

Companies Act 2006 - Guide to the October 2007 changes



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Update (December 2007)

As set out in government announcements on 7 November 2007 and 13 December 2007, implementation of some provisions of the Companies Act 2006 originally scheduled for 1 October 2008 has been postponed to 1 October 2009. References on page 1 to further changes taking effect in October 2008 should therefore be read as referring to October 2008 and 2009. Further information on these timetable changes is included on page 21, updating the information given on page 20. Timings referred to on pages 2 to 19 of this guide are unaffected.

Introduction

The Companies Act 2006 is a mammoth piece of legislation. With 1,300 sections and 16 schedules, it is reported to be the largest single piece of legislation ever passed in the UK. It will have a significant impact on UK companies - not only as a result of some extensive reforms but also due to the high number of changes and the size of the new legislation, which replaces or restates most of the old Companies Acts 1985 and 1989.

This guide is intended as an introduction to the key changes affecting private and public companies that will come into force on 1 October 2007. Further changes will also take effect in April 2008 and October 2008. These changes taking place in 2008 are briefly summarised on page 20 and fuller guides to these changes will be available nearer those dates.

The key objectives of the reforms being implemented by the Companies Act 2006 (the Act), which follow many years of review and consultation, are:

- enhancing shareholder engagement and a long-term investment culture
- ensuring better regulation and a "Think Small First" approach
- making it easier to set up and run a small company, and
- providing flexibility for the future.

These objectives have led to a different approach in some areas of the Act for private and public companies - deregulatory in some areas for private companies but imposing some additional obligations for public companies.



Background ... What has happened so far?

Aside from some minor provisions that came into force when the Act obtained Royal Assent on 8 November 2006, the principal changes made so far include:

- 20 January 2007
 - New company communication provisions – making it easier for companies to communicate with shareholders electronically and by means of a website
 - Repeal of the regime under sections 198-210 of the Companies Act 1985 for disclosure of material interests in public companies (*replaced by chapter 5 of the FSA's Disclosure and Transparency Rules for listed, AIM and PLUS companies*)
 - Limitation of directors' liability for untrue or misleading statements in or omissions from the directors' report, directors' remuneration report or summary financial statements
- 6 April 2007
 - Provisions on takeovers and compulsory acquisition of minority shareholdings
 - Repeal of the Companies Act 1985 requirement for directors to disclose their interests in shares in the company (*regulatory requirements remain for listed, AIM and PLUS companies*)

The changes coming into force on 1 October 2007 are much more substantial and cover the following principal areas:

- Directors' duties
- New statutory derivative action
- Transactions with directors requiring shareholder approval
- Directors' indemnities
- Shareholder meetings and resolutions
- Exercise of members' rights by third parties
- Access to the register of members
- Appointment of auditors by private companies
- Business review

A fuller guide to directors' duties and transactions with directors is also available. Please contact Debbie Cloake on email d.cloake@taylorwessing.com or Andrew Telling on email a.telling@taylorwessing.com or speak to your usual contact at Taylor Wessing if you would like a copy of this guide also.



Directors' duties

The general duties which directors owe to their companies are now set out in statute, in the Act. This marks a departure from past practice, where the general duties of directors arose from case law.

In addition to placing these duties on a statutory footing, the statutory statement of the general duties of directors changes the approach to directors' conflicts of interest. It also includes a duty to promote the success of the company, which seeks to enshrine in statute the concept of "enlightened shareholder value". This was described by the Minister of State for Industry and the Regions, in June 2007, as marking "a radical departure in articulating the connection between what is good for a company and what is good for society at large".

The statement of directors' duties consists of seven separate general duties, as follows:

- A duty to act in accordance with the company's constitution and only to exercise powers for the purposes for which they are conferred
- A duty to act in a way which a director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole
- A duty to exercise independent judgment
- A duty to exercise reasonable care, skill and diligence
- A duty to avoid conflicts of interest (other than in relation to a transaction or arrangement with the company – see below)
- A duty not to accept benefits from third parties
- A duty to declare to the other directors an interest in a proposed transaction or arrangement with the company.

The first four of these duties will take effect on 1 October 2007. The remaining three, which relate to conflicts of interest, will take effect in October 2008. New requirements for the declaration of interests in existing transactions or arrangements will also take effect in October 2008.

These duties are (with the exception of the duty to exercise reasonable care, skill and diligence) all fiduciary duties. They are expressed to replace the existing common law duties but will continue to be interpreted by reference to the body of case law in this area.



Duty to act within powers

A director must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred.

A company's constitution, for these purposes, includes resolutions or decisions made by the company in accordance with the articles of association of a company, as well as the articles of association themselves. This duty replaces similar common law duties.

Duty to promote the success of the company

A director must act in a way which that director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

- *the likely consequences of any decision in the long term,*
- *the interests of the company's employees,*
- *the need to foster the company's business relationships with suppliers, customers and others,*
- *the impact of the company's operations on the community and the environment,*
- *the desirability of the company maintaining a reputation for high standards of business conduct, and*
- *the need to act fairly as between members of the company.*

This duty is an extension of, and replaces, the common law duty on directors to act in good faith and in the interests of the company.

The decision as to what will promote the success of the company, and what constitutes such success, is one for a director's good faith judgment. This is intended to ensure that business decisions on, for example, strategy and tactics are for the directors, and not subject to decision by the courts, provided the directors are acting in good faith. A director acting in good faith should not be held liable for a process failure which would not have affected his decision on which course of action would best promote the success of the company.

This list of matters to which a director must have regard is not exhaustive, but highlights areas of particular importance, which are intended to reflect wider expectations of responsible business behaviour.

Directors will need to exercise reasonable care, skill and diligence (a separate duty – see page 5) in determining which matters are relevant to a particular decision and in weighing these up. On this basis, directors must then decide what they consider likely to promote the success of the company for the benefit of the members as a whole. For a commercial company, this will usually mean a long-term increase in value. It is important for directors to remember that they must act in the interests of the members as a whole, and not merely some of them.

Where a company is in financial difficulties, this duty to promote the success of the company for the benefit of members will be modified by a duty to act in the interest of creditors.

For certain companies, such as charities, whose purposes are expressed to be, or to include, matters other than the benefit of its members, the duty to promote the success of the company for the benefit of members must also be read as a duty to promote the success of the company in achieving those purposes.

