C/M/S/ Cameron McKenna

Companies Act 2006

Overview

September 2007
(updated version)

Contents

Directors and corporate governance 4

General meetings, resolutions and shareholder rights 11

Capital maintenance and transactions benefiting shareholders 15

Takeovers 17

Auditors and accounts 19

Company administration 23

Application of the Act to existing companies 27

Further reform of company law 29

This note summarises those provisions of the Companies Act 2006 that are likely to be most significant for companies and their advisers. It was initially published in April 2007, and we have updated it to reflect developments since then.

The Act received Royal Assent on 8 November 2006 and is coming into effect in pre-announced stages: some provisions on enactment, others since then, and the rest between now and October 2008. For further details, including provisions that have already come into force, see:

- Companies Act 2006: implementation timetable (September 2007), published at the same time as this note
- the May 2007 edition of our bulletin, Clearly Corporate, which contains articles on electronic communications under the new Act and the implementation in the UK of the Transparency Directive (including the introduction of a new major shareholding notification regime).

Eventually the 2006 Act will repeal and replace nearly all of the Companies Act 1985: the only significant parts that will remain relate to company investigations and community interest companies. Around 800 sections of the new Act contain rules that are entirely new or that are significantly different from the existing law; the rest is intended simply to restate those parts of the 1985 Act that have not been amended.

Most company legislation will therefore be contained in a single consolidated Act. In principle, provisions that are restated from the 1985 Act should have the same effect, but lawyers are likely to scrutinise any differences in language to assess whether the meaning has been changed in the process.

How we have updated and amended this note since April

We have:

- revised the section on directors' duties (for example, to reflect material published by the Government in June)
- specified the commencement date of provisions that are particularly significant or imminent (for further details refer to our Implementation Timetable which accompanies this note), and identified provisions that came into force on 6 April 2007
- updated the section on derivative actions to reflect the procedural rules published in August
- updated the section on inspecting a company's register of members to reflect guidance published by the ICSA in June and a change in the implementation timetable announced in May
- highlighted the issues for private companies to consider when proposing to enter into a transaction that under the 2006 Act will no longer be prohibited as financial assistance
- highlighted information about potential impediments to a takeover that listed companies will have to include in their annual directors' report
- included the recommendations of Professor Paul Davies made in June as to whether the statutory liability regime in section 90A Financial Services and Markets Act 2000 should be extended to AIM and PLUS Markets companies, and to ad hoc announcements
- made various other changes to take account of regulations under the 2006 Act and other materials that have been published by the Government since this note was originally published.

"Eventually the 2006 Act will repeal and replace nearly all of the Companies Act 1985: the only significant parts that will remain relate to company investigations and community interest companies."

Directors and corporate governance

"The new duty requires a director to act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of the members as a collective body."

Statutory statement of directors' duties

For the first time, the principal duties owed by directors to their company have been set out in statute, making them clearer and more accessible. The statutory duties will replace the common law duties of directors on which they are based, and are coming into force on 1 October 2007 (except those relating to conflicts of interest, which will come into force on 1 October 2008).

Promoting the success of the company

The most controversial aspect of the new Act is section 172, which replaces the common law fiduciary duty of loyalty (often phrased as the duty to act in good faith in the best interests of the company). The new duty requires a director to act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of the members as a collective body: not just the majority shareholders, or any particular shareholder or section of shareholders. According to statements made in Parliament, the success of the company means what the members collectively want the company to achieve. For a commercial company, this will usually mean long-term increase in value; for charitable and community interest companies, the attainment of the objectives for which the company was established.

The duty requires the director to have regard (amongst other matters) to six specified factors:

- 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
- the need to act fairly as between members of the company.

The Government says that this is a radical departure and that it reflects a cultural change in the way that companies conduct their business – that it is now recognised that pursuing the interests of shareholders and embracing the wider responsibilities flagged in the list of factors are complementary purposes, not contradictory ones. The intention is that no director has any excuse for thinking that acting in the interests of the company's members necessarily precludes acting in the interests of those who depend on the company, like its employees and its supply chain.

The decisions taken by a director and the weight given to the factors are a matter for his good faith judgement. It is therefore fundamentally a subjective matter, although there is an element of objectivity in that all directors must exercise reasonable skill, care and diligence (see below). The Government says that directors must give the factors – and any other relevant factors - proper consideration, and not merely pay lip service to them. To a large extent, this is what any responsible board would do as part of its decision-making. Section 172 can be seen as a means of improving the processes of boards, rather than imposing an additional substantive burden. But the duty will apply to everything that a director does as a director, not just his participation in formal board meetings.

Where an urgent decision is necessary, the requirements of section 172 should not be read as preventing a decision being made until (for example) formal reports have been commissioned – it is simply the case that the directors must do their best in the time that is available.

Not all the factors will always be relevant, and sometimes one factor may be irreconcilable with another one: investing in new technology, for example, may be better for the environment but cause job losses. The obligation is not to ensure that the company achieves a positive score on each factor, but to think about them when deciding what course will best promote the company's success. Where factors conflict with each other, or with what the directors consider to be the promotion of the company's success, it is legitimate to discount a particular factor or give it less weight – as long as it has been thought about, if it is relevant, with whatever attention is due and feasible in the particular circumstances.

It will be a fundamental element of discharging a director's duties that he is aware of the factors. Processes may need to be overhauled and training given – and not just to directors. Where directors receive briefing papers and similar background material prepared by others, the individuals compiling these papers should also be thinking about the matters that directors may need to take into account.

Other fiduciary duties

A director must also:

- Act in accordance with the company's constitution (which for these purposes includes all lawful shareholder and board resolutions), and only exercise powers for the purposes for which they are conferred
- Exercise independent judgement, and not fetter his discretion except as the company's constitution (in its extended definition) permits or pursuant to an agreement that was considered to promote the success of the company when it was entered into
- Avoid conflicts of interest
- Not accept benefits from third parties
- Declare his interest in any proposed transaction or arrangement.

Changes to rules on conflicts of interest

Where a transaction is proposed between a director and his company, so that the director's duties to the company may be in conflict with his personal interests, the rules of equity currently require the director to account to the company unless the shareholders approve the transaction. Companies' articles usually modify this equitable duty, instead simply requiring directors to disclose their interest to the rest of the board.

"The Government has included provisions in section 176 of the Act that allow the other directors, provided they have no interest in the matter, to authorise a director to proceed notwithstanding his conflict of interest."

Section 178 of the Act reflects the current position in section 317 of the 1985 Act and in the articles of most companies by requiring an interested director to disclose the nature of his interest to the rest of the board before the transaction is approved. One change is that disclosure need not be made if the interest cannot reasonably be regarded as likely to give rise to a conflict of interest or if the other directors are already aware of the director's interest.

Existing equitable rules prevent a director from exploiting personally without permission any opportunity that properly belongs to the company, even if the company is not itself in a position to exploit it. Believing this to hinder entrepreneurial and business start-up activity, the Government has included provisions in section 176 of the Act that allow the other directors, provided they have no interest in the matter, to authorise a director to proceed notwithstanding his conflict of interest. Directors of public companies will only be able to authorise such conflicts if the articles allow it (and this method of authorising a conflict will not be allowed for private and public companies formed before the duty comes into force unless approved by shareholders). There could, of course, be difficulty if none of the directors is without an interest in the matter; in that case, only a shareholder resolution could absolve the conflicted directors.

"Although the new duties expressed in the Act will displace those formulated in previous cases, cases on directors' duties will continue to be relevant for the purpose of determining how those duties should be applied in particular circumstances."

Because most public (and some private) companies will want to change their articles to specify how and when independent directors can authorise a conflict of interest, the introduction of the relevant provisions in the Act has been deferred until 1 October 2008. This will allow quoted companies, in particular, to propose appropriate changes to their articles at the 2008 AGM, rather than hold a special EGM.

Duty of skill and care
The standard of skill and care expected of directors adopts the combined objective/subjective test prescribed in the Insolvency Act 1986 for judging whether directors are liable for wrongful trading i.e. the higher of the knowledge, skill and experience reasonably expected of a director in that position, and the knowledge, skill and experience of that particular director. The courts have in fact used this test for many years to assess compliance with a director's common law duty of skill and care.

Relevance of case law
Although the new duties expressed in the Act will displace those formulated in previous cases, cases on directors' duties will continue to be relevant for the purpose of determining how those duties should be applied in particular circumstances. Historically, courts have sometimes decided that a particular duty implies additional obligations: for example, the Court of Appeal recently ruled that a director's duty under the current law to act in what he in good faith considers to be the best interests of his company imports an obligation to disclose his own breach of the duty. This 'dynamic' approach is likely to continue under the new Act.

Transactions between directors and their companies

Various changes will be made to the rules on substantial property transactions between companies and their directors, on loans to directors, payments to directors for loss of office, and on long-term service contracts, principally to make the rules more accessible and consistent, and to remove a number of ambiguities.

