



BURGES SALMON BRIEFING

The Companies Act 2006

What does it mean for public and quoted 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, public and/or quoted companies. Companies admitted to trading on AIM are not quoted companies for the purposes of the new Act. Instead the term refers to UK companies admitted to the Official List or officially listed in another EEA State.

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

The following boxes set out some of the key changes that apply specifically to, or have particular relevance to, public and/or quoted companies. (Those marked with * apply to all companies including private companies.)

All public companies – key changes

- New statutory regime for directors' liability in respect of narrative reporting*
- Exercise of members' rights by nominees*
- Enhanced proxy rights*
- Time limits for filing accounts reduced to six months after financial year end
- AGM must be held within six months of end of financial year
- Liability limitation agreements with auditors*
- Constitutional documents consolidated*
- New model articles for public companies
- Notice periods for special resolutions reduced from 21 to 14 days*
- Political donations and expenditure rules simplified*
- Enhanced use of electronic communications (see our earlier Overview briefing)*
- Concept of authorised share capital abolished*
- Clarification of the distributions in kind regime (relevant to intra-group asset transfers)*
- Access to register of members restricted*
- New power for Government to require disclosure of voting by institutions

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Official List only – additional key changes

- Expanded business review
- Information rights for indirect investors
- Independent report on polls on members' request
- Members' right to raise audit concerns
- Website publication of annual report and accounts, results of poll, independent report on poll and audit concerns
- Auditors always required to make statement of circumstances connected with resignation

Transparency Directive

We looked at the impact of the Transparency Directive in our briefing "**Disclosure and Transparency Rules – Implementation of the EU Transparency Directive**". An analysis is outside the scope of this briefing but the DTR has introduced changes covering:

- Major shareholding notifications (Official List/AIM and PLUS Market)
- Periodic financial reporting (Official List only)
- Dissemination of regulated information (Official List only)

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 will 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 current 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 (rights of indirect investors) (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 business review section of the directors' report; and
- those relating to resolutions and meetings (Part 13).

How will the new Act affect existing companies?

It is not yet clear how the majority of the provisions of the new Act will apply to existing companies. 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 (Companies Act 2006 Implementation Consultative Document). The consultation paper is available on the DTI website 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. For further details see the box headed "**Existing companies - Government consultation**" at the end of this briefing.

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 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 public companies and quoted companies

Narrative reporting

The expanded 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. Most significantly, however, companies admitted to the Official List will be subject to additional contents requirements which, to a large extent, mirror the forward looking material they would have been obliged to disclose in the OFR. This is an interesting result given that the repeal of the OFR was promoted as a measure to cut red tape because it unnecessarily "gold-plated" the actual requirements of the EU Accounts Modernisation Directive which imposed the underlying requirement.

Most companies will have experience of preparing a business review. In view of best practice guidelines in this area (see box below "**Narrative Reporting – current best practice for companies admitted to the Official List**"), 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 (and which will be required under the new expanded business review when it is implemented).

Purpose and general content

All public companies

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.

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.

Expanded content

Official List only

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. This is the controversial and much publicised 'supply chain reporting' introduced in the very last weeks of the passage of the bill through Parliament which raised much opposition from business organisations. The Government has stated that supply chain reporting "*is not a requirement on companies to list their suppliers and customers or to provide details about contracts. The provision is about reporting significant relationships, such as with major suppliers or key customers critical to the business, which are likely to influence, directly or indirectly, the performance of the business and its value*" (Lord Sainsbury, Hansard col. 455, 2 November 2006).

If the directors have nothing to report on environmental, employee, social and community or essential contractual arrangements the business review must say so.

Companies admitted to the Official List will need to consider the contents of their business review in light of the requirements set out in the Disclosure and Transparency Rules for periodic financial reporting. Under DTR 4 the management report comprised in the annual financial report must contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company. The review must be a balanced and comprehensive analysis of the development and performance of the company's business during the financial year and the position at the end of that year. To the extent necessary for the understanding of the development, performance or position of the business, the review must include analysis using financial and other key performance indicators (including information on environmental matters and employee matters). We considered the new reporting regime in our briefing "**Disclosure and Transparency Rules – Implementation of the EU Transparency Directive**".

