

Companies Act 2006

Overview

April 2007



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This note summarises those provisions of the Companies Act 2006 that are likely to be most significant for companies and their advisers.

The Act received royal assent on 8 November 2006 and is coming into effect in pre-announced stages: some provisions on enactment, others since then, and the rest between now and October 2008. For further details, including provisions that have already come into force, see:

- “Companies Act 2006: implementation timetable”, published at the same time as this note
- the May 2007 edition of our bulletin, Clearly Corporate, which contains articles on electronic communications under the new Act and the implementation in the UK of the Transparency Directive (including the replacement of the major shareholding notification regime).

Eventually the 2006 Act will repeal and replace nearly all of the Companies Act 1985: the only significant parts that will remain relate to company investigations and community interest companies. Around 800 sections of the new Act contain rules that are entirely new or that are significantly different from the existing law; the rest is intended simply to restate those parts of the 1985 Act that have not been amended.

Most company legislation will therefore be contained in a single consolidated Act. In principle, provisions that are restated from the 1985 Act should have the same effect, but lawyers are likely to scrutinise any differences in language to assess whether the meaning has been changed in the process.

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Directors and corporate governance

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Statutory statement of directors' duties

For the first time, the principal duties owed by directors to their company have been set out in statute, making them clearer and more accessible than at present. Sections 171-182 are intended to codify duties that have been established in cases, although slight changes have been made in relation to conflicts of interest.

Fiduciary duties

A director must:

- Act in accordance with the company's constitution, and only exercise powers for the purposes for which they are conferred
- “Act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:
 - the likely consequences of any decision in the long term
 - the interests of the company's employees
 - the need to foster the company's business relationships with suppliers, customers and others
 - the impact of the company's operations on the community and the environment
 - the desirability of the company maintaining a reputation for high standards of business conduct
 - the need to act fairly as between members of the company.

The obligation to “have regard” to these statutory factors is said to embody the concept of “enlightened shareholder value”, tempering an aggressively narrow view that companies exist simply to maximise the returns to their owners with a recognition that it is in a company's long term interests to take account of social and environmental concerns.

The key question is whether the obligation has any real teeth: could directors be found liable for failing to have due regard to these factors, or for attaching insufficient weight to them? The formula “have regard to” clearly acknowledges that, depending on the circumstances, directors may legitimately decide that other pressures and constraints outweigh any or all of the statutory factors. Judges have normally been reluctant to re-examine commercial judgements of this kind made by directors, but this has not prevented the courts from occasionally attacking decisions where, on the facts they knew or ought to have known, the directors have come to a conclusion that no reasonable director, properly directing himself as to his duties, could have reached.

In the Explanatory Notes to the Act, the Government stresses that the obligation to “have regard” to the statutory factors cannot be discharged merely by paying lip service to them: directors must exercise the same level of skill, care and diligence as they would in carrying out any other function. When assessing whether in taking any decision a director has acted with reasonable skill and care, the courts will take into account all the circumstances, including the director's own role and expertise, the seriousness of the matter in issue, and what it is reasonable to expect of a director in that situation. Broadly speaking, therefore, directors are expected to do all that they reasonably can to take the statutory factors into account; the more significant a decision, the more important it will be to ensure there is a paper trail showing that the board has actively considered how a particular decision will impact the company's

employees, customers, suppliers, the environment and its commercial reputation – and any other relevant factors.

In practice, directors would be well advised to consider the statutory factors when they are determining the company's strategy. It will then be more likely that each individual decision is made in a manner which complies with the law.

As regards individual decisions, as long as a director can show that he did actually consider the relevant factors, even if he ultimately decided that they were less important than other factors, he will probably have discharged his duty. In any event, liability will only follow if the company can show that it suffered a loss as a result of the director's breach of duty.

The new duty to have regard to the interests of the company's employees has a direct precedent in section 309 of the 1985 Act. As to whether a claim could ever be brought by or on behalf of the company against a director for breach of that section, it has been said that "the obvious difficulties are, not only to prove ... the fact of a director having acted without due regard to the interests of the employees, but also to prove what damage was suffered by the company."

A director must also:

- Exercise independent judgement, and not fetter his discretion except pursuant to an agreement that was considered to be in the best interests of the company when it was entered into
- Avoid conflicts of interest
- Not accept benefits from third parties
- Declare his interest in any proposed transaction or arrangement.

Changes to rules on conflicts of interest

Where a transaction is proposed between a director and his company, so that the director's duties to the company may be in conflict with his personal interests, the rules of equity currently require shareholders to approve the transaction. Companies' articles usually modify this equitable duty, instead simply requiring directors to disclose their interest to the rest of the board.

Section 178 of the Act reflects the current position in section 317 of the 1985 Act and in the articles of most companies by requiring an interested director to disclose the nature of his interest to the rest of the board before the transaction is approved. One change is that disclosure need not be made if the interest cannot reasonably be regarded as likely to give rise to a conflict of interest or if the other directors are already aware of the director's interest.

Existing equitable rules prevent a director from exploiting personally without permission any opportunity that properly belongs to the company, even if the company is not itself in a position to exploit it. Believing this to hinder entrepreneurial and business start-up activity, the Government has included provisions in section 176 of the Act that allow the other directors, provided they have no interest in the matter, to authorise a director to proceed notwithstanding his conflict of interest. Directors of public companies will only be able to authorise such conflicts if the articles allow it. There could, of course, be difficulty if none of the directors is without an interest in the matter; in that case, only a shareholder resolution could absolve the conflicted directors.

Duty of skill and care

The standard of skill and care expected of directors reflects the combined objective and subjective test in section 214 of the Insolvency Act 1986, which has been applied in recent cases – i.e. the higher of the knowledge, skill and experience reasonably expected of a director in that position, and the knowledge, skill and experience of that particular director.

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Relevance of case law

Although the new duties expressed in the Act will displace those formulated in previous cases, cases on directors’ duties will continue to be relevant for the purpose of determining how those duties should be applied in particular circumstances. Historically, courts have sometimes decided that a particular duty implies additional obligations: for example, the Court of Appeal recently ruled that a director’s duty under the current law to act in what he in good faith considers to be the best interests of his company imports an obligation to disclose his own breach of the duty. This ‘dynamic’ approach is likely to continue under the new Act.

Some have suggested that the duty in the new Act to “promote the success of the company” may be subtly but significantly different from the existing duty to act “in the best interests of the company”. It seems to us more likely, however, that the courts will regard the wording in the Act simply as a new label for the same fundamental duty.

The DTI has said that it will publish plain English guidance on the duties of directors under the new Act.

Transactions between directors and their companies

Various changes will be made to the rules on substantial property transactions between companies and their directors, on loans to directors, payments to directors for loss of office, and on long-term service contracts, principally to make the rules more accessible and consistent, and to remove a number of ambiguities.

For example:

- All companies will be able to make loans to their directors if, after full details have been provided, the loan is approved by shareholders. At present such loans are generally prohibited, subject to various exceptions
- Companies will be able to enter into transactions that would currently fall within section 320 of the 1985 Act (substantial property transactions with directors and their connected persons) before shareholder approval has been obtained, as long as the transaction is made conditional on such approval
- Shareholder approval will be required where a company proposes to make a payment to a director in compensation for loss of his employment as a director of the company (not just for loss of his office as a director) which goes beyond his existing contractual entitlement
- The complex rules in section 346 of the 1985 Act determining which persons are “connected” to a director for these purposes will also be re-written and extended to catch a director’s civil partner, a person who lives with the director “as partner in an enduring family relationship”, the director’s parents, and any infant children or step-children of the director’s partner who live with him.

