

The Companies Act 2006: Private Companies

The Companies Act 2006 received Royal Assent on 8 November 2006. The Act will be fully implemented by October 2009, although some parts come into force earlier than that. This briefing introduces the key changes in the Act which will be of particular relevance to private companies and indicates when these changes will come into force. We have prepared similar briefings for private equity firms and for listed companies, which are available on our website at www.traverssmith.com.

Directors will be subject to new statutory duties

The Act contains new statutory duties for directors which apply to executive and non-executive directors alike, and in some cases, to former directors. The statutory duties are based on, and replace, the previous common law duties, and are designed to make the law more accessible. The new statutory regime includes familiar concepts such as duties to exercise reasonable skill and care and not to accept benefits from third parties.

Some of the new statutory duties go beyond the common law equivalent, however. For example, there is a new core duty of directors to promote the success of the company for the benefit of its members and in doing so, directors must have regard to the interests of the company's employees, its business relationships with its customers and suppliers and others, and the impact of its operations on the wider community and environment. This is a controversial new concept and until the new law has bedded down, there may be uncertainty as to how the courts will interpret it.

There are also new rules on directors' conflicts of interest. A conflict or potential conflict of interest involving a director (other than in relation to a transaction with the company) can be authorised by the non-interested directors unless the company's articles prohibit them from doing so. Directors must also still declare interests in transactions with the company, but the declaration may be made in writing rather than in person at a board meeting.

The new statutory duties came into force on 1 October 2007, apart from the new rules on conflicts, which will not come into force until October 2008 (to give companies more time to change their articles to accommodate the new conflicts regime).

Claims against directors

The Act also provides a framework for shareholders to bring a claim on behalf of a company against directors who are in breach of duty or have been negligent. Shareholders will need the consent of a court to bring a claim, and damages will be owed to the company, rather than to the shareholders themselves. These limitations should ensure that only deserving claims are pursued, but the statutory procedure may make it easier for shareholders to bring actions against directors.

The new procedure came into force on 1 October 2007, at the same time as the new statutory duties for directors came into force. Directors of high-profile companies may need to consider whether to minute key board decisions with extra care to demonstrate that the directors have complied with their statutory duties, particularly in potentially contentious situations. However, the Government is keen to discourage a box-ticking approach and provided the directors have understood and applied the new statutory requirements to business decisions, using their good faith business judgment, the absence of a paper trail should not necessarily be taken to mean they have not complied with their duties.

Directors' home addresses may be kept confidential

The rules which currently allow directors who are considered to be at risk of violence or intimidation to keep their home addresses off the public register will be extended to apply to all directors from 1 October 2009, whatever the nature of the company's activities. All directors will file a service address (which can be the company's registered office) and their home addresses will be kept on a separate, protected register by both the company and Companies House. Details of existing directors' home addresses on the register at Companies House will not be expunged automatically. Directors who can show they are at risk of violence or intimidation will be able to apply to the registrar to remove such details, under Regulations

which have yet to be finalised.

Companies' memorandum and articles are to be simplified

The new model articles for private companies, which will be effective from 1 October 2009, are shorter and simpler than Table A. Table A will remain in force, so existing companies with Table A-based articles will not be forced to adopt new articles, but many are expected to amend their articles to reflect the new model articles and to take advantage of other new freedoms in the Act itself. Also, the memorandum of association will be much simplified, and will no longer restrict the scope of the company's activities unless it has a restricted objects clause in its articles.

Board decision-making easier

Under the new model articles, directors will be able to take decisions on a more informal basis than at present and the company's articles may specify which decisions require unanimity and which require only a specified majority to vote in favour, either with or without a meeting. Companies will need to change their articles to take advantage of these new procedures, which will come into effect on 1 October 2009.

Private companies will no longer have to have a company secretary

The requirement for a private company to have a company secretary is to be abolished with effect from 6 April 2008, although private companies can retain a company secretary if they wish (provided they continue to file details of the secretary at Companies House), and many larger private companies are expected to do so. The duties currently carried out by the company secretary will not fall away, so directors of private companies choosing to do without a secretary will need to ensure these are taken care of, and check their articles and key contractual arrangements for references to the company secretary.

No statutory prohibition on financial assistance for private companies

The statutory prohibition on financial assistance is to be abolished for acquisitions of shares in private companies, and the "whitewash" procedure in the 1985 Act will become redundant. This should make acquisition finance and structuring easier. This is expected to take effect from 1 October 2008.

Written resolutions will no longer require unanimity

Under the Act, as from 1 October 2007, private companies are able to pass written resolutions without needing the consent of all shareholders. It is now possible for any resolution to be approved by shareholders in writing with a simple majority for an ordinary resolution and a 75% majority for a special resolution. This should avoid the need to convene a general meeting to pass shareholders' resolutions in most cases.

AGMs will no longer be required

Private companies no longer need to hold AGMs after 1 October 2007 unless they positively elect to do so. However, the transitional provisions preserve any express requirement in a private company's articles for an AGM, so any such requirement will need to be removed by special resolution before a company can dispense with the AGM.

Authorised share capital is to be abolished

Companies will no longer be required to have an authorised share capital (i.e. a limit on the maximum amount of share capital which can be allotted) after 1 October 2009. Shareholder approval for share issues will also cease to be a statutory requirement unless the company has more than one class of shares (or is a public company). This will mean that, from October 2009, the directors of a private company with only one class of shares will be free to allot shares up to an unlimited amount (subject to statutory pre-emption rights on cash issues), unless the company introduces restrictions in its articles or elsewhere on share issues taking place without shareholder approval. However, the transitional provisions are expected to

treat an existing authorised share capital clause in a company's memorandum as a restriction in the articles on the number of shares the directors can allot, so this deemed "restriction" will need to be removed from the articles before new share issues exceeding the authorised share capital can be made.

Reductions of capital permitted without court approval

Private companies will be able to reduce share capital or cancel all or part of their share premium account without having to go through the lengthy court process which is currently required. The reduction will be based on a solvency statement made by the board and approved by shareholders. The new non-court-based procedure will be available from 1 October 2008.

Shorter time period for filing accounts

The time period for filing private companies' annual reports and accounts is to be reduced from 10 months to 9 months after the year end, with effect from 6 April 2008 (for reports and accounts relating to financial years commencing after that date).

Auditors are able to agree contractual limits on their liability

After much debate, the Government has decided to allow auditors to agree contractual limits on their liability with their audit clients with effect from 6 April 2008. Companies will need to consider how to approach requests from their auditors for liability limitation agreements. The limit must reflect a "fair and reasonable" proportion of the liability bearing in mind the role and responsibility of the auditors. The FRC is due to provide guidance on auditors' liability limitation agreements later this year.

Companies are able to communicate with shareholders electronically

The Act facilitates greater use of electronic communications between companies and their shareholders. The relevant provisions came into force on 20 January 2007 and many listed companies are taking advantage of the new regime to send meeting notices and annual reports and accounts to shareholders by e-mail or by publishing them on the company's website. Private companies with a large shareholder base may wish to do the same. To use e-mail, shareholders must provide an e-mail address for this purpose. To use the website, shareholders must be asked individually if they wish to receive information in this way, but if they fail to respond within 28 days, they may be deemed to have agreed provided the shareholders as a body have passed a resolution approving the use of website communications, or the articles authorise website communications.

If you would like more information on any of the topics discussed in this Note, or on what you should do to prepare for the changes, please contact your usual contact at the firm. We will be providing further guidance for clients during the coming months before the Act is fully implemented.

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