Duty to exercise independent judgment

A director must exercise independent judgment.

In practical terms, this duty is likely to be most relevant where a director wishes to bind himself to a future course of action which might be seen as "fettering the discretion" of the director to make future decisions, or where directors or a board wish to delegate.

The duty to exercise independent judgment is not infringed by a director acting in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors. When deciding whether to bind a company to a future course of action, the directors will need to fulfil their other duties, for example their duty to promote the success of the company (see above).

The duty to exercise independent judgment is also not infringed by a director acting in a way authorised by the company's constitution. It will, therefore, be open to a director to delegate provided this is authorised in the company's articles (which will generally be the case). A director must, however, continue to exercise judgment in deciding whether and how to delegate and whether to accept someone else's judgment on a matter. Although specific tasks and functions may be delegated, overall responsibility as a director cannot be.

Duty to exercise reasonable care, skill and diligence

A director of a company must exercise reasonable care, skill and diligence.

The care, skill and diligence required of a director is that of a reasonably diligent person with:

- the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
- the general knowledge, skill and experience that the director has.

A director is, therefore, required to exercise not only the general knowledge, skill and experience he has (for example, a particular expertise in financial matters), but also the general knowledge, skill and experience that may reasonably be expected given his position and responsibilities to the company. This reflects the position reached in case law prior to the Act.

Duty to avoid conflicts of interest (comes into force in October 2008)

A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company, unless the situation cannot reasonably be regarded as likely to give rise to a conflict of interest.

This applies, in particular, to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity). It also applies to circumstances where a director has duties to third parties which conflict with duties he owes to the company.

However, a director does not breach this duty if the matter has been authorised by the directors, provided that:

- the quorum requirement at the meeting at which the matter is authorised is met without counting the director in question or any other interested director, and
- the director in question or any other interested director did not vote on the matter or the vote would still have been passed even if their votes had not been counted.



For a *private company*, the independent directors will be able to authorise a conflict provided that there is nothing in the company's constitution (in practice, likely to be its articles of association) which invalidates such an authorisation. However, under transitional arrangements for existing companies, existing private companies will need to seek express shareholder approval if they want to permit authorisation of conflicts of interest by directors.

For a *public company*, the independent directors will be able to authorise a conflict only if the company's constitution (likely to be the articles) includes wording enabling the directors to authorise the matter and the authorisation is given in accordance with that provision.

The Act also preserves the ability of shareholders (under the company's articles or under the general law) to authorise conflicts which would otherwise be a breach of this duty.

The articles of association of a company will be important in regulating how directors' conflicts of interest are dealt with. The Act makes clear that anything done (or omitted) by a director in accordance with provisions in the company's articles of association dealing with conflicts of interest will not be a breach of duty.

Duty not to accept benefits from third parties (comes into force in October 2008)

A director must not accept a benefit from a third party conferred by reason of (a) his being a director, or (b) his doing (or not doing) anything as a director, unless this cannot reasonably be regarded as likely to give rise to a conflict of interest.

This does not apply to benefits received from (or on behalf of) the company or other group companies. Nor does it apply to benefits paid by a third party which itself provides the services of the director to the company.

The Act preserves any current ability of shareholders (under the company's articles and under the general law) to authorise conflicts, which would otherwise be a breach of this duty.

Duty to declare an interest in a proposed transaction or arrangement with the company (comes into force in October 2008)

If a director is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, the director must declare the nature and extent of that interest to the other directors. A director is not under an obligation to avoid having such interests.

A director need not declare an interest:

- if he is not aware of the interest or of the transaction or arrangement in question (but a director will be treated as being aware of matters of which he ought reasonably to be aware),
- if it cannot reasonably be regarded as likely to give rise to a conflict of interest,
- if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as being aware of anything of which they ought reasonably to be aware), or
- if, or to the extent that, it concerns terms of his service contract that have been or are to be considered (i) by a meeting of the directors or (ii) by a board committee appointed for the purpose.

A declaration of an interest in a proposed transaction or arrangement may (but need not) be made:

- at a meeting of the directors,
- by notice in writing sent to the other directors, or
- by general notice (of an interest in a specified body corporate or firm or of being "connected" with a specified person), which must be given at a meeting of directors or which the director must take reasonable steps to secure is brought up and read at the next meeting of directors after it is given.

Related statutory obligations for directors to declare interests in existing transactions or arrangements with the company will also come into force in October 2008.

Ratification of directors' actions

The Act preserves the current law on ratification, allowing ratification by shareholders of conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company. This can extend to former directors and shadow directors.

However, in a change from the existing position, a decision by the company to ratify conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be passed by the shareholders without reliance on the votes of the director (if a shareholder) and of any shareholder connected with the director. This could give rise to difficulties in practice if a director and major shareholder (or a parent company) are treated as connected.

Therefore, where the ratification resolution is proposed as a written resolution (which will only be possible for a private company) the votes of the director and of any connected shareholder are disregarded, as they are not treated for these purposes as "eligible members".

Likewise, where the ratification resolution is proposed at a meeting, it is passed only if the necessary majority is obtained disregarding votes cast in favour of the resolution by the director and any connected shareholder. This does not prevent the director or any such member from attending, being counted towards the quorum and taking part in the proceedings at any meeting at which the decision is considered.

The statutory definition of who is "connected" with a director has been widened in the Act as regards family members and now also includes a director's parents, children over 18 (in addition to children under 18), a co-habitee and any children of the co-habitee who are under 18 and living with the director.

Statutory ratification will be subject to any additional requirements in the articles of association and any other statutory provision or rule of law imposing additional requirements for valid ratification or as to acts that are incapable of being ratified by the company.



New statutory derivative claim

The general duties of directors set out in the new statutory statement are owed by a director to a company, and not directly to the company's shareholders. The Act allows a shareholder to bring a claim against a current or former director (including a shadow director) for an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director.

However, any such claim (known as a "derivative claim") must be made on behalf of the company seeking redress for the company, not for the shareholder itself. Any damages awarded would go to the company, not to the shareholder bringing the claim. A shareholder can bring a claim in respect of conduct while it is a shareholder as well as prior conduct.

