

The Companies Act 2006:

Political donations

The Companies Act 2006 received Royal Assent on 8 November 2006. The Act will be fully implemented by October 2009, although some parts, including Part 14 which deals with political donations, came into force mainly on 1 October 2007.

This briefing introduces the changes made to the Companies Act requirements on political donations by the 2006 Act and briefly summarises the law on approval of donations by companies.

We have prepared briefings on other aspects of the 2006 Act, including directors' duties and liabilities, and more general summaries of the key changes for private companies, private equity firms, companies listed on AIM and Official List companies, all of which are available on our website at <http://www.traverssmith.com>.

Background

The Political Parties, Elections and Referendums Act 2000 ("PPERA") introduced sections 347A-347K into the Companies Act 1985, with effect from February 2001. Under that regime, a company must not make a donation to a party registered under the PERA or to any other EU political organisation or incur any EU political expenditure unless the donation or expenditure is authorised by a resolution passed by the shareholders in a general meeting.

Under the 2006 Act, there will continue to be exemptions for donations within a 12-month period of less than £5,000 and for membership subscriptions to trade associations and to all-party parliamentary groups or where the Secretary of State has made an order setting out additional, specific exemptions¹.

Under the previous regime, companies wishing to make political donations or incur political expenditure (or those simply wishing to pass a precautionary resolution) had to obtain shareholder approval by a resolution passed in general meeting. The resolution could last for four years, although in line with institutional investor voting guidelines, most listed companies renewed their resolutions on an annual basis. The resolution had to be approved before any donation was made or expenditure incurred (or before any contract was entered into by the company in pursuance of which the donation was made or expenditure incurred). The resolution was to be drafted in general terms and should not have related to a specific payment.

These requirements, with the modifications mentioned below, have been re-enacted as Part 14 of the 2006 Act.

¹ See the Companies (EU Political Expenditure) Exemption Order 2001 (SI 2001/445) which is to be replaced by the Companies (Political Expenditure) Exemption Order 2007 (SI 2007/2081) (published in final form by the Government in July 2007). The Orders exempt activities such as the publication of newspapers which, by their very nature, involve the publication or dissemination of material which seeks to influence the views of the public.

Changes introduced by the 2006 Act

In summary, the main changes to the previous requirements are:

- private companies can authorise donations and/or expenditure by written resolution, rather than having to hold a general meeting;
- a holding company is permitted to seek authorisation of donations and expenditure in respect of both the holding company itself and one or more subsidiaries through a single approval resolution;
- a holding company must authorise a donation or expenditure by a subsidiary only if it is a "relevant holding company" (ie. the ultimate holding company or, where such a company is not a UK-registered company, the holding company highest up the chain which is a UK-registered company);
- companies are allowed to table separate approval resolutions in respect of donations to political parties and donations to other political organisations;
- donations to independent election candidates will be covered by the provisions with effect from 1 October 2008;
- there is greater clarity about the provision of facilities for trade union officials through the introduction of a specific exemption for donations to trade unions, other than contributions to the union's political fund which require prior approval;
- there are important changes to the rules on ratification and liability in cases of unauthorised donations or expenditure; and
- the new provisions apply to companies incorporated in Northern Ireland (but with a commencement date of 1 November 2007 instead of 1 October 2007).

The 2006 Act's explanatory notes clear up any uncertainty by confirming that there is no specific exemption in relation to paid leave for local councillors because this does not constitute a political donation or political expenditure under the existing or the new provisions.

The 2006 Act also includes clearer language to the effect that donations by other group companies (including subsidiaries) must be taken into account in calculating whether the £5,000 threshold has been exceeded.

Subsidiaries

The 1985 Act included special rules for approving donations or expenditure by subsidiaries. If the subsidiary was not wholly-owned then its holding company had to pass an additional approval resolution. Where the subsidiary was wholly-owned then the holding company had to pass the resolution rather than the subsidiary. The resolution could authorise the subsidiary to make donations and/or incur expenditure up to a specified amount.

In the 2006 Act there is a change in relation to subsidiaries in that members of both any relevant holding company (ie. the ultimate UK-registered holding company) and the subsidiary must approve the resolution. However, if the subsidiary is a wholly-owned subsidiary of a UK-registered company then a separate approval resolution by the subsidiary is not required. The Government has previously stated that in order to reduce burdens on companies the existing special provisions for parent companies of non-GB subsidiaries would be repealed. So, there is now one regime for subsidiaries.

