



## BURGES SALMON BRIEFING

# The Companies Act 2006 What does it mean for private companies?

March 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". The purpose of this briefing note is to focus further on the key areas of the new Act which affect only or have particular relevance to private companies.

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. An implementation timetable is set out at the end of this briefing.

### Key changes under the new Act

The following box sets out some of the key changes that apply specifically to, or have particular relevance to, private companies.

#### Private Companies – Key Changes

##### *Directors*

- Codification of directors' duties
- New procedure for shareholders to take action against directors on behalf of a company
- Relaxation of rules prohibiting transactions between a director and a company

##### *Company secretary*

- No longer any requirement to have a company secretary

##### *Shareholder resolutions and meetings*

- No need to hold an AGM, lay accounts before an AGM or appoint an auditor annually
- Written resolutions no longer require unanimous consent
- All meetings can be called on 14 days' notice
- Enhanced proxy rights

##### *Electronic communications*

- Enhanced use of electronic communications

##### *Constitutional documents*

- Constitutional documents consolidated
- Abolition of objects clause – objects now unrestricted
- New model articles of association for private companies

### *Political donations and expenditure*

- Rules simplified

### *Share capital and capital maintenance*

- Prohibition on financial assistance abolished (unless private company is a subsidiary of a public company)
- Concept of authorised share capital abolished
- Where a private company only has one class of shares, shareholder approval will not be required for share allotments
- Reduction of capital allowed without court approval
- Clarification of the distributions in kind regime (relevant to intra-group asset transfers)

### *Company administration*

- Access to register of members restricted
- New procedure to challenge the registration of a company name
- Articles can provide for members' rights to be exercised by nominees

### *Narrative reporting, accounts and auditors*

- Time limits for filing accounts reduced to nine months after financial year end
- New statutory regime for directors' liability in respect of narrative reporting
- Liability limitation agreements with auditors

## Will the new Act replace the current Companies Acts?

Yes. The new Act will replace the vast majority of the existing companies legislation contained in the Companies Act 1985, the Companies Act 1989 and the Companies (Audit, Investigations and Community Enterprise) Act 2004. The provisions that will survive relate mainly to community interest companies and investigations. This helps to explain the length of the new Act.

## When will the new Act come into force?

All provisions of the new Act are expected to come into force by October 2008. A few have already become effective and the implementation timetable at the end of this briefing sets out the position. The key implementation dates are 1 October 2007, 6 April 2008 and 1 October 2008. The provisions of the new Act coming into force this October include:

- the exercise of members' rights by nominees (Part 9);
- directors' duties and other provisions relating to directors (but not those relating to conflicts of interest) (most of Part 10);
- the new derivative claims regime (Part 11);
- section 417 relating to the content of the directors' report; and
- those relating to shareholder resolutions and meetings (Part 13).

## How will the new Act affect existing companies?

The application of the new Act to existing companies is still being considered. A limited DTI consultation on the application of the Companies Bill to existing companies in relation to constitutional matters was carried out in August 2006 and the Government reported the results of this consultation in late December 2006.

Further transitional issues are being considered as part of a wider consultation on implementation which started on 28 February 2007. Final transitional provisions for existing companies are therefore still awaited. However the DTI has stated that it will ensure as far as possible that existing bargains between shareholders and companies are not overridden, whilst trying to ensure that it is as easy as possible for existing companies to take advantage of the freedoms that the new Act offers.

The current consultation paper is available at <http://www.dti.gov.uk/consultations/page37980.html>. The consultation period closes on 1 May 2007 as regards political donations and 31 May 2007 for all other issues.

## Will we benefit from the new Act?

The new Act is intended to simplify and modernise current company law. It seems to achieve this for private companies where there will be some significant areas of deregulation. However, public companies will face additional procedural requirements and quoted companies (for this purpose companies admitted to the Official List) even more, designed mainly to ensure increased disclosure and the availability of information to members and the public generally. The regulatory gap between private and quoted companies will increase.

## Specific issues for private companies

### Directors

#### Directors' duties (sections 170-181)

The new Act sets out for the first time the general duties owed by directors to their company. For further information please see our briefing "[The Companies Act 2006 – What does it mean for Directors?](#)".

#### Claims against directors (sections 260-264)

The new Act will introduce, in October 2007, a statutory procedure allowing shareholders to sue directors on behalf of a company for breach of duty or trust, negligence or default. For further information please see our briefing "[The Companies Act 2006 – What does it mean for Directors?](#)".

#### Notification of directors' interests

The obligation on a director to notify a company of his interests in shares or debentures under section 324 and related sections of the Companies Act 1985 including the requirement to keep a register of directors' interests notified under section 324 are being repealed with effect from 6 April 2007.