This new right to bring a statutory derivative claim applies in a wider set of circumstances than was the case under the previous common law, meaning that it will be easier for shareholders to take directors to court. However, safeguards have been built into the Act requiring a shareholder to demonstrate a *prima facie* case and to apply for permission to continue a claim, before the claim can proceed to full trial. Matters to be taken into account by a court at this stage include whether a shareholder is acting in good faith and the views of independent shareholders.

The upshot is that the new regime places greater risks on directors. However, there are safeguards to prevent claims proceeding if they lack merit. Also, any damages awarded go to the company, not to the shareholder bringing the claim. It remains to be seen where the balance will lie, for example, between activist shareholders and special interest groups who may wish to bring a claim to put directors under pressure, and boards who will wish to see such claims struck out at an early stage where they lack merit.

If a claim arises from conduct occurring before 1 October 2007, it will only be allowed to proceed to the extent that it would have been allowed to proceed as a derivative claim under the law in force before 1 October 2007.

Many companies will wish to review existing directors' indemnities and directors' and officers' (D&O) insurance policies to consider whether these require updating generally, in light of the new general duties, or to take account of the new statutory derivative claim.



Transactions with directors

The Act specifically sets shareholder approval as a requirement for certain transactions with directors. As under the Companies Act 1985, these are:

- substantial property transactions
- loans, quasi-loans and credit transactions
- long-term service contracts, and
- payments for loss of office.

These rules have been substantially redrafted in the Act but, in substance, remain broadly as under the previous law. The key changes are as follows.

Alignment of provisions

The rules have been aligned wherever appropriate so as to achieve greater consistency of approach. They generally apply to transactions involving either a director of the company or a director of the company's holding company and, in some cases, people who are connected with such a director.

The statutory definition of who is "connected" with a director has been widened in the Act as regards family members and now also includes a director's parents, children over 18, co-habitee and any children of the co-habitee who are under 18 and living with the director.

Where the director in question is also a director of a UK holding company, the transaction must be approved by the shareholders of both the company and the holding company (unless an exception applies). Shareholder approval is not required for any of these transactions by shareholders of a company which is itself a wholly-owned subsidiary or an overseas company.

Shareholder approval is by ordinary resolution, but the company's articles may require a higher majority or even unanimity.

Except in the case of substantial property transactions, a memorandum setting out certain details of the transaction requiring approval of the shareholders must be made available to the shareholders at the company's registered office for a 15 day period prior to the meeting and at the meeting itself. If the approval is to be given by way of written resolution, the memorandum must be sent to the eligible shareholders at or before the time when the written resolution is sent to them.

None of these rules concerning transactions with directors now imposes any criminal penalties. Civil consequences in respect of substantial property transactions and loans, quasi-loans and credit transactions include the company having the right to cancel the transaction unless this is prevented by other events or the arrangement is affirmed by shareholder vote in the meantime. Even if shareholder affirmation occurs, other civil consequences remain, such as an obligation to account to the company for any gain and indemnify the company for any loss it suffers. Failure to obtain approval for a long-term service contract allows the company to terminate the service contract at any time by giving reasonable notice. Failure to obtain approval for a payment for loss of office results in the payment being held on trust by the director for the company and, in some cases, indemnification obligations.

Loans to directors

The most substantial change in relation to transactions with directors is that companies will now be able, with prior shareholder approval, to make loans or quasi-loans, enter into credit transactions, give guarantees or provide security in connection with a loan, to a director. Previously these loan arrangements were unlawful, subject to some limited exceptions.

Therefore, shareholder approval is required (subject to some limited exceptions) for:

- loans and related guarantees or security made by a private company (which is not in the same group as a public company) to a director of the company or its UK holding company, and
- loans, quasi-loans, credit transactions and related guarantees or security made by a public company (or private company which is in the same group as a public company) to a director of the company or its UK holding company or to persons connected with that director.

Substantial property transactions

As before, these are transactions with a director of the company (or a director of a UK holding company or a connected person) where the company buys or sells a non-cash asset, the value of which exceeds £100,000 or 10% of the company's net assets (based on its last set of annual accounts or called-up share capital if it has not yet produced any accounts).

In a change to the existing position, the Act permits a company to enter into a contract amounting to a substantial property transaction which is conditional on shareholder approval. Therefore, shareholder approval will no longer have to be given before the arrangement is entered into, provided that the arrangement is conditional upon that approval being given.

Long-term directors' service contracts

Broadly, these are contracts under which a director is guaranteed at least two years of employment with the company of which he is a director or with any subsidiary of that company.

The principal change under the Act is that approval is now required for service contracts longer than two years, as opposed to five years previously. This will apply to service contracts made on or after 1 October 2007.

A director's "service contract" includes a contract of service, a contract for services and, in a change from the previous position, a letter of appointment as director. As before, failure to obtain approval allows the company to terminate the service contract at any time by giving reasonable notice.

Payments to directors for loss of office

As under the Companies Act 1985, shareholder approval will be required for compensation payments paid to a director when he retires from the company or otherwise loses his office as director, unless they are damages for breach of contract, pension for past services, payments in accordance with the terms of the director's service contract or payments in settlement or compromise of claims.

The Act makes several changes. The regime will now extend to:

- compensation for loss of employment in connection with the management of the affairs of the company (or any of its subsidiaries) while a director of the company or in connection with his ceasing to be a director of it, and not just loss of office as director, and
- payments in connection with retirement from any other office or employment (relating to the management of company affairs) with the company or a subsidiary (if in connection with his ceasing to be a director).

