



THE Far-Reaching Impact of the Companies Act 2006

As the annual holiday pilgrimage approaches, before you all leap in to your eco-friendly wigwam for the obligatory 10 days, please spare a thought for the Companies Act 2006



It is a gigantic piece of statute weighing in at a massive 700 pages. It is designed by the Government to simplify and collate company law with a view to encouraging business growth and development apparently - but as the biggest piece of legislation Parliament has ever passed, it will no doubt provide controversy and case law in abundance. It affects virtually every aspect of how a company is run, introducing wide-ranging reforms that will affect everyone from company secretaries and directors to bankers, lawyers, auditors and even shareholders. With the majority of the Act coming into force in October this year, how will it affect businesses and the individuals involved in running them? One thing is certain – it will be to your detriment if you ignore it! Below is a thumbnail sketch of some key points to mull over...

Impact on Directors

The Act consolidates seven key duties of directors which were previously established through case law. These briefly include:

- To act within their powers as set out by decisions of shareholders and company articles;
- To promote the success of the company and protect the interests of shareholders;
- To exercise independent judgement;
- To exercise reasonable care, skill and diligence to the standard expected by a reasonable person carrying out the duties of directors but bearing in mind any particular skills or expertise the individual may have;
- To avoid conflicts of interest between the director and the company, particularly in relation to the exploitation of information or opportunities arising from their role as a director;
- Not to accept benefits from third parties during and after his directorship which arise as a result of this role;
- To declare any interest in a proposed transaction with the company.

The idea of these provisions was to simplify and make these duties more understandable to individuals involved in them, although whether this will happen in practice remains to be seen.

In addition to the directors' duties, the other area which has been hotly debated is that of claims against directors made by the shareholders of the Company. Previously shareholders have only had limited rights to sue directors for wrongdoing. However, under the new Act all shareholders will be able to take legal action against directors for negligence, breach of duty or trust.

This obviously exposes directors to much greater personal liability in their roles and could even prevent people taking on the position of director for fear of repercussions. This seems in complete contradiction to the principles of promoting the development of business in the UK and so the Act does set a restriction on this power in that the shareholders will have to get the permission of the court to proceed with such a claim and such permission will only be given where the claim is brought in good faith and for the benefit of the company.

The exact impact of this provision and the willingness of the court to allow such action remains to be tested at this stage but suffice to say that at present it gives directors some scope to feel more exposed to personal claims against them.

Further changes which will affect directors include the change of the minimum age of directors to 16 and the removal of the restriction preventing people from continuing as directors after 70. Directors will also be able in the future to prevent their home addresses being disclosed on public registers and do not have to disclose their interest in company shares or debentures, although where such details have already been registered they will not be erased on historical documents. Sensible? Contradictory?

The Act has also relaxed the restriction relating to loan transactions between directors and companies so that the previous prohibition on loans has been replaced with a requirement for shareholder approval.

However, shareholder approval is required for the following transactions:

- Appointment of any service contract for more than 2 years (rather than the previous 5 year limitation);
- Any payment for loss of office;
- Substantial property transactions involving non-cash assets valued in excess of 10% of the company's net asset value.

In addition where documents previously executed on behalf of a company have required either the company seal or signature of two directors, execution by a single director in the presence of a witness will now be sufficient to bind a company – one may wonder how this will help temper the fraudsters?

Impact on Shareholders

The amendments in relation to shareholders aim to remove procedural obstacles and allow companies to operate more easily in the future. Shareholder meetings can be held more quickly with special resolutions

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requiring only 14 rather than 21 days notice (unless proposed at an AGM) and the rights of proxies have been improved to allow shareholders to be involved in decision making, even where they are unable to attend meetings in person. Furthermore, private companies will no longer be legally required to hold an AGM.

Again with a view to removing some of the red tape when it comes to shareholder procedure, the Act aims to encourage the use of written resolutions by providing that there will no longer be a requirement for unanimity for shareholders' written resolutions with a simple majority or 75% vote being sufficient depending on the nature of the resolutions. In addition members holding 5% of the voting rights (or less if specified in the Articles) will be able to require a written resolution to be circulated.

Other Key Changes

A private company will no longer have to have a company secretary.

The period for filing company accounts has been reduced from ten to nine months.

The requirement for authorised share capital has been removed so that there is no longer any restriction on the number of shares that can be issued unless such a restriction exists in the Company's articles.

The real impact of the Companies Act 2006 will inevitably take some time while companies and their lawyers test out the new provisions in practice and many companies will need to review their boardroom practices and articles of association in the light of these changes.

Speaking at a Confederation of British Industry (CBI) conference in London, Stephen Timms, the Competitiveness Minister stated that: “The new Companies Act is designed to help secure Britain's position as a place where business can prosper, by creating the right conditions for business success in a world economy characterised by fierce international competition.”

Whilst the removal of some of red tape involved in running a company seems to have been lifted, the increase in the possibility for legal action being taken against directors personally seems to have overshadowed all other provisions and until the first cases reach the courts the government seems to have run the risk of making the position of director seem less attractive which seems an unusual way to promote business to me.

Have a good summer break and if you do wake up worrying – feel free to email or call Giles Ward at www.milnerslaw.com or 0113 245 0852.