#### Other provisions affecting directors

The new Act re-states and amends existing Companies Act provisions dealing with transactions with directors, directors' liabilities and introduces some new provisions affecting directors. For further information please see our briefing "[The Companies Act 2006 – What does it mean for Directors?](#)".

### Company secretary

A private company is no longer required to have a company secretary (section 270). However, if a company wishes to retain the role of company secretary (particularly as all the duties of a company secretary re filing returns and maintaining records remain) they can do so. A company secretary of a private company will carry the same status as that of a secretary of a public company including authority to sign documents. The duty to keep a register of secretaries and notify the Registrar of Companies of changes will still apply. Where an existing company has a reference in its articles of association that directly requires or assumes the requirement for a company secretary, this will continue to have effect until the articles of association are amended.

## Shareholder resolutions and meetings

### AGMs

Private companies will no longer be required to hold an AGM. Under the current regime, if a private company wants to opt out of the requirement to hold an AGM it needs to pass an elective resolution to do so. An elective resolution requires the agreement of all the members entitled to attend and vote (section 366A Companies Act 1985). A private company can still hold an AGM each year but it will not have any obligation to do so.

The knock-on effect of this is that for private companies there is no longer a requirement to lay accounts and reports at a general meeting. Auditors will not need to be reappointed at a meeting, instead they will be deemed to be reappointed (section 487) unless the articles of association require actual reappointment or 5% of the shareholders send notice to the company that the auditors should not be reappointed (section 488).

Any existing company with an express requirement to hold an AGM in its articles of association 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 of association require that directors shall retire by rotation at an AGM, their appointment will continue until terminated in accordance with the new Act or other provisions of the articles of association.

## Written resolutions (sections 288-300)

The new Act will allow 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 (section 282) and a special resolution in writing will require the agreement of not less than 75% of shareholders eligible to vote (section 283). Currently section 381A of the Companies Act 1985 requires written resolutions to be signed by all the members of the company entitled to attend and vote at general meetings.

These new provisions, together with the fact that private companies will no longer need to hold an AGM, should mean that in future private companies will be able to handle most of their business without holding a general meeting. This should make life easier for private companies. However, 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.

Under the new procedure:

- a written resolution can be proposed by the directors (section 291) or by members holding not less than 5% of the total voting rights (section 292);
- if a special resolution is to be passed using the new written resolution procedure, the written resolution must state that the resolution is being proposed as a special resolution (section 283(3));
- the resolution can be sent to members in hard copy form, electronic form or by means of a website depending on how the company has agreed to communicate with its members; and
- members can require any resolution to be moved as a written resolution unless:
  - it would if passed be ineffective;
  - it is defamatory of any person; or
  - it is frivolous or vexatious (section 292(2)).

Members and directors are likely to have differing views on the interpretation of these limits on the types of resolutions which can be circulated;

- members can also require the company to circulate a statement with the resolution of not more than 1,000 words on the subject matter of the resolution. A company must circulate this statement unless it makes an application to court under section 295 and the court is satisfied that the rights conferred by sections 292 and 293 are being abused;
- the company must also send out guidance to members explaining how to signify agreement to the resolution and the date by which the resolution must be passed if it is not to lapse;
- a proposed written resolution lapses if it is not passed before the end of the period specified in the articles or (if the articles of association are silent) 28 days beginning with the circulation date (section 297); and
- a member is taken to have agreed to a written resolution when the company receives from him an authenticated document (in hard copy form or electronic form) identifying the resolution and indicating his agreement to the resolution (section 296). Once signified a member's agreement to a written resolution may not be revoked.

The new Act has not retained the option for companies to follow their own written resolution procedure in their articles of association. Therefore there will not be an equivalent of regulation 53 of Table A in the new model articles of association for private companies. All written resolutions must follow the statutory procedure.

## Proxies (sections 324-332)

Members' rights to appoint proxies are enhanced. Proxies will have the same rights to attend and to speak and vote at meetings as the member. On a vote on a show of hands, every proxy present at the meeting will have one vote. Articles of association 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 will 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.

Arguably the wording of the new Act potentially gives additional voting ability to a shareholder if he appoints a proxy in respect of some of his shares and both he and the proxy attend the meeting. In such a scenario both the shareholder and the proxy could vote on a show of hands (see section 284(2)). This could be adopted by disgruntled shareholders as a way of increasing their voting power and raising their voice. Whilst companies can amend their articles of association to prevent this by stipulating that the member and any of his proxies have only one vote between them on a show of hands it may be difficult to police this in practice and prevent multiple voting. This will only have an impact on private companies with a diverse shareholder base who continue to hold AGMs.

### Notice periods

All general meetings can be held on 14 days' notice, subject to any longer period stated in the articles of association (section 307). This includes meetings to consider special resolutions which previously required not less than 21 days' notice.