The approval resolution

Under the 2006 Act, the approval resolution may relate to donations and/or expenditure by:

- the company passing the resolution alone;
- one or more subsidiaries of that company; or
- the company passing the resolution and one or more subsidiaries of that company.

A resolution may be expressed to relate to all companies that are subsidiaries of the company passing the resolution either at the time the resolution is passed or at any time during the period for which the resolution has effect, without identifying them individually. A company may authorise donations or expenditure under one or more of the following heads:

- donations to political parties or independent election candidates;
- donations to political organisations other than political parties;
- political expenditure.

The resolution must authorise donations or expenditure up to a specified amount and must specify such amounts for each company (including all of the subsidiaries) to which it relates.

As in the 1985 Act, the resolution has effect for a period of four years (although we expect that listed companies will continue to seek annual approval in line with institutional investor guidance) and should relate to general payments and not to specific donations or expenditure.

Ratification and directors' liability

Under the Companies Act 1985, ratification (or other retrospective approval) by shareholders of an unauthorised payment was specifically prohibited. Ratification is not prohibited by the 2006 Act and is therefore possible, as will an application by directors for relief under new section 1157 (the successor to section 727 of the 1985 Act) which gives the court power to grant relief to directors in certain circumstances.

Under both the previous and the new provisions, directors in default of the requirement for authorisation are jointly and severally liable to pay to the company the amount of the unauthorised donation or expenditure, with interest, and also to compensate the company for any loss or damage sustained by it as a result of the unauthorised donation or expenditure having been made. The directors in default are those who were directors of the company which made the donation or incurred the expenditure at the time the unauthorised amount was paid.

The 1985 Act extended liability to directors of holding companies (if the subsidiary had made an unauthorised payment) although if the subsidiary was not wholly-owned and the holding company had passed an approval resolution then its directors would not be liable. The 2006 Act specifically states that where the company making the donation or expenditure is a subsidiary, and the directors of the relevant holding company "failed to take all reasonable steps to prevent the donation being made or expenditure being incurred," then the directors of the relevant holding company are also liable. The option of the directors of the holding company avoiding liability because the holding company had passed an approval resolution prior to the donation being made or expenditure being incurred is not available.

Under the 1985 Act it was a defence to a claim for reimbursement of an unauthorised payment for a director actually to make the reimbursement and for the members of the relevant company to approve that repayment in a general meeting. This exemption from liability has been removed in the 2006 Act. However, where shareholders seek to bring an action in respect of an unauthorised payment, it has been and will continue to be possible for a director to apply to the court for an order directing that the proposed proceedings should not be brought because the unauthorised amount has been "made good" to the company.

The 1985 Act permitted a claim to be brought against the relevant director(s) by an authorised group of members as well as by the company. This, and the other provisions on the cost of and information for the purposes of the shareholder action, are re-enacted in the 2006 Act. The only change in these provisions is that the 2006 Act permits, in the case of a liability of a director of a holding company to a subsidiary, proceedings to be brought in the name of the subsidiary or the holding company by an authorised group of members of the relevant company.

Timing

Part 14 of the 2006 Act came into force on 1 October 2007 except:

- the provisions on independent election candidates which will not come into force until 1 October 2008; and
- Part 14 will not come into force in Northern Ireland until 1 November 2007.

Transitional provisions

The Government's Third Commencement Order, which sets out which provisions of the 2006 Act came into force in October 2007, states that, in relation to political donations, Part 14 of the 2006 Act applies to donations made or expenditure incurred on or after 1 October 2007. Part XA of the 1985 Act applies to donations made or expenditure incurred before that date. In both cases, where an amount is incurred pursuant to a contract the relevant date will be the time when the contract is entered into.

Disclosure of donations

The requirements for disclosure in a company's directors' report of any relevant donations or expenditure continues under the 2006 Act. Directors' reports relating to financial years beginning on or after 6 April 2008 must disclose details of donations to independent election candidates. For financial years beginning before 6 April 2008, the existing provisions in paragraphs 3 and 4 of Schedule 7 to the 1985 Act will continue to apply.

Practical effect

The most immediate impact of the changes is to the wording of the resolution on political donations and expenditure which may be proposed at a company's AGM. Any such resolution should be extended to cover independent election candidates - depending on when the resolution is to be passed the new words may need to be added at the 2007 or 2008 AGM. Groups will also need to consider which companies should be covered by any resolution since they might wish to take advantage of the opportunity to have a single resolution for a holding company and its subsidiaries.

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

Travers Smith

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10 Snow Hill, London EC1A 2AL

Tel: +44 (0)20 7295 3000 Fax: +44 (0)20 7295 3500

www.traverssmith.com