

“ Plain speaking legal advice ”

## COMPANIES ACT 2006

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The Companies Act 2006 (the ‘Act’) received Royal Assent on 8 November 2006. The Act, which consists of 1,300 sections and covers nearly 700 pages, is the single largest piece of British Parliamentary legislation ever enacted. In spite of its length, the Act is designed to simplify and modernise the existing rules rather than make any dramatic shift in the company law regime. This briefing covers the key implications for your company.

**How will the Act affect private companies?**

The emphasis of the current law will change so as to introduce a much simpler and more lightly regulated regime for private companies. The provisions relating to all companies are set out first in the Act, followed by the extra requirements which apply to public and quoted companies.

The Act applies certain provisions only to “quoted” companies. These are defined to include companies on the Official List of the London Stock Exchange but not companies on AIM).

**How will the Act affect public and quoted companies?**

The changes are largely designed to ensure greater transparency of company information and proceedings as well as accountability, and to give all shareholders, including indirect shareholders, a greater opportunity to participate in company business.

**When will the Act come into force?**

Most provisions of the Act will become effective by October 2008, but some parts will be effective sooner. For instance, the Takeover Directive is implemented into UK law under the Act and the Takeover Panel will have statutory powers to make and enforce rules. These provisions will be effective in January 2007, together with the sections allowing companies to use electronic communications with their members.

**Business Stationery**

The change in law in relation to Business Stationery is effective already. As more and more company business and correspondence is transacted by e-mail or online, you will need to ensure your electronic communications are compliant with the business stationery

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requirements. All electronic correspondence is still subject to the requirements to legibly display your company's name and other registered office details. This requirement also extends now to your company's website.

### **What happens to the Companies Act 1985?**

The Act replaces most of the Companies Act 1985. A small part will remain, mainly relating to company investigations, financial services and community interest companies.

#### **1. Method of forming companies**

Section 7 of the Act replaces sections 1(1) of the Companies Act 1985. It retains the current requirement that individuals who wish to form a company must subscribe their names to the memorandum of association. However the Act provides that a single person is able to form any sort of company (not just a private company).

The Act also makes it possible to form a company online - the registration documents can be filed with the Registrar of Companies either by post or in an electronic format.

#### **2. Company Secretary**

At present every company must have a company secretary. This requirement will not change for public companies. However private companies will no longer be required to have a company secretary, although they may choose to have one. Thus the Act allows for single member private companies.

The authority of a private company secretary will be unchanged so that he or she can continue to be a co-signatory for the execution of documents by the company. This will certainly assist companies with only one director (who cannot currently also act as secretary).

However, given that secretarial tasks will still need to be performed it is questionable whether this change will be of any great benefit other than to small owner-managed businesses. If the Articles of an existing company make references to or require a company secretary,

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these references and requirements may need to be deleted (by amending the Articles) before the company can take advantage of this change.

**3. New model default Articles**

All companies (both private and public) will have only one constitutional document and this will be their Articles.

The Companies (Tables A-F Regulations) 1985 currently provide Model Articles for most companies. In future there will be new simplified default Articles for private companies. Separate default Articles based on current Table A will also be available for public companies. The new Model Articles will not apply to an existing company unless an existing company wishes to adopt them (in whole or part).

**4. Authorised share capital**

While a company's share capital must continue to have a nominal value (or values), the concept of an authorised share capital is abolished by the Act. Neither private nor public companies limited by shares will need to assess whether they have sufficient spare authorised but un-issued share capital before issuing shares.

**5. Authority to allot shares**

Under the new Act the directors of private companies with only one class of share will no longer need the authorisation of shareholders to allot shares of that class. This will be subject to any requirements in the company's Articles.

If an existing company wishes to benefit from this relaxation, it will need to change its Articles. However, the directors of private companies with more than one class of share, and of public companies, will continue to need such prior authority in the same way as now.

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**6. Financial Assistance & Simplified Capital Maintenance Provisions**

It is currently unlawful for any private or public company to provide financial assistance to the purchaser of its shares either before, at or after the completion of the acquisition. For example, it may not:

- Lend or give money to someone to buy its shares
- Lend or give money to someone to pay back bank finance raised to buy its shares
- Guarantee or provide security for a bank loan to finance purchase of its own shares
- Buy assets from a person at an overvalue to enable that person to purchase its own shares

There are some limited exceptions to the rule and private companies may also undertake what is known as the “whitewash procedure” to circumvent the rule. However, the procedure is convoluted and the process involving an auditors report can be expensive.

The Act abolishes the prohibition for private companies, provided that they are not subsidiaries of public companies, so they will be able to provide financial assistance in such circumstances. To take advantage of the new rules on financial assistance you will still need to check your company’s Articles for any prohibitions or provisions therein on financial assistance, and a Board Minute should still record the decision. Public companies will still be subject to the existing prohibition.

