The Company Law Reform Bill: A Guide

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Introduction

This Guide is intended as an introduction to the major issues for listed companies and their UK subsidiaries arising from the Company Law Reform Bill.¹

Scope of the Bill

This “gargantuan Bill”² contains 885 clauses and has 15 schedules, and yet it will not contain the full body of UK company law. It is not a consolidating measure, but will have to be read alongside the Companies Act 1985.³

Its provisions will affect directors, shareholders, auditors and others involved in the administration of all kinds of companies. It establishes frameworks for the regulation of takeovers, and of actuaries.

The reforms put forward in the Bill have a variety of provenances, including:

– the Company Law Review commissioned by the Government in 1998 - this involved a variety of practitioners, business people and academics in a wide-ranging consideration of how existing company law could be improved upon,
– various Law Commission recommendations (the Law Commissions are independent bodies established by Parliament to keep the law under review and recommend reforms),

The key objectives of the Bill, as stated by the Government, have been almost universally welcomed. They are:

– enhancing shareholder engagement and a long-term investment culture,
– ensuring better regulation and a “think small first” approach,
– making it easier to set up and run a company,
– providing flexibility for the future.

But not every provision of the Bill meets these objectives. There are some provisions which create new uncertainties, or which may increase, rather than decrease, the burden of company administration. Some such provisions may be improved by changes to the drafting of the Bill; others raise more fundamental concerns.

Parliamentary process

The Bill is currently at the early stages of the Parliamentary process and is not likely to become law before late 2006. A considerable number of amendments

¹ This Guide was previously made available in two parts: Part One: Directors, auditors and shareholder relations, and Part Two: Company administration, share capital, capital maintenance, takeovers and company reform power. This document is a consolidated version of those two volumes.
² Lord Hodgson of Astley Abbots, Second Reading debate, Hansard Col. 188, 11 January 2006.
³ Although large parts of the Companies Act 1985 (the “1985 Act”) are being repealed, some parts are to be retained and amended by the provisions of the Bill.
have already been tabled by both the Government and the Opposition. We cannot therefore be certain that all its provisions as discussed in this Guide will survive as currently drafted. Most of the Bill is, however, uncontroversial and many of the proposed amendments are of a minor, technical or typographical nature.

The Bill was published in November 2005 and had its Second Reading (a high level debate on the Bill) in the House of Lords on 11 January 2006. The next stage in the Parliamentary process is consideration in Grand Committee, where detailed amendments will be considered, but no votes are taken. The Grand Committee stage began on 30 January and will continue for some weeks. The Bill will then move to the Report stage, and to the Third Reading (at which amendments can be made), before transferring to the House of Commons, where it will go through a similar process to that followed in the House of Lords.

Given the size and complexity of the Bill, this Guide does not purport to contain a comprehensive summary of the Bill’s provisions but merely to highlight issues of particular interest. This Guide is intended to give general information only, and should not be relied on as legal advice.
Directors and officers: their duties and liabilities

In this section, we examine the provisions of the Bill that will directly affect directors, shadow directors and auditors. These provisions focus on the duties and liabilities of such persons, and also revise the requirements relating to transactions between a company and its directors or their connected persons. We also consider the impact of the new derivative claims procedure, particularly in the light of the statutory statement of directors' duties.

General duties of directors

Introduction

Almost since the beginning of the law of companies, it has been clear that directors had a duty to act in the best interests of their company as a whole. Over time, this duty has been developed and expanded, but always in court, never in a way accessible to the thousands of directors who run small private companies.

Following one of the key recommendations of the Company Law Review, the Bill seeks to take the current state of the common law on directors’ duties and put it in statutory form, with the intention of making these duties clearer and more accessible (Clauses 154-170). However, effective codification of such a complex area of law is not easily achieved. In particular:

– it risks creating a more rigid and restrictive regime, compared with the ability of case law to apply and develop established principles in a way that distinguishes between different situations and circumstances,
– the Bill uses new wording to describe the existing duties, and it is not clear whether the courts will be able to interpret the new wording in the same way as the old principles that it replaces. Thus codification creates areas of uncertainty,
– the statement of duties does not cover all of the duties a director may owe to a company, for example the duty to consider the interests of creditors in times of threatened insolvency. To that extent, the objective of making the law more accessible to directors is not achieved, since it will still be necessary to refer to other statutory or common law duties apart from those set out in the Bill.

The Bill also seeks to enshrine the concept of “enlightened shareholder value” - in other words principles of corporate social responsibility - in the directors’ statutory duties, and for that reason, in particular, the statutory statement of duties is one of the Bill’s key policy objectives.

Relationship between the codified general duties and the common law

The statutory statement of directors’ duties is intended in general to be based on, and not to alter but to replace, common law and equitable principles. Yet, somewhat paradoxically, the Bill provides that “regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties” (Clause 154(4)). Thus, it will be necessary to refer to the existing historic body of case law to understand the new provisions. Quite
how this is supposed to work where the statutory codification and common
law/equitable rules and principles do not “correspond” is inevitably a matter of
uncertainty. There are, for example, differences between the existing law and
the codified duties in relation to:

– conflicts of interest, and
– the obligation to consider the success of the company and its shareholders
  alongside factors such as the impact of the company’s operations on the
  environment, the community and relations with other stakeholders.

The statutory statement of directors’ duties
The seven duties of directors as stated in the Bill are described below, followed
by a discussion of the consequences of breaches of duty.

Duty to act within powers
A director must exercise powers in accordance with the company’s
constitution and for the purposes for which they were conferred (Clause
155). This is an expression of the existing principle that a director must exercise
his powers in accordance with the terms on which they were granted, and for a
proper purpose. The words “proper purpose” could imply an overriding standard
that is lacking in the phrase “the purposes for which they were conferred”. The
latter expression suffers from the difficulty that these purposes may not be clear
in every case.

Promoting success of company and stakeholder considerations
A director must act in good faith in the way the director considers to be
most likely to promote the success of the company for the benefit of its
members as a whole (Clause 156(1)). The phrase “success of the company for
the benefit of its members” replaces the usual common law formulation “best
interests of the company”. Some concerns have been raised as to the meaning
of “success” in this context, and as to whether the word has a different meaning
from “best interests of the company”, for example, in the case of a Board
considering whether to recommend a takeover offer. The Government has
stated that “success” will normally mean (for commercial companies) “long-term
increase in value”.

The enlightened shareholder value concept is enshrined within this duty by
Clause 156(3) which provides that in fulfilling the duty to promote the
success of the company, a director must have regard (so far as
reasonably practicable) to the following factors:

– the likely consequences of any decision in the long term,
– the interests of the company’s employees (this corresponds to the
  existing section 309 of the 1985 Act),
– the need to foster the company’s business relationships with
  suppliers, customers and others.

4 Lord Sainsbury of Turville, Second Reading debate, Hansard Col. 245, 11
  January 2006.
– the impact of the company’s operations on the community and the environment,
– the desirability of the company maintaining a reputation for high standards of business conduct, and
– the need to act fairly as between members of the company.

As formulated, Clause 156(3) seems to go beyond a codification of the existing law. It grafts onto a duty that has historically been subjective (i.e. the director's perception of his actions is paramount) an objective standard by which the discharge of his duty needs to be measured. This risks undermining the principle that the courts will not seek to overturn directors’ good faith business decisions.

There is no guidance in the Bill on exactly what is required to fulfil the obligation “to have regard so far as reasonably practicable” to the specified factors, and indeed it is difficult to see how there could be. The wording thus creates a real difficulty for directors in judging how far they need to go to meet this obligation, how the interests of members are to be balanced against those of other stakeholders, and even how competing interests of different stakeholders are to be balanced against one another. For example, a company wishes to purchase its raw materials from environmentally sustainable sources, but these are more expensive than those that are not from environmentally sustainable sources. Must it pay more, and if so how much more? Ultimately it would be for the courts to decide whether the directors have appropriately fulfilled their duty, but how can they do so without second-guessing the directors’ business decisions?

A further consequence of Clause 156, as drafted, is that by identifying certain factors which directors must take into account, the burden of proof is imposed upon directors to establish that they have duly considered the factors, or that they were irrelevant. To quote the DTI: “it will not be sufficient to pay lip service to the factors. In many cases [the directors] will need to take action to comply with this aspect of the duty”. 5 This would suggest that merely reciting in Board minutes that the directors have considered the factors is not, in itself, going to suffice. Directors will need to consider not only monitoring the basis for their deliberations, decisions and actions, but also establishing appropriate processes where they have delegated their powers. They will need to consider the terms of any delegation, such as its scope, reporting obligations and provisions for monitoring.

**Duty of independent judgment**

A director must exercise independent judgment (Clause 157). Directors may not fetter future exercise of their discretion nor delegate unless authorised to do so by the company's constitution or an agreement duly entered into by the company.

**Duty to exercise reasonable care, skill and diligence**

This duty (Clause 158) sets a minimum standard required by law of all directors, which is increased should the director possess a higher standard of general knowledge, skill or experience. The director owes a duty to his company to

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5 Explanatory Notes to Company Law Reform Bill, para 327.
exercise the same standard of care, skill and diligence that would be exercised by a reasonably diligent person with:

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as the director in relation to that company (an objective test), and

(b) the general knowledge, skill and experience that the director actually has (a subjective test).

This provision follows recent case law in adopting the twofold objective/subjective duty found in Section 214 of the Insolvency Act 1986. However, the application of a test seen as appropriate in the insolvency context, and in the particular contexts from which recent case law has emerged, may cause some concerns where applied generally for all situations and all types of companies. Smaller companies in particular, including those that are not established for purely commercial reasons, may find that this standard is unduly onerous for some of their directors. Non-executive directors will need to consider themselves as bringing all their own skills and knowledge to the Board, at the same time as being judged by the same objective standard as the executive directors.

Third party benefits

A director must not accept benefits from third parties (Clause 160). Acceptance of such a benefit is only permitted if authorised by members or if it “cannot reasonably be regarded as likely to give rise to a conflict of interest”. It may be hard in practice to determine whether the reasonable likelihood test is met, and, in the absence of any de minimis threshold, existing practices, such as corporate hospitality, may be called into question.

Duty to avoid conflicts of interest

(Clause 159) (see below).

Duty to declare interests in proposed transactions with the company

(Clause 161) (see below).

The final two duties are discussed below in the context of conflicts of interest generally.

Conflicts of interest

The one area in which the Government intended to make a substantive change to the existing law on directors’ duties is in relation to conflicts of interest. The intended change is to liberalise the law on conflicts by permitting independent directors to authorise another director’s conflict. However, the basic duty to avoid conflicts, as written, is a strict statement of the law that may create issues, in particular, for individuals with multiple directorships.

The Bill distinguishes between three different situations in which directors have potential or actual conflicts of interest (in addition to the duty not to accept benefits from third parties, discussed above). These are:
– conflicts with the interests of the company in relation to transactions/arrangements to which the company is not a party - for example the exploitation of an opportunity, whether or not the company could have taken advantage of it,

– conflicts in relation to proposed transactions/arrangements to which the company will be party; and

– conflicts in relation to existing transactions/arrangements to which the company is party.

Each of these types of conflict is dealt with in a different way, as described below.

**Interests in transactions/arrangements to which the company is not a party**

As the sixth codified duty, directors must avoid “a situation in which they have, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company” (Clause 159).

Such situations might arise in relation to the exploitation of property, information, opportunities or transactions in which the company is indirectly interested.

The unconflicted directors of a company may authorise such conflicts provided that, in the case of a public company, they are permitted to do so by the constitution and, in the case of a private company, they are not prohibited from doing so by the constitution. It is not clear whether the Board can authorise potential conflicts arising out of, say, a directorship of another company, in general terms, or whether each particular matter giving rise to a potential conflict would need specific authorisation. Because of the new duty to declare the extent of a director’s interests (see below), a cautious approach to this issue seems desirable until judicial guidance is available.

Where Board authorisation is not permitted by the constitution, conflicts may only be able to be authorised by the members. Conflicts can no longer be authorised by blanket provisions in the Articles, such as commonly exist in companies’ Articles at the moment. Such provisions typically allow directors at least to be a director or employee of a different company, and to be party to a transaction, in which the company is interested (provided such interest is disclosed).

**Interests in proposed matters to which the company will be a party**

If a director has any direct or indirect interest in any proposed transaction or arrangement with the company, he will have a duty to declare both the nature and the extent of that interest to the other directors (Clause 161). This is the seventh and final codified duty.

Unlike under Section 317 of the 1985 Act, a director is not obliged to declare his interest at the meeting at which entering into the transaction is first considered but only before it is entered into by the company. Of course, a company’s Articles may provide for a stricter approach.
Directors are required to update declarations of interests in proposed transactions or arrangements that become inaccurate or incomplete before the company enters into the transaction or arrangement. No materiality threshold applies when considering what constitutes inaccuracy or incompleteness. A small change in a director’s shareholding in a company specified in a general notice of declaration will trigger the obligation to update.