Transactions with third parties: ultra vires

Sections 35-35B of the 1985 Act, which deal with a company’s capacity and the power of directors to bind it, will be replaced with new provisions that do not make any substantive change to the current rules. A third party will continue to be protected if he deals with the company in good faith. Third parties dealing with a company will still have to concern themselves with the question of whether the director they are dealing with has sufficient authority.

As between the company and themselves, directors will still have a duty to observe the company’s constitution, including any restrictions on the company’s activities in the articles of association.

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Service addresses

All directors – and not just those at serious risk of violence or intimidation - will be able to provide a service address for the public record. A director's residential address will still have to be filed at Companies House but will be kept on a separate register, access to which will be limited to certain public authorities and credit reference agencies. The company itself will also maintain a record of each director's residential address, but this will not be open to public inspection.

As there are around five million registered directors, Companies House has said that it is unable to remove all existing residential addresses from the record. However, the Government proposes to allow directors who can show that they are at risk of violence or intimidation to apply for their residential address to be removed from documents filed after 1 January 2003 (documents filed before that date are kept on microfiche, making it impractical to remove details). Directors who have already been granted a confidentiality order under the 1985 Act will be deemed to have made such an application.

Appointment and eligibility

At least one director of every company will have to be a natural person (who need not be domiciled in the UK).

The 70-year age limit for directors of public companies and subsidiaries of public companies (which applies unless the articles exclude it) will be abolished. There will be a 16-year minimum age limit for directors of all companies.

Dealings in shares

Provisions in the 1985 Act that require directors and certain other persons to disclose to the company their interests in shares in and debentures of the company or any holding or non-wholly-owned subsidiary company within the group were repealed on 6 April 2007. Directors of companies listed on the Official List, AIM or PLUS Markets (and certain persons connected to them) will continue to be required under the Disclosure and Transparency Rules, AIM or PLUS Markets Rules to notify their company of any dealings.

The prohibition in the 1985 Act on directors (including shadow directors) and their spouses and children from buying put and call options over listed shares or debentures in the company, or another in the same group, was repealed at the same time.

Company secretaries

Private companies will no longer be required to have a company secretary, but they may choose to do so.

Where a company secretary is appointed, he will have the same status as under the 1985 Act – in particular, he will be able to file documents at Companies House and be one of the signatories to a deed made by the company. Companies without a secretary will not be at a disadvantage, though, since the rules on execution of deeds are being changed (see under Company Administration below) so that only a single director's (witnessed) signature will be required.

Personal liability

Derivative actions initiated by shareholders

As a general rule, if a wrong is done to a company, only the company itself (and not a shareholder) can bring an action for damages or some other remedy. In practice, the directors must decide whether or not to bring a claim. Clearly, if the wrong was done by the directors themselves, or a majority of them, no claim is likely to be pursued. Unless

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shareholders are able to force the board to bring a claim, either by passing an ordinary resolution to replace the existing directors, or by giving a direction to the board by means of a special resolution, the company and the shareholders will have no remedy in respect of any loss the company has suffered. Minority shareholders can therefore find it difficult to force directors to overturn their decision not to bring an action.

However, where it can be shown that an act amounts to a ‘fraud on the minority’ – basically, some wrongdoing by the directors or majority shareholders, or some ultra vires action, illegality or infringement of a shareholder’s personal rights – and that the wrongdoers are in control of the company, the courts have for some years allowed minority shareholders to bring a “derivative action” – in effect, allowing the shareholder to prosecute a claim on behalf, and for the benefit, of the company. A derivative claim can only be brought at the discretion of the court. Moreover, no claim can be brought where a majority of independent shareholders do not wish the action to proceed.

Because of the difficulty in bringing such claims, the Government accepted the Company Law Review’s recommendation that derivative actions should be put onto a statutory footing. In the event, the sections in the Act dealing with derivative actions proved to be among the most controversial, due largely to companies’ fear that the new rules would make it easier for activist shareholders and special interest groups to sue directors. For the reasons given below, we believe these fears to be largely unfounded.

Sections 260-264 of the Act deal with derivative claims. As at present, a claim can only be brought with the permission of the court. In practice, the court will hear evidence from the company and the claimant at a preliminary hearing, and decide whether to allow the claim to proceed. Historically, most claims have been struck out at this stage. Over the last three years, there have only been seven reported cases on derivative actions, and in the only one of these where permission was granted the company did not oppose the application. Also at this stage, the court is likely to be asked to decide whether the company should be made to bear the claimant’s costs of bringing the action. Arguments over whether permission should be granted, and what order should be made as to costs, can take many days: in one famous case, the preliminary hearing lasted 18 days.

Under the new Act, a derivative claim can only be brought:

- in respect of a cause of action “arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company” (whether arising before or after the claimant became a shareholder). At present, a claim can only be brought in respect of a director’s negligence if he himself has benefited from it; the new regime is therefore much wider in this regard
- where it appears to the court that the claimant has a prima facie case. In all but the most open and shut cases, the court will probably be reluctant to dismiss a claim on the basis of what may be rather limited evidence at a preliminary hearing, so few claims are likely to fail on this ground.

There is no need to show that an act amounts to a ‘fraud on the minority’, or that the wrongdoers are in control of the company. But the court must dismiss the claim if it is satisfied that:

- a (hypothetical) director acting so as to promote the success of the company for the benefit of its members as a whole would not continue the claim; or
- where the act or omission is yet to occur, it has been authorised by shareholders or, where it has already occurred, it was authorised beforehand by shareholders or has subsequently been ratified by them.

In effect, therefore, the court will have to put itself into the position of an independent director of the company and decide whether or not it is appropriate for a derivative claim to be pursued. This kind of judgement, which depends upon a mixture of commercial and legal factors, is of a sort that courts are usually reluctant to make.

“The court is also required to have particular regard to the views of any disinterested shareholders: for example, if the company produces evidence that a majority of those shareholders do not favour pursuing the claim, this is likely to weigh heavily with the court.”

“The rules will be extended to allow a corporate trustee of an occupational pension scheme (or a member of its group) to indemnify its directors against liability incurred in connection with the company’s activities as trustee of the scheme.”

In deciding whether to give permission, the court must take various matters into account, including whether the shareholder is acting in good faith; the importance of the claim to the company; whether the company has decided not to bring the claim; and whether the shareholder could bring a claim in his own right, rather than on behalf of the company. The court is also required to have particular regard to the views of any disinterested shareholders: for example, if the company produces evidence that a majority of those shareholders do not favour pursuing the claim, this is likely to weigh heavily with the court. To get a derivative claim struck out, a company will want to show that, essentially, the board’s decision not to pursue a claim against a director is a reasonable one in the circumstances: it will help if the board can show that it has taken independent legal advice and, preferably, that the decision has the support of the majority of disinterested shareholders.

Until the new rules are applied in practice by the courts, it is difficult to know whether the number of derivative claims is likely to increase. It has been suggested that the possibility of bringing claims in respect of directors’ negligence or breach of duty, without having to show ‘fraud on the minority’, means that more claims are likely. But even activist shareholders are still likely to be discouraged from bringing such claims by the fact that any damages recovered will go to the company, and not the shareholder personally. There is still the possibility, however, that claimants might bank on being able to settle out of court for a cash payment.

