

CHAPTER 3: MODEL ARTICLES OF ASSOCIATION

A Introduction

3.1 This chapter is about the contents of the regulations which will be made under section 19 of the Companies Act 2006, prescribing three different sets of model articles for the most commonly used types of company: private companies limited by shares; private companies limited by guarantee, and public companies. Comments are sought on the contents of the model articles.

3.2 This consultation follows on from separate consultations on earlier drafts of the model articles for private companies limited by shares (which formed part of the March 2005 White Paper, Company Law Reform) and the model articles for public companies (conducted as an electronic consultation from June to August 2006). This is the first time that draft model articles for private companies limited by guarantee have been issued for comment; they follow closely the draft model articles for private companies limited by shares.

3.3 We are grateful to all those who responded to these earlier consultations.

How this chapter is organised

3.4 The “front end” of the regulations will be very brief. A draft is attached at **Annex C** of this document. Each of the three sets of model articles will occupy a separate Schedule to the regulations. Drafts of the model articles for private companies limited by shares, private companies limited by guarantee, and public companies are set out in **Annex C**.

3.5 **Section B** in this chapter sets out the general principles underpinning the drafting of the model articles.

3.6 **Sections C to G** provide a commentary on the draft model articles, arranged according to the main subject areas into which their provisions fall. The commentary explains why the draft has followed particular approaches.

3.7 **Annex C** sets out in tabular form the relationship between the draft model articles and the 1985 (1986 in Northern Ireland) Table A.

Northern Ireland

3.8 Under the Companies Act 2006 model articles will apply throughout the United Kingdom.

What are articles?

3.9 A company’s “articles of association” are its internal rulebook. Every company which will be formed under the Companies Act 2006 or that has been formed under the various Companies Acts (or their Northern Ireland equivalents) that have preceded it over the last 150 years, will have articles of association – commonly referred to simply as the company’s “articles”.

3.10 A company’s articles are an important constitutional document. If a company formed under the Companies Acts (or Northern Ireland Companies Orders) does not wish to rely entirely on statutory model articles applying by default (see below), it must register its articles with the registrar of companies

when it is formed, so that they become a matter of public record. When a company's articles are changed (usually by special resolution of its members), an up to date copy of the articles must be registered with the registrar of companies. Companies must also make up to date copies of their articles available to their members on request.

What are model articles?

3.11 Many companies do not want to reinvent the wheel by drafting their own elaborately customised internal rules. For 150 years, successive Companies Acts (or Northern Ireland Companies Orders) have balanced UK companies' freedom to make their own rules by providing for standardised model articles set out in legislation. No company is obliged to adopt the provisions of these model articles, but they provide useful guidance and, in some cases, a safety net.

3.12 Under the Companies Act 1985 (and Companies (Northern Ireland) Order 1986), model articles are prescribed for all companies limited by shares in "Table A" (contained in the Companies (Tables A to F) Regulations 1985 [S.I. 1985/805]) (S.R. 1986 No. 264 in Northern Ireland). If a company limited by shares has not registered articles of its own devising with the registrar of companies, or if it has registered articles but they do not exclude all the provisions of Table A, the provisions of Table A will apply to the extent that the company's own registered articles do not exclude or modify them. This is known as "default application" of model articles. (There are a number of different ways in which the provisions of Table A can be excluded or modified: a company's articles may simply state that Table A, or a particular provision of Table A, does not apply; they may make provision which contradicts, and therefore implicitly excludes, provisions of Table A; or they may state that Table A, or particular provisions of Table A, apply with specified modifications.)

3.13 The default application of Table A means that, under the Companies Act 1985 (or Companies (Northern Ireland) Order 1986), companies limited by shares do not need to register articles at all when they are formed if they are happy to rely on Table A, whereas companies limited by guarantee and unlimited companies must register articles when they are formed. Although such companies are free to choose to use Table A, the provisions of Table A do not apply to them by default.

Model articles under the Companies Act 2006

3.14 The Companies Act 2006 does not change the principle of model articles. It also retains – and expands – the principle of applying model articles by default, by giving the Secretary of State power (in section 19) to make regulations prescribing model articles for different descriptions of company, rather than just a single Table A set of model articles for all companies limited by shares.

3.15 There are many different ways of describing companies, and in theory there is a wide range of different types of company for which model articles could be prescribed. However, the Government thinks regulations should prescribe model articles for the three most commonly used types of company:

private companies limited by shares; private companies limited by guarantee, and public companies.