**Interests in existing matters to which the company is a party**

Bizarrely, a parallel duty to declare the nature and extent of interests in transactions/arrangements already entered into by the company is imposed by the Act, but not identified as one of the codified duties. Instead, directors will commit a criminal offence (Clause 165) if they:

- fail to declare a direct or indirect interest in an existing transaction or arrangement with the company to the other directors (except if it was already declared before the transaction was entered into by the company),
- fail to update a declaration of interest in an existing transaction or arrangement with the company that becomes inaccurate or incomplete (regardless of whether the initial declaration was made before or after the transaction or arrangement was entered into by the company and whether the inaccuracy or incompleteness is material),
- fail to comply with the requirements as to form and content of their declarations or updates in existing transactions or arrangements, including the requirement to make such declarations or updates “as soon as reasonably practicable”.

As under existing Section 317 of the 1985 Act (which is to be repealed by the Bill), failure to declare an interest is an offence punishable by a fine. However, the new offence under the Bill is broader in that:

- it applies more generally, to transactions and arrangements, **whether or not legally binding**,  
- it requires the **extent** of interests to be declared,  
- declarations must be **updated**.

**Scope of interests to be declared**

Interests to be declared, whether in relation to proposed or existing transactions, may include those of “connected” persons. Directors are not required to make or update a declaration of interest if they are not aware of the interest or transaction in question. However, directors are presumed to be aware of matters of which they “ought reasonably” to have been aware. In other words, a director might breach his duty or commit an offence where, although not in fact aware of an interest, he would be expected to be aware of it. It is not clear how far a director’s due diligence should extend in this respect.

There is also no obligation to declare an interest if, or to the extent that, the non-conflicted directors are already aware (or ought reasonably to have been aware) of the interest.
Situations not giving rise to likelihood of conflict
In each case, the new conflict of interest provisions do not apply to situations which “cannot reasonably be regarded as likely to give rise to a conflict of interest”. This exclusion may need to be relied upon in many situations where there is a theoretical possibility of interests conflicting. It provides little comfort, however, since it may be difficult in practice to determine when this exclusion can be relied on.

Impact of the conflict of interest provisions
The new conflict of interest provisions create a rather complex regime to address what is, admittedly, currently a somewhat difficult area of law. It seems odd that there should be a duty to the company to declare interests in a proposed transaction - but no criminal liability - whereas in relation to existing transactions, where an interest arises, failure to declare it is a criminal offence.

The general approach under the current law, where a director has a potential conflict of interest, is to treat him as debarred from attending directors’ meetings or voting on the matter in question (save where the Articles specifically allow otherwise). The Bill does not recognise this as a solution to conflicts. The other directors will have to approve each potential conflict and this could make it more difficult for directors to hold multiple positions - for example, as non-executive director. Nominee directors may also be in a more difficult position than at present. It would help if the Bill made clear that it was possible for directors or members to give general authorisations of potential conflicts of interest, in the same way as general notices may be given (under Clause 168) to satisfy the obligation to declare interests in existing or proposed transactions and arrangements with the company.

Consequences of breach of duty
To whom are duties owed?
The Bill does not impinge upon the important principle that the duties of directors are normally owed to the company. The Government has specifically stated that it does not favour the so-called “pluralist” approach - i.e. the idea that directors should owe duties to stakeholders apart from shareholders.

The Bill also does not attempt to codify the circumstances in which duties to consider or act in the interests of creditors arise. However, the duty to promote the success of the company is expressly subject to any other enactment or rule of law establishing such duties in relation to creditors - for example, duties under the Insolvency Act 1986 (Clause 156(4)).

Remedies
A significant omission from the Bill is any attempt to codify the remedies for breach of the statutory duties. It is merely stated that the consequence of a breach will be “the same as would apply if the corresponding common law rule or equitable principle applied” (Clause 162). The new statutory duties, with the exception of the duty to exercise reasonable care, skill and diligence, are said to be enforceable in the same way as fiduciary duties. A breach of a fiduciary duty gives rise to a range of potential remedies, including damages, restitution of property, and accounting for profits made, as well as injunctive and declaratory
relief. By contrast, the remedy for a breach of the duty of care and skill would be one of damages.

Apart from doing little to enlighten the ordinary director as to the consequences of any breach of general duties, the Bill leaves open to doubt the effect of new or newly formulated duties, including that in Clause 156(3) to have regard to the external "enlightened shareholder" factors. Although the possibility of obtaining an injunction is not necessarily excluded by absence of loss, it is not easy to see what the appropriate remedy would be for a past breach of this duty - for example, the duty to have regard to the community - given that the duty is owed to the company (and not to other stakeholders), unless the company had demonstrably suffered a loss as a result of the breach. The clause might, therefore, appear relatively toothless, were it not for the potential for litigation under the new derivative claims procedure described below.

**Ratification of directors’ breaches**

The Bill partially codifies the existing law on ratification of acts of directors, with one significant change (Clause 216). Breaches of duty or trust, or acts of negligence or default, can (as at present) be ratified by a resolution of members. However, the Bill requires that the votes of any member who has a “personal interest, direct or indirect” in the ratification must be disregarded if they are cast in favour of the resolution.6 “Personal interest” is not defined for these purposes, and there is no threshold below which any interest may be disregarded. This may mean that in many cases it will be difficult to ratify any actions of the directors under this provision. In particular, widely held companies will find it difficult to ascertain whether members have personal interests in a particular matter or not.

The common law principle that all the members of the company, unanimously and whether or not by a formal vote, may ratify directors’ actions is unaffected, but will be of little use to widely held companies. It will, however, be valuable in the context of wholly-owned subsidiaries and closely held private companies.

**Derivative claims**

The Bill introduces a new derivative claims procedure (Clauses 239-246) which potentially adds a significant level of litigation risk for directors. Although the procedure contains in-built safeguards (to halt for example, actions that would not be pursued by someone acting in good faith to promote the success of the company in accordance with the duty in Clause 156, or which has been authorised or ratified by the company in general meeting), these safeguards may not be sufficient to prevent litigation against public companies. Although such litigation may not ultimately be successful, it could nevertheless be potentially highly damaging to the company.

The introduction of a new statutory procedure was originally recommended by the Law Commission in 1997 in order to clarify the basis on which shareholders can bring claims against directors under exceptions to the general principle (the rule in *Foss v Harbottle*) that only the company itself (not individual members)
may pursue a claim that is properly a claim of the company. The procedure was conceived as likely to displace a number of cases currently brought under Section 459 of the 1985 Act, and the Law Commission did not believe it was likely to result in large numbers of additional claims. However, at that stage, the new statutory statement of directors’ duties had not been developed. Moreover, some of the common law limits that currently apply to derivative claims are not reproduced in the Bill, most notably the requirement that the alleged wrong amounts to fraud. Indeed, the Bill makes it clear that for the first time a derivative action for mere negligence will be possible.

Given the context in which this procedure is now placed - alongside the statutory statement of directors’ duties - there is much concern that the safeguards to protect the company and its directors against unwarranted or inappropriate claims may not be sufficient. In particular:

– the procedure allows a claim to be brought by any member (even if they were not a member at the time the actions complained of took place),
– there is no need for a particular number of members, nor a percentage threshold of shareholding, to launch a claim. This would make it easy for aggrieved stakeholders or campaigners to purchase a single share and launch an action,
– claims may be brought in respect of any actual or proposed act or omission involving negligence, default, breach of duty or breach of trust on the part of a director,
– there is no need to demonstrate any actual loss suffered by the company, or any benefit gained by the directors, before commencing a claim,
– claims may be brought against both directors and other persons - the latter might, for example, include counterparties to a transaction which is alleged to involve, or result from, the negligence or breach of duty of the directors,
– although a claim may only be pursued with the permission of the court, the court may not be able to conclude that the claim should not be allowed without a substantive consideration of the issues. The test the court has to consider is an objective one and there appears to be no scope to rely, as a defence, solely on the good faith business judgment of directors,
– until the operation of Clause 156(3) is better understood, judges may be reluctant to refuse to grant permission to continue derivative claims based on its breach,
– elimination of the risk of litigation by ensuring that actions are authorised or ratified by shareholders will rarely be practical for listed companies.

It is to be hoped that the courts will be robust in refusing permission for claims by pressure groups or others seeking to gain publicity or impose their views on the company. Unless and until this becomes the established practice of the courts, companies will be exposed to claims which will at least require a defence at the hearing for permission to pursue the claim. While it would be an abuse of the court process for a shareholder to seek to pursue a claim for his own personal benefit, it may be difficult to prove that such an individual is pursuing his own interests rather than acting for the benefit of the company.
Decisions taken by the courts in relation to the awarding of costs will also have an important bearing on the likelihood of litigation. It is worth bearing in mind that the court has in the past been willing to order a defendant company to pay the costs of even an unsuccessful derivative claimant, provided that it was reasonable for the shareholder(s) to bring the claim.\(^7\)

**Impact**

Combined with the expansion of the scope of directors’ duties, the derivative claims procedure creates a real danger for UK companies, and some may conclude that the UK is no longer an attractive location for business, particularly for publicly quoted companies. This could lead businesses to consider migrating to jurisdictions where the duties of directors are less onerous and the risk of litigation more limited. Even in the United States, states such as Delaware apply the “business judgment” rule - whereby the decisions of a director who has acted in good faith and with due care cannot be called into question by the court. Such jurisdictions will be seen as more business-friendly in this respect than the UK.

**Other influences on directors’ liability**

One of the dogs that has failed to bark in this Bill is limitation of directors’ liability. This was a topic consulted upon as part of the March 2005 White Paper on Company Law Reform. However, the Government made clear that they were only likely to bring forward reform if they were satisfied that the liability position was damaging companies’ ability to recruit directors. Apparently, the Government has not had sufficient evidence of this to justify a change in the law. The Government’s position on this contrasts with some independent studies and anecdotal evidence, and great concern was expressed on this issue in the debate on the Bill’s second reading in the House of Lords.

Those companies which have not already taken advantage of the wider powers to indemnify their directors introduced by the Companies (Audit, Investigations and Community Enterprise) Act 2004 may wish to consider doing so. These provisions, which are restated without substantive amendment in the Bill, allow indemnities, or the purchase of insurance, in relation to liabilities incurred by a director to third parties - i.e. persons other than the company or an associated company. Since the company will be the beneficiary of any claim brought under the derivative claims procedure, directors will not be able to be protected by their companies against successful derivative claims. Companies will be able, as at present, to make loans to a director (without shareholder approval), in defending claims in respect of any alleged negligence, default, breach of duty, or breach of trust in relation to the company (this would include derivative claims), but only on the basis that any such loan is repaid if judgment is given against the director.

Fears of a growing liability climate for directors have, to some extent, been eased by the settlement of Equitable Life’s litigation against some of its former directors. In addition, the Government’s U-turn on the introduction of the Operating and Financial Review has, for the moment, removed the risk for directors of being obliged to publish forward-looking information in order to

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\(^7\) This principle was first expressed by Lord Denning MR in *Wallersteiner v Moir* (No. 2) [1975] QB 373 but remains current: *Jones v Jones* [2003] BCC 226, 229.
satisfy the requirement for OFRs. Government statements suggest, however, that there may still be some move to see more forward-looking information. Meanwhile, the International Accounting Standards Board is consulting on whether to introduce an OFR-like reporting standard.

The Transparency Directive, due to be implemented in January 2007, will introduce a requirement for directors to give a responsibility statement in relation to annual and half-yearly reports. This too could reopen concerns regarding director liability. Implementation of this Directive is due to be consulted on later this year by the FSA, but any protections for directors against an extension of liability on accounts would have to be contained in primary legislation (or introduced under the new company reform procedure proposed by the Bill itself).
Transactions between a company and directors

The Bill restates the provisions of the 1985 Act dealing with transactions between directors and companies. These are complex provisions which have always been difficult to follow, and the Bill only succeeds in making them slightly clearer. They fall into four categories:

– substantial property transactions,
– loans, quasi-loans and credit transactions,
– payments for loss of office,
– long-term service contracts.

Each of these is considered in more detail below. Generally, there are some substantive changes, including a consistent theme that these transactions can be entered into with the approval of an ordinary resolution of members (unless the company’s constitution imposes a higher standard). In addition, where a company enters into a transaction with a director of its holding company, approval is required by members of both the company and the holding company.

The Bill removes the criminal sanctions associated with some of these offences. In some respects, however, the rules are made more, rather than less, onerous: in particular, the scope of the loans and quasi-loans provisions is extended to all companies, not just public companies or subsidiaries of public companies.