The Government believes that the new provisions should as a rule be used for all claims brought on or after 1 October 2007. It is considering whether to make transitional and savings provisions so as to maintain the existing approach for certain categories of claims, such as claims where all the events giving rise to the claim took place before commencement day and there are no continuing issues.

Application for relief

Under a section that will replace section 727 of the 1985 Act, if a director “has reason to apprehend that a claim will or might be made against him in respect of negligence, default, breach of duty or breach of trust”, he will be able to apply to court for relief without having to wait for the claim to be made.

Protection for directors

The rules introduced on 6 April 2005 allowing companies to indemnify their directors in certain circumstances, and to advance funds to them to meet defence costs, will be restated without significant amendment. However, the rules will be extended to allow a corporate trustee of an occupational pension scheme (or a member of its group) to indemnify its directors against liability incurred in connection with the company’s activities as trustee of the scheme, other than fines, penalties or the costs of defending criminal proceedings in which the director is convicted. At present, the rules do not appear to allow such indemnities, meaning that directors of corporate trustees may be in a worse position than non-corporate trustees, who can be indemnified out of the scheme’s assets.

The exception that allows companies to lend money to their directors to fund their defence costs will be extended to cover not just proceedings relating to the company but also relating to any associated companies. There are also new requirements relating to the keeping of copies of relevant indemnities and making them available to members.

In the light of the new rules on derivative actions, and the codification of directors’ duties, boards should review their D & O insurance and consider whether to extend the scope of any existing indemnity arrangements, or to put new ones in place.

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Defective accounts; fraudulent trading

Contrary to its original proposal to make the maximum sanction for approving defective reports and accounts a term of imprisonment, the Government finally decided that the maximum penalty should be an unlimited fine. But the maximum prison term for fraudulent trading will be increased from seven to ten years.

Liability for offences committed by company

The general principle adopted in the new Act is that where the only victims of the offence are the company or its members, the company itself should not be liable for the offence. But where the members of the company are only some of the potential victims, the company itself should be liable. A director or other officer of the company will be personally liable where he "authorises, permits, participates in, or fails to take all reasonable steps to prevent" the offence.

In the light of responses to its original consultation, which criticised the proposals on both policy and technical grounds, the Government decided not to extend to "senior executives" and "responsible delegates" the category of "officers in default".

General meetings, resolutions and shareholder rights

“Shareholders in public companies (whether quoted or not) will be able to require the company to circulate resolutions and statements at the company's expense (rather than their own) if the materials are provided to the company before the end of the financial year. ”

“Members of companies whose shares are admitted to trading on the Official List or another EU regulated market will be entitled to nominate someone else to receive copies of all communications sent by the company to its members generally.”

Quoted companies

Shareholder rights to raise questions

Shareholders in quoted companies (which here means listed on the UK's or another EU member state's official list, or on the NYSE or NASDAQ, but not AIM) who hold at least 5% of the voting rights, or who number at least 100 (with an average of at least £100 of share capital each) will have the right to publish on the company's website free of charge a statement of any concerns about the audit, or the circumstances in which the auditors have resigned, that they intend to raise at the AGM. But contrary to the Government's original plans, the auditors will not be legally obliged to answer shareholder questions.

A proposal in an early draft of the Bill to grant shareholders of quoted companies a right, within a 15-day “holding period” after the accounts become available, to propose a resolution to be moved at the general meeting where the accounts are laid was also dropped. Instead, as originally proposed, shareholders in public companies (whether quoted or not) will be able to require the company to circulate resolutions and statements at the company's expense (rather than their own) if the materials are provided to the company before the end of the financial year.

Exercise of voting rights

To make it easier for beneficial owners to exercise voting rights held by the registered holder (who is often a nominee or intermediary), all companies will be permitted, but not required, to change their articles to allow registered holders to nominate someone else (such as the beneficial owner) to exercise some or all of their statutory rights as a member, including the right to appoint a proxy and to circulate a proposed resolution or statement prior to a general meeting. The relevant commencement provisions will be drafted so as to enable nominee investment operators to send indirect investors' requests to companies from 1 October 2007 to entitle indirect investors to enjoy information rights from 31 December 2007.

Without any change being made to the articles, members of companies whose shares are admitted to trading on the Official List or another EU regulated market will be entitled to nominate someone else to receive copies of all communications sent by the company to its members generally, including notices of meetings and copies of reports and accounts. But until the company's articles are changed to permit such nominated persons to exercise voting rights directly, they will need to arrange for the registered member to vote in accordance with their wishes. To facilitate this process, the new Act will allow registered members who hold shares on behalf of several beneficiaries to exercise their rights in different ways.

The provisions in the Act allowing companies to communicate electronically with shareholders (see below) will apply to nominated persons.

In case voluntary shareholder engagement does not appear to be working in practice, the Government has taken power in the Act to make regulations forcing institutional shareholders to publicly disclose their voting records. A number of institutions have

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already started to do so voluntarily, including Fidelity International, one of the UK’s largest fund managers, which has published its voting record at shareholder meetings on every motion proposed by companies in which it invests in the UK, Europe, the US and Asia since 1 July 2004. The Government has promised that it will not introduce such regulations without prior consultation and a proper cost/benefit analysis. The Institutional Shareholders’ Committee, which comprises leading industry bodies, is reported to be preparing a comply-or-explain code by this summer.

Polls

Quoted companies will have to disclose the results of any poll on their website - some already do so as a matter of best practice. Shareholders who hold at least 5% of the voting rights, or who number at least 100 (with an average of at least £100 of share capital each) will be able to require the directors to obtain an independent report on any polled vote.

All companies

Electronic communications

Provisions in the Act that came into force in January make it easier for companies to use the internet to communicate with shareholders, and so reduce printing and distribution costs.

Although it has been possible for some years for companies to use electronic means to deliver certain documents to shareholders, the Act has extended the range of information that can be communicated electronically and relaxed certain requirements for communication by website. If a company already has agreements in place with shareholders under which they agree to accept electronic communications, those agreements remain valid. But, depending on the terms of the agreements, they may not cover every type of document that the company may wish to send.

There is a two-tier system under the new regime. The first tier covers the sending of documents electronically or in electronic form: for example, by e-mail or in the form of disks, tapes etc through the post. To do this, the company needs the individual shareholder’s agreement (and, of course, in the case of e-mail, the shareholder needs to provide an e-mail address).

The second tier is concerned with making material available on a website and notifying shareholders that it is there, and where to find it. Again, an individual shareholder’s agreement to accept website delivery is required, but in this case (unlike the first tier) the Act allows companies to default shareholders into a so-called “deemed” agreement. This is done by writing to the shareholder and informing him that, unless he responds within 28 days, he will be deemed to have consented to website communication. To do this, the company must have been authorised, either by appropriate provisions in its articles or by a shareholder resolution, to send or supply documents or information to shareholders by making them available on a website. Many companies will prefer, rather than change their articles, to propose an ordinary resolution this year and leave changing their articles till next year, when they may need to make other Companies Act-related changes.

