

The Companies Act 2006

The Companies Act 2006 is not so much a new law but an important consolidation of company legislation. Parliament started working on a reform of company legislation 10 years ago but it is only now that some of its provisions have come into effect. Other provisions will come into force progressively over the next year until the whole Act is effective from 1 October 2008.

WHAT IT MEANS FOR TREASURERS For corporate treasurers the Act's main impact is on directors' duties. The legislation includes new disclosure and transparency rules for listed UK companies, and the implementation of the Transparency Directive. Companies listed on the London Stock Exchange will have to produce an annual report, a half-yearly report and quarterly reports or interim management statements for reporting periods starting on or after 20 January 2007.

WHAT HAS ALREADY BEEN IMPLEMENTED? Provisions already in force (including periodic financial reporting) include:

Annual financial report This should be published within four months of the beginning of the financial year and include:

- audited financial statements (prepared under IFRS);
- management report, with a fair view of the business and a description of principal risks and uncertainties; and
- responsibility statements.

The report must give an indication of financial risk management objectives and policies, and exposure to price, credit, liquidity and cashflow risks. Quoted companies must also list the main trends and factors likely to affect their future performance.

Semi-annual financial report This needs to be published no later than two months after the half-year and should include:

- condensed financial statements;
- an interim management report, indicating important events during the first six months and a description of principal risks and uncertainties for the remaining six months; and
- responsibility statements.

Quarterly statements Companies should have either quarterly financial statements or interim management statements produced 10 weeks after the half-year period and completed six weeks before

IN OCTOBER, THE COMPANIES ACT 2006 CAME INTO FORCE, IMPOSING NEW OBLIGATIONS ON BUSINESSES. **JENNIFER CARRUTH** ATTENDED AN ACT REGIONAL MEETING, SPONSORED BY SLAUGHTER AND MAY, TO FIND OUT MORE.

the end of the half-year period. The interim management statements should detail material events and transactions and a general description of financial position and performance.

WHAT IS THE BIGGEST CHANGE?

Liability for financial reports A company is liable for any omission of the required information or any untrue or misleading statement. Directors are liable for disclosure and transparency reports and statements and directors' report, but only to the company and not the shareholders, and liability exists only where a director knew there was an error or an omission.

PROVISIONS THAT CAME INTO FORCE ON 1 OCTOBER 2007

Directors' duties The codification of common law has created an authoritative statement of duties, although pre-existing case law has not been swept away. The aim of the codification is simplification. Four duties were introduced on 1 October 2007 (three more will be introduced next October), as follows:

- to act in accordance with the company's constitution and for proper purposes;
- to exercise independent judgement;
- to use reasonable care, skill and diligence; and
- to promote the success of the company.

The key change is the duty to promote the success of the company. Success in this context will usually mean a long-term increase in value although a company may adopt a different definition of success in its constitution, such as short-term dividend maximisation, long-term capital growth, or even a non-financial measure.

Executive summary

- The Companies Act 2006 codifies directors' duties to reflect the existing common law position.
- All companies should ensure board members and management are aware of their duties under the Act.
- More provisions will come into force next year.

The Act obliges directors to act in a way they consider in good faith to be most likely to promote the success of the company for the benefit of its members as a whole. Under section 172, a director, in fulfilling this duty, must have regard (among other matters) to:

- the long-term consequences of any decision;
- the interests of employees, and the need to foster business relationship with suppliers and customers and others;
- the impact of company operations on the community and environment;
- maintaining a high reputation for high standards; and
- the need to act fairly as between members.

Directors are required to consider the interest of creditors in times of threatened insolvency and have specific duties such as filing company reports and accounts.

There is a concern that section 172 exposes directors to increased litigation risk, especially as the Act allows shareholders to commence derivative claims against directors on behalf of the company in certain circumstances (which have been revised to make the criteria for bringing claims more flexible and understandable). Claims are derivative in the sense that the shareholder's claim is on behalf of the company and derives from a right of the company to claim in respect of a wrong done to it.

PROVISIONS THAT COME INTO FORCE ON 6 APRIL 2008 Where intra-group transfers are a distribution, they will be subject to rules applicable to dividends. An example would be the transfer of an asset to the parent at book value when this is well below market value – the law doesn't change, but provides a statutory basis of evaluation.

Box 1: Ten changes introduced by the Act

1. Directors' duties codified, including new duty to promote the success of the company.
2. All directors given option of filing service addresses on the public record rather than private residential addresses.
3. Promotion of shareholder engagement and long-term investment culture through enhanced proxy power and enfranchisement of indirect investors.
4. Simplification of requirements for running private companies through simplified capital maintenance provisions and end of prohibition on financial assistance for private companies purchasing their own shares.
5. Shareholders gain right to sue directors for negligence and other defaults, and the right to bring derivative claims on the company's behalf.
6. New criminal offence of recklessly or knowingly including misleading, false or deceptive details in audit reports.
7. Companies allowed to limit the liability of their auditors.
8. Company formation process simplified, including end to requirement for authorised share capital.
9. E-communications simplified.
10. Future updates of company law made easier.

Box 2: Deregulation of private companies

Largely a consolidation. Most changes are in the following areas:

1 October 2007

- No requirement for unanimity for written resolutions.
- No requirement to hold an AGM.

6 April 2008

- No requirement to have a company secretary.

1 October 2008

- Execution of documents.
- Abolition of Memorandum of Association.

PROVISIONS THAT COME INTO FORCE ON 1 OCTOBER 2008

Three remaining directors' duties will be codified:

- to avoid conflicts of interest;
- not to accept benefits from third parties; and
- to declare interests in proposed transactions or arrangements.

THE NEW REGIME

With seven new directors' duties coming into force now and in the coming years, directors of companies will need to update their knowledge of the Companies Act in order to adhere to the 2006 legislation.

The intention behind the codification of directors' duties is not to alter them radically, but it is inevitable that such codification will have a practical effect on board procedures. As a general rule, analysis of the duties set out in the Act will be most effectively covered in the papers prepared by management to be presented to the board. Ultimately, consideration of the duties will always lie with the directors, but in drafting the minutes it may be prudent not to create a precedent for having to evidence their thought processes.

Jennifer Carruth is a Reporter on *The Treasurer*.
editor@treasurers.org