Substantial property transactions

These provisions (Clauses 173-179) apply to arrangements under which a director of a company or of its holding company, or a person connected with such a director, acquires from the company (directly or indirectly) a “substantial non-cash asset” (for example, the purchase of a company flat). They also apply to acquisitions from such a person of a substantial non-cash asset by the company. Such arrangements must not be entered into without approval by a resolution of the members of the company.

The existing regime is somewhat relaxed by the provisions of the Bill, in that:

– an arrangement may be entered into conditional upon shareholder approval,
– anything to which a director is entitled under his service contract is excluded,
– transactions with administrators are exempt,
– the de minimis threshold is raised from £2,000 to £5,000 (if more than 10 per cent of the company’s asset value - for larger companies the current £100,000 threshold remains).

The exemption for matters provided under a service contract is particularly welcome and will give companies considerable latitude. For example, present concerns that Section 320 of the 1985 Act catches the provision of accommodation to directors would fall away where it was provided for in the service contract. On the other hand, shareholders may therefore wish to
scrutinise directors’ service contracts more carefully. Payments for loss of office, however, are covered separately, as described below.

**Loans, quasi-loans, credit transactions and related transactions**

The current provisions (Sections 330-342 of the 1985 Act) prohibit loans, quasi-loans, credit transactions and certain related transactions with directors. These are incapable of approval by shareholders and contravention is a criminal offence. Further, some rules apply to all companies and others only to a public company or a group with a public company in it. Some of the prohibitions extend to persons connected with the director and others do not. Unsurprisingly, these provisions have presented a maze for directors to navigate. It is very likely that many companies unwittingly breach the rules.

The Bill introduces a lighter and more consistent regime (Clauses 180-194). Gone are the criminal penalties. The ambit of each prohibition is now broadly similar. Significantly, it is now possible for shareholders to approve such arrangements and the numerous existing exemptions remain. The financial limits that apply to some of these exemptions have in most cases increased, so as to allow:

- loans and quasi-loans to an aggregate value of £10,000 (£5,000 under the current law),
- credit transactions to a value of £15,000 (£10,000 under the current law),
- ordinary course lending by banks and similar institutions on normal terms (the current £100,000 limit is abolished).

Where it is not possible to value a transaction, it is deemed to exceed £50,000 - this is lower than the current £100,000 deemed value for such transactions.

However, the more lenient approach generally has come at the price of the prohibitions being extended to all companies and in all cases to persons connected with directors. One opportunity missed is that the innovation in the context of substantial property transactions of permitting arrangements conditional upon members’ approval has not been introduced here.

**Payments for loss of office**

The existing provisions on payments for loss of office are complex and, in a number of respects, inconsistent and ambiguous. The Bill simplifies and rationalises these provisions, but potentially prohibits more payments than the existing law.

The new provisions include a comprehensive definition of payments for loss of office (Clause 195). Broadly, this covers:

- payments on dismissal, redundancy or retirement in respect of a director’s loss of office or employment,
- payments connected with loss of office on a sale of a business of the company,
- payments connected with loss of office on a transfer of shares in the company as a result of a “takeover bid” (undefined).
The provisions are extended to capture payments both to connected persons and to past directors, and the new definition places it beyond doubt that a payment to an executive director in his capacity as an employee is caught. However, there are helpful new exceptions for:

- payments made in discharging an existing legal obligation (including the provisions of a pre-existing service contract),
- payments in settlement of a claim arising in connection with the termination of a person’s office or employment,
- small payments (totalling less than £200).

Each type of payment may now be made if it has been approved by a resolution of the company’s shareholders. In addition, the civil consequences of breach are clarified and conflicts between different potential remedies for the same breach are resolved.

**Directors’ service contracts**

The Bill provides a new, wider definition of directors’ “service contracts” together with greater rights for shareholders to scrutinise them at their leisure (Clauses 205-206). The provisions will promote fuller transparency of directors' remuneration and benefits.

The new definition covers not only the typical service contract between a director and the company but also letters of appointment and contracts for services (i.e. consultancies). It also applies where a personal services company contracts to supply the services of a director. Furthermore, there is no territorial restriction so as to exclude contracts to work wholly or mainly outside the UK. There is also no exclusion (as there is at present) from the disclosure regime for service contracts which expire or can be terminated within 12 months.

In addition to the existing obligation to make service contracts available for inspection by members:

- members will be entitled on request, and on payment of a prescribed fee (to be set out in regulations), to be provided with a copy of any director’s “service contract” (or a written memorandum setting out its terms if not in writing),
- the copies and memoranda of terms must be retained for at least one year after cessation of the contract and must remain available for inspection during that time.

Contravention will be a criminal offence for which officers of the company will be liable to a fine. In addition, the court may by order compel an immediate inspection or direct that the copy requested be sent to the person requesting it.

The provisions prohibiting directors’ service contracts with a period of more than five years have been restated without substantive amendment. The existing prohibition on tax-free payments to directors is to be repealed.
Disclosure of interests in shares and debentures

The obligations under Section 324 of the 1985 Act regarding disclosure of directors’ interests in shares or debentures are to be repealed. Directors of companies traded on a regulated market, and their connected persons, will continue to have to disclose dealings under the FSA’s Disclosure Rules.

Definition of connected persons

As well as extending the scope of the directors’ transaction rules to apply consistently in relation to directors’ “connected persons”, the Bill extends the definition of “connected persons” (Clauses 231-234). The extended definition will catch (in addition to the director’s spouse and children or step-children under 18, who are connected persons under the current law) the director’s parents, his children and step-children over 18, a person with whom the director lives as partner in an “enduring family relationship”, and children or step-children of the director’s unmarried partner if they are under 18 and live with the director. The Law Commission’s proposal to extend the definition further to include the director’s siblings has not been taken up.
Other provisions on directors

Directors’ home addresses

The procedure for directors to apply to keep their home address off the public register held by the Registrar of Companies is greatly simplified by the Bill. Instead of needing to establish a serious risk of violence or intimidation (with police certification), individuals will be able, on payment of a fee, to obtain a non-disclosure certificate from the Registrar of Companies. The company will then be able to make public filings with simply a service address for the individual, together with a unique identifier number and a statement of the country and state, or part of the UK, in which the director is resident. There will be no expiry date set for non-disclosure certificates, thereby removing the current need for renewal of confidentiality orders every five years.

Company secretaries will be allowed, without needing a non-disclosure certificate, to give a business address rather than a home address.

The flaw in the non-disclosure procedure is that, as now, there is no obligation on the Registrar of Companies to cleanse the historic record, so, unless they move house, directors whose home address has once appeared in the register will still be exposed. We can expect much lobbying on this point in the months ahead: it seems illogical not to deal with this issue properly once the principle of confidential home addresses has been accepted. However, Companies House argues that removal of historic material from the public record is impracticable.

Age restrictions

In line with the general policy against age discrimination, the Bill removes restrictions on directors over 70 by repealing Section 293 of the 1985 Act. (This section, which applies to public companies and their subsidiaries, requires the appointment of a director over the age of 70 to be approved by the company in general meeting, with special notice.) Articles of Association will need to be checked for the inclusion of provisions reflecting the existing statutory age limit.

There is, however, a new minimum age requirement for a director of 16 (subject to the power of the Secretary of State to prescribe exceptions). Those under the age of 16 will automatically cease to be directors once the new provisions come into force (Clause 143).

Disclosure

The Bill makes a number of changes to the disclosures required to be made in a company’s register of directors. Particulars of a director’s other directorships will no longer need to be recorded. Other changes include (Clauses 147-148):

- under the provisions requiring former names to be disclosed, it is only necessary to disclose names by which the person was known for business purposes and there is no longer an exception for a married woman’s former name,
- in addition to filing its corporate name and registered or principal office, a corporate director will need to disclose the register where it is registered and
its registration number. Corporate directors that are non-EEA companies will also need to disclose particulars of legal form and the law by which the company is governed.

**Natural persons**

The minimum number of directors for public and private companies of two and one, respectively, remains unchanged but the Bill introduces a requirement for all companies to have at least one director who is a natural person (Clause 139). Although the Government stopped short of an outright ban, this will have repercussions for many companies, especially in the banking sector. Corporate groups should review their structures and appoint natural directors where necessary in order to comply with Clause 139.
Auditors and their liability

The most significant change in the Bill so far as auditors are concerned - the ability to limit liability - has been negotiated by the profession with the Government to meet concerns that auditors’ unlimited liability reduces competition in the profession and risks the demise of another major firm. Codification of the leading case on auditor liability, Caparo v Dickman, has not been included in the Bill.

Other changes include provisions to improve audit quality and transparency - part of the price of allowing limitation of liability. The Bill also makes a number of consequential changes to the rules governing the appointment of auditors arising from the abolition of the requirement for private companies to hold an AGM, and new provisions dealing with the implementation of the forthcoming EU Statutory Audit Directive.

Limitation of liability

Clauses 518-523 allow public and private companies, with shareholders’ approval, to agree to limit the liability of their auditors to an amount specified in a liability limitation agreement (an “LLA”). The key features of this important new development are as follows:

- no limitation in any LLA can reduce the auditors’ liability to less than such an amount as is fair and reasonable in all circumstances, having regard to the auditors’ responsibilities, their contractual obligations and the professional standards expected of them,
- approval of an LLA may be secured either before or after the company enters into the agreement with the auditor (private companies may alternatively resolve to waive the need for approval),
- an LLA with the auditors must be disclosed in the annual accounts or directors’ report, as required by regulations to be produced in due course,
- an LLA is only effective in relation to the audit for one financial year,
- the company’s shareholders have the right, by ordinary resolution, to terminate an LLA in respect of any act or omission subsequent to the date set by the resolution.

The accounting profession is understandably delighted by the inclusion in the Bill of provisions to limit their liability, so relaxing the longstanding and strict prohibition in Section 310 of the 1985 Act. However, there is concern that the provisions as drafted fail to deliver the ultimate prize of “proportionate liability”, which is what the profession had thought had been accepted in principle. This provision is therefore likely to be the subject of fierce negotiation as the Bill proceeds through Parliament.

Audit accountability and transparency

The Bill’s concession to the auditing profession in allowing the limitation of liability comes at the price of a number of other measures, some of which will be of concern to the individuals carrying out the audit, while others will require action by companies themselves. In summary:
**Offences**: There are two new criminal offences for auditors (Clause 494), where they:

- knowingly or recklessly cause an audit report to include “any matter that is misleading, false or deceptive in a material particular”, or
- knowingly or recklessly cause a report to omit a statement that is required under certain sections of the Bill.

Each such offence is punishable by a fine - the sanctions originally proposed included imprisonment, but this was dropped from the Bill following consultation. The offence can be committed by a director, member, employee or agent of an audit firm, if such person is an accountant who would be qualified to act as auditor of the company in his own name. There are concerns that the introduction of these offences will encourage excessive caution amongst auditors and thereby increase audit costs.

Moreover, auditors may feel compelled to qualify audit opinions more frequently – for example, the absence of one invoice from a file could be taken to indicate that the company did not keep “proper accounting records”. This could result in a qualified audit opinion since there is no materiality element to the requirement to keep proper records.

**Signature of senior auditor**: Where the auditor is a firm, the auditors’ report will need to be signed by the “senior statutory auditor”. This anticipates a new requirement that will be introduced as a result of the new EU Statutory Audit Directive. The senior statutory auditor will be identified according to standards issued by the European Commission pursuant to that Directive or, in the absence of these, by guidance issued by the Secretary of State (Clause 491).

**Right for shareholders to raise issues**: Shareholders of a quoted company may require the company to publish a statement on its website on any matter which they intend to raise at the meeting relating to (i) the audit of the accounts to be laid at the next meeting or (ii) any circumstances connected with the auditor’s ceasing to hold office (Clause 512). Such a requisition may be made by members representing not less than 5 per cent of total voting rights or 100 members who hold shares on which there has been paid up an average sum per member of not less than £100.

**Disclosure of engagement terms**: There is a new power for the Secretary of State to publish regulations requiring a company to disclose information about the terms on which the auditor is appointed, remunerated or performs its duties and any change in those terms (Clause 480).

**Statements on resignation**: There are changes to the rules governing the making of statements by auditors when they leave office. Under Section 394 of the 1985 Act, a departing auditor was only required to make a statement if there were circumstances which should be brought to the attention of the members or creditors. By contrast, a departing auditor will in future always be required to make a statement. For quoted companies, the statement should explain the circumstances surrounding their departure. For other public and all private companies, it should explain the circumstances unless the auditors think that
there is no need for them to be brought to the attention of shareholders or creditors (Clause 506).

**Private company auditors**

The appointment and reappointment of auditors of private companies has been simplified in light of the fact that private companies will no longer be required to hold an AGM, although special notice and a meeting will still be required for a private company to dismiss an auditor before the end of its term of office.
Shareholder relations

In this section we focus on the changes that will affect relations between listed companies and their investors, including electronic communications, meetings and disclosure.

