The Companies Act 2006: Private Equity Firms

ihe 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 changes in the Act which will be of particular relevance to private equity firms and indicates when these key changes will come into force. We have prepared similar briefings for investee companies and for listed companies, which are available on our website at www.traverssmith.com.

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 is expected to take effect from 1 October 2008. This should assist in structuring acquisition finance for private equity transactions. The statutory prohibition will remain largely unchanged for public companies, so will still need to be considered in public-to-private transactions, but it is usually possible to structure a public-to-private in such a way that any financial assistance is given only once the company has been taken private.

Written resolutions will no longer require unanimity

Under previous law, written resolutions required unanimity and a general meeting was often advisable when there was any doubt as to whether all shareholders would agree to a resolution, in view of the lower thresholds needed to pass resolutions at a meeting. From 1 October 2007, it is now possible for any ordinary or special resolution to be approved by shareholders in writing with the usual majority (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, except for those needed to remove a director or the auditors, where a meeting will be required (as was previously the case).

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 1 October 2009, directors of private companies 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), so it may be important for these companies to place specific restrictions on dilutive share issues taking place without shareholder approval. However, 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 by special resolution before new share issues exceeding the authorised share capital can be made.

Companies' memorandum and articles are to be simplified

There will be a new set of model articles for private companies which will be effective from 1 October 2009 and which are shorter and simpler than Table A and written in plain language. Table A will remain in force, so investee companies with Table A-based articles will not be forced to adopt new articles, but many companies are expected at least 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 contain an objects clause, so there will be no restriction on 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 for private companies, directors will be able to take decisions in a more informal manner 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. Whilst this may be useful in some circumstances, private equity investors may need to ensure their investee companies adapt the standard provisions to guarantee the involvement of investor directors in decision-making. Companies will need to change their articles in any event to take advantage of these new procedures, which come into effect on 1 October 2009.

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. Directors will all file a service address (which can be the company's registered office) and their home addresses will be kept on a separate, protected register, both by 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 published.

Directors will be subject to new statutory duties

The Act contains new statutory duties for directors which apply to executive and non-executive directors, investor directors and shadow directors, and in some cases to former directors. The statutory duties replace the previous common law duties, and are designed to make the law more accessible for directors. The new statutory regime includes familiar concepts such as duties to exercise reasonable skill and care and not to accept benefits from third parties. However, some of the statutory duties go beyond the common law equivalent. 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. Until the new law has bedded down, there will be uncertainty as to what is meant by the "success" of a company, to what extent interests of other stakeholders must be taken into account, and whether decisions taken by directors in good faith may be susceptible to challenge on the basis that they were unreasonable.

There are also new rules on directors' conflicts of interest which may be particularly significant for non-executive directors with multiple directorships. 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. In future, multiple directorships raising any potential conflict issue may therefore need to be approved by the rest of the board. 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. Executive and non-executive directors, shadow directors and former directors are all "directors" for these purposes. Shareholders will need the consent of the 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 is available from 1 October 2007, at the same time as the new statutory duties for directors came into force. Directors of high-profile companies may be advised to minute 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.

Auditors will be 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. Private equity investors will need to consider how to approach requests from auditors of their investee companies 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. Investee 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 or your investee companies 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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