



## BURGES SALMON BRIEFING

### The Companies Act 2006

Provisions coming into force on 1st October 2007

September 2007

#### Introduction

The Companies Act 2006 (the new Act) received Royal Assent on 8 November 2006. The new Act contains 1,300 sections, 16 schedules, is over 700 pages long and the index alone runs to just short of 60 pages. It is the result of the longest bill ever to pass through Parliament. This briefing is one in a series looking at the key implications of the new Act for companies and their directors. For other briefings in this series see the box headed "Companies Act 2006 briefings" at the end of this briefing.

Many of the headline issues arising out of the new Act were looked at in our earlier briefing "Companies Act 2006 – An Overview".

On 28 February 2007 the Government announced the implementation timetable for the new Act. All of the new Act will be in place by October 2008. The key implementation dates are 1 October 2007, 6 April 2008 and 1 October 2008.

The Third Commencement Order under the new Act was published in July 2007 and will bring into force the sections of the new Act which take effect from 1 October 2007. The purpose of this briefing note is to focus on these areas.

#### Directors (Part 10)

##### Directors' duties (sections 171-174)

The new Act sets out for the first time the general duties owed by directors to their company. There are seven statutory duties in total, however, only four are coming into force in October this year. The remainder, relating to conflicts of interest, accepting benefits and interests in transactions are not due to come into force until October next year. This is because it is anticipated that many companies will want to amend their articles of association to accommodate these new duties and the delay in commencement will allow this to happen during the next AGM season.

##### Statutory Directors' Duties coming into force on 1 October 2007

- duty one – to act within powers (section 171);
- duty two – to promote the success of the company (section 172);
- duty three – to exercise independent judgment (section 173);
- duty four – to exercise reasonable care, skill and diligence (section 174);

##### Duty to act within powers (section 171)

A director must act in accordance with the company's constitution and exercise all powers for the purposes for which they were conferred. The constitution for these purposes is defined in section 257.

##### Duty to promote the success of the company (section 172)

This duty replaces the common law duty to act in good faith in the best interests of the company as a whole.

Directors will need to have regard to a list of factors when considering how to act in a manner which promotes the success of the company for the benefit of its members. The factors set out in the new Act embody the concept of "enlightened shareholder value".

### Enlightened Shareholder Value (section 172)

A director of a company must 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; and
- the need to act fairly as between members of the company.

What does "success" mean in this context? During the passage of the Companies Bill through Parliament the Government stated that success for a commercial company will normally mean a "long-term increase in value" (Lord Sainsbury of Turville) (Hansard col. 245 11 January 2006).

Arguably, the list of factors simply represents the matters which a director would in any event have borne in mind where relevant when exercising his normal duty of skill and care. The key for directors will be to continue to ensure that they exercise their judgment in good faith and have properly considered the wider implications of their actions. Directors should resist the temptation to engage in a box ticking exercise, but should ensure that decisions are documented properly.

### Duty to exercise independent judgment (section 173)

A director must exercise independent judgment. However, a director can act in accordance with an agreement entered into by the company which restricts the future exercise of discretion by its directors or in a way authorised by the company's constitution.

### Duty to exercise reasonable care, skill and diligence (section 174)

This duty codifies the existing duty to exercise reasonable care, skill and diligence. A director owes a duty to his company to exercise the same care, skill and diligence that would be exercised by a reasonably diligent person with:

- the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as the director in relation to that company (an objective test); and
- the general knowledge, skill and experience that the director actually has (a subjective test).

The subjective test can only operate to increase the standard of knowledge, skill and diligence expected of a director.

### Claims against directors – the statutory derivative claim (sections 260-264)

The new Act introduces a statutory procedure allowing shareholders to sue directors on behalf of a company for breach of duty or trust, negligence or default. The new regime is wider than the rights presently available under the existing common law. Key points to note are that:

- there is no requirement that the director must have benefited from his conduct;
- there is no shareholding qualification so a claim can be brought by any member holding any number of shares;
- a derivative claim may 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 on the part of a director; and
- an action can be brought even if the member bringing the action was not a member at the time of the alleged wrongdoing.