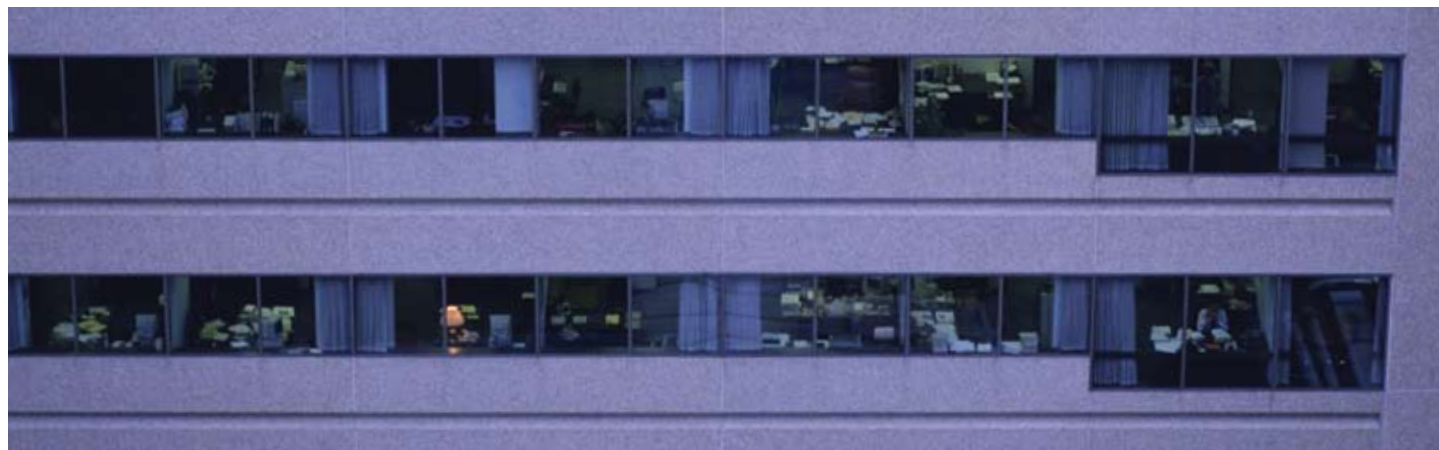
The requirement for shareholder approval is also extended to apply to payments to connected persons.

Where a company is to make a payment for loss of office to a director of its UK holding company, the proposal must now be approved by a resolution of both the company (unless it is a wholly-owned subsidiary) and the holding company.

Shareholder approval will also be required if any person (whether the company or anyone else) wishes to make a payment for loss of office to a director of the company in connection with:

- the transfer of the whole or any part of the undertaking or the property of the company or of a subsidiary of the company, or
- a transfer of shares in the company or in a subsidiary of the company, resulting from a takeover bid.

Therefore, for payments for loss of office in connection with a successful takeover bid, disclosure of the arrangement will no longer be an alternative to gaining shareholder approval.



Directors' indemnities

The Act largely restates the existing statutory provisions on the ability of a company to indemnify its directors, with relatively minor changes.

As under existing law, a company may not exempt a director from, or indemnify him against, liability in connection with any negligence, default, breach of duty or breach of trust by him in relation to the company, but is permitted to grant an indemnity which constitutes a qualifying third party indemnity provision ("QTPIP").

Under a QTPIP, a company may:

- indemnify its directors (and directors of an associated company) in respect of proceedings brought by third parties (covering both legal costs and the financial costs of any judgment against the director, except for the legal costs of an unsuccessful defence of criminal proceedings, fines imposed in criminal proceedings and penalties imposed by regulatory bodies), and
- pay directors' defence costs as they are incurred, even if the action is brought by the company, provided that the director is liable to repay his defence costs to the company if his defence is unsuccessful (although the company may choose to indemnify him for legal costs incurred in third party civil proceedings).

The principal change under the Act is to introduce a separate provision enabling companies to provide indemnities which constitute qualifying pension scheme indemnity provisions ("QPSIPs").

Under a QPSIP, companies (and their associated companies) will be able to indemnify a director of a corporate trustee of an occupational pension scheme against liability incurred in connection with the company's activities as trustee of the scheme, except for the legal costs of an unsuccessful defence of criminal proceedings, fines imposed in criminal proceedings and penalties imposed by regulatory bodies.

Other changes include:

- a new right for shareholders to request a copy of a QTPIP or QPSIP, and
- a new requirement for all QTPIPs and QPSIPs to be retained by the company for at least one year after they have expired.

In addition, failure to provide a copy of a QTPIP (or QPSIP) for inspection will no longer be a criminal offence by the company, although it will remain a criminal offence for directors.



Shareholder meetings and resolutions

Written resolutions

Written resolutions will need to be passed by shareholders in accordance with the new statutory procedure, which will override any procedure set out in a company's articles of association. Only private companies will be able to pass written resolutions under the statutory procedure. All shareholder resolutions of a public company will need to be passed at a meeting.

It will be easier for private companies to use written resolutions for decisions by shareholders under the Act, as the requirement for unanimity on a written resolution has been relaxed (for proposed written resolutions circulated for approval on or after 1 October 2007). Instead, an ordinary resolution will be passed as a written resolution if simply approved by shareholders holding a simple majority of the voting shares. Likewise, a special resolution will be passed as a written resolution if approved by shareholders holding 75% or more of the voting shares. On a written resolution shareholders will have one vote for each voting share held.

As a result, written resolutions are expected to become the more usual format for shareholder decision-making in private companies. Shareholders can still demand a meeting if the holders of at least 10% (5% in certain circumstances) wish to.

The shareholders who are eligible to approve a proposed written resolution are those persons who are listed in the company's register of members when the first written resolution is sent out to shareholders for their agreement. Company secretaries should ensure that they record the date and time when the first written resolution is sent.

Shareholders must be informed how they need to signify their agreement to the proposed written resolution that has been supplied to them and the date by which the resolution will lapse if a sufficient level of agreement has not been obtained. Typically and most simply, agreement could be communicated by the shareholders signing and returning the proposed written resolution. However, with the new increased ease of communicating with shareholders electronically (such as by email) or by means of a website, some companies may wish to consider asking shareholders to communicate their agreement in other ways, perhaps by email to a specified email address.

The requisite majority of shareholders must approve the written resolution within a specified period or else it will lapse. This period will be the period specified in the articles for this purpose or, if none is specified, 28 days from the first written resolution being sent out to shareholders for their agreement.

As before, resolutions to remove a director or auditors, which require special notice, cannot be passed by way of written resolution. These resolutions must be passed at a meeting.

Notice of meetings

The minimum notice periods required to convene shareholder meetings have been streamlined for notices given on or after 1 October 2007. All general meetings (apart from AGMs of public companies) will require a minimum of 14 clear days' notice, regardless of the type of resolution proposed at the meeting. Companies need to check their articles of association to see if they impose a longer minimum notice period.

Public company AGMs will require a minimum of 21 clear days' notice. Listed companies should also note the recommendation of the Combined Code that AGM notices and papers be sent at least 20 working days before the meeting.