The new Act will allow members of a private company holding 90% of the share capital to agree to hold a meeting on short notice. Currently, a private company can only take advantage of the 90% threshold if it has passed an elective resolution which requires the agreement of all the members.

### Shareholder communications (section 1144-1148)

We looked at the new electronic communications regime in our briefing "**Companies Act 2006 – An Overview**". Companies can benefit from the increased efficiency and potential cost savings of website communication (provided they follow the procedures laid out in the new Act). This new regime was introduced with effect from 20 January 2007.

## Constitutional documents

### Memorandum and articles of association

The constitutional documents of a company, the memorandum and articles of association, will effectively be consolidated. The articles of association will be the sole forward-looking document. The memorandum will in effect become a formation document with little significance going forward after incorporation. Existing companies will not need to update their constitution merely to reflect this consolidation as the provisions set out in their memorandum that will not form part of the new style memorandum will automatically be deemed to form part of their articles of association (section 28).

### Abolition of objects clause

In a further significant change to the constitution of a company, the new Act removes the need for companies to include objects provisions in their constitution. Currently all companies are required to state their objects in the memorandum and many companies have long lists of objects (for example, to dispose of assets, to borrow, to charge assets, to act as a holding company, etc). Under the new regime a company's objects will be unrestricted unless specifically restricted by the articles of association (section 31).

Looking at how this will apply to existing companies, in the response to the initial consultation carried out last summer (see earlier section "**How will the new Act affect existing companies?**") the Government indicated that the objects provisions of existing companies should operate as restrictions unless removed by shareholder resolution. Given that existing objects provisions are worded as positive powers and any restrictions to the freedom under the new Act would naturally be worded as negative restrictions, it is not entirely clear at present how the automatic deemed incorporation of provisions from the memorandum into the articles of association will work in this case. However, should companies wish to benefit from the freedom of the new Act it appears that they will need to ask their shareholders for approval. Whilst most companies could probably carry on as they are with their current objects it may be an opportune time to review the relevant provisions of the memorandum to see if any are unnecessarily restrictive.

### New model articles of association

The new Act will introduce separate model articles of association for public and private companies (and also companies limited by guarantee) to replace the current Table A articles of association. This is a welcome step as it will go some way to address the different structures and needs of companies. A draft of these articles was published on 28 February 2007 and is annexed to the Companies Act 2006 Implementation Consultative Document issued on that date. The draft model articles of association for private companies are very short and simple and drafted to enable private companies to take full advantage of all the new de-regulatory provisions in the new Act. They do not contain, for example, any provisions on conduct of shareholder meetings or notice for shareholder meetings. This is because it has been presumed that most private companies will decide not to hold AGMs.

When introduced, the final version of the model articles of association will automatically apply as a default position to companies incorporated after that date but not to existing companies. Existing companies may wish to adopt the model articles of association wholesale to take advantage of the relaxed regulatory environment. However, larger private companies may decide this is not appropriate and may instead use the model articles as a source of guidance when considering what, if any, changes need to be made to their current articles of association to update them in line with the new Act.

#### Articles of association – entrenched provisions (sections 22-24)

The new Act will make it more difficult for companies to have entrenched provisions (those provisions that cannot be changed without a condition being met which is more onerous than passing a special resolution) in their constitution.

In the future, whilst companies will still be able to alter or remove existing entrenched provisions according to their articles of association, the introduction of a new entrenched provision will only be allowed on the formation of a company or with the consent of all the shareholders. Every time the articles of association are amended (whether in relation to the entrenched provision or not) a statement must be made to the Registrar of Companies stating that the articles of association have been complied with (section 24).

### Political donations and expenditure (sections 362-379)

The existing regime was introduced into the Companies Act 1985 (by the Political Parties, Elections and Referendums Act 2000) in February 2001. The basic principle is that 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, including:

- only a "relevant holding company" (the ultimate UK holding company) must authorise a donation or expenditure by a subsidiary company (rather than each holding company in the group);
- a holding company can use a single resolution to authorise donations and expenditure in respect of the company itself and its subsidiaries (section 367(1));
- the resolution may authorise donations under separate heads in respect of donations to political parties and donations to other political organisations and other political expenditure (section 367(3));
- companies will be required to seek authorisation for donations to independent candidates to any election to public office held in the UK or other EU member state and for expenditure by the company relating to independent election candidates;
- the new Act introduces a specific exemption for donations to trade unions (clause 374);
- the existing legislation provides an exemption where the aggregate donations by a company in a 12 month period do not exceed £5,000. This exemption is retained by the new Act but amended so that donations by other group companies must be taken into account in calculating the £5,000 threshold (section 378).

Due to the wide definition of what amounts to a political donation or expenditure, many companies routinely obtain shareholder approval to avoid accidental breach. This is likely to continue when the new Act is implemented although companies will need to review the wording of renewal resolutions to track the provisions of the new Act.