For example:

- All companies will be able to make loans to their directors if, after full details have been provided, the loan is approved by shareholders. At present such loans are generally prohibited, subject to various exceptions
- Companies will be able to enter into transactions that would currently fall within section 320 of the 1985 Act (substantial property transactions with directors and their connected persons) before shareholder approval has been obtained, as long as the transaction is made conditional on such approval
- Shareholder approval will be required where a company proposes to make a payment to a director in compensation for loss of his employment as a director of the company (not just for loss of his office as a director) which goes beyond his existing contractual entitlement
- The complex rules in section 346 of the 1985 Act determining which persons are "connected" to a director for these purposes will also be re-written and extended to catch a director's civil partner and adult children and step-children, the director's parents, a person who lives with the director "as partner in an enduring family relationship", and any children or step-children under 18 of such a person who are not also the director's children or step-children. This extended definition flows into the provisions that determine whether a director is connected with, or controls, a body corporate.

Transactions with third parties: *ultra vires*

Sections 35-35B of the 1985 Act, which deal with a company's capacity and the power of directors to bind it, will be replaced with new provisions that do not make any substantive change to the current rules. Capacity will be less of an issue in future,

"All directors – and not just those at serious risk of violence or intimidation - will be able to provide a service address for the public record."

anyway, as companies formed on or after 1 October 2008 will have unrestricted objects unless they choose to include restricted objects in their articles, and most existing companies will be able to dispense with their objects.

In relation to the directors' power to bind the company, there is the same protection as under the 1985 Act for third parties dealing with the company in good faith, although there may be significance in the fact that the new provision, unlike the old one, refers to dealings with the directors, not the board. According to previous case law, they will still have to concern themselves with the question of whether the person they are dealing with has sufficient authority.

As between the company and themselves, directors will still have a duty to observe the company's constitution, including any restrictions in the articles of association.

Service addresses

All directors – and not just those at serious risk of violence or intimidation - will be able to provide a service address for the public record. A director's residential address will still have to be filed at Companies House but will be kept on a separate register, access to which will be limited to certain public authorities and credit reference agencies. The company itself will also maintain a record of each director's residential address, but this will not be open to public inspection.

As there are around five million registered directors, Companies House has said that it is unable to remove all existing residential addresses from the record. However, the Government proposes to allow directors who can show that they are at risk of violence or intimidation to apply for their residential address to be removed from documents filed after 1 January 2003 (documents filed before that date are kept on microfiche, making it impractical to remove details). Directors who have already been granted a confidentiality order under the 1985 Act will be deemed to have made such an application.

Appointment and eligibility

From 1 October 2008 at least one director of every company will have to be a natural person (who need not be domiciled in the UK). However, companies without a natural person as a director on 8 November 2006 (the date the Act received Royal Assent) will have until October 2010 to appoint at least one natural person as a director.

The 70-year age limit for directors of public companies and subsidiaries of public companies (which applied unless the articles excluded it) was abolished on 6 April 2007. From 1 October 2008 there will be a 16-year minimum age limit for directors of all companies.

Dealings in shares

Section 324 and related provisions in the 1985 Act that required directors and certain other persons to disclose to the company their interests in shares in and debentures of the company or any holding company or non-wholly-owned subsidiary company within the group were repealed on 6 April 2007. Directors of companies listed on the Official List, AIM or PLUS Markets (and certain persons connected to them) continue to be required under the Disclosure and Transparency Rules, AIM or PLUS Markets Rules to notify their company of their dealings.

The prohibition in the 1985 Act on directors (including shadow directors) of listed companies and their spouses and children from buying put and call options over shares or debentures in the company, or another in the same group, was repealed at the same time.

"The sections in the Act dealing with derivative actions proved to be among the most controversial, due largely to companies' fear that the new rules would make it easier for activist shareholders and special interest groups to sue directors."

Company secretaries

Private companies will no longer be required to have a company secretary, but they may choose to do so.

Where a company secretary is appointed, he will have the same status as under the 1985 Act – in particular, he will be able to file documents at Companies House and be one of the signatories to a deed made by the company. Companies without a secretary will not be at a disadvantage, though, since the rules on execution of deeds are being changed (see under Company Administration below) so that only a single director's (witnessed) signature will be required.

Personal liability

Derivative actions initiated by shareholders

As a general rule, if a wrong is done to a company, only the company itself (and not a shareholder) can bring an action for damages or some other remedy. In practice, the directors must decide whether or not to bring a claim. Clearly, if the wrong was done by the directors themselves, or a majority of them, no claim is likely to be pursued. Unless shareholders are able to force the board to bring a claim, either by passing an ordinary resolution to replace the existing directors, or by giving a direction to the board by means of a special resolution, the company and the shareholders will have no remedy in respect of any loss the company has suffered. Minority shareholders can therefore find it difficult to force directors to overturn their decision not to bring an action.

However, where it can be shown that an act amounts to a 'fraud on the minority' – basically, some wrongdoing by the directors or majority shareholders, or some ultra vires action, illegality or infringement of a shareholder's personal rights - and that the wrongdoers are in control of the company, the courts have for many years allowed minority shareholders to apply to bring a "derivative action" which, in effect, allows the shareholder to take proceedings on behalf, and for the benefit, of the company. A derivative claim can only be brought at the discretion of the court. Moreover, no claim can be brought where a majority of independent shareholders do not wish the action to proceed.

Because of the difficulty in bringing such claims, the Government accepted the Company Law Review's recommendation that derivative actions should be put onto a statutory footing. In the event, the sections in the Act dealing with derivative actions proved to be among the most controversial, due largely to companies' fear that the new rules would make it easier for activist shareholders and special interest groups to sue directors. For the reasons given below, we believe these fears to be largely unfounded.

Sections 260-264 of the Act deal with derivative claims in England and Wales or Northern Ireland. As at present, a claim can only be brought with the permission of the court. In practice, the court will hear evidence from the company and the claimant at a permission hearing, and decide whether to allow the claim to proceed. Historically, most claims have been struck out at this stage. Over the last three years, there have only been seven reported cases on derivative actions, and in the only one of these where permission was granted the company did not oppose the application. Also at this stage, the court is likely to be asked to decide whether the company should be made to bear the claimant's costs of bringing the action. Arguments over whether permission should be granted, and what order should be made as to costs, can take many days: in one famous case, the permission hearing lasted 18 days.

Under the new Act, a derivative claim can only be brought against a director or another person (or both):

"The court is also required to have particular regard to the views of any disinterested shareholders: for example, if the company produces evidence that a majority of those shareholders do not favour pursuing the claim, this is likely to weigh heavily with the court."

- in respect of a cause of action "arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company" (whether arising before or after the claimant became a shareholder). At present, a claim can only be brought in respect of a director's negligence if he himself has benefited from it; the new regime is therefore much wider in this regard; and
- where it appears to the court that the claimant has a prima facie case. In all but the most open and shut cases, the court will probably be reluctant to dismiss a claim on the basis of what may be rather limited evidence at the permission hearing, so few claims are likely to fail merely on this ground.

There is no need to show that an act amounts to a 'fraud on the minority', or that the wrongdoers are in control of the company. But the court must dismiss the claim if it is satisfied that:

- a (hypothetical) director acting so as to promote the success of the company for the benefit of its members as a whole would not continue the claim; or
- where the act or omission is yet to occur, it has been authorised by shareholders or, where it has already occurred, it was authorised beforehand by shareholders or has subsequently been ratified by them (disregarding any votes cast by the directors concerned, if they are shareholders, or by any shareholder connected with them).

In applying the hypothetical director test, the court is unlikely to engage in a balancing exercise: as at present, it will only refuse permission on this ground if it is satisfied that no reasonable director would pursue the claim.

In deciding whether to give permission, the court must take various matters into account, including whether the shareholder is acting in good faith; the importance of the claim to the company; whether the company has decided not to bring the claim; and whether the shareholder could bring a claim in his own right, rather than on behalf of the company. The court is also required to have particular regard to the views of any disinterested shareholders: for example, if the company produces evidence that a majority of those shareholders do not favour pursuing the claim, this is likely to weigh heavily with the court. To get a derivative claim struck out, a company will want to show that, essentially, the board's decision not to pursue a claim against a director is a reasonable one in the circumstances: it will help if the board can show that it has taken independent legal advice and, preferably, that the decision has the support of the majority of disinterested shareholders.

Until the new rules are applied in practice by the courts, it is difficult to know whether the number of derivative claims is likely to increase. It has been suggested that the possibility of bringing claims in respect of directors' negligence or breach of duty, without having to show 'fraud on the minority', means that more claims are likely. But even activist shareholders are still likely to be discouraged from bringing such claims by the fact that any damages recovered will go to the company, and not the shareholder personally.

The new derivative claims rules will apply to all claims started on or after 1 October 2007. But where a claim relates to acts or omissions by a director that occurred before that date, the court will determine the outcome on the basis of the old common law that applied at the time of the act or omission.

Application for relief

Under a section that will replace section 727 of the 1985 Act, if a director "has reason to apprehend that a claim will or might be made against him in respect of negligence, default, breach of duty or breach of trust", he will be able to apply to court for relief without having to wait for the claim to be made.

"The rules will be extended to allow a corporate trustee of an occupational pension scheme (or a member of its group) to indemnify its directors against liability incurred in connection with the company's activities as trustee of the scheme."

