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**PRACTICE NOTE**

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**PN19/2014**

**Date: 7<sup>th</sup> Jan 2014**

**Requirements with Respect to the Memorandum and Articles of Association of an Isle of Man Incorporated Company.**

This practice notes replaces practice note 19/2010 which was originally issued in February 2005. The original Court case took place when the Companies Registry was part of the Financial Supervision Commission. From the 1<sup>st</sup> April 2010 responsibility for the Companies Registry transferred from the Financial Supervision Commission to the Department of Economic Development. References to the Commission have not been removed.

**Introduction**

This Practice Note clarifies the permitted contents of the Memorandum and Articles of Association of an Isle of Man incorporated company following the judgement handed down by His Honour Deemster Kerruish in the Matter of Salvia Foundation Limited ("Salvia") in The High Court Of Justice of the Isle Of Man, Common Law Division on 5<sup>th</sup> January 2005. It is intended as a general guide only and must be read in conjunction with the relevant legislation. Copies of the judgement can be obtained from the Librarian in the Office of the High Court (687593) and from the Law Society. This Practice Note should not be relied upon and should not be used as a substitute for legal advice.

**Background**

Until 1988, when the Companies Act 1986 came fully into force, all Isle of Man companies were required to have an "Objects Clause" in their Memorandum of Association setting out the objects for which the company was established. In addition, the Memorandum had to set out the powers that the company could use to achieve its objects. Anything that the company did that was outwith its objects and/or powers was "ultra vires" and, as a result, void.

The so-called "ultra vires rule" was established to protect investors in the company and its creditors from the consequences of the directors undertaking unexpected and potentially risky business. However, the consequences of acting ultra vires (the whole transaction was treated as if it had never happened, sometimes with disastrous consequences) and the speed with which business opportunities developed were such that companies came to be incorporated with very long and complex objects clauses. Such clauses were felt to confer little protection on investors or those dealing with the company and to have potentially serious commercial consequences. Accordingly, the Isle of Man followed New Zealand in abolishing the ultra vires rule in the Companies Act 1986.

Since that Act came into force in 1988, Isle of Man companies have had all the rights, powers and privileges of an individual (s.2 (1)). In addition, companies can do the things set out in s.2 (2). As a result there is no need for extensive objects and powers so, with the intention of abolishing completely the ultra vires rule for Isle of Man companies, all Isle of Man companies, except charities, have been prohibited (by s. 5(6)) from including any provision relating to the rights powers and privileges of the company in the memorandum except restrictions on the "extra" powers set out in s.2 (2).

**The Facts**

In March 2004 incorporation papers were submitted to the Companies Registry for Salvia in terms of Part 1 of the Companies Act 1931. The Commission considered that the Memorandum of Association offended against sections

2(2) and 5(6) of the Companies Act 1986, as they attempted to restrict, or prohibit the exercise of certain rights, by the company other than the rights contained in the list identified in Section 2(2).

The papers were therefore rejected in terms of Section 283B (2) of the Companies Act 1931 on the grounds that they were contrary to the 1986 Act.

The papers were resubmitted and again rejected on the same grounds. The presenters then exercised their right of appeal in terms of Section 283C of the Companies Act 1931. His Worship The High Bailiff dismissed the appeal in September 2004. The presenters then appealed to the Common Law Division of the High Court. The appeal was heard on the 10<sup>th</sup> December 2004.

### **The Appeal Decision**

His Honour Deemster Kerruish dismissed the appeal against a decision of the Financial Supervision Commission to refuse to accept incorporation papers it considered offended against sections 2(2) and 5(6) of the 1986 Act.

In his judgement, which considered the correct interpretation of Sections 2(2) and 5(6) of the Act, His Honour confirmed that:

1. The legislative purpose of the sections was to abolish the ultra vires rule, which rendered void any act of a company not in accordance with its objects and powers;
2. The sections achieved that legislative purpose and convey clearly Tynwald's intention by prohibiting restrictions on the objects or powers of a company, except in relation to restrictions of the powers specifically mentioned in section 2(2); and
3. The decision of the Commission to refuse to accept for registration documents that purported to restrict the powers of the company other than those conferred by section 2(2) was correct.

### **Implications**

This judgement confirms that companies incorporated after the commencement of the Act (1<sup>st</sup> June 1988), except those incorporated for charitable purposes, are prohibited from including in their Memoranda of Association: -

an objects clause, or any provision purporting to set out what the company can do (e.g., "The object of the company is to hold shares in xyz limited");

any provision that seeks to restrict the activities of the company, (e.g., "The Company shall not be authorised to carry on the business of banking or insurance."); and

any restriction on the powers of the company other than in respect of the specific matters set out in section 2(2) (e.g., "The company cannot grant security for borrowings" – although a restriction on the granting or a floating charge **would** be permissible).

The purported inclusion of any of the above in the Articles of Association will also be contrary to the Act.

In light of the above, the Commission will continue to decline to accept incorporation papers purporting to contain an objects clause or any restriction on the company's rights powers or privileges, except as permitted by the 1986 Act.

The Commission is aware that there may be companies currently registered which do not comply with the 1986 Act. The Companies Registry therefore recommends that all Corporate Service Providers, company secretaries and directors to review existing Memoranda of Association to ensure they comply with that Act.

If you are uncertain about any requirement under the Acts you should seek appropriate legal advice.