The level of consent needed for a meeting to be held on short notice has been reduced for private companies from 95% to 90%, although this threshold can be increased up to 95% (but no higher) in the company's articles of association. The threshold for consent to short notice for public company meetings remains at 95%, but unanimous assent is needed for a public company AGM to be held on short notice.

Notices of meetings will need to contain new wording notifying shareholders of their statutory rights to appoint a proxy to attend, vote and speak at a meeting, as well as any more extensive rights conferred under the company's articles.

Resolutions

As a result of the changes made in relation to company meetings and resolutions, elective resolutions and extraordinary resolutions are abolished.

References to extraordinary resolutions in a company's memorandum or articles of association or in a contract will continue to be interpreted by reference to the Companies Act 1985.

Annual general meetings

The existing statutory requirement for private companies to hold an AGM (unless an elective resolution is passed) will be abolished. Private companies can therefore dispense with holding an AGM each year, although they will still be able to hold an AGM if they wish to.

Existing private companies, however, will need to check their articles of association for any requirement to hold AGMs which would override this new relaxation. Provision specifying that one or more directors are to retire at an AGM of the company will not be treated as a requirement to hold an AGM.

In a related change, private companies will no longer need to lay their accounts and reports, for financial years ending on or after 1 October 2007, before the company in general meeting.

Public companies will still need to hold an AGM. Their AGM must be held within six months of the year end. For existing public companies, however, the existing requirements for an AGM to be held each year and within 15 months of the previous AGM will still apply to the first AGM to be held after 30 September 2007, but all subsequent AGMs will need to be held within six months of the year end.

Proxies

Shareholders will have enhanced rights to appoint proxies at meetings of which notice is given on or after 1 October 2007. They will have an absolute right, which cannot be restricted by the articles of association, to appoint a proxy who can attend, vote and speak at a meeting. At present, statute does not give proxies a vote on a show of hands, nor a right to speak at a public company meeting.

Proxies will also be able to demand, or join in demanding, a poll and will have an additional default power, subject to a company's articles of association, to be appointed (by ordinary resolution at a meeting) as chairman.

Shareholders will also be able to appoint multiple proxies, where each proxy is appointed in respect of different shares. Where more than one proxy appointed by the same shareholder attends the meeting, this may necessitate the chairman calling a poll if this would affect the result of a vote, as each proxy will have, subject to the company's articles, one vote on a show of hands (and therefore have more votes on a show of hands than the appointing shareholder). The articles may not, however, provide for a proxy or proxies to have fewer votes on a resolution on a show of hands than the appointing shareholder would have if present at the meeting.

Companies will be able to make a small change to the provisions in their articles of association relating to time limits for lodging appointments of proxies before a meeting. Under the Companies Act 1985, these provisions in articles cannot require proxies to be lodged more than 48 hours before a meeting. Most articles use this maximum period as their time limit for lodging proxies. This statutory restriction has been slightly altered, so that these provisions in a company's articles will now be able to exclude non-working days from the 48 hour period.



Corporate representatives

Corporate shareholders will be able to appoint multiple corporate representatives, but in the event that more than one corporate representative votes or exercises another power, they must act in the same way. If the corporate representatives vote in different ways, they are treated as not having voted at all.

Additional requirements for listed companies

Companies listed on the Official List will have to comply with two further new requirements in relation to meetings where notice is given on or after 1 October 2007. These requirements do not apply to AIM companies.

First, they must make available on the company's website the results of any vote taken by poll (including the date of the meeting, the text of the resolution or description of the subject matter and the number of votes cast in favour of and against the resolution). This applies to polls taken on or after 1 October 2007.

This strengthens the existing Combined Code recommendation that companies publish details on their websites of proxies lodged for a shareholder meeting where a vote is conducted on a show of hands, as well as the number of votes cast in favour of and against the resolution.

Secondly, the directors may be required, by shareholders representing 5% or more of the voting rights or by 100 shareholders holding shares with on average at least £100 paid up capital per shareholder, to obtain an independent report on any poll taken, or to be taken, at a shareholder meeting. The report will cover, amongst other things, the adequacy of the procedures adopted in connection with the poll, whether the votes cast were fairly and accurately recorded and whether the validity of proxy appointments was fairly assessed.

Directors will need to appoint an assessor who meets the statutory independence criteria within one week of the shareholders' request. In view of this timescale, companies may wish to consider preparing a list of possible candidates in advance.

The assessor will have the power to attend meetings (where the assessor is appointed before the poll is taken) and the right of access to the company's records relating to the relevant poll on which the assessor is reporting or the meeting at which the poll will or has been taken.

Shareholders considering making a request for an independent report may wish to time their request so as to ensure that the assessor is appointed before, rather than after, the relevant meeting.

The appointment and identity of the independent assessor, together with the assessor's report, must be made available on the company's website as soon as reasonably practicable and kept there for two years.



Exercise of members' rights by third parties

As part of moves to encourage more active shareholder engagement, particularly where shares are held through nominee accounts, the Act introduces three new provisions giving certain shareholder rights to third parties.

The aim of these provisions is to help "indirect investors", who hold shares through intermediaries, to become more involved in the company's affairs. The first applies only to listed companies (and not AIM companies); the second and third apply to any company, public or private.

Information rights

First, nominee shareholders in listed companies may nominate the beneficial owner of the shares to enjoy all "information rights" in relation to that company. The nominated beneficial owner will then be entitled to receive a copy of all shareholder communications sent by the company as well as the company's report and accounts. The nominated person will also be able to elect to receive these communications in hard copy form.

Nominations may be made at any time on or after 1 October 2007, but companies will not be required to act on these nominations before 1 January 2008 (although they may choose to do so).

These information rights are enforceable against the company by the registered shareholder, rather than the nominated person, as if contained in the company's articles. This is not an automatic right for the beneficial owner, but requires nomination by the registered shareholder. If no address is provided, the nominated person will be regarded as having agreed to website communication.

Where notices of shareholder meetings are sent to beneficial owners nominated for information rights, those notices will need to be accompanied by a statement that the beneficial owner may have rights under an agreement with the nominee as to appointment of proxies or exercise of voting rights.

In addition, as notices will now need to notify shareholders of their statutory rights to appoint a proxy to attend, vote and speak at a meeting and this will not apply to these nominated beneficial owners, this section must be removed from the notices sent to nominated beneficial owners or a statement included explaining that it does not apply to nominated beneficial owners.