3.16 As with Table A, the model articles prescribed for companies of each of these types will apply by default to any company of the relevant type which is formed and registered under the 2006 Act, to the extent that it does not choose to modify or exclude the provisions of the relevant model articles in its own registered articles. The model articles prescribed for companies of a particular type are referred to in the Act as the “relevant model articles” for that type of company (see section 20). However it should be noted that these model articles are designed for use by companies formed and registered under the Companies Act 2006. Other companies wishing to adapt all or part of these model articles should check their compatibility with the legislation under which they were formed.

3.17 Going beyond the “default” application of model articles, companies will also be able to make a conscious choice to include in their articles provisions of model articles, with or without modification, whether or not they are the relevant model articles for the type of company that they are. However it should be noted that these model articles are designed for use by companies formed and registered under the Companies Act 2006. Other companies wishing to adopt some or all of the provisions of these model articles should check their compatibility with the legislation under which they were formed.

3.18 So, for example:

- (a) a company limited by shares or by guarantee formed under the Companies Act 2006 might begin its registered articles by stating that the relevant model articles apply, with specified modifications and omissions (for example, “the public company model articles apply, except for articles 43 to 79”);
- (b) a private company limited by shares might include in its articles some of the provisions from the model articles for public companies.

3.19 Under Section 26 of the Companies Act 2006, where a company amends its articles it must send the registrar of companies a copy of the articles as amended not later than 15 days after the amendment take effect. This will be enforceable by a new civil penalty under Section 27.

3.20 It is worth noting that, under the Companies Act 2006 (section 20), the default application of model articles is tied to the kind of company a company is when it is formed. If a company is formed as a public company and it subsequently re-registers as a private company limited by shares, it will remain subject to the default application of the public company model articles unless its articles provide otherwise. If a company is formed as a private company limited by shares and it subsequently re-registers as a public company, the public company model articles will not apply to it unless it adopts them, wholly or in part, in its own articles (it can do this either by reproducing the text of the relevant provisions or by incorporating them by reference). If a company starts life as an unlimited company (a type of company for which it is not proposed that any model articles should be prescribed under the Act) and subsequently re-registers as a private company

limited by shares, no model articles will apply to it unless it makes provision to that effect in its articles.

Question 3. 1 Do you have any specific drafting comments on any of the model articles?

Question 3. 2 Do you have any comments in particular on articles 79 to 81 of the model articles for public companies?
(These articles supplement Part 9 of the Companies Act 2006 which acquired its final shape at a relatively late stage in the passage of the Companies Act 2006 through Parliament and we would welcome any comments.)

B General principles

For which types of company should model articles be prescribed?

3.21 As explained earlier, the Government has decided there will be three sets of model articles under the Companies Act 2006: one for private companies limited by shares, one for private companies limited by guarantee and one for public companies.

3.22 It would be possible to prescribe model articles for other types of companies: for example, for unlimited companies. But these types of company either do not differ sufficiently from the types of company for which model articles will be prescribed, or are too specialised and likely to need to have “bespoke” registered articles, to justify statutory model articles of their own.

3.23 In the case of commonhold associations and right-to-manage companies, for which particular mandatory forms of articles are prescribed by statute, the model articles which are currently set out in legislation for such companies, which are heavily based on Table A, will be revised to reflect the changes from Table A to the model articles prescribed under the Companies Act 2006.

3.24 In the case of community interest companies, all of which are required to register articles and to include certain special provisions in their constitutions, the non-statutory model articles published by the Regulator of Community Interest Companies (which do not apply by default), will be updated to reflect the changes brought about by the Act. Community interest companies will continue, as now, to be obliged to register articles in all cases, but, subject to compliance with the requirements of the community interest companies legislation, they will be able to incorporate provisions from the model articles prescribed under the Companies Act 2006, and, if they are formed under that Act, they will be able to benefit from the default application of the relevant model articles prescribed under the Act (since they are all limited either by shares or by guarantee).

Purpose and scope of the model articles for private companies

3.25 One of the challenges for Table A is that it aims to provide a single set of model articles to satisfy the requirements both of large and complex public companies and small private companies limited by shares. That means it includes some provisions which most smaller companies will never need, and may obscure some provisions which are relevant to them.

