The Companies Act 2006

April 2008 implementation and Articles of Association update

March 2008

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.

On 13 December 2007 the Government announced the final implementation timetable for the new Act. A significant proportion of the new Act's provisions previously expected to be implemented in October 2008 have been delayed until October 2009. The major exceptions are the introduction of the directors' conflicts of interest provisions and the repeal of the prohibition on financial assistance for private companies which will both still happen on 1 October 2008.

The remaining implementation dates for the new Act are 6 April 2008, 1 October 2008 and 1 October 2009. A list of the key provisions coming into force on each of these dates is set out in the timetable at the end of this briefing.

Later in this briefing we look at certain of the provisions coming into force on 6 April 2008 but first we consider some of the amendments which companies may wish to make to their articles during the course of this year.

Articles of association – update now or wait?

Many companies are considering whether they should amend their articles of association to reflect the implementation of the new Act and when that review should take place. Given the delayed implementation of the new Act it will no longer be possible for public companies to use this year's AGM to update their articles to reflect full implementation of the new Act.

Possible changes to the articles fall into two broad categories:

- Housekeeping - changes to remove inconsistencies where the new Act's provisions override provisions in the articles. For example, articles restricting a proxy's right to speak and vote on a show of hands and articles stating that no reasons have to be given on a refusal to register a transfer of shares. These changes are not strictly necessary as, in any event, the new Act overrides such provisions. However if they are not made a company may be left with a misleading and confusing set of articles which could result in an accidental breach of company law. These amendments could be picked up either during a full review when all of the new Act is in force or when the company is next amending its articles.
- Deregulatory - changes to take advantage of some of the benefits of the new Act. For example, articles providing for a 21 day notice period for special resolutions could be amended to the shorter 14 day period now required under the new Act.

The key provisions which companies should review relate to:

Directors' conflicts of interest (deregulatory). This is the most significant change for public and private companies. Companies should consider amending their articles to ensure they are able to take advantage of the new regime. With effect from 1 October 2008, a director will have a statutory duty to avoid a situation in which he has, or can have, a conflict (or possible conflict) of interest with the interests of his company. A director will not breach this provision if the matter giving rise to the conflict (or possible conflict) of interest has been authorised by the board.

- Public companies - the directors' authorisation route will only be available for public companies if their articles expressly give the directors the permission to authorise conflicts.

  The GC100 has published a guidance paper on directors' conflicts of interests which is aimed at listed companies. The paper, which has been reviewed by the ABI, explains the changes which companies may wish to make to their articles and provides guidance for directors on the practicalities of exercising their power to authorise conflicts. The GC100 expects that shareholders are unlikely to object to proposals to amend articles to include directors' authorisation wording provided companies have an existing sound corporate governance structure, procedures in place for ensuring that the board's powers

Burges Salmon LLP, Narrow Quay House, Narrow Quay, Bristol BS1 4AH
Tel: +44 (0) 117 939 2000 Fax: +44 (0) 117 902 4400

Chancery Exchange, 10 Furnival Street, London EC4A 1AB
Tel: +44 (0) 20 7685 1200 Fax: +44 (0) 20 7685 1266

www.burges-salmon.com

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of authorisation are operated effectively and commit to confirming compliance with the procedures.

Where companies decide to include provisions dealing with conflict authorisation in their articles, provisions dealing with confidential information, attendance at board meetings and availability of board papers to protect a director being in breach of duty if a conflict of interest or potential conflict of interest arises should also be included. These provisions will only apply where the position giving rise to the potential conflict has previously been authorised by the directors.

- Private companies - the articles do not need to expressly allow the directors to authorise conflicts. However they must not contain anything which would invalidate such an authority. Under the commencement regulations, existing private companies must pass an ordinary resolution allowing the directors to authorise conflicts. Private companies may wish to consider including specific provisions in their articles dealing with confidential information, attendance and board papers as mentioned above.

This is one of the most significant aspects of the new Act. Directors must consider whether any of their other business interests conflict, or possibly may conflict, with the interests of the company. Any such conflicts must be authorised by the board or by shareholders. If not the director will be in breach of the new statutory duty.