First, some definitions. The Bill contains specific provisions for communications by “traded” companies - that is, companies with securities traded on a regulated market either in the UK or elsewhere in the EEA.

On the other hand, certain of the provisions apply only to “quoted” companies, meaning companies officially listed in the UK, elsewhere in the EEA or on the NYSE or NASDAQ.

Companies admitted to official listing and traded on the London Stock Exchange fall within both these categories. Companies quoted only on AIM do not fall within either category.

Communicating with shareholders and other stakeholders

Electronic communications

The last 10 years have seen considerable developments in electronic communications law. The 1985 Act was extensively amended in 2000 by the Companies (Electronic Communications) Order 2000, and the principles underpinning these changes are largely reflected in the Bill’s provisions on electronic communication by companies (Clauses 749-755 and Schedules 6-7). These provide the next step in the modernisation process, anticipating certain imminent changes due to UK implementation of the EU Transparency Directive, and are a further attempt on the part of the Government to help companies to increase their efficiency and lower costs by reducing their use of paper.

The most significant change involves those provisions relating to the use of website publication for communication with the company’s members: members will be required to “opt out” of this form of communication rather than to “opt in” to it, as at present. This should significantly increase the volume of shareholder communications in electronic form, in comparison with the current position. Shareholder approval is required for both bilateral electronic communication between the company and the shareholder, and for website communication, reflecting the authorisation required under the Transparency Directive. The provisions are also drafted generally, rather than (as at present) by reference to specific communications (annual reports, notices of meeting and proxy appointments): this will make the process more accessible than the current piecemeal approach.

– Use of the website by a traded company: a shareholders’ resolution can authorise a company to communicate with shareholders by posting documents on its website. Companies may cease sending hard copies to shareholders who either specifically agree or fail to respond within 28 days to a request to do so. The request must clearly state that failure to respond will be deemed consent to communication of documents through
the website. Companies must notify shareholders who have consented (or deemed to consent) to website communications when new documents (which would otherwise be sent to them) are published on the website. Such notifications will still need to be sent in hard copy (except where the shareholder has elected for email or fax communication), limiting the cost savings that companies will achieve.

A similar regime will apply for communication via the website with holders of debt securities and other debentures, subject to authorisation by pari passu holders of the relevant class(es) of securities.

- **Documents sent or supplied by a traded company**: companies will be required to pass a shareholders’ resolution authorising the company to send communications in electronic form (for example, by email) to shareholders. In addition to general authorisation, consent for communications in this way must be given by individual shareholders. The recipient may specify how the identity of the sender or supplier must be confirmed - companies will need to consider whether this requirement is consistent with the email systems they use.

- **Non-traded companies**: very similar provisions apply, save that, in the case of website communication, appropriate provision in the company’s Articles removes the need for a shareholders’ resolution. The 28-day deemed consent mechanism operates in the same way as for traded companies.

- **Sending or supplying documents to a company**: electronic communication with the company will also be possible, subject to the company agreeing (or being deemed to have agreed) to this method of communication. The company may specify how the identity of the sender or supplier must be confirmed. Such communication can only be sent to an address specified by the company (or deemed to have been specified). This means of communication is available not only for shareholders and debenture holders, but also for other stakeholders such as customers and suppliers.

**Voting**

**Enhanced proxy rights**

The Bill gives enhanced statutory rights to proxies, extending the right to vote on a show of hands to every proxy present at a shareholders’ meeting who has been properly appointed by a member, subject to any contrary provision in the company’s Articles (Clause 261). Proxy appointments, for both public and private companies, can also authorise the proxy to speak at the meeting. Multiple proxy appointments are specifically permitted, in the case of both public and private companies, provided each proxy represents a different part of the appointor’s holding.

These provisions appear to give additional voting power to a shareholder who both appoints a proxy (or proxies) and also attends the meeting in person, although it seems likely that this anomaly will be ironed out as the Bill is refined in the Parliamentary process. More worryingly, the new provisions appear to have the result that, on appointment of multiple proxies, each proxy is entitled to a vote on a show of hands – an unexpected bonus for shareholder activists and
pressure groups. This problem can, however, be overcome (if not addressed by Parliament) by inserting a suitable provision in the Articles, as it will still be open to companies to make specific provision about proxies in their Articles. However, Articles may not provide for a proxy (or proxies together) to have fewer votes on a show of hands than a member would have had, if he were present in person. Proxies having more votes on a show of hands than the appointing member does not seem to have been addressed by the Bill. The significance of this is greatly reduced by the trend, encouraged by Sir Paul Myners’ reports in 2004 and 2005 on impediments to voting UK shares, towards voting on a poll on all substantive resolutions.

The latest time for delivery of a proxy form to the company will be 48 hours before the meeting (Clause 302). In a change to current practice, weekends and bank holidays must be ignored in calculating this period, meaning that shareholders potentially have slightly less time to deliver their proxy forms.

Publication of poll results
Quoted companies will be required to publish the results of polls at their general meetings on their websites, showing votes cast “for” and “against” (Clause 315). A failure to comply will not affect the validity of the poll or the resolution.

The information must be made available on a website maintained by or on behalf of the company (in other words, a website operated by a website service provider) “as soon as reasonably practicable” and be kept available for two years. Access to the poll information and the ability to obtain a hard copy must not be subject to payment of a fee or be otherwise restricted.

The requirement for website publication of poll results is in line with, and should eliminate some inconsistencies in, current best practice.

The FRC is currently consulting about the publication of proxy votes (including “votes withheld”) on the website when resolutions are dealt with on a show of hands. Neither the Bill nor the FRC consultation propose the publication of details of “votes withheld” on the website where a poll is taken, but this seems likely to become best practice, even absent a statutory or Combined Code requirement.

Independent report on polls
A new right has been included for the shareholders of a quoted company to require the directors to obtain an independent report on any poll taken at a shareholders’ meeting (Clauses 316-325). Like other requisition rights under the Bill and existing law, the requisitionists must hold 5 per cent of the voting rights or number at least 100 members holding shares on which, on average, the amount paid up per member is at least £100. The requisition must be received by the company before, or not later than one week after, the date on which the poll was taken.

The directors must appoint an “independent assessor” within one week of the requisition to prepare a report. The independence requirements correspond to those for the company’s auditor although the independent assessor need not be
an auditor. In addition, anyone who has another role in relation to the poll is also excluded to avoid them being required to report on their own work.

The appointment and identity of the independent assessor together with the report must be made available on the company’s website on the same basis as poll results. Reports must state (giving reasons) whether the procedures for the poll were adequate, whether the votes (including proxy votes) were fairly and accurately counted and whether the validity of proxy appointments was assessed. The independent assessor is granted powers to attend meetings and gain access to information from the company and its directors, employees, shareholders and agents. It will be an offence to fail to provide the relevant information or knowingly/recklessly to make a false statement.

Concern has been expressed at the additional administrative burden of an independent report on any poll and it remains to be seen to what extent this power is used both by those with legitimate concerns and those seeking to draw attention to a separate agenda.

**Institutional disclosure of voting**

There has been a growing trend in the UK towards voluntary disclosure by institutions of how they exercise voting rights following the release in October 2002 of the Institutional Shareholders’ Committee’s Statement of Principles on the Responsibilities of Institutional Shareholders and their Agents. This requires agents (i.e. fund managers) to report details on how they have discharged their responsibilities to their clients, including a judgment on the impact and the effectiveness of their engagement.

The Bill (Clause 866) confers on the Secretary of State for Trade and Industry and on the Treasury power to make regulations requiring voting disclosure by specified categories of institutional investor. These include unit trust schemes, investment trusts, pension schemes and collective investment schemes. These entities could be required to disclose how they have voted the shares they own or in which they have an interest. Whether or not the Government exercises these powers will depend on the progress of voluntary disclosure.

The scope of the power is very wide:

- the information required to be disclosed is “such information as may be specified about the exercise or non-exercise of voting rights on specified occasions during specified periods”. However, the Government indicated during consultation that it was not minded to require disclosure of the number of shares voted;
- the regulations may specify to whom the disclosure is to be made. This could be limited to clients and members, but could also extend to the public generally;
- the regulations can specify the securities, markets and investors to which the disclosure is to apply; and
- where institutional investors hold shares through another collective investment vehicle, they may be required to procure disclosure of voting by second tier entities.
Not surprisingly, the investment management industry is lobbying strongly against a mandatory regime. The Investment Management Association argues that a statutory statement could result in burdensome, but not necessarily useful, disclosure.

**Enfranchising indirect shareholders**

In line with a general trend towards more active shareholder engagement, the Bill aims to help indirect investors become involved in company proceedings (Clauses 136-137). Investors holding shares in listed companies frequently do so through one or more intermediaries and need to rely on contractual arrangements to obtain company information and exercise voting rights. The reports by Sir Paul Myners published in 2004 and 2005 on impediments to voting UK shares urge companies to facilitate shareholder engagement.

The provisions in these Clauses are a departure from the principle that a company is only obliged to recognise those members who are registered holders of its shares.

Companies will be able to make provision in their Articles to extend rights to people holding shares through intermediaries (such as nominees). Such provisions may enable registered members to nominate another person or persons entitled to enjoy or exercise all or any specified rights of the registered member. Where a company does make such provision in its Articles, any persons nominated will be able to be treated for most purposes as though they were actual members. The two exceptions to this principle are that only true members will be able to enforce rights against the company and transfer their interests in shares.

Although the DTI has stated that bespoke drafting of Articles to deal with this issue should not be necessary in light of the new provisions, practical issues will need to be decided upon and dealt with, including how the registered shareholder is to notify a company of any nomination and which rights (if not all) can be exercised by non-registered holders.

In addition, and pursuant in part to a Company Law Review recommendation, the Bill provides for a reserve power to require companies to extend certain rights to investors whose names are not on the register. Any regulations made under this power could compel companies to provide information to those nominated by registered members without there being any need for the company’s Articles to provide for this situation. However, to avoid imposing unnecessary costs on companies, the regulations could not require information to be sent or supplied in hard copy, unless the Secretary of State is satisfied that the cost of this would not be disproportionate to the benefits derived by indirect investors. Nonetheless, if such regulations were introduced, there would be an additional administrative burden for listed companies, which could have significant cost implications.

**AGM business**

**Timetable**

**When AGM is to be held**: The Bill requires that AGMs of public companies must be held within six months of the end of the financial year (Clause 311).
This replaces the rule that there must be no more than 15 months between one AGM and the next.

**Filing and publishing accounts:** The time limit for a public company to file its reports and accounts with the Registrar of Companies is reduced from seven months to six months after the year-end and it must send the report and accounts to members at least 14 days before the six-month deadline or, if earlier, by the date it actually files the report and accounts with the Registrar (Clauses 400-420). For listed companies this will represent no change, since the FSA’s Listing Rules also require publication of the annual report and accounts within six months of the year-end.

**Notice period:** The notice period required for the AGM of a public company remains at least 21 days (Clause 283). The Combined Code, in contrast, requires the notice of AGM and related papers to be sent at least 20 working days before the date of the meeting. The Bill does not adopt the proposal (in the March 2005 White paper) to require a 15-day holding period after publication of the report and accounts on the company’s website before giving notice of the AGM.

**Shareholder requisition of AGM resolutions**

The right for members (that is, shareholders holding 5 per cent of the voting rights or 100 members holding on average £100 of paid-up capital) to requisition resolutions to be passed at an AGM is subject to two changes:

- if the requisition is delivered before the end of the financial year preceding the AGM, the company may not require the requisitionists to pay the expenses of circulating the resolution (Clause 313),
- the 5 per cent/100 member threshold applies to voting rights eligible to be cast on the relevant resolution. Thus if, say, a member was seeking to have a company wound up, the votes of any preference shareholders would generally be exercisable on such a resolution and would have to be counted for the purposes of the 5 per cent threshold.

The Bill also makes clear that a resolution may not be proposed by requisitionists if it would be ineffective (for example because inconsistent with the company’s constitution or a provision of statute), or is defamatory, frivolous or vexatious.

**Political donations**

The Bill restates and, to some extent, simplifies the regime requiring shareholder authorisation of companies’ political donations or expenditure (Clauses 335-352). As the current legislation is ambiguously drafted and wide ranging, there has been much uncertainty and debate about its application. As a result, directors run the risk of incurring personal liability for accidentally failing to comply with these provisions – including liability to repay unauthorised donations/expenditure, plus interest and damages. No ratification of unauthorised payments is permitted and access to the court process for relief where a director has acted honestly and reasonably is specifically excluded.
The Bill’s extensive redrafting of this legislation brings some welcome changes to what is currently an unnecessarily burdensome process. Most notably:

- where several companies within a group may make political donations or expenditure, there will be no need for a separate resolution of the holding company to be proposed in respect of each relevant company - a single resolution may cover a holding company and/or one or more of its subsidiaries,

- it is now clear that only the ultimate UK holding company of a subsidiary making political donations or expenditure (rather than each holding company within a group) needs to pass an authorising shareholders’ resolution. No resolution of the subsidiary itself is required if it is wholly owned by a UK company,

- trade unions are expressly exempted, so that “donations” (in the artificially wide meaning the term carries for these purposes) to trade unions are no longer caught by the legislation,

- the regime for overseas (“non-GB”) subsidiaries - which imposed obligations on UK holding companies to procure such subsidiaries not to make political donations or incur political expenditure without appropriate authorisation by the holding company - is abolished,

- the prohibition on retrospective ratification by shareholders of unauthorised payments is to be lifted, and the exclusion of the directors’ right to appeal to the court for relief is to be removed.

