Briefing Note: Companies Act 2006 – An Overview

An Introduction to the Guide

This Guide is aimed firmly at owner managed businesses in the small to medium-sized enterprises (SME) sector and is designed to be a practical resume of points to consider rather than detailed technical advice. This guide should not be relied upon as legal advice and you should contact us for advice on your specific circumstances.

Briefing Note
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Summary:
An overview of this major piece of legislation including the background to the Act, the timetable for its implementation and the key changes introduced.

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1. Background

Previously company legislation could be found in a variety of Acts including the Companies Act 1985, the Companies Act 1989 and the Companies (Audit Investigations and Community Enterprise) Act 2004.

The purpose of the Companies Act 2006 ("the Act") was to repeal, simplify, modernise and consolidate existing company law.

There was much discussion about how to make the law more relevant to small businesses but the possibility of a separate small companies statute was rejected after initial consideration as so many of the provisions of company law can apply equally to small and large companies. However, there was recognition that the regulatory burden for small companies needed to be simplified. This resulted in a "think small first" approach.

The 2006 Act uses simpler language than before and exempts the private company from a number of procedures and regulations.

When the beginning of the company law review was originally announced, it was stated that the proposed Act would be drafted in:

"clear concise and unambiguous language which can be readily understood by those involved in business enterprise"

And the result? Well, the Act runs to over 1300 sections stretching to almost 800 pages applying to over 1 million companies. Clear and unambiguous it may be in some areas but concise and readily understood by ordinary business people it most certainly is not.

The Act has four main themes:

- **A think small first approach** - so that the basic law applies to private companies and additional requirements apply to public quoted and traded companies. This is a reversal of the previous approach.
- **Making it easier to set up and run a company** - this stems from the desire to make the UK a more attractive place for business.
- **Enhancing shareholder engagement and a long term investment culture** - these changes are aimed mainly at listed companies and stem from a desire to make directors of these companies more accountable to shareholders.
- **Flexibility for the future** - many specific parts of the Act still empower the Government to supplement the Act by regulations, eg statutory instruments, which may of course be changed much more easily than the main Act.

2. Timetable

Although Royal Assent was received on 8 November 2006 much of the 2006 Act did not come into force until October 2009 (rather than the intended target date of October 2007). The later end date was introduced to give Companies House, companies and their advisors additional time to prepare.

Provisions commenced in January 2007
Increased facilities for e-communications with Companies House Companies may now use electronic communications for all notices and correspondence where this has been agreed in a general meeting although individual members may specifically request 'snail mail'. A company's name must appear legibly in all its:- business letters; notices and other official notifications; websites; cheques, orders for money or goods purporting to be signed by or on behalf of the company; and invoices, receipts, letters of credit. In addition the company's business letters, order forms and websites have to include fuller particulars, ie:- the company's place of registration and the number with which it is registered; the address of its registered office' and in the case of an investment company, the fact that it is such a company. All these requirements apply whether the document is in hard copy, electronic or any other form.
Provisions commenced on 1 October 2007
Directors' Duties (except for conflict of interests, third party benefits and declaring interests). Abolishment of need to hold AGM's Derivative claims brought by a shareholder on behalf of the company where the director has breached his duties. Loans can be made to directors with shareholder approval. Shareholder approval required for directors' fixed term contracts in excess of two years. Written Resolution procedure simplified.
Provisions commenced on 6 April 2008
Private companies are no longer required to have a company secretary unless they choose to do so.
Provisions commenced on 1 October 2008
Minimum age for directors is 16 years. Directors' Duties (remainder). Requirement to have at least one director who is a natural person (but grace period until 1 October 2010).
Provisions commenced on 1 October 2009
All other provision that had not yet commenced, including:-Directors can notify service address to Companies House instead of home address.

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3. Key Changes

A major aim of the Act is to introduce a simpler and more lightly regulated regime for private companies. Dealing with a number of the key changes in turn:

Company Communications

From 1 October 2009, companies have been entitled to use electronic communications for all notices and correspondence when agreed in a general meeting. The Act has comprehensively embraced the electronic age and appears to permit the use of all electronic media for company, director, shareholder communication as long as all concerned agree or are deemed to agree under the Act.

In saying this any member may request the provision of any information or documents by hard copy at any time at no cost and such must be provided within 21 days of request.

E-communication can be used for circulating proposed written resolutions and responding or calling meetings.

Directors

Previously, there was no minimum age for directors. Under the new Act the minimum age for a director is 16 years. The new age limit came into force on 1 October 2008 (s.157). Following this date directors under the age of 16 years ceased to be directors.

Although corporate directors are still permitted, at least one director must be a natural person.