3.26 In keeping with the policy objective of “thinking small first”, the draft model articles for private companies limited by shares (Annex C) have been designed with the needs of small, owner-managed businesses in mind. The provisions have been kept as simple as possible, and a number of assumptions have been made. For example, it has been assumed that companies using these model articles will not have alternate directors and will have fairly simple capital structures and issue no partly paid shares. More details of the matters for which the private company model articles do not make provision are provided in sections C to G below.

3.27 Some private companies limited by shares are large and complex businesses. Some that start small will grow over time and develop more complex needs. Since there are more than a million private companies limited by shares, no single set of model articles can satisfy the needs of all of them equally well. Model articles for private companies limited by shares should focus on the requirements of the small businesses which make up the vast majority of this class of company, rather than on the minority of such companies whose needs are more complex. Companies which need more extensive articles are free to adopt provisions from the public company model articles as appropriate.

3.28 The draft model articles for private companies limited by guarantee (Annex C) are closely based on those for private companies limited by shares, with the provisions relating to shares removed. Most private companies limited by guarantee are small businesses. In most cases, they only need relatively simple articles. Where their needs are more complex, it tends to be because of circumstances which are too individual (for example, in connection with particular charitable activities) to be provided for in default model articles.

3.30 Model articles for companies limited by guarantee will only be prescribed for private companies limited by guarantee. It has not been possible to form a public company limited by guarantee since 22 December 1980 (in England and Wales or Scotland) or 1 July 1983 (in Northern Ireland), and this will continue to be the case under the Companies Act 2006.

Purpose and scope of the model articles for public companies

3.31 The Government recognises that the model articles for public companies will have more limited application than those prescribed for private companies limited by shares. Public companies, whether they are formed as public companies or re-register as public companies after being formed as private companies, will typically have more complex requirements than most private companies limited by shares. They are therefore more likely to have tailor-made articles drafted for them than to rely on statutory model articles. Since most public companies start life as private companies and are subsequently re-registered as public companies, and the public company model articles will only apply by default to a company which is formed as a public company, there will be few companies to which the public company model articles are capable of applying by default.

3.32 The Government envisages the model articles for public companies in Annex C being used as a drafting resource for particular types of provision rather than as a complete template for any company’s articles. They may also

be of use to larger and more complex private companies as well as to public companies.

3.33 The Government does not consider it appropriate for model articles for public companies to seek to satisfy listing requirements or best practice for listed companies, or the requirements and best practice for companies traded on other markets such as AIM. If a company's shares are to be listed on the London Stock Exchange or any other market, it will seek legal advice to ensure that its articles comply with any relevant listing requirements and best practice, and are consistent with these over time.

3.34 The draft public company model articles aim to cover all the areas dealt with in the current Table A, except to the extent that provisions in the Companies Act 2006 which were not included in the Companies Act 1985 (or Companies (Northern Ireland) Order 1986) make this unnecessary or inappropriate. In addition, we have reviewed the articles of a sample of public companies and incorporated some features of those articles which are not found in Table A, but which are likely to be useful to a significant proportion of the companies adopting the provisions of the public company model articles.

Ordering and presentation

3.35 The substantive provisions of Table A begin with shares and then deal successively with general meetings, appointment and proceedings of directors, distributions and miscellaneous matters.

3.36 Model articles for private companies limited by shares follow a slightly different pattern. They begin with directors (and put their proceedings before their appointment), and then go on to deal with shares and distributions, general meetings and miscellaneous matters. This is a modified version of the order of the corresponding Parts of the Companies Act 2006, and is intended to reflect the predominant concerns of the owner/managers of a small owner-managed business. The order used in the other sets of model articles is similar, except that the provisions on shares and distributions are placed after those on general meetings in the public company model articles.

Relationship with the Companies Act 2006

3.37 The Companies Act 2006 now includes provision on some subjects which were either not covered, or were covered in much less detail, in the Companies Act 1985 (or Companies (Northern Ireland) Order 1986). Perhaps the most obvious example of this is Part 13 on resolutions and meetings. In particular, under Chapter 4 of Part 13 private companies are no longer required to hold an annual general meeting. Private companies will still be able to hold general meetings to transact the type of business they would previously have transacted at an AGM.