Companies will be able to check with nominated persons as to whether they still wish to retain their "information rights". The rights will cease if the nominated person does not respond to the company within 28 days of this request, but these checks can only be made of a nominated person once a year. "Information rights" will also cease on the death, bankruptcy or winding up of either the registered shareholder or the nominated person.

Provision in articles for exercise of members' rights

Secondly, a new provision gives statutory confirmation that companies may make provision in their articles of association for shareholders to nominate third parties to enjoy or exercise any rights attaching to their shares (except for the right to transfer the shares, which will always remain with the registered shareholder). This change does not automatically confer any new rights on third parties – a company's articles will need to be amended (assuming they do not already contain these rights) so as to allow for this nomination by registered shareholders. This can be put in place by any company, public or private, but companies will need to consider whether this provision is appropriate for them.

Exercise of rights relating to members' requests

Thirdly, where shares are held by a nominee on behalf of a beneficial owner, the beneficial owner will be able to participate in certain shareholder requests, as if a member of the company. The beneficial owner will be able to count in the 100 persons needed for certain members' requests, including requests for circulation of statements, circulation of resolutions (at public company AGMs) and (in the case of listed companies) requests for an independent report on a poll.

These three new type of rights for indirect investors will give rise to new issues for companies. The register of members will no longer be conclusive evidence of who is entitled to exercise certain rights or who is entitled to certain documents. Likewise, companies will need to consider (in conjunction with their registrars if publicly-traded companies) how nominations are to be notified to the company and how records of these nominations should be kept.

Access to the register of members

As before, shareholders and third parties will be able to inspect or request a copy of a company's register of members. However, new restrictions are being introduced under the Act, including a new "proper purpose" requirement, with the intention that the information found in the register of members is only available for proper purposes, protecting shareholders from the risk of their details being provided for improper purposes.

Companies will be subject to these new provisions relating to access to the register of members (for requests made on or after 1 October 2007) once they have filed an annual return made up to a date after 30 September 2007. Companies wishing to take advantage of this new regime quickly may, therefore, wish to submit an annual return earlier than required, made up to 1 October 2007 (or later).

A person wishing to inspect the register of members or requesting a copy of the register of members will need to supply the company with his name and address, the purpose for which the information will be used and whether the information will be disclosed to any other person (in which case, the same information must be provided for that person also).

It will be an offence to make a false statement when providing the details required for access to the register of members. It will also be an offence to disclose information obtained from a company's register of members to another person, knowing or having reason to suspect that that person may use the information for a purpose that is not a proper purpose.

If the company does not wish to grant access to the register to the person making the request, it will need to apply to court within five days of the request, for an order not to comply with the request where the court is satisfied that the information is not sought for a "proper purpose".

It will be for the court to decide what is a "proper purpose". It is not defined under the Act. However, the Institute of Chartered Secretaries and Administrators (ICSA) has published some helpful guidance for company secretaries on this topic. This can be found at www.icsa.org.uk. Whilst this will depend on the particular circumstances, the ICSA guidance suggests that a "proper purpose" might include, for example:

- a request from a regulatory body
- an executor wishing to check the shareholdings of a deceased person for probate purposes, and
- shareholders or indirect investors or others wishing to contact shareholders about company issues or to gather support for the exercise of shareholder rights.

Improper purposes might include, for example:

- any unlawful purpose (such as infringement of data protection legislation)
- commercial mailings to shareholders unrelated to shareholders in their capacity as shareholders of the company or to the exercise of shareholder rights, and
- credit or identity checks on shareholders.

Annual returns

In a related change, companies will, in future, no longer need to include the addresses of their shareholders in the annual return filed at Companies House. Listed companies will, however, still need to provide this information in their annual returns for members holding 5% or more of any class of share at any time during the year in question.

This change will take effect from October 2008. Therefore, the first annual return filed at Companies House made up to a date after 1 October 2007 will still need to contain the addresses of shareholders. The company's next annual return filed after 1 October 2008 will not require shareholder addresses (unless a listed company - see above).

Appointment of auditors by private companies

An auditor must be appointed by a private company for each financial year of the company, unless audited accounts are unlikely to be required. The Act simplifies the appointment procedure by providing for automatic reappointment of auditors by private companies except in certain circumstances. This applies in relation to appointments for financial years beginning on or after 1 October 2007.

Auditors will still be generally appointed by ordinary resolution, with power for the directors to appoint the first auditors or to fill a casual vacancy.

In a change to the existing position, however, auditors of a private company will be deemed to be reappointed at the end of the term unless:

- the auditors had been appointed by the directors
- the company's articles require actual reappointment
- members holding 5% (or a lower percentage specified in the articles) or more of the voting rights in the company have given notice requiring reappointment
- a shareholder resolution has been passed requiring reappointment, or
- the directors decide that no auditors are needed for the next year.

In addition, auditors' terms of office will now typically run from the end of the 28 day period following circulation of the accounts until the end of the corresponding period in the following year. This will apply even if the auditors are appointed at a meeting where the accounts are laid.

The provisions in the Act relating to appointment of auditors by public companies will come into force in April 2008.



Business review

As at present, all companies (other than small companies) will need to produce a business review. The business review forms part of the directors' report, giving a review of the company's business during the reporting period, in particular, a balanced and comprehensive analysis of the development and performance of the company.

The provisions in the Act relating to the business review come into force on 1 October 2007 for financial years beginning on or after 1 October 2007. Generally, the other provisions relating to the directors' report come into force in April 2008.

The purpose of the business review will be to inform members of the company and help them assess how the directors have performed their statutory duty to promote the success of the company for the benefit of its members as a whole.

