In the Wake of the Companies Act 2006: An Assessment of the Potential Impact of Reforms to Company Law

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Introduction

The United Kingdom’s Companies Act 2006 is subtitled:

“An Act to reform company law and restate the greater part of the enactments relating to companies; to make other provision relating to companies and other forms of business organisation; to make provision about directors’ disqualification, business names, auditors and actuaries; to amend Part 9 of the Enterprise Act 2002; and for connected purposes.”1

It contains 47 Parts with 1,300 sections and is followed by 16 Schedules. It is the largest Act of Parliament ever enacted. It appears sufficiently comprehensive as its provisions have absorbed most of the Companies Act 1985, Companies Act 1989 and Companies (Audit, Investigations and Community Enterprise) Act 2004, while also codifying certain aspects of the case law.2although in reality it is not a complete code. It is the purpose of this article to look at some of the changes introduced by the legislation, including some measures heralded by the Government as of particular benefit to businesses, with a view to assessing whether the provisions introduced in the Act may bring the desired changes to the framework for the governance of companies in the United Kingdom today.

From the Company Law Review to the Companies Act 2006

The Company Law Review, which began in 1998, had the overall objective of simplifying the structure of UK law. It set out to do this by promoting competitiveness, striking the proper balance between the interests of participants in corporate life so as to promote “straightforward, cost-effective and fair” regulation, and promoting consistency, predictability and transparency in the law.3 After extensive consultation with interested parties and the production of a considerable number of volumes of individual reports and an interim report, the Company Law Review presented its Final Report to the Secretary of State for Trade and Industry on July 26, 2001. The report contained a range of recommendations for substantive changes to many areas of company law, and a set of principles to guide the development of the law more generally, most notably that it should be as simple and as accessible as possible for smaller firms and their advisers and should avoid imposing unnecessary burdens on the ways companies operate. Two White Papers followed as part of a wide consultation process initiated by the Government.4 Draft clauses were appended to the 2005 paper, which also contained declarations of intent with respect to the Government’s legislative intentions. Further clauses were the subject of consultation later

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2. The parts of the Companies Act 1985 that survive contain provisions on investigations (corporate and other bodies) and restrictions on shares following investigations (other provisions on Scottish floating charges were subsequently incorporated in Pt 2 of the Bankruptcy and Diligence (Scotland) Act 2007). Those parts of the Companies Act 1989 that survive contain provisions on assistance to overseas regulatory authorities, incorporated charities in Scotland and the relationship between financial markets and insolvency.

in 2005.\(^5\) The Companies Bill was introduced in Parliament on November 4, 2005, although most of its stages were not completed until 2006. Royal Assent being received on November 8, 2006. The Government then embarked on a consultation process with the intention of bringing the Act into force during the course of 2007–2008. Owing to difficulties with the scale of the proposals and the changes the Act intended to make, the timetable was eventually extended, with the Act to achieve full implementation by October 1, 2009, nearly three years after its enactment.\(^6\) Although regrettable, the extended transition period will enable companies to better adjust to the changes that are proposed and will allow company directors and advisers to measure the implementation of compliance with the new rules.\(^7\)

### Substantive company law: the constitution, objects and ultra vires

- “The company memorandum will become a formal document recording the position at the point of registration, with just the articles being the continuing constitutional document. Companies will no longer be required to specify their objects.”\(^8\)

The history behind the statement of corporate objects is a long one and reflects predominantly judicial concern over the misuse of the incorporated form.\(^9\) The Company Law Review’s Final Report recommended that companies should have a single constitutional document. Furthermore, companies should have unlimited capacity so that third parties would no longer have to be concerned with whether the constitution contained an objects clause. This is a step that has already been taken by many other Commonwealth countries which have inherited companies’ legislation descended from predecessors of the Act.\(^10\) Nevertheless, the proposals would include new provisions clarifying when directors would be deemed to have authority or delegate authority to others to bind the company.\(^11\) The proposed Bill would include a clause removing the last vestiges of the ultra vires rule and to ensure that challenges could not be brought to the actions of any company on the basis of the powers being exceeded. It was the intention that the effect of an illegal act will be governed by the rule or statute that creates the illegality. It was also the intention that companies will no longer be permitted objects in a constitution that serve to limit its capacity.\(^12\)

In response, the 2002 White Paper stated that the Government considered both objects clauses and the existence of two separate constitutional documents to no longer serve any useful purpose. While companies could still retain objects, their effect would be limited to internal disputes between directors and members. While members could entrench clauses in the single constitutional document that would be required, protecting clauses deemed of great interest, outsiders doing business with the company would not have to worry about its contents.\(^13\) The Bill accompanying the White Paper accordingly contains a cl.1(5) conferring unlimited capacity on the company and a cl.17 governing the exercise of a company’s powers by directors and those mandated on behalf of the company. These are now ss.31 and 40 of the Act respectively. However, one significant difference exists: s.31(1) of the Act now states that, “[u]nless a company’s articles specifically restrict the objects of the company, its objects are unrestricted”.

