Royds Solicitors

Companies Act 2006

Royds held a well attended Seminar on the Companies Act 2006 on 9th November last year, as it happened, the very day on which the Act came into force.

The Government has recently announced the timetable for implementation of the Act, one of the unanswered questions, and this is set out below:-

Timetable

31st December 2006	Listed companies required to publish details of their issued share capital and voting rights on their website with effect from this date;
1st January 2007	Commencement of electronic disclosure and filing provisions. Companies may now deliver almost all documents that they need to submit to the Registrar of Companies electronically. Companies must now state their registered name, place of registration, registered office address and number on hard and soft copy correspondence, including on Order Forms and emails and on their website. Companies failing to meet these requirements will be liable to a fine not exceeding a maximum of £1,000;
20th January 2007	The Transparency Directive and provisions relating to director's safe harbour for misleading statements implemented;
6th April 2007	Provisions in Part 28 of the Act which implement the EU Takeover Directive commence. The detailed provisions are expected to be covered in a second Commencement Order to be published at a later date. The Repeal of certain provisions that relate to directors' obligations will also be implemented on this date. These relate to: • The restriction on directors age 70 and over in public companies; • The rules which require directors and their families to disclose share dealings in the company's shares; • The prohibition on a company paying a director a director's fee free of Income Tax; • The prohibition on directors and their family dealing with share options of trading companies.
Autumn 2007	Secondary legislation to be finalised.
Autumn 2008	Remaining provisions of the Act to be implemented.

The Act is the longest ever published so, necessarily, what follows is a summary of the principal areas likely to be of concern to clients.

1. Statutory Statement of Directors Duties

The Companies Act will introduce a statutory statement of directors' duties.

Currently, the duty that a director owes to the company is defined by common law and equitable principles that have been built up over the years in case law. These establish that directors are subject to fiduciary duties of good faith and honesty as well as separate duties of skill and care.

The case law that has built up over the years overlaps with the statutory duties imposed on directors, not only in the Companies Act 1985 and the Insolvency Act 1986, but in various other statutes relating for example to health and safety law and environmental law.

To address this, the Government has now codified directors' duties in order to try to provide greater clarity. However, the new statutory statement of directors' duties does not replace existing case law, it is designed to run along side it —directors must still comply with all other applicable laws.

The statutory statement sets out seven general duties:-

- Duty to act within the company's powers;
- Duty to promote the success of the company;
- Duty to exercise independent judgment;
- Duty to exercise reasonable skill, care and diligence;
- Duty to avoid conflicts of interest;
- Duty not to accept benefits from third parties;
- Duty to declare interest in proposed transaction or arrangement with the company.

Perhaps the most controversial of the codified duties is the duty imposed on a director to "promote the success of the company for the benefit of its members". In fulfilling the duty, the director must "have regard to" various stakeholder interests, namely, the interests of the employees, the company's relationship with its suppliers and customers, the impact of any decision on the wider community and the environment, the need to act fairly and within the highest standards of business conduct, and the long term consequences of any decision. This has been referred to as "enlightened shareholder value".

In practice, it is unclear how directors are expected to exercise this duty.

It is possible to envisage that one or more stakeholder interests may not be consistent with promoting the "success of the company". Having regard to all these factors might reduce the overall profitability of the business, thereby creating tension with the shareholders.

As under current law, the general duties will apply to directors, shadow directors, non-executive directors and in certain cases to former directors.

If a director acts in breach of any of these duties he will be subject to a civil action for breach.

The Companies Act also contains a new statutory right for shareholders to bring a "derivative" action on behalf of the company for negligence, default or breach of trust or duty by a director.

2. Derivative Actions

Currently, a derivative action, that is to say a member's ability to bring proceedings on behalf of a company, is not contained in statute but is a matter of common law.

Derivative actions at common law have two distinct parts:-

- a shareholder can bring an action on behalf of the company or a wrong done to the company. The company is the injured party and therefore any right of action vests in the company;
- the Court will not intervene in the internal management of the company acting within its powers.

Some exceptions to this rule exist:-

- where the member can show "fraud on the minority". Fraud in this sense does not have the same meaning as is commonly used. The member must show fraud in the sense that the company is controlled by "wrongdoers";
- illegality on behalf of the directors and major shareholders;
- failure to approve the matter in question by the appropriate resolution.

In practice, there is no right to bring a derivative action. It is in the Court's discretion whether or not to allow it and for that reason, it is rarely used. As the claim is brought on behalf of the company, any remedy awarded will be for the benefit of the company.

Aggrieved minority shareholders tend, therefore, to rely on a claim for unfair prejudice under section 459 of the Companies Act. However, this involves lengthy proceedings and high costs.

The Companies Act contains a definition of a statutory derivative action for the first time.

The Government states that the Act will make the law "clearer and more accessible, but will not result in a major change in the law".