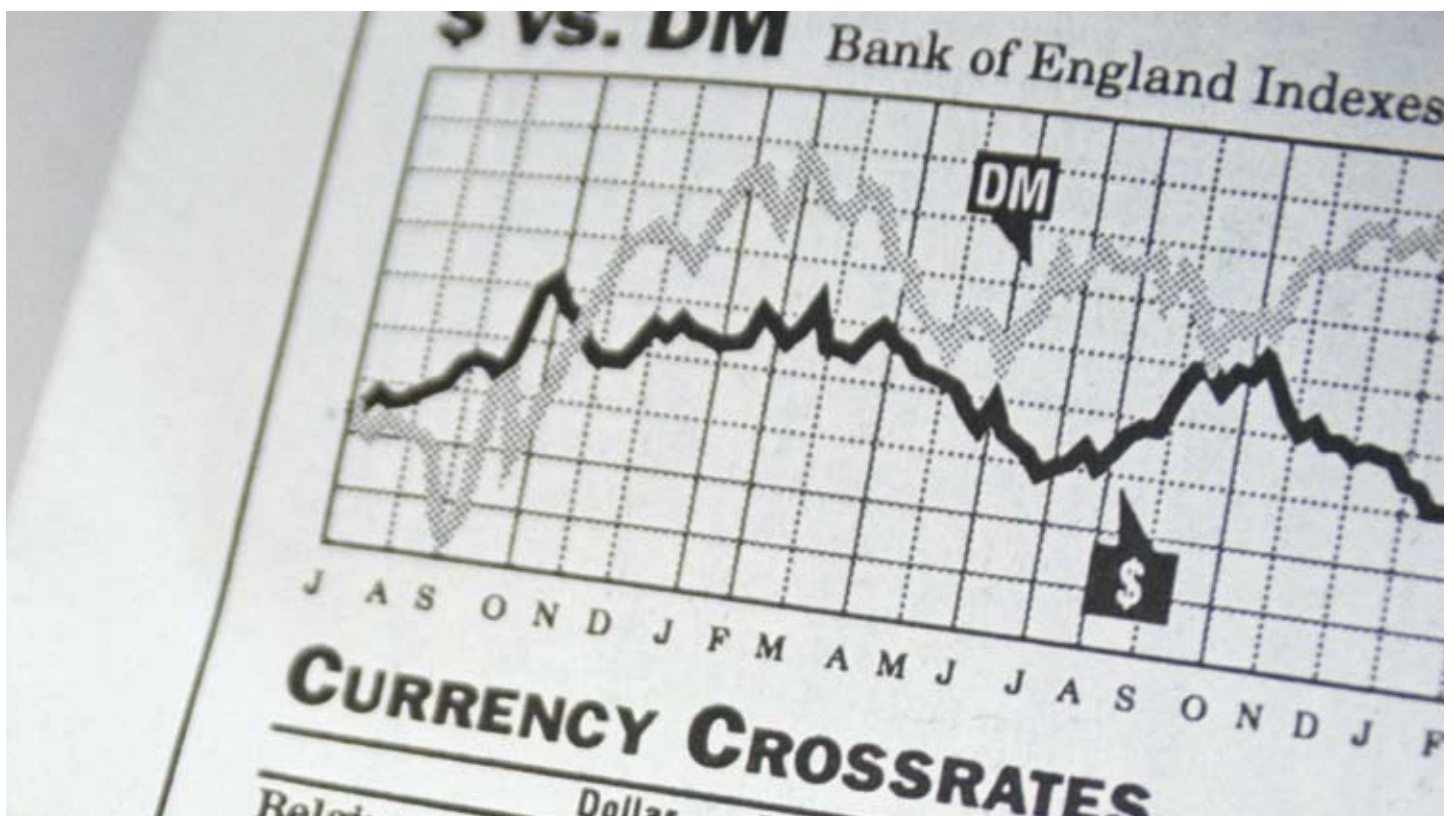
Listed companies have some new additional requirements to comply with in relation to their business reviews. These requirements apply to UK companies that are listed on the Official List or another "EU regulated market" or listed on the NYSE or NASDAQ, but do not apply to companies admitted to AIM.

These additional requirements for listed companies are largely forward-looking in nature (unlike the business reviews of non-listed companies which look back over the past year). A listed company must, to the extent necessary for an understanding of the development, performance or position of its business, include in its business review details of:

- main trends and factors likely to affect the future development, performance and position of the company's business
- environmental matters, the company's employees and social and community issues (including information about any company policies in relation to those matters and the effectiveness of those policies), and
- people with whom the company has arrangements which are essential to its business - the government has indicated that this does not necessitate lists of all customers and suppliers, but requires reporting on significant relationships (such as major suppliers or key customers) critical to the business which are likely to influence the performance or value of the company's business.

Information does not need to be disclosed by any company about a person if disclosure would, in the directors' opinion, be seriously prejudicial to that person and contrary to public interest.

In addition, information about impending developments or matters in negotiation do not need to be disclosed by any company if disclosure would be seriously prejudicial to the company's interests.



Practical steps to take to prepare for October 2007

Companies may wish to consider taking some or all of these steps (to the extent appropriate for them) to prepare for the changes in legislation that take effect on 1 October 2007.

1. Ensuring compliance with new directors' duties

- Arrange a thorough briefing on directors' duties under the Act for directors, the company secretarial team and members of management who report to the board or assist with the preparation of materials for consideration by the board. All directors and everyone involved in helping directors comply with their duties need to understand the new statutory duties fully.
- Review your procedures for preparing papers for consideration by the board, the conduct of board discussions and the way board decisions are minuted to ensure that directors' compliance with their duty to promote the success of the company (and have regard to the listed factors) are appropriately documented.
- On appointment, all new directors should be briefed on their duties under the Act.
- The terms of appointment and description of the role of any director should specifically refer to their duties.
- The terms of reference of any committee should reflect the new duties of directors, including the requirements of the duty to promote the success of the company.
- Review directors' indemnities and D&O insurance policies. Ensure that D&O policies from 1 October 2007 provide cover against derivative claims brought under the Act as well as providing cover against derivative claims brought by shareholders under the law as it currently stands.
- Review any existing company policies (such as ethics policies or corporate social responsibility policies) to reflect compliance with the duties.

2. Review the company's articles of association

Private and public companies should consider the following:

- Review your articles for any areas of inconsistency with the new regime or provisions that will be unenforceable under the Act.
- Consider whether to amend the provisions in the articles on when proxies must be lodged before a meeting, so as to take advantage of the fact that the 48 hour time limit may exclude non-working days.

Private companies should consider the following:

- Review your articles for any requirement to hold an AGM which will override the relaxation in the Act which allows private companies to dispense with holding an AGM.
- Review your articles for any requirement that the threshold for consent to short notice be 95%, overriding the Act which makes 90% the default threshold (subject to the articles requiring a higher threshold up to 95%).
- Consider whether the default period of 28 days is an appropriate time limit for passing written resolutions or whether a longer provision should be included in the articles. If a sufficient majority of shareholder approval is not obtained within this time period, the written resolution will lapse.
- Consider whether automatic reappointment of the auditors is appropriate or whether shareholders require provision to be included in the articles requiring their annual approval for reappointment.

