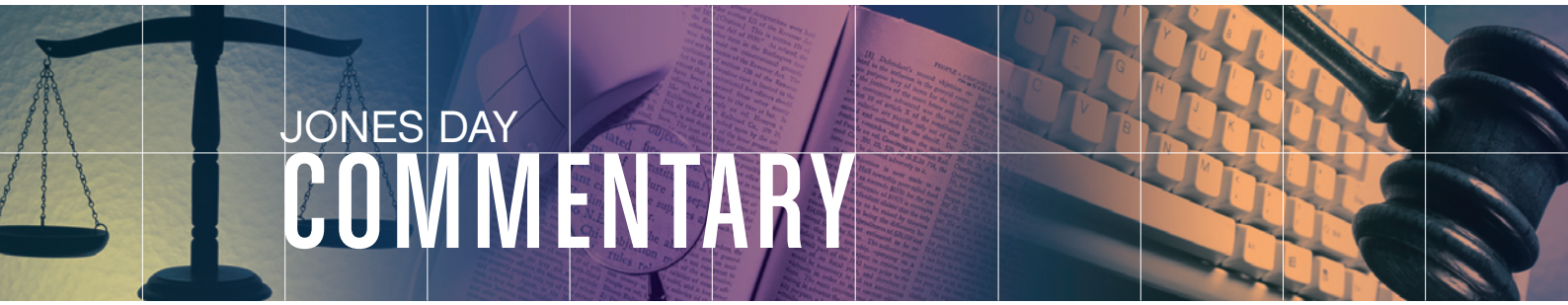
JONES DAY

JUNE 2008



COMPANIES ACT 2006

The Companies Act 2006 (the "New Act") effects the most sweeping and significant alteration of UK companies legislation for over 20 years. Significant portions of the New Act were implemented on 1 October 2007 and 6 April 2008, with the remainder coming into force on 1 October 2008 or 1 October 2009.

IMPLEMENTATION TIMETABLE

Whilst certain, mainly administrative parts of the New Act had already come into force, a substantial portion of new measures came into force on **1 October 2007**. These measures effected changes in the law concerning directors, shareholders' meetings, information rights for indirect investors, derivative actions and business review provisions in directors' reports. Changes were also brought in concerning fraudulent trading, company investigations, appointment of auditors, control of political donations and protection of members against unfair prejudice.

A further, limited number of provisions came into effect on **6 April 2008**. They included those concerning accounts and audit, distributions in kind and company secretaries of private companies.

The remainder of the New Act addresses matters including company formation and constitution, share capital and the abolition of the prohibition on financial assistance for private companies. These remaining provisions were originally due to come into force on **1 October 2008**. However, many of these provisions will not now come into force until **1 October 2009** (although, notably, the prohibition on private companies giving financial assistance will cease on 1 October 2008).

MAIN CHANGES

The main changes to UK company law made by the New Act include the following:

- a general scheme of electronic and web-based company communications has been introduced (**January 2007**).
- directors' duties have become codified and the regime regulating transactions between companies and their directors has been altered (**October 2007**).
- the regulatory regime for private companies is streamlined:

- private companies no longer need have a company secretary (**April 2008**).
- they will be able to give financial assistance for purchases of their shares (**October 2008**).
- they will be able to reduce their capital without court approval (**October 2008**).
- the requirements for passing a written resolution have been relaxed (**October 2007**).
- the current elective regime set out in section 379A of the Companies Act 1985 (the "1985 Act") has become the default regime for private companies (**October 2007**).

- indirect investors have been given new rights (**October 2007**).
- a new procedure for derivative actions has been established (**October 2007**).
- some new requirements for information to be set out in companies' directors' reports have been introduced (**January and October 2007** and **April 2008**).
- auditors will be given the power to agree liability limits with companies (**April 2008**).
- the Panel on Takeovers and Mergers has been put on a statutory footing (**April 2007**).

These changes are discussed in more detail below.

In addition, some of the terminology used in companies legislation has been altered. In particular, "shareholders" will now be referred to as "members".

PROVISIONS IN FORCE PRIOR TO 1 OCTOBER 2007

Electronic and Web-based Communications

Any document or information sent or supplied electronically *to* a company is deemed to have been validly sent or supplied provided that:

- the company has agreed, either generically or specifically, to it being sent electronically (or is deemed to have so agreed by virtue of a provision of the Companies Acts); and
- it is sent to an electronic address specified by the company for that purpose.

Any document may only be sent or supplied *by* a company in electronic form if the recipient has agreed to that form of communication (although in certain circumstances prescribed in the Companies Acts, a recipient which is a company will have been deemed to have accepted this).