As for the constitutional documentation required, although the words “memorandum of

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6. The latest table of implementation is available at [http://www.berr.gov.uk/files/file46774.doc](http://www.berr.gov.uk/files/file46774.doc) [Accessed August 15, 2008]. Interestingly, some of the implementation orders effect changes to the text of the Act itself, meaning that the shape of the Act by the end of the implementation process will be subtly altered.

7. The impact on academic lawyers cannot be neglected either, given that the Act came after the beginning of the 2006–2007 academic year, requiring changes to be made that year, while the three years that follow straddle the implementation period, leading many to have to reference the extensive provisions of both the 1985 and 2006 Acts in course materials.

8. The bullet points heading the discussion that follows are those the Government identified as key changes to be brought in by the Act. A full list is available at [http://www.berr.gov.uk/bbfs/co-act-2006/Major%20Benefits%20of%20Business/page35194.html](http://www.berr.gov.uk/bbfs/co-act-2006/Major%20Benefits%20of%20Business/page35194.html) [Accessed November 12, 2008].


10. Examples include s.124(1) of the Corporations Law 2001 (Australia); s.16 of the Companies Act 1993 (New Zealand); s.15(1) of the Business Corporations Act 1985 (Canada). See also s.3(3) of the Limited Liability Partnerships Act 2000 granting unlimited capacity to this new type of business vehicle in the UK, a precursor which might have served as a model for the new dispensation.


12. Final Report (2001), para. 16.5, which goes on to state that s.35 of the Companies Act 1985 would be abolished save for subs.(4) dealing with charitable companies.

association” are used in s.8 of the Act, in substance its use is limited to the formation process, where it contains statements as to the desire to form a company and, in cases where share capital is to exist, what shares are subscribed to. The company’s constitution is defined in s.17 of the Act to comprise the articles and any later resolutions of the company. Section 18 of the Act further requires the articles to be contained in a single document with numbered paragraphs, while s.19 of the Act provides that the secretary of state may prescribe model articles. Section 20 of the Act, interestingly, states that limited companies, even if they have their own drafted articles, will have the model articles applied where the in-house articles do not exclude this possibility, thus causing the default structure to potentially require reference to two formulations internal and external. The inconvenience this may cause is palliated by the fact that the new constitutional structure is somewhat simplified in comparison with the old arrangements. For existing companies, s.28 of the Act will treat any old memoranda as part of the articles of the company for the purposes of s.17 of the Act. The cumulative effect of changes to constitution and objects frees most companies from the tedious and prolix drafting formerly required, although, with the number of companies incorporated under the previous companies’ legislation, memoranda and the objects they contain will continue to feature in corporate life for some time to come. There remains also the option for companies incorporated under the new Act to continue to state objects, perhaps where it is felt a certainty of the object assists the attraction of investment or serves to delineate a limitation on the capacity its promoters desire. It will be interesting to see whether the courts will treat these “voluntary” objects as having the same limiting effect to those required under former companies’ legislation.

Directors’ qualification and public record details

In a bid to ensure the transparency of directors’ appointments, the Act makes new rules for the composition of boards. Although proposals previously mooted to abolish corporate directorships have been toned down, from October 1, 2008 s.155 of the Act requires every company to have at least one director who is a natural person, exceptions being made for corporations sole and appointments held on a representative basis.14 Similarly, s.157 of the Act now prohibits appointments of those under 16 unless excepted under s.158 of the Act. From that day, anyone who is not yet 16 will no longer be a director and liability as a shadow director will attach to anyone acting despite this disqualification. The changes are consonant with the rule in contract law that edicts capacity once the threshold age is reached (16 for necessaries and 18 for other contracts).15 As a consequence, fact situations such as that in cases like *Cardiff Savings Bank, Re*,16 where the director sought to be held liable was appointed at the age of one, will now disappear. Any impact on entrepreneurship can be dealt with by the facility to apply for the exemption in s.158 of the Act.

- “Directors will automatically have the option of filing a service address on the public record (rather than their private home address).”17

A new Ch.8 of the Companies Act 2006 deals with the rise of a recent phenomenon: the targeting of directors of companies by animal rights activists, who have in the recent past threatened and/or harassed directors (as well as staff and auditors) of research laboratories and even of other companies that have supplied materials to or constructed facilities for animal testing or research.18 The incidental risk from terrorist activity is also a consideration adverted to by the Government.19 Under the Criminal Justice and Police Act 2001, a confidentiality order could be applied for, protecting home and residential addresses from disclosure by the substitution of a service address.20 Nonetheless, concerns over abuse of the historic right to have public access to the register led to the Company Law Review recommending that all directors should have the option to file a service address on the public record, while residential addresses could be kept on a separate secure register accessible only by enforcement and regulatory bodies.21 As a result, s.240 of the Act sets out the type of information that may be protected and that, under ss.241–242 of the Act, may not be disclosed to third parties.