In some respects, however, the Bill goes further than the existing regime, and a number of uncertainties remain:

- the regime is extended to cover activities relating to independent election candidates,

- the definition of “political donation” continues to be wide. More specific provision in this area would be most welcome. For example, there is no specific exemption for paid leave for local councillors since the DTI takes the view\(^8\) that such paid leave does not constitute a political donation caught by the 1985 Act or the redrafted provisions in the Bill. This contrasts with advice obtained from Mr David Mabb QC by The Law Society. A specific exemption could have been provided, as for trade unions,

- directors of a parent company will still be at risk of personal liability where a wholly-owned subsidiary, without the knowledge of such directors, makes unauthorised payments or donations. This risk is partly removed by entitlement to apply to the court for relief where the directors have acted reasonably and honestly,

- authorising resolutions can (as at present) cover a four-year period, although the normal practice for those companies that take authority under these provisions has been to seek annual renewal. It is not clear that a company can take a four-year authority permitting an annual amount of donations/expenditure,

- resolutions may authorise any of:
  - donations to political parties or independent election candidates,

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\(^8\) Explanatory Notes to Company Law Reform Bill, para 611.
– donations to other political organisations,
– political expenditure,

specifying, for each (if applicable) of the above three heads, a limit for each of the companies to which it relates. This appears to require a resolution which covers more than one company to name each company to which it applies. It is hard to see how this provision (Clause 340) stacks up with the DTI’s comment in the Explanatory Notes to the Bill that companies will not need to be separately named.\(^9\)

At present it is common for listed companies to pass a resolution authorising political donations and expenditure in an attempt to avoid inadvertent breaches of the law. This practice seems likely to continue, in view of continuing uncertainties as to the scope of the legislation.

### Dematerialisation of shares

The Bill contains provisions to enable regulations to be made for mandatory dematerialisation of shares (Clauses 585-587). This follows pressure, particularly from the securities industry, to do away with the need to handle paper in the process of transferring shares. The regulations would extend the provisions under which shares are currently traded through CREST so that shareholders who hold their shares outside CREST would no longer have paper certificates for their shares. Instead, it is likely that their shareholdings would be recorded through some kind of book-entry system and they would receive statements of their holdings each time an acquisition or disposal was made.

From the point of view of issuers, it is not immediately obvious that this would have any particular benefit, as although they would not need to send out certificates, nor pay registrars for the handling of paper-based transfers, there would still be costs involved in the maintenance of records and the production and postage of shareholding statements.

### Disclosure of interests in shares

The Bill paves the way for a new disclosure regime in respect of interests in companies' shares, with the FSA being granted the power to make rules to this end (Clause 861). These new provisions will implement the EU Transparency Directive, which is due for implementation in January 2007 and which lays down disclosure standards in relation to the shares of companies admitted to trading on a regulated market (including the London Stock Exchange Main Market, but excluding AIM). In accordance with the Transparency Directive, it is envisaged that disclosure by reference to registered holding or “voting rights” will be substituted for the current regime that requires disclosure in respect of “interests” - a term which is defined very broadly. The FSA will also have power to make rules requiring the disclosure of voting rights in shares traded on other markets, such as AIM.

\(^9\) Explanatory Notes to the Company Law Reform Bill, para 617.
Constitutional reforms

In the interests of simplicity and the “think small first” concept, the Bill makes some fundamental reforms to the way that companies are constituted and administered. These are most far-reaching in the case of private companies, but many of the changes – for example, the abolition of the objects clause and the revision of the *ultra vires* rule – will apply to all companies. Many of the constitutional changes will affect not just companies newly formed under the provisions of the Bill, but also existing companies.

Memorandum and Articles of Association

Abolition of the objects clause

The Bill implements the recommendation of the Company Law Review that all rules on the internal workings of a company should be set out in one document, the Articles of Association. Currently, a company’s Memorandum of Association is a fundamental part of a company’s constitution, defining its purposes and the powers of the directors. The Memorandum of a company formed under the Bill will only contain details of the initial subscriber(s) for shares (Clause 8). It will therefore become “an historical snapshot”[10] relevant only to the initial formation of a company and will have no continuing relevance.

For existing companies, provisions that were in the Memorandum will not be deleted by the Bill, but will be treated as provisions of the company’s Articles of Association (Clause 29). The effect of the objects clause of an existing company will, however, be altered by the new regime. This follows a recommendation by the Company Law Review for a simplification of the law in relation to corporate capacity.

Historically, under the common law a company could only act within the powers set out in the objects clause in its Memorandum – anything outside the objects would be void (the “*ultra vires*” rule). The Companies Act 1989 went a long way towards abolishing the concept of *ultra vires*, by providing that a transaction outside the company’s capacity would not thereby be invalidated (now Section 35(1) of the 1985 Act). This is replicated in Clause 39 of the Bill. The 1989 Act also provided a short form of objects clause that was intended to confer on a company power to carry on any business or trade whatsoever and to do anything incidental or conducive to the carrying on of such business or trade. Doubts as to what, in practice, were the limitations to the phrase “incidental or conducive” led to most companies preferring to retain the traditional long-form objects clause, drafted as widely as possible to try to ensure that the company’s capacity would not be limited in any way.

The Bill goes further than the 1985 Act (as amended by the 1989 Act). It provides that a company’s objects will be unrestricted, unless the Articles of Association specifically restrict them (Clause 33). This applies to both newly-formed and existing companies.

Presumably, an object currently set out in the Memorandum of a company – for example, to carry on business of a particular nature – will not be deemed for

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these purposes to be a specific restriction. A restriction would involve words stating that a company should **not** do a particular thing, which would be unusual for commercial companies. Accordingly, for most companies, the objects clause would at first sight seem to become redundant under the Bill’s provisions. However, before deleting objects clauses in their entirety, companies may wish to consider whether any of the specific powers they confer should be retained. For example, objects clauses frequently include provisions intended to permit the company to dispose of all or part of its business, to borrow, to give guarantees, to give benefits to present or former employees, to make charitable donations and so on. Some companies may wish to retain their express objects after the Bill is enacted for the avoidance of doubt as to the powers of the directors – particularly with regard to matters involving benefits for directors or gratuitous payments. In our view, however, it should not be necessary to retain the objects clause in the absence, perhaps, of particularly unusual provisions, or unless there are specific restrictions to be preserved.

There are separate rules on capacity, and on dealings with third parties, applicable to charitable companies.

Where a company wishes to amend or remove a statement of objects in (or deemed to be in) the Articles, whether or not it contains restrictions, it will have to follow a special procedure for notifying the Registrar of Companies of the change. The change will not be effective until registered by the Registrar (Clause 33).

**Company capacity and directors’ authority**

The clear statements in the Bill that a company’s objects are unrestricted unless specifically restricted, and that acts of a company cannot be called into question even if they breach restrictions in the constitution, are welcome. However, directors will still be under a duty to observe restrictions in the constitution (Clause 155) and may be liable to the company (on the basis of a claim brought by the company or a derivative claim brought by shareholders) if they execute a transaction in breach of such a restriction.

Moreover, the Bill fails to take the opportunity to clarify some doubts that apply in relation to the ability of third parties to transact with companies without the fear that the transaction may be voidable as a result of directors acting beyond their powers. The 1989 Act established that third parties dealing with a company in good faith do not need to concern themselves as to any limitation on the directors’ powers under the company’s constitution – and the Bill arguably widens this principle by referring to “the powers of directors” rather than the “the powers of the **board** of directors”, which is helpful in relation to concerns about dealing with an individual director or board committee (as opposed to the board as a whole) (Clause 40). However, concerns about what circumstances might constitute, under the existing law, not acting “in good faith” (despite a presumption of good faith unless the contrary is proved) typically lead third parties entering into high value transactions with a company, such as substantial bank loans, to take a cautious approach. The Bill retains the existing position in relation to the requirement of good faith.
As at present, particular care will need to be taken by directors to ensure that they act in accordance with the company’s constitution, particularly in cases where directors or their connected persons are themselves party to the transactions (Clause 41). Directors may be personally liable to indemnify the company if they act in excess of their powers in relation to such transactions.

**Entrenched provisions**

The Bill introduces new procedures and restrictions relating to the entrenchment of provisions in a company’s constitution (Clauses 23-25). These will make it more difficult for companies to introduce such provisions, as well as requiring additional formalities when Articles containing entrenched provisions are amended.

A “provision for entrenchment” is defined as a provision in Articles identifying specific provisions of the Articles which may not be altered or repealed at all, or may only be altered or repealed if conditions are met or procedures complied with that are more restrictive than those applicable to a special resolution (Clause 23).

For existing companies, any such provisions set out in their Memorandum will be deemed to be part of the Articles of Association (Clause 29).

Companies will only be able to adopt entrenchment provisions on initial formation or with the agreement of all the members to the amendment of the Articles of Association (Clause 23). If a company has such provisions in its Articles, it will have to make a statement to the Registrar of Companies confirming that the Articles have been complied with whenever the Articles are amended (even if the amendment does not relate to an entrenched provision).

Those affected by these new rules are likely to include joint venture companies and other companies whose Articles confer super-voting rights on a particular shareholder in relation to particular matters. The rules will also affect dual-headed groups which have special voting rights in their constitution to ensure that shareholders in each company are effectively represented at both companies’ general meetings. These types of companies may well have entrenched provisions in their Articles – an existing entrenched provision can be altered or removed in accordance with the Articles, but the introduction of a new one would require unanimity. Quoted companies for whom obtaining unanimity would be impossible would have to impose a new holding company on top of the existing company to achieve the same result.

**Other provisions on Articles of Association**

The Secretary of State will have the power to prescribe model Articles of Association for different types of company formed under the Bill. The model Articles of Association being proposed for private companies limited by shares as set out in the March 2005 White Paper are very short and commendably simple compared with the model Articles set out in “Table A” under both the 1948 and the 1985 Companies Acts. However, they contain no provisions on, for example, notices to shareholders, the conduct of shareholder meetings or alternate directors. The reason for the lack of provision relating to shareholder meetings is the presumption that private companies will not hold AGMs and will
pass most resolutions by written resolution (see further below). Nevertheless, some private companies may need to hold Extraordinary General Meetings from time to time (for example, to remove a director). They therefore may wish to consider whether to incorporate with fuller Articles of Association that, at least, lay down procedures for shareholder meetings.

For existing companies, the version of the model Articles of Association that was in force at the time that a particular company was registered will continue to apply. Some provisions may become unclear or redundant because of changes being made by the Bill. For example, given that extraordinary and elective resolutions will no longer exist, it will make no sense to refer to them in Articles, so existing companies may wish to amend their Articles of Association for greater coherence.

Existing companies should also consider whether there is any conflict between the provisions of their Memorandum and the Articles of Association. Under the current law, in the case of an inconsistency the Memorandum will prevail. Since Clause 29 of the Bill treats the provisions of the Memorandum as provisions of the Articles, the position is unclear. This issue may be dealt with through transitional provisions at the time the Bill comes into force. If not, existing companies may wish to amend their Articles to prevent or deal with any conflict.

The Bill includes a new provision to strengthen the power of the Registrar of Companies to enforce the requirement for companies to file an updated set of Articles of Association when they make an amendment. Failure to do so will (as at present) be a criminal offence (punishable by a fine of £1,000 and a daily default fine) (Clause 27). In addition, the Registrar will have power (Clause 28) to give notice to a company to comply with its filing obligations within 28 days. If the company does not comply, it will be liable for a civil penalty of £200.

Company formation
The Bill is intended to simplify the rules on formation of companies, in keeping with the Government’s aim of “think small first”. Although the procedures are in some respects simpler than the current requirements, they could have been streamlined further by requiring a single application form, rather than several documents, to be submitted to the Registrar of Companies. For a company limited by shares, the documents to be submitted to the Registrar of Companies will be (Clause 9):

- the Memorandum stating the names of the subscribers forming the company, and signed by them,
- an application for registration (specifying many of the details that used to be contained in the Memorandum, such as details as to registered office, whether the liability of members is to be limited by shares or guarantee, whether the company is a public or private company),
- a statement of initial shareholdings,
- a statement of share capital. The concept of authorised share capital has been abolished (see Alterations of share capital below),
- a statement of the proposed directors (and, for a public company, the secretary),
– a statement of compliance (which need not be witnessed and can be made in electronic or paper form). This will replace the requirement for a witnessed statutory declaration. Rules to be made by the Registrar of Companies will determine the form of this statement and who will have to make it.