### Share capital and capital maintenance

#### Prohibition on financial assistance abolished

The new Act abolishes the prohibition on the giving of financial assistance by a private company for the purchase of its own shares. Therefore the relaxation for private companies (known as the "whitewash procedure") is not repeated in the new Act. Directors will still need to consider their general directors' duties before approving any loans, guarantees or security to be given by the company in connection with any such acquisition.

Concerns have been raised that the common law rules relating to maintenance of capital may still operate to prevent a private company giving financial assistance for the acquisition of its shares. The Government has prepared a "savings" provision which will confirm that the removal of the prohibition on financial assistance will not stop a company entering into transactions which it can lawfully enter into now under the whitewash procedure. A draft of this provision is annexed to the Companies Act 2006 Implementation Consultative Document issued on 28 February 2007.

It is hoped that banks and finance houses, which are used to the comfort that the financial assistance whitewash gives, will not attempt to re-introduce such a procedure as part of their facility documentation. This would limit the deregulatory benefits for private companies.

### Authorised share capital abolished

Under the new Act, companies will no longer be required to have an authorised share capital. If appropriate, the articles of association can still be used to create a restriction on the number of shares that can be issued. The Government's report on the initial limited consultation carried out last summer indicated that the authorised share capital of an existing company will continue to operate as a restriction on a company's ability to issue shares unless removed by a resolution of the shareholders.

### Allotment of shares – shareholder authorisation (sections 549-551)

The rules which govern the directors' ability to allot shares have been re-stated in the new Act with one major change. A private company with one class of share capital is excluded from the regime. This means that unless there are restrictions on allotment in the articles of association, directors will not need shareholder approval for allotments.

The Government's initial consultation also considered how existing directors' allotment authorities should be treated. The responses were in favour of maintaining the status quo and the Government has indicated that existing section 80 authorities will continue to have effect according to their terms until they fall due for renewal.

### Pre-emption rights (sections 560-577)

The existing pre-emption regime for new issues of equity is largely restated in the new Act but there are some important changes:

- the 21 day minimum period for acceptance of rights' issues is maintained but the Secretary of State has power to make regulations to vary this to any period being not less than 14 days. There is no indication at present whether this power will be utilised.
- the 21 day offer period can start when the offer is sent rather than when it is received (or deemed received) as under the existing regime.

As under the current rules, private companies will be able to exclude the need to make a pre-emptive offer or modify the way in which such offers are made. This exclusion can be set out in the articles of association or in a shareholder resolution for specific allotments. Companies with one class of shares need not align any pre-emption disapplication with an allotment authorisation as no such authorisation is required therefore the disapplication will not have to be time limited (section 569). However, for all other companies the two will be linked as they are under the current rules so when an allotment authority expires, so does the pre-emption disapplication.

### Public offers of shares by private companies (sections 755-760)

The new Act retains the basic prohibition that a private company cannot offer shares or debentures to the public. However, it does allow a private company to offer securities to the public:

- as part of arrangements under which the company is to re-register as a public company before the securities are allotted; or
- if, as part of the terms of the offer, the company undertakes to re-register as a public company within six months.

There are no longer criminal sanctions for breach. Instead, a court can:

- order the company to re-register as a public company unless it appears to the court that the company does not meet the requirements for re-registration as a public company and that it is impractical or undesirable to require the company to take steps to effect the re-registration;
- make a remedial order against anyone knowingly concerned in the contravention (whether or not an officer of the company) whereby anyone affected should be put back into the position they would have been in had the contravention not occurred; or
- make an order for the compulsory winding up of the company.

### Alteration of share capital (section 617-619)

The number of ways in which a company can alter its share capital has been increased by the new Act. A new notification procedure requires a company which has altered its share capital to file a Statement of Capital with the Registrar of Companies giving details of the total number of shares in issue, the aggregate nominal value of those shares, particulars of any rights attached to shares and the amount paid up or left unpaid on the shares.

## Reduction of capital (sections 641-653)

The new Act contains two procedures by which a private company can reduce its capital. The court approved procedure (sections 645-651) remains mainly unchanged from the procedure currently available and is available to all companies. The new Act also introduces a new procedure for private companies to enable them to reduce capital without the extra time and expense of the court procedure by way of a special resolution and a directors' solvency statement (sections 642-644).

Under this new procedure all the directors will be required to state that they have formed the opinion that there is no ground on which the company could be found to be unable to pay its debts at the date of the statement and for the next 12 months. If the statement is made without reasonable grounds each director is guilty of an offence punishable by fine and/or imprisonment (section 643).

There is no requirement that the solvency statement be accompanied by an auditors opinion. Of course directors may decide that an auditors opinion is necessary to provide them with comfort to give such a solvency statement. In light of the extra expense and time of obtaining such an opinion, the advantages of this procedure over the court approval route diminish somewhat, particularly when the court route gives directors protection against personal liability.