However, a number of hurdles have been introduced to protect directors from unjustified claims including:

- the need to obtain the court's permission to pursue a derivative claim;
- the need to demonstrate a clear case against the defendant; and
- the possibility of being responsible for the costs of an unsuccessful action.

The new procedure applies to all claims after 1 October 2007, however, where a claim relates to an act or omission which occurred before this date, then a derivative claim can only be brought if or to the extent that a derivative action would have been allowed under the old regime.

#### Directors' long-term service contracts (sections 188-189) and disclosure requirements

The new Act reduces the maximum guaranteed term allowed in a director's service contract without prior members approval from five years to two years. The definition of "service contract" will also be wider than before and includes letters of appointment and consultancies and will also apply when a personal services company is engaged to supply the services of a director. These provisions apply to contracts made on or after 1 October 2007.

Copies of service contracts must be retained by the company for at least one year from the date of termination or expiry of the contract. This applies to all contracts in force on 1 October 2007 regardless of length of time left to run. Shareholders will still be able to inspect copies of directors' service contracts and they will also be able to request a copy of a service contract on payment of a fee (section 229). Copies must be provided within seven days after the request is received by the company.

#### Substantial property transactions (sections 190-196)

These sections apply to transactions or arrangements under which a company buys from or sells "a substantial non-cash asset" to a director of a company or its holding company or a person connected with such a director. These transactions or arrangements will require the approval of the shareholders of the company and, if the person entering into the transaction is a director of the holding company, approval of the shareholders of the holding company.

Approval is only required where the non-cash asset exceeds 10% of the company's asset value (based on its last set of annual accounts) and is more than £5,000 or exceeds £100,000.

The most significant change to the existing regime is that a contract can now be conditional on shareholder approval. The company is not liable under a conditional contract if approval is not forthcoming. These provisions apply to transactions or arrangements entered into on or after 1 October 2007.

#### Loans, quasi-loans, credit transactions and related transactions (sections 197-214)

The new Act abolishes the absolute prohibition on loans, quasi-loans credit and related transactions and replaces this with a requirement for members approval provided that disclosure is made in advance of certain information including the nature of the transaction and the amount of the loan/quasi-loan (or value of the credit transaction).

There will no longer be any criminal penalties for breach of these provisions.

There are numerous exceptions in the new Act to the requirement for members approval and many of the financial limits that already apply will be increased in many cases. These provisions apply to transactions or arrangements entered into on or after 1 October 2007.

#### Payments for loss of office (section 215-222)

The new Act expands the definition of "payment for loss of office" and provides that such payments are now possible provided the payment has been approved by a resolution of the members of the company. The existing provisions have been extended so that they now capture payments to connected persons and payments to former directors. These provisions apply to transactions or arrangements entered into on or after 1 October 2007. These provisions apply to loss of office or loss of employment or retirement occurring on or after 1 October 2007.

#### Connected persons (section 252)

The definition of a person "connected" with a director has been expanded under the new Act and now includes adult children and parents.

#### Directors' defence costs (section 205-206)

A company will still be allowed to lend money to help fund defence costs of a director in legal proceedings, including investigations by regulatory authorities, without needing members' approval. However, any loan can only be in relation to proceedings brought in connection with any alleged negligence, default, breach of duty or trust by a director in relation to the company or associated companies.

#### Directors' indemnities (sections 234-235)

The existing directors' indemnity provisions are largely unchanged in the new Act. The new Act does extend the scope of the

possible indemnity to include a director of a company that is a trustee of an occupational pension scheme against liability incurred in connection with that company's activities as a trustee of the scheme. There would, however, be no protection from a successful derivative claim as the beneficiary under a claim is in fact the company.

#### Breach of duty - ratification (section 239)

All breaches of duty, trust, acts of negligence or default by directors can be ratified by a resolution of the members of the company. However, any votes in favour cast by the director (if he is a member) or any shareholder connected with him must be disregarded.