The new provisions have been drafted to be consistent with online incorporation which will be offered by the Registrar of Companies from 1 January 2007.

One person acting alone will be able to form any kind of company (not just a private company) by subscribing his or her name to the Memorandum. However, a public company will continue to need two directors.
Private company deregulation

Company secretary

One of the principal deregulatory proposals for private companies is the abolition of the requirement for such companies to appoint a company secretary (Clause 247).

The functions and tasks normally carried out by company secretaries – including maintaining company records and filing statutory returns – are not, however, being abolished. Directors will need to determine who should carry out these tasks. Some private companies may wish to continue to retain a company secretary, but the Bill provides no mechanics to support this and in some cases makes it more difficult for the company secretary to act:

– since there is no requirement for a private company to file details of the company secretary with the Registrar of Companies, there may be problems for a company secretary to prove its authority,

– the task of “authenticating” documents on behalf of the company requires the signature of a director or a person authorised to act on the company’s behalf (Clause 48). The secretary is not designated by the Bill for this purpose and therefore will need to get the express authority of the company to sign documents on its behalf,

– a document is no longer validly executed by a private company if it is signed by a director and a secretary – the presumption of valid execution only applies for private companies if the document is signed by two directors or a sole director signs it in the presence of a witness (Clause 44). Company secretaries in private companies will need to remember to witness documents in future, rather than sign ex officio. The same will apply for deeds.

Despite these lacunae, a secretary of a private company – or a person carrying out the functions of a secretary – will still be an officer of the company and, as such, is potentially liable for offences under the Bill or the 1985 Act.

AGMs

Another example of the Bill’s “think small first” approach is the removal of the requirement for a private company to hold an annual general meeting. Under current law, a private company needs to pass an “elective resolution” (requiring the agreement of all the members) if it wishes to dispense with the holding of AGMs. The Bill changes this “opt out” system to an “opt in” one, so that a private company will only need to hold AGMs if it wishes to do so.

A number of consequences flow from removal of the requirement for a private company to hold an AGM:

– Accounts and reports: There is no longer a need for a private company to lay accounts and reports in general meeting but it must send them to

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11 The term “authenticated” is used frequently in the Bill. A document or information is defined as authenticated (Clause 753) if (a) in the case of a hard copy document, it is signed by the person sending or supplying it or (b) in the case of information in electronic form, the identity of the sender has been confirmed in a manner specified by the company, failing which in accordance with normal commercial practice.
members within 9 months of the year end, reduced from 10 months, or, if earlier, by the date it actually files its accounts and reports with the Registrar of Companies (Clauses 400 and 420),

- **Appointment of auditors:** The term of office of auditors of private companies will generally run from the end of the 28 day period following circulation of the accounts until the end of the corresponding period the following year. This will apply even if the auditor is appointed at a meeting where the company’s accounts are laid.

To avoid the need for an AGM, the auditors of a private company are generally **deemed** to be reappointed, subject to certain specified circumstances, for example, if the Articles of Association require actual reappointment or at least 5 per cent of the members (or any lesser percentage specified in the Articles of Association) send a notice excluding deemed reappointment (Clause 473).

Existing private companies will of course need to check that their Articles do not require them to hold AGMs before ceasing to do so.

**Written resolutions**

The Bill (Clauses 265-273) introduces new procedures for written resolutions. Rather than requiring unanimity for written resolutions, the Bill introduces the concept of ordinary and special written resolutions. An ordinary resolution can be passed by the agreement of 50 per cent of all those eligible to vote, while a special resolution requires the agreement of 75 per cent of those eligible to vote. Together with the removal of the requirement for private companies to hold an AGM, the new procedure should relieve private companies from the requirement to hold general meetings in normal circumstances although, as now, it will not be possible to pass a written resolution to remove a director or an auditor before the expiry of his/its term of office.

The main features of the new procedure are that:

- a written resolution can be proposed by the directors or by members holding 5 per cent of voting rights (although the company can apply to the court not to circulate a written resolution if it would be ineffective or is frivolous or vexatious),

- a resolution can be communicated in hard copy or electronic form or by means of a website, depending on how the company communicates with its members. If a company gives an electronic address it is deemed to have agreed to documents being sent to it by electronic means. A written resolution can be sent to all members simultaneously or in turn, or by using a combination of the two,

- a written resolution does not have to be physically signed by shareholders. A member is treated as signifying his agreement to a resolution when the company receives from him an authenticated document (in hard copy or electronic form) identifying the resolution and indicating his agreement. Once signified in this way, agreement to a written resolution cannot be withdrawn,

- the resolution lapses if not passed before the end of the period specified in the Articles of Association or 28 days from the circulation date,
– the company must circulate a statement with the resolution informing the members how to signify agreement and the date the resolution is to pass if it is not to lapse,
– there is no longer a requirement to send a copy of the resolution to the auditors,
– there is a new procedure for members to require the circulation of written resolutions, together with a statement of up to 1,000 words.

The reduction in the majority required to pass a written resolution and the flexibility in the means of circulation and assent should make life easier for private companies. Unlike the existing regime for written resolutions, the Bill does not preserve the right of companies to have other procedures for written resolutions in their Articles of Association. This should not cause significant problems in practice, however, given the flexibility allowed by the Bill.
Simplification of notice periods and short notice requirements

The Bill contains a number of deregulatory provisions making it easier and quicker for companies (both public and private) to convene meetings (Clause 283). In particular, the notice requirement for a special resolution is reduced from 21 days to 14 days.\(^{12}\)

As a result, any general meeting of a private company can be called on 14 days’ notice (subject to anything in the Articles). In the case of public companies (again, subject to the Articles), the required notice period for a meeting other than an AGM will be 14 days also, although for public company AGMs, it will remain at least 21 days.

For listed companies, this, combined with the proposed power for the DTI to reduce the period for which pre-emptive share offers must remain open from 21 days to 14 days, could reduce the timetable for some rights issues from six weeks to four weeks. However, the proposed EU Shareholder Rights Directive would, in its current form, require 30 days’ notice for all general meetings of companies traded on a regulated market. This could considerably add to timetables for capital raising and other transactions requiring shareholder approval and so potentially increase the cost of capital for listed companies.

The Bill will allow members of a private company holding 90 per cent (or such higher percentage as may be specified in the Articles of Association, but not more than 95 per cent) to agree to hold a meeting (including an AGM) on short notice. Previously, reduction of the 95 per cent threshold was only available to private companies that passed an elective resolution (requiring the agreement of all the members). For public companies, the short notice threshold remains at 95 per cent, although short notice may not be agreed in the case of a public company’s AGM.

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\(^{12}\) Since the key difference between a special resolution and an extraordinary resolution (requiring a 75 per cent majority of the affected class of shares on a variation of rights) is that an extraordinary resolution only requires 14 days’ notice, the shortening of the notice period required for special resolutions has the incidental effect of doing away with the concept of extraordinary resolutions.
Company records and the Registrar of Companies

Company records

The Bill clarifies and updates existing requirements as to company records. Company records are now defined (Clause 742) and include registers, minutes and other documents required to be kept by company legislation. They may be kept in hard copy or electronic form, provided that they are adequately recorded for future reference. If kept in electronic form, they must be capable of being reproduced in hard copy form. There is also a new provision that company records may be arranged in such manner as the directors see fit (Clause 743). This should enable companies to separate information about past members from that about current members and is intended to avoid disputes as to whether electronic registers fully comply with the detailed statutory requirements.

The Bill generally reduces the time period for which companies must keep records:

- companies currently have to keep minutes of directors’ and company meetings indefinitely. The Bill reduces this to 10 years from the date of the relevant meeting (Clauses 227 (directors) and 329 (general meetings)),
- the retention period for records in relation to former members is reduced from 20 years to 10 years (Clause 118).

Whilst these changes should reduce companies’ storage costs, there are concerns that a 10-year retention period might be too short if a company were involved in litigation that required the review of documents over a lengthy period.

The Bill attempts to deal with the problem of third parties purchasing copies of the register and using it for direct mailing, or in some cases, intimidation of shareholders. The public right of access to the register and index of members’ names is retained, but the right to inspect and request copies can only be exercised for a “proper purpose” (Clause 116). A company can apply to the court for a direction that it need not comply with a request for inspection or copy on the grounds that it is not for a proper purpose. The period for compliance is reduced from 10 to 5 days. Within this time the company must either comply or apply to the court for relief from the obligation.

The objective of preventing abuse of the right to inspect and request copies of shareholder registers will be widely supported. Unfortunately, however, the provisions place the burden on the company to go to the expense of a court application, and the meaning of “proper purpose” is not entirely clear.

Other changes to the law governing the register of members include:

- where a person exercises his right of inspection or demands a copy of the register, the company is under a new obligation to inform him of the most recent date on which alterations were made to the register and that there are no further alterations to be made (Clause 117),

The retention period for many company documents is reduced

A company can apply to court if it thinks the right to obtain the register of members is being abused

Companies must comply with new formalities where a person demands to inspect the register of members
– the register may be kept at any address in the part\textsuperscript{13} of the United Kingdom in which a company is registered (Clause 114),

– joint holders of a share are to be treated as a single member. All their names must be stated but only a single address is required (Clause 113),

– the period for which companies are liable for errors in the register is reduced from 20 years to 10 years (Clause 125),

– the repeal of Section 358 of the 1985 Act will mean that it is no longer possible to close the register for 30 days each year. Companies whose securities are eligible for trading in CREST may not close their registers in any case but the ability to close the register is useful for larger private companies in relation to the declaration and payment of dividends and, if they continue to hold meetings, for determining the entitlement to attend and vote.

\textbf{Dealings with the Registrar of Companies}

The Bill seeks to streamline the system for company filings, in particular to ensure the accuracy and timeliness of information on the public register and to facilitate electronic communications:

– the Registrar of Companies will have greater powers to specify the form and manner in which companies submit information (Clauses 679 to 683). The Registrar may not require documents to be delivered by electronic means – that power is reserved to the Secretary of State. However from 1 January 2007, the Registrar must ensure that all documents required to incorporate a company may be delivered by electronic means,

– there is a new offence of knowingly or recklessly filing information that is misleading, false or deceptive in a material particular (Clause 719),

– in certain limited circumstances the Registrar of Companies will be able to telephone companies who have provided incomplete or internally inconsistent information in order to obtain the missing element without having formally to reject the incoming form (Clause 685). This only applies where the companies have informed the Registrar of Companies that it should apply,

– the Registrar of Companies will be able to accept a replacement document where a document was delivered in the wrong form (Clause 686),

– the Registrar of Companies will be able to remove items from the public register which had been erroneously placed there or for which there was no legal requirement (Clause 687),

– there is a more detailed procedure to remedy delivery that did not satisfy the detailed statutory requirements, for example as to contents, authentication and form and manner of delivery (Clause 688),

– the Registrar of Companies may notify a company of an apparent inconsistency on the public register and require it to provide additional or replacement documents to resolve the inconsistency (Clause 704).

\textsuperscript{13} i.e. England and Wales, Wales, Scotland or Northern Ireland (the Bill’s provisions, unlike previous Companies Act provisions, extend to Northern Ireland).
The Bill attempts (Clauses 685 to 688 and Clause 704) to deal with the difficulty of removing incorrect information from the public record. There is currently no statutory power for the Registrar to do this and the courts only have limited jurisdiction to order amendments. The new clauses help but they may not go far enough to justify removing a document which is complete but incorrect, e.g. a change of name resolution filed by mistake or a document filed with the wrong company name and number. However, there is now a provision for the court to make an order for rectification of the register (Clause 705). Where the registration has had legal consequences, the order may only be given where the court is satisfied that (i) the presence of the material has caused or may cause damage to the company and (ii) the company’s interest in removing the material outweighs any interest of other persons in the material continuing to appear on the register.
Company names

The Bill contains provisions to assist victims of “name-squatting” and reforms to the manner in which a company can change its name.

Right to object to names

The Bill creates a new right to challenge the improper or opportunistic registration of a company name to which someone else has a better claim (Clauses 70-74). Under the existing law, an aggrieved party may write to the Registrar of Companies but the Registrar has limited powers to intervene.

Under the new provisions any person or company may object to a company’s name if it is the same as, or misleadingly similar to, one in which the applicant (i.e. the objector) has goodwill. Goodwill is described as including “reputation of any description” (although there is no further clarification of what evidence of reputation will be required). An objection may be made at any time after the name is registered to a company names adjudicator (to be appointed by the Secretary of State).