Exemptions from disclosure requirements

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. Potentially this would appear to be a useful exemption and a significant amount of commercially sensitive information may fall into this category. However companies admitted to the Official List will need also to consider the impact of the new rules for financial reporting under the Disclosure and Transparency Rules where no similar exemption exists; and
- 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. This relaxation was introduced following concern that supply chain reporting could be abused by animal welfare campaigners. It will however be difficult to rely on this exemption for general commercial reasons given the condition that disclosure must be contrary to the public interest. There is currently no guidance on what may satisfy this condition but the bar is likely to be set high and boards will need to consider any decision to omit a disclosure on this basis very carefully.

Assuming the Government brings the new business review regime into effect for financial years starting after 1 October 2007 (the date it implements section 417) the first expanded business reviews will not be published until early 2009. The Government has indicated that it will review how effectively the new narrative reporting regime is being implemented two years after its introduction.

Narrative Reporting – current best practice for companies admitted to the Official List

In November 2006, the Association of British Insurers (**ABI**) issued a position paper on narrative reporting in which they highlighted the delivery of forward-looking information and non-financial key performance indicators as priority areas for improvement. They also emphasised that they continued to consider the guidance on narrative reporting developed by the Accounting Standards Board (**ASB**) in relation to the now withdrawn OFR to be best practice (Reporting Statement on the Operating and Financial Review published by the ASB in January 2006).

On 1 February 2007, the ABI published its Responsible Investment Disclosure Guidelines which update and replace its Socially Responsible Investment Guidelines (published in 2001) in light of the new business review regime and its recent review of narrative reporting. These Guidelines offer guidance as to the disclosures institutions expect to see in annual reports. Amendments incorporated into the Guidelines include the following additional questions in the list of questions which companies can use as a framework for reporting:

- does the annual report include a forward-looking assessment of environmental, social and governance (**ESG**) matters?
- is there a description of the role of the board in overseeing risk management?
- has the company followed ASB guidance on narrative reporting (see below)?
- does the company produce key performance indicators on material ESG rules?

The new Responsible Investment Disclosure Guidelines are available at www.ivis.co.uk.

The ASB Reporting Statement started life as the first Reporting Standard issued by the ASB (under its then legal powers to make standards for the OFR) following extensive consultation. It sets out a framework of the main elements to be disclosed and is accompanied by implementation guidance setting out some illustrations and suggestions of specific content. It is available from the Financial Reporting Council at www.frc.org.uk.

A recent ASB Review of Narrative Reporting (published in January 2007) indicates that many companies admitted to the Official List are already exceeding their legal disclosure obligations and moving towards best practice by adopting the principles set out in the ASB's Reporting Statement. It identifies disclosure of forward-looking information as one of the key areas for improvement and recommends that companies start preparing themselves for the increasing requirements in this area.

Liability for narrative reporting

The Government has included two provisions in the new Act dealing with liability for financial reporting disclosures. The first determines directors' liability and applies to all public companies. The second determines companies' liability and applies only to companies admitted to the Official List.

Directors' liability (section 463)

All public companies

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 statements 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?**".

Companies' liability (section 1270)

Official List only

Listed companies are subject to a new statutory liability regime in respect of annual financial reports, half-yearly financial reports and interim management statements published as a result of a requirement imposed by the Transparency Directive. The same regime will also, subject to certain conditions, apply to preliminary announcements if published. The new Act introduces provisions which make companies admitted to the Official List liable to pay compensation to a person who has acquired securities issued by it and suffered loss in respect of them as a result of any untrue or misleading statement in a relevant publication or the omission from any such publication of any matter required to be included in it (section 1270).

However a company will only be liable if a person discharging managerial responsibilities (**PDMRs**) within the company in relation to the relevant publication knew the statement to be untrue or misleading or was reckless as to whether it was untrue or misleading, or knew the omission to be a dishonest concealment of a material fact. For the purposes of this section only directors of the company will be PDMRs (which contrasts with the current use of that term in the Financial Services and Markets Act 2000 which also covers senior executives with regular access to inside information relating to the company and power to make managerial decisions affecting the future development and business prospects of the issuer).

Only the company will be liable to a person who has acquired securities in these circumstances. Investors will not be able to bring claims against directors as a result of this provision. The new provision will apply to reports produced for financial years commencing on or after 20 January 2007.

For further details please see our briefing "**Disclosure and Transparency Rules – Implementation of the EU Transparency Directive**".