Protection for directors

The rules introduced on 6 April 2005 allowing companies to indemnify their directors in certain circumstances, and to advance funds to them to meet defence costs, will be restated without significant amendment. However, the rules will be extended to allow a corporate trustee of an occupational pension scheme (or a member of its group) to indemnify its directors against liability incurred in connection with the company's activities as trustee of the scheme, other than fines, penalties or the costs of defending criminal proceedings in which the director is convicted. At present, the rules do not appear to allow such indemnities, meaning that directors of corporate trustees may be in a worse position than non-corporate trustees, who can be indemnified out of the scheme's assets.

The exception that allows companies to lend money to their directors to fund their defence costs will be extended to cover not just proceedings relating to the company but also relating to any associated companies. There are also new requirements relating to the keeping of copies of relevant indemnities and making them available to members.

In the light of the new rules on derivative actions, and the codification of directors' duties, boards should review their D & O insurance and consider whether to extend the scope of any existing indemnity arrangements, or to put new ones in place.

As at present, under the new Act shareholders can ratify by ordinary resolution actions taken by a director negligently or in breach of duty, provided that the negligence or breach is specifically identified, all relevant information is disclosed, and the company is solvent. However, the new Act makes clear that the resolution will have no effect unless the necessary majority is obtained without counting any votes cast by the director concerned (if he has shares) or any shareholder connected with him.

Defective accounts; fraudulent trading

Contrary to its original proposal to make the maximum sanction for approving defective reports and accounts a term of imprisonment, the Government finally decided that the maximum penalty should be an unlimited fine. But the maximum prison term for fraudulent trading will be increased from seven to ten years.

"A director or other officer of the company will be personally liable where he "authorises, permits, participates in, or fails to take all reasonable steps to prevent" the offence."

Liability for offences committed by company

The general principle adopted in the new Act is that, where the only victims of the offence are the company or its members, the company itself should not be liable for the offence. But where the members of the company are only some of the potential victims, the company itself should be liable. A director or other officer of the company will be personally liable where he "authorises, permits, participates in, or fails to take all reasonable steps to prevent" the offence.

In the light of responses to its original consultation, which criticised the proposals on both policy and technical grounds, the Government decided not to extend to "senior executives" and "responsible delegates" the category of "officers in default".

General meetings, resolutions and shareholder rights

"Shareholders in public companies (whether quoted or not) will be able to require the company to circulate resolutions and statements at the company's expense (rather than their own) if the materials are provided to the company before the end of the financial year. "

"The registered holder of a share in a company listed on the Official List or another EU regulated market will be entitled to nominate one or more other persons (such as the beneficial owner(s)) to receive copies of all communications sent by the company to its members generally."

Quoted companies

Shareholder rights to raise questions

Shareholders in quoted companies (which here means listed on the UK's or another EU member state's official list, or on the NYSE or NASDAQ, but not AIM) who hold at least 5% of the voting rights, or who number at least 100 (with an average of at least £100 of share capital each) will have the right to publish on the company's website free of charge a statement of any concerns about the audit, or the circumstances in which the auditors have resigned, that they intend to raise at the AGM. But contrary to the Government's original plans, the auditors will not be legally obliged to answer shareholder questions.

A proposal in an early draft of the Company Law Reform Bill (as it was then called) to grant shareholders of quoted companies a right, within a 15-day "holding period" after the accounts become available, to propose a resolution to be moved at the general meeting where the accounts are laid was also dropped. Instead, as originally proposed, shareholders in public companies (whether quoted or not) will be able to require the company to circulate resolutions and statements at the company's expense (rather than their own) if the materials are provided to the company before the end of the financial year.

Exercise of voting rights

Without any change being made to the articles, the registered holder of a share in a company listed on the Official List or another EU regulated market will be entitled to nominate one or more other persons (such as the beneficial owner(s)) to receive copies of all communications sent by the company to its members generally, including notices of meetings and copies of reports and accounts (so-called "information rights"). The new provisions, which will operate from the start of 2008, are designed to make it easier for indirect investors to inform themselves about the companies they invest in, and to encourage them to influence the company's strategy and governance by voting. Nominee investment operators are therefore expected to ask their investors whether they would like to exercise their information rights, and to communicate any requests to the relevant companies before the year-end. The provisions in the Act allowing companies to communicate electronically with shareholders (see below) will apply to nominated persons. Operators who offer a voting service – under which investors can instruct the registered holder how to vote their shares – are likely to have a commercial advantage. To facilitate this process, the new Act will allow registered members who hold shares on behalf of several beneficiaries to exercise their rights in different ways.

In case voluntary shareholder engagement does not appear to be working in practice, the Government has taken power in the Act to make regulations forcing institutional shareholders to publicly disclose their voting records. A number of institutions have already started to do so voluntarily, including Fidelity International, one of the UK's largest fund managers, which has published its voting record at shareholder meetings on every motion proposed by companies in which it invests in the UK, Europe, the US and Asia since 1 July 2004. The Government has promised that it will not introduce such regulations without prior consultation and a proper cost/benefit analysis. In June, the Institutional Shareholders' Committee published guidelines for UK institutions on disclosing publicly how they have exercised their voting rights. It envisages a "comply or explain" approach: if institutional shareholders or their agents have a policy to disclose and they conclude that disclosure is not appropriate in a particular case, they should explain why they have taken this view; and if their overall approach is not to disclose, they should explain the reasons for that policy.

Polls

Quoted companies will have to disclose the results of any poll on their website – some already do so as a matter of best practice. Shareholders who hold at least 5% of the voting rights, or who number at least 100 (with an average of at least £100 of share capital each) will be able to require the directors to obtain an independent report on any polled vote.

All companies

Information rights

The Act allows, but does not require, all companies to change their articles to allow a registered holder to nominate someone else (such as the beneficial owner) to exercise some or all of his statutory rights as a member, including the right to appoint a proxy and to circulate a proposed resolution or statement prior to a general meeting.

Electronic communications

Provisions in the Act that came into force in January make it easier for companies to use the internet to communicate with shareholders, and so reduce printing and distribution costs.

Although it has been possible for some years for companies to use electronic means to deliver certain documents to shareholders, the Act has extended the range of information that can be communicated electronically and relaxed certain requirements for communication by website. If a company already has agreements in place with shareholders under which they agree to accept electronic communications, those agreements remain valid. But, depending on the terms of the agreements, they may not cover every type of document that the company may wish to send.

"The Act allows companies to default shareholders into a so-called "deemed" agreement. This is done by writing to the shareholder and informing him that, unless he responds within 28 days, he will be deemed to have consented to website communication."

There is a two-tier system under the new regime. The first tier covers the sending of documents electronically or in electronic form: for example, by e-mail or in the form of disks, tapes etc through the post. To do this, the company needs the individual shareholder's agreement (and, of course, in the case of e-mail, the shareholder needs to provide an e-mail address).

The second tier is concerned with making material available on a website and notifying shareholders that it is there, and where to find it. Again, an individual shareholder's agreement to accept website delivery is required, but in this case (unlike the first tier) the Act allows companies to default shareholders into a so-called "deemed" agreement. This is done by writing to the shareholder and informing him that, unless he responds within 28 days, he will be deemed to have consented to website communication. To do this, the company must have been authorised, either by appropriate provisions in its articles or by a shareholder resolution, to send or supply documents or information to shareholders by making them available on a website.

The deemed agreement does not dispense with the need to communicate by post, however, since the Act requires the company to notify the shareholder in writing when material is posted on the website. This is, of course, less costly than posting long documents. But if the company wants to dispense with paper altogether and do the notification by e-mail, it has to secure the shareholder's actual (rather than deemed) agreement, and his e-mail address, under the first tier.

Whenever the company sends out a notice of meeting, or a proxy form, to shareholders containing an electronic address it is deemed to agree to receive electronic communications from the shareholders in relation to the meeting. Care must be taken to ensure that, where this happens, the company can apply proper authentication procedures (and that it can ask for proper hard copy supporting documents where someone is voting on another person's behalf - for example, as representative of a corporate shareholder, or under a power of attorney).

"If the company wants to dispense with paper altogether and do the notification by e-mail, it has to secure the shareholder's actual (rather than deemed) agreement, and his e-mail address."

If the company is listed, it must also comply with a new rule under Chapter 6 of the FSA's Disclosure and Transparency Rules, which requires it to obtain shareholder approval in general meeting if it wishes to use electronic communications (although this is not required in respect of agreements that were in place before the new rules came into effect). A single ordinary resolution will satisfy this requirement and the Companies Act requirement for shareholder authority to use website delivery. The resolution must be filed at Companies House.

Where the company has defaulted a shareholder into accepting website delivery but the shareholder later transfers his shares, the company will not be able to rely on the deemed agreement. The speed with which shareholdings can change hands through CREST might make this a problem. If the company wants to use website delivery for the new shareholder, it will either have to secure an actual agreement with the shareholder or start the 28-day default process again. The Act prohibits companies from using the default process in relation to a shareholder more than once every 12 months, so, to avoid having to maintain individual timelines for each shareholder, most large companies are expected to use the default process only on alternate annual postings to shareholders.

The Institute of Chartered Secretaries and Administrators (ICSA) has produced best practice recommendations and guidance, available on its site at:
http://www.zoomerang.com/recipient/survey-intro.zgi?p=WEB2266CA2J5UZ

> "Once a company has filed an annual return made up to a date after 30 September 2007, a person requesting access to the register of members will have to tell the company what the information will be used for, and who it will be passed to, and if the company can persuade a court that this is not a proper purpose it may obtain permission to reject that particular request and any similar ones made in future."