3.38 Where the 2006 Act makes provision for something, the Government does not generally consider it appropriate for the model articles to duplicate that provision. In some cases it is possible for a company's articles to vary or supplement provision made in the Act: this is true, for example, of many of the provisions on general meetings in Part 13. However, since the Act has been designed as a set of generally applicable default provisions, the model articles do not vary any of the provisions of the Act, although in some cases they supplement them.

Guidance and timetable

3.39 It is intended that there will be non-statutory guidance to accompany the model article regulations. It is the Government's intention to make the relevant necessary regulations in autumn 2007, to come into effect from October 2008 when the provisions enabling companies to be formed under the 2006 Act will be brought into force.

C “Front end”, interpretation and general drafting issues

3.40 Annex C of this document contains an indicative draft of the “front end” of the regulations under which it is proposed that model articles should be prescribed. As explained above, the relevant model articles will only apply by default to companies which are formed under the Companies Act 2006. Just as the current Table A does not apply by default to companies formed under, for example, the Companies Act 1948 (or Companies Act (Northern Ireland) 1960), so the draft regulations prescribing the content of the model articles provide that companies formed under the Companies Act 1985 (or Companies (Northern Ireland) Order 1986) and earlier Companies Acts (or their Northern Ireland equivalents) will continue to be subject to whatever default provision was made under those Acts (or Northern Ireland Companies Orders) and the relevant Table A, and will not benefit automatically from the new model articles. However, companies formed under pre-2006 Companies Acts may adopt any provision of the new model articles by special resolution. If they do so, they must ensure it is compatible with the legislation under which they were formed.

3.41 To assist users of the private company model articles they refer to “shareholders”, while the public company model articles and the model articles for private companies limited by guarantee refer to “members”. Under section 112 of the Companies Act 2006 (as under section 22 of the Companies Act 1985 or Article 32 of the Companies (Northern Ireland) Order 1986), a “member” of a company is defined as someone who agrees to become a member and whose name is entered in the register of members. The draft model articles for private companies limited by shares define “shareholder” as the person whose name is entered in the register of members as the holder of the relevant shares. It is rare for UK companies to issue non-registered shares (and thus to have shareholders who are not members, or do not automatically have the rights of members) and this is more likely to occur in public companies.

3.42 The model articles of Table A are referred to as “regulations”. We have used the term “model articles” in the front end of the draft regulations, but have simply referred to “articles” in the text of the model articles themselves. We hope that this will make it a little easier to integrate provisions from the model articles into a company’s registered articles.

3.43 In response to comments from consultees, references to certain articles being subject to the provisions of the Companies Acts have been removed, since they have no effect – provisions of the articles cannot override primary legislation. Some draft articles continue to be expressed in general terms as “subject to the articles”. Some consultees asked that reference to specific articles be inserted. However the Government does not consider that to be desirable. Companies will often wish to adopt only part of the model articles, or to insert extra tailor-made articles into the model, in which case any specific cross-references would be inaccurate.

D Provisions about directors' powers and responsibilities, decision-making and appointment

[The following system of abbreviations is used in Sections D to G of this document-

eg "plc 2" means article 2 of the draft model articles for public companies in Annex C

"pcls 2" means article 2 of the draft model articles for private companies limited by shares in Annex C

"clg 2" means article 2 of the draft model articles for private companies limited by guarantee in Annex C]

Directors' general authority (plc 2, pcls 2, clg 2)

3.44 Although the Companies Act 2006 contains much more provision about the nature of directors' responsibilities than is found in previous Companies Acts (or Northern Ireland Companies Orders), it is still left to the articles to state what it is that directors actually do. This is the function of this article.

3.45 The article's basic propositions, that the directors manage the company's business and may exercise all the powers of the company, are found in every version of Table A since 1856. However, it has been suggested that the article should not refer to the powers of the company, particularly given the shift in the 2006 Act (section 31) towards companies having unrestricted objects.

3.46 The Government thinks that it is appropriate to talk about the powers of the company in this context. It may be that in most cases a company will be able to do almost anything lawful, either because it takes advantage of the new "unrestricted objects" provision, or because it adopts the traditional form of drafting with a very wide-range of objects and powers. But that simply means that "the directors may exercise all the powers of the company" gives the directors correspondingly wide powers. The Government believes that it is worth setting out in the articles the breadth of directors' general authority as agents of the company.