Enhanced Shareholder Engagement

One of the Government's key objectives in reforming company law was the concept of enhanced shareholder engagement - improving the provision of information to and participation by investors. The new Act recognises that investors (whether major institutions or individuals) are increasingly likely to hold shares through an intermediary or chain of intermediaries. As a result investors are in many respects disenfranchised and must typically rely on contractual arrangements with the intermediaries both to obtain information and give any instructions on how they wish shares to be voted. Some of the key changes introduced by the new Act to achieve this objective include:

Exercise of members' rights (sections 145 and 146)

The new Act introduces two new provisions dealing with the rights of indirect investors to exercise governance rights. One applies to all companies, the other only to companies admitted to the Official List. Both will be introduced on 1 October 2007. There is concern that these new rights will add to the administration costs of the company.

Nominations to exercise members' rights – any third party

All public companies

All companies will be able to include a provision in their articles of association allowing the registered member to nominate another person to enjoy and exercise all or some of his member's rights (section 145) including:

- to require circulation of a resolution for the AGM;
- to require directors to call general meeting;
- to receive notice of general meetings;
- to appoint proxy; and
- to be sent a copy of the annual report and accounts.

Whilst this provision is aimed at giving rights to the indirect investor who holds shares through an intermediary member, unless restricted by the company's articles of association the registered member will be free to nominate any person to enjoy such rights.

The new Act makes it clear that the nominee will not be able to enforce their rights directly against the company. It will be the registered member only who can enforce the rights.

It is worth emphasising that these are not automatic rights. Firstly the company will need to include appropriate authorities in its articles of association. The company is not obliged to do this at all and may use the articles to limit the rights which can be exercised by a nominee as it thinks appropriate. Secondly the registered member must agree to confer such rights on the indirect investor (or other person).

We doubt whether public companies will rush to include this sort of provision in their articles given the administrative and cost issues involved.

Nominations to receive information – beneficial owners only

Official List only

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 enjoy certain information rights (section 146):

- to receive a copy of all communications that the company sends to members generally or to any relevant class of members;
- to receive copies of reports and accounts; and
- to receive a hard copy version of a document provided in another form (e.g. on a website).

When a listed company sends a copy of a notice of meeting to a nominated person, the notice must be accompanied by a statement that:

- the nominated person may have a right under an agreement with the member who nominated him to be appointed as a proxy for that meeting; and
- he may alternatively have a right to give voting instructions to that member.

The copy must either omit the standard statement about the right to appoint a proxy or make it clear that it does not apply to the nominated person.

There is no need for companies to amend their articles of association for the information rights provisions to take effect. Similarly, a listed company will not be able to use its articles of association to remove or limit these information rights. If the registered member submits a nomination in accordance with the new Act then the company is obliged to comply. Crucially, the registered member may only nominate the beneficial owner to enjoy all of these information rights and not merely some. A nomination which attempts to select certain information rights only will be ineffective (thankfully, as the potential administrative burden on companies if members could pick and choose in individual cases would be increased even further).

The Government has announced that nominee investment operators will be able to send indirect investors requests to companies from 1 October 2007 to entitle indirect investors to enjoy information rights from 31 December 2007. Companies will need to consider how records of nominations are to be held and administered. We recommend that this topic is discussed with registrars in good time. Companies will also need to consider whether they wish to contact nominated persons and ask them if they want to retain information rights. Any such enquiry can only be made once a year but may help to manage the number of nominated persons. If no response is received within 28 days, the nomination rights will cease.

Proxies (sections 324-331)

All public companies

Members' rights to appoint proxies are enhanced. 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 (many articles of association already provide for this). Proxies will have the same right to attend, speak (currently only allowed for private companies) and vote at meetings as the member, even on a show of hands.

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 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. In practice, many companies are in any event moving towards poll votes as a matter of good governance which reduces the significance of this issue.

For details on how discretionary proxies are caught by the new major shareholding notification provisions under the Disclosure and Transparency Rules (which apply to companies admitted to the Official List and AIM and Plus Market) see our earlier briefing "**Disclosure and Transparency Rules – Implementation of the EU Transparency Directive**".

Independent report on polls (sections 342-351)

Official List only

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 request must be made no later than one week after the date on which the poll is taken by:

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

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.

Whether this becomes a publicity tool for disgruntled shareholders or is used by those with genuine concerns remains to be seen but either way there is some concern as to the level of additional administrative work and cost potentially involved.

Allied to the concept of enhanced shareholder engagement, members of companies admitted to 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 general meeting at which the company's annual report and accounts are to be considered. A company will need to publish the statement once it has received 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. Whilst shareholders will feel more involved it is not clear what, if anything, companies or auditors are obliged to do in relation to such statements.