There is a list of circumstances which will raise a presumption that the name was selected legitimately – for example, that the name was registered before the applicant started the activities in which it claims goodwill. If these do not apply, the objection will be upheld. Even if one of the specified grounds does apply, the objection will still be upheld if the applicant can show that the main purpose of the respondent in registering the name was to obtain money (or other consideration) from the applicant or to prevent the applicant from registering the name.

Change of name

Currently, a company can only change its name by special resolution or following a direction from the Secretary of State in circumstances which only apply to companies which are not required to use “limited” in their name. The Bill provides two further means (Clause 77):

– whatever means are provided in the company’s Articles of Association,
– by order of the company names adjudicator if an objection under the new right of challenge (Clauses 70 to 74) is upheld.

In addition, there is a new procedure for a company to follow if it passes a special resolution to change its name, where the change is conditional on some other event. The notice given to the Registrar of Companies of the change must specify that it is conditional and state whether the event has occurred (Clause 78).

Conditional resolutions to change a name have given rise to discussions with the Registrar of Companies in the past, so addressing them in the Bill is welcome. They are frequently passed, for example, where a company plans to change its name on completion of an acquisition, disposal or merger. It is important to note that a conditional resolution will not enable a company to reserve a name and that the Registrar is not required to issue a new certificate of incorporation until further notice by the company that the event has occurred.
Restricted names

The Bill also provides a new power for the Secretary of State to make regulations specifying what letters, symbols etc. may be used in a company’s registered name and what formats (Clause 58). This has been prompted by the trend to adopt special script and symbols in company names and is intended to prevent companies adopting names that people would find hard to trace in the public record.
Share capital and capital maintenance

The reforms relating to companies' share capital are mostly highly technical in nature, but do include some important deregulatory measures. While deregulatory, some of them are also mandatory – for example, the abolition of the concept of authorised share capital. As a result of this, filings with the Registrar of Companies will take a different form. Other routines, such as authorising the directors to allot shares, will also be affected. Overall, however, the benefits of the changes in this area should outweigh any new burdens. In particular, the abolition of financial assistance for private companies has long been campaigned for, and will reduce the cost and complexity of many corporate transactions.

Allotment of shares

Allotment authorities

The regime governing the power of directors to allot shares is restated and amended in the Bill (Clauses 534-536). There are three substantive changes:

- abolition of the concept of "relevant securities" which covers both shares, and rights to subscribe or convert into shares. Shares and rights to subscribe/convert are now separately dealt with,
- allotment authorities will in future relate to numbers of shares, not nominal value,
- private companies with one class of share capital are outside the allotment authority regime, although their Articles may still require shareholder authority for allotments.

As a consequence of the first two changes, the wording of routine allotment authorities at AGMs will need to be adjusted. In addition, companies (including many of our clients) which have "enabling provisions" in their Articles of Association, allowing annual renewal of their allotment authorities at the AGM by a short resolution, will need to amend their Articles to reflect the changes. Although the existing pre-emption right regime under Sections 89-95 of the 1985 Act (see below) is also substantially unchanged, its interaction with the allotment authority regime will require both to be considered together to determine the overall approach to these two items of routine AGM business.

Transitional provisions will be required when the Bill comes into force to ensure that allotment authorities under the existing regime remain valid until new authorities can be put in place under the new legislation.

Pre-emptive offers and disapplication of rights

The statutory pre-emption regime for new issues of equity under Sections 89-95 of the 1985 Act is left broadly unchanged, although unhelpfully it will now be split between the 1985 Act (which will continue to cover, in Sections 89-94, the requirement for, and manner of, pre-emptive offers to shareholders) and Clauses 543-547 of the Bill (which will cover the disapplication of pre-emption rights, currently set out in Section 95 of the 1985 Act).
However:

– a legislative power (exercisable by statutory instrument) is being introduced to reduce the mandatory 21-day period for pre-emptive offers to not less than 14 days. This could helpfully shorten timetables for some equity issues, potentially reducing underwriting costs,

– the existing exemption in the 1985 Act enabling private companies to issue equity securities on a non-pre-emptive basis, where so permitted by their Memorandum or Articles of Association, is to be withdrawn, and replaced by a provision enabling only those private companies with one class of shares to disregard the pre-emption regime. Private companies will now be able to take advantage of this exemption by special resolution, as well as by provision in their Articles of Association.

Although these changes are relatively minor, the alterations to the allotment authority regime under Section 80 of the 1985 Act will require some adjustment to routine AGM “Section 89 disapplication” resolutions and Articles of Association (where these contain wording to facilitate short Section 89 disapplication resolutions at the AGM). This is because pre-emptive offers of equity securities by public companies have to be made pursuant to a valid allotment authority.

Transitional provisions will be required to preserve existing disapplications of pre-emption rights until new ones can be put in place under the new legislation.

**Alteration of share capital**

Public and private companies are permitted under Sections 121-123 of the 1985 Act to increase, consolidate, divide, sub-divide and cancel their share capital by ordinary resolution and a notification regime is established requiring notice of any such alteration of share capital to the Registrar of Companies. These “actions” relate in some cases to “authorised” share capital only (e.g. increase and cancellation), in other cases to both “authorised” and issued. The list of actions is not comprehensive – it does not, for example, cover purchase, redemption or forfeiture. As such, therefore, it has always been a rather strange and incomplete list of actions which may have been appropriate when first included in companies legislation, but now requires updating.

Under the Bill:

– the concept of “authorised share capital” will be abolished, so that an “increase” in share capital will refer to an increase in the allotted and issued share capital, resulting from an allotment of new shares under Part 18 of the Bill, and the surviving provisions of Part IV of the 1985 Act. The requirement to state a company’s “authorised” share capital in the Memorandum of Association will cease,

– the common law rule that shares may be denominated in any currency, and that different classes of shares may also be denominated in different currencies, is captured in statute for the first time (Clause 549),

– the notification regime for any alteration of share capital will require the filing with the Registrar of Companies of a “Statement of Capital” giving the precise number of issued shares and specified details about those shares,
including nominal value, the amount paid up or unpaid on each share and the rights attached to each class of shares. This requirement extends to the basic “return of allotments” (currently dealt with in Section 88 of the 1985 Act). The DTI has at last relented and given up the requirement to file originals or certified copies of contracts conferring the entitlement to allotment; this requirement has often given rise to concerns over confidentiality of sensitive information contained in the contract.

### Financial assistance

Sections 151-8 of the 1985 Act currently prohibit any private or public company from giving financial assistance for the purpose of an acquisition of shares in the company or its parent. This is subject to certain exemptions and, in the case of private companies, a whitewash procedure.

The prohibition on financial assistance will be abolished by the Bill in so far as it relates only to private companies (Clause 565). The regime and the detailed statutory language is, however, unchanged for assistance given either (a) in relation to the acquisition of shares in a public company which remains a public company, by that company or any of its subsidiaries or (b) in relation to the acquisition of shares in a private company, by a public company subsidiary of that private company.

The changes will greatly simplify private company acquisitions, public-to-private transactions (once the target has converted into a private company), and internal group reorganisations and will, for instance, no longer prohibit loans or security given to finance the purchase of a private company. There will be no further need for whitewash procedures to authorise financial assistance.

Private companies giving financial assistance will, however, still need to consider fiduciary duties and corporate benefit issues.

The regime will remain in place for public companies and is unlikely to change until the Second Company Law Directive is amended – there are currently proposals to allow public companies to provide financial assistance subject to a whitewash procedure similar to that currently available to UK private companies.

### Reductions of capital

At present all reductions of capital by limited companies require approval of the court, whose principal function is to satisfy itself that the company’s creditors will not be prejudiced by the reduction. The involvement of the court builds extra time and cost into the procedure and it has long been thought that an adequate level of protection can be afforded to creditors outside a court process.

As a result of the Bill (Clauses 561-564):

- **Private** companies will have the ability to reduce their capital without court approval by way of a special resolution supported by a solvency statement. The solvency statement must be made available to the shareholders before the special resolution is passed. For **public** companies, court approval will still be required.
– In the solvency statement, to be made not more than 15 days before the special resolution is passed, all the directors are required to express the opinion that the company is solvent and will continue to be able to pay its debts as they fall due during the year immediately following the date of the statement. If the statement is made without reasonable grounds, each director in default will be guilty of an imprisonable offence.

The reduction will take effect upon registration by the Registrar of Companies of the special resolution, solvency statement and a Statement of Capital reflecting the effect of the reduction. These documents must be delivered to the Registrar of Companies within 15 days after the resolution is passed.

Under both the court procedure and the new private company process, it will not be possible for a resolution to be expressed to take effect later than the date when the relevant documents are registered by the Registrar.

One of the commonest reasons for reducing capital is to create distributable reserves. At present the accounting profession recognises that the reserve which arises on a reduction of capital automatically constitutes a realised profit where the court has approved the reduction. This is reflected in guidance issued in 2003 by the Institute of Chartered Accountants (Tech 7/03). For this treatment to apply to the new non-court based process, a change to Tech 7/03 will be required.

A consensus will need to be developed as to what the directors should do in order to show that they had “reasonable grounds” in forming the opinions expressed in the solvency statement. The DTI decided that it was unnecessary for the solvency statement to be supported by an auditor’s opinion (as, for example, in the case of a financial assistance whitewash), but directors may take the view that they require comfort on solvency from their auditors.

**Intra-group transfers**

Currently, the law governing distributions to shareholders, including distributions in kind, is contained both in Part VIII of the 1985 Act and the common law. “Distributions in kind” can include transactions such as a sale to a shareholder of an asset at an undervalue, or a sale at an overvalue.

The Bill introduces new rules in relation to distributions in kind and provides that, in relation to such distributions, the statutory rules apply, to the exclusion of the common law (Clause 577). However, in relation to other (cash) distributions, it will still be necessary to consider the common law and, in relation to all distributions (cash and in kind), it will still be necessary to have regard to a company’s constitution and any other applicable statutes.

The new rules introduced by the Bill determine the **quantum** of a distribution in kind. It is then necessary to consider the other requirements of Part VIII of the 1985 Act to determine whether or not the distribution is lawful.

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14 Important cases include Trevor v Whitworth (1887) 12 App Cas 409 and Aveling Barford Limited v Perion Limited and Others [1989] BCLC 626.
The effect of the new rules is to codify and preserve the position in *Aveling Barford*, so that where a company which does not have any distributable profits transfers an asset to a shareholder at an undervalue, this will be an unlawful distribution. However, the Bill also confirms that, where a company does have some (i.e. greater than zero) distributable profits and transfers an asset to a shareholder at not less than book value, the amount of the distribution is zero.

The Bill sets out two bases for determining the quantum of a distribution in kind. In summary:

*First basis:* This will apply to a company which has some (i.e. greater than zero) profits available for distribution. In this case, the quantum of a distribution is determined by reference to the book value of the assets transferred. If the book value of the assets transferred is greater than the consideration received by the company for such distribution, then the quantum of the distribution is equal to the difference. If the book value is equal to or less than the consideration received, the quantum is zero.

*Second basis:* For a company that does not have profits available for distribution, the quantum of a distribution is determined by reference to the market value of the assets transferred. The quantum is the amount by which the market value of the asset transferred exceeds the consideration received.

For these purposes, a company’s profits available for distribution are increased by the amount (if any) by which the consideration received for the asset transferred exceeds its book value. Accordingly, the “profit” arising on transfer will be taken into account when determining whether the quantum of any distribution should be determined on the first or second basis.

Although one would not ordinarily expect a distribution to be permissible on the second basis if it is not permissible on the first basis, this might be so if the market value of the asset to be distributed is less than its book value.

**Redenomination of share capital**

Currently, the only way in which a company can convert its shares from one currency to another under existing law is by way of a Court-approved reduction of capital. A company may wish to do this, for example, if its income and cost base are largely expressed in a foreign currency, so that it makes commercial sense to prepare its accounts in that foreign currency. Unless its share capital is denominated in the same currency as its functional accounting currency, the company may find that the translation of an amount standing to the credit of share capital account creates an unwelcome volatility in year end results.

The Bill will facilitate redenominations into a different currency (Clauses 578 - 584):

- unless its Articles provide otherwise, a company will be able to convert some or all of its share capital into a foreign currency by simply passing an ordinary resolution changing the nominal value of the shares. A resolution can be made conditional, but the conditions must be satisfied within 15 days of the resolution being passed,
– where the redenomination produces a strange nominal value per share, it will be possible by special resolution passed within three months of the resolution effecting the redenomination to reduce the company’s share capital to achieve a more suitable nominal value. The amount by which the company’s share capital is reduced must not exceed 10 per cent of the nominal value of the company’s allotted share capital immediately after the reduction. The amount of the reduction has to be transferred to a “redenomination reserve” which can only be used for paying up bonus shares,

– if it is desired to increase the new nominal value of the shares, it will (as is the case at present) be possible to apply distributable reserves to adjust the nominal value.

This new procedure avoids the need for involvement of the court and allows what ought to be sufficient flexibility in calculating an equivalent amount in foreign currency.