The deemed agreement does not dispense with the need to communicate by post, however, since the Act requires the company to notify the shareholder in writing when material is posted on the website. This is, of course, less costly than posting long documents. But if the company wants to dispense with paper altogether and do the notification by e-mail, it has to secure the shareholder’s actual (rather than deemed) agreement, and his e-mail address, under the first tier.

Whenever the company sends out a notice of meeting, or a proxy form, to shareholders containing its e-mail address it is deemed to agree to receive electronic

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communications from the shareholders in relation to the meeting. Care must be taken to ensure that, where this happens, the company can apply proper authentication procedures (and that it can ask for proper hard copy supporting documents where someone is voting on another person's behalf - for example, as representative of a corporate shareholder, or under a power of attorney).

If the company is listed, it must also comply with a new rule under Chapter 6 of the Disclosure and Transparency Rules, which requires it to obtain shareholder approval in general meeting if it wishes to use electronic communications (although this is not required in respect of agreements that were in place before the new rules came into effect). A single ordinary resolution will serve to satisfy this requirement and the Companies Act requirement for shareholder authority to use website delivery.

Where the company has defaulted a shareholder into accepting website delivery but the shareholder later transfers his shares, the company will not be able to rely on the deemed agreement. The speed with which shareholdings can change hands through CREST might make this a problem. If the company wants to use website delivery for the new shareholder, it will either have to secure an actual agreement with the shareholder or start the 28-day default process again. The Act prohibits companies from using the default process in relation to a shareholder more than once every 12 months, so, to avoid having to maintain individual timelines for each shareholder, most large companies are expected to use the default process only on alternate annual postings to shareholders.

The Institute of Chartered Secretaries and Administrators has produced best practice recommendations and guidance, available on its site at:

<http://www.zoomerang.com/recipient/survey-intro.zgi?p=WEB2266CA2J5UZ>

Right to inspect a company's register of members

In the original Bill, a company would have been entitled to refuse a request from any person to inspect its register of members if it could persuade a court that the request was not made for a "proper purpose". Following a number of high-profile cases in which animal rights activists have obtained the names and addresses of shareholders in pharmaceutical companies, these provisions have been tightened up. In effect, the person requesting the information will have to tell the company what the information will be used for, and who it will be passed to, and if the company can persuade a court that this is not a proper purpose it may obtain permission to reject that particular request and any similar ones made in future.

In addition, it is proposed that public companies will be exempt from the obligation to supply details to Companies House of those who hold less than 5% of any class of shares, and for private companies not to require the addresses of their members. This is intended to be a practical way of ensuring that the restriction of the right to inspect a company's register of members is not circumvented by the information being publicly available at Companies House.

It is proposed that companies should be able to have somewhere other than their registered offices for public inspection of records that are subject to statutory inspection rights; and the Government is consulting on when and how long records should be open to inspection.

Proxies

Members of both private and public companies will be able to appoint more than one proxy. Proxies will be given the same rights as registered holders to ask questions, demand a poll and vote on a show of hands at general meetings (as well as on a poll).

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Rights issues

The statutory minimum period of 21 days for acceptance of rights offers will be retained, but the Act allows the Secretary of State to make regulations to vary this period upwards or downwards (but to not less than 14 days).

Transfer of shares

Directors will have a statutory obligation to provide a proposed transferee of shares with reasons for any refusal to register the transfer.

Class rights

Various technical changes will simplify the variation of class rights provisions currently in force under sections 125-127 of the 1985 Act.

New rules will also expressly allow companies to include in their articles provisions that can be changed only with the consent of a particular majority (e.g. 90% of all the members) – so-called conditional entrenchment. But an entrenched provision can always be overridden by a unanimous resolution of all the members.

Political Donations

Technical changes will also be made to the regime requiring companies to obtain shareholder authorisation before making any donation to an EU political party or organisation or incurring any EU political expenditure. The regime has been criticised for being too wide, so that it could catch various activities that would not normally be thought of as party political, and for requiring an excessive number of shareholder resolutions.

Among other things:

- private companies will be able to authorise donations and/or expenditure by written resolution
- a holding company will be able to seek authorisation of donations and expenditure in respect of both the holding company itself and one or more subsidiaries (including wholly-owned subsidiaries) through a single approval resolution
- a specific exemption will be introduced for donations to non-political funds of a trade union.

Two statutory instruments are being made, to come into effect on 1 October 2007, exempting certain media and publishing-related companies and setting the interest rate on the liability for unauthorised expenditure. The threshold for disclosure in accounts of charitable and political donations will be raised from £200 to £2,000.

Capital maintenance and transactions benefiting shareholders

“The restriction on private companies giving financial assistance for the purpose of the acquisition of their own shares or those of their (private company) parent will be repealed, as will the whitewash procedure.”

“Private companies will be able to reduce their share capital by passing a special resolution, supported by a directors’ solvency statement signed by all the directors, rather than having to go to court.”

Statement of capital

One of the company’s constitutional documents will be its statement of capital. This will provide prescribed particulars of the rights attached to the shares. It is intended that the information provided to the Registrar of Companies about the shares should cover the same matters as are presently required to be disclosed, which include the right to participate in dividends, voting rights and the right to a return of capital in a winding-up.

Financial assistance

The restriction on private companies giving financial assistance for the purpose of the acquisition of their own shares or those of their (private company) parent will be repealed, as will the whitewash procedure. Even a private company subsidiary of a public company will be free of the restriction in relation to an acquisition of its own shares or the shares in an intermediate private company holding company. But public companies will still be prohibited from giving financial assistance for the acquisition of their own shares or those of their parent company (whether public or private), and private company subsidiaries will be under the same prohibition in relation to acquisitions of shares in their public company parents.

Directors will still need to consider whether a proposed arrangement will promote the success of their company. A saving provision is expected to make clear that these repeals will not revive any equivalent common law rule that existed prior to the introduction of the statutory prohibition on financial assistance.

A public company will be able to re-register as private in order to give financial assistance (as some public companies presently do in order to take advantage of the whitewash procedure) – for example, where a takeover bid of a public company is financed by debt and the bank wants to take security over the target’s assets. The Government does not propose to take advantage of the relaxation for public companies offered by the Directive amending the Second Company Law Directive.

The relaxation of the rules on financial assistance is likely to simplify many M & A transactions which involve only private companies and also public to private transactions.

Reduction of capital

Private companies will be able to reduce their share capital by passing a special resolution, supported by a directors’ solvency statement signed by all the directors, rather than having to go to court. The statement will be similar to a statutory declaration of solvency for the purposes of a financial assistance whitewash under the current law. The current procedure for companies to reduce their capital by applying to court will remain and in some circumstances may be advantageous.

Section 654 of the Act enables the Secretary of State to specify by order the cases in which a reserve arising on a reduction of capital will be distributable and when it will

“Shareholders in both public and private companies will be able to adopt articles that allow the directors to decide the terms on which redeemable shares are to be redeemed (rather than having to set out those terms in the articles).”

be treated as realised profit. The Government proposes to use the order to specify that, where companies reduce their share capital using the new solvency statement procedure, the amount arising on the reduction will constitute a realised profit, but must be credited to the company's profit and loss account. As a result, it will be distributable only the extent that (following the reduction) the company will have positive distributable reserves. The repayment method, which by-passes the restriction on distributions, will only be available for a limited company in a court-approved reduction. The Government thinks that this strikes the right balance between making reductions easier and protecting the interests of long-term creditors.

