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Client Alert

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The Model Constitution: an opportunity for private companies to achieve regulatory alignment

The Companies (Model Constitutions) Regulations 2015 ("**2015 Regulations**") was passed on 3 January 2016, to coincide with the coming into force of nearly all of the remaining Phase 2 amendments to the Companies Act. As prescribed under section 36(1)(a) of the Companies Act, the 2015 Regulations provide in their First and Second Schedules two forms of model constitution:

- one for private companies ("**Model Constitution**"); and
- the other for companies limited by guarantee.

This client alert will focus on the Model Constitution for private companies.

Both the memorandum of association ("**Memorandum"**), which states the fundamental conditions on which the company is incorporated, and the articles of association, which set out the internal regulations of the company and govern the rights, powers and obligations of the shareholders and directors (collectively with the Memorandum, the **"M&AA"**), are important documents especially to potential investors and creditors. The coming into force of the 2015 Regulations and the latest sections of the Companies Act present directors and shareholders with an opportunity to fully align their M&AA, to be known as the "Constitution" with provisions in the Model Constitution and the requirements of the Companies Act which affect:

- company administration;
- directors' duties; and
- shareholders' rights.

Admittedly, the amended Companies Act and the 2015 Regulations do not require companies to update their existing M&AA. In fact, the Ministry of Finance, when earlier addressing public feedback to the proposed amendments to the Companies Act, gave assurances that companies will not need "to take any steps or incur any costs" to replace their M&AA with the Model Constitution. Indeed, section 4(1)(b) of the Companies Act already deems the "constitution", in the case of a private company incorporated before 3 January 2016, to mean the memorandum of association of the company, the articles of association of the company, or both, in force immediately before that date.

The points of alignment we propose below are especially relevant for the more outdated, pre-2004 M&AAs, being the date when the last round of major revisions was made to the Companies Act prior to 2015. For consistency and to make the distinction clear between the existing M&AA and the provisions in

the Model Constitution, we will refer to provisions in the M&AA as “Articles” and the provisions in the Model Constitution as “regulations”:

a. Deleting the extensive recitation of objects: Before the last series of amendments to the Companies Act in 2004, the *ultra vires* doctrine required a company to recite all the activities it had the capacity or power to enter into. If the company entered into a transaction outside this list, then the company would have acted *ultra vires* or outside its powers, and the transaction would be void and not binding on the company. As a result, and to provide companies with as much flexibility and scope of activity as possible, M&AAs of companies incorporated prior to 2004 contained the fullest possible recitation of all potential activities, whether or not relevant to the actual business of those companies. After 2004, the *ultra vires* doctrine was reversed by section 23 of the Companies Act in 2004, which requires a company’s M&AA to only state those activities which the company is restricted from engaging in. The M&AAs of most companies incorporated after 2004 contain only a brief statement that the company has full capacity, rights, powers and privileges to carry on or undertake any business or activity or enter into any transaction. In 2016, the Model Constitution goes further by not stating the objects of the company.

b. Deletion of statement excluding Table A: Table A in the Fourth Schedule to the Companies Act previously prescribed the form of a company’s M&AA, such that companies had to expressly state that Table A was excluded or the default position in Table A would apply. The Fourth Schedule of the Companies Act has since been repealed. Additionally, a company is expressly allowed to adopt only some, or none, of the Model Constitution regulations, and whether or not it does so, its constitution need not expressly state that the Model Constitution is excluded. The 2015 Regulations, and amendments to the Companies Act, intend to provide the Model Constitution only as a helpful reference for companies and to reduce their set-up cost. Companies choosing to adopt the Model Constitution in full will not have to file it with the Accounting and Corporate Regulatory Authority (“**ACRA**”).

c. Providing for ACRA’s electronic register of members (EROM): The new Section 196A of the Companies Act, which introduced ACRA’s EROM, has:

- fundamentally changed director’s responsibilities in relation to keeping records of the company’s shareholders; and
- made obsolete any pre-section 196A provision for the company to maintain a register of members.

Articles which continue to require directors to maintain the register of members do not accurately capture the director’s new obligations set out in the Model Constitution, which are to lodge particulars with ACRA on instances of share allotments, share transfers, a company’s acquisition of its own shares and cancellation of shares. Similarly, the provision enabling a company to maintain a branch register of shareholders outside Singapore is also moot as ACRA's EROM is now *prima facie* definitive as to the registered shareholders. Where relevant, a company may maintain a branch register of its debentureholders.

d. Deletion of Articles prohibiting financial assistance: Unless a private company is a subsidiary of a public company, the new section 76(1) of the Companies Act no longer prohibits private companies from financing dealings in their shares and any Article limiting or prohibiting this does not state the current law.

e Replacing “account”, “balance sheet” and “director’s report” with appropriate terminology: “financial statement” and “directors’ statement”: As from 1 July 2015, the form of disclosure of directors’ benefits set out in the directors’ report was repealed and section 201(16) of the Companies Act now requires directors to issue a directors’ statement the contents of which must comply with the Twelfth Schedule of the Companies Act. Also from 1 July 2015, section 199 of the Companies Act has adopted components of the Singapore Financial Reporting Standards (SFRS) terminology. The SFRS and the Accounting Standards Council will be the determinants as to the contents of financial statements, as further elaborated in ACRA’s Practice Direction No. 6 of 2015 “Effect of Companies (Amendment) Act 2014 on sections relating to Financial Reporting in the Companies Act” and ACRA’s Financial Reporting Practice Guidance No. 2 of 2015: “Areas of Review Focus for FY2015 Financial Statements”.