Directors are able to give a service address for the public record instead of their home address which previously appeared on the record. This is a welcome change. However, the Registrar of Companies is not obliged to change existing information so it may be some time before the change is of any real effect.
A company must in any event keep a private register of directors' residential addresses but this is not open to general inspection.

Prior shareholder approval will be required for directors service contracts with a duration of more than two years as opposed to the previous position where approval was required for contracts of more than five years in length.

Codification of directors' duties

Previously the duties of directors were largely governed in case law making it difficult to know the precise nature of their duties and if they have breached them. In the new Act the general duties are set out and form a code of conduct which governs how directors are expected to behave. This code of conduct is referred to as a 'Statutory Statement of Directors' Duties'. The purpose behind codification of directors' duties is to make the development of the law in this area more predictable and certain.

The Statement of Duties is perhaps the biggest single change introduced by the 2006 Act. However, it is important to note that despite the intentions of the reformers who wanted to codify all directors' duties in an easily accessible, and comprehensible form, the statutory statement does not cover all the duties that a director will owe to the company. It is therefore by no means a one stop shop for directors' duties. There are many other duties that are imposed elsewhere in the Act such as: the duty to file accounts and reports, the duty to protect the health and safety of employees and the duty to consider the interests of creditors in times of threat and insolvency.

The Statement, therefore, is just the minimum standard.

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The Statutory Statement encompasses seven general duties. For the most part these duties reflect the position of the previous law but there are implications of the newly codified duties, particularly the duty to promote the success of the company, which I will explain in more detail in a moment:

- **To act in accordance with the company's constitution and only exercise powers for the purposes of which they are conferred;**

- **To promote the success of the company for the benefit of its members.** This is perhaps the duty which attracted most comment during the passage of the Bill through Parliament and the Act states that:

  `a director of a company must act in the 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 and in doing so have regard (amongst other matters) to…'

There then follows a non-exhaustive list which can be encapsulated by the phrase 'enlightened shareholder value'. It includes:-

- 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, and
- the need to act fairly as between members of/he company.

This is a new general duty and is probably the most controversial clause in the whole Act. This new duty imposes wider corporate social responsibility into the issues directors must consider when making decisions. It also means the thought process behind directors' decisions will need to be documented as evidence that an informed decision has been made.

What does promoting "the success of the company" mean? During the passage of the Bill through the House of Lords, Lord Sainsbury said that this would mean "long term increase in value". It is clear, however, that “success” and “increase in value” to a charitable company is something quite different to a commercial company.

- **To exercise independent judgment.**

This duty codifies the established principle under which directors must exercise their powers independently without subordinating their powers to the will of others.

- **To exercise reasonable care, skill and diligence.**

This is self explanatory and codifies previous law.

- **To avoid conflicts of interest.**

A director will be required to avoid a situation in which he has, or could have, a direct or indirect interest that conflicts or may conflict with the interests of the company. However as long as the Articles don't provide differently, the non-conflicted directors may authorise any such conflicts.

- **Not to accept benefits from third parties.**

A director may accept a benefit from a third party if acceptance of the benefit will not be likely to give rise to a conflict of interest with the company. There is clearly some overlap with the duty to avoid conflicts of interest

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but under the duty to avoid conflicts of interest, authority can be granted by the board of directors but a director can only accept benefits from third parties which will give rise to a conflict if authority is granted by the shareholders.

- **To declare interests in proposed transactions or arrangements with the companies.**

As was previously the case, directors have a duty to declare their interest in a proposed transaction or arrangement with the company. One difference with this new duty is that it requires directors to state both the nature and the extent of his interests. It will no longer be sufficient for a director simply to state that he has an interest. It will also apply even if the director is not a party to the transaction, eg if the other person's interest amounts to a direct or indirect interest on the part of the director, eg his wife and children.

The consequences of breach

The codified duties are owed to the company and generally, therefore, only the company will be able to enforce them. However, in certain circumstances shareholders may be able to bring a derivative action on the company's behalf. The consequences of an action against a director might include:

- damages or compensation where the company has suffered loss; restoration of the company's - property;
- an account of profits made by the director; or
- rescission of a contract where the director failed to disclose an interest.

Shareholder rights

The Act is intended to give shareholders improved rights.

The Act gives shareholders a statutory right to sue directors on behalf of the company for negligence (or breach of reasonable skill and care), default, breach of duty, breach of trust. This covers a broader range of conduct than existed previously. Previously, shareholders were not empowered to take action for a wrong doing to the company except in a few situations such as fraud and ultra vires actions. This is therefore a significant change from the previous position.

To protect the directors the shareholders will need to obtain the Court's consent to bring a claim by showing that they have a case.

