

## The U.K. Companies Act 2006: Key Provisions

*Portfolio Media, New York (October 10, 2007)*

Provisions coming into force on 1 Oct. 2007 will have an immediate impact on businesses' day-to-day operations.

On 1 Oct. 2007 some of the key provisions of the U.K. Companies Act 2006 (the Act) will come into force, including those relating to part of the new statutory statement of directors' general duties, derivative claims, the business review, shareholder resolutions and meetings. This will have an immediate impact on businesses and how they are run on a day-to-day level. Below we have highlighted in brief some of the main provisions concerned.

### \* Directors' Duties \*

Sections 171 to 177 of the Act codify seven general duties of a director: (1) to act within his or her powers; (2) to promote the success of the company; (3) to exercise independent judgment; (4) to exercise reasonable care, skill and diligence; (5) to avoid conflicts; (6) not to accept benefits from third parties; and (7) to declare interests in proposed transactions.

Only codified duties 1 to 4 will come into force on 1 October 2007. The new provisions regarding duties 5 to 7 will not take effect until 1 October 2008.

In the interim, the existing common law will continue to govern in respect of the duties to avoid conflicts and not to accept third party benefits (and will of course continue to aid in the interpretation of the other duties going forward).

Section 317 of the Companies Act 1985 will continue to apply in the meantime to the declaration of interests in proposed transactions.

The new codified duty to promote the success of the company has led commentators to question how success is to be measured, and whether it is predominantly a financial test or is effectively another way of describing the requirement to act in the best interests of the company.

The explanatory notes to the Act indicate that it is envisaged that the purposes of the relevant company will have a bearing on the construction of this duty.

It should be noted that the list of codified duties is not comprehensive. Other duties,

such as the duty to act in the best interests of creditors in times of threatened insolvency, remain uncodified.

#### \* Board Procedure when Deliberating on the Promotion of the Success of the Company \*

Section 172 of the Act sets out a list of matters to which the directors must have regard when assessing whether a proposed action would be most likely to promote the success of the company for the benefit of its members as a whole. These matters are as follows:

The likely consequences of any decision in the long term

The interests of the company's employees

The need to foster the company's business relationships with suppliers

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

The need to act fairly as between the members of the company.

It will not be necessary to record the board's deliberations on each of those issues, but it would be prudent to record the board's conclusions in respect of any of those matters having particular relevance to the decision being made. The list is by no means exhaustive. It will be noted that this list omits one of the more obvious factors likely to weigh on the directors' minds in the decision-making process—the likely effect on profits.

#### \* Substantial Property Transactions \*

The Act significantly changes the requirements in respect of entering into substantial property transactions with directors. It will now permit the company to enter into the relevant contract, conditional upon member approval, and raises the minimum value of what may be regarded as a substantial non-cash asset from £2,000 to £5,000.

#### \* Loans \*

The Act abolishes the prohibition on loans and quasi-loans to directors and credit transactions with directors, and replaces it with a requirement for member approval. The criminal penalty for breach has also been abolished and the affirmation of loans, quasi-loans, etc., is now permitted.

A new exception is created for expenditure in connection with regulatory action or investigations. The existing exception in relation to expenditure on defending criminal or civil proceedings is now restricted to proceedings in connection with any alleged negligence, default, breach of duty or breach of trust by the director in relation to the company or an associated company.

#### \* Service Contracts \*

Shareholder approval is required for directors' service contracts (including contracts of service, contracts for services and letters of appointment) which guarantee a director's term of employment, which is two years, or possibly longer (down from five years under the 1985 Act).

### \* Directors' Liabilities – Indemnities and Ratification \*

The Act will now permit companies to indemnify directors of companies acting as trustees of an occupational pension scheme.

The Act introduces substantive reform of the law on the ratification of acts giving rise to liability on the part of directors for conduct amounting to negligence, default, breach of duty or breach of trust. Ratification must be by resolution of the company, and the relevant director and his connected persons may not vote on the resolution (nor are they eligible to sign in the case of a written resolution).

It should be noted that although breach of fiduciary duty is ordinarily ratifiable by ordinary resolution, existing case law requiring unanimous approval in the case of conduct that potentially constitutes a fraud on the minority, will continue to apply. The ability to rely on unanimous consent of the members is preserved.

### \* Minimum Number \*

The minimum number of directors for a private company is one, and for a public company, two.

### \* Derivative Claims \*

The major reform to derivative actions is in relation to procedure. A new two-stage statutory procedure has been introduced. At stage one, the applicant will be required to make a prima facie case for permission to continue a derivative claim, which the court will consider on the basis of the evidence filed by the applicant only, without requiring evidence from the defendant.

The court must dismiss the permission application if the applicant cannot establish a prima facie case. At the second stage, but before the substantive action begins, the court may require evidence to be provided by the company. The new procedure is supplemented by new provisions in the Civil Procedure Rules (CPR) and a new Practice Direction.

However, there are also important changes to the substance of the law in relation to derivative claims. There is no requirement for the claimant to prove "wrongdoer control". In addition, the Act will permit a derivative claim to be brought on the grounds of "negligence, default, breach of duty or breach of trust" by a director of the company. This is widely viewed as an expansion of the scope of directors' liability.

