.***

Telephone: 24567

Facsimile: 21567/25567

FORMATION AND STRUCTURE OF A COMPANY

In considering venturing into the business world you have the following options available to you which are:-

- (a) Carrying on business as a sole trader;
- (b) Carrying on business in a partnership;
- (c) Carrying on business through a Company.

A. SOLE TRADER

This is the simplest economic and legal entity available to you. As an individual you can carry on business either entirely alone or employing others. However, as such an economic entity you are very vulnerable in that you can have your personal assets claimed by creditors to cover your business debts.

B. PARTNERSHIP

Partnership is a relationship of two or more persons carrying on business in common with a view to profit. The firm (as it is called in this instant) is a collection of partners who share profits and have individual not collective authority to bind the firm for transactions in the course of business. Because of the structure of a firm the assets of each partner is available for debts of the partnership (even if it was another partner which made mistake).

C. FORMATION OF A COMPANY

A private company is the most common form of business entity in the Cook Islands. We believe that it is a preferable choice available to an individual when considering venturing into the business world. The primary reason is that the shareholders of a company have limited liability in respect of the failure of a company to creditors. Creditors can only attack the assets of the company and cannot have resort to the private assets of shareholders or directors (e.g. if the business is sued by a creditor that creditor has no right to personal land, motor vehicles or other assets of an individual shareholder). Also it is easier to claim taxation expenses in respect of a company than as a private person.

THE PRIVATE COMPANY

A private company is governed by the Companies Act 1955 (New Zealand as applied in the Cook Islands) and therefore the provisions of this Act must be followed as to formation.

All private companies must have:

1. A name.
2. Memorandum of Association - which sets out the objects or purpose of a company.
3. Articles of Association - which sets out the rules of procedure for the administration of a company.

2.

4. A registered office.
5. A Governing director or board of directors.
6. Secretary.
7. A minimum number of two shareholders.
8. Share Capital.

1. A NAME

The formation of a new company with a particular name, or name change of an existing company needs approval of the Registrar of Companies under Section 31 and 32 of the Companies Act 1955.

The Registrar is forbidden to register a name which is "identical with that of a company carrying on business in the Cook Islands or so nearly resembles that name as to be calculated to deceive". That means by using such a company name you may be mistaken for another company with the original name. If the company with the original name agrees to you in writing to have a similar company name, the Registrar may grant consent.

Section 116 of the Act says that every company must exhibit on the outside of every office or place in which business is carried on, its name and also, in the case of the registered office the words "registered office". That section of the Act also specifies requirements as to the appearance of the name on letters and other documents. The important point to remember is that your company name must be fully and correctly set out on all letters, orders, invoices, receipts etc and under no circumstances should you omit the word "limited" or its abbreviation "Ltd" from such documents.

2. MEMORANDUM OF ASSOCIATION

One of the principal documents to be registered at the Companies Office is the memorandum of association, which sets out the objects of a company. The memorandum of association of a company limited by shares, states the name of the company, whether it is a private company, any restrictions on its objects and powers; the basis of liability; the initial share capital, and the number of shares into which it is divided. It is subscribed to by the original members of the company and states their name, address and the number of shares they subscribed to. The main function of the memorandum of association is to describe the essential attributes of the particular company and its a relationship with the outside world (i.e. it would state the main objects of the company and any proposed aims and avenues which the company may chose to pursue either presently or in the future).

Section 14 of the Companies Act 1955 requires the memorandum to state:

- (i) The name of the company with the word "limited" as the last word of the name.

3.

- (ii) In the case of a company limited by shares, that the liability of its members be limited.
- (iii) In case of a company with a share capital the amount of the share capital with which the company proposes to be registered and its division.

The formal requirements are that:

- (i) In the case of a company with a share capital no subscriber "shareholder" to the memorandum may take less than one share and each must write opposite his/her name the number of shares he/she takes. (Section 14(b) and (c)).
- (ii) The memorandum and articles must be signed by each subscriber or their agent (Section 14(4)(c)). The original is dated and filed with the Registrar of Companies.

3. ARTICLES OF ASSOCIATION

The other principal document to be registered, apart from the memorandum of association, is the articles of association. The articles of association deal with such rules of procedure for the administration or government of a company including such matters as classes of shares, class rights, transfer and transmission of shares, procedure at general meetings and meetings of directors, and dividends; in other words the internal organisation of the company. It can be viewed as a sort of set of rules by which the company must run by.

As the Articles of Association can be considered the rules of the company sometime in the future may present itself whereby the company wishes to change those rules. Under Section 24(1) of the Companies Act 1955 the company may by special resolution alter its articles. A company cannot deprive itself of this power to alter its articles either by agreement or by provision in its articles.

You should take the time to read through the Articles to familiarise yourself with ways in which the Articles can help guide the shareholders and directors in the management and operation of the company.