For a fuller explanation of the much publicised new regime for directors' conflicts of interest refer to our earlier briefing **"Companies Act 2006 – What does it mean for directors?"**.

- **Electronic communications** (deregulatory). Companies need to be authorised by specific members' resolution or provisions in their articles to communicate with shareholders by way of their website.
- **Meetings and resolutions** (deregulatory and housekeeping), for example:
  - removing provisions relating to members' written resolutions. With effect from 1 October 2007, public companies can no longer pass written resolutions and private companies must follow the detailed procedures laid down in the new Act;
  - provisions dealing with convening general meetings, in particular an extraordinary general meeting to consider a special resolution can be convened on 14 days' notice whereas articles will refer to the 21 days' notice previously required;
  - private companies may wish to remove provisions which expressly require them to hold AGMs if they have previously held them and would now like to avoid the time and expense involved;
  - under the new Act proxies are entitled to vote on a show of hands whereas under many articles proxies are only entitled to vote on a poll.
- **Age of directors** (housekeeping). Many articles contain provisions requiring a director's age to be disclosed prior to election or re-election if he has reached 70 or limiting the age at which a director can be appointed. Such provisions could now be contrary to the Employment Equality (Age) Regulations 2006.
- **Directors' indemnities** (housekeeping). The powers of a company to indemnify directors and to fund expenditure incurred in connection with certain actions against directors have been extended. The existing exemption allowing a company to fund a director's defence in court proceedings now expressly covers regulatory proceedings and extends to associated companies. Perhaps more significantly, a company that is a trustee of an occupational pension scheme can now indemnify a director against any liability incurred in connection with the company's activities as trustee of the scheme.

The key trigger for public companies is likely to be the directors' conflict of interest provisions referred to above. If public companies decide to update their articles to cater for directors' authorisation of conflicts they may also wish to deal with other relevant areas listed above at the same time. On the other hand existing private companies which simply need to pass an enabling resolution to benefit from the new directors' authorisation regime, will probably wait until 2009 and do a single review exercise unless an earlier review of their articles is needed for any other reason.

Update on published guidance relating to the new Act

There have been a number of guidance papers published by various organisations over recent months which are useful for companies trying to interpret and apply the provisions of the new Act.

- GC100 guidance on directors' conflicts of interest

  Published by the Association of General Counsel and Company Secretaries of the FTSE 100
- ICSA guidance on directors' duties
- ICSA guidance on proxies and corporate representatives

- ICSA guidance on indirect investors

  See ICSA website at http://www.icsa.org.uk/index.php?option=com_content&task=view&id=61
- FRC draft guidance on Auditor Liability Limitation Agreement (public companies)

  See FRC website at http://www.frc.org.uk/about/auditorliability.cfm
- ASB – OFR guidance remains effective for business reviews (Official List)

  See ASB website at http://www.frc.org.uk/asb/press/pub1480.html

What is coming into force in April 2008?

The key areas of the new Act coming into force on 6 April 2008 where substantive changes will be introduced are provisions relating to:

- Accounts and reports
- Audit
- Distributions
- Execution of company documents
- Company secretary
- Transfer of securities

Accounts and reports

Accounts and reports - new framework to legislation

The new Act introduces a much simpler framework which should help companies to identify relevant requirements more easily. Much of the detail dealing with the format and content of accounts and reports which was set out in schedules to the Companies Act 1985 remains substantially the same. It is now set out in stand-alone regulations. The regulations group together the requirements for particular categories of companies in an attempt to make them more accessible.

Most helpfully, in line with the "think small first" ethos that the Government has aimed to apply to the new Act, a separate set of regulations has been produced which deal with the requirements for small companies. This means that small companies will just need to look in one place to ascertain what they must include in their accounts and reports rather than having to look at regulations that also apply to large companies and work out which provisions apply to them.

A further set of regulations then deal with requirements applicable to medium and large companies.

Small and medium-sized companies – thresholds increased

Regulations under the new Act will slightly increase the thresholds which determine which category a company falls within. For financial years commencing on or after 6 April 2008, the following will apply:

To qualify as a small company, at least two of the following requirements must be met:

- Annual turnover must be not more than £6.5 million (up from £5.6 million).
- Balance sheet total must be not more than £3.26 million (up from £2.8 million).
- Average number of employees must be not more than 50.

