



Together, we've seen an opportunity.

**FASKEN
MARTINEAU** 

Companies Act 2006 - 1 October 2008

The Companies Act 2006 (CA 2006) received Royal Assent on 8 November 2006 and its provisions are being phased in over a 3 year period. Various provisions are already in force, previous effective dates having been in January, April and October 2007 and in April 2008. The next key date is 1 October 2008 when, inter alia, the following provisions come into force:

- Three remaining duties of directors – to avoid conflicts of interest, not to accept benefits, and to declare interests in proposed transactions and existing transactions and arrangements, under sections 175 to 187
- Reduction of capital, including a new procedure for private companies, under sections 641 to 654
- Repeal of the restrictions on financial assistance for the acquisition of shares in private companies

Directors Duties

The CA 2006 introduced a new statutory statement of directors' duties. The statement of duties does not cover all the duties which a director may owe to the company as some duties, such as the duty to deliver accounts, are contained elsewhere in the CA 2006 and some remain uncodified. The first four duties came into force on 1 October 2007:

- Duty to act within powers
- Duty to promote the success of the company
- Duty to exercise independent judgment
- Duty to exercise reasonable care, skill and diligence

The three remaining duties come into force on 1 October 2008:

- Duty to avoid conflicts of interest (s175)
- Duty not to accept benefits from third parties (s176)
- Duty to declare interest in proposed transactions or arrangements (s177)

Duty to avoid conflicts of interest

The current law provides that a director must not place himself in a situation where his personal interests conflict with his duties to the company. If such a conflict of interest does exist, the company's articles of association will generally permit the director to vote at the relevant meeting and to be counted in the quorum, provided such interest is declared.

From 1 October 2008, a director will have a positive duty to avoid situations in which he has or can have a direct or indirect interest that conflicts with or may conflict with the company's interests. This applies in particular to the exploitation of property, information or opportunity (whether or not the company could take advantage of the property, information or opportunity). It should be noted that s175 only applies to situations arising after 1 October 2008.

The duty to avoid a conflict of interest does not apply:

- To a conflict of interest arising in relation to a transaction or arrangement with the company (these do not have to be authorised by either the members or by the board and instead the directors must declare their interests in transactions or arrangements with the company under s177 (in the case of proposed transactions) or under s183 (in the case of existing transactions) unless an exception applies under those sections);
- If the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or
- If the matter is authorised by the directors.

The concept that a conflict can be authorised by the directors is a new one.

Directors of private companies formed after 1 October 2008 may give authorisation as long as there is nothing in the articles of association to prohibit the authorisation. Existing private companies formed before 1 October 2008 will need to obtain shareholder authorisation for the independent directors to authorise conflicts.

For public companies, the articles of association must contain express provisions allowing the directors to authorise conflicts of interest. Companies that have not already changed their articles of association prospectively should now do so at the earliest opportunity.

To prevent abuse, such board authorisation is only effective if the required quorum is met without including the director in question or any other interested director and the matter is passed without such director voting, or would be agreed if his votes had not been counted. In some small companies it may be difficult to meet the quorum requirements if all the directors are conflicted or if the articles of association prescribe that certain directors must be present to constitute a quorum.

In addition, the directors must act in accordance with their other general duties, such as the duty to promote the success of the company for the benefit of the members as a whole, in deciding to authorise a conflict.

A conflict of interest includes a conflict of interest and duty, and a conflict of duties. A director who holds several directorships in companies which have conflicting interests will have duties which conflict (i.e. to promote both companies when they are in competition with one another) and such a dual role will need to be authorised. In addition, a director cannot accept a position which gives him a duty to another person (e.g. a trustee of a trust) which conflicts with his duty to the company, without an authorisation from the board. However, a director may now be able to exploit an opportunity which the company decides not to exploit, by seeking authorisation from the board, where he previously would have required the approval of shareholders.

A person who has ceased to be a director remains subject to the duty to avoid conflicts as regards the exploitation of information, opportunity and property of which he became aware whilst he was a director. The duty will be applied "subject to any necessary adaptations" to reflect the fact that the person is a former director. This is intended to allow the court some flexibility in the way it interprets and applies the duties to former directors. It is unclear whether the board authorisation procedure is available to a former director.

Companies need to be aware of this change to the law in October 2008 and to understand its impact. Companies will not only need to inform their directors of the new positive duty to identify and notify existing and potential conflicts of interest, but also to put in place appropriate procedures and guidance to deal with conflicts and ensure that the articles of association contain the necessary power to authorise such conflicts. This is particularly important for public companies as the directors of a public company can only authorise conflicts of interest arising after 1 October 2008 if permitted to do so by the articles of association.