f. Lowering of threshold of members to demand for a poll from 10% to 5%: The threshold set out in section 178(1)(b)(ii) of the Companies Act for a shareholder to demand for a poll has been lowered from 10% to 5% of the total voting rights of the company. There is no compelling reason to maintain a 10% threshold in the Articles if shareholders holding less than 10% of the voting rights have the power to call for a poll under the alternative 5-shareholder threshold under section 178(1)(b)(i). Moreover, lowering the threshold to 5% would be consistent with the 5% threshold adopted for the purposes of notification of substantial shareholdings under the Companies Act.

g. Retention of the 48 hour cut off for depositing proxy form: Most companies’ M&AAs allow shareholders a 48-hour period prior to a general meeting to deposit their proxies. With the intention of allowing a company more time to process proxy instruments, section 178(1B) of the Companies Act was supposed to act as a transitional provision to deem as amended the usual 48 hour period with the new 72 hour period in section 178(1)(c) of the Companies Act, prior to the company’s own alteration of its Articles for compliance. However, ACRA has announced that section 178(1B) is not being brought into force due to a drafting inaccuracy. The M&AA of companies which state a 48-hour cut-off will therefore not have a transitional provision which would allow them to automatically rely on the longer period of 72-hours. Depending on how much administrative time a company requires in the run up to its general meeting, a company can amend its Articles accordingly to extend the cut-off time, or it can retain the shorter 48-hour cut off.

h. Whether or not appropriate to include reference to “Chief Executive Officer” (“**CEO**”) or replace references to Managing Director with references to CEO: A person, by whatever title he/she was appointed, will be defined by the Companies Act as a CEO if he/she is principally responsible for the management and conduct of the business of the company. A CEO may or may not also be a director. For proper corporate governance, the Companies Act imposes on the CEO similar disclosure requirements as a director and requires the company to provide ACRA with particulars for ACRA’s register of CEOs. However, given that the Companies Act does not impose on a non-director CEO the same duties of honesty and reasonable diligence as a director, a non-director CEO’s powers and role will be more properly documented under an employment contract and not the company’s M&AA.

i. Additional grounds for disqualification of director: The Model Constitution reflects the expanded section 154 of the Companies Act. Circumstances under which a person will be subject to the disqualification

from acting as a director to now include disqualifications under banking, securities and financial advisory legislation.

j. Shareholders' implied consent to receive documents by email: The new section 387C of the Companies Act allows the company to email to shareholders documents such as notices, accounts, balance sheets, financial statements and reports if the company obtains the shareholder's express consent or if the company's Constitution provides for this mode of delivery. This provision may take two forms, the company can either:

- imply the shareholders' consent by clearly stating in the constitution that electronic communications will be used; or
- deem the shareholders' consent by allowing the shareholder a specified period to elect delivery by email, and on expiry of that period without the shareholder making an election, deeming any shareholder's failure to elect as his/her consent.

Of the three options, providing for the shareholder's implied consent to receiving emailed documents is the most preferable. Obtaining each shareholder's express consent may be onerous and may require the company to maintain two separate systems of delivery for those shareholders who consent to email delivery and those who prefer receiving physical copies of documents. As for the deemed consent method, this is also procedurally more demanding as it requires the company to abide by the safeguards set out in Regulation 89C(a)(i) to (v) of the Companies Regulations 2016. These safeguards require the company to additionally send to each shareholder a separate notice explaining of the effects of the shareholder's election as well as allow the shareholder the right to make a fresh election at any time. Do also note that Regulation 89D of the Companies Regulations 2016 excludes the following notices and documents from express, implied and deemed consent:

- notices relating to any take-over offer of the company; and
- notices relating to any rights issue by the company.

k. Allowing shareholders and company officers to email their particulars to the company: The Companies Act has placed on the company new responsibilities to keep ACRA supplied and updated with particulars of its shareholders and directors, CEOs, secretaries and auditors. The type of particulars has also changed because company officers are now allowed to elect to provide an alternate address to their residential address. Whereas M&AAs usually only provide for the mode of transmission of information and documents from the company to its shareholders and officers, we also suggest companies include a new provision in their Constitution to specify how necessary information and supporting documents should be submitted to the company.

l. Indemnification of director for liability incurred to 3rd parties and not liabilities incurred to the company: Most M&AAs contain some limited provisions to indemnify a director for certain liabilities incurred while acting as director, whether the liability is to the company itself or to third parties. The revised Section 172(1) of the Companies Act voids any provision in the M&AA (as well as in any other contract) which exempts a director from, or indemnifies him/her against, any liability in relation to the company where there has been any negligence, breach of duty, default or breach of trust. Section 172B of the Companies Act however, allows a company to indemnify any director against any liability incurred by him to a third party save for certain circumstances. This presents an opportunity to include appropriate provisions in the Constitution for shareholders looking to protect the directors.

Conclusion

The above summary of alignment points applies to companies incorporated prior to 3 January 2016. For sponsors/promoters seeking to incorporate a new private limited company, our corporate secretarial agent, Abogado, has updated its incorporation procedure and can provide a fully aligned constitution as a base which a new company's stakeholders can then tailor to their needs.