There is considerable doubt as to whether at present a derivative action can be brought based on an allegation of mere negligence on the part of a director, where the director has not benefited personally as a result of the breach.

In view of the potential expansion of the scope of derivative actions under the Act, coupled with the existing power of a claimant under the CPR to seek an indemnity for costs incurred in a derivative action out of the assets of the company at the outset of the claim (which is preserved in new Rule 19.9E of the CPR for claims commenced on or after 1 October 2007), directors should ensure their D&O insurance policies cover the new statutory derivative action.

### \* Resolutions \*

Resolutions can only be passed in accordance with the Act. This is a new provision. Where a provision of the Act requires a resolution of the members but does not specify

what kind of resolution, then an ordinary resolution is required, unless the articles specify a higher majority or unanimity.

Elective resolutions may no longer be passed (save in relation to elective resolutions to renew authority to allot under section 80A of the 1985 Act). Elective resolutions will effectively become the default position for private companies.

#### \* Written Resolutions and Unanimous Consent \*

Written resolutions need no longer be passed unanimously in all cases. A special resolution can be passed as a written resolution if 75 per cent of those entitled to vote pass the resolution (provided it is identified as a special resolution). An ordinary resolution can be passed as a written resolution if a simple majority of those entitled to vote pass the resolution.

It should be noted that the relevant majority of all members must be achieved (as opposed to the relevant majority of those voting), i.e., failure to sign is effectively a vote against the resolution. New procedural requirements stipulate that an explanatory statement informing the member how to signify his agreement to the resolution be enclosed with the resolution. There is now a time limit for agreeing to written resolutions (28 days from the date of circulation, unless a different period is specified in the company's articles).

#### \* Notice of Meetings \*

There is no longer a requirement of 21 days notice of intention to pass a special resolution at a meeting. Fourteen days' notice of a general meeting is generally sufficient, save in the case of an Annual General Meeting (AGM) of a public company (21 days), but the articles can specify a longer period.

Consent to short notice can be given by shareholders with 90 per cent of the vote in the case of private companies, and 95 per cent in the case of public companies (or such higher percentage as is specified in the articles), save in the case of AGMs where it must be 100 per cent. The Act facilitates electronic communication and contains detailed provisions in that regard. The notice of the meeting must contain new standard wording explaining the member's ability to appoint multiple proxies.

#### \* AGMs \*

Private companies need no longer hold AGMs unless their articles require them to do so, or the requisite percentage of the members request that they do so (5 to 10 per cent depending on the circumstances).

It should be noted that the phrase "extraordinary general meeting" has been expunged from the Act. Meetings are now simply "general meetings" or "annual general meetings".

#### \* Procedure at General Meetings \*

The rules on proxies have been overhauled. In particular, it should be noted that the statutory 48 hour cut-off period for returning forms of proxy is now calculated using working days, with the result that it will never fall on a weekend or bank holiday (in contrast to the position under the 1985 Act) unless the articles provide otherwise. Quoted companies must publish poll results on their websites in respect of all general and class meetings.

#### \* Records of Resolutions and Meetings \*

Copies of all written resolutions, minutes of general meetings and decisions of sole members must be kept available for inspection by members for 10 years (the 1985 Act envisaged they would be preserved forever).

\* Members Calling Meetings \*

The 1985 Act provided that members holding 10 per cent of the voting rights could require the directors to call a general meeting. This has been reduced to 5 per cent if more than 12 months have elapsed since the date of the last general meeting, in advance of which members had a right to circulate resolutions.

\* Members' Resolutions \*

If members of a public company holding 5 per cent of the voting rights or 100 members with holdings averaging not less than £100 in paid up capital (the "Requisite Proportion") propose resolutions to be moved at an AGM or statements of up to 1,000 words with regard to a proposed resolution or other business to be dealt with at a general meeting, and the request is received before the financial year-end, the members are not required to pay for the costs of circulation.

\* Members' Rights to Raise Audit Concerns \*

The Requisite Proportion of members of quoted companies have a new right to require that a statement relating to certain audit concerns they may have, be published on the company's website. Quoted companies must draw attention to this right in the notice of the "accounts meeting" (the general meeting at which its annual accounts and report are laid).

\* Exercise of Members' Rights \*

The Act introduces new provisions dealing with the ability of indirect investors to exercise governance rights.

\* Political Donations \*

A company must not make a political donation to a political party or other political organisation, or incur any political expenditure unless the donation or expenditure is authorised by a resolution of the members of the company, and in certain cases, also its holding company.

Unlike the 1985 Act, there is no provision for retrospective ratification of breaches of the rules. A new exemption for donations to trade unions has been introduced.

\* Directors' Report – Business Review \*

All private companies must produce a business review as part of the directors' report, except those under the small companies accounting regime, and all public companies must do so.

Medium-sized companies are excepted from reporting non-financial key performance indicators. A new additional list of matters must be addressed in the business review of quoted companies.

This note highlights in brief some of the main provisions of the Act coming into force on 1 Oct. 2007. It is not intended to be comprehensive.

--By Brigid Breslin, **McDermott Will** & Emery UK LLP

*Brigid Breslin is a senior associate with McDermott, based in the London office.*

---

All Content Copyright 2007, Portfolio Media, Inc.