

Companies Act 2006 Update

Codification of Directors Duties and Repeal of Prohibition on Financial Assistance

Further Codification of Directors Duties Now in Force

A key change introduced by the Companies Act 2006 (**2006 Act**) was the codification of the duties of company directors. Part of this codification was introduced almost a year ago and further implementation has just taken place.

Sections 171 to 174 2006 Act have been in force for some time. These are the duties to:

1. act within powers;
2. promote the success of the company (including factors to which the director or directors must have regard);
3. exercise independent judgement; and
4. exercise reasonable care, skill and diligence.

The provisions which came into force on 1 October 2008 relate to conflicts of interest of directors.

Previous Law

Under the previous law a director (or shadow director) of a company who is in any way, whether directly or indirectly, interested in a contract or a proposed contract with the company has a duty to declare the nature of his interest at a meeting of the directors of the company.

2006 Act Changes

The 2006 Act divides the duty of directors to declare their interests in transactions and arrangements into two provisions:

1. declaration of interests in transactions or arrangements which are proposed but have not yet been entered into by the company; and
2. declaration of interests in relation to existing transactions or arrangements that the company has already entered into.

Key Sections – Directors Duties: Conflicts of Interest 2006 Act

Please note, the summary detailed below focuses on private limited companies only. Certain additional requirements may need to be considered in the case of public limited companies

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2006 Act Section and Duty	Summary	Application
<p>175 – Duty to avoid conflicts of interest</p>	<p>Duty to avoid situations in which there is, or could be, a direct or indirect interest that conflicts with, or may conflict with, the interest of the company of which he (or she) is a director.</p> <p>Specifically relates to property, information or opportunity.</p> <p>This is a change to the previous law as independent directors can now authorise a conflict - shareholder approval is not required (as previously).</p>	<p>All directors, shadow directors and former directors of the company.</p> <p>Situations giving rise to a conflict arising on or after 1 October 2008.</p>
<p>176 – Duty not to accept benefit from third parties</p>	<p>Requirement to declare the nature and extent of any interest (direct or indirect) in a proposed transaction or arrangement with the company prior to the company entering into the transaction or arrangement.</p> <p>Receipt of a benefit in breach of this section can only be authorised by the shareholders of the company not the board.</p>	<p>All directors, shadow directors and former directors of the company.</p>
<p>177 – Duty to declare interest in proposed transaction or arrangement with the company</p>	<p>Requirement to declare the nature <u>and extent</u> of any interest (direct or indirect) in a proposed transaction or arrangement with the company prior to the company entering into the transaction or arrangement.</p> <p>This, in part, replaces the current provision made by section 317 Companies Act 1985.</p> <p>The director does not need to be a party to the transaction for the duty to apply.</p>	<p>All directors and shadow directors.</p> <p>To transactions or arrangements entered into by the Company on or after 1 October 2008.</p>
<p>182 (1) - Duty to declare interest in an existing transaction or arrangement with the company</p>	<p>Requirement to declare the nature <u>and extent</u> of any direct or indirect transaction or arrangement entered into by the company.</p> <p>This, in part, replaces the current provision made by section 317 Companies Act 1985.</p> <p>The director does not need to be a party to the transaction for the duty to apply.</p>	<p>All directors and shadow directors.</p> <p>To transactions or arrangements entered into by the Company on or after 1 October 2008.</p>

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Exclusions, Enforcement and Remedies

Specific exclusions apply to all of the duties detailed above.

The duties set out above are owed to the company by the directors and only the company will be able to enforce them, although in certain circumstances, the shareholders may be able to bring a derivative action on the company's behalf.

The consequences of a breach or threatened breach of the duties are the same as for breach of the current corresponding duties, for example: damages, setting aside of a relevant transaction, restitution and account of profits and termination of the director's service contract.

Practical Steps

- Directors must be aware of their duties under the 2006 Act.
- Those persons responsible for preparing board papers and others involved in corporate governance must also be aware of the new duties.
- Companies incorporated prior to 1 October 2008 should seek shareholder approval to permit independent directors to authorise transactions under section 175.
- Determine whether the articles of the company should be amended to:
 - i. Permit independent authorisation of conflicts of interest;
 - ii. Provide for specific conflicts of interest, such as multiple directorships;
 - iii. Remove redundant provisions relating to the current law on conflict of interests;
 - iv. Include a requirement for shareholder approval for certain transactions which would otherwise only need to be authorised by directors under section 175 or declared to the board under section 177;
 - v. Include or retain restrictions on a director's participation in board discussions on matters to which sections 177 and 182 apply;
 - vi. Provide that where directors accept certain benefits from third parties (for example under a specified value) they will not be in breach of their duty to the company under section 176.

Repeal of the Provisions of Companies Act 1985 Prohibiting Financial Assistance by a Private Company

Pursuant to the provisions of the Companies Act 1985 it was prohibited for a private (or public) company to give financial assistance for the purpose of the acquisition of its own shares. This prohibition was relaxed for private companies by the application of the "Whitewash Procedure".

The prohibition on private companies giving financial assistance for the purpose of the acquisition of its own shares was, on 1 October 2008, repealed. However, private companies must still have regard to maintenance of capital requirements when giving any financial assistance for the acquisition of its shares.

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The repeal of this prohibition will make transactions for the acquisition of shares and financing transactions a much simpler process, although lenders may replace the requirements of the whitewash procedure with their own, new, requirements for lending.

Other Provisions of Companies Act 2006 and Changes Which Came into Force on 1 October 2008

- Sections 69-74: Right of a third party to object to a company's registered name;
- Sections 82-85: Power of Secretary of State to require companies to disclose particular details of the company in specified locations;
- Sections 155-156: Requirement for companies to have at least one director who is a natural person;
- Sections 157 & 159: Minimum age for appointment as a director increased to 16;
- Sections 362-379: Control of political donations made by companies
- Sections 641-652: Circumstances in which a company may reduce its share capital and liability of members following a reduction of capital;
- Section 1157: Power to grant relief from liability in certain cases of negligence, default, breach of duty or breach of trust;
- Sections 1277-1280: Power to require information about exercise of voting rights in certain circumstances;
- Changes to the requirements for annual returns – after 1 October 2008 annual returns will contain reduced information on the company's shareholders;
- Changes to bring accounts and audit procedures of Limited Liability Partnerships into line with regulations currently applied to companies.

If you would like more information on how the new law affects you and your company, please contact any member of our Corporate Commercial Team on 020 7242 3191 or by e-mailing:

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