Where capital reductions previously required court approval, the Act introduces a simpler solvency based procedure for private companies to reduce their capital without court approval (share capital can be reduced through a special resolution of the members supported by a solvency statement made by the directors.)

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**7. A Simplified Decision-Making Process for Private Companies**

At present private and public companies must hold an AGM at least every 15 months, unless, in the case of private companies, they have passed an elective resolution to dispense with this requirement.

The new law makes the elective regime the default position for private companies. Accordingly, no AGM will need to be held unless the company chooses to do so. Public companies must not only continue to hold AGMs, but must also do so within six months from the end of their financial year.

Under the current law written resolutions are only effective if they have been signed by all of the members of a private company. The Act will now permit resolutions to be passed by the members of private companies with the written approval of the necessary majority – so for ordinary resolutions, this will be members who together hold a simple majority of voting rights and for special resolutions, those who together hold 75% or more.

**8. Accounts**

The time limits for the filing of accounts will be reduced. These will be within nine months after the year-end for private companies and within six months after the year-end for public companies. In addition, while private companies will no longer need to hold AGMs, they must send their year-end accounts to all shareholders at the earlier of the date those accounts are filed or nine months from their year end.

**9. Auditors**

The Act will allow auditors to limit their liability (if approved by a majority of members), but this has been balanced by two qualifications. First, their liability may not be limited below an amount that is “fair and reasonable in all the circumstances”. This will be open to future interpretation by the courts.

Second, the Act makes it a criminal offence for auditors to knowingly or recklessly give an incorrect audit opinion – this offence will carry an unlimited fine.

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**13. Company communications**

The Act intends to make electronic communications with shareholders the default position. This could lead to a significant cost saving for companies, in particular listed companies. Broadly, companies will be able to communicate electronically with their shareholders or by website with their shareholders by express agreement (which agreement can be obtained under the Articles, or by the shareholder failing to indicate that they do not wish to communicate via the website, as well as by more usual methods). Impact on Directors

**1. Directors' duties codified**

The Act codifies for the first time, and at the same time revises, the law on directors duties in the UK.

These general duties broadly codify the existing common law with two exceptions. The first is that the Act includes a controversial new obligation for a director to act in way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so the directors must have regard to the principle of 'enlightened shareholder value'. This replaces the current duty to act in good faith in the best interests of the company. The Act provides that the following factors should be considered as part of the duty to promote the company's success:

The likely long-term consequences of a decision;

- The interests of the company's employees
- Relationships with the company's trading partners
- The effect of the company's operations on the community and the environment
- The desirability of maintaining the company's reputation for high standards of business conduct; and
- The need to act fairly as between members

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It is anticipated that there will be an initial period of uncertainty during which directors will need to “get to know” their new duties. Standard market practice will no doubt emerge when it comes to the extent to which board minutes and other key Board documents record the steps that have been taken and the factors that have been considered in compliance with the new requirements.

## **2. Corporate directors**

At present a public company must have two directors, while a private company may operate with only one director. There is no change here. However, it is currently possible for all directors of a company to themselves be companies. The Act will change this so that every company will need to have at least one director who is a natural person.

In addition, there will now be a minimum age of 16 for a person to be a company director under the Act. The current rule that a director of a public company or a private company subsiding thereof aged 70 will be abolished so there is no upper age limit on directors.

## **3. Confidentiality of Directors’ Residential addresses**

Directors are currently required to disclose their personal residential addresses in Companies House documents – which of course are publicly available. The Act provides that directors will be able to use a service address. While they must still disclose their residential addresses on Companies House forms, if they choose to use a service address, only their service addresses will be publicly available. Residential addresses previously disclosed will not, however, be removed from historical information on file at Companies House.

## **4. Loans to Directors**

While section 334 of the Companies Act 1985 currently makes it possible for a company to make loans to directors of up to £5,000, the shareholders of the company do not have the ability to authorise loans in excess of this amount. The Act provides that companies will be able to make loans to directors in excess of £10,000 with shareholder approval.

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**5. Shareholder rights**

The current law is that shareholders have a limited common law right to sue directors for wrongs done to the company. The new law will provide for improved rights for shareholders, such as extended rights to sue directors for negligence and other defaults – the statutory derivative action.

However this will require the permission of the court and the court will refuse permission in circumstances where the conduct of the director in question has been approved by the company or the court considers that a person acting to promote the success of the company would not seek to pursue the claim. There will be restricted access to shareholders' addresses on the Register of Members held by companies, and indirect shareholders are to be entitled to certain information and voting rights.

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If you have any questions relating to the new Companies Act please contact Yavan Brar, Company Law Partner, e-mail: [ysb@herrington-carmichael.com](mailto:ysb@herrington-carmichael.com).

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