Documents to be made available on website under the new Act – Official List only

Companies admitted to the Official List will need to ensure they have adequate facilities to make certain information available on their websites:

- Annual report and accounts must be made available on the website as soon as reasonably practicable (in addition to sending to members). These must be available on the website until the next year's report and accounts are available. Appropriate restrictions can be put in place to comply with foreign securities laws as necessary (section 430).
- Results of all polls taken at a general meeting must be available for two years and must include:
 - the date of the meeting;
 - the text of the resolution or subject matter; and
 - the number of votes for and against (section 341).
- Independent reports on polls must be available for two years (section 342).
- Statements of members' audit concerns to be raised at accounts meetings of the company must be available until after the relevant meeting (section 528).

These are compulsory requirements under the new Act and are not to be confused with the voluntary use of websites as a convenient vehicle for dissemination of information under the recently introduced and expanded electronic communication regime.

Companies will also need to make other information available on websites to comply with the applicable regulatory and governance requirements. For example, provision D.2.2 of the Combined Code (applying to financial years beginning on or after 1 November 2006) requires the publication of certain information on a website where votes are taken on a show of hands.

Accounts and auditors

See also sections above "**Narrative reporting**" and "**Right to raise audit concerns**".

Period for filing reports and accounts (section 442)

All public companies

The period for filing accounts will be shortened from seven months from the end of the relevant accounting period to six months for public companies. This ties in with the new rules to be introduced requiring an AGM to be held within 6 months of a company's financial year end. 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.

Official List only

As part of the new periodic financial reporting rules under the new Disclosure and Transparency Rules, companies admitted to the Official List are required to publish annual reports within 4 months of the end of their financial year.

Auditors' liability (sections 534-538)

All public companies

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 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)

All public companies

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 (except one that is admitted to the Official List) need not make a statement unless he considers there are such circumstances. For companies admitted to the Official List, an auditor is always required to make a statement of the circumstances connected with his resignation – regardless of whether he considers these should be brought to members' or creditors' attention.

Administrative

Company communications

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

All public companies

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 and the memorandum will basically 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.

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 (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 continue to 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 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 to see if any are unnecessarily restrictive.

New model articles

All public companies

The new Act will introduce separate model articles for public and private companies (and also companies limited by guarantee) to replace the current Table A articles. This is a welcome step as it will go some way to address the different structures and needs of companies. An initial draft of the model articles for public companies was issued in June 2006 using a more modern plain English approach. A further 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.

When introduced, the final version of the model articles will automatically apply as a default position to companies incorporated after that date but not to existing companies. We do not expect existing companies to adopt the new model articles on a wholesale basis but they should provide helpful guidance when considering what, if any, changes need to be made to a company's current articles to update them in line with the new Act.

AGMs and general meetings

All public companies

AGM timing

Currently, an AGM must be held in each year and not more than 15 months after the previous AGM. For public companies the new Act requires the AGM to be held within six months of the company's financial year end (section 336).

Rights issues

The existing pre-emption regime for new issues of equity is largely restated in the new Act (sections 560-577) but there are some key 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 not less than 14 days (section 562). There is no indication at present whether this

power will be utilised but a reduction to 14 days would result in significantly shorter offer timetables when combined with the reduced notice periods discussed below; and

- 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.

Notice periods

The new Act retains the minimum 21 days' notice period for AGMs but all other meetings can be held on 14 days' notice, subject to any longer period stated in the articles (section 307). This includes meetings to consider special resolutions.

Political donations and expenditure (sections 362-379)

All public companies

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 listed companies routinely obtain shareholder approval to avoid an 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.

Access to the Register of Members (sections 116-120)

All public companies

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 and whilst this will be an improvement on the current law 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 5 days is not sufficient time for the company to properly check out the person requesting inspection and make a court application if appropriate.

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.

To bolster the restrictions on access to the register the Government intends (subject to consultation) to tighten disclosure of information at Companies House. In our briefing "**Companies Act 2006 – An Overview**" we looked at how access to the register of members ties in with disclosure of shareholder details in the company's annual return. At the time of that earlier briefing the Government had indicated that private companies would no longer have to supply the addresses of their shareholders in the annual return but that all public companies would be required to supply addresses of members holding 5% or more of any class of shares. In its February 2007 consultation paper the Government refined this proposal to the effect that private companies and public companies not listed on a regulated market (the UK regulated market being the Official List) will be exempt from filing shareholder addresses. 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.