3.47 Section 171(b) of the Act provides that directors must only exercise powers for the purposes for which they are conferred, codifying the existing common law principle. The reader of the model articles may ask for what purpose powers are conferred on directors. The draft model articles previously answered this question by stating that directors may exercise the powers of the company "for any purpose connected with the company's business". Consultees have commented that this phrase suggests that the directors could not dispose of the company's business without the consent of the shareholders. In the light of these concerns, the reference to purposes connected with the company's business has been removed.

Members' reserve power (plc 3, pcls 3, clg 3)

3.48 This article provides that the company's members have a reserve power to tell the directors what to do (or not to do). This reflects the fact that, although the members generally delegate the running of the company to the

directors, they may decide to reassert their authority in relation to a particular matter.

3.49 Directors are not compelled to comply with such directions where they involve them doing something, which is unlawful or contrary to their general duties as directors.

3.50 The March 2005 draft model articles also referred to the members' power to alter the scope of directors' powers by special resolution. Since such an alteration can in any event be achieved by amending the articles (again, by means of a special resolution), the provision was superfluous and has been removed.

3.51 It has been suggested that this article should also make it clear that a members' resolution cannot invalidate any action taken that might commit the company to a particular course of action, or prevent the directors from taking such steps as the company is required to take in pursuance of any such commitment. The Government does not consider that such provision should be made. It is not contained in the current Table A. The article as drafted will preserve the effectiveness of any contract entered into by the directors before the passing of the resolution. But just as directors have the ability to breach a contract, so shareholders should have the ability to direct them to do so (indeed it is possible to envisage circumstances when the directors might want to seek such a direction from the shareholders).

Directors may delegate (plc 4, pcls 4, clg 4)

3.52 Some respondents were surprised at the breadth of this article. Although it effectively does the work of regulation 71 of Table A, it is primarily intended to replace regulation 72 of Table A as the provision which enables the board of directors, to whom the management of the company is delegated as a group, to delegate further to individual directors or committees.

3.53 Article 2(1) of the March 2005 draft model articles for private companies limited by shares referred to the management of the company's business and the exercise of its powers as the director's "functions". Article 4(1) then went on to describe directors' power to delegate in terms of the delegation of their functions. Some respondents were not comfortable with the expression "directors' functions", so the June 2006 draft model articles for public companies adopted the term "powers and responsibilities" more or less as a substitute, with the index of defined terms stating that it meant "the powers and responsibilities conferred on them by the articles". One respondent to the later consultation suggested that the use of the term "responsibilities" in the context of this article may be confusing – perhaps because regulation 72 of Table A refers only to the delegation of powers. It has therefore been deleted.

3.54 In general, where powers are delegated to a person or body (here, in the first instance, by the members to the board), that person or body has no implied power to delegate those powers further. Paragraph (2) is designed to enable further delegation by the directors to others, since in large companies it is likely that there will often be a number of layers of delegation. For example, the board may delegate a number of management responsibilities to an executive committee, who in turn may delegate the financial aspects of

those responsibilities to the chief finance officer, who in turn delegates some of those matters to one of his staff. To the extent that what is being delegated in each case falls within the scope of the powers conferred on the directors by the articles, the articles should legitimise each link in the chain of delegation and sub-delegation.

3.55 There was some comment on the version of paragraph (2) consulted on in June 2006 because it automatically validated all sub-delegation of the directors' powers or responsibilities, except in those cases where the directors specifically decided that it should not be capable of sub-delegation. Respondents indicated that this provision was too broad, and not consistent with how companies work in practice. This provision has therefore been amended to provide that the directors must authorise further delegation.

3.56 In response to comments from consultees the list of exclusions from the power of delegation has been omitted.

Committees (plc 5, pcls 5, clg 5)

3.57 It is usual for articles to make provision about how any committees (as opposed to individuals) to whom they delegate are to operate. This article has been simplified in line with respondents' comments (in particular, that it was not necessary to define "committee").

3.58 Regulation 72 of Table A at present only permits the board to delegate matters to committees consisting of one or more directors. Some companies' articles only permit the board to delegate matters to committees, a majority (or all) of whose members are directors. Some consultees have pointed out that in other cases boards may want to delegate to committees comprised of persons all of whom are not directors. The Government has taken the view that a rule specifying whether or not a committee must include directors is inappropriate for a default provision. The current versions of this article therefore include no such restriction.