16. *Cardiff Savings Bank, Re* [1892] 2 Ch. 100 Ch D.
17. The bullet point heading the discussion that follows is one of those the Government identified as key changes to be brought in by the Act. A full list is available at [http://www.berr.gov.uk/bb/bb/co-act-2006/Major%20Benefits%20to%20Business/page35194.html](http://www.berr.gov.uk/bb/bb/co-act-2006/Major%20Benefits%20to%20Business/page35194.html) [Accessed November 12, 2008].
20. Explanatory Note, para.447, stating that, by October 2006, some 7,000 orders (out of 11,000 in total) had been made for the benefit of company directors and partners in limited liability partnerships.
21. Explanatory Note, para.448 extending the facility to company liquidators and, in some circumstances, creditors or shareholders.

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14. i.e. a directorship held because of an appointment to another position.
by the company or the registrar of companies. Limited disclosure is available under s.243 of the Act to public authorities or credit reference agencies. Under s.244 of the Act, a court may make an order for disclosure of a residential address to a liquidator, creditor, shareholder or interested party where service or enforcement via the address on the public record is ineffective. The impact of these provisions is to balance the need for protection with access to information by those entitled, as opposed to the merely curious or potentially malicious.

**Directors’ duties**

- “The statutory statement of directors’ general duties makes the well established law in this area more accessible and brings it into conformity with modern business practice.”

A core feature of the corporate governance focus of the Company Law Review, the recommendation was to rationalise the case law, which had been accreting and adjusting principles since the dawn of companies’ legislation in the United Kingdom. The extensive coverage in the reports produced by the Company Law Review may be summed up in an intention to provide a new statement of directors’ duties to appear in the statute in a codified form. This formulation was to include a duty of obedience, including the duty to act for a proper purpose (Principle 1), a duty to act in good faith (Principle 2), a duty not to delegate (unless authorised) and to exercise independent judgment (Principle 3), a duty to exercise reasonable skill and care and diligence, patterned after the model of s.214 of the Insolvency Act 1986, but defined more objectively and without the specific focus on creditors (Principle 4), a duty to avoid transactions in which there is a personal interest (subject to disclosure being available) (Principle 5), and a fiduciary duty of fidelity with two elements (Principles 6 and 7). It was not intended that the s.214 duty to creditors be introduced into general company law, given its specific application to insolvency situations and also given that creditors are able to exercise independent judgment (Principle 3), a duty to act for a proper purpose (Principle 1), a duty to act in good faith (Principle 2), a duty not to delegate (unless authorised) and to exercise independent judgment (Principle 3), a duty to exercise reasonable skill and care and diligence, patterned after the model of s.214 of the Insolvency Act 1986, but defined more objectively and without the specific focus on creditors (Principle 4), a duty to avoid transactions in which there is a personal interest (subject to disclosure being available) (Principle 5), and a fiduciary duty of fidelity with two elements (Principles 6 and 7). It was not intended that the s.214 duty to creditors be introduced into general company law, given its specific application to insolvency situations and also given that creditors are able to source information about their debtor from the public record or from pressure exercised as part of their commercial relationship with the debtor. It was also not intended to introduce a duty to avoid wrongful trading, again given its connection to insolvency matters. The Company Law Review favoured the view that the statement would be as exhaustive as possible in order to ensure clarity and the predictable development of the law, without, however, preventing the courts from being able to “develop” principles. A minor departure would deal with the issue of what authority would continue to be necessary in a situation of conflicts of interest (director’s interest in corporate transactions and exploitation of opportunities with third parties), where a duty to disclose would replace the previous and cumbersome requirement to seek approval.

The result of the legislative process is, with slightly different wording and ordering of the principles identified by the Company Law Review, to be found in Ch.2 of Pt 10 of the Act, containing ss.170–181. These provisions have already been the subject of extensive analysis by the commentators, particularly focusing on s.172 of the Act. Although the intention in this article is not to recite the provisions ad nauseam, what is interesting is that, apart from the changes, the purpose is to ensure the continuity of the statement, as far as possible, with the existing law. To that end, s.170 of the Act, which sets out the relationship between the statement and the law that it is intended to replace, is instructive. Subsection 3 provides that the statement is based on common law rules and equitable principles and is to have effect in place of these. In the very next subsection, however, the duties in the statement are to be interpreted and applied in the same way as the common law and equitable rules, with regard being had to “corresponding common law rules and equitable principles” in order to interpret the new. The explanation is that common law rules and equitable principles may well continue to develop outside company law.

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22. The bullet point heading the discussion that follows is one of those the Government identified as key changes to be brought in by the Act. A full list is available at [http://www.beer.gov.uk/bbf/co-act-2006/Major%20Benefits%20to%20Business/page3194.html](http://www.beer.gov.uk/bbf/co-act-2006/Major%20Benefits%20to%20Business/page3194.html) [Accessed November 12, 2008].


25. [Multinational Gas & Petrochemical Co v Multinational Gas & Petrochemical Services Ltd [1983] 1 Ch. 238 CA (Civ Div), subject to the limited exception in Winkworth v Edward Baron Development Co Ltd [1987] 1 All E.R. 114 HL, where a divorcing couple paid no attention at all to their jointly managed company and were held liable under a duty of care to a creditor.]

