



Company

Companies Act 2006: the first instalments

Introduction

The Companies Act 2006, which will in due course repeal and replace almost all the previous companies legislation in England and Wales, is being brought into force in a number of stages. Some relatively minor changes have been implemented from January 2007, but the main changes will take effect on 1 October 2007, 6 April 2008 and 1 October 2008.

This article focuses on some of the main alterations which are due to be introduced on 1 October 2007, namely the codification of directors' duties, the new law in relation to derivative claims and some other practical issues relating to company meetings and resolutions and directors' conduct generally. Subsequent articles will look at the changes scheduled for 2008.

Statutory Statement of Directors' Duties

The Act introduces for the first time a statutory statement of the principal duties owed by directors to their company, making them clearer and more accessible than at present.

In doing so, the Act provides that the duties should be implemented in the same way as existing common law rules and equitable principles and will also largely apply to shadow directors. In summary, the general duties of a director include the duty:-

- To act in accordance with the company's constitution and within his powers;
- To promote the success of the company for the benefit of its members as a whole and, in doing so, to have regard to:-
 - the likely long-term consequences of any decision;
 - the interests of the company's employees;
 - the need to foster the company's business relationships with its suppliers, customers and others;
 - 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
- To exercise independent judgement, although this duty is not infringed by, for example, acting in accordance with an agreement that restricts the future exercise of his discretion;
- To exercise reasonable care, skill and diligence;
- To avoid conflicts of interest;
- Not to accept benefits from third parties;
- To declare to the other directors any interest in a proposed transaction or arrangement of the company.

Much has already been written and said as to how these duties should be implemented, and seen to be implemented, in practice.

The main question is whether directors could be held liable for failing to have due regard to their statutory duties or to attach sufficient importance to them.

On the one hand, the words “have regard to” in relation to the duty to promote the success of the Company appear to acknowledge that directors may quite properly decide that other factors outweigh all or any of the statutory ones, depending on the particular circumstances. On the other hand, the Explanatory Notes issued with the Act make it clear that the obligation to “have regard to” the statutory factors cannot be discharged merely by paying lip service to them and that the directors of a company must in reality exercise the same level of skill, care and diligence in the light of the statutory duties as they would in carrying out any other function.

We anticipate that, in interpreting the new law, the courts will take into account all relevant circumstances, including each director’s role and expertise, the seriousness of the matter in issue and whether a reasonable director, properly directing himself as to his statutory duties, could reasonably be expected to have acted in the manner in which he did. It will be important, therefore, to ensure that there is good evidence in place that the board has actually considered how a particular decision will for example affect the company’s employees, customers and suppliers, as well as its commercial reputation, the environment and any other relevant factors provided for in the new rules.

As part of this exercise, we would recommend that in most cases, before the law comes into force on 1 October 2007 and thereafter when a new director is appointed, companies should provide their directors with a memo setting out the new codified duties and that directors should countersign a copy of the memo to acknowledge that they have received and read it. We would also recommend that companies should have an ongoing statement of company policy in relation to the directors’ statutory duties and that, in respect of any future change of strategy, the implication of that change in relation to those duties should be considered and set out. The new duties will apply with appropriate adjustments to all forms of company regardless of their business and whether the company is public or private, family or charitable or public interest.

The new law is potentially complex and is untested, so that until there have been a number of judicial interpretations, it is difficult to give more than general advice in this article.

It seems clear, however that, before accepting any appointment as a director, a person should, even more than has been the case up to now, carefully consider his or her personal position in the light of the new statement of duties and whether for example the objectives which he or she may be seeking to achieve by becoming a director could not be obtained in some other way, by contract or otherwise. If in doubt, we would recommend that companies and others contemplating directorships should seek specific advice as appropriate.

Derivative Claims

The Act establishes a new statutory procedure which will replace the previous common law rules relating to situations where shareholders wish to put right a wrong which has been done to the company.

Under current law and with limited exceptions only the company itself can bring an action in these circumstances. Under the new law, a revised procedure is established so that action can be taken as appropriate by a member on behalf of the company, a so-called derivative claim, subject always to the permission of the court. An action in these circumstances can only be taken in respect of an actual or proposed act or omission by a director involving negligence, default, breach of duty or breach of trust. It will no longer be necessary to show that the director has benefited personally from the breach or that the directors who carried out the wrongdoing are in control of the board.

Derivative actions are relatively rare, but the new statutory procedure should give additional rights, in particular to minority shareholders.

The legislation does not replicate existing case law, so that it will be necessary to wait and see how it is interpreted in practice by the courts. It is important to note however that, although the new Act expressly enables shareholders to ratify, by ordinary resolution, a director's conduct amounting to negligence, default, breach of duty or breach of trust in relation to the company (subject to anything in the company's articles requiring a higher majority or unanimity), the votes of shareholders with a personal interest in the ratification will not count when determining whether the ratifying resolution has been passed.

Company Meetings and Resolutions

The Act aims to streamline a number of procedures relating to decision making by a company’s shareholders. Briefly these include provision for the following:-

- Private companies will no longer be required to hold an annual general meeting, to lay their accounts or to appoint an auditor, although they may continue to do so if they wish, and the related elective resolutions will accordingly no longer be required;
- Public companies will have to continue to hold an annual general meeting and to do so within six months of the financial year end;
- Extraordinary general meetings of both private and public companies will in future require only 14 days’ notice, even if a special resolution, which previously required 21 days’ notice, is proposed;
- All resolutions of private companies, other than resolutions to remove a director or auditor, will in future be capable of being passed as written resolutions;
- Written resolutions will no longer require unanimity: ordinary written resolutions will require a simple majority and special written resolutions a 75% majority of the total voting rights of members eligible to vote;
- On a written resolution each member will have one vote unless the Articles provide otherwise; and

- The requirement for shareholder consent to holding a meeting on short notice will in future be 90% for a private company and 95% for a public company.

Directors' Conduct

Apart from the above, other changes to be introduced which affect the conduct and dealings of directors include:-

- Shareholder approval will be required for directors' service contracts in excess of two, as opposed to five, years;
- Companies will be required, as now, to retain copies of directors' contracts and shareholders will be entitled to request a copy, on payment of a fee;
- The general company law prohibition on loans to directors will be replaced by a requirement for shareholders to
- approve the arrangement, subject to prior disclosure of the terms and to the existing levels of exemption from the requirement being increased;

- Substantial property transactions with directors will be able to be entered into conditionally on shareholder approval being given in the future and the de minimis level will be increased to £5,000; and
- The provisions relating to approval of compensation payments to directors and others are being amended and extended.

It is anticipated that the changes relating to company meetings and resolutions and directors' conduct, which will come into effect on 1 October 2007, together with some of the further changes to be

implemented in April and October 2008, will simplify a number of procedural aspects in the operation in particular of private companies.

For further information or advice on the above, or on any other changes to be implemented by the Companies Act 2006, please get in touch with your usual contact in the Company and Commercial Department of Payne Hicks Beach.