Other changes
Variations of class rights
Sections 125-9 of the 1985 Act currently set out the regime for the variation of class rights by companies with a share capital. Many companies include provisions in their Articles of Association dealing with variation of class rights, requiring the consent in writing of holders of 75 per cent of the relevant class, or the sanction of an extraordinary resolution passed at a separate meeting of the holders of the relevant class. This reflects the statutory regime but enables companies to implement any variation of class rights under their tailored requirements rather than following the statutory regime.

The Bill seeks to simplify the regime (Clauses 556-559). As part of the simplification, all companies will have to comply with the new statutory regime, although Articles of Association can in addition impose a more onerous regime. The few companies who currently require less than a 75 per cent majority of the class to vary class rights will now need a 75 per cent majority. The regime is also being extended to other companies which do not have a share capital. Companies without a share capital have previously had only to comply with their Articles of Association.

The sometimes vexed question of whether a class right is being varied or not by a particular change in the Articles will remain. Provisions in Articles which state that certain events (eg. issues of further shares) are not variations of rights of a particular class of shares will need to be examined carefully to ensure they are still effective to prevent the relevant event creating a class rights issue. The Bill will create uncertainty which did not exist previously, as the old regime expressly allowed the Articles to override the Companies Act, and so effectively dictate what events required a class vote.

Companies will need to review provisions in their Articles relating to variation of rights (which most public companies have) to confirm their status. If more onerous than the Bill, they will continue to apply in parallel with the Bill. This may in certain circumstances be undesirable. If they are less onerous than the Bill, they will be of no effect. If companies wish to remove such provisions, any
such removal will need to be checked to ensure that it itself is not a variation of class rights, so requiring class consent. Companies may in those circumstances wish to leave the relevant provisions in until they make another variation to class rights.

**Share premium account**

Section 130 of the 1985 Act requires the transfer to “share premium account” of any excess over nominal value when shares are allotted at a premium (whether for cash or non-cash assets), subject to the “merger relief” provisions in Sections 131-4 of the 1985 Act in the context of share-for-share acquisitions satisfying strict criteria. The share premium account is treated as share capital under the maintenance of capital regime, although certain specific uses are permitted:

- paying up “bonus” shares under a capitalisation issue,
- writing off “preliminary expenses” and expenses, commissions and discounts relating to the issue of any shares or debentures of the Company,
- providing for any premium on the redemption of debentures.

Under the Bill (Clause 560), the available uses of the share premium account are to be limited. Its use in writing off “preliminary expenses”, writing off expenses, commissions and discounts on the issue of debentures, and providing for any premium payable on redemption of debentures will no longer be permitted.

In addition, the use of the share premium account in writing off expenses incurred, and commissions paid, on the issue of new shares will be restricted to the premium arising on the issue of the relevant shares, so that any pre-existing balance on the share premium account will not be available for such purpose.

The restriction of uses for the share premium account will mean it will be harder to take advantage of share premiums, although in practice, for mature listed companies, the more usual uses of the share premium account – writing off share issue expenses (including underwriting commissions), bonus issues and as a “pot” available where a reduction of capital is undertaken – will remain available.
Takeovers

Implementation of the EU Takeovers Directive

The Bill includes the legislative provisions necessary to implement the EU Takeovers Directive, which is required to be implemented by Member States by 20 May 2006. Given that the Bill is unlikely to become law before the end of this year, the Government has stated that it will ensure timely implementation of the Directive by making appropriate regulations, substantially in the form set out in the Bill. However, such regulations will not be able to make changes which do not derive from the Directive: this will mean that the statutory regime may not, initially, cover all types of companies and all types of transactions which are currently covered by the Code. This will require adjustment, when the Bill is finally enacted, of the regime introduced by the regulations.

The provisions of the Bill currently fall into the following broad categories:

– establishing a statutory framework for regulation of takeover activity in the UK and designating the Takeover Panel as the supervisory authority for such activity,
– prescribing requirements in respect of barriers to takeovers, and disclosure of share rights and potentially defensive structures,
– modifying the compulsory acquisition regime to bring it in line with the Directive.

Perhaps the most noticeable impact for companies traded on a regulated market will be in respect of the additional disclosures which will be required in directors’ reports (whether or not the company is actually involved in any takeover activity).

Statutory framework and Takeover Panel functions

The Bill gives the existing Takeover Panel statutory powers to make rules in relation to takeover regulation, effectively on the basis of the existing Takeover Code and the current procedures for its amendment. The Panel’s rules must cover the matters stipulated in the Directive as requiring regulation. As well as “takeover bids” within the meaning of the Directive, the Panel is also given power to make rules in connection with the regulation of “merger transactions” and other transactions that “have or may have, directly or indirectly, an effect on the ownership or control of companies” (Clause 618). This preserves the current scope of the Code and will enable the Panel to continue to regulate takeovers of public companies whose shares are not admitted to trading on a regulated market and other types of company and transaction which fall outside the scope of the Directive.

15 “Whilst Section 2(2) [of the European Communities Act 1972] is wide enough to enable provision for matters arising out of, or related to, implementation of the Directive, a single regime, rather than parallel ones, could only be achieved through primary legislation.” (DTI consultation paper on Implementation of the European Directive on Takeover Bids, January 2005).

16 Those matters include protection of minority shareholders, mandatory bid and equitable price (Article 5), contents of takeover documentation (Article 6), timetable for acceptance (Article 7), disclosure and publicity in respect of a bid (Article 8), obligations of target management (Article 9) and other aspects of bid conduct including conditionality, revision, lapse and competing bids (Article 13).
of the Directive, including dual-holding company transactions, schemes of arrangement and offers to acquire minorities.

The Panel will have statutory power to make rulings on the interpretation, application or effect of its rules (Clause 620). In the exercise of its functions, the Panel is also empowered to require production of such documents and information as it may reasonably require.

The Bill also makes provision for the judicial functions of the Panel, which will be exercised by a Hearings Committee and an independent Takeover Appeal Board (Clause 626). Statutory powers will be conferred on the Panel to enable it to enforce its rulings, including the power to order restitution or financial redress following breach of the Code and power to require parties to take a certain course of action or refrain from so doing. The Bill will enable the Panel to apply to the court for enforcement of its rulings in the event of non-compliance. In practice, however, the Panel is unlikely to take advantage of these powers except in extreme cases and will continue to achieve compliance with its rules through risk of reputational damage.

The Bill imposes new criminal liability in respect of takeover documentation (Clause 628). This will apply to offeror companies and their directors, shareholders, employees and agents who knowingly or recklessly allow an offer document to be published which fails to satisfy the contents requirements for such documents. Similar criminal liability will also apply in respect of target company documents. The offence will not be committed unless there is knowing or reckless non-compliance with the documents contents requirements. On the other hand, it may be committed even where the non-compliance is minor in nature.

One of the principal and long-standing concerns in the UK about the Takeover Directive and its implementation has been the risk of increased litigation in the takeover context. Due to the “Datafin” principle 17 – that the Court should not, otherwise than in exceptional circumstances, interfere with the workings of the takeover regulatory system in the course of a takeover – tactical litigation relating to takeover bids has historically been extremely limited.

However, with the Panel and its rulebook being put on a statutory footing, there are continuing concerns that the risks of tactical litigation will be increased, notwithstanding provisions in the Directive which should have the result that the Datafin principle is unaffected. Express provisions are included in the Bill intended to exclude tactical litigation against the Takeover Panel and between the parties to a takeover, and protecting concluded transactions from challenge for breach of the Panel’s rules.

**Barriers to takeovers**

The provisions in the Directive regarding barriers to takeovers proved to be one of the biggest obstacles to agreement along the Directive’s slow path to adoption. The compromise eventually reached through delicate political negotiations allows the existing UK rules in this area be retained virtually unchanged.

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17 *R v Panel on Takeovers and Mergers, ex parte Datafin plc* [1987] QB 315.
The prohibition on boards of target companies from taking “frustrating action” against a hostile bidder without shareholder approval already largely reflects the provisions of the current Takeover Code and does not require enactment in the Bill.

With regard to the “breakthrough provisions” in the Directive, which enable a bidder to break through a target’s defence structures (i.e. restrictions on transfers of shares or voting rights and multiple voting rights), the DTI has opted out of imposing such provisions mandatorily. However, companies may opt in to the breakthrough mechanism, subject to shareholder approval by way of special resolution (Clause 641). In reality, very few UK companies are currently protected by such structures and this is unlikely to be a significant issue in the UK. It will raise greater concerns in other Member States where such defensive structures are more common.

The most significant provision for UK companies is likely to be the extensive new disclosure requirements aimed at giving investors greater transparency where barriers to takeovers exist (Clause 649). These provisions apply to all companies with shares traded on a regulated market (i.e. not only those which are engaged in takeover activity). Descriptions of any provisions in the company’s constitution, or in other agreements, relating to change of control will be required to be set out in the company’s annual report, including details of:

- share transfer and voting rights,
- agreements with directors or employees providing for compensation for loss of office or employment following a takeover,
- contracts which may be terminated or amended as a result of a takeover (unless disclosure would be seriously prejudicial to the Company).

These obligations will add yet further to the length and detail of the annual report and accounts.

Compulsory acquisition procedures

The Bill will enact changes to the 1985 Act in order to bring existing compulsory acquisition procedures in line with the squeeze-out and sell-out provisions in the Takeover Directive (Clause 650).

In order to trigger squeeze-out in accordance with the Directive, the Bill makes provision for a dual test whereby a bidder must have acquired both 90 per cent of the shares (or class of shares) to which the offer relates and 90 per cent of the voting rights carried by those shares (or class of shares). This differs from the current threshold under the Act which merely requires a bidder to attain 90 per cent of the shares (or class of shares) to which the offer relates. In practice, this will make little difference in the UK as the percentage of total capital carrying voting rights in a class of shares and the percentage of voting rights will normally be the same. The impact of the Directive will be greater in Member States where corporate structures involving multiple classes of shares, and differential share rights, are more common.

The sell-out threshold similarly will comprise a dual test under which a bidder must hold both 90 per cent of the capital carrying voting rights in the company (or class of shares) and 90 per cent of the voting rights in the company (or class
of shares). This differs from the current threshold which is 90 per cent of all shares in the company (or class of shares) but again will make little difference in practice.

The existing provisions under the 1985 Act regarding the period during which squeeze-out rights may be exercised will be amended to reflect the Directive requirements that they cannot be exercised after expiry of a three month period following the time allowed for acceptance of the bid. (The existing provisions require the 90 per cent threshold to be reached to within four months of the date of the offer and the squeeze-out must be exercised within two months of reaching that threshold.) No change is required to be made to the existing provisions regarding timing of exercise of sell-out rights, which accord with the Directive requirement that they must be exercisable within the three months following the time allowed for acceptance of the bid.

**Takeover Code: Consultation**

Reform power

One of the key objectives of the Bill is to establish a flexible framework of company law with the ability to develop to reflect a changing business environment. The Bill therefore proposes the creation of a novel and wide-ranging power to amend company law, including to make policy changes (Clauses 774-788).

This power is conferred on the Secretary of State for Trade and Industry but is subject to mandatory consultation with, at least, organisations representative of the interests of those who will be affected. There is also an enhanced parliamentary approval process, including a requirement for a formal explanation of the proposed changes, together with the draft text of the proposed legislation, to be laid before Parliament and a period of 60 sitting days for parliamentary consideration. In framing the draft legislation, the Secretary of State will have to have regard to any resolution or report of, or of any Committee of, either House of Parliament about the draft text and explanation.

The Bill itself limits the power, for example, prohibiting its use to impose taxation or to make retrospective provision, and restricting the imposition of penalties for criminal offences.

The House of Lords Delegated Powers and Regulatory Reform Committee describes this as “a Henry VIII power of enormous proportions”\(^\text{18}\) (a “Henry VIII power” is a power in a bill which enables primary legislation to be amended by secondary legislation with or without parliamentary scrutiny). The Government has offered Ministerial undertakings not to use the power for “large and politically controversial” matters, but these would not be binding on future governments. The Committee recommends against the inclusion of the reform power in the Bill on the grounds of its very wide scope. In particular, the Committee is concerned that the Parliamentary scrutiny process might not give sufficient protection, while not necessarily being quicker than a bill, and that the power might set a precedent which other government departments would seek to follow.

The Law Society’s Company Law Committee, on the other hand, strongly supports this new power, on the grounds that it would speed up company law-making, enabling future problems that may arise to be resolved more quickly. Given the concerns of the Delegated Powers and Regulatory Reform Committee, however, the reform power promises, surprisingly, to be one of the more controversial provisions of the Bill.

Further information

If you would like to discuss any aspect of the Company Law Reform Bill, please contact Lucy Fergusson (0207 456 3386), Steven Turnbull (0207 456 3534) or your usual contact at Linklaters.