Company 'to do' list

- Establish a register of existing conflicts of interest as at 30 September 2008, and to register future conflicts and authorisations
- Consider establishing a Board committee with responsibility to review requests for authorizations of conflicts of interest and make recommendations to the Board
- Consider whether conflicts of interest should be a standing item on the Board Agenda
- Note all existing (as at 30 September 2008) conflicts of interest at the next Board meeting
- Review the GC 100 Guidance on Conflicts on this topic
- Arrange for the Board to have an update session on new requirements and procedures, and build into the induction programme for new directors
- Amend the Articles of Association at the next opportunity, if not already done – and why not review all the Articles at the same time?

Duty not to accept benefits from third parties

A director must not accept any benefit from a third party which is conferred because he is a director, or because of actions (or inaction) as a director. This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest, for example, a gift which is not of an unreasonable amount in relation to the company. Benefits conferred by the company, its holding company or subsidiaries and benefits given by the director's service contract are excluded.

Unlike its ability to authorise conflicts of interest, the board has no power or authority to approve the acceptance of benefits, but it is suggested that companies should include in their articles of association provisions allowing directors to accept benefits. Companies should also set up board policies, guidelines and procedures on the acceptance of gifts and corporate hospitality, etc. A director obtaining a benefit from a third party can only be authorised by the members of the company.

Company 'to do' list

- Establish Board policies on the acceptance of gifts and hospitality
- Consider establishing a register of benefits and gifts

Duty to declare interests

The provisions are contained in sections 177 to 187 and replace the current s317 of CA 1985.

The disclosure requirements are now separated between declarations in relation to **proposed** transactions with the company (s177) and declarations for **existing** transactions already entered into by the company (s182). Once a declaration has been made under s177 no further declaration is required under s182. However, in either case if the declaration becomes inaccurate or incomplete, a further declaration must be made.

The declaration must be made to the other directors but it is no longer required to be made at a meeting. If not made at a meeting then the notice must be given to all the other directors. No declaration is needed in the case of a company with a sole director. It is still possible to give a general notice that a director is interested in all transactions with a particular party.

There is no requirement to make a declaration if the director is not aware of his interest or is not aware of the transaction in question. Nor is there a requirement to declare the interest if it cannot reasonably be regarded as likely to give rise to a conflict of interest.

The declaration must be the nature and extent of the interest, as opposed to just the nature of the interest at present. Failure to make the declaration is still an offence liable to a fine.

Table A to CA 1985 permits directors to be interested in transactions with a company but prohibits the director from being counted in the quorum or voting in the matter except in certain cases. These provisions are routinely amended to permit the director to count towards the quorum and vote, provided he has disclosed his interest.

The new model articles (set out in The Companies (Model Articles) Regulations 2008) make similar provisions to Table A, excluding the director from the decision making process unless (i) the company disapplies this by ordinary resolution, (ii) such an interest cannot reasonably be regarded as likely to give rise to a conflict of interest or (iii) the conflict of interest arises from a permitted cause (as defined in The Companies (Model Articles) Regulations 2008). There seems no reason not to amend this provision to permit a director to take part in the decision-making process as currently provided for.

Company 'to do' list

- Review the register of directors' interests, to take the additional disclosure information
- Remind the directors of their disclosure obligations

Reduction of Share Capital

Under s135 of CA 1985, all companies wanting to reduce share capital had to have authority to do so in their articles of association, and had to obtain confirmation from the court. The court acts to protect the interests of creditors who may object to the reduction.

Sections 641 to 654 of CA 2006 change the provisions for a court-approved reduction and introduce a new procedure for private companies to reduce share capital by way of special resolution.

Reduction of Capital approved by the Court

The main changes to court-approved reductions include:

- It is no longer necessary for the articles of association to authorise reductions of capital, although reductions will have to take account of any articles that restrict or prohibit a reduction.

- The ‘minute of reduction’ is replaced by a ‘statement of capital’ in a new form providing details of all of the issued shares of the company, the classes into which it is divided and the amount paid up on the shares, to be filed with the Registrar of Companies. Transitional arrangements until 1 October 2009 replace the statement of capital by a “memorandum” showing equivalent information – though it is not yet clear whether this refers to the amended memorandum of association or to a stand alone memorandum.
- Where a reduction forms part of a scheme of arrangement under s895 of CA 2006, it will come into effect on delivery of the court order and statement of capital to the registrar of companies rather than on registration, unless the court orders otherwise. Other reductions of capital will continue to take effect on registration of the court order and statement of capital.