Assuming the results of the consultation follow the Government's proposals, companies traded on the AIM and PLUS markets will not file shareholder addresses but they will be required to confirm in their annual return that they are not traded on a regulated market. Companies admitted to the Official List will need to supply addresses of those members who held 5% or more of any class of shares at any time during the year in question.

Disclosure of voting by institutional investors (sections 1277-1280)

All public companies

Currently, there is no statutory obligation on institutional investors to disclose details of how they have voted shares which they hold. The new Act gives the Government the power to require institutions to provide information about the exercise of voting rights attached to certain shares in which they have an interest. If introduced, this obligation to disclose will be enforceable by civil proceedings brought by any person to whom the information should have been provided or any regulatory authority specified in any relevant regulations.

There has been an increasing trend towards voluntary disclosure by institutions, often on websites, but the Treasury has indicated that only about a third of voting decisions are currently declared. Institutional investors have expressed concern about the necessity of a mandatory regime and the parliamentary debates on the Bill raised concern as to whether mandatory disclosure could actually undermine the voting process where a particularly sensitive issue is being considered. The Government has maintained the position that it requires a very wide power so that it can shape the disclosure regime as necessary at the relevant time and that it will only use the power following consultation if the voluntary regime does not improve current disclosure practice.

In early March Ed Balls, Treasury Minister for the City announced an agreement with big City firms to introduce a "comply or explain" code of practice within the next six months requiring institutional investors to either declare how they voted or explain why they are unable to disclose the information. The timetable has been agreed by the Institutional Shareholders Committee (which represents investment and pension fund managers) which will draft the code. The content of the code is likely to cause some controversy, with debate over how comprehensive the information disclosed should be.

We will need to wait and see whether the threat of statutory mandatory disclosure coupled with the proposed code of practice encourages and develops the trend towards adequate voluntary disclosure.

Share capital

Capital maintenance

All public companies

The Government has indicated that it is in favour of reforming the capital maintenance regime for public companies. However at this point in time the new Act does not make significant changes to the rules affecting public companies in this area. Capital maintenance reform is caught in the scope of amendments to the EU Second Company Law Directive aimed at simplifying the rules applying to public companies. Optional relaxations under the amending Directive would allow member states to raise (or remove completely) the 10% cap on the holding of treasury shares and also to allow public companies to provide financial assistance for the purchase of own shares provided certain conditions are met. However, in its February 2007 consultation paper on the new Act, the Government indicated that (subject to consultation) it does not propose to implement the optional elements of the amending Directive in the UK, stating "*..although implementation of these relaxations might provide some additional degree of flexibility for companies, it will increase legislation in an already in an already complex area of company law*".

Authorised share capital abolished

All public companies

Under the new Act companies will no longer be required to have an authorised share capital. If appropriate, the articles of association will still be used to create a restriction on the number of shares that can be issued. The Government's report on the initial consultation carried out last summer indicates 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.

The existing requirement for public companies to have a minimum share capital will be retained (section 761). This will remain at £50,000 for the time being.

The directors of public companies will still need shareholder authority (as with the current "section 80" authority under the Companies Act 1985) to allot shares, grant rights to subscribe for, or to convert any security into, shares (section 551). As part of the deregulatory approach for private companies the new Act exempts private companies (including subsidiaries of public companies) with a single class of shares from this requirement. 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.

The new Act removes the familiar concept of "relevant securities" and separates out shares and the rights to subscribe for or to convert into shares. The key practical consequence of this is that the wording of routine renewal allotment authorities sought at AGMs will need to be changed and consequential amendments to articles of association may be required.

Financial assistance

All public companies

The new Act does not remove the prohibition on public companies giving financial assistance. Amendments to the EU Second Company Law Directive, if implemented in the UK, would allow public companies to give financial assistance for the acquisition of their own shares up to the limit of their distributable reserves, provided the transaction meets certain other requirements designed to protect shareholders and creditors. However, as mentioned earlier, the Government's consultation paper expresses the view that the amendments should not be implemented in the UK as they will "...not simplify legislation in respect of the capital maintenance regime". It seems that public companies will continue to be prevented from providing financial assistance for the foreseeable future.

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

All public companies

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 box below.

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".

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

Redenomination of share capital (sections 622-628)

All public companies

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.

Notification of directors' interests

The obligations under section 324 and related sections of the Companies Act 1985 including the requirement to keep a register are being repealed with effect from 6 April 2007. However directors of companies admitted to the Official List, AIM and PLUS Market are subject to Chapter 5 of the Disclosure and Transparency Rules (for further details see our briefing "**Disclosure and Transparency Rules – Implementation of the Transparency Directive**").