Redeemable shares

The procedure for private companies to purchase or redeem their own shares out of capital will be retained, but as companies will be able to return capital to shareholders by means of a reduction of capital, the procedure will probably be used less often.

Shareholders in both public and private companies will be able to adopt articles that allow the directors to decide the terms on which redeemable shares are to be redeemed (rather than having to set out those terms in the articles). The terms and manner of redemption – which will have to be decided before the shares are actually allotted – must be set out in the company's statement of capital.

Intra-group transfers and the rule in *Aveling Barford*

Section 845 of the Act will confirm the generally-held view that assets can be transferred intra-group at their book value, rather than a higher market value, provided that the transferor has distributable profits. If an asset is sold at less than its book value, the company will need to have sufficient distributable profits to cover the amount of the difference between the sale price and book value.

Authorised share capital abolished

Concerns over whether a company has sufficient headroom to issue new shares will disappear, as the Act abolishes the concept of authorised share capital. However, an early proposal to allow companies to issue shares of no par value was dropped: shares must have a fixed nominal value.

The authorised minimum share capital for public companies will remain £50,000 (or the euro equivalent; but it cannot be a combination of the two), although this is higher than EU law requires. The amount can be changed by regulations. There is nothing to prevent a company from converting its entire capital, including the authorised minimum, to another currency. If, having done this, the company wishes to reduce its share capital and remain a public company, it must notionally reconvert the shares to sterling or euros so as to be able to show that it will still satisfy the minimum requirement.

Allotment of shares by private company

Unless its articles provide otherwise, a private company's directors will no longer need shareholder approval to allot shares, although approval will be necessary if the company has, or will have as a result of the allotment, more than one class of shares.

Re-denomination of shares

A simplified procedure will allow limited companies to convert their share capital from one currency to another, and to re-denominate their shares after conversion to achieve round share values, without having to go to court or buy back shares out of capital and issue new shares.

Takeovers

“The new Act extends the Takeover Panel’s statutory powers to cover all takeovers, rather than only those within the scope of the Takeovers Directive, and, as well as making other changes, implements permanently various other provisions of the Directive - replacing the interim arrangements that were put in place in May 2006 to meet the Directive’s deadline.”

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Changes to the squeeze-out procedure

Sections 428-430F of the 1985 Act and the Takeovers Directive (Interim Implementation) Regulations 2006 were replaced on 6 April 2007 by Part 28 of the new Act.

Although it is rare for a minority shareholder to challenge a bidder’s right to acquire his shares compulsorily under the statutory squeeze-out procedure, in fact there were a number of traps under the old regime which, if a bidder fell into one of them, could result in its compulsory acquisition being declared invalid. For example:

- It is normally of vital importance to a bidder to be able to count shares that it has been promised under an irrevocable undertaking towards the 90% threshold for effecting the squeeze-out. Section 428(5) of the 1985 Act allowed this, provided that the irrevocable was given by the registered holder of the shares and the bidder did not give any consideration other than a promise to make the offer. In practice, where shares are held by a nominee on behalf of a pension fund or other institution, it is not always possible to get the registered holder to give the irrevocable, and the bidder has to rely on one signed by, say, the fund manager.
- There could also be difficulties under the old rules where the offer included shares “to be issued” pursuant to the exercise of options or convertibles, so that in the fraction to calculate whether the bidder had acquired 90% of the shares to which the offer related the denominator varied according to the number of shares that were actually issued after the offer document was posted (creating a “floating threshold”). Similarly, if options were exercised after the deadline for sending squeeze-out notices has passed, the bidder could not acquire the resulting shares.

Several years ago the Company Law Review Steering Group recommended that these and other problems should be ironed out. In particular, the existing provisions were found to be ambiguous as to whether shares should count as shares the bidder had contracted to acquire where it had contracted conditionally; and it was felt that legislative sanction should be given to the long-standing but legally uncertain practice of extending an offer to certain overseas shareholders by putting an advert in the UK edition of the Financial Times.

When the Interim Regulations were introduced, they applied a new squeeze-out mechanism to takeovers of companies whose shares were traded on an EU regulated market. As a result, for takeovers of companies within the scope of the Directive, the Regulations dealt with the issue of conditionally acquired shares, and allowed a bidder to extend its offer to overseas shareholders by placing a notice in the Gazette and making the offer document available for inspection at a place in an EEA state or on a website. But, as the Secretary of State’s power to make the Regulations extended only to implementing the Directive, the Regulations did not clear up the other problems, or apply to takeovers that fell beyond the scope of the Directive. These have now been dealt with in Part 28.

“Where the offer includes shares “to be issued” pursuant to the exercise of options or convertibles, in calculating whether it has acquired 90% of the shares to which the offer relates the bidder will be able to freeze the denominator at the number of shares that are actually in issue at the time it proposes to initiate the squeeze-out.”

The rules in the new Act are therefore designed principally to apply the May 2006 changes to takeovers of all UK companies (whether or not within the scope of the Directive), and to remove the remaining traps, in order to make it easier for a bidder to operate the squeeze-out machinery safely. In particular:

- as long as the giver of an irrevocable intends “to secure that the [legal] holder will accept the offer when it is made”, under the new provisions the shares can be counted towards the 90% threshold
- where the offer includes shares “to be issued” pursuant to the exercise of options or convertibles, in calculating whether it has acquired 90% of the shares to which the offer relates the bidder will be able to freeze the denominator at the number of shares that are actually in issue at the time it proposes to initiate the squeeze-out
- in most takeovers there will be no effective deadline for the bidder to send squeeze-out notices, so even if option-holders exercise their options to acquire target shares late in the day, a bidder should be able to acquire their shares compulsorily
- if a minority shareholder wishes to challenge the compulsory acquisition of his shares by applying for a court order, he will have to notify the bidder of his application, and in turn the bidder must notify all the other minority shareholders that proceedings have been started. Formerly there were no such obligations, and it could be difficult for a bidder to discover whether any shareholder had objected to the squeeze-out.

Auditors and accounts

"The new Act therefore includes sections which will extend the scope of the business review for quoted companies to bring it closer to the OFR, but without going quite as far."

Business review

In March 2005 amendments were made to the 1985 Act to require all large and medium-sized companies to include in their directors' report for financial years starting on or after 1 April 2005 a "business review" containing:

- A description of the principal risks and uncertainties facing the company
- A fair review of the company's business containing a balanced and comprehensive analysis, consistent with the size and complexity of the business, of:
 - the development and performance of the business during the financial year; and
 - the position of the company at the end of that year.

"To the extent necessary for an understanding of the development, performance or position of the business of the company", the review must also contain:

- analysis using financial key performance indicators (KPIs)
- where appropriate, analysis using other key performance indicators, including information relating to environmental and employee matters.

Medium-sized companies need not include any KPI analysis of non-financial information. The scope of the business review is designed to reflect, but go no further than, the EC Accounts Modernisation Directive.

At the same time, new provisions were introduced to require quoted companies to produce an OFR for financial years starting on or after 1 April 2005. In May 2005 the Accounting Standards Board published the final version of its accounting standard on the OFR. The OFR covered a wider range of matters than the business review and would have had to include some forward-looking information.

However, in November 2005 the Chancellor took the decision to scrap the OFR, announcing instead that quoted companies would simply have to produce a business review. Following protests by environmental groups and others, the Government agreed to consult further on what should replace the OFR. The new Act therefore includes sections which will extend the scope of the business review for quoted companies to bring it closer to the OFR, but without going quite as far.