However, a company may now make available documents or information on a web site, and they will be deemed to have been validly sent or supplied to a recipient, if the recipient has agreed to it being supplied by web site publication (e.g. by members' resolution) or is "taken to have agreed" to this form of publication. A recipient is taken to have agreed to this if the company has asked the recipient to agree to such communication and the individual failed to respond within a period of 28 days.

The Takeover Panel

In order to bring UK takeover regulation within the requirements of the Takeovers Directive, the Takeover Panel has been placed within a statutory framework and now has the power to make rulings and directions which are enforceable through the courts.

PROVISIONS WHICH CAME INTO FORCE ON 1 OCTOBER 2007

New Rights for Indirect Investors

Information rights for indirect members of traded companies. Where a member of a traded company holds shares on behalf of another person, he may nominate that other person to enjoy all the rights the member has to receive copies of communications which the company sends to members generally or to any class to which the member belongs, as well as the right to demand copies of accounts and reports. A traded company is one whose shares are admitted to trading on a regulated market (note: this does not include AIM).

Companies may authorise members to nominate other persons to exercise their rights. Any company may now include a provision in its Articles allowing members to nominate other persons to exercise certain of their rights as members. These rights include the rights to receive and

require circulation of written resolutions; the rights to notice of general meetings and to require directors to call general meetings; the right to appoint proxies to act at general meetings; the right to receive the annual accounts and reports; and in the case of public companies, the right to require circulation of a resolution for the AGM.

As a practical consideration, listed companies should consult with their registrars as to how members are to notify any nominations made and how records of nominations are to be kept. Certain changes to IT systems may also be necessary.

Directors

Codification of directors' duties. New provisions are primarily designed to codify (but do not completely replace) the duties of directors previously established by common law.

The four new *statutory* general duties of a director in force from 1 October 2007 are:

(i) to act within his powers.

This includes a duty to act in accordance with the company's constitution and to exercise powers for the purposes for which they were conferred.

(ii) to promote the success of the company.

Each director must act in the way which he considers in good faith would be most likely to promote the success of the company for the benefit of the members as a whole. In doing so the director must have regard to:

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

This list is not exhaustive and the duty is subject to any other rules of law requiring directors to consider the interests of the company.

(iii) to exercise independent judgement.

(iv) to exercise reasonable care, skill and diligence.

This is an obligation to exercise the care, skill and diligence that would be exercised by a reasonably diligent person with:

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

It is therefore both an objective and a subjective test.
Further statutory duties to avoid conflicts of interest, not to accept benefits from third parties and to declare any interest in a proposed transaction or arrangement with the company will come into force in October 2008.

Transactions with directors. The regime regulating transactions between a company and its directors has been retained with substantial alterations to the types and values of transactions which require approval of the company's members.

In particular:

- the prohibitions on loans to directors have been abolished in favour of requiring approval of the company's members.
- service contracts over two years in length now require shareholder approval.
- conditional material property transactions can now be approved (i.e. a company may now enter into a contract relating to such a transaction which is conditional on it being approved. This was not the case previously).

The definition of connected persons for these purposes has also been extended.

Derivative Claims Procedure

A statutory derivative claims procedure has now been established which is broader than and replaces the previous

common law action. A derivative claim may be brought by a member in respect of a cause of action arising from any negligence, breach of duty, default or breach of trust of a director (including the duty to exercise reasonable care, skill and diligence). A claim may be brought against a third party as well as against a director himself, and a director need not have personally profited to be liable. As under the previous law, a member may bring a claim in respect of wrongs done to the company prior to his becoming a member.

Companies may wish to consult with their insurers to ensure that the new broader liability is covered by their D&O policy.

Meetings and Resolutions

Annual General Meetings. The requirement for private companies to hold an AGM is abolished. If a private company wishes to avail itself of this relaxation in requirements, it should check to ensure that its Memorandum and Articles do not still contain a requirement to hold AGMs and make such alterations as are necessary.

Public companies are still required to hold AGMs, and they must now be held within six months of the end of the company's financial year.

Members' meetings. New procedures governing voting at and conduct of meetings have been introduced and proxy rights have been enhanced. In particular, there are new provisions for quoted companies that they must publish results of a poll on their web site, and in certain circumstances members can demand an independent report on the poll.

Resolutions of members. The definition of a special resolution retains the 75% majority requirement, but the requirement for 21 days' notice of such a resolution before the holding of a meeting at which it is to be moved has been removed. All resolutions now simply require 14 clear days' minimum notice (except notice of public company AGMs, which still require 21 clear days, and provisions which require special notice).

Where any provision of the Companies Acts requires a resolution and the type of resolution is not specified, it is made clear that an ordinary resolution meets the requirement, unless the company's Articles require a higher majority or unanimity.