26. There is, however, a European initiative on wrongful trading (see below).

27. Explanatory Note, paras 300–301.


law and that the connection should not be lost, despite the enactment of the statutory statement.\(^3\) The interpretation that can be drawn from this provision is that the continuity between the common law and the statute is designed deliberately. Many of these sections are unproblematic. Section 173, containing the duty to exercise independent care, skill and diligence (patterned after the model law and the statute is designed deliberately.\(^3\) As mentioned earlier, s.177 of the Act, the duty to declare an interest in a transaction, is different from the previous dispensation and is also made subject to the rules in ss.182–187 of the Act, setting out the conditions in which declarations of interest are to be made. However, debates within the case law as to the proper content or extent of these duties may have to be reflected in the jurisprudence dealing with the new provisions. Potentially, s.171 of the Act, containing a duty to act within powers, may be viewed as analogous to the previous formulation of the duties to act within powers or under the company constitution and for those purposes any powers are conferred. That this is the case might also require an assessment of the way these duties are exercised, represented by the bona fide or proper purpose tests,\(^3\) in which the case law is not entirely free of ambiguity. Similarly, s.175 of the Act, which is a duty to avoid conflicts of interest,\(^3\) would perhaps require the courts to determine whether the duty envelops the type of misuse or misappropriation of company property sanctioned in some cases,\(^3\) where the dishonest diversion of assets and business opportunities to the director and to a foreign company under his control occurred.\(^3\)

The section that has aroused the most interest is s.172 of the Act and the curiously worded duty to promote the success of the company with regard to a variety of factors being required. These include 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, 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. The apparent novelty of this section stems from its embracing the enlightened shareholder concept,\(^3\) under which profit maximisation is qualified by external considerations, analogous to the way in which profit optimisation theories are put forward. Although as far as employees are concerned, a direct relationship with s.309(1) of the Companies Act 1985 can be drawn, while fair treatment of shareholders is inherent in the way in which company law is organised, the other considerations are quite different and are not necessarily the “codification of the current law” that the Explanatory Memorandum suggests.\(^3\) The view is that they are more properly reflective of the business environment, perhaps illustrating how law embraces commercial developments by enacting rules codifying accepted business practices. The upshot is that the courts will be required to develop new principles here and case law is eagerly anticipated to clarify the extent of this section. Of note, this section is also qualified by two subsections, allowing for the displacement of the duty in the event of insolvency and for companies embodying altruistic objectives to promote these over the interests of the members.\(^3\) The result is that, especially in the “altruistic” provision, directors might have other objectives to promote these over the interests of the members.\(^3\)

**Disqualification orders**

Part 40 of the Act enhances the disqualification regime under the Company Directors and Disqualification Act 1986 to permit disqualification orders to be made and undertakings received where the director concerned has been disqualified overseas. Section 1184 of the Act allows for two procedures: automatic disqualification by the effect of

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37. Gencor ACP Ltd v Daly [2000] 2 B.C.L.C. 734 Ch D; Coleman Taymar Ltd v Oakes [2001] 2 B.C.L.C. 749 Ch D; Ball v Eden Project Ltd [2002] 1 B.C.L.C. 313 Ch D.
38. See also Ch.4 of Pt 10 of the Act, which contains rules covering particular transactions with directors requiring approval, including s.188 (long-term service contracts), s.190 (substantial property transactions), ss.197–198 (loans and security for loans), s.201 (credit transactions) and s.215 (payments for loss of office).
40. Explanatory Note, para.325.
41. Companies Act 2006 s.172(5)–(4).
an order made pursuant to regulations or following an application to court. The order or undertaking is made or obtained for the same period as the original disqualification and expires at the same time. Rules may be made under s.1185 of the Act on the basis of three factors, including the conduct giving rise to the foreign disqualification, the nature of the disqualification and the country or territory imposing them. The suggestion is that the third factor will require courts to form “value judgments” about foreign companies’ legislation and their enforcement regimes, a situation judges may not appreciate. Under the same section, courts may then be required to have regard to other factors, chiefly related to whether the conduct would attract a UK sanction or would be unlawful under UK law, when involvement with the United Kingdom began and whether the director intends to undertake activity overseas. Section 1186 of the Act makes it an offence for a person to act while so disqualified, while s.1187 of the Act imposes personal liability for so acting.

The result is to fill a lacuna in the previous law, which failed to deal adequately with an unintended consequence of the phenomenon of entrepreneurial migration relying on the four freedoms enshrined in the EC Treaty, particularly the use of arts 43 and 48 of the EC Treaty by astute continental entrepreneurs taking advantage of inexpensive and faster incorporation facilities in the United Kingdom. The fact that entrepreneurs were crossing borders to use UK incorporation facilities and then “export” these vehicles was revealed in the case of Centros Ltd v Erhvervs- og Selskabsstyrelsen, where the desire to avoid certain domestic rules, in particular minimum capital requirements and stricter employee protection rules, led to entrepreneurs using the tactic. The possibility that rogue directors would do the same is a natural consequence of the European Court of Justice’s pronouncement in a number of cases, including Centros, that the freedom of establishment principle trumped these and other domestic rules which had the effect of preventing the conduct of business without compliance with those rules. It is interesting that the Explanatory Memorandum makes deliberate reference to the need to prevent persons disqualified elsewhere from forming an operating a company either in the United Kingdom or in the state where disqualified. In an environment where, post the accessions in 2004 and 2007, the European Union now has a membership of 27 countries, the probability of incorporations by European entrepreneurs increases and, with it, the possibility of misuse of the incorporated form. One difficulty that remains is how information is to be obtained from foreign authorities, especially given potential human rights concerns over privacy, and whether automatic disqualification would infringe the right to a fair trial.