A company no longer needs to have a specific power to reduce its capital in its articles of association. Therefore companies will be permitted to reduce their capital unless their articles of association prohibit or restrict the right.

## 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 [1989] BCLC 626*) 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 introduction of section 845. This provides that if a company which has profits available for distribution 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 the following box.

### Statutory clarification of quantum and distributions in kind

Amount of distributable reserves and value of asset	Amount of consideration	Lawful or unlawful?
Company has £100 <b>positive</b> distributable reserves Book value of asset being transferred is £1000. Market value of asset is £2500.	Asset is transferred for £1000	Lawful. The company has positive distributable reserves.
Company has £100 <b>negative</b> distributable reserves Book value of asset being transferred is £1000. Market value of asset is £2500.	Asset is transferred for £1500	Lawful. Although the company appears to have negative distributable reserves, its distributable reserves are treated as increased by the amount by which the consideration paid exceeds the book value of the asset. This gives the company positive distributable reserves of £400.

<p>Company has £100 <b>negative</b> distributable reserves</p> <p>Book value of asset being transferred is £1000.</p> <p>Market value of asset is £2500.</p>	<p>Asset is transferred for £1000</p>	<p>Unlawful. The company has negative distributable reserves and the transfer is at an undervalue as it is for less than market value.</p>
<p>Company has £100 <b>positive</b> distributable reserves</p> <p>Book value of asset being transferred is £1000.</p> <p>Market value of asset is £2500.</p>	<p>Asset is transferred for £500</p>	<p>Unlawful. The company does not have sufficient distributable reserves to cover the shortfall between book value and the actual consideration.</p>
<p>Company has £1000 <b>positive</b> distributable reserves</p> <p>Book value of asset being transferred is £1000.</p> <p>Market value of asset is £2500.</p>	<p>Asset is transferred for £500</p>	<p>Lawful. The company has sufficient distributable reserves to cover the shortfall between book value and the actual consideration paid.</p>

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".

#### Redenomination of share capital (sections 622-628)

The new Act will introduce a simplified procedure for redenominating share capital into another currency by shareholder resolution. Under the current legislation the only way a company can do this is by cancelling its shares and issuing new shares by way of a time consuming and costly court approved reduction of capital.

## Company Administration

#### Company records

Company records are now defined in section 1134 and include registers, minutes, agreements and other documents. They can be kept in hard copy or electronic form provided they can be reproduced adequately (section 1135). The time limits for retaining records have in some situations been reduced, e.g. minutes currently have to be kept indefinitely, under the new Act they will only need to be kept for 10 years.

#### Registrar of Companies

The new Act gives the Registrar of Companies greater powers to specify the form and manner in which companies deliver information to the Registrar. The Registrar can also correct any information on a document delivered to the Registrar provided the relevant company has given its consent (section 1075).

#### Company names

The new Act creates a right for any person (not just a company) to challenge the registration of a name if the name proposed is the same as or similar to one in which the objecting party has goodwill. There are a number of grounds upon which such an objection might fail (section 69) e.g. the name was registered before the commencement of the activities on which the applicant relies to show goodwill. The new Act also introduces four new ways to change a company name (section 77) including enabling companies to set out a method for changing the company's name in the articles of association.

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

In a time of increasing concern over the availability and abuse of personal information and in the wake of publicity surrounding protection of shareholders, 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 has a shorter period to comply with a request for access than under the existing law, 5 days rather than 10 days. Alternatively, 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. The new provisions will make it much easier for companies to control access to their shareholders' details. Whilst this will be an improvement on the current position it is not an ideal solution for a number of reasons:

- a court application will be inconvenient and carries cost implications (although if the court considers a person is seeking information for an improper purpose it may require that person to pay the company's costs); and
- arguably five days is not sufficient time for the company to properly check out the person requesting inspection and make a court application if appropriate.

To bolster the restrictions on access under the new Act the Government intends (subject to consultation) to tighten disclosure of information at Companies House. If implemented, private companies will no longer have to supply the addresses of their members to Companies House in the company's annual return. The Government sees this as a practical way of ensuring that the protection provided to members by section 117 of the new Act is not eroded by the availability of personal details from Companies House.

Companies will no longer be able to close the register of members at any time with the result that it must remain open for inspection at all times.

#### Members' rights to be exercised by nominees (section 145)

The new Act introduces a section which 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.

We doubt whether companies will rush to include this sort of provision in their articles given the administrative and cost issues. Private companies particularly are unlikely to find this of any practical use. It is worth noting that the latest draft of the model articles for a private company does not include such a provision.

## Narrative reporting, accounts and auditors

#### The business review (section 417)

As a result of the Government's consultation on what should replace the ill-fated operating and financial review (OFR), the new Act introduces changes to the existing regime for business reviews.