4. REGISTERED OFFICE

A company must, as from the day in which it commences business or the fourteenth day after incorporation, whichever is earlier, have a registered office to which communications and notices may be addressed. This is stated in Section 115 of the Act. If you change your registered office, then Section 115 says that you must notify the Registrar of any change of address within 14 days after the date of that change.

4.

5. PARTICULARS OF DIRECTORS AND SECRETARY

Section 354 of the Act says that every private company must have at least one director and Section 181 of the Act says that every company must have one or more secretaries. This document is designed to give notice to the Registrar and to anyone searching the register of your company, of the identity of the directors and secretaries. Although your company need have only one director and one secretary, the sole director of a private company cannot be, or act as secretary for the company (Section 355 of the Act). In other words, if you have only one director in your company, the secretary must be somebody else. There is no reason why you cannot change your directors or secretary at any time. The procedures for doing this are set out in the Articles of Association and you should read those carefully. If you make any change to the directors or secretary of your company, the company must lodge a return with the Registrar containing particulars of the directors and secretaries and of any change to them within 14 days of the making of any change. This is an important point, and if you have any doubt as to how to prepare those particulars, you can approach the Registrar or his Deputy for advice, or seek the assistance of a lawyer.

6. MINIMUM NUMBER OF TWO SHAREHOLDERS

The Companies Act states that a company must have a minimum of two shareholders. The shareholders must be 21 or over to hold shares in their own right. Shares may be held for a minor in trust.

7. THE DIRECTORS AND SECRETARY

(i) **Directors**

In theory directors of the company have extremely wide powers. To curb these wide powers the law has devised this use of principal which collectively limit what the directors can do. The directors must act in the best interests of the company. They are its agents. In other words, whatever powers they are given must be exercised with the company's well being in mind. That is the most basic limitation on the directors apparently wide powers, and it is expressed in these terms again and again. When a person is under a duty to act for the benefit of another (a company or person) he is often called a "fiduciary". Directors are therefore said to be fiduciaries, and to owe fiduciary duties to the company. In carrying out the duties the director must always act in the interest of the company as stated previously. The director must not exercise their powers for any improper, collateral purpose and the director is obliged to exercise reasonable care and such skill as might be reasonably expected of a person of their knowledge and experience and the performance of their functions. Most importantly a director must not place himself or herself in a position where their duty to the company and their own interest, conflict or may conflict. An aspect of this principal is that the director may not profit from their position (except by way of approved remuneration) in particular; he must not divert company opportunities for themselves.

This duty of the directors is owed exclusively to the company only. In many cases being a shareholder you will not have to be confronted with the directors abusing their position in the company, as you will often be the director and the shareholder within the same company.

(ii) **Secretary**

All companies are required to have a secretary and if there is only one director in the company the director cannot also act as secretary. Normally the secretary is appointed by the directors as opposed to the general meeting. The secretary is often responsible for the number of books and registers that the Companies Act requires you to keep.

STATUTORY OBLIGATIONS

Once your company has been incorporated there are certain statutory requirements you must complete:

Annual General Meeting. Your company must hold an annual general meeting once in every calendar year. Although you do not have to hold the Annual General Meeting on the same date in every year, you cannot allow more than 15 months to pass between two annual general meetings. The Act makes it clear however that in the case of a new company, it can hold its first annual general meeting at any time within 18 months of its incorporation. The requirements of an annual general meeting are fairly simple, and most private companies do not hold a meeting, but simply pass resolutions instead of holding a meeting. Those resolutions will note and approve the accounts of the company, and if appropriate resolve that no auditor be appointed.

Annual Return. Your company must file an annual return every year. Preparation and completion of an annual return is quite a simple matter, and there is no reason why you cannot undertake this work yourself. The Registrar and his Deputy are available to advise on the filing and completion of annual returns, and will be happy to check your work. The Companies Office has printed forms, which you can fill out for this purpose. If you do not wish to fill out your annual return yourself, you can instruct a lawyer or an accountant to do it for you. We will not prepare annual returns for your company unless you wish us to do so, in which case we would appreciate your written instructions.

Appointment of Auditors. The job of an auditor is to check the accounts of the company to make sure that they are in order. A private company does not take money from the general public, so the main advantage of appointing an auditor is to enable minority shareholders, who perhaps do not have control or general access to the accounts of the company, to obtain independent assurance on an annual basis, that the accounts of the company are in order. The Act recognizes that the minority shareholders' interests must be protected as it states that a private company must appoint an auditor at each annual general meeting unless the members pass a unanimous resolution that no auditor be appointed at that meeting.