Shareholder remedies

• “The Act sets out the criteria whereby a shareholder can bring a ‘derivative’ action on behalf of the company against a director for breach of duty, while making sure that unmeritorious suits are quickly dismissed and costs fall to the person bringing the claim.”

The area that, other than directors’ duties, seems to have stimulated commentary is that of shareholder remedies and, in particular, the introduction of the statutory derivative action. Rationalisation of the whole area was first proposed by a Law Commission report, recommending that a new derivative action governed by rules of court to replace the main exception to the rule in Foss v Harbottle, which, in requiring that a “proper plaintiff” (the company) sue for harm done to it, inaugurated 150 years of judicial attempts to evade

43. Explanatory Note, para.1506.
45. A survey referenced in W. Niemeier, “GmbH und Limited im Markt der Unternehmensrechts träger” [2006] 49 Zeitschrift für Wirtschaftsrecht 2237, 2244 states that the number of UK limited companies incorporated by German entrepreneurs rose, as a proportion of all incorporations, from 0.27% in 2002 to 14.8% in 2005. The author is indebted to Alexander Daehnert, formerly at Sussex, for this source.
46. Explanatory Note, para.1506.
47. European Convention of Human Rights arts 6 and 8.
48. The bullet point heading the discussion that follows is one of those the Government identified as key changes to be brought in by the Act. A full list is available at http://www.berr.gov.uk/bff/co-act-2006/Major%20Benefits%20to%20Business/page35194.html [Accessed November 12, 2008].
51. Foss v Harbottle (1843) 2 Hare 461.
its strict application. Furthermore, “modern, flexible and accessible criteria” for bringing a derivative action would replace the current “fraud on the minority” exception, while amendments to Table A would allow for self-help remedies and avoid (as far as possible) recourse to litigation. 52 The idea was that derivative actions would remain exceptional actions given the proper plaintiff rule and the need to ensure the freedom of management from unnecessary interference. 53 The result, in line with similar statutory developments in other Commonwealth jurisdictions, 54 is Pt 11 of the Act (ss.260–264). This provides for a new statutory derivative action, grounded in the negligence, default, breach of duty or breach of trust by a director. Furthermore, Pt 30 of the Act, 55 dealing with the protection of members from unfair prejudice, will also ground a derivative action under Pt 11.

There are requirements in s.261 of the Act for proof of a prima facie case as well as court permission for continuing a claim. The effect of the provisions is to abolish the common law form of action. Furthermore, where a company initiates a claim, s.262 of the Act permits a member to continue the claim on grounds that the company’s conduct of the action is an abuse of the court process, that the company has failed to prosecute the matter diligently and that it is appropriate that the member pursue the claim. Section 264 of the Act permits the continuation by a member of a claim brought by another member on the same grounds. In s.263 of the Act, a list of factors to be considered by the court is set out, including whether the proposed claimant is acting in good faith, whether it is likely that the actual or proposed management act or omission has been or will be ratified, whether the company has decided not to pursue the claim and whether it would be more appropriate for the member to pursue the claim in a personal capacity (if the cause of action is revealed as being more appropriate for such an action). Intriguingly, a further factor is whether a person who could bring such an action would in fact do so, a feature that Keay and Loughrey say is in line with the “independent board” test developed in cases like Mumbray v Lapper, 56 in which the cogency of an action is to be determined by looking at whether those who would originate such an action consider there to have been a breach of duty or excusable default. In itself, there is nothing particularly objectionable about the introduction of a statutory form of action. The issue will be to what extent existing case law will influence the examination of the factors to be taken into account by the court when ruling on permission for cases to proceed. This is not as clear cut a position as may be the case with directors’ duties (ss.172 and 177 of the Act aside) and developments in this field are occurring with the advent of decided cases. 57

Private company proposals

- “As part of our ‘think small first’ agenda, we will set out a separate, comprehensive ‘code’ of accounting and reporting requirements for small companies,” 58

The avowed intention of the last two Governments has been to “deregulate”: to reduce the impact of legislation and respond to perennial calls from business for a less burdensome operating environment. 59 The impact on small businesses, in particular, has been a concern of the representative bodies in this field, especially the Confederation of Business and Industry and the Institute of Directors. The response has been to introduce a useful range of changes. 60

- “There will be separate and simpler model Articles of Association for private companies, reflecting the way small companies operate.
- Private companies will not need to hold an annual general meeting unless they positively opt to do so.”
- It will be easier for companies to take decisions by written resolutions. 56

52. Law Commission Report No.246 (1997), para.6.15. Note also the changes in Companies Act 2006 s.239, (permitting ratification of directors’ acts) that require a members’ resolution to be passed disregarding votes by the directors and connected members.


