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Companies Act 2006 - Guide to the April 2008 changes

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Introduction

The Companies Act 2006 (the "Act") 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 is having 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 (the "1985 Act") and 1989.

This guide is intended as an introduction to the key changes affecting private and public companies that will come into force on 6 April 2008. Further changes will also take effect in October 2008 and October 2009. Those further changes are briefly summarised on pages 9 and 10 and fuller guides to those changes will be available nearer the time.

The key objectives of the reforms being implemented by 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?

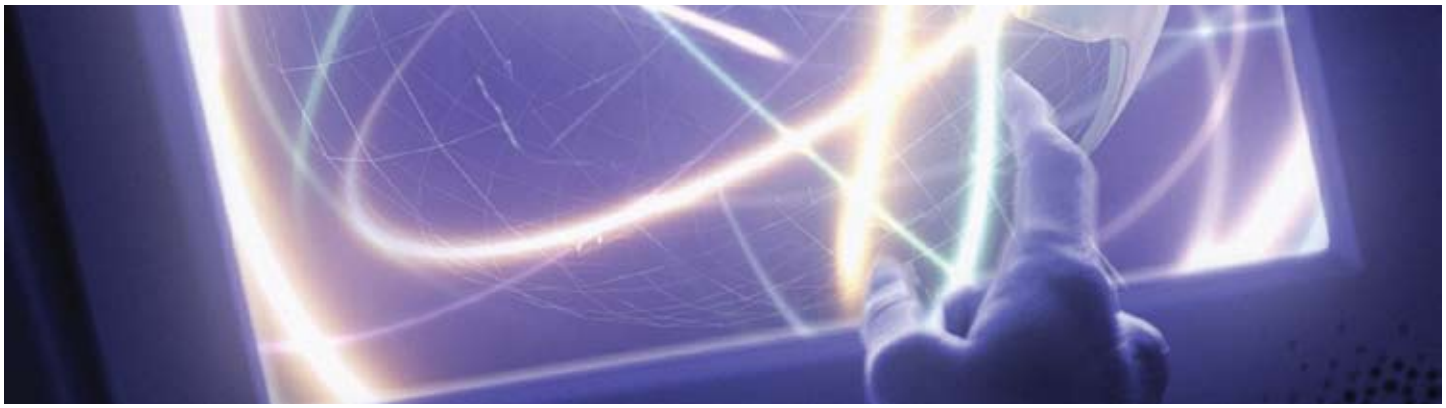
Aside from some minor provisions that came into force when the Act obtained Royal Assent on 8 November 2006, the principal changes made so far include:

- **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 1985 Act 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
  - Repeal of the 1985 Act requirement for directors to disclose their interests in shares in the company (regulatory requirements remain for listed, AIM and PLUS companies)
- **1 October 2007**
  - New provisions concerning directors' duties and ratification of directors' actions
  - New statutory procedure for members to bring a derivative claim on behalf of a company against a director
  - New provisions concerning the indemnification of directors of corporate trustees of an occupational pension scheme
  - New provisions for shareholder approval of directors' substantial property transactions, loans, long term service contracts and payment for loss of office
  - Extensive provisions on shareholder meetings and resolutions
  - Restrictions on right to inspect register of members
  - Provisions allowing for the exercise of members' rights by third parties
  - Provisions on appointment of auditors by private companies
  - Listed companies (not AIM) to include further information in their Business Review

The changes coming into force in April 2008 cover the following principal areas:

- Company secretaries
- Execution of documents
- Offer of shares to the public
- Minimum share capital requirements
- Accounts
- Audits
- Distributions
- Certification and transfer of securities
- Debentures

A guide to the changes which came in on 1 October 2007, as well as a fuller guide to directors' duties and transactions with directors, are also available. Please contact Andrew Telling on e-mail a.telling@taylorwessing.com or speak to your usual contact at Taylor Wessing if you would like a copy of these guides.



April 2008 overview

Company secretaries and the execution of documents

The Act introduces an additional, simpler method for companies to execute deeds. As previously allowed for, a document will be validly executed using the company's common seal or, if it is signed on behalf of the company, by either two directors, or one director and a secretary (or joint-secretary). However, from 6 April 2008, a document will be validly executed if it is signed by a single director in the presence of a witness who attests the signature.