Directors to take decisions collectively (plc 6)

3.59 In the public company model articles, this article has been simplified in response to consultees' comments. The intention is simply to state that where directors take decisions as a board (i.e., in relation to matters where they have not delegated to individuals or committees), they must use the procedures specified by the articles. The public company model articles require directors to take collective decisions either in a formal directors' meeting or by means of a directors' written resolution.

Private company general provisions on directors' decision-making (pcls/clg 6-8)

3.60 Although the private company model articles are drafted somewhat differently, it is open to the directors of companies using them to take decisions by means of a formal directors' meeting or by means of a directors' written resolution. Instead of just legitimising two specific procedures, the private company model articles adopt a broader and more conceptual approach, distinguishing simply between those decisions which are "unanimous" (article 7) and those, which are taken by a majority vote (article 8). In particular, the model articles for private companies limited by shares or

by guarantee give the directors of such companies more flexibility when they take a decision, which is not unanimous, because they are not obliged to do so simultaneously. Under the model articles for private companies, a string of e-mails over a period of time where all the requisite directors were copied in, and in the course of which a majority of them agree to a particular course of action, is an acceptable substitute for a meeting in “real time”.

3.61 The intention is not to set a different standard of corporate governance for companies using the private company model articles; rather, it is to recognise that the directors of small companies may need to take collective decisions more often than directors of large companies, and that in the natural course of business – particularly in a world of e-mails and text-messages – they may sometimes debate possible courses of action, and end up taking collective decisions about them, without having started the process by calling a meeting.

Calling directors’ meetings (plc 7, pcls 9, clg 9)

3.62 Case law has established a number of principles about the calling of board meetings, such as that, in the absence of special circumstances, every director ought to have sufficient notice of them. In the past, Table A has been largely silent on these points – although it has provided that notice does not have to be given to directors who are not in the UK.

3.63 Given modern communications technology, this last provision – although still widely replicated in public company articles – seems to add limited value. A director who is in New York on business may be very easy to notify; a director who is holidaying on a remote island may not.

3.64 More generally, it seems desirable to attempt to lay down some general rules about the mechanics of calling directors’ meetings that are flexible enough to deal with a range of different circumstances without being so vaguely drafted as to be a source of uncertainty and confusion. This article has been redrafted to meet the comments of a number of respondents to the two previous consultations.

Participation in directors’ meetings (plc 8)

3.65 The model articles aim to facilitate the holding of directors’ meetings by conference call, video-conferencing, or other methods that enable directors located in different places to communicate with each other. The drafting of this article has been simplified in response to feedback from consultees.

3.66 The model articles for private companies have briefer provision on this point (see pcls/clg article 8(5)).

Quorum for directors’ meetings / majority decisions (plc 9, pcls 10, clg 10)

3.67 For public companies, a default quorum of two has been provided (corresponding to the minimum number of directors they must have), but the directors are able to set a higher quorum if they wish. Earlier drafts of the model articles for private companies did not include a default quorum requirement, but on balance we think it is better to include one. The default quorum rule is disapplied if the company has (and is only intended to have) one director (see pcls/clg article 6(2)).

3.68 Previous drafts of the model articles allowed the quorum for directors' meetings to be set by an ordinary resolution of the members as well as by a decision of the directors. This facility has been removed in response to consultees' comments. Obviously, it always remains open to members to change the provisions of the model articles so as to set the quorum themselves.

3.69 For public companies, there is no provision for the alternate of a conflicted director to be excluded from participating in a meeting or part of a meeting which his appointor would not be able to participate in because of a conflict of interest. Alternates are already unable to vote on matters where their appointors cannot vote: see plc article 12.

Meetings where total number of directors less than quorum (plc 10)

3.70 Where a company's articles provide that a certain number of directors (a "quorum") must participate in all directors' meetings, it is necessary to make provision for what happens when the total number of directors accidentally falls below that figure.

3.71 The immediate need in such a case is to appoint sufficient new directors to make up a quorum. This can be either be done directly by the remaining director(s), or by them calling a general meeting to appoint the new directors.

3.72 The private company model articles take a simpler approach to these situations (see pcls/clg article (10(3))).

Chairing of directors' meetings / majority decision-making processes (plc 11, pcls 11, clg 11)

3.73 The public company model articles previously required the directors to appoint a chairman of the board. Table A article 91 provides that the directors "may", rather than that they "shall" appoint a chairman. Consultees made the point that it is not always appropriate for public companies to have a chairman: the particular example given was of joint venture companies. The public company model articles have therefore been brought in line with those for private companies – they provide for the appointment of a chairman, but give the directors discretion as to whether to make such an appointment.