Company investigations into shareholdings - "section 212 notices" (section 793)

The new Act carries over the old section 212 company investigation provisions substantially unchanged. New rules replacing the previous regime for the disclosure of major shareholdings under the Companies Act 1985 apply to the disclosure of major shareholdings for companies admitted to the Official List, AIM or PLUS Market.

These new rules are set out in Chapter 5 of the Disclosure and Transparency Rules and we looked at these in detail in our earlier briefing "**Disclosure and Transparency Rules – Implementation of the EU Transparency Directive**". Please note that disclosure under the company investigation provisions of the new Act continues to relate to "*interest in shares*" whereas disclosure under the Disclosure and Transparency Rules relates to "*voting rights*". Therefore shareholders and companies will need to get used to two different concepts and ensure that their internal systems and processes reflect this dual regime.

Conclusion

The new Act will affect nearly every aspect of company law. Whilst we do not expect the new regime to have a huge impact on the foundations of the way companies operate in the UK, there will undoubtedly be many procedural changes and, for companies admitted to the Official List, increased regulatory and administrative measures to get to grips with over the next few years. The more significant perhaps being the expanded business review and the information rights given to indirect investors. The active EU Directives environment is likely to add to this state of flux.

Further information

For further information please speak to your usual contact at Burges Salmon or contact **Nick Graves** (Partner) on 0117 939 2200 or email him at nick.graves@burges-salmon.com or **Alyson Whale** (Professional Support Lawyer) on 0117 939 2294 or email her at alyson.whale@burges-salmon.com.

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 private companies? (published March 2007). This may be of interest to you when assessing the impact of the new Act on your subsidiaries.

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).

Please visit http://www.burges-salmon.co.uk/our_work/content/Corporate/Corporate_Publications.htm if you would like to download pdf copies of these briefings 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.
- 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 it 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 http://www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en.pdf).
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 http://www.dti.gov.uk/files/file36130.doc).
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. http://www.dti.gov.uk/consultations/page37980.html
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	The following provisions of the new Act came into force: <ul style="list-style-type: none"> - the company communication provisions (sections 1143 to 1148 and schedules 4 and 5) including provisions facilitating electronic communication; - 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. - 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). <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 http://fsahandbook.info/FSA/index.jsp.</p>

Implementation timetable - key dates continued

Date	Event
6 April 2007	<p>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 http://www.opsi.gov.uk/si/si2007/draft/20075771.htm).</p> <p>The following sections of the Companies Act 1985 will be repealed:</p> <ul style="list-style-type: none">- authentication of documents (section 41);- maximum age limit for directors of a public company (sections 293 and 294);- prohibition on company paying a director remuneration free of income tax (section 311);- 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);- 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;- special provisions for banking companies etc in respect of loans to directors (sections 343 and 344);- power for the Secretary of State to bring civil proceedings on company's behalf (section 438);- certain companies, including insurance companies, to publish periodical statement (section 720); and- annual report by Secretary of State to Parliament in respect of matters within the Companies Acts (section 729).
1 October 2007	<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>

Implementation timetable - key dates continued

Date	Event
6 April 2008	Part 12 (Company secretaries); Part 15 (Accounts and reports), other than section 417; Part 16 (Audit), other than sections 485-488; Part 19 (Debentures); Part 20 (Private and public companies); Part 21 (Certification and transfer of securities); Part 23 (Distributions); Part 26 (Arrangements and reconstructions); Part 27 (Mergers and divisions of public companies); Part 42 (Statutory auditors).
1 October 2008	Part 1 (General introductory provisions); Part 2 (Company formation); Part 3 (A company's constitution); Part 4 (A company's capacity and related matters); Part 5 (A company's name); Part 6 (A company's registered office); Part 7 (Re-registration as a means of altering a company's status); Part 8 (A company's members); Part 10 (A company's directors) - provisions relating to directors' conflict of interest duties, directors' residential addresses and underage and natural directors Part 17 (A company's share capital); Part 18 (Acquisition by limited company of its own shares); Part 24 (A company's annual return); Part 25 (Company charges); Part 31 (Dissolution and restoration to the register); Part 33 (UK companies not formed under the Companies Acts); Part 34 (Overseas companies); Part 35 (The registrar of companies); Part 41 (Business names). 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). All provisions in force.

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.

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