

Moorcrofts' Update: Companies Act changes which came into force on 1 October

I thought I should send you a quick update on key Companies Act 2006 changes that came into effect on 1 October 2008 and how they may affect you and your company. The Companies Act 2006 is, in my view, an overly lengthy bit of law, but it does have some worthwhile innovations.

Headlines:

1. Financial assistance rules abolished (but still needs careful thought).
2. Reduction of share capital simplified – new procedure.
3. Directors' duties – new provisions.
4. Changes to Articles of Association – some mandatory changes now in force.
5. Right to object to a Company name – new procedure.
6. Control of political donations.

Repeal of financial assistance prohibition for private companies

Until 1 October, it was illegal for a company to give "financial assistance" to help someone acquire a company's own shares. This was creditor protection mechanism – a creditor who knew what he risked in the event the company went "bust" would find himself shunted down the pecking order behind a secured bank. The bank would lend money secured on the company's assets to allow a purchaser to acquire that company's shares and so ordinary creditors who knew nothing about the change of share ownership would find themselves ranking behind the purchaser's bank debt. The 1985 Companies Act protected the creditor by making the directors do a 12 months look forward to swear a declaration that the company's debts could be paid as they fell due, and the auditors had to give a declaration that the directors' declaration was not unreasonable in all the circumstances. So in corporate transactions the practice of giving these declarations (the so called "whitewash") was common. However, from 1 October, the giving of financial assistance by a private company for the acquisition of shares in itself or another private company is no longer prohibited. The prohibition remains in force for public companies. The consequence of the repeal means that private companies will not have to go through the "whitewash" procedure.

But, as with so much recent legislation, what the Government giveth with one hand, it taketh away with the other.... In the future, if you are involved in a transaction that would have been financial assistance under the old regime (let's call it "pseudo financial assistance"), you will still need to take general company law principles seriously, such as:

- ensuring the transaction is in the best interests of the company and all its shareholders (not only the incoming ones!),
- not breaching statutory rules on distributions and ensuring there is no illegal reduction in the capital of the company; and
- bearing in mind that a transaction may be called into question under insolvency provisions if the company goes into insolvency.

Beefed up directors' duties mean directors who don't think about creditors, and give "pseudo financial assistance" may find themselves under attack if the company goes into liquidation within two years of the deal.

Although no longer a statutory requirement, we will be advising clients to continue to get shareholder approval before giving “pseudo financial assistance” and, in some exceptional cases, to ask their auditors to review the company’s cashflows and projections. It does remain to be seen how exactly this area of the law will turn out, and much of course will depend on what banks’ funding transactions will require. Our current experience of deals done since 1 October is, as Roger Daltry said, “meet the new boss, same as the old boss”. The paperwork we have been providing on “pseudo financial assistance” bears an uncanny resemblance to what we used to produce and that is because the paperwork demonstrates the directors’ approved the “pseudo financial assistance” on an informed basis – thus rendering them less likely to be attacked for their decisions on an insolvency . . .

Reducing Share Capital

Since 1 October private companies are now allowed to reduce their share capital without having to apply for court approval, where such reduction is supported by a solvency statement made by each of the directors. Making the solvency statement without reasonable grounds for the opinions expressed in it will be a criminal offence by the directors.

A company might like to consider this new power:

- if it was a start up that has accumulated losses that prevent the payment of dividends even though the company has now become profit-making;
- to return excess capital to shareholders where the company was set up with a large amount of share capital that is no longer needed for operational reasons.

The new route will certainly be a less onerous way to reduce a company’s capital than via the old court procedure. This solvency statement and special resolution required could be completed in a day or two where a written resolution is passed (although you will need to factor in time needed to put the directors in a position that they have a clear view of the company’s financial health for the next twelve months and so can make the solvency statement). Again, the directors may wish to obtain comfort before signing the solvency statement by consulting the company’s auditors.

The solvency statement route to reducing capital is a potentially cheaper and quicker way for a company to tidy up its share capital (including the share premium account and capital redemption reserve). Whether it has other uses for returning shareholder funds remains to be seen.

Further changes made to Directors’ Duties

Most of the “codification” on directors’ duties came into force in October 2007. However, the introduction of the following was deferred until 1 October 2008:

- to avoid conflicts of interest with the company;
- to declare interests in proposed or existing “transactions or arrangements” with the company; and
- not to accept benefits from third parties conferred by reason of a director’s position.

The key thing to note about these “codification” provisions is that they are broadly drawn, and are capable of covering not only directors pursuing opportunities on their own account rather than the company’s, but also to situations such as multiple directorships. There is therefore an increase in the risks for directors in potential conflict situations. Protection is available via a new power for the other directors of a company to authorise potential conflicts (a more flexible alternative to the current law authorising conflicts

through shareholder approval or the articles). Companies will either need to pass a shareholder resolution or change their articles to allow the directors to authorise conflicts in future. It is also vital for directors to realise that failures to declare interests in existing transactions with the company will be a **criminal** offence. All directors therefore need to look closely to ensure they have declared all interests in transactions with the company.

Directors approving their fellow directors' "conflicts" will need to be careful that, in giving approval they have carefully thought through the reasons. They may want to record their decision-making process in writing, with appropriate legal advice being taken.

Changes to Articles of Association

A number of changes to a company's articles of association will be required to reflect various Companies Act 2006 changes. Unfortunately, there are yet more changes coming into force in October 2009 (which we think is really an unsatisfactory way of proceeding). You may decide to wait until then to review your Articles, but you should at least be aware of the following in particular:

- the ability of a company's "non-conflicted" directors, rather than its shareholders, to authorise "conflicted" directors' conflicts of interests will require either a special resolution or a change to the Articles to be effective;
- Some provisions, such as private companies no longer having to hold annual general meetings, the reduction of the statutory notice period for all shareholder meetings to 14 days, and communicating with shareholders by electronic means, will also require amendment to the Articles to be effective.

Do let us know if you do want to review your Articles now. Otherwise, we will contact you again shortly before October 2009 to remind you of the need to review Articles then.

Right to object to Company name

From 1 October, 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 objector has "goodwill" (described as "reputation of any description"). An objection may be made at any time after the name is registered to a company names adjudicator appointed by the Secretary of State. This change makes it easier to challenge opportunistic registrations of company names, as previously the Registrar of Companies only had limited powers to intervene. How this will pan out in the future remains to be seen, but it is potentially a valuable weapon in a company's armoury of "brand" protection.

Control of Political Donations

Political donations, including to independent candidates, of £5,000 or more now require shareholder approval.

If you do want to discuss any of these points above, please do not hesitate to contact me or my Corporate Partner, Teri Hunter.

Adrian Phillips