Right to inspect a company's register of members

Following a number of high-profile cases in which animal rights activists obtained the names and addresses of shareholders in pharmaceutical companies, the Government agreed to impose restrictions on the rights of members of the public and shareholders to inspect and copy a company's register of members. In May it was announced that the introduction of the new rules would be brought forward to 1 October 2007. Once a company has filed an annual return made up to a date after 30 September 2007, a person requesting access to the register of members will have to tell the company what the information will be used for, and who it will be passed to, and if the company can persuade a court that this is not a proper purpose it may obtain permission to reject that particular request and any similar ones made in future.

"Proper purpose" is not defined in the Act and it will therefore be left for determination by the courts. In June the ICSA published guidance for companies, setting out a non-exhaustive list of purposes that it considers proper and improper. Those considered proper include:

- a shareholder checking that his personal details are accurately recorded on the register
- shareholders or indirect investors wanting to contact other shareholders about matters relating to the company, their shareholding or a related exercise of rights. Such matters might include:
  - general representations about the activities or management of the company
  - communications in connection with the exercise of member rights under the Act, such as garnering of support for a requisition, circulating a member's statement relating to a resolution to be put to a shareholder meeting, communications concerning requests for an independent scrutiny of a poll, the publication on the company's website of audit concerns and voting/support for a particular course of action
- a request relating to takeover offers and private acquisitions, such as a bidder or potential bidder or anyone acting on their behalf requesting access to the target's register prior to a bid being announced
- register analysis for the purpose of producing statistical research data which would be of general public interest, but in which no individual or personal information would be subsequently disclosed
- a stockbroker checking a register entry to confirm ownership of shares before processing a transaction relating to the shares.

An improper purpose might include:

- any representation or communication to members that the company is concerned would threaten, harass or intimidate members
- offers relating to securities
- performing credit or identity checks on individual shareholders
- any other purpose not related to the members in their capacity as members of the company or to the exercise of their shareholder rights (for example, commercial mailings).

Companies also need to consider shareholders' data protection rights when responding to requests for access to the register of members: there is a risk that disclosure of a shareholder's personal data for an improper purpose will constitute a breach of the company's duty under the Data Protection Act 1998 to ensure that personal data which it controls is not disclosed unfairly or unlawfully.

"Companies will not have to include the address of any shareholder in an annual return unless the company's shares are traded on an EU regulated market and the shareholder held 5% or more of any class of shares at any time during the year in question."

"In calculating the deadline for proxy forms to be submitted - which cannot be more than 48 hours before the meeting - non-working days will no longer be counted."

Similar rules will apply to requests to access a company's register of interests, which records information about interests in the company's shares that it has obtained by sending out notices under section 793 of the Act (formerly section 212 of the 1985 Act).

In addition, companies will not have to include the address of any shareholder in an annual return unless the company's shares are traded on an EU regulated market and the shareholder held 5% or more of any class of shares at any time during the year in question. This is intended to be a practical way of ensuring that the restriction of the right to inspect a company's register of members is not circumvented by the information being publicly available at Companies House.

It is proposed that companies should be able to have somewhere other than their registered offices for public inspection of records that are subject to statutory inspection rights; and the Government is consulting on when and how long records should be open to inspection.

Proxies

Members of both private and public companies will be able to appoint more than one proxy. Proxies will be given the same rights as registered holders to ask questions, demand a poll and vote on a show of hands at general meetings (as well as on a poll).

In calculating the deadline for proxy forms to be submitted - which cannot be more than 48 hours before the meeting - non-working days will no longer be counted. This will avoid difficulties that could arise under the 1985 Act – for example, if the meeting was to be held at 11 am on a Monday, the deadline for submitting proxies would have to be set no earlier than 11 am on the preceding Saturday, making it difficult for the registrars to count the proxy votes in time for the meeting.

Rights issues

The statutory minimum period of 21 days for acceptance of rights offers will be retained, but the Act allows the Secretary of State to make regulations to vary this period upwards or downwards (but not to less than 14 days).

Transfer of shares

Directors will have a statutory obligation to provide a proposed transferee of shares with reasons for any refusal to register the transfer.

Class rights

Various technical changes will simplify the variation of class rights provisions currently in force under sections 125-127 of the 1985 Act.

New rules will also expressly allow companies to include in their articles provisions that can be changed only with the consent of a particular majority (e.g. 90% of all the members) – so-called conditional entrenchment. But a conditionally entrenched provision can always be overridden by a unanimous resolution of all the members.

Political Donations

Technical changes will also be made to the regime requiring companies to obtain shareholder authorisation before making any donation to an EU political party or organisation or incurring any EU political expenditure. The regime has been criticised for being too wide, so that it could catch various activities that would not normally be thought of as party political, and for requiring an excessive number of shareholder resolutions.

Among other things:

- private companies will be able to authorise donations and/or expenditure by written resolution
- a holding company will be able to seek authorisation of donations and expenditure in respect of both the holding company itself and one or more subsidiaries (including wholly-owned subsidiaries) through a single approval resolution
- a specific exemption will be introduced for donations to non-political funds of a trade union.

Two statutory instruments will be made, to come into effect on 1 October 2007, exempting certain media and publishing-related companies and setting the interest rate on the liability for unauthorised expenditure. The threshold for disclosure in accounts of charitable and political donations will be raised from £200 to £2,000.

Capital maintenance and transactions benefiting shareholders

"The restriction on private companies giving financial assistance for the purpose of the acquisition of their own shares or those of their (private company) parent will be repealed, as will the whitewash procedure."

Financial assistance

The restriction on private companies giving financial assistance for the purpose of the acquisition of their own shares or those of their (private company) parent will be repealed, as will the whitewash procedure. Even a private company subsidiary of a public company will be free of the restriction in relation to an acquisition of its own shares or the shares in an intermediate private company holding company. But public companies will still be prohibited from giving financial assistance for the acquisition of their own shares or those of their parent company (whether public or private), and private company subsidiaries will be under the same prohibition in relation to acquisitions of shares in their public company parents.

A public company will be able to re-register as private in order to give financial assistance (as some public companies presently do in order to take advantage of the whitewash procedure for private companies in sections 155-158 of the 1985 Act) – for example, where a takeover bid of a public company is financed by debt and the bank wants to take security over the target's assets. The Government does not propose to take advantage of the relaxation for public companies offered by the Directive Amending the Second Company Law Directive (2006/68).

The relaxation of the rules on financial assistance will remove one of the potential obstacles to M & A transactions which involve only private companies, and also public-to-private transactions. But a company proposing to enter into an arrangement that is designed to assist one or more of its shareholders, or even a purchaser, whether in connection with an acquisition of its shares or otherwise, will have to consider carefully whether the arrangement:

- will promote the success of the company;
- may be treated as an indirect distribution of profits to one or more members, which would be unlawful if the company does not have sufficient distributable profits to cover the net book value of the assets distributed. In addition, any shareholders who do not benefit will probably need to be asked to waive their entitlement to participate in the distribution; and/or
- may be susceptible to challenge in the event of insolvency.

As a result, directors may be advised to follow a procedure similar to the whitewash – i.e. formally to consider the effect of the proposed arrangement on the company's solvency over the following 12 months; ensure that the arrangement either does not deplete the company's net assets or, to the extent that it does, that the assistance is provided out of distributable profits; and to obtain the approval of shareholders.

"Private companies will be able to reduce their share capital by passing a special resolution, supported by a directors' solvency statement signed by all the directors, rather than having to go to court."

Reduction of capital

Private companies will be able to reduce their share capital by passing a special resolution, supported by a directors' solvency statement signed by all the directors, rather than having to go to court. The statement will be similar to a statutory declaration of solvency for the purposes of a financial assistance whitewash under the current law. The current procedure for companies to reduce their capital by applying to court will remain and in some circumstances may be advantageous.

Section 654 of the Act enables the Secretary of State to specify by order the cases in which a reserve arising on a reduction of capital will be distributable and when it will be treated as realised profit. A draft of the order published in May stipulates that such

a reserve will be distributable if the reduction is confirmed by the court; the company is unlimited; or the reduction is supported by solvency statement, but in the latter case only to the extent that the reserve is treated as a realised profit. This provision may be refined in the light of discussions with the accounting profession and feedback from industry, but the Government's intention is that a reserve arising from an out-of-court reduction will first have to be set off against any realised losses before it can be distributed. To use the repayment method, which by-passes the restriction on distributions, a company will therefore have to obtain court approval.

Redeemable shares

The procedure for private companies to purchase or redeem their own shares out of capital will be retained but, as companies will be able to return capital to shareholders by means of a reduction of capital, the procedure will probably be used less often.

Shareholders in both public and private companies will be able to adopt articles that allow the directors to decide the terms on which redeemable shares are to be redeemed (rather than having to set out those terms in the articles). The terms and manner of redemption – which will have to be decided before the shares are actually allotted - must be set out in the company's statement of capital.

"Shareholders in both public and private companies will be able to adopt articles that allow the directors to decide the terms on which redeemable shares are to be redeemed (rather than having to set out those terms in the articles)."