The business review forms part of the directors' report in the annual report and accounts. The current provisions relating to the content of the business review are set out in the Companies Act 1985 and were first introduced (along with the OFR) in relation to financial years starting on or after 1 April 2005. The current requirements of the business review will largely be repeated in the new Act but a number of changes will apply to the business reviews of all companies required to produce one.

Many companies will have experience of preparing a business review in its currently required form. In view of best practice guidelines in this area, many companies with larger market capitalisations will also already be including in their directors' reports much of the additional forward-looking and social responsibility information which would have been required by the OFR.

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. We looked at this duty and the underlying concept of "enlightened shareholder value" in our earlier briefing "**Companies Act 2006 – What does it mean for Directors?**". Directors may well find it helpful to keep this purpose in mind when preparing their company's review.

In addition, 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. Potentially this would appear to be a useful exemption and a significant amount of commercially sensitive information may fall into this category.

The general requirements of the business review which will apply to all companies (except those that are subject to the small companies regime for accounts and reports) 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.

#### Liability for narrative reporting (section 463)

The new Act has introduced (with effect from 20 January 2007) a statutory regime for directors' liability for narrative reporting which incorporates what has become known as a 'safe harbour' for directors. The provision provides that a director will be liable to compensate the company for any loss it suffers as a result of any untrue or misleading statement in, or omission from, the directors' report, directors' remuneration report or information in summary financial statements derived from those reports, only if he:

- knew or was reckless as to whether the statement was untrue or misleading; or
- knew the omission to be a dishonest concealment of a material fact.

This new regime does not apply to a directors' report, directors' remuneration report or summary financial statement report sent to members before 20 January 2007.

A director's liability under this new provision is limited to the company and does not open him up to direct claims from shareholders or others who may have relied on the information contained in such reports or statements. However, the "safe harbour" for directors created by the new Act only applies to the statutory obligation to publish reports and does not extend to situations where a director may use the accounts and reports for other purposes. Directors should also remember the new statutory derivative claim procedure to be introduced by the new Act on 1 October 2007 which arguably makes it easier for shareholders to pursue a claim against a director on behalf of the company if the company itself fails to do so. For further details see our earlier briefing "**Companies Act 2006 – What does it mean for Directors?**".

#### Period for filing reports and accounts (section 442)

The period for filing accounts will be shortened from ten months from the end of the relevant accounting period to nine months for private companies. The Government's intention in shortening reporting periods was to create a regime where the information in the published annual report and accounts will be more recent and useful. On a practical level, companies may need to instruct their auditors to start work earlier to meet the shortened reporting period.

It is possible that these time limits will be changed again in the future to reconcile the time differences for filing with Companies House and with HM Revenue and Customs as the Government has asked that they work towards implementing a joint filing facility by 2010.

#### Auditors' liability (sections 534-538)

We looked at the provisions of the new Act relating to liability limitation agreements (LLAs) in our earlier briefing "**Companies Act 2006 – An Overview**". By way of update, an EU consultation is currently under way to seek views on whether the law on auditors' liability for negligence is in need of reform. The consultation considers various options including:

- a cap based on the size of the company (measured by its market cap);
- a fixed monetary cap at European level;
- a cap based on a multiple of the audit fees; and
- the introduction of proportionate liability.

The EU legislative process is a fairly lengthy one and any change arising from this EU consultation is likely to be some way off yet. However, it is worth noting that this area is being reviewed on an EU level even before the regime for LLAs under the new Act is implemented.

The new Act introduces a new criminal offence for auditors (section 507). An auditor will potentially be liable to a fine where 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 need not make a statement unless he considers there are such circumstances.

## Conclusion

The new Act will affect nearly every aspect of company law. Whilst there are many procedural and administrative changes, the most significant being those relating to the codification of directors' duties, the majority of the reforms should make life for private companies significantly easier in the future. In the short term existing companies will need to review articles of association to ensure that they are able to benefit from the changes introduced by the new Act and to take advantage of the deregulatory measures for private companies.

### 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 **Maggie Mitchell** (0117 902 7791) (maggie.mitchell@burges-salmon.com) (Professional Support Lawyer).

## Companies Act 2006 – briefings

Other briefings in this series to date 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).

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)

These briefings 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.

## Existing Companies - Government Consultation

Some of the key transitional issues for existing companies considered in the Government consultations are summarised below.

### August 2006 Consultation (Constitutional matters)

The Government expressed a general intention that a company's existing arrangements/bargains should be respected. Some of the key conclusions were:

- References to the authorised share capital in articles will be treated as a restriction on the ability to allot shares, but the company will be able to remove this restriction by ordinary resolution.