The New Procedure for Private Companies

Subject to any prohibition or restrictions in the articles of association, a private company will be able to reduce its share capital by special resolution supported by a solvency statement. However, this procedure is not available if as a result there would be no members holding shares other than redeemable shares.

The solvency statement must be made not more than 15 days before the passing of the resolution. The statement must either accompany a written resolution when it is circulated or be available at the meeting if the resolution is proposed at a meeting. Failure to do this does not invalidate the resolution, but it is an offence committed by the directors.

The solvency statement will be in prescribed terms requiring each of the directors to have formed an opinion that there are no grounds on which the company could then be found to be unable to pay or discharge its debts, and also:

- If it is intended to wind up the company within 12 months of that date, that the company will be able to pay or discharge its debts in full within 12 months of the commencement of the winding up; or
- In any other case, that the company will be able to pay or discharge its debts as they fall due during the year immediately following the date of the statement.

Making the statement without reasonable grounds for the opinions expressed therein is an offence. The statement does not require an auditors report like the declaration under the financial assistance whitewash procedure, although the directors may want a report from the accountants to support the reasonableness of their statement. If a director is unwilling or unable to sign the statement, removing him from the board on a temporary basis will not avoid the requirement. However, a genuine resignation by a director who does not agree with the proposal would be effective.

Within 15 days after the resolution is passed, the resolution and solvency statement must be filed with the registrar of companies together with:

- A statement of capital; and
- A statement by the directors confirming the statement of solvency was not made more than 15 days before the date the resolution was passed and was provided to the members in accordance with CA 2006.

The resolution for reducing capital does not take effect until a copy of the solvency statement and the statement of capital are registered.

Repeal of Financial Assistance Provisions

The prohibition on a company giving financial assistance for the purchase of its shares is to be abolished for private companies. Consequently, the whitewash procedure contained in sections 155 to 158 of CA 1985 will become redundant and will be repealed. This will be a mixed blessing, as the whitewash procedure provided a ‘safe harbour’ in effect, if properly followed. Lenders will now need to look more carefully at the fundamentals of the proposed financial assistance, and may want accountants to do more than sign off on solvency.

A public company will still be prohibited from giving financial assistance (subject to all the current exceptions, as well as a new exception that permits post-acquisition financial assistance if the company has become a private company by the time the assistance is given). Financial assistance given by a public company to acquire shares in its private holding company will also remain prohibited, as will financial assistance given by a private company subsidiary in relation to the acquisition of shares in its public company parent.

Company 'to do' list

- Prepare for a different approach from lenders who will still need to be satisfied as to the fundamentals of the proposed financial assistance

Other provisions coming into force on 1 October 2008

The following matters are also brought into force on 1 October 2008:

Objections to company names – now allowing objections on the basis that a name is the same as a name associated with the objector, or sufficiently close as to suggest an association with the objector.

Trading disclosures – allowing regulations to be made on the display of a company's name and other information.

Appointment of directors – requiring companies to have at least one natural person as a director, and requiring directors to be at least 16 years old.

Power of court to grant relief – where the court can relieve a director from liability for negligence, breach of duty or breach of trust, if he has acted honestly and reasonably.

For more details on the complaints procedure for objections to company names, our briefing note "Opportunistic Company Names" is available on our website."

For further information please contact Nicholas Narraway (nnarraway@fasken.co.uk) or June Paddock (jpaddock@fasken.co.uk), or your usual Fasken Martineau LLP contact.

FASKEN MARTINEAU LLP

17 Hanover Square
London
W1S 1HU
Tel: +44 (0)20 7917 8500
Fax: +44 (0)20 7917 8555
law@fasken.co.uk
www.fasken.co.uk

You can opt out of receiving our communications by e-mail at any time by simply sending an e-mail to unsubscribe@fasken.co.uk.

These notes are of general application and specific advice should be taken on particular situations. © Fasken Martineau 2007.

Fasken Martineau LLP is a limited liability partnership which is registered in England and Wales. A list of the members, all of whom are Solicitors or Registered Foreign Lawyers, may be inspected at the registered office. Any reference to a "partner" shall, subject to the context, be interpreted as referring to a member of Fasken Martineau LLP. Registered number: OC 309059. Registered Office: 17 Hanover Square, London W1S 1HU. Regulated by the Solicitors Regulation Authority.