Keeping your Books and Registers. The Act requires you to keep a number of books and registers, some of which we have opened for you (and will be pleased to keep up to date provided you keep us advised as to changes) and some of which you must take care of yourself:

- Register of Members: This is a list of the members and their shareholdings. It is normally kept at the registered office of the company; although it can be kept at some other place provided the Registrar of Companies is told.
- Register of Directors and Secretaries: This is a list of the directors and secretaries, containing the same information, which is filed with the Registrar on the particular form mentioned above.
- Any voluntary winding up of the company whether by members or by creditors (Section 268).
- Register of Directors' Shareholdings: This register simply notes the shares held by a director in the company.
- Register of Mortgages and Charges: This register gives brief details of any mortgage, debenture, instrument by way of security, or other charge, which the company has granted to secure its obligations.
- Minutes of All Proceedings of General Meetings and of Meetings of its Director and of its Managers: You should refer to your Articles of Association because these will set out in greater detail how these meetings are to be called, held, and recorded. It is good business practice for the company's shareholders and directors to get into the habit of keeping full and correct minutes of these meetings. Quite apart from the statutory requirements, the keeping of these minutes will assist you in the efficient running of your business.
- Accounting Records: The Act requires you to keep such accounting and other records as will sufficiently explain the transactions and financial position of the company and enable true and fair profit and loss accounts and balance sheets and any documents required to be attached to those documents to be prepared from time to time. This is a requirement of the Act (Section 151), but as a business you have similar obligations under Cook Islands tax legislation. You should seek advice from an accountant as to how best to comply with these requirements. Again, the keeping of proper accounting and other records is good business sense and you should, for the sake of your business, establish proper procedures.
- Special Resolutions: Some matters require special authorization from the shareholders. Three quarters of the shareholders (in number and voting power) needs to approve them. These matters are approved by "special resolution" a term, which is defined by Section 145 of the Act.

A special resolution is required for the following matters:

7.

- Any change of name of the company (Section 23)
- Any alteration of the objects of the company set out in the Memorandum of Association (Section 18)
- Any alteration to the Articles of Association (Section 24)
- Any reduction of the share capital of the company (Section 64)
- Any conversion of your company from a private company to a public company (Section 366 and note 365 for the reverse procedure)
- Any voluntary winding up of the company whether by members or by creditors (Section 268).

Although the Act contains some exceptions, in general terms, a copy of every special resolution must be lodged with the Registrar at the Companies Office within 15 days after it has been passed (Section 147).

Mortgages and Charges: When the company grants a charge to any person securing its property, that charge must be lodged with the Registrar. If it is not, then it is likely to be held invalid or unenforceable. The definition of "charge" as contained in Section 102 of the Act is rather complicated and this is an area in which legal advice should be obtained. Where a charge is given a copy of the charge and associated documents must be lodged within 21 days after execution of the charge, if it is executed in the Cook Islands or within 3 months if it is executed overseas. Every copy must be accompanied by statutory declaration of due execution. These provisions must be complied with if the charge is to be held valid and so it is usual for any charge holder itself to seek legal assistance to make sure that these requirements are complied with.

Increase of Share Capital: Although the share capital of your company is set out in the Memorandum of Association, it can be altered, fairly simply, in a number of ways. The most common alteration is to increase the share capital (to allow new shareholders to come into the company, or perhaps to satisfy the paid up capital requirements of a lending institution). In this case, a special resolution is required (see above) and a copy of the resolution, which authorises an increase in share capital, must be lodged within 15 days after passing the resolution. There will be some additional fees to be paid on this to the Registrar (details are available from the Companies Office). Other alterations to the share capital must be lodged with the Registrar within one month after the passing of the resolution (Section 71). Reducing the share capital of the company is less straightforward, as it requires an application to the High Court. In some cases though you may wish to reduce the share capital and you should seek legal advice as to how best this can be done.

We have prepared this brochure to help you and your company understand some of the main requirements of the Companies Act 1970-71 and the regulations made under that Act. The brochure is not a full statement of the obligations imposed on companies or their officers and if you require advice, at any time, as to your company you can obtain this from any one of three places:

- You can obtain a copy of the Companies Act and its regulations from the Registrar of Companies in the Justice Department at Avarua and study its provisions yourself;
- You can approach the Registrar or Deputy Registrar directly for advice. At the date of preparing this brochure, the Registrar is Nooapii Tearea and the Deputy Registrar is Mrs. Marie Haupini. Both the Registrar and his Deputy have considerable experience in the administration of the Act and regulations;
- You may approach a lawyer for advice. As the solicitors forming your company, we will be pleased to advise you whenever required.

CONCLUSION: If you have any inquiries relating to the information in this brochure, or general queries with regard to the Act, feel free to contact our office, as we would be more than happy to assist. Alternatively, you should not hesitate to contact the Registrar of Companies or his deputy at the Justice Department, as they will be happy to assist you.

BROWNE GIBSON HARVEY P.C.