3.74 Provision for the appointment of deputy or assistant chairmen has been added in response to consultees' comments.

Conflict of interest: rule and exceptions (plc 15, pcls 13, clg 13)

3.75 Section 175(1) of the Companies Act 2006 states that directors must avoid situations in which they have, or can have, an interest that conflicts, or may possibly conflict, with the interests of the company. Subsection (2) of section 175 states that this duty applies in particular to the exploitation of any property, information or opportunity. However, subsection (4)(b) provides that the duty is not infringed if the matter is authorised by the directors. In the case of public companies, subsection (5) imposes an additional requirement, which is that if it is to benefit from subsection (4)(b), the company's constitution must include a provision enabling the directors to give such authorisation, and that it must be proposed to and authorised by them in accordance with such provision.

3.76 It has been suggested that the model articles for public companies should include a provision of the kind referred to in section 175(5), under which the directors could, for example, authorise directors to take personal advantage of corporate opportunities. Since Parliament has not given the directors of public companies this power of authorisation as a matter of course, but has left it up to each individual public company to decide whether it wants to confer such a power on its directors, such a provision has not been included in the model articles, particularly given their default application.

Directors' written resolutions (plc 16 and 17)

3.77 Since 1948, Table A has included a provision stating that if all the directors who are entitled to receive notice of a directors' meeting sign a written resolution, it shall be as effective as if it had been passed at a valid directors' meeting. It is not intended that the written resolution procedure should function as a general substitute for the holding of directors' meetings, but it may be a useful supplement to it in certain circumstances.

3.78 In the Government's view this provision is most likely to be of continuing value if it is expressed more permissively than the corresponding provision of Table A (article 93). The draft public company articles therefore allow a written resolution to be adopted if it is circulated to as many directors as practicable in the circumstances, if they all agree to it in writing, and if the number of directors so agreeing is at least as many as would be required to make up a quorum for a directors' meeting.

3.79 Some public companies' articles provide for directors' written resolutions to be effective only where all the directors (rather than all who are entitled to receive notice at the relevant time) have signed them. This requirement makes any provision about written resolutions legally redundant, since as a matter of general law, if all the directors unanimously, but informally, agree to a proposal (whether or not in writing), their agreement has the force of a resolution passed in accordance with the company's articles – although it will be easier to prove that there was unanimous agreement if one or more documents signed by the directors provides evidence of it.

3.80 The distinctive feature of the written resolution procedure appears to be that it enables a decision to be taken when the directors involved are not necessarily all in a position to discuss what is being proposed with each other. This may make it a useful procedure at times when a decision needs to be taken but practical difficulties prevent them from convening to discuss it, even "remotely" – perhaps particularly where what is being proposed is not expected to be contentious, but a board decision on it is essential.

3.81 Under the model articles, when a meeting is called, individual directors' entitlement to receive notice of it is to be determined by reference to their anticipated ability to receive such notice before the meeting is to take place. In order to translate this approach into the context of written resolutions, article 16(4) provides for the person proposing the written resolution to have a deadline in mind for securing the directors' agreement to what is proposed.

3.82 There is no express provision for written resolutions in the model articles for private companies. The Government does not believe that such

provision is necessary given pcls/clg article 8 on majority decision-making other than by directors' meeting.

Records of decisions to be kept (Pcls 14, clg 14)

3.83 Section 248 of the Companies Act 2006 requires companies to keep records of proceedings at directors' meetings. Pcls/clg article 14 is intended to ensure that directors of private companies are under a similar obligation to record decisions of the kinds which the model articles permit them to take without directors' meetings. Plc article 17(5) performs a similar gap-filling function in relation to decisions taken by written resolution under the public company model articles.

Directors' discretion to make further rules (plc 18, pcls 15, clg 15)

3.84 This article is intended to correspond to the first sentence of regulation 88 of the 1985 (1986 in Northern Ireland) Table A ("Subject to the provisions of the articles, the directors may regulate their proceedings as they think fit."). It has been suggested that the draft has a wider meaning than the current Table A provision, which "is generally taken to refer to fixing the timing of periodic meetings, the circulation of agendas and other administrative matters". This may be because in all pre-1985 (1986 in Northern Ireland) versions of Table A, the corresponding provision was: "The directors may meet together for the despatch of business, adjourn, and otherwise regulate their meetings as they think fit".