Intra-group transfers and the rule in *Aveling Barford*

Section 845 of the Act will confirm the generally-held view that assets can be transferred intra-group at their book value, rather than a higher market value, provided that the transferor has distributable profits. If an asset is sold at less than its book value, the company will need to have sufficient distributable profits to cover the amount of the difference between the sale price and book value.

Authorised share capital abolished

Concerns over whether a company has sufficient headroom to issue new shares will disappear, as the Act abolishes the concept of authorised share capital. However, an early proposal to allow companies to issue shares of no par value was dropped: shares must have a fixed nominal value.

The authorised minimum share capital for public companies will remain £50,000 (or the euro equivalent; but it cannot be a combination of the two), although this is higher than EU law requires. The amount can be changed by regulations. There is nothing to prevent a company from converting its entire capital, including the authorised minimum, to another currency. If, having done this, the company wishes to reduce its share capital and remain a public company, it must notionally reconvert the shares to sterling or euros so as to be able to show that it will still satisfy the minimum requirement.

Allotment of shares by private company

Unless its articles provide otherwise, a private company's directors will no longer need shareholder approval to allot shares, although approval will be necessary if the company has, or will have as a result of the allotment, more than one class of shares.

Redenomination of shares

A simplified procedure will allow limited companies to convert their share capital from one currency to another, and to redenominate their shares after conversion to achieve round share values, without having to go to court or buy back shares out of capital and issue new shares.

Statement of capital

Alterations of the share capital – for example, new allotments, reductions, buybacks and redenominations – will, as at present, need to be notified to Companies House on prescribed forms. A statement of capital containing prescribed particulars of the share capital (as altered) must accompany the forms. This will state, for example, the total number of shares in issue and their aggregate nominal value and the extent to which the shares are paid up, and will set out certain rights attaching to the shares, such as any rights to vote at general meetings of the company (including rights that arise only in certain circumstances), rights to participate in income and capital distributions, and whether the shares are to be redeemed and, if so, at the option of the company or the shareholder and any terms or conditions relating to their redemption.

"Alterations of the share capital – for example, new allotments, reductions, buybacks and redenominations – will, as at present, need to be notified to Companies House on prescribed forms. A statement of capital containing prescribed particulars of the share capital (as altered) must accompany the forms."

Takeovers

"The new Act extends the Takeover Panel's statutory powers to cover all takeovers, rather than only those within the scope of the Takeovers Directive, and, as well as making other changes, implements permanently various other provisions of the Directive - replacing the interim arrangements that were put in place in May 2006 to meet the Directive's deadline."

Part 28 of the new Act extends the Takeover Panel's statutory powers to cover all takeovers, rather than only those within the scope of the Takeovers Directive, and, as well as making other changes, implements permanently various other provisions of the Directive - replacing the interim arrangements that were put in place in May 2006 to meet the Directive's deadline. Part 28 came into force on 6 April 2007.

Changes to the squeeze-out procedure

Sections 428-430F of the 1985 Act and the Takeovers Directive (Interim Implementation) Regulations 2006 were repealed and replaced with squeeze-out provisions in the new Act which are broadly similar. However, some difficulties that existed under the 1985 Act have been alleviated.

Although it is rare for a minority shareholder to challenge a bidder's right to acquire his shares compulsorily under the statutory squeeze-out procedure, in fact there were a number of traps under the old regime which, if a bidder fell into one of them, could result in its compulsory acquisition being declared invalid. For example:

- It is normally of vital importance to a bidder to be able to count shares that it has been promised under an irrevocable undertaking towards the 90% threshold for effecting the squeeze-out. Section 428(5) of the 1985 Act allowed this, provided, among other things, that the irrevocable was given by the registered holder of the shares. Strictly, an irrevocable given by a person who was not the registered holder (the beneficial owner, for example) could be challenged as not within the exemption, so that the shares could not be counted towards the threshold.
- There could also be difficulties under the old rules where the offer included shares "to be issued" pursuant to the exercise of options or convertibles, so that in the fraction to calculate whether the bidder had acquired 90% of the shares to which the offer related the denominator varied according to the number of shares that were actually issued after the offer document was posted (creating a "floating threshold"). Similarly, if options were exercised after the deadline for sending squeeze-out notices had passed, the bidder could not acquire the resulting shares.

Several years ago the Company Law Review Steering Group recommended that these and other problems should be ironed out. In particular, the existing provisions were found to be ambiguous as to whether shares should count as shares the bidder had contracted to acquire where it had contracted conditionally; and it was felt that legislative sanction should be given to the long-standing but legally uncertain practice of extending an offer to certain overseas shareholders by putting an advert in the UK edition of the Financial Times.

When the Interim Regulations were introduced, they applied a new squeeze-out mechanism to takeovers of companies whose shares were traded on an EU regulated market. As a result, for takeovers of companies within the scope of the Directive, the Regulations dealt with the issue of conditionally acquired shares, and allowed a bidder to extend its offer to overseas shareholders by placing a notice in the Gazette and making the offer document available for inspection at a place in an EEA state or on a website. But, as the Secretary of State's power to make the Regulations extended only to implementing the Directive, the Regulations did not clear up the other problems, or apply to takeovers that fell beyond the scope of the Directive. These have now been dealt with in Part 28.

"Where the offer includes shares "to be issued" pursuant to the exercise of options or convertibles, in calculating whether it has acquired 90% of the shares to which the offer relates the bidder can freeze the denominator at the number of shares that are actually in issue at the time it sends notice to dissenting shareholders that it intends to acquire their shares."

The rules in the new Act are therefore designed principally to apply the May 2006 changes to takeovers of all UK companies (whether or not within the scope of the Directive), and to remove the remaining traps, in order to make it easier for a bidder to operate the squeeze-out machinery safely. In particular:

- under the new provisions, shares subject to an irrevocable undertaking can be counted towards the 90% threshold even if the undertaking is not given by the registered holder of the shares, as long as the giver intends "to secure that the [legal] holder will accept the offer when it is made"
- where the offer includes shares "to be issued" pursuant to the exercise of options or convertibles, in calculating whether it has acquired 90% of the shares to which the offer relates the bidder can freeze the denominator at the number of shares that are actually in issue at the time it sends notice to dissenting shareholders that it intends to acquire their shares
- in takeovers of companies whose shares are listed on the Official List there is no effective deadline for the bidder to send squeeze-out notices, so even if option-holders exercise their options to acquire target shares late in the day, a bidder will be able to acquire their shares compulsorily as long as it continues to have acceptances from 90% of the shares to which the offer relates
- if a minority shareholder wishes to challenge the compulsory acquisition of his shares by applying for a court order, he will have to notify the bidder of his application, and in turn the bidder must notify all the other minority shareholders that proceedings have been started. Formerly there were no such obligations, and it could be difficult for a bidder to discover whether any shareholder had objected to the squeeze-out.

Auditors and accounts

“It is intended to elicit information about significant relationships, such as major suppliers or key customers that are critical to the business, and which are likely to influence, directly or indirectly, the performance of the business and its value.”

Business review

In March 2005 amendments were made to the 1985 Act to require all large and medium-sized companies to include in their directors’ report for financial years starting on or after 1 April 2005 a “business review” containing:

- A description of the principal risks and uncertainties facing the company
- A fair review of the company’s business containing a balanced and comprehensive analysis, consistent with the size and complexity of the business, of:
  - the development and performance of the business during the financial year; and
  - the position of the company at the end of that year.

“To the extent necessary for an understanding of the development, performance or position of the business of the company”, the review must also contain:

- analysis using financial key performance indicators (KPIs)
- where appropriate, analysis using other key performance indicators, including information relating to environmental and employee matters.

Medium-sized companies need not include any KPI analysis of non-financial information. The scope of the business review is designed to reflect, but go no further than, the EC Accounts Modernisation Directive.

At the same time, new provisions were introduced to require quoted companies to produce an OFR for financial years starting on or after 1 April 2005. In May 2005 the Accounting Standards Board published the final version of its accounting standard on the OFR. The OFR covered a wider range of matters than the business review and would have had to include some forward-looking information.

However, in November 2005 the Chancellor took the decision to scrap the OFR, announcing instead that quoted companies would simply have to produce a business review. Following protests by environmental groups and others, the Government agreed to consult further on what should replace the OFR. The new Act therefore includes sections which will extend the scope of the business review for quoted companies to bring it closer to the OFR, but without going quite as far.

In particular, quoted companies will have to ensure that, “to the extent necessary for an understanding of the development, performance or position of the company’s business”, their business review includes:

- the main trends and factors likely to affect the future development, performance and position of the company’s business
- information about (i) environmental matters (including the impact of the company’s business on the environment); (ii) the company’s employees; (iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies; and (iv) “persons with whom the company has contractual or other arrangements which are essential to the business of the company”.

Category (iv) is potentially broad and, as well as key suppliers and customers, it could include any person that has granted the company a key licence or with whom the company has any critical joint venture or other contractual arrangement. In Parliament, the Minister stated that this does not require companies to list all their suppliers: it is intended to elicit information about significant relationships, such as major suppliers or key customers that are critical to the business, and which are likely to influence, directly or indirectly, the performance of the business and its value. It will be for the directors to exercise their judgement on what they need to report. For example, if a company relies on a single supplier for a key component, so that if the supplier were to become insolvent this would have a serious impact on the company's business, the business review should disclose the existence of the relationship.