## Shareholder Resolutions and Meetings (Part 13)

### AGMs

Private companies are no longer required to hold an AGM, but can still do so if they wish. Any existing company with an express requirement to hold an AGM in its articles will need to remove the requirement before it can take advantage of this relaxation. However, any indirect references to an AGM can be disregarded, for example if the articles require that directors shall retire by rotation at an AGM. The knock on effect of this is that private companies no longer need to lay their accounts before an AGM, nor re-appoint their auditor annually (provided the shareholders not the directors appointed the first auditors) and the third Commencement Order contains some complicated transitional provisions for existing companies.

Public companies must continue to hold AGMs, and they must now be held within six months of the company's financial year end. However, the transitional provisions have made for a complex run in to the new rules, whereby an existing public company must hold its first AGM after 30 September 2007 within 15 months of its previous AGM, thereafter the next AGM must be within seven months of the company's financial year end and all subsequent AGMs should then fall to be held under the new rules i.e. within six months of the company's financial year end.

### Notice periods

All general meetings can be held on 14 days' notice, subject to any longer period stated in the articles of association. This includes meetings to consider special resolutions which previously required not less than 21 days' notice. A public company AGM still requires 21 days' notice. The new rules apply to meetings where notice is given on or after 1 October 2007.

The Act will allow members of a private company holding 90% of the share capital to agree to hold a general meeting on short notice. Consent of members holding 95% of the share capital is still required for public companies to hold a general meeting on short notice. Consent of members holding 100% of the share capital is required for holding a public company AGM on short notice.

### Written resolutions (sections 288-300)

The new Act allows written resolutions to be passed with the same consent level as ordinary and special resolutions (as appropriate). Therefore an ordinary resolution in writing will require the agreement of more than 50% of shareholders eligible to vote and a special resolution in writing will require the agreement of not less than 75% of shareholders eligible to vote.

In line with current requirements, the new written resolution procedure cannot be used to remove a director or an auditor before the end of their term of office.

The new Act has not retained the option for companies to follow their own written resolution procedure in their articles of association. All written resolutions must follow the statutory procedure. The new procedure applies to written resolutions where the circulation date is on or after 1 October 2007. The new procedure is not available to public companies, nor can they use a procedure set out in their articles, but the principle of unanimous consent has been retained by the new Act, however, this should only be relied on in extreme circumstances.

A copy of the written resolution must be sent to the company's auditors.

### Proxies (sections 324-332)

Proxies now have the same rights to attend and to speak and vote at meetings as a member. On a vote on a show of hands, every proxy present at the meeting will have one vote, unless the articles state that between them a member and any proxies appointed shall have only one vote on a show of hands. Articles cannot provide that a proxy has fewer votes on a resolution on a show of

hands than the member would have if he was present in person.

Members also have the statutory right to appoint more than one proxy, provided each is appointed to exercise the rights attached to different shares held by the member.

#### Independent report on polls (sections 342-351)

Members of companies admitted to the Official List will in certain circumstances be able to request an independent report on any poll taken or to be taken at a general meeting of the company.

The appointment of an independent assessor (who may be the company's auditor) must be made within one week of the request for a report. A copy of his report must be made available on a website that is maintained by or on behalf of the company. Reports must contain the assessor's opinion on whether the procedures adopted in connection with the poll were adequate, whether the votes cast (including proxy votes) were fairly and accurately counted and whether the validity of proxy appointments was assessed. The independent assessor is granted powers to attend meetings and gain access to information from the company and its directors, employees, shareholders and agents.

### Political Donations And Expenditure (Sections 362-379) (Part 14)

The basic principle from the existing regime remains unchanged, a company must obtain shareholder approval (by way of ordinary resolution) before making any political donation or expenditure. The ambit of what requires approval is wide. The existing rules are largely restated in the new Act but there are a number of changes to be introduced to clarify ambiguities and simplify the process. Due to the wide definition of what amounts to a political donation or expenditure, many companies routinely obtain shareholder approval to avoid accidental breach, and this practice is likely to continue under the new provisions

### Other Provisions

#### Exercise of members' rights (sections 145 and 146)

The new Act allows companies to include a provision in their articles of association allowing a member to nominate another person or persons to enjoy or exercise all or any of his member's rights including for example the right to be sent a copy of the annual report and accounts.