To qualify as a medium-sized company, at least two of the following requirements must be met:

- Annual turnover must be not more than £25.9 million (up from £22.8 million).
- Balance sheet total must be not more than £12.9 million (up from £11.4 million).
- Average number of employees must be not more than 250.

Period for filing reports and accounts (section 442)

The period for filing accounts will be shortened under the new Act. It will reduce from seven months from the end of the relevant accounting period to six months for public companies and from ten months to nine months for private companies (and LLPs). On a

practical level, companies may need to instruct their auditors to start work slightly earlier to meet the shortened reporting period. However as the shortened filing periods will apply to accounts and reports prepared in respect of financial years beginning on or after 6 April 2008 there is a fairly long lead time involved.

Regulations which come into force on 6 April 2008, determine the penalties which companies must pay to the registrar of companies if they file their annual accounts and reports late. The level of penalty depends upon the financial year in question and whether the company was public or private at the end of that financial year. For financial years beginning on or after 6 April 2008 the penalty is doubled for late filing in two successive financial years.

As part of the periodic financial reporting requirements under the new Disclosure and Transparency Rules, companies admitted to the Official List are required to publish annual reports (for financial years commencing on or after 20 January 2007) within 4 months of the end of their financial year.

Website access to annual accounts and reports (section 430) — Official List only

The annual accounts and reports of companies admitted to the Official List (for financial years beginning on or after 6 April 2008) must be made available on a website as soon as reasonably practicable (in addition to being sent to members in the agreed manner). These must be available on the website until the accounts and reports for the next financial year are available. Appropriate restrictions can be put in place to comply with foreign securities laws as necessary.

True and fair view (section 393)

The true and fair view criteria will continue to apply to accounts prepared under the new Act. The new Act however reinforces this requirement by imposing an obligation on directors not to approve the accounts (for financial years beginning on or after 6 April 2008) unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss of the company.

Audit and auditors

Auditors' liability limitation agreements (sections 534-538)

Auditors and companies will be able to agree a limit on the auditor's liability to the company for negligence, default, breach of duty or trust in relation to their audit work for a particular year by way of a liability limitation agreement (**LLA**). It will not be possible to enter into a rolling agreement for future audits. Shareholders will need to approve the principal terms of the LLA each year (although private companies may resolve on a yearly basis to waive the need for approval). It is likely that companies will come under pressure to enter into such agreements and that the negotiation of a LLA may become an integral part of a company's annual engagement terms with its auditors. Companies will be required to disclose, by way of a note to the annual accounts, the principal terms of the LLA together with details of the fees payable to their auditors.

A LLA will not be effective if it attempts to limit the auditor's liability to an amount which is less than that which is *"fair and reasonable"* having regard to the auditor's responsibilities, the nature and purpose of the auditor's contractual obligations to the company and the professional standards expected of him. However, despite the courts' power to look through any cap that limits liability below this standard and adjust it to an amount that the court thinks is fair and reasonable, there has been concern that the new Act has left open the possibility of fixed financial caps being introduced. The NAPF (and, we understand the ABI) are against fixed financial caps and are favouring a proportional liability approach (where the auditor's liability is proportionate to his share of responsibility for any losses suffered by the company). The NAPF has stated that unless there are compelling reasons to do otherwise investors should vote against resolutions which propose limitation on any basis other than proportional liability.

The Financial Reporting Council (**FRC**), which oversees corporate reporting, established a working group to produce guidance on the use of LLAs. The consultation paper and draft guidance issued in December 2007 is intended to provide assistance to directors, auditors and shareholders on the new provisions. The draft guidance does not give recommendations as to what the FRC considers to be a *"fair and reasonable"* level of liability but it does:

- set out factors to consider when looking at whether to enter into a LLA;
- set out matters to be covered in a LLA;
- explain the process to be followed for obtaining shareholder approval;
- provide specimen clauses for the LLA and suggested wording for resolutions and the notice of general meeting.