Coupled with the new duty to promote the success of the company concerns have been raised that shareholders, especially activist shareholders of traded companies, will use these provisions to bring spurious claims that will take up valuable management time as well as resulting in adverse publicity for the company.

Under the old law, members of the public could inspect and obtain copies of the Register of Members which show the addresses of shareholders. Under the new Act a person wishing to inspect or obtain copies of the Register must submit a request to the company specifying the purpose for which the information will be used and whether it will be disclosed to any other person.

Deregulation, Meetings and Resolutions

Private companies no longer need have a company secretary but if they do, the secretary will have the same authority as they did before the changes were made, ie the secretary can continue to be a co-signatory for the execution of documents by the company.

Private companies are now able to give financial assistance for the acquisition of its shares. This is a major change to the previous position which prohibits a company from giving financial assistance, eg by way of a mortgage over its assets or a loan where a person is acquiring shares in that company. The reason for the

prohibition was largely to protect creditors of a company. If, in the acquisition of its shares, the company uses its assets as security for the purchaser's borrowing then its true value is decreased and the position of the company's creditors is weakened. It used to be possible to get around this prohibition with something called the whitewash procedure which involved directors and accountants giving various reports and assurances as to the solvency of the company. The abolition of the rule against financial assistance means the position of creditors of a company may be weakened and also that transactions previously involving financial assistance will be more streamlined.

Private companies are now able (subject to solvency) to reduce their capital without the need for approval by the Court. Previously the procedure involved obtaining approval by the Court but under the new legislation companies will merely need to pass a special resolution accompanied by an appropriate solvency statement from the directors.

Written resolutions will no longer require unanimity. A simple majority will suffice to pass a written ordinary resolution and a 75% majority for a written special resolution.

A general meeting will still be needed where the business to be transacted concerns the removal of a director or an auditor.

Private companies are no longer required to hold an Annual General Meeting although they may still choose to do so. The thinking behind this was borne of the fact that small companies frequently ignored the previous requirement for AGM's. The new Act has therefore taken account of this practice. It also means that private companies will no longer need to lay accounts before the AGM although shareholders will still be entitled to receive the accounts.

Companies are now allowed to make loans to directors with shareholder approval.

Auditor liability and accounts

Previously, auditors could not limit their liability in respect of an audit. The Act permits auditors to agree contractually with their corporate clients to limit their liability in respect of an audit, subject to annual shareholder approval and to the limit being "fair and reasonable". The agreement can only apply to a single year's audit and shareholders must authorise its principal terms.

There is a new criminal offence of knowingly or recklessly including materially misleading information in an audit report.

Private companies will have 9 months from their year end to file their annual accounts.

Company formations and constitution

The way in which companies are to be formed does not appear to have essentially changed. This is not really surprising because the present system is not unduly cumbersome or complex.

Previously model Articles are prescribed for all companies limited by shares in Table A. If a company does not have bespoke Articles then Table A will apply by default. Under the new legislation Table A will continue but in a simplified form, the “Model Articles”.

Under the new Act the Model Articles will serve some of the functions previously served by the Memorandum of Association. Previously the Memorandum of Association set out the objects of a company and what type of trading it can undertake. Under the new Act, companies will have unrestricted objects unless the objects are specifically restricted by the Articles. The Memorandum has not been abolished but it does serve a limited purpose and it will look very different from that of a company registered under the 1985 Act.

Directors will not require specific authority to allot shares unless the Articles require.

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Company Stationery

Many companies are not aware of the following information which, **from 1 January 2007**, must be shown on company stationery.

The company name, must be stated in full (e.g. XYZ Limited, as opposed to a trading name) on the following documents (whether in hard copy, electronic or any other format):

a) Business letters (including faxes);
b) Order forms;
c) Notices and other official publications;
d) Cheques;
e) Orders for goods signed by, or on behalf of, the company;
f) Company invoices, receipts and letters of credit;
g) All company websites; and
h) All company e-mails.

All business letters, order forms, websites and e-mails (whether in hard copy, electronic or any other format) must show, in addition to the company name:

i) Place of registration e.g. 'registered in England and Wales';
j) Company registration number; and
k) Registered office (if more than one address is shown, it is advisable to confirm which address is the registered office address).

It is not obligatory to show the names of the directors on company stationery. However, if any name(s)is/are included, the names of all directors must be shown.

4. Conclusion

In conclusion the Government's stated purpose when introducing the Act was to improve the UK's position as one of the most attractive places in the world to set up and run a business. The Act has certainly modernised existing company legislation and abolished certain provisions which were outdated and cumbersome. While undoubtedly the new Act includes some useful fine tuning of the existing law there are some doubts as to the effect of key provisions which may become apparent over time.

If you would like to know more about this topic or our other legal services, please contact:

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