In addition to the potential nomination rights described above, a member of a company admitted to the Official List who holds shares on behalf of others may request that the beneficial owner of shares should receive a copy of all communications that the company sends to members generally or to any relevant class of members; receive copies of reports and accounts; and receive a hard copy version of a document provided in another form (e.g. on a website).

A request may be made under both these sections from 1 October 2007, however, a company does not need to comply until 1 January 2008.

#### Access to register of members (sections 116-120)

The new Act introduces restrictions on the ability of third parties to inspect a company's register of members. A person wishing to inspect the register will have to provide their name, address, the purpose for which they will use the information, whether the information will be disclosed to any other person and, if so, for what purpose. It will be an offence to knowingly or recklessly make false or misleading statements when making a request for access to inspect the register or to disclose information to another person knowing or suspecting that that person may use the information for an improper purpose. A company must comply with a request for access within 5 days or if it considers that the request is not being made for a proper purpose it may (within that 5 day period) apply to the court for permission to refuse the request. These provisions only apply to a company once it is obliged to deliver an annual return made up to on or after 1 October 2008, until then the old rules apply.

#### The business review (Section 417)

The business review forms part of the directors' report in the annual report and accounts. The current requirements of the business review are largely repeated in the new Act. Most significantly, however, companies admitted to the Official List will be subject to additional contents requirements. A key change is that the new Act now links the business review directly with the new statutory directors' duties by stating that the underlying purpose of the business review is to inform members and help them assess how the directors have performed their duty to promote the success of the company.

The general requirements of the business review are a fair review of the company's business covering the development and performance of that business during the financial year and its position at the end of that year consistent with the size and complexity of the business and a description of the principal risks and uncertainties facing the company.

Companies admitted to the Official List will also need to include in their business review, to the extent necessary for an understanding of the development, performance or position of the company's business:

- the main trends and factors likely to affect the future development, performance and position of the company's business;
- information about environmental matters (including the impact of the company's business on the environment), the company's employees and social and community issues; and
- information about persons with whom the company has contractual or other arrangements which are essential to the business of the company. If the directors have nothing to report on environmental, employee, social and community or essential contractual arrangements the business review must say so.

There are two exemptions in the new business review regime:

- Directors may omit information about impending developments or matters in the course of negotiation where in their opinion disclosure would be seriously prejudicial to the interests of the company. This exemption is available to all companies.
- Directors may omit information about a third party which would otherwise fall to be disclosed as an essential contractual or other arrangement where in their opinion it would be seriously prejudicial to that third party (i.e. in this case it is irrelevant if it is prejudicial to the company itself) and contrary to the public interest. This exemption is only available for companies admitted to the Official List.

The provisions apply to directors' reports for the financial years beginning on or after 1 October 2007.

## Further information

For further information please speak to your usual contact at Burges Salmon or contact **Nick Graves** (0117 939 2200) ([nick.graves@burges-salmon.com](mailto:nick.graves@burges-salmon.com)) (Partner) or **Maggie Mitchell** (0117 902 7791) ([maggie.mitchell@burges-salmon.com](mailto:maggie.mitchell@burges-salmon.com)) (Professional Support Lawyer) or **Alyson Whale** (0117 939 2294) ([alyson.whale@burges-salmon.com](mailto:alyson.whale@burges-salmon.com)) (Professional Support Lawyer).

### Companies Act 2006 briefings

Other briefings in this series are:

**Companies Act 2006 –provisions coming into force in January 2007** (published December 2006)

**Companies Act 2006 – An Overview** (published February 2007)

**Companies Act 2006 – What does it mean for Directors?** (published February 2007)

**Companies Act 2006 – Implementation Timetable now published** (published March 2007)

**Companies Act 2006 – What does it mean for public companies?** (published March 2007).

**Companies Act 2006 – What does it mean for private companies?** (published March 2007).

We have also considered the issues raised by the implementation in the UK of the EU Transparency Directive in our briefing **Disclosure and Transparency Rules – Implementation of the EU Transparency Directive** (published January/February 2007).

The briefings shown above are available on our website [http://www.burges-salmon.co.uk/our\\_work/content/corporate/corporate\\_publications.htm](http://www.burges-salmon.co.uk/our_work/content/corporate/corporate_publications.htm) or please contact us to request a copy.