While public companies may only pass members' resolutions at a meeting of their members, private companies may pass such resolutions either at a members' meeting or by a new written resolution procedure which no longer requires unanimity of members.

New written resolution procedure. Written resolutions need no longer be passed unanimously (even if such requirement is provided in a company's Articles). Ordinary resolutions now require the agreement of the holder(s) of a simple majority of votes capable of being cast and special resolutions will require the agreement of the holder(s) of a 75% majority, mirroring the thresholds for votes cast on a poll in a meeting. Each member is given one vote in respect of each share held except to the extent provided otherwise in the company's Articles.

The new provisions allow that members do not need to sign a copy of the resolution itself. They instead set criteria for what constitutes acceptance of the resolution, paving the way for passing written resolutions electronically.

Once circulated, a written resolution lapses (and so is no longer capable of being passed) if it has not achieved the required majority of votes within 28 days of circulation.

Certain prescribed information must be included in a written resolution circulated to members, such as the manner in which completed resolutions are to be returned to the company. Failure to provide the information is a criminal offence and so the procedure needs to be followed carefully.

Also, only persons who are members at the date a resolution is circulated for signature may sign the document for it to be effective. Transfers of shares made between the dates of circulation and of the resolution coming into effect are ignored.

Directors' Report

There are new provisions which set out the information that must be included in the business review section of a company's directors' report. Most notably the information required for quoted companies is more onerous than under the previous regime and includes the need for certain forward-looking statements. The required information for quoted companies includes information on:

- the main factors likely to affect the company's future business.
- environmental matters (including the impact of the company's business on the environment), the company's employees and social and community issues, including information about any policies of the company in relation to such matters.
- persons with whom the company has contractual or other arrangements which are essential to the business of the company. However, the report need not disclose such information if it would, in the opinion of the directors, be both seriously prejudicial to one of those persons and contrary to the public interest.

Other Provisions

Other provisions brought into force on 1 October 2007 relate to:

Fraudulent trading. The maximum custodial sentence for this offence is increased to 10 years.

Company investigations. The Secretary of State is granted wider powers in respect of investigations.

Auditors—private companies. Auditors are now deemed to be reappointed unless the company decides otherwise.

Control of political donations. Various changes have been made to the previous regime.

Protection of members against unfair prejudice. These provisions are restated with minor amendments.

PROVISIONS WHICH CAME INTO FORCE ON 6 APRIL 2008

Accountants and accounts

Provisions have been enacted which enable auditors to limit their liability.

Directors have a new general obligation not to approve accounts unless they give a true and fair view of the financial position of the company (and, in the case of group accounts, the other members of the group included in the consolidation as a whole), so far as concerns members of the company.

The current exemption for parent companies heading medium-sized groups from the requirement to prepare group accounts has been abolished.

The notes to companies' annual accounts no longer have to disclose transactions made between the company and officers other than directors.

A quoted company is obliged to publish its full annual accounts and reports on a web site maintained by the company or on its behalf, and these must remain available on the web site until the following year's accounts are published.

The obligation to lay the annual accounts and reports before a general meeting has been restricted to public companies. As a result, the time for a private company to distribute its accounts and reports is no longer linked to the date of a general meeting; instead, they must be sent out no later than the earlier of the date of actual delivery to Companies House or of the six-month deadline for delivery set out in the New Act.

The period for filing accounts and reports has been reduced to nine months after the end of the relevant accounting reference period for private companies, and to six months for public companies.

Company secretaries

The requirement for private companies to have a company secretary has been abolished. If, but only if, a private company chooses not to have a secretary, anything that is required or authorised to be done by or to a company secretary is validly done if done by or to a director or a person authorised on his or her behalf by the directors. Similarly, anything required or authorised to be served on or sent to the company by being served on or sent to its secretary is validly transmitted if served on or sent to the company itself.

Where a private company does choose to have a company secretary, it will be (save for certain qualification requirements) subject to the same obligations as a public company in respect of its secretary.

The requirement for a public company to have a secretary has been restated.

There is no longer any requirement that a public company secretary be a natural person.

Distributions in kind

A new provision has been enacted to clarify the value of distributions in kind (or distributions *in specie*). If a company has distributable profits, the amount of a distribution of, or arising from, a non-cash asset will be (i) the amount by which the book value of the asset exceeds the value of the consideration for it or (ii) nil if the consideration is equal to or exceeds the book value. This provides welcome clarification on a much debated area of case law.

REMAINING PROVISIONS TO BE IMPLEMENTED ON 1 OCTOBER 2008

Reductions in capital

The need for prior authorisation in its Articles before a company may undertake a reduction in its share capital will be removed.