Companies should note that further changes are likely to be necessitated by the changes coming into force in 2008.

3. Access to register of members

- Consider preparing a company policy for dealing with requests made to access the register of members, including purposes that the company will usually regard as a proper purpose or improper purpose. The company will have to react to requests quickly, so having a policy in place will help protect the company in this situation.
- Consider filing an annual return made up to October 2007 to take advantage of the new regime more quickly.

4. Listed companies only

- Prepare your company website for inclusion of the results of any vote taken by poll on or after 1 October 2007 and ensure that systems are in place to make this information available on the website promptly on an ongoing basis.
- Consider preparing a list of possible candidates to approach to act as independent assessor of a poll, should a shareholder request be made, as the appointment must be made within seven days of the request.
- Discuss the new requirements for the business review with your auditors and ensure that all relevant staff are briefed on and understand these new requirements.
- Liaise with your registrars as to how nominations for information rights should be notified and how records of these nominations will be kept.

Changes coming into force in 2008

Further changes will take place in April 2008 and October 2008. Here is a summary of the key points.

April 2008

- **Company secretaries** - Private companies will no longer be required to have a company secretary, although they may retain one if they wish. Public companies will still need to have a qualified company secretary.
- **Filing accounts** - The period for filing accounts at Companies House will be reduced from 10 months after the year-end to nine months for private companies and from seven months to six months for public companies.
- **Intra-group transfers of assets** - The law will be clarified so that a company with positive distributable reserves of any amount will be able to transfer an asset intra-group at less than market value (but at or above book value) without being required to have distributable reserves equal to the shortfall between the transfer price and the market value of the asset. Companies without distributable profits will still need to effect intra-group asset transfers at market value.

October 2008

- **Directors** - All companies will need to have at least one director who is a natural person. The government has announced that it intends to provide a grace period until October 2010 for any company which did not have at least one director who was a natural person when the Act received Royal Assent on 8 November 2006.
In addition, a minimum age limit of 16 years for directors of all companies will be introduced. The age limit of 70 for directors of public companies and their subsidiaries was repealed on 6 April 2007.
- **Directors' duties** - As highlighted on page 3, three new statutory general duties of directors relating to conflicts of interest will come into force in October 2008: the duty to avoid a conflict of interest, the duty not to accept benefits from third parties and the duty to declare an interest in a proposed transaction or arrangement with the company.
The codification of these duties includes a new ability for independent directors to approve a director's conflict of interest, subject (in the case of public companies and existing private companies) to there being authorisation for this in the company's articles of association. New private companies will not require specific authorisation in their articles to take advantage of this relaxation.
- **Directors' residential addresses** - Directors will be able to file a service address (for the public record) in addition to their residential address at Companies House. Directors' residential addresses will be kept on a separate and secure register.
- **Execution of deeds** - Companies will be able to execute a deed by a single director signing on behalf of the company in the presence of a witness (in addition to the existing methods of execution by affixing the company seal or by two directors (or a director and the company secretary) signing on behalf of the company).
- **Issuing shares** - The concept of authorised share capital is being removed. However, for existing companies it will continue to operate as a restriction on the company's ability to issue new shares. It will be treated as a restriction in the articles of association and, therefore, existing companies will need to amend their articles if they want to remove this restriction on their ability to issue new shares. The government has indicated that, as a transitional provision, this specific amendment to the articles will only require an ordinary resolution rather than a special resolution.
It will also be easier for private companies with only class of share to allot shares, as the directors will not require authority to allot shares (unless the company's articles require this). Authority to allot shares will still be required for private companies with more than one class of share and public companies.
- **Formation of public companies** - A single member will be able to form a public company. Currently public companies require at least two members.
- **Financial assistance** - The prohibition on private companies providing financial assistance is being relaxed and, as a result, the whitewash procedure is being abolished. It will, however, still be unlawful (a) for a public company target or any of its subsidiaries (public or private) to give financial assistance for the purpose of the acquisition of shares in that public company target or (b) for a public company subsidiary to give financial assistance for the purpose of the acquisition of shares in its private company parent.
- **Company objects** - The objects of new companies will be treated as unrestricted, unless the articles provide otherwise. The general commercial objects of existing companies will be treated as a restriction on those companies' objects. A company's objects will be treated as having been moved into the company's articles, as the memorandum will become a historical document relating to formation.
- **Auditors** - Auditors will be able to enter into liability limitation agreements with the company, limiting their liability to the company for negligence, default, breach of duty or breach of trust in the course of the audit of the company's accounts (provided, amongst other things, that liability is not limited to lower than a fair and reasonable amount).
- **Reduction of capital** - A new and simpler procedure, using a directors' solvency statement, for private companies wishing to reduce their share capital will be introduced as an alternative to the existing court-approval procedure.
- **Re-denomination of share capital** - Companies will be able to re-denominate share capital into foreign currency, by way of an ordinary resolution (subject to the company's articles).

Detailed guides to these changes coming into force in April and October 2008 will be available nearer those dates. If you would like a copy of these guides, please contact Debbie Cloake on email d.cloake@taylorwessing.com or Andrew Telling on email a.telling@taylorwessing.com or your usual contact at Taylor Wessing.

Notes

Update (December 2007)

As set out in government announcements on 7 November 2007 and 13 December 2007, implementation of some provisions of the Companies Act 2006 originally scheduled for 1 October 2008 has been postponed to 1 October 2009 and certain other changes have been made. References on page 1 to further changes taking effect in October 2008 should therefore be read as referring to October 2008 and 2009. Timings referred to on pages 2 to 19 of this guide are unaffected. In relation to the matters described on page 20 (opposite), the implementation timetable is now as follows:

April 2008

- Company secretaries
- Filing accounts
- Intra-group transfers of assets
- Execution of deeds
- Auditors

October 2008

- Directors (natural persons, minimum age)
- Directors' duties (conflicts of interest)
- Financial assistance
- Reduction of capital

October 2009

- Directors' residential addresses
- Issuing shares
- Formation of public companies
- Company objects
- Re-denomination of share capital

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