54. Corporations Act 2001 (Aus) ss. 236–242; Companies Act (Ch 50 of the Statutes of Singapore) ss.216A–B.


58. The bullet point heading the discussion that follows is one of those the Government identified as key changes to be brought in by the Act. A full list is available at http://www.berr.gov.uk/bbf/co-act-2006/Major%20Benefits%20to%20Business/page35194.html [Accessed November 12, 2008].

59. The Deregulation and Contracting Out Act 1994 (c.40) was a first attempt in this field.


61. The bullet points heading the discussion that follows are those the Government identified as key changes to be brought in by the Act. A full list is available at http://www.berr.gov.uk/bbf/co-act-2006/Major%20Benefits%20to%20Business/page35194.html [Accessed November 12, 2008].
Table A, the default rules for companies, was updated in 2007. There are some subtle changes. As an example, r.37 of Table A has been amended so that all meetings of a private company are called “general meetings”. There is now no need to distinguish between “annual” and “extraordinary” general meetings, although it remains possible to have an “annual” meeting should the articles require it. Although s.303 of the Act retains the threshold provision stating that a request for the summoning of a general meeting may come from members representing at least 10 per cent of the share capital, one novelty is the reduction of the threshold to 5 per cent in the case of private companies who have gone without a general meeting for 12 months or more. More importantly, however, s.307 of the Act reduces the notice period from 21 to 14 days for a general meeting for private companies, now reflected in r.38 of Table A. Also because of the changes to the requirements for private companies to hold meetings, the written resolution procedure, first introduced in 1989, has undergone some alterations. Under s.288 of the Act, written resolutions may be proposed by the directors or members of the company and are to have effect as if passed by the company or relevant class of members in a general meeting. There are only two exceptions, for which a general meeting will need to be called, which prevent the removal of a director (under s.168 of the Act) or auditor (under s.510 of the Act) before their term of office is due to expire. The cumulative result of these changes is to streamline the decision-making process for smaller companies, many of whose members might have met regularly in any event, but were constrained by the law to hold specified meetings within narrow windows of opportunity.

• “Private companies will not be required to have a company secretary.”

The Company Law Review recommended that private companies no longer be required to have secretaries. Although r.99 of Table A still refers to the “secretary”, the formal exemption for private companies is now contained in s.270 of the Act. Nothing prevents a company choosing to retain the position and it is interesting that Jordans, one of the largest company formation agents in the United Kingdom, note that a replacement for the role will still be necessary. In fact, under the new dispensation, company directors will still have to ensure that the compliance role formerly undertaken by secretaries is carried out and will ultimately be liable for any default or failure to comply with the reporting obligations that remain.

• “There will be simpler rules on share capital, removing provisions that are largely irrelevant to the vast majority of private companies and their creditors.
• Private companies will no longer be prohibited from providing financial assistance for the purchase of their own shares.”

Under the Companies Act 1985, a company limited by shares was required to state the amount of capital and the nominal value of individual units of shares. Although the increase of share capital was possible, the amount of capital acted as a “ceiling” on the amount of shares that could be issued by the company. The Company Law Review recommended the abolition of this outdated practice, the result being that companies no longer have to state an amount of authorised share capital, but may issue shares as required, providing that each share has a nominal value in compliance with s.542 of the Act. Interestingly, a statement of capital and initial shareholdings is still required under s.10 of the Act during the incorporation process. This “snapshot” at the point of registration does not prevent any subsequent issue of shares. Furthermore, in an extension of the authority to allot, s.550 of the Act (a new provision) states that the directors may, unless prohibited by the articles, exercise any power of the company to allot shares. Although share-watering and the dilution of power may be a possible consequence of these changes, it is likely that closer control in smaller companies will prevent most unwarranted exercises of this power. Of particular interest, the dispensation in defined circumstances from the prohibition on financial assistance, contained in the Companies Act 1985, has been abolished, given that the...
prohibition is no longer to apply to private companies.74 These reforms, in particular, were not seen as contentious and, together with the removal of the limitation caused by the need for authorised share capital, are to be welcomed as permitting adjustments of capital by private companies.75

Sundry reforms

As part of the overall reform package, a number of incidental changes are notable. These include rules on auditors’ liability, business names and communications with shareholders.

• “Shareholders will be able to agree limitations on the liability of auditors.”76