If the review does not contain the required information, it must say so. Information cannot be withheld from the business review on the grounds that it is confidential or commercially sensitive. But it is not necessary to include information about a person if its disclosure “would, in the opinion of the directors, be seriously prejudicial to that person

and contrary to the public interest". This carve-out is intended to protect suppliers and others who do business with companies that are at risk of attack by extremist groups.

Although the Act does not include a general safe harbour for forward-looking information included in the business review, under section 463 a director will have protection in relation to investors (see below) and will be liable to compensate the company for any loss suffered as a result of any omission or untrue or misleading statement in the directors' report only if the director either knew that the statement was untrue or misleading, or was reckless as to whether it was, or (in relation to omissions) only if he dishonestly intended to conceal a material fact.

The business review provisions will apply to directors' reports for financial years starting on or after 1 October 2007. Later this year, or early in 2008, the ASB is expected to publish an accounting standard on the business review.

Companies that already publish an OFR on a voluntary basis are likely to continue to do so, but when the relevant provisions of new Act come into force they will need to ensure that their OFR complies with the new business review requirements.

Disclosure of impediments to takeovers

"For financial years starting on or after 20 May 2006 the directors' report of a company incorporated in Great Britain with voting shares listed on the Official List or another EU regulated market must include information about certain matters that a potential bidder might consider relevant."

Under new rules that implement the Takeovers Directive, for financial years starting on or after 20 May 2006 the directors' report of a company incorporated in Great Britain with voting shares listed on the Official List or another EU regulated market must include information about certain matters that a potential bidder might consider relevant, including:

- the structure of the company's capital
- any restrictions on transferring shares
- the identity of any significant shareholders
- any restrictions on voting
- the procedures for appointing and replacing directors, and amending the articles
- any "significant agreements to which the company is a party that take effect, alter or terminate on a change of control", unless disclosure would be "seriously prejudicial" to the company.

For companies whose financial year coincides with the calendar year, the 2007 annual report (likely to be published in March/April 2008) will be the first time that this information will have to be disclosed. For companies whose financial year starts on 1 April, the impact will be felt slightly later.

Duty of care to investors

To a limited extent the Act puts on a statutory basis the principle expressed by the House of Lords in *Caparo Industries plc v Dickman* [1990] 2 AC 605 that the responsibility of auditors (and, by extension, directors) for misstatements in a company's financial statements is owed to the company's shareholders as a body, but not to individual shareholders or the public at large who may have relied on the statements when deciding whether or not to invest in the company:

- section 463 provides that, as regards the directors' report (which will include the business review) and the directors' remuneration report, and any summary financial statements insofar as they are derived from those reports, no director, auditor or other person is liable to anyone other than the company resulting from his, or anyone else's, reliance on information in the reports. The section applies to any such report that is first sent to shareholders on or after 20 January 2007
- section 90A of the Financial Services and Markets Act 2000 (FSMA), inserted under the new Act, broadly makes listed companies liable to compensate investors who suffer loss in acquiring securities where they have reasonably relied on periodic financial reports, or any preliminary announcement of results, published in respect of financial years commencing on or after 20 January 2007 that are misleading or untrue as a result of dishonesty or recklessness by any director (in other words, more than negligence), but that no other person (for example, a director or an auditor) is liable to anyone other than the company in respect of any such loss.

"In order to bring them within the safe harbour afforded by section 463, some companies have chosen to consolidate the chairman's statement, financial review and corporate governance statements into the directors' report."

In order to bring them within the safe harbour afforded by section 463, some companies have chosen to consolidate the chairman's statement, financial review and corporate governance statements into the directors' report.

“As soon as the relevant sections of the Act become law on 6 April 2008, audit firms are likely to ask their clients to sign a liability limitation agreement restricting their liability to an amount proportionate to the auditor’s fault and, most likely, subject to a monetary cap.”

For non-listed companies (which are not presently subject to 90A FSMA), it will be left to the courts to determine on a case-by-case basis the circumstances when auditors are liable to pay damages to third parties who rely on those parts of periodic financial reports that are not covered by section 463. But in June Professor Paul Davies, in a report commissioned by the Government, recommended that the statutory liability regime in section 90A FSMA should be extended on the following basis:

- The regime should cover all ad hoc statements made by publicly-traded companies, not just periodic financial reports
- Companies should be liable for any dishonest delay in making an announcement required by market rules
- Companies admitted to trading on AIM or PLUS Markets should be subject to the same regime as listed companies.

The report also recommended that the standard of liability should continue to be deceit – i.e. the maker of the statement must either know that the statement is false or not care whether it is true or false; but he need not intend the recipient to rely on it – and that only companies themselves, and not individual directors, should be liable. The Government has yet to decide whether and when it will implement these recommendations.

Whether or not section 90A is extended, it will remain the position that, even if the company is listed, auditors and others can make themselves liable where statements accepting responsibility for the accuracy of a document are made outside the company’s reporting processes.

Limitation of auditors’ liability to company

Auditors have campaigned for many years for changes to section 310 of the 1985 Act to allow them to impose limits on the amount of damages that an audit client could recover in respect of a negligent audit. In particular, they have argued that their share of liability should be proportionate to the degree of fault rather than their being potentially liable for the whole of any loss even where their negligence was a minor factor. Arguments have raged inconclusively over whether such a change would hinder or enhance competition between audit firms. It is certainly true, however, that it would reduce the risk of one of the Big Four being destroyed by a single huge claim.

Chapter 6 of Part 16 of the new Act, which will come into force on 6 April 2008, is therefore a welcome development for the audit profession, as it makes it possible for auditors to limit their liability by agreement with a company on an annual basis. A so-called “liability limitation agreement” will not be subject to the Unfair Contract Terms Act 1977, but will not be able to limit the auditor’s liability to less than an amount that a court considers is "fair and reasonable in all the circumstances of the case". In deciding what is fair and reasonable, the court must have regard in particular to:

- the auditor’s statutory responsibilities;
- the nature and purpose of the auditor’s contractual obligations to the company; and
- the professional standards expected of him.

The court must not take account of events arising after the loss or damage occurred, or of what probability there is of the company recovering from any other person who may also have been at fault.

As soon as the relevant sections of the Act become law on 6 April 2008, audit firms are likely to ask their clients to sign a liability limitation agreement restricting their liability to an amount proportionate to the auditor's fault and, most likely, subject to a monetary cap. Companies will have to assume that such restrictions are valid unless and until they challenge them successfully in court.

The Financial Reporting Council intends to publish by the first quarter of 2008 guidance on agreements to limit the liability of auditors of public companies. The guidance is expected to include a suggested standard form of agreement, including principal terms; and a suggested process for obtaining shareholder approval. The guidance will not, however, define what a “fair and reasonable” amount would be, or provide a mechanism for calculating it.

A company that has entered into a liability limitation agreement with its auditors will have to disclose the principal terms in the notes to its annual accounts.

"Private companies will have to file annual reports and accounts at Companies House within nine months of the year-end (down from ten months at present), and public companies within six months (down from seven)."

Recognising that audit firms may propose similar restrictions, so that in practice companies may have little choice but to accept the terms proposed, the Government has reserved the right in future to make regulations prohibiting or prescribing certain terms in order, particularly, to prevent anti-competitive behaviour. The Government does not expect to have to use this power, and no regulations will be made on commencement of the provisions. Regulations will be made requiring the principal terms of the limitation agreement and the date of the resolution approving (or waiving approval of) the agreement to be disclosed by way of a note to the accounts.

A liability limitation agreement will not be able to limit auditors' liability for past audits.

Generally

Website publication of annual reports and accounts
Quoted companies will have to make copies of their annual reports and accounts freely available to the public on their website as soon as reasonably practicable, and ensure that they remain available until those for next year are published. It will only be possible to restrict access to the extent necessary to comply with UK or overseas law or regulations.

Time limits for filing annual accounts
Private companies will have to file annual reports and accounts at Companies House within nine months of the year-end (down from ten months at present), and public companies within six months (down from seven).

"There will be a single self-contained set of regulations governing the accounting and reporting requirements for small companies, with a separate set for large and medium-sized companies. Both sets of regulations will come into force on 6 April 2008 and apply to financial years beginning on or after that date."

Contents of reports and accounts
There will be a single self-contained set of regulations governing the accounting and reporting requirements for small companies, with a separate set for large and medium-sized companies. Both sets of regulations will come into force on 6 April 2008 and apply to financial years beginning on or after that date. In general terms, they will replace provisions currently found in Schedules to Part 7 of the 1985 Act, but amendments will be made to implement various EC Directives on accounting, and to increase the turnover thresholds for small and medium-sized companies.

Appointment of auditors
There will be a presumption that auditors of private companies will be automatically reappointed each year.

Resignation of auditors
A firm which ceases to hold office as auditor of a quoted company will always have to make a statement about the circumstances of its departure. The statement will have to be circulated to the company's shareholders unless a court is persuaded that the auditor is "abusing his rights". A copy must also be sent to Companies House and the Financial Reporting Council.

True and fair view
Apparently in response to concerns that the introduction of IFRS and changes to UK GAAP are eroding the concept of the 'true and fair view', section 393 of the Act provides that the directors of a company must not approve annual accounts unless they are satisfied that they give a true and fair view. It also requires auditors to have regard to this standard in carrying out their audit. The existing requirement for auditors to state in their report whether or not the accounts give a true and fair view has been retained.

