

*The Companies Act 2006:
Private Equity Firms*



The Companies Act 2006 received Royal Assent on 8 November 2006. The Act will be fully implemented by October 2009, although some parts have come into force prior to that. This briefing summarises the changes in the Act, that are of particular relevance to private equity firms and indicates when these key changes came or 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

With effect from 1 October 2008, the statutory prohibition on financial assistance has been abolished in relation to acquisitions by private companies of shares in private companies, with the effect that the "whitewash" procedure in the 1985 Act is no longer of relevance. The statutory prohibition remains largely unchanged for public companies, so will still need to be considered in public-to-private transactions; however, 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. Since October 2007, under the Act, 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 still be required (as was previously the case).

Authorised share capital is to be abolished

From 1 October 2009, 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). 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 share 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 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.

"The Act contains statutory duties, which apply to executive and non-executive directors alike....the statutory duties are designed to make the law more accessible."

Companies' memorandum and articles are to be simplified

The Government has published new Model Articles of Association for private companies, which will be effective from 1 October 2009. These articles are shorter and simpler than Table A and are 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. In addition, 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 a company's activities unless it has a restricted objects clause in its articles.

Directors' home addresses may be kept confidential

From 1 October 2009, 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, both by the company and Companies House (although there are certain circumstances in which this information may need to be disclosed to specified public bodies). 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.

Directors subject to statutory duties

The Act contains 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 statutory regime includes familiar concepts such as duties to exercise reasonable skill and care and not to accept benefits from third parties.

The Act has introduced codified 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 from doing so. Directors must also still declare interests in transactions with the Company, but the declaration may be made in writing other than at a board meeting.

The statutory duties came into force on 1 October 2007, apart from the new rules on conflicts, which came into force in October 2008.

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 procedure came into force on 1 October 2007, at the same time as the statutory duties for directors came into force. Directors of high-profile companies should consider whether 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 may agree contractual limits on their liability

After much debate, with effect from 6 April 2008, the Government decided to allow auditors to agree contractual limits on their liability with their audit clients. 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. To date we are not aware that any investee companies (or any listed companies for that matter) have entered into such LLAs.

Companies are able to communicate with shareholders electronically

From January 2007, the Act has facilitated greater use of electronic communications between companies and their shareholders. Many listed companies have been taking advantage of this regime to send meeting notices and annual reports and accounts to shareholders by e-mail or by publishing them on the company's website. Certain Investee companies with a large shareholder base have chosen to do the same. To use e-mail, shareholders must provide an e-mail 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.

Execution of Deeds

From 6 April 2008, in addition to the existing execution formalities for deeds, which shall continue to apply, deeds may be signed by a director in the presence of a witness. This will apply to all companies; not just to those companies that have sole directors.

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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September 2009

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