In order to bring a claim under the new Act:-

- it must be brought by a member of the company;
- it must relate to a course of action undertaken by the company;
- the relief must be sought on behalf of the company.

A member seeking to bring such an action must show a prima facie case to the Court and it is at the Court's discretion whether or not to give permission for the application to proceed.

A claim might be brought for a breach of the new directors' duties codified in the Act. Further, if leave is granted by the Court for an application to proceed, the company must reimburse the shareholder for bringing the action.

The absence of a costs risk and the extension of matters of conduct in respect of which shareholders can complain creates a concern that the new provisions may be abused by disgruntled or activist shareholders.

3. Financial Assistance

The Companies Act abolishes the prohibition on the giving of financial assistance by private companies to purchase the company's own shares.

The Companies Act 1985 prevented a company from giving unlawful financial assistance in relation to the acquisition of its own shares. This means that a complicated sequence of procedural and regulatory steps was required, subject to certain exemptions, known as the "whitewash procedure", before a company's assets could be used to fund the acquisition of shares in that company.

The prohibition will be abolished as it is thought that the company's creditors are better protected by other safeguards under the existing restrictions on fraudulent and wrongful trading and the new statutory duties on directors codified within the Act.

It is anticipated that the lifting of the ban on financial assistance will cut transaction costs considerably where shares in private companies are bought or sold.

The "whitewash procedure" will continue to apply to financial assistance given:-

- in relation to the acquisition of public companies;
- by a public company or any of its subsidiaries; or
- by a public company subsidiary of a private limited company.

4. Auditor Liability

At present, auditors are not allowed to limit their liability to the companies they audit. A company may not exempt its auditors from, or indemnify them against, liability for any negligence, default, breach of duty or breach of trust in relation to the company. Instead, most companies purchase and maintain auditor insurance against such liability.

The new Act permits auditors to agree with their corporate clients to limit their liability in respect of an audit, subject to annual shareholder approval and to the limit being "fair and reasonable". This arrangement has been referred to as a liability limitation agreement.

In determining what is fair and reasonable, the courts must have regard to all the circumstances of the case, the auditors' responsibilities, the nature and purpose of the auditors' contractual obligations to the company, and the professional standards expected of him will be taken into consideration.

Liability limitation agreements must be approved by ordinary resolution, although private companies may resolve to waive the need for such approval. Such agreements must be limited to one financial year's audit and are likely to form part of the firm's annual negotiations with their auditors.

5. Changes to Private Companies

There are wide reaching changes to a private company's constitution under the new Act. A company's constitution is its governing documents comprising its Memorandum and Articles of Association. The Memorandum will not cease to exist but will now simply contain a statement by the owners of the two initial shares in the company that they wish to form a company. Further, there will be simplified default Articles for private companies.

It will now be possible, however, for private companies to specify a maximum number of shares which can be allotted. This restriction is intended to prevent any dilution and diminution in the value of investors' shareholding and initial investment.

The company's objects—that is to say the reason for which the company exists—will be unrestricted. This will mean that a contracting party will no longer be concerned to inquire as to whether the company they are contracting with has a power to enter into the transaction in question, thereby removing the "ultra vires" rule.

Company formation will be made easier and the requirement for private companies to have a company secretary has been abolished. On-line incorporation will be made easier and directors will automatically have the option of filing a service address on the public record rather than their private home address.

There have also been changes designed to streamline company decision making. These are in respect to meetings and resolutions so as to make the decision making process in private companies easier and quicker. Currently, private companies can bypass the need for a general meeting by passing written resolutions. However, these written resolutions require the signature of all members entitled to vote at such a meeting and such a resolution will not be possible even if one shareholder is unavailable to sign. The new Act will remove the requirement for all shareholders to sign written resolutions and written resolutions will now be passed by a simple 75% majority of those entitled to vote.

Private companies will now not need to hold an annual general meeting unless they opt to do so positively.

The provisions on accounts and reports have been restated to make them much easier to understand for smaller companies and their advisers. The advance in online technology is extended in relation to private companies and subject to members' consent, companies may use electronic communications with their members.

6. Changes to Public Companies

In addition to a number of procedural changes designed to move the formation and day-to-day running of public companies more straightforward, there have been some large scale changes proposed under the Companies Act that relate to greater transparency.

It is now a requirement for public companies to operate a website.

Public companies must now publish the result of shareholder polls taken at a general meeting on the companies' website. Up to 5% of shareholders may now demand an independent report of any poll taken, or to be taken, at a general meeting, the result of which must also be published on the company website.

Under the Companies Act, the Government has reinstated the power to require institutions to declare how they voted. This power had previously been removed by the House of Lords but has been re-instated following pressure from Trade Unions. It is largely the same as the original power but now demands further detail. For example, the exercise or non-exercise of voting rights and instructions or delegations made relating to their (non)–exercise is now required.

The new Act incorporates the European Takeover Directive.

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