Since the case of Caparo Industries Plc v Dickman,77 it has been the case that auditors owe their principal duty to the company and do not have in their contemplation for liability purposes any other party, unless the fact has been brought to their attention of any special use for their reports. The inclusion of this facility in the Act suggests that there have been problems with obtaining certification of accounts, perhaps as a result of a number of factors, including an increasing trend for litigation against auditors, difficulties with obtaining adequate insurance cover as well as the extra-territorial effect on some UK auditors of the Sarbanes-Oxley Act.78 Although the general prohibition on blanket provisions exempting liability remains in s.532 of the Act,79 the conclusion of an express “liability limitation agreement” can now occur, subject to a requirement that any such agreements are fair and reasonable.80 Furthermore, under s.533 of the Act, an exception also exists for indemnities against liability and the financial year to which the agreement relates. In addition, approval may be signified after the conclusion of the agreement. Furthermore, disclosure of the agreement must occur in the annual accounts, which must also contain details of the principal terms and the date of the resolution approving the agreement.81 Lastly, the effectiveness of any agreement is limited under s.537 of the Act by the requirement that it be fair and reasonable, a fact situation to be measured against a number of factors, including whether the limitation has an impact on recovery of damages to less than what may be fair and reasonable, having regard to the auditors’ responsibilities, their contractual obligations and professional standards applicable. Interestingly, the concerns on litigation and insurance are replicated at European level, where there is at present an initiative in similar terms to the provisions of the Act seeking to introduce similar protection for auditors so as to encourage competition and a rise in the numbers of auditors. This will have the added benefit of protecting European capital markets and enabling audits of listed companies to occur.82

• “There will be improved rules for company names.”83

A new system for dealing with company names has been introduced into the Act and the process of duty or trust may be limited. Under s.535 of the Act, the agreement cannot be entered into relating to more than one financial year and is also subject to the inclusion of provisions to be specified by rules.84 While awaiting action in this area, the Financial Reporting Council has produced in June 2008 guidance on the use of liability limitation agreements.85

In any event, s.536 of the Act also requires that any such agreements be authorised by the shareholders of the company in order for the agreement to be effective. Prior resolutions may waive the need for approval or may approve only the principal terms (i.e. the acts or omissions exempt from liability, the overall limit on liability and the financial year to which the agreement relates). In addition, approval may be signified after the conclusion of the agreement. Furthermore, disclosure of the agreement must occur in the annual accounts, which must also contain details of the principal terms and the date of the resolution approving the agreement.86

81. s.535(3) states that the power to make rules may be exercised so as to prevent adverse effects on competition.
85. The bullet point heading the discussion that follows is one of those the Government identified as key changes to be brought in by the Act. A full list is available at http://www.berr.gov.uk/bbb/co-act-2006/Major%20Benefits%20to%20Business/page35194.html [Accessed November 12, 2008].

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77. Caparo Industries Plc v Dickman [1990] 2 A.C. 605 HL.
78. The United States Public Company Accounting Reform and Investor Protection Act 2002 (116 Stat 745), whose s.106 applies the Act’s provisions to “foreign public accounting firms”.
79. Indemnities against claims by the company for negligence and default are void and unenforceable.
for obtaining clearance of certain words and phrases has been streamlined. Disputes over names are now to be dealt with by company names adjudicators appointed under s.70 of the Act, whose role it will be to preside over proceedings involving disputed names in compliance with procedural rules to be introduced under s.71 of the Act. Decisions are rendered public (s.72 of the Act) and orders for name changes may be issued, subject to a right of appeal. These provisions have the benefit of allowing for disputes to be arbitrated more speedily than used to be the case, when challenges to the use of a particular name on incorporation required court action or an application for judicial review of the decision to incorporate the company concerned. The rules for name changes have also altered. Section 77 of the Act retains the previous formulation that companies may change their names by special resolution (complying with s.78 of the Act) or following a direction from the secretary of state so as to add the word “limited” for those companies otherwise exempt from doing so. It also authorises name changes in other circumstances, including where the company names adjudicator orders it or, on appeal from him, a court does so and where a company is restored to the register under s.1033 of the Act. The novelty in this section is the inclusion of a facility allowing companies to change their name by any means specified in their articles and to notify the registrar of companies of the name change and the fact that it has been effected in accordance with the articles. Registration of the new name under s.80 of the Act entails the issue of a new certificate of incorporation, which has effect under s.81 of the Act, subject to verification of the appropriateness of the new name, once the altered certificate is issued. The benefit of these provisions is to make name changes easier for companies, particularly for those in the throes of reorganisation or concluding a scheme of arrangement under Pt 26 of the Act. The downside of these provisions is that they may well encourage name changes with the evasion of creditors in mind.

- “Companies will be able to make greater use of electronic communications for communications with shareholders.”

The general principle of the Act is that companies should, subject to shareholder approval, be able to default to using e-communications. Individuals however will retain the right to receive information on paper if they wish. The company communications provisions set out in the Act apply to all companies, public and private and create an extensive framework for all corporate communications, including those by electronic means. This is in line with the general thrust of the Electronic Communications Act 2000, which implemented European Directives in fields related to the delivery of services via the use of technology and, in particular, the power enabling current rules on formalities to be disappplied in the case of electronic transactions and communications. It has been possible for some time to file documents with Companies House and maintain the statutory registers in electronic form. This facility extends the governance initiative to permit the company to keep its members informed and up to date and may, in the future, permit, as some other countries do, the holding of meetings and consultations via the internet. For the moment, ss.298 and 333 of the Act permit shareholders to communicate responses to resolutions and the calling of meetings to any email address supplied by the company in communications. Written resolutions may also be published on a website under s.299 of the Act prior to the meeting at which they are to be discussed. Furthermore, for quoted companies, ss.341 of the Act requires the results of any poll taken at a general meeting to be made available on the company’s website. Similarly, s.351 of the Act requires that any independent observer’s report on the poll be published in the same way, with s.353 of the Act calling for this information to be made available for a period of not less than two years after it is published. Also for quoted companies, members’ concerns as to the reliability of audited accounts, if the number of members meets the threshold required in s.527 of the Act, must also be displayed on the company’s website until after the meeting at which the audited accounts are due to be discussed. The upshot is to enable companies to take advantage of modern technology while preserving the shareholder’s right to obtain communication in his preferred medium. It is likely that, as the level of sophistication of shareholder participation by electronic means increases, the time will come for consideration of the possibility of “virtual” meetings and consultations.