From 6 April 2008 private companies will no longer be required to have a company secretary, although they may still choose to have one. This is part of the wider amendments in the Act aimed at simplifying the regime applicable to private companies and providing private companies with a greater degree of flexibility in relation to their internal administrative arrangements.

Private companies may have specific provisions in their articles that either require the company to have a company secretary or assume that it has one. Any express requirement will mean that a private company will still need to have a secretary.

Note that any provision in the articles:

- requiring or authorising things to be done by or in relation to a secretary, or
- as to the manner in which, or terms on which, a secretary is to be appointed or removed,

is not a provision expressly requiring the company to have a secretary.

Public companies will still be required to have a company secretary, who must meet certain qualifications.

Offer of shares to the public

Substantive amendments have been made to the law regarding the offer of shares to the public. The prohibition in the 1985 Act on private limited companies offering their shares to the public remains. However, there is more flexibility under the Act, so that if a private company intends to become a public company it will be able to make an offer before it has completed the formalities of re-registration as a public company. Acts done in good faith before allotment in anticipation of re-registration will not be treated as breaching the prohibition on offers to the public. The exemption also applies if, as part of the terms of the offer, the company undertakes to re-register as a public company and then complies with that undertaking not later than six months after the day on which the offer is first made to the public.

A further change is that, from 6 April 2008, a private company will no longer commit an offence if it offers its securities to the public, but will be compelled to re-register as a public company, unless it appears to the court that the company does not meet the requirements for re-registration or that it is impractical or undesirable to require it to do so, in which case, the court may make a remedial order and/or an order for the compulsory winding up of the company.

Minimum share capital requirement

The Act preserves the concept of an authorised minimum share capital for public companies which must be maintained in order for a company to obtain a trading certificate or re-register as a public company. The minimum share capital requirement will remain at £50,000 but, under the Act, this can be in the prescribed Euro equivalent (but not a combination of both). An exact figure for the Euro equivalent is likely to be announced by the Secretary of State prior to April 2008 and the Secretary of State may adjust this subsequently.

The requirement for a public company to obtain a trading certificate from the registrar prior to conducting any business remains, yet a company will not need to provide a statutory declaration upon application, but rather a statement of compliance covering various requirements and including a statement that the company has the necessary authorised minimum share capital.

Once a company has obtained a trading certificate, there is no requirement for the authorised minimum to remain denominated in Sterling or Euro and, if it wishes, a company may subsequently redenominate its share capital, or any class of its share capital (including the authorised minimum) into another currency. There is provision for regulations to be made as to the application of the authorised minimum in these circumstances. Redenomination will become more straightforward once new provisions of the Act relating to redenomination of share capital come into force in October 2009.

Accounts

Under the Act, it will still be the case that a company's accounts must be approved by the board of directors and the balance sheet signed, although it is no longer a requirement that a director of a company should sign the copy of the balance sheet delivered to the registrar, as this would hamper developments in the electronic delivery of accounts.

As a result of changes which took effect on 1 October 2007, private companies are no longer required to lay their accounts for financial years ended on or after 1 October 2007 at general meeting (as there is no requirement in the Act for private companies to hold general meetings). Instead, they must send their accounts to members by the earlier of the date of actual delivery to the registrar or the deadline for delivery. Under the changes taking effect on 6 April 2008, public companies must still send out their annual accounts at least 21 days before the relevant general meeting.

In addition, for financial years beginning on or after 6 April 2008, a quoted company (as defined, which includes the Official List but not AIM) ("Quoted Company") will have to put its annual accounts on a website (which is to be accessible to the public and free of charge) until the accounts for the following financial year are published, in addition to sending those accounts to its members. (This is in addition to the existing requirement under Chapter 6 of the FSA's Disclosure and Transparency Rules ("DTR 6") to indicate which website the annual financial report and certain other financial information are available on when their publication is announced. Although both this new requirement under the Act and DTR 6 do not apply to AIM companies, AIM companies are, nevertheless, required to make available their most recent annual report and other financial information on their website under the AIM Rules for Companies.)

