

# Companies Bill - First Introductory Paper



## Introduction

This brief overview is our first introductory note to the Companies Bill (the "Bill"). The Bill, which was introduced into Parliament in autumn 2005 and has been developed over a period of some seven years, currently runs to over 900 sections. It is intended to be a major step towards a far reaching reform of UK company law. The planned legislation repeals and replaces large parts of current UK companies legislation and introduces reforms in a number of areas. This will have an impact on shareholders, directors and auditors of both private and public companies – indeed of every company in the UK. The Department of Trade and Industry ("DTI"), which is responsible for the passage of the Bill through Parliament, expects the Bill to become law some time in late 2006 with most of its provisions coming into force not earlier than April 2007.

Until the end of July 2006 the structure of the Companies Bill was such that when the Bill became law, it would have created its own new provisions, as well as making major changes to and repealing large parts of the Companies Act 1985. This meant that UK company law would have been contained both in the 1985 Act and the Bill. However, it now appears to have been agreed that the entire Companies Act 1985 will be consolidated within the Bill which will clearly be of benefit to all those who have to use and advise on the legislation. We await more information on this point.

Although the Bill is still going through the Parliamentary process and changing on an almost daily basis, we thought that it would still be useful for you to have a brief introduction to a few of its key concepts. As the Bill takes on a more final form we will send out further briefing notes.

## Main Objectives

The Bill has been prepared after years of consideration and discussion by the Government and many other interested parties. It has been drafted with various objectives in mind, including the following:

1. To bring companies legislation into line with current best practice and to respond to today's business needs.
2. To introduce plain English into companies legislation.
3. To reflect changes that have arisen since previous companies legislation was introduced, such as electronic communications.

4. To ensure the UK remains an attractive place for companies to base themselves and to carry on their businesses.
5. To provide flexibility for those responsible for running and managing companies.

Much of the Bill concentrates on private limited companies. These make up the vast majority of companies incorporated in the UK. Until now, many have considered that company law has been written mainly with large companies in mind. In practice, these make up only a very small percentage of companies incorporated in the UK.

The DTI has itself noted that the Bill has four key concepts as follows:

1. Enhancing shareholder engagement and a long term investment culture

The DTI wants to promote wide participation of shareholders in companies ensuring that they are informed and involved. They also want decisions to be made with the longer term view in mind and not just based on immediate returns.

2. Ensuring better regulation and a “think small first” approach

As mentioned, although the vast majority of UK companies are small, company law has been written traditionally with large companies in mind. In addition to the changes to the law itself, the Government wishes to ensure that there is appropriate advice and guidance available to users of company law, particularly for smaller firms and their advisors, so that all can understand the options available and requirements placed on them.

3. Making it easier to set up and run a company

The Government wants to remove unnecessary burdens on directors.

4. Providing flexibility for the future

As the DTI has stated, company law is not static. It is currently considering the introduction of a new reform power to allow updating and amendments of company law as circumstances dictate.

### Directors’ Duties

This, we feel, is probably one of the key changes and is likely to affect almost every UK company. A new statutory and codified statement of directors’ general duties is intended to replace the existing duties found in common law rules and equitable principles which have been built up over many years although, in reality, these are also still likely to be applied.

A director will in future have a duty to act in the manner he considers in good faith to be most likely to promote the success of the company for the benefit of members as a whole. The meaning of “success” and how success will be judged is left open. In fulfilling this duty the Bill states that the director must have regard to:-

1. The likely consequences of any decision in the long term.
2. The interests of the company’s employees.
3. The need to foster business relationships with suppliers, customers and others.  
*“Others” we suggest could cover a large group of competing interests.*

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4. The impact of the company's operations on the community and the environment.
  5. The desirability of maintaining a reputation of high standards of business conduct.
  6. The need to act fairly as between members of the company.

In acting for the benefit of its members as a whole directors will be expected to have regard to the new concept of "enlightened shareholder value". The directors will need to consider the points just described, although the list itself is not exhaustive. We suspect that in many cases directors will have a difficult balancing act when considering these matters. Whether this new set of principles will make it easier or more uncertain for directors as they try and balance these different obligations remains to be seen. Criticism is already being levelled against this new approach. The Government has said that directors will be required to pay attention to these obligations (presumably meaning they cannot pretend they do not exist) and in many cases directors will need to take action to comply. This creates potential concerns for boards of directors, particularly we would suggest for boards of smaller companies; exactly the group for whom this Bill is trying to make life easier. Perhaps in the longer term there will be more certainty. However, in the short term more litigation seems almost inevitable.

The last key point to mention with regard to directors is one which gives a right to shareholders to bring a statutory "derivative" action against the directors. This will be an action on behalf of the company for negligence, default, breach of duty or breach of trust. However the courts will need to approve any such action before it begins and we will have to wait for the first decisions as to how the courts will apply these provisions.

### Private Companies – Overview

As mentioned above, much of the current law is drafted from the perspective of large public companies, while over 90% of UK companies are small, private, owner-managed businesses. The law is being changed to recognise this. The following examples illustrate this process:-

(a) Simplified Articles of Association

The existing standard articles of association for private limited companies (known as "Table A") will be replaced by a much simpler set of articles, drafted from the view of small, owner-managed businesses. Existing companies can continue to use their existing articles or adopt the new default set.

(b) Share capital

Many areas will be simplified:

The concept of "authorised share capital" will be abolished.

Private companies will find it much easier to reduce their share capital – rather than having to apply to the Court they will be able to do so by passing a special resolution based on a solvency statement by directors, although this in itself will raise new issues.

To the great relief of most practising corporate lawyers in the UK the prohibition on private companies giving financial assistance for the purpose of the acquisition of their shares or those of their private company parent will be abolished. This is an area of current companies legislation for which breach can create a criminal offence and void the transaction, so no tears will be shed in this regard.

## (c) Meetings

The requirement for private companies to hold annual general meetings is to be abolished – it will become a so called “opt in” regime, instead.

The use of “written resolutions” is likely to become much more common replacing formal meetings of shareholders.

The ability to pass shareholder resolutions by way of written resolution will be improved by reducing the required percentage of signatories to 50% for ordinary resolutions and 75% for special resolutions. At the moment the key threshold for both is 95%.

Private companies will no longer be required to have a company secretary although they may choose to continue to have one.

We should also mention one new area of law and practice. Companies will be able to communicate electronically with shareholders by placing documents on their websites unless a shareholder elects specifically to receive hard copies of the documentation.

We believe that all of these matters and others which are in the Bill but which we have not mentioned, are certainly to be commended. If passed this should lead to a useful simplification of the law and practice for private companies.

## (d) Auditors and accounts

Companies and auditors will be permitted to agree a cap on auditors’ liability to the company subject to annual shareholder approval. A liability limitation agreement will need to be approved by an ordinary resolution. In addition this agreement will need to be disclosed to shareholders by the company. However the court may, in respect of a particular claim, determine that the amount recoverable by the company will be what is fair and reasonable rather than the cap.

Although there will be no change in who can sue an auditor, it will be a new criminal offence for an auditor knowingly or recklessly to include in an audit report anything that is materially misleading, false or deceptive. It will also be an offence to omit a statement required to be included in the report. Interestingly, personal liability will attach to the responsible individual auditor.

Finally, the time limit for filing annual accounts at Companies House after the year end will be reduced to nine months (from ten) for private companies and to six months (from seven) for public companies. Why such minor changes have been made to these time limits is a question no one seems to be able to answer.

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