It is likely that companies may resist negotiating, and seeking shareholder approval for a LLA until the FRC issue final guidance on this area. The FRC consultation closed on 14 March 2008 and it is anticipated that final guidance will be published in May 2008.

Auditors' liability – new criminal offence (section 507)

The new Act introduces a new criminal offence for auditors in respect of auditor's reports for financial years beginning on or after 6 April 2008. An auditor will potentially be liable to a fine if he:

- knowingly or recklessly causes an audit report *"to include any matter that is misleading, false or deceptive in a material particular"*; or
- knowingly or recklessly causes an audit report to omit a statement required under the Act (ie. statements relating to problems with the accounts).

This new offence has raised concerns that auditors will become increasingly cautious with consequential cost implications and potentially a higher level of qualified reports.

Resignation of auditors (section 519)

Under the current legislation an auditor is required to make a statement *"of any circumstances connected with his ceasing to hold office which he considers should be brought to the attention of members or creditors of the company"*. If there are no such circumstances a negative statement is required.

Under the new Act an auditor of a company admitted to the Official List who ceases to hold office on or after 6 April 2008 will always be required to make a statement of the circumstances connected with his resignation – regardless of whether he considers these need to be brought to members' or creditors' attention.

Right to raise audit concerns (sections 527-531) — Official List only

Members of companies on the Official List will be able to require the company to publish a statement on the company website of their concerns or questions about the annual audit (or any circumstances connected with the company's auditor ceasing to hold office) which they intend to raise at the next AGM. A company will need to publish the statement if it receives requests from:

- members holding at least 5% of the total voting rights of all members who have a relevant right to vote; or
- at least 100 members who have a relevant right to vote and hold shares in the company with an average sum of not less than £100 paid up on those shares.

The request (and presumably the statement) must be received by the company at least one week before the meeting to which it relates. The notice of meeting must draw attention to the following:

- the possibility of a statement being placed on a website in accordance with this new right;
- the fact that the company cannot require members requesting website publication to pay the company's expenses;
- that if the company is required to place a statement on a website it must at the same time send the statement to its auditor; and
- that the business which can be dealt with at the meeting includes any such statement published on the company's website.

Listed companies will need to put in place a procedure for notifying the auditors of questions received.

Distributions

The provisions of the new Act apply to distributions made on or after 6 April 2008 and largely restate the existing law. The key area of change relates to the treatment of distributions in kind.

Intra-group transfers – distributions in kind (section 845)

An intra-group transfer of assets can be caught by the rules relating to distributions in kind. The existing law on distributions in kind is found in both the Companies Act 1985 and common law rules. There has been concern since the decision in the *Aveling Barford* case (*Aveling Barford Ltd v. Perion Ltd*) as to whether an intra-group transfer of assets can be conducted by reference to the book value of the asset rather than its market value. The *Aveling Barford* case established that where a company does not have any distributable profits and transfers an asset to a shareholder at less than market value, the company will have made an unlawful distribution.

The uncertainty has now been resolved by the new Act for distributions made on or after 6 April 2008. If a company has profits available for distribution and transfers a non-cash asset to a shareholder, the amount of the distribution arising from the transfer of the non-cash asset is:

- zero if the consideration is equal to or exceeds the book value of the asset; or

- the amount by which the book value of the asset exceeds the consideration received. In this case the difference must be covered by the company's distributable profits.

The company's distributable profits are deemed to be increased by the amount (if any) by which the amount paid exceeds the book value of the asset. For the effect of this see the examples in our earlier Companies Act 2006 briefings **"What does it mean for public companies?"** and **"What does it mean for private companies?"**.

This clarification of the ambiguity that has existed for some time is welcomed. The explanatory notes to the new Act envisage cost savings for companies, stating that this *"avoids the potential need for many companies to carry out asset revaluations requiring professional advice and incurring fees to advisers prior to making a distribution of a non-cash asset"*. However, in reality the practical impact may be less marked as many lawyers have already been following the approach set out in the new Act.