Audit report
Section 507 of the Act makes it a criminal offence for an auditor knowingly or recklessly to cause a misleading, false or deceptive audit report to be made. The maximum penalty will be an unlimited fine - not imprisonment, as originally proposed. The new offence will apply to audit reports in respect of financial years beginning on or after 6 April 2008.

For the first time, the audit report will have to be signed by the lead auditor, as well as the audit firm. However, the risk attaching to this will be reputational rather than legal: section 504 provides that the signatory will not be subject to "any civil liability to which he would not otherwise be subject".

Auditors' terms of engagement
Regulations may be made in future requiring auditors or companies to publish audit engagement letters and/or details of the services provided by the auditors (and their associates) to the company, and the remuneration received.

Company administration

> "Instead of needing unanimity, an ordinary resolution will be capable of being passed in writing by a simple majority of the total voting rights of eligible members; and a special resolution in writing by 75%."

Resolutions and meetings

Company decision-making processes will be streamlined. In particular:

- Private companies will not be required to lay their accounts or to appoint an auditor (if they have one) at an AGM. Companies that wish to continue to hold AGMs may do so
- Public companies will have to hold their AGM within six months of their financial year-end
- Unless the articles specify a longer period, EGMs of both private and public companies will only require 14 days' notice, even if a special resolution is proposed. But 21 days' notice will continue to be required for a public company AGM
- Other than resolutions to remove a director or auditor, all resolutions of private companies will be capable of being passed in writing. But public companies will not be able to pass resolutions in writing, even if their articles purport to allow it
- Instead of needing unanimity, an ordinary resolution will be capable of being passed in writing by a simple majority of the total voting rights of eligible members; and a special resolution in writing by 75%
- Written resolutions will be capable of being circulated and approved by email, as well as in hard copy
- It will not be necessary to send the company's auditors a copy of a proposed written resolution
- The percentage of shares or voting rights necessary to hold a meeting in a private company at short notice will be reduced from 95% to 90%
- A company will be able to change its name either by special resolution or by any other means provided in its articles.

Formation of companies

Companies will not be capable of being formed under the Act until October 2008. On formation, the subscribers or their agent will have to file the memorandum and articles; an application for registration specifying (among other things) the company's proposed name, registered office and officers; a statement of capital containing details of (among other things) the number of shares of each class taken by each subscriber, the rights attached to them, and the amount to be paid up; and a statement that the registration requirements of the Act have been met.

Single member companies

It will be possible to have single member public companies, and single-member unlimited companies, as well as private limited ones.

Constitution

Companies formed under the Act will have unlimited capacity. If those forming the company wish to restrict what the company may do – for example, if it is a special purpose vehicle or a charity - they will be able to set out limited objects in the articles of association (and the objects clauses of existing companies will be treated as if they were in the articles). The memorandum of association will be a brief document signed by the subscribers simply stating that they have agreed to become members and to take at least one share each.

Draft model articles for private limited companies, private companies limited by guarantee and public companies have been published, with a view to finalising them in the form of regulations in autumn 2007. From 1 October 2008 they will apply automatically to companies that are incorporated after that date, but not to companies incorporated before. In both cases, shareholders will be able to choose to adopt all or any part of the new model articles. Among other things:

- the public company articles are not intended to be suitable for public quoted companies and do not reflect listing requirements or market best practice; neither do they contain a disenfranchisement article. As far as other public companies are concerned, the Government envisages that the model articles will be used as a drafting resource for particular types of provision rather than as a complete template
- there are provisions in the public company articles (but not the others) enabling directors' meetings by conference call, video-conferencing and other methods
- section 175 of the Act provides that a director's duty not to have a conflict (for example, in relation to the exploitation of opportunities) is not breached if the matter is authorised by the directors. In the case of a public company this applies only if the constitution includes a provision enabling the directors to give this authority. The model articles for public companies do not, however, include such a provision, since the Government does not think that this should be the default position and that each company must decide whether or not it wants such a provision
- the public company articles include retirement by rotation provisions intended to be consistent with the Combined Code
- only the public company articles provide for removal of a director when all the other directors decide that he should be removed
- only the public company articles provide for alternates, as the Government thinks it unlikely that directors in most private companies will want to appoint alternates. In fact, alternates are rarely used in quoted companies and at least one investor body strongly objects to them
- in all sets of model articles, the article dealing with attendance and speaking at general meetings has been drafted in such a way as to be amenable to "virtual" attendance and electronic voting
- the private company articles do not cater for partly-paid shares (and in fact provide that all shares are to be issued fully paid), and do not provide for dematerialised or bearer shares
- each set of model articles contains provisions allowing the company to indemnify its directors to the extent permitted by the Act, and to purchase D&O insurance in respect of any liability incurred in performing their duties as directors or in acting as trustees of the company's pension fund or employee share scheme.

"Slight changes will be made to the current Table A to reflect the new provisions on directors' duties and on resolutions and meetings that will come into force on 1 October 2007, and the provisions relating to electronic communications that are already in force."

Table A under the 1985 Act

Slight changes will be made to the current Table A to reflect the new provisions on directors' duties and on resolutions and meetings that will come into force on 1 October 2007, and the provisions relating to electronic communications that are already in force. Two updated versions of Table A - one for private and one for public companies - will apply to companies formed between 1 October 2007 and 1 October 2008 (when the new model articles come into force). If an existing company decides that it wants to adopt some or all of the new provisions it will need to pass a special resolution.

"It will also be possible for one director (even if there are other directors) to execute a deed by signing it in the presence of a witness who attests the signature."

Execution of deeds and documents

At present, unless the company's common seal is used, deeds must be signed by two directors or one director and the secretary. This method will still be valid, but it will also be possible for one director (even if there are other directors) to execute a deed by signing it in the presence of a witness who attests the signature.

From April 2008 private companies will not have to have a secretary, and the new deeds provisions will therefore enable a sole director of a company without a secretary to execute deeds without using the common seal. Originally, the Government

proposed to introduce the deeds provisions in October 2008, but it has since announced that they will be brought forward to 6 April 2008.

Many companies will welcome the flexibility offered by this change, which will mean that it will no longer be necessary, for example, to courier documents between directors in different locations. On the other hand, from a corporate governance point of view, the security inherent in having to involve more than one officer will be lost.

Company names and trading disclosures

New provisions will enable a person to object to a company's name if that name is the same as, or confusingly similar to, a name in which the objector has goodwill. A new company names adjudicator will uphold the objection if the name was not adopted in good faith or if the main reason for its choice was either to obtain money from the person objecting or to prevent their using the name. The Government is consulting on the choice of characters that may be used, a proposal to restrict the number of characters in any name to 160, and the rules for determining whether names are too similar.

On 1 January 2007 the Companies (Registrar, Languages and Trading Disclosures) Regulations 2006 extended to websites and various electronic communications the longstanding statutory requirement for companies to state certain particulars on their stationery and other hardcopy documents. The Regulations amended the relevant provisions of the Companies Act 1985, making it an offence, among other things, for a company incorporated under the Companies Acts (or the equivalent Northern Ireland legislation) not to state the company's name, its place of registration and the number with which it is registered, and the address of its registered office on all the company's websites and all its business letters and order forms that are in electronic form.

"A private company that is intending to re-register as public will be able to offer shares to the public without waiting for the re-registration to complete."

Further regulations to be made under the Act are expected to require:

- every company that is not dormant to display its registered name at (i) its registered office; (ii) any place at which it keeps available for inspection any company records; and (iii) any other location at which it carries on business, other than premises that are primarily used as living accommodation or that are used (broadly) by a company that is at risk of violence or intimidation
- a company's registered name to "be displayed in a prominent position so that it may be easily read by any visitor to that office, place or location". New provisions will allow names to be displayed on a scrolling electronic display
- a company's registered name to appear on all its notices and other official publications, websites "and all other forms of business correspondence and documentation".

The new rules will take effect on 1 October 2008.

The Business Names Act 1985, which governs the use of trading names by certain companies, partnerships and sole traders, will be repealed and replaced with similar provisions in the Act.

Private companies offering shares to the public

Like the 1985 Act, the new Act will prohibit private companies from offering shares or debentures to the public. The definition of "offer to the public" currently in section 742A of the 1985 Act (which is quite different to the definition used for prospectus purposes) will remain largely unchanged.

An offer is not made to the public if (broadly speaking) it is (i) made to persons who are already connected to the company, such as existing shareholders and employees and members of their families; (ii) made in connection with an employee share scheme; or (iii) not "calculated to result" in the shares or debentures being offered to persons other than the original recipients of the offer. In the latter case, doubts remain about whether "calculated to result" requires an element of intention by the issuer and its directors (as

"There will be a new offence of knowingly or recklessly delivering information to the registrar of companies that is misleading, false or deceptive in a material particular."

the Government has said) or whether it is enough that, objectively speaking, the shares are likely to end up in the hands of third parties (as leading counsel has advised in the past). It is regrettable that this uncertainty has not been removed.

Breach of the prohibition will no longer be a criminal offence, but the company will normally have to re-register as a public company.