- Where articles do not contain authority to make an alteration to share capital, the company will continue to be unable to make such an alteration until the articles are amended to remove the restriction.
- Where a company has an existing authority under section 80 or section 80A of the 1985 Act to allot shares at the time that the relevant provisions of the new Act come into force, this authority should continue to have legal 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.
- 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.
- Any references in the articles of a private company that directly require or assume the requirement for a company secretary will continue to have effect.

## February 2007 Consultation (Further matters)

The Government emphasised that it is guided by three main objectives (acknowledging that there may be a tension between these different objectives):

- The new law should come into force for existing companies and companies formed under the new Act at the same time.
- To ensure so far as possible that existing bargains are not overridden.
- 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 consultation sets out a selection of examples (and asks for other suggestions) where transitional arrangements may be justified because existing bargains or rights may otherwise be affected. The Government states it will be working with representative bodies to identify others. The examples include:

- The new Act provides that every company must have at least one director who is a natural person. The Secretary of State may order the company to make an appointment if he becomes aware of a breach but will the decisions taken by the board in such circumstances still be valid? The consultation asks whether transitional provisions are needed to allow the board to continue to operate up to some specified cut-off date.
- Contributions to independent election candidates will be caught by the rules on political donations in an extension to the scope of the existing regime. Companies with a broad existing resolution, sufficient to cover donations to such candidates, will be able to rely on that resolution. For others, the consultation asks whether the commencement of the new rule on independent election candidates should be deferred for a further year in order to give companies time to pass a new or wider resolution.
- The Government believes that the new statutory derivative action provisions should as a rule be used for all claims brought on or after the commencement day (ie 1 October 2007). The consultation asks whether transitional provisions are needed to maintain the existing regime for certain categories of claims, such as claims where all the events giving rise to the claim took place before the commencement day and there are no continuing issues.
- Where provisions in articles of association or private contracts rely on concepts which are abolished or different under the new Act, whether any transitionals are required. For example, the expression 'authorised share capital', is a concept which does not feature in the new Act. Contracts, such as joint venture agreements, may contain restrictions on the company increasing its authorised share capital. There may also be some contracts where a right to subscribe for shares, or a conversion right, is fixed by reference to a percentage of a company's authorised share capital. The consultation asks whether transitional provisions are needed to say how such references are to be interpreted or whether this should be left to the courts.

## Implementation timetable – key dates

Date	Event
8 November 2006	Companies Bill received Royal Assent.
7 December 2006	Companies Act 2006 published in electronic form (available at <a href="http://www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en.pdf">http://www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en.pdf</a> ).
20 December 2006	Government published "Results of Consultation on the application of the Companies Bill to existing companies on issues related to the constitution – Summary of responses and the Government's conclusions" (available at <a href="http://www.dti.gov.uk/files/file36130.doc">http://www.dti.gov.uk/files/file36130.doc</a> ).
28 February 2007	Government announced full implementation timetable.
28 February 2007	Government published the consultation paper "Implementation of Companies Act 2006 – A Consultative Document". The deadline for responses is 31 May 2007. <a href="http://www.dti.gov.uk/consultations/page37980.html">http://www.dti.gov.uk/consultations/page37980.html</a> .

Date	Event
1 January 2007	The Companies Act 2006 (Commencement No.1, Transitional Provisions and Savings) Order 2006 ((2006/3428) came into force. This sets the 1 January, 20 January and 6 April implementation and repeal dates which are referred to below.
1 January 2007	The Companies (Registrar, Languages and Trading Disclosures) Regulations 2006 (2006/3429) came into force. These Regulations implement provisions of the First Company Law Amendment Directive (EEC 2003/58/EC) relating to electronic communications with the Registrar of Companies and related matters.
20 January 2007	<p>The following provisions of the new Act came into force:</p> <ul style="list-style-type: none"> <li>- the company communication provisions (sections 1143 to 1148 and schedules 4 and 5) including provisions facilitating electronic communication;</li> <li>- the provisions dealing with a public company's right to investigate who has an interest in its shares (sections 791 to 810, 811(1) to (3), 813 and 815 to 828). These replace equivalent provisions contained in sections 212 to 219 of the Companies Act 1985. Section 212 notices are replaced by section 793 notices.</li> <li>- directors' liability for false or misleading statements in the directors' report, the directors' remuneration report and any summary financial statement derived from such reports (section 463).</li> </ul> <p>The existing provisions relating to the disclosure of major shareholdings in sections 198 to 211 of the Companies Act 1985 are repealed and replaced by the new Disclosure and Transparency Rules (which also commenced on 20 January 2007). The new Disclosure and Transparency Rules are available at <a href="http://fsahandbook.info/FSA/index.jsp">http://fsahandbook.info/FSA/index.jsp</a>.</p>
6 April 2007	Commencement date for provisions relating to public company takeovers which are contained in Part 28 of the new Act. A draft commencement order (The Companies Act 2006 (Commencement No.2, Consequential Amendments, Transitional Provisions and Savings) Order 2007) was laid before Parliament on 8 February 2007 (available at <a href="http://www.opsi.gov.uk/si/si2007/draft/20075771.htm">http://www.opsi.gov.uk/si/si2007/draft/20075771.htm</a> ).