In particular, quoted companies will have to ensure that, "to the extent necessary for an understanding of the development, performance or position of the company's business", their business review includes:

- the main trends and factors likely to affect the future development, performance and position of the company's business
- information about (i) environmental matters (including the impact of the company's business on the environment); (ii) the company's employees; (iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies; and (iv) "persons with whom the company has contractual or other arrangements which are essential to the business of the company".

Category (iv) is potentially broad and, as well as key suppliers and customers, it could include any party which has granted the company a key licence or with whom the company has any critical joint venture or other contractual arrangement. In Parliament,

“It is intended to elicit information about significant relationships, such as major suppliers or key customers that are critical to the business, and which are likely to influence, directly or indirectly, the performance of the business and its value.”

“As far as unlisted companies (for example, AIM companies) are concerned, it will be left to the courts to determine on a case by case basis the circumstances when auditors are liable to pay damages to third parties who rely on those parts of periodic financial reports that are not covered by section 463.”

the Minister stated that it does not require companies to list all their suppliers: it is intended to elicit information about significant relationships, such as major suppliers or key customers that are critical to the business, and which are likely to influence, directly or indirectly, the performance of the business and its value. It will be for the directors to exercise their judgement on what they need to report. For example, if a company relies on a single supplier for a key component, so that if the supplier were to become insolvent this would have a serious impact on the company's business, the business review should disclose the existence of the relationship.

If the review does not contain the required information, it must say so. Information cannot be withheld from the business review on the grounds that it is confidential or commercially sensitive. But it is not necessary to include information about a person if its disclosure “would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest”. This carve-out is intended to protect suppliers and others who do business with companies that are at risk of attack by extremist groups.

Although the Act does not include a general safe harbour for forward-looking information included in the business review, under section 463 a director will have protection in relation to investors (see below) and will be liable to compensate the company for any loss suffered as a result of any omission or untrue or misleading statement in the directors' report only if the director either knew that the statement was untrue or misleading, or was reckless as to whether it was, or (in relation to omissions) only if he dishonestly intended to conceal a material fact.

It is likely that the business review provisions will apply to financial years starting on or after 1 October 2007. The ASB has promised to publish an accounting standard on the business review.

Companies that already publish an OFR on a voluntary basis are likely to continue to do so, but when the relevant provisions of new Act come into force they will need to ensure that their OFR complies with the new business review requirements.

Duty of care to investors

To a limited extent the Act puts on a statutory basis the principle expressed by the House of Lords in *Caparo Industries plc v Dickman* [1990] 2 AC 605 that the responsibility of auditors (and, by extension, directors) for misstatements in a company's financial statements is owed to the company's shareholders as a body, but not to individual shareholders or the public at large who may have relied on the statements when deciding whether or not to invest in the company:

- section 463 provides that, as regards the directors' report (which will include the business review) and the directors' remuneration report, and any summary financial statements insofar as they are derived from those reports, no director, auditor or other person is liable to anyone other than the company resulting from their, or anyone else's, reliance on information in the reports
- section 90A of the Financial Services and Markets Act 2000, inserted under the new Act, broadly makes listed companies liable to compensate investors who suffer loss in acquiring securities where they have reasonably relied on periodic financial reports, or any preliminary announcement of results, published in respect of financial years commencing on or after 20 January 2007 that are misleading or untrue as a result of dishonesty or recklessness by any director (in other words, more than negligence), but that no other person (for example, an auditor) is liable to anyone other than the company in respect of any such loss.

As far as unlisted companies (for example, AIM companies) are concerned, it will be left to the courts to determine on a case by case basis the circumstances when auditors are liable to pay damages to third parties who rely on those parts of periodic

financial reports that are not covered by section 463. As to what the section does and does not cover, some companies may try to extend the safe harbour by including such things as the chairman's statement, the financial review and corporate governance statements in the directors' report.

It will remain the position that, even if the company is listed, auditors and others can make themselves liable where statements accepting responsibility for the accuracy of a document are made outside the company's reporting processes.

Limitation of auditors' liability to company

Auditors have campaigned for many years for changes to section 310 of the 1985 Act to allow them to impose limits on the amount of damages that an audit client could recover in respect of a negligent audit. In particular, they have argued that their share of liability should be proportionate to the degree of fault rather than their being potentially liable for the whole of any loss even where their negligence was a minor factor. Arguments have raged inconclusively over whether such a change would hinder or enhance competition between audit firms. It is certainly true, however, that it would reduce the risk of one of the Big Four being destroyed by a single huge claim.

Chapter 6 of Part 17 of the new Act is therefore a welcome development for the audit profession, as it makes it possible for auditors to limit their liability by agreement with a company on an annual basis. A so-called "liability limitation agreement" will not be subject to the Unfair Contract Terms Act 1977, but will not be able to limit the auditor's liability to less than an amount that a court considers is "fair and reasonable in all the circumstances of the case". In deciding what is fair and reasonable, the court must have regard in particular to:

- the auditor's statutory responsibilities
- "the nature and purpose of the auditor's contractual obligations to the company"
- the professional standards expected of him.

The court must not take account of events arising after the loss or damage occurred, or of what probability there is of the company recovering from any other party who may also have been at fault.

As soon as the relevant sections of the Act become law on 6 April 2008, audit firms are likely to ask their clients to sign a liability limitation agreement restricting their liability to an amount proportionate to the auditor's fault and, most likely, subject to a monetary cap. Companies will have to assume that such restrictions are valid unless and until they challenge them successfully in court.

The Financial Reporting Council is understood to be holding discussions with various investors, companies and audit firms about the principles that should be followed in drawing up limited liability agreements. Formal guidance may be published later this year.

A company that has entered into a liability limitation agreement with its auditors will have to disclose this in its annual financial statements.

Recognising that audit firms may propose similar restrictions, so that in practice companies may have little choice but to accept the terms proposed, the Government has reserved the right in future to make regulations prohibiting or prescribing certain terms in order, particularly, to prevent anti-competitive behaviour. The Government does not expect to have to use this power, and no regulations will be made on commencement of the provisions. Regulations will be made requiring the principal terms of the limitation agreement and the date of the resolution approving (or waiving approval of) the agreement to be disclosed by way of a note to the accounts.

A liability limitation agreement will not be able to limit auditors' liability for past audits.

"As soon as the relevant sections of the Act become law on 6 April 2008, audit firms are likely to ask their clients to sign a liability limitation agreement restricting their liability to an amount proportionate to the auditor's fault and, most likely, subject to a monetary cap."

“Private companies will have to file annual reports and accounts at Companies House within nine months of the year-end (down from ten months at present), and public companies within six months (down from seven).”

Generally

Time limits for filing annual accounts

Private companies will have to file annual reports and accounts at Companies House within nine months of the year-end (down from ten months at present), and public companies within six months (down from seven).

Small and medium-sized companies

A single self-contained set of regulations governing the accounting and reporting requirements for small companies is proposed, so that it would not be necessary to consult sections of regulations that also applied to larger companies. It is also proposed that small and medium-sized companies should disclose turnover in their abbreviated accounts.

Appointment of auditors

There will be a presumption that auditors of private companies will be automatically reappointed each year.