The Act also introduces a reduction in the time limit for private companies to file their accounts from 10 months to nine months after the year end. For public companies, there is a reduction in the time limit to lay full financial statements before the company in general meeting and file them from seven months to six months after the year end. These changes apply to accounts for financial years beginning on or after 6 April 2008.

Audits

The most significant change the Act will introduce regarding auditors is in relation to auditors' liability. The Act continues the prohibition on a company indemnifying its auditors against claims by the company in the case of negligence or other default, and continues the current exemption which allows a company to indemnify its auditors against any costs of successfully defending themselves against a claim (the exception to allow a company to buy insurance for its auditor is no longer available).

The Act introduces a new exception, whereby it will be possible for auditors to limit their liability by agreement with a company to cover liability for negligence, default, breach of duty and breach of trust.

Members' approval will be needed by resolution for such a liability limitation agreement to be effective. Members of a private company will be able to pass a resolution waiving the need for approval of the agreement. Members of a private or a public company can pass a resolution before an agreement is signed approving its principal terms, or can approve the agreement after it is signed. An agreement will not be effective to limit an auditor's liability to less than an amount that is fair and reasonable.

In contrast to the position introduced on 1 October 2007 for private companies, there is no deemed re-appointment of auditors of public companies and their period of appointment will generally be from one general meeting where the accounts are laid (generally the AGM) to the next.

Other changes to be introduced in April 2008 regarding audits and auditors include:

- the power for the Secretary of State to require the disclosure of the terms of appointment of auditors;
- the introduction of the concept of a senior statutory auditor. Where an auditor is a firm, a senior statutory officer must sign the report in his own name on behalf of the firm;

- a company will not have to reveal the name of its auditor/senior statutory auditor in a published auditor's report if it considers that it would lead to a serious risk of violence or intimidation;
- there are further obligations on companies and departing auditors to notify the audit authorities of the reasons for an auditor departing a company;
- there will be a new criminal offence, punishable by fine, in relation to an inaccurate auditor's report; and
- there will be a new right for shareholders of Quoted Companies to raise questions about the work of the auditors or the circumstances connected with an auditor ceasing to hold office, and to have a response to those concerns published on a website.

Distributions

The 1989 case *Aveling Barford v Perion* gave rise to questions concerning intra-group asset transfers at less than market value, namely, whether such transfers constitute distributions in kind, and how the amount of the distribution should be determined - whether by reference to the asset's book value or market value.

The Act clarifies that, where there are positive distributable reserves at the time of distribution, the amount of any distribution consisting of or arising from the sale, transfer or other disposition by a company of a non-cash asset should be calculated by reference to the asset's book value. Therefore:

- if an asset is transferred for more than its book value, then the amount of the distribution is zero, and the distribution is lawful; and
- if an asset is transferred for less than its book value, the amount of the distribution is equal to that shortfall, which will then have to be covered by distributable profits.

In determining whether it has profits available for distribution for these purposes, a company will be able to treat unrealised profits in respect of the non-cash asset distributed as realised profits.

It is still unlawful for a company which does not have distributable profits to make a distribution by way of a transfer of assets at an undervalue.

Although the new provisions on distributions in kind simply confirm widely accepted legal opinion, their inclusion in the Act is to be welcomed as they resolve longstanding uncertainties relating to this area of company law. Note that these provisions do not affect the need for directors to have regard to other matters in deciding whether to approve such a distribution, including the duty to promote the success of the company for the benefit of its members as a whole.

Certification and transfer of securities

No changes to shareholders' rights to paper share certificates have been made at this time, but the Act includes sections giving the Secretary of State power to make regulations for enabling or, for the first time, requiring title to securities to be evidenced without a written instrument. The Institute of Chartered Secretaries and Administrators ("ICSA") has been consulting on behalf of an industry dematerialisation working group on the introduction of the dematerialisation of all shares. If there is sufficient support for the proposals, ICSA intends to work with a wider group to develop a detailed implementation plan, although timing is unclear.