Administrative

Company secretary (section 270)

A private company will no longer be required to have a company secretary but can retain the role if it chooses. A company secretary of a private company which retains the role will continue to enjoy the same status as the position previously had, including authority to sign documents. Existing private companies who are keen to do away with the role will need to check their articles first. If the articles expressly require the company to have a secretary then it must retain a secretary or amend its articles accordingly. Provisions in the articles which merely require or authorise things to be done by a secretary or which relate to the manner of appointment or removal of a secretary are not considered to be an express requirement to have a secretary.

Execution of deeds and documents (section 44)

Companies will be able to execute documents in one of three ways:

- by company seal;
- by two authorised signatories (being each of the company's directors and the secretary);
- (the new method) by a single director in the presence of a witness.

The new method will give more flexibility to companies, particularly those private companies who choose not to have a company secretary going forward. It will apply to documents executed on or after 6 April 2008.

Transfer of securities (section 771)

There is a new requirement for a company to give reasons for refusing to register a transfer of shares or debentures which is lodged with the company on or after 6 April 2008. A company which refuses to register a transfer must notify the transferee of the refusal together with reasons for the refusal as soon as practicable and in any event within 2 months of the transfer being lodged. The company is obliged to provide *"such further information about the reasons for the refusal as the transferee may reasonably request"*. It is not clear what this could potentially consist of but the Act expressly states that this will not include minutes of board meetings.

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) (Partner) or **Alyson Whale** (0117 939 2294) (alyson.whale@burges-salmon.com) (Professional Support Lawyer).

Companies Act 2006 – briefings

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- **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)
- **Companies Act 2006 – provisions coming into force on 1 October 2007** (published September 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)

Companies Act 2006 implementation timetable – key dates

Date	Event
20 January 2007	Company communication provisions (sections 1143-1148, schedules 4 and 5)
	Public company's right to investigate interest in shares (sections 791 to 810, 811(1) to (3), 813 and 815 to 828)
	Directors' liability for false or misleading statements in the directors' report (section 463)
6 April 2007	Public company takeovers (Part 28)
1 October 2007	Exercise of members' rights (Part 9)
	A company's directors (other than provisions relating to directors' conflict of interest duties, directors' residential addresses and underage and natural directors) (Part 10)
	Derivative claims and proceedings by members (Part 11)
	Resolutions and meetings (and related sections 485-488 of Part 16 Audit) (Part 13);
	Control of political donations and expenditure (Part 14);
	Section 417 Contents of directors' report: business review;
	Appointment of private company auditors (sections 485-488)
	Fraudulent trading (Part 29);
	Protection of members against unfair prejudice (Part 30);
	Company investigations: amendments (Part 32).
6 April 2008	Company secretaries (Part 12);
	Accounts and reports (Part 15);
	Audit (Part 16);
	Debentures (Part 19);
	Private and public companies (including public offers by private companies and minimum share capital for public companies (Part 20);
	Certification and transfer of securities (Part 21);

Continued...

Date	Event
	Distributions (Part 23);
	Arrangements and reconstructions (Part 26);
	Mergers and divisions of public companies (Part 27);
	Statutory auditors (Part 42).
1 October 2008	Directors' conflict of interest, underage and natural directors
	Company names – objection to adjudicator (sections 69-74)
	Trading disclosures (name and other details) (sections 82-85)
	Reduction of share capital by solvency statement (sections 641-643 and related)
	Prohibition on financial assistance abolished for private companies
1 October 2009	General introductory provisions (Part 1);
	Company formation (Part 2);
	A company's constitution (Part 3);
	A company's capacity and related matters (Part 4);
	A company's name (Part 5);
	A company's registered office (Part 6);
	Re-registration as a means of altering a company's status (Part 7);
	A company's members (Part 8);
	Directors residential addresses (sections 240-247 and related Part 10)
	A company's share capital (Part 17);
	Acquisition by limited company of its own shares (Part 18);
	A company's annual return (Part 24);
	Company charges (Part 25);
	Dissolution and restoration to the register (Part 31);
	UK companies not formed under the Companies Acts (Part 33);
	Overseas companies (Part 34);
	The registrar of companies (Part 35);
	Business names (Part 41).
	All provisions in force.

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