A private company that is intending to re-register as public will be able to offer shares to the public without waiting for the re-registration to complete. It will also be able to undertake to re-register as a public company and then do so within six months of the offer being made.

Paper-free holding and transfer of shares

The Act extends the power under section 207 of the Companies Act 1989 for the Secretary of State to make regulations providing for shares to be transferred electronically. It is under this power that the Uncertificated Securities Regulations 2001, which enable shares in quoted companies to be held in and transferred through CREST, were made. The Government has said that it needs further information before using the power to make dematerialisation compulsory for listed companies.

Regulations will clarify that an assured payment obligation under CREST will constitute payment up in cash of new shares.

On 6 April 2007 the power in the 1985 Act for companies to close their registers of members for up to 30 days a year was repealed. It has not been replaced under the 2006 Act.

Companies House filings

Since 1 January 2007 it has been possible to incorporate a company on-line, and companies can file most documents and particulars electronically.

There will be a new offence of knowingly or recklessly delivering information to the registrar of companies that is misleading, false or deceptive in a material particular. The Registrar will have power to remove filed material that could be used to commit fraud (for example, company hijacking) following application by persons claiming to be affected. She will also have express powers to remove from the register on application any material that derives from anything invalid or ineffective, that was done without authority, or that is factually inaccurate, and to annotate the register where this will help avoid confusion.

Overseas companies

At present, there are two similar, but mutually-exclusive, regimes that apply to overseas companies that operate here. Prior to 1993, an overseas company that established a place of business in Great Britain had to register it at Companies House and comply with certain filing and publicity requirements. In 1993, a separate "branch" regime was introduced to implement the 11th Company Law Directive. This requires a limited company incorporated outside the UK and Gibraltar that establishes a branch in Great Britain to register the branch at Companies House and comply with certain (slightly more onerous) filing and publicity requirements. The old place of business regime now only applies to overseas companies that fall outside the branch regime. For some time there have been calls for the two regimes to be consolidated into one.

This summer the Government indicated that it intends to make regulations under the Act to create a single regime based on the "place of business" regime but accommodating the more extensive filing and publicity requirements under the Directive. Draft regulations are expected to be published at the end of September.

Application of the Act to existing companies

"For existing companies, the authorised share capital will be treated as a restriction in the company's articles, but the company will be able to remove this restriction by ordinary resolution."

The Government's general approach to implementing the Act for existing companies is guided by three main objectives: the starting assumption is that the new law should come into force for existing companies and companies formed under the Act at the same time, and that it should apply to existing companies in the same way; the second objective is to ensure so far as possible that existing bargains are not overridden; and the third objective is to make it as easy as possible for existing companies to take advantage of the new freedoms that the Act offers and to comply with its requirements.

The Government has concluded that:

- there is no need for further transitional provisions covering the change in the nature of memoranda and articles – because section 28 of the Act does enough by providing that provisions in an existing company's memorandum that would under the new Act be part of the articles will be deemed to form part of the company's articles
- a change of name by an existing company should have the effect of removing references to the name from its articles, and would therefore not require it to change its articles
- the effect of existing absolute entrenchments (i.e. provisions placed in the memorandum with the intention that they should not be capable of being changed) will be preserved indefinitely
- for existing companies, the authorised share capital will be treated as a restriction in the company's articles, but the company will be able to remove this restriction by ordinary resolution
- where the articles of an existing company do not contain an authorisation to make an alteration in its share capital, the company will continue to be unable to make such an alteration until the shareholders amend the articles to remove the restriction
- where at the time that the Act comes into force a company's directors have a subsisting authority under section 80 or section 80A of the 1985 Act to allot shares, this authority should continue to have legal effect
- if a private company has express provision for holding AGMs in its articles the effect of this will be preserved. But indirect references to the AGM will be disregarded, so that where the articles provide for the directors or officers to retire by rotation at the AGM, their appointments will continue until terminated in accordance with the Act or other provisions of the articles
- any references in the articles that directly require or assume the requirement for a company secretary will continue to have effect
- in relation to directors' conflicts of interest arising as a result of another position held by a director, transitional arrangements will require existing companies (private as well as public) to seek the approval of their members if they want to permit independent director authorisation of such conflicts
- in relation to directors' conflicts of interest arising from directors' transactions with the company, transitional arrangements will preserve whatever provisions an existing company has for dealing with such conflicts.

“The Government also foresees the need for transitional provisions involving provisions in articles of association or private contracts that rely on concepts that are abolished or different under the new Act.”

The Government is consulting on various areas where transitional provisions may be required – for example, in relation to acts done by a company secretary after a private company has decided not to have a secretary. The Government also foresees the need for transitional provisions involving provisions in articles of association or private contracts that rely on concepts that are abolished or different under the new Act: for example, extraordinary resolutions do not feature in the new Act, but some articles of association may provide for certain resolutions to be proposed as extraordinary resolutions. It would be possible for a transitional provision to say how surviving references to extraordinary resolutions are to be interpreted.

Similarly, stemming from the abolition of the concept of authorised share capital, it is proposed that any statement of a company's authorised share capital in its articles should continue to operate as a restriction on the number of shares and nominal amount of share capital that the directors may allot. Contracts, such as joint venture agreements, might contain restrictions on increasing a company’s authorised share capital, and some contracts might fix a right to subscribe for shares, or a conversion right, by reference to a given percentage of a company's authorised share capital. The Government says that it would be possible for a transitional provision to say how such references to authorised share capital are to be interpreted - or it could be left to the courts.

Further reform of company law

"Because no consensus of support for the Law Commission's proposals emerged from the recent consultation exercise, the Act does not make any significant changes to most of the existing rules on registration of company charges."

Company law reform power

To help ensure that company law remains up to date, the original Bill contained power for the Secretary of State to make orders to amend primary legislation "in relation to companies" (so-called "company law reform orders"). Such orders would have been subject to a consultation process with interested parties and an accelerated Parliamentary approval process. However, this power was dropped after the Delegated Powers and Regulatory Reform Committee of the House of Lords published a damning report saying that it would give Ministers too much discretion to amend primary legislation without proper Parliamentary scrutiny.

As a result, amendments to the new Act or to the 1985 Act that are required in future – for example, to implement the Shareholder Rights Directive and the Directive on migration of companies between Member States, and to make changes recommended by the Law Commission on company charges (see below) – will have to be introduced using powers under the European Communities Act 1972 or by means of new primary legislation.

Company charges

Because no consensus of support for the Law Commission's proposals emerged from the recent consultation exercise, the Act does not make any significant changes to most of the existing rules on registration of company charges.

"Slavenburg filings" will be brought to an end. At present, lenders to companies incorporated outside Great Britain but with an established place of business here that grant a charge over property in England or Wales risk their security being invalid unless they attempt to register it. Companies House will reject the filing if the company has not been registered, and lenders keep the rejection letter as proof that they have done all they can to perfect the security. New regulations to be made under Part 25 are expected to state that the duty to register will apply only if the overseas company is registered with Companies House as a branch: it will not apply if the company is not required to register as a branch or if it simply fails to do so. The duty to register will end if the company gives notice to the Registrar of Companies that it has ceased to have a registrable presence in any part of the UK.

The Government has said that it intends to consult further about making more radical reforms to the current regime for company charges.

For further information on any of the topics covered in this bulletin, please contact Peter Bateman at peter.bateman@cms-cmck.com or on +44 (0)20 7367 3145, Simon Howley at simon.howley@cms-cmck.com or on +44 (0)20 7367 3566, or the partner you normally deal with.

This bulletin is intended for clients and professional contacts of CMS Cameron McKenna LLP. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The bulletin is intended to simplify and summarise the issues which it covers.

C/M/S/ Cameron McKenna

Law-Now™

CMS Cameron McKenna's free online information service

Receive expert commentary and analysis on key legal issues affecting your business. Register for free email alerts and access the full Law-Now™ archive at **www.Law-Now.com**

CMS Cameron McKenna LLP
Mitre House
160 Aldersgate Street
London EC1A 4DD

T +44 (0)20 7367 3000
F +44 (0)20 7367 2000

CMS Cameron McKenna LLP is a limited liability partnership registered in England and Wales. It is able to provide international legal services to clients utilising, where appropriate, the services of its associated international offices and/or member firms of the CMS alliance.

The associated international offices of CMS Cameron McKenna LLP are separate and distinct from it.

CMS Cameron McKenna LLP and its associated offices are members of CMS, the alliance of independent European law firms. Alliance firms are legal entities which are separate and distinct from CMS Cameron McKenna LLP and its associated international offices.

CMS offices and associated offices worldwide: Berlin, Brussels, London, Madrid, Paris, Rome, Utrecht, Vienna, Zürich, Antwerp, Aberdeen, Amsterdam, Arnhem, Beijing, Belgrade, Bratislava, Bristol, Bucharest, Budapest, Buenos Aires, Casablanca, Chemnitz, Cologne, Dresden, Düsseldorf, Edinburgh, Frankfurt, Hamburg, Hilversum, Hong Kong, Kyiv, Leipzig, Lyon, Marbella, Milan, Montevideo, Moscow, Munich, New York, Prague, Sao Paolo, Seville, Shanghai, Sofia, Strasbourg, Stuttgart, Warsaw and Zagreb.

© CMS Cameron McKenna LLP 2007