

It has been a lengthy process but finally the new Companies Act has been issued. It is the longest piece of legislation ever to have been passed by parliament and at over 700 pages that is not the end of it! Further consultation on many of the detailed provisions will now take place and it is expected that all provisions will come into force by October 2008. In this briefing we consider some of the main practical changes you can expect to see that will affect you and your company.

Companies Act 2006 - all change for directors

Looking back

The company law reform process began as far back as 1998, with an independent review. White Papers followed in 2002 and 2005 and a Bill was eventually published in November 2005. The Act itself finally received Royal Assent on 8 November 2006.

The overall objectives

The government's overall objectives were to simplify and modernise company law so that it better meets today's business needs and provides flexibility for the future. While the reform process aimed to 'think small first', the resulting legislation has an impact on directors, auditors, shareholders and company secretaries of private, public and quoted companies.

The Act itself has been written in simplified language, with a particular focus on small business.

The changes

Directors

- **A statement of director's duties**

In order to help make it easier to understand the general duties that a director owes to their company, there will be a formal, statutory code of directors' general duties to the company. This will clarify the existing duties that have developed over the years through case law.

The Act requires each director to act in a way that they consider, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders as a whole. This broadly replaces the existing duty to act in the company's best interests.

Where this duty is breached, the company, or the shareholders on behalf of the company with the consent of the court, will be able to sue the directors. However, directors will only be liable for a breach of this duty if the company has suffered a loss as a result of the breach.

- **Wider social responsibility**

In performing the above duty, the Act requires that directors give some consideration as to how their decisions affect the wider interests of their employees, the community, the environment, their suppliers as well as other factors.

This is seen as one of the more controversial requirements of the Act, although it is not expected to result in a 'multi-stakeholder' approach to decision making.

- **Directors' safe harbour from liability**

As reporting requirements increase for some companies, the Act gives directors a 'safe harbour' that will restrict their civil liability in respect of material omissions from, or statements made in, directors' reports. Broadly, liability will only arise if statements are for example untrue or misleading and made deliberately or recklessly.

In these circumstances, a director would only be liable to the company and not to shareholders.

- **Transactions with directors**

The current rules that regulate transactions between directors and their company, which require shareholder approval, have been reformed and restated. In particular, the Act permits companies, with shareholder consent, to make loans, give guarantees or provide security in connection with a loan to a director.

Comment

This reverses the existing prohibition on such transactions.

Directors will also:

- have an automatic option to file a service address, rather than their private residential address, on the public records at Companies House. A company must keep a register of directors' residential addresses and these will still have to be notified to Companies House even though they need not appear on the public register
- no longer need to file details of other directorships

The Act continues to allow companies to have corporate directors, although at least one director will have to be a natural person.

Comment

While these new rules will not help directors whose current home addresses already appear on records at Companies House, additional regulations are expected which will allow an address already on the public record to be removed in certain circumstances.

Auditors and accounts

January 2004 saw the definition criteria for small and medium-sized companies and the audit exemption limit rise significantly, meaning that many more companies could benefit from the exemptions available. More recent changes mean that many small financial services companies that were previously prevented from doing so can also benefit from these exemptions.

One exemption that will be removed under the new Act will be the specific exemption for medium-sized groups from preparing group accounts.

In addition, the 2006 Act:

- **will introduce a comprehensive 'code' of accounting and reporting requirements for small companies**

The Act makes distinctions between companies that are small and those that are not and those that are quoted companies and those that are not.

- **reduces the time allowed to file accounts at Companies House**

Filing deadline:	Current	Proposed
	months from the end of the accounting period	
Private limited company (Ltd)	10	9
Public limited company (Plc)	7	6

Comment

The potential impact of this change has been somewhat lessened, as initial proposals intended to decrease the filing deadline for private limited companies to seven months. It is worth remembering that there are automatic penalties if your company's accounts are filed late. These range from £100 to £1,000 for private companies and from £500 to £5,000 for public companies, dependent upon how late the accounts are filed.

- **continues to help improve audit quality**

The Act introduces a new criminal offence for an auditor to knowingly or recklessly include anything that is materially misleading, false or deceptive in an audit report.

Companies will be able to agree a limit on their auditors' liability arising from an audit for a specified year, subject to shareholders approving the main terms of the agreement. The amount of the limit must be 'fair and reasonable' in order to be effective.

Audit reports will be signed by the 'senior statutory auditor' in their own name, for and on behalf of the firm.

- **retains the option to file abbreviated accounts at Companies House**

Small and medium-sized companies will continue to be able to file abbreviated accounts.

Comment

Earlier proposals intended to abolish the option for small and medium-sized companies to file abbreviated accounts at Companies House. However, it is expected that turnover will have to be disclosed.

Electronic communications

Some of the first provisions of the Act to come into force allow companies to make greater use of electronic communications.

Electronic communications with shareholders by email, or via a website with notification, will be allowed where an individual shareholder consents. Individual shareholders who prefer not to use this option have the right to request continued communication as hard copy.

Comment

The range of measures intended to further electronic communication should lead to substantial cost savings for quoted plcs and other multi-shareholder companies. Smaller companies should also see some practical benefits.

Decision making

The decision making process has been simplified in a number of ways, including:

- all resolutions of private companies will be capable of being passed in writing, with the exception of those to remove a director or an auditor
- written resolutions will be able to be carried with a majority of:
 - over 50 per cent (for ordinary resolutions)
 - 75 per cent (for special resolutions) of eligible votes
- a private company will no longer need to hold an Annual General Meeting (AGM) unless the shareholders positively opt to do so. Public companies will continue to be required to hold an AGM. This must be within six months of the financial year end.

Other areas

- **Forming a company**

The formation and administration of companies will soon become simpler. The company memorandum will become a formal document recording the details of the company at the time of registration. Going forward the articles alone will be the continuing constitutional document, containing the minimum key rules on the internal workings of the company. Private companies will have separate, simple model articles that will better reflect the way that they operate.

- **The company secretary**

The requirement for a private company to have a company secretary is abolished, although it may continue to appoint one if it wishes.

Comment

While the office of company secretary will not be mandatory, many of the responsibilities previously carried out by the secretary will continue to exist.

As with many provisions in the Act we do not yet know the precise date that this change will become effective.

Public companies will continue to require a company secretary.

- **Other simplifications**

The existing rules regarding capital maintenance and share capital provisions are complex and the Act simplifies these by removing unnecessary and burdensome requirements for private companies. In addition, private companies will not be prohibited from giving financial assistance for the purchase of their own shares, provided they are not subsidiaries of public companies.

The requirement to have an authorised share capital is removed for both public and private companies.

Finally, while the Companies Bill disappointingly did not propose a consolidating Act, the government had a change of heart. The 2006 Act repeals and replaces virtually all of the existing Companies Acts.

How will the Act affect existing companies?

It is not yet fully clear how the new Act will apply to existing companies. While an initial consultation process began in 2006, further consultation in 2007 will look to address this question in detail. Broadly, the intention is to respect existing company arrangements. Therefore if a company's current articles include an explicit provision requiring something that the Act itself no longer requires, the existing articles will have to be amended if the company wishes to take advantage of the deregulation allowed by the Act.

What's next?

2007 will begin as a year of consultation, which will lead to secondary legislation that will implement many of the detailed provisions of the Act. Therefore a number of provisions are unlikely to come into force for over a year, which will provide us with time to prepare.

If you would like to discuss the changes to company law in more detail including how you might begin to plan for them please contact us.