86. Companies Act 2006 ss.73–74.
88. This is normally done so as to enable a claim or litigation against the company to take place.
89. The bullet point heading the discussion that follows is one of those the Government identified as key changes to be brought in by the Act. A full list is available at http://www.berr.gov.uk/bib/co-act-2006/Major%20Benefits%20to%20Business/page33194.html [Accessed November 12, 2008].
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90. Companies Act 2006 ss.1143–1148 and Schs 4 and 5.
91. Electronic Communications Act 2000 s.8.
92. This facility is continued by ss.1069–1070 of the Act.
93. Members representing 5% of shares in value or 100 members each having at least £100 paid-up shares.
The European dimension

The impact of European measures on UK law first began in 1973 with the United Kingdom’s accession to the European Community (now Union). The EC Treaty provides the primary context for the approximation of company law as an adjunct to the rights of free movement for companies inherent in arts 43 and 48. Progress on work reliant on this legal basis began early on in the life of the European Community but has so far tended to concentrate on elements of the framework for company operations, including matters such as issues of share allotment and pre-emption rights, listing particulars, format of accounts and qualification of auditors as well as disclosure of information. There have been to date some 10 Company Law Directives in these mainly technical areas, although the First Company Law Directive also deals with pre-incorporation contracts and the ultra vires rule.

In September 2001, the European Commission set up a Group of High Level Company Law Experts. Their remit was to initiate a discussion on the need for the modernisation of company law in Europe. Their brief was twofold; first, to address concerns raised by the European Parliament in 2000 related to the negotiation of the then Draft 13th Company Law Directive dealing with takeover bids and, secondly, to address the state of the company law harmonisation programme with a view to providing the European Commission with recommendations for a modern regulatory company law framework in Europe.

A number of issues were canvassed as a part of the consultation process that culminated in a report by the group in late 2002. The issues covered included the creation and operation of companies and company groups, corporate governance, shareholders’ rights, the use of technology for decision-making, enhancing cross-border shareholder ownership, corporate restructuring and mobility and the need for possible new legal forms. Furthermore, in light of an ongoing scheme aiming at simplification of legislation within the Single Market (also referred to as the SLIM initiative), the group was to look at the possible further simplification of company law rules, including those arising from the recommendations made relating to simplifying the First and Second Company Law Directives. The Final Report, issued on November 4, 2002, contained recommendations reached as a result of the consultation process and identified what the Group of Experts considered to be the priorities for a new EU company law action plan, which is still in the course of development, although some proposals, particular the 13th Company Law Directive mentioned above and a proposal for a new European Private Company Statute, have seen the light of day. A new Small Business Act programme has also emerged in June 2008, embracing the European Private Company Statute and a number of other initiatives to improve the operating environment for small and medium-sized enterprises (SMEs), many of which will require translation into domestic law and consequent amendments to the rules in the Companies Act 2006 and subsidiary legislation.

Summary

The history of company law reforms has a respected pedigree. The Companies Act 2006 adds to this in a way which is both novel and yet in keeping with the accumulated body of corporate rules that the United Kingdom has become familiar with. The Explanatory Note accompanying the Companies Act 2006 stated:

“The UK was one of the first nations to establish rules for the operation of companies. Today our system of company law and corporate governance, setting out the legal basis on which companies are formed and run, is a vital part of the legal framework within which business is conducted. As the business environment evolves, there is a risk that the legal framework can become gradually divorced from the needs of companies, in particular the needs of smaller private businesses, creating obstacles to ways that companies want and need to operate.”

The 20-year cycle of review that has taken place since the foundations of company law resulting in legislation in 1862, 1883, 1908, 1929, 1948 and, after a slightly larger gap, 1985, with the

95. EC Treaty art.44(2)(g).
96. Directive 68/151 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of art.58 of the Treaty, with a view to making such safeguards equivalent [1977] OJ L65/8.
98. Directive 77/91 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of art.58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [1977] OJ L26/1 as amended by Directive 2006/68 [2006] OJ L264/32.
101. Explanatory Note, para.3.
new Act now seeing light in 2006, indicates that there is a conscious effort being made to keep company law relevant to current needs. In the last analysis, although the Act has not dealt with every concern of company law commentators, it remains sufficiently contemporary in content and scope. It may be said to be a very worthy successor to the Companies Act 1985 and will do much to enable UK businesses to operate in the modern environment with all the challenges that competition, technology and integration in the European and global markets will provide.