*Continued...*

Date	Event
	<p>The following sections of the Companies Act 1985 will be repealed:</p> <ul style="list-style-type: none"> <li>- authentication of documents (section 41);</li> <li>- maximum age limit for directors of a public company (sections 293 and 294);</li> <li>- prohibition on company paying a director remuneration free of income tax (section 311);</li> <li>- prohibition on directors and their families dealing in options over shares in a company admitted to the Official List, AIM or PLUS Markets (sections 323 and 327);</li> <li>- disclosure by a director of dealings by that director and members of his family in the company's shares or debentures (section 324 to 326, 328 to 329 and parts 2 to 4 of schedule 13). The register of directors' interests required by section 325 will become redundant;</li> <li>- special provisions for banking companies etc in respect of loans to directors (sections 343 and 344);</li> <li>- power for the Secretary of State to bring civil proceedings on company's behalf (section 438);</li> <li>- certain companies, including insurance companies, to publish periodical statement (section 720); and</li> <li>- annual report by Secretary of State to Parliament in respect of matters within the Companies Acts (section 729).</li> </ul>
<b>1 October 2007</b>	<p>Part 9 (Exercise of members' rights);</p> <p>Part 10 (A company's directors), other than provisions relating to directors' conflict of interest duties, directors' residential addresses and underage and natural directors;</p> <p>Part 11 (Derivative claims and proceedings by members);</p> <p>Part 13 (Resolutions and meetings), and, related to this, sections 485-488 of Part 16 (Audit);</p> <p>Part 14 (Control of political donations and expenditure);</p> <p>Section 417 of Part 15 (Contents of directors' report: business review);</p> <p>Part 29 (Fraudulent trading);</p> <p>Part 30 (Protection of members against unfair prejudice);</p> <p>Part 32 (Company investigations: amendments).</p> <p>The commencement provisions in respect of Part 9 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.</p>

Date	Event
<b>6 April 2008</b>	<p>Part 12 (Company secretaries);</p> <p>Part 15 (Accounts and reports), other than section 417;</p> <p>Part 16 (Audit), other than sections 485-488;</p> <p>Part 19 (Debentures);</p> <p>Part 20 (Private and public companies);</p> <p>Part 21 (Certification and transfer of securities);</p>

*Continued...*

Date	Event
	<p>Part 23 (Distributions);</p> <p>Part 26 (Arrangements and reconstructions);</p> <p>Part 27 (Mergers and divisions of public companies);</p> <p>Part 42 (Statutory auditors).</p>
<b>1 October 2008</b>	<p>Part 1 (General introductory provisions);</p> <p>Part 2 (Company formation);</p> <p>Part 3 (A company's constitution);</p> <p>Part 4 (A company's capacity and related matters);</p> <p>Part 5 (A company's name);</p> <p>Part 6 (A company's registered office);</p> <p>Part 7 (Re-registration as a means of altering a company's status);</p> <p>Part 8 (A company's members);</p> <p>Part 10 (A company's directors) - provisions relating to directors' conflict of interest duties, directors' residential addresses and underage and natural directors</p> <p>Part 17 (A company's share capital);</p> <p>Part 18 (Acquisition by limited company of its own shares);</p> <p>Part 24 (A company's annual return);</p> <p>Part 25 (Company charges);</p> <p>Part 31 (Dissolution and restoration to the register);</p> <p>Part 33 (UK companies not formed under the Companies Acts);</p> <p>Part 34 (Overseas companies);</p> <p>Part 35 (The registrar of companies);</p> <p>Part 41 (Business names).</p> <p>In the light of further consultation with business, section 358 of the Companies Act 1985, which provides a power for companies to close the register of members, will be repealed with effect from 1 October 2008. (Originally scheduled for April 2007).</p> <p>All provisions in force.</p>

Disclaimer: This briefing gives general information only and is not intended to be an exhaustive statement of the law. Although we have taken care over the information, you should not rely on it as legal advice. We do not accept any liability to anyone who does rely on its content.

© Burges Salmon LLP 2007. All rights reserved. Extracts may be reproduced with our prior consent, provided that the source is acknowledged.

Data Protection: Your details are processed and kept securely in accordance with the Data Protection Act 1998. We may use your personal information to send information to you about our products and services, newsletters and legal updates; to invite you to our training seminars and other events; and for analysis including generation of marketing reports. To help us keep our database up to date, please let us know if your contact details change or if you do not want to receive any further marketing material by contacting [marketing@burges-salmon.com](mailto:marketing@burges-salmon.com).