A private company will be able to undertake a reduction of capital by means of a special resolution supported by a solvency statement. It will no longer be necessary for a private company to obtain the approval of the Court (though they may still do so if they wish); public companies will, however, still have to use the Court procedure.

Financial assistance

The prohibition on a company giving financial assistance for the purchase of its shares is to be abolished for private companies. Consequently, the whitewash procedure contained in sections 155 to 158 of the 1985 Act will become redundant and be repealed. A public company will still be prohibited from giving financial assistance (subject to all the current exceptions, as well as a new exception that permits post-acquisition financial assistance if the company has become a private company by the time the assistance is given). Financial assistance given by a public company to acquire shares in its private holding company will also remain prohibited, as will financial assistance given by a private company subsidiary in relation to the acquisition of shares in its public company parent.

REMAINING PROVISIONS TO BE IMPLEMENTED ON 1 OCTOBER 2009

Formation of a company

A single individual will be able to form any type of company, not just a private company.

Constitution of a company

A statement of capital and initial shareholdings in the prescribed form will be required to be delivered to Companies House on an application for the registration of a company having a share capital.

The Memorandum of Association will simply be a snapshot of the subscribers on incorporation. All provisions in the Memorandum of existing companies, other than provisions required by the new style of Memorandum, will be deemed to be provisions of the company's Articles.

A company's constitution will, by definition, include the company's Articles and any of the constitutional-type resolutions and agreements now specified in the New Act.

Companies will be able to "entrench" provisions of their Articles, either on formation or subsequently by unanimous agreement of the members. Once a provision is "entrenched" it can only be amended by unanimous agreement of the members or a court order. The company is required to notify Companies House on the addition or removal of entrenched provisions.

A company's objects will be unlimited unless its Articles specifically restrict them—i.e. the objects clause (which currently provides the scope of a company's objectives and authorities) will be abolished.

The Secretary of State will have the power to prescribe default model Articles for all types of company, not just for companies limited by shares. It is intended that the current "Table A" Articles will be replaced with a simplified prescribed version which will be the default Articles of a private company unless the company adopts different provisions. There will also be a prescribed document which will be the default Articles of a public company unless that company adopts different provisions.

A company will be able validly to execute documents with the signature of two authorised signatories, or of one authorised signatory made in the presence of a witness who attests the signature. Every director and, if there is one, the company secretary will be classed as being authorised signatories.

The provisions of a company's constitution will be stated to be binding on the company and its members to the same extent as if they were covenants to observe those provisions signed and sealed by each member and by the company itself. This enhances the current statutory position by putting onto a statutory footing the common law principle that the provisions of a company's Articles constitute a contract between the company and individual members.

Share capital

The requirement for an authorised share capital is to be abolished for all companies. Shares will simply be capable of being issued, subject to any restrictions on the number of shares contained in a Company's constitution. It is not yet known when the repeal of the requirement in the 1985 Act for an authorised share capital will take effect, but it is expected to be 1 October 2009.

A company will no longer be able to convert shares into stock, but it may reconvert stock to shares in accordance with the New Act.

The directors of a private company with only one class of shares will be free to allot shares (or to grant rights to subscribe for shares or to convert any security into shares) without prior authorisation from the members, subject to any restriction or prohibition on this power in the company's Articles—i.e. the old "Section 80" authority to allot will no longer be required unless shares of a new class are issued (in which case shareholder approval will be required). Allotments by a private company with several classes of shares will still be subject to rights of pre-emption in favour of existing shareholders, although, as before, the directors may be given a power by the Articles or by a special resolution to disapply pre-emption rights.

Purchase by a company of its own shares

The requirement for authorisation in a company's Articles for a purchase of its own shares is to be removed, but Articles may still prohibit or restrict such purchases—i.e. the current position is reversed.

Redemption or purchase by a company out of capital

A private company need not have prior authorisation in its Articles before it is able to make a payment out of capital in respect of the redemption or repurchase of its own shares, though the Articles may expressly restrict or prohibit such payments—i.e. the current position is reversed.

The directors need only make a simple statement of solvency, rather than a statutory declaration as before, but they must now take into account the contingent and prospective liabilities of the company when forming their opinion on the company's solvency.

FURTHER INFORMATION

This *Commentary* is intended to provide a summary of the main provisions of the New Act where current law is changing significantly.

A web site on which the Government sets out its proposals in relation to secondary legislation and revised drafts of model Articles of Association for private and public companies, together with checklists for existing private companies summarising the key areas of change and a set of Frequently Asked Questions about the implementation of the Act, can be found at http://www.berr.gov.uk/bbf/co-act-2006.

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