The Act also introduces a new provision regarding the registration of transfers, whereby the directors of a company must, as soon as practicable, but in any event within two months of the transfer being lodged with the company, either register a transfer of shares or debentures or provide the transferee with reasons for their refusal to register. Where the directors refuse to register such a transfer, the transferee is entitled to receive such information as the transferee may reasonably require regarding the reasons for refusal. Where a company fails to comply, the company and every officer of the company who is in default will have committed an offence. It appears that this does not affect the ability of the directors of a company to refuse any registration where the Articles give them discretion to do so, although this decision must be made in good faith to promote the success of the company for the benefit of its members as a whole.

Debentures

As before, it will be possible to inspect or request a copy of a company's register of debenture holders. 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 debenture holders is only available for proper purposes, protecting debenture holders from the risk of their details being provided for improper purposes.

A person wishing to inspect or request a copy of the register of debenture holders will need to supply the company with their 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 debenture holders, or to disclose information obtained from a register of debenture holders 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 working days of the request, to obtain an order not to comply. The court will need to be satisfied that the information is not sought for a proper purpose.

The restrictions on the right of a third party to obtain access to a company's register of debenture holders should make it easier for companies to control the disclosure of debenture holder information to persons who might abuse the right.

There will also be a new obligation on companies that allot debentures to register an allotment of debentures as soon as reasonably practicable, but in any event within two months of the allotment date.

Practical steps to take to prepare for April 2008

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 6 April 2008:

1. Internal procedures for the execution of documents

- Review any internal procedures regarding signing authorities (and check the Articles do not require otherwise), to take into account the new arrangement whereby a deed will be able to be signed by only one director if required (in the presence of a witness who attests the signature).

2. Whether to have a company secretary

Private companies should consider the following:

- Review the Articles to see whether they require the company to have a company secretary, and decide whether to maintain that requirement. Note that the functions traditionally performed by a company secretary will still need to be undertaken and company secretaries will still retain their existing power to execute and authenticate documents, so many private companies may decide to retain this role.

3. Ensuring compliance with accounts regulations

Private companies should consider the following:

- Ensure that procedures are put in place to take into account the reduction in the time limit to file accounts and reports from 10 months to nine months after the year end.

Public companies should consider the following:

- Ensure that procedures are put in place to take into account the reduction in the time limit to lay full financial statements before the company in general meeting and file them from seven months to six months after the year end.
- If a Quoted Company, check the company website includes annual accounts and reports, and ensure that systems are in place for this information to be available on the website on an ongoing basis. (AIM companies should also be doing this to comply with the AIM Rules for Companies.)

4. Ensuring compliance with audit regulations

- Consider company procedures for dealing with:
  - (a) (if a Quoted Company) the right of shareholders to raise questions about the work of the auditors or the circumstances connected with an auditor ceasing to hold office, and the requirement to publish such concerns on a company website; and
  - (b) the new regulations governing the situation whereby an auditor ceases to hold office.

5. Access to register of debenture holders

- If the company has debenture holders, consider preparing a company policy for dealing with requests made to access the register of debenture holders, including purposes that the company will usually regard as a proper purpose or not. The company will have to react to requests quickly, so having a policy in place will help protect the company in this situation. This policy is likely to be very similar to that required for access to the register of members.

6. Certification and transfer of securities

- Consider preparing a company policy to take into account the new provisions regarding the registration of a transfer of shares or debentures.

Changes coming into force in October 2008

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

- **Directors** - All companies will need to have at least one director who is a natural person. There will be a grace period until October 2010 for any company that 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** - 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.

- **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:

  - 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
  - for a public company subsidiary to give financial assistance for the purpose of the acquisition of shares in its private company parent.

- **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 which will remain.

Changes coming into force in October 2009

The final changes are due to take place in October 2009.

Here is a summary of the key points:

- **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.

- **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 one 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.

- **Company objects** - The objects of new companies will be treated as unrestricted, unless the Articles provide otherwise. The existing 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.

- **Re-denomination of share capital** - A new procedure will be introduced making it easier for companies to re-denominate share capital into foreign currency, by way of an ordinary resolution (unless the company's Articles restrict this power or require a higher majority).

Detailed guides to these changes coming into force in October 2008 and October 2009 will be available nearer the time. If you would like a copy of these guides, please contact Andrew Telling on email a.telling@taylorwessing.com or your usual contact at Taylor Wessing.

Notes

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