Resignation of auditors

A firm which ceases to hold office as auditor of a quoted company will always have to make a statement about the circumstances of its departure. The statement will have to be circulated to the company's shareholders unless a court is persuaded that the auditor is “abusing his rights”. A copy must also be sent to Companies House and the Financial Reporting Council.

True and fair view

Apparently in response to concerns that the introduction of IFRS and changes to UK GAAP are eroding the concept of the ‘true and fair view’, section 393 of the Act provides that the directors of a company must not approve annual accounts unless they are satisfied that they give a true and fair view. It also requires auditors to have regard to this standard in carrying out their audit. The existing requirement for auditors to state in their report whether or not the accounts give a true and fair view has been retained.

Audit report

Section 507 of the Act makes it a criminal offence for an auditor knowingly or recklessly to cause a misleading, false or deceptive audit report to be made. The maximum penalty will be an unlimited fine - not imprisonment, as originally proposed.

For the first time, the audit report will have to be signed by the lead auditor, as well as the audit firm. However, the risk attaching to this will be reputational rather than legal: section 504 provides that the signatory will not be subject to “any civil liability to which he would not otherwise be subject”.

Auditors' terms of engagement

Regulations may be made in future requiring auditors or companies to publish audit engagement letters and/or details of the services provided by the auditors (and their associates) to the company, and the remuneration received.

Company administration

"Instead of needing unanimity, an ordinary resolution will be capable of being passed in writing by a simple majority of the total voting rights of eligible members; and a special resolution in writing by 75%."

Resolutions and meetings

Company decision-making processes will be streamlined. In particular:

- Private companies will not be required to lay their accounts or to appoint an auditor (if they have one) at an AGM. Companies that wish to continue to hold AGMs may do so
- Public companies will have to hold their AGM within six months of their financial year-end
- EGMs of both private and public companies will only require 14 days' notice, even if a special resolution is proposed
- Other than resolutions to remove a director or auditor, all resolutions of private companies will be capable of being passed in writing
- Instead of needing unanimity, an ordinary resolution will be capable of being passed in writing by a simple majority of the total voting rights of eligible members; and a special resolution in writing by 75%
- The percentage of shares or voting rights necessary to hold a meeting in a private company at short notice will be reduced from 95% to 90%
- A company will be able to change its name either by special resolution or by any other means provided in its articles.

Formation of companies

Companies will not be capable of being formed under the Act until October 2008.

Single member companies

It will be possible to have single member public companies, as well as private ones.

Constitution

Companies formed under the Act will have unlimited capacity. If those forming the company wish to restrict what the company may do – for example, if it is a special purpose vehicle - they will be able to set out limited objects in the articles of association (and the objects clauses of existing companies will be treated as if they were in the articles). The memorandum of association will be a brief document simply stating that the subscribers have agreed to become members and to take at least one share each.

Draft model articles for private limited companies, private companies limited by guarantee and public companies have been published, with a view to finalising them in the form of regulations in autumn 2007. From 1 October 2008 they will apply automatically to companies that are incorporated after that date, but not to companies incorporated before. In both cases, shareholders will be able to choose to adopt all or any part of the new model articles. Among other things:

- the public company articles are not intended to be suitable for public quoted companies and do not reflect listing requirements or market best practice; neither do they contain a disenfranchisement article. As far as other public companies are concerned, the Government envisages that the model articles will be used as a drafting resource for particular types of provision rather than as a complete template
- there are provisions in the public company articles (but not the others) enabling directors' meetings by conference call, video-conferencing and other methods

“It will also be possible for one director (even if there are other directors) to execute a deed by signing it in the presence of a witness who attests the signature.”

- section 175 of the Act provides that a director's duty not to have a conflict (for example, in relation to the exploitation of opportunities) is not breached if the matter is authorised by the directors. In the case of a public company this applies only if the constitution includes a provision enabling the directors to give this authority. The model articles for public companies do not, however, include such a provision, since the Government does not think that this should be the default position and that each company must decide whether or not it wants such a provision
- the public company articles include retirement by rotation provisions intended to be consistent with the Combined Code
- all the sets of articles provide for removal of a director when all the other directors decide that he should be removed
- only the public company articles provide for alternates, as the Government thinks it unlikely that directors in most private companies will want to appoint alternates. In fact, alternates are rarely used in quoted companies and at least one investor body strongly objects to them
- in all sets of model articles, the article dealing with attendance and speaking at general meetings has been drafted in such a way as to be amenable to “virtual” attendance and electronic voting
- the private company articles do not cater for partly-paid shares (and in fact provide that all shares are to be issued fully paid), and do not provide for dematerialised or bearer shares
- none of the sets of model articles contains provisions dealing with directors' indemnities or insurance, since the Government thinks that there are so many possible permutations that it would not be appropriate to provide default provisions.

Execution of deeds and documents

At present, unless the company's common seal is used, deeds must be signed by two directors or one director and the secretary. This method will still be valid, but it will also be possible for one director (even if there are other directors) to execute a deed by signing it in the presence of a witness who attests the signature.

From April 2008 private companies will not have to have a secretary, and this change will enable a sole director of a company without a secretary to execute deeds without using the common seal. According to the DTI's published timetable, the deeds provisions are not due to come into force until October 2008, but we understand that the DTI is considering either bringing in the relevant sections early or making transitional provisions.

Many companies will welcome the flexibility offered by this change, which will mean that it will no longer be necessary, for example, to courier documents between directors in different locations. On the other hand, from a corporate governance point of view, the security inherent in having to involve more than one officer will be lost.

Company names and trading disclosures

New provisions will enable a person to object to a company's name if that name is the same as, or confusingly similar to, a name in which the objector has goodwill. The objection will be upheld if the name was not adopted in good faith or if the main reason for its choice was either to obtain money from the person objecting or to prevent their using the name. The Government is consulting on the choice of characters that may be used, a proposal to restrict the number of characters in any name to 160, and the rules for determining whether names are too similar.

On 1 January 2007 the Companies (Registrar, Languages and Trading Disclosures) Regulations 2006 extended to websites and various electronic communications the longstanding statutory requirement for companies to state certain particulars on their

"A private company that is intending to re-register as public will be able to offer shares to the public without waiting for the re-registration to complete."

stationery and other hardcopy documents. The Regulations amended the relevant provisions of the Companies Act 1985, making it an offence, among other things, for a company incorporated under the Companies Acts (or the equivalent Northern Ireland legislation) not to state the company's name, its place of registration and the number with which it is registered, and the address of its registered office on all the company's websites and all its business letters and order forms that are in electronic form. The Government is now proposing to require every UK company and every company doing business in the UK to include its registered name on all forms of company documentation in whatever form (except where its registration details and trading name are included, where the trading name is the same as the registered name but without "Ltd" etc, or in communications following from an agreement made in the previous 12 months between the company and the recipient). There are also proposals about directors' names, display of the name at premises, fines, and whether shadow directors should be liable.

The Business Names Act 1985, which governs the use of trading names by certain companies, partnerships and sole traders, will be repealed and replaced with similar provisions.

Private companies offering shares to the public

Like the 1985 Act, the new Act will prohibit private companies from offering shares or debentures to the public. The definition of "offer to the public" currently in section 742A of the 1985 Act (which is quite different to the definition used for prospectus purposes) will remain largely unchanged.

An offer is not made to the public if (broadly speaking) it is (i) made to persons who are already connected to the company, such as existing shareholders and employees and members of their families; (ii) made in connection with an employee share scheme; or (iii) not "calculated to result" in the shares or debentures being offered to persons other than the original recipients of the offer. In the latter case, doubts remain about whether "calculated to result" requires an element of intention by the issuer and its directors (as the Government has said) or whether it is enough that, objectively speaking, the shares are likely to end up in the hands of third parties (as leading counsel has advised in the past). It is regrettable that this uncertainty has not been removed.

Breach of the prohibition will no longer be a criminal offence, but the company will normally have to re-register as a public company.

A private company that is intending to re-register as public will be able to offer shares to the public without waiting for the re-registration to complete. It will also be able to undertake to re-register as a public company and then do so within six months of the offer being made.

Paper-free holding and transfer of shares

The Act extends the power under section 207 of the Companies Act 1989 for the Secretary of State to make regulations providing for shares to be transferred electronically. It is under this power that the Uncertificated Securities Regulations 2001, which enable shares in quoted companies to be transferred through CREST, were made. The Government has said that it needs further information before using the power to make dematerialisation compulsory for listed companies.

Regulations will clarify that an assured payment obligation under CREST will constitute payment up in cash of new shares.

From 1 October 2008, companies will no longer have a statutory power to close their registers of members for up to 30 days a year.

“There will be a new offence of knowingly or recklessly delivering information to the registrar of companies that is misleading, false or deceptive in a material particular.”

Companies House filings

There will be a new offence of knowingly or recklessly delivering information to the registrar of companies that is misleading, false or deceptive in a material particular. The Registrar will have power to remove filed material that could be used to commit fraud (for example, company hijacking) following application by persons claiming to be affected.

Since 1 January 2007 it has been possible to incorporate a company on-line, and companies can file most documents and particulars electronically.

Application of the Act to existing companies

“For existing companies, the authorised share capital will be treated as a restriction in the company’s articles, but the company will be able to remove this restriction by ordinary resolution.”

The Government’s general approach to implementing the Act for existing companies is guided by three main objectives: the starting assumption is that the new law should come into force for existing companies and companies formed under the Act at the same time, and that it should apply to existing companies in the same way; the second objective is to ensure so far as possible that existing bargains are not overridden; and the third objective is to make it as easy as possible for existing companies to take advantage of the new freedoms that the Act offers and to comply with its requirements.

The Government has concluded that:

- there is no need for further transitional provisions covering the change in the nature of memoranda and articles – because section 28 of the Act does enough by providing that provisions in an existing company’s memorandum that would under the new Act be part of the articles will be deemed to form part of the company’s articles
- a change of name by an existing company should have the effect of removing references to the name from its articles, and would therefore not require it to change its articles
- the effect of existing absolute entrenchments (i.e. provisions placed in the memorandum with the intention that they should not be capable of being changed) will be preserved indefinitely
- for existing companies, the authorised share capital will be treated as a restriction in the company’s articles, but the company will be able to remove this restriction by ordinary resolution
- where the articles of an existing company do not contain an authorisation to make an alteration in its share capital, the company will continue to be unable to make such an alteration until the shareholders amend the articles to remove the restriction
- where at the time that the Act comes into force a company’s directors have a subsisting authority under section 80 or section 80A of the 1985 Act to allot shares, this authority should continue to have legal effect
- if a private company has express provision for holding AGMs in its articles the effect of this will be preserved. But indirect references to the AGM will be disregarded, so that where the articles provide for the directors or officers to retire by rotation at the AGM, their appointments will continue until terminated in accordance with the Act or other provisions of the articles
- any references in the articles that directly require or assume the requirement for a company secretary will continue to have effect
- in relation to directors’ conflicts of interest arising as a result of another position held by a director, transitional arrangements will require existing companies (private as well as public) to seek the approval of their members if they want to permit independent director authorisation of such conflicts
- in relation to directors’ conflicts of interest arising from directors’ transactions with the company, transitional arrangements will preserve whatever provisions an existing company has for dealing with such conflicts.

“The Government also foresees the need for transitional provisions involving provisions in articles of association or private contracts that rely on concepts that are abolished or different under the new Act.”

The Government is consulting on various areas where transitional provisions may be required – for example, in relation to acts done by a company secretary after a private company has decided not to have a secretary, and whether there should be a grace period for existing companies to comply with the requirement that at least one of the directors must be a natural person. The Government also foresees the need for transitional provisions involving provisions in articles of association or private contracts that rely on concepts that are abolished or different under the new Act: for example, extraordinary resolutions do not feature in the new Act, but some articles of association may provide for certain resolutions to be proposed as extraordinary resolutions. It would be possible for a transitional provision to say how surviving references to extraordinary resolutions are to be interpreted.

Similarly, stemming from the abolition of the concept of authorised share capital, it is proposed that any statement of a company's authorised share capital in its articles should continue to operate as a restriction on the number of shares and nominal amount of share capital that the directors may allot. Contracts, such as joint venture agreements, might contain restrictions on the company increasing its authorised share capital, and some contracts might fix a right to subscribe for shares, or a conversion right, by reference to a given percentage of a company's authorised share capital. The Government says that it would be possible for a transitional provision to say how such references to authorised share capital are to be interpreted - or it could be left to the courts.

Further reform of company law

"Because no consensus of support for the Law Commission's proposals emerged from the recent consultation exercise, the Act does not make any significant changes to most of the existing rules on registration of company charges."

Company law reform power

To help ensure that company law remains up to date, the original Bill contained power under Part 31 for the Secretary of State to make orders to amend primary legislation "in relation to companies" (so-called "company law reform orders"). Such orders would have been subject to a consultation process with interested parties and an accelerated Parliamentary approval process. However, this power was dropped after the Delegated Powers and Regulatory Reform Committee of the House of Lords published a damning report saying that it would give Ministers too much discretion to amend primary legislation without proper Parliamentary scrutiny.

As a result, amendments to the new Act or to the 1985 Act that are required in future – for example, to implement the Shareholder Rights Directive and the Directive on migration of companies between Member States, and to make changes recommended by the Law Commission on company charges (see below) – will have to be introduced using powers under the European Communities Act 1972 or by means of new primary legislation.

Company charges

Because no consensus of support for the Law Commission's proposals emerged from the recent consultation exercise, the Act does not make any significant changes to most of the existing rules on registration of company charges.

"Slavenburg filings" will be brought to an end. At present, lenders to companies incorporated outside Great Britain but with an established place of business here that grant a charge over property risk their security being invalid unless they attempt to register it. Companies House will reject the filing if the company has not been registered, and lenders keep the rejection letter as proof that they have done all they can to perfect the security. New regulations to be made under Part 25 are expected to state that the duty to register will apply only if the overseas company is registered with Companies House as a branch: it will not apply if the company is not required to register as a branch or if it simply fails to do so. The duty to register will end if the company gives notice to the Registrar of Companies that it has ceased to have a registrable presence in any part of the UK.

The Government has said that it intends to consult further about making more radical reforms to the current regime for company charges.

For further information on any of the topics covered in this bulletin, please contact Peter Bateman at peter.bateman@cms-cmck.com or on +44 (0)20 7367 3145, Simon Howley at simon.howley@cms-cmck.com or on +44 (0)20 7367 3566, or the partner you normally deal with.

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