3.85 The new drafting is intended to make clear that the directors are able to "fill in the gaps" which there may in particular circumstances turn out to be in the model articles' provisions on directors' decision-making.

3.86 There should be no question of those rules interfering with the provisions of the articles because this article expressly states that they are to be subject to the articles. There is no more scope for conflict between what the directors decide under this article and the other provisions of the model articles, than between decisions taken under the first sentence of regulation 88 and its antecedents.

Minimum and maximum number of directors (no provision)

3.87 Until 1985 (1986 in Northern Ireland), Table A provided that the number of directors which the company was to have should be determined by the subscribers to its memorandum of association. On this model, the number of directors was fixed, which is one reason why the appointment of new directors was traditionally referred to as "filling a vacancy or appointing an additional director".

3.88 Since 1985 (1986 in Northern Ireland), regulation 64 of Table A has provided for a minimum of two directors and has explicitly provided that there is to be no upper limit on the number of directors unless the members determine otherwise by ordinary resolution.

3.89 Previous drafts of the model articles have turned the Table A provision around by providing that the company may, by ordinary resolution, decide that it is to have not more than, or not less than, a particular number of directors. There is no need to provide for a default minimum number of directors, as the

Act (section 154) requires all private companies to have at least one director and all public companies to have at least two directors.

3.90 Consultees questioned the need for a provision based on regulation 64 in the new model articles. It was said that in cases where the precise number of directors which a company has really matters to those setting it up (for instance, in joint ventures, or companies whose governance arrangements otherwise reflect the outcome of negotiations between different stakeholder groups), there will generally be specific provision about the number of directors in the articles from the outset. The Government accepted this view and the provision has therefore been omitted from the present versions of the model articles.

Directors' retirement by rotation (plc 20)

3.91 There is a consensus that it is desirable that in a public company, all directors should be subject to periodic re-election by the members, and that any directors who are appointed in the first instance by the board rather than the members should be subject to re-appointment by the members at the next annual general meeting after their appointment (see the Combined Code, paragraph A.7.1).

3.92 The Government believes that articles which aim to provide a comprehensive "safety net" of default provisions should include provision on such a key corporate governance issue. The model articles need to say something about re-appointment and retirement by rotation, even if many companies are likely to choose to adopt different provisions.

3.93 We have considered how frequently those directors who have not been appointed since the last AGM should offer themselves for re-election. Currently, Table A has a third of them retiring each year – effectively meaning that any individual director will be subject to re-election approximately every third year. The Combined Code states that re-election should occur "at intervals of no more than three years." On the other hand, some consultees suggested that the whole board should be submitted to re-election every year. The Government has opted for re-election every three years to ensure consistency with the Code.

3.94 A further, more technical question is whether the retirement provisions should operate on the directors as individuals or on a specified proportion of the directors each year. The responses received were convincing on this point, and so the Government agrees that it is better for reasons of fairness and simplicity to treat directors as individuals.

3.95 Finally, responses to the last consultation suggested it might be unhelpful given the approach adopted elsewhere in the model articles to include provision about the mechanics of proposing that someone other than a director retiring by rotation should be appointed at a general meeting. The Government has considered this, and agrees with this. In the absence of such provision in the model articles, Part 13 of the Companies Act 2006 provides an adequate framework for such appointments. In particular, provisions such as sections 292, 303, 338 and 340 provide members with an opportunity to propose candidates for the office of director independently of anyone put forward by the company's management. Moreover, the possibility

that a general meeting may end with the company not having “enough” directors is catered for by plc article 10.

3.96 No provision has been made for directors to retire by rotation under the model articles for private companies.

Termination of directors’ appointment (plc 21, pcls 17, clg 17)

3.97 It is usual to provide that a director’s appointment terminates automatically on the happening of certain events, without the need for the company (or, in most cases, the directors) to take a decision. This provision has been simplified in a number of ways in response to comments from consultees.

3.98 Prohibition by law from being a director may come about for a variety of reasons, for example as a result of proceedings under the Company Directors Disqualification Act 1986. Table A has traditionally provided that directors who become incapable of discharging their duties should cease to hold office. Consultees appear to agree with this general principle.

3.99 The approach taken by the 1985 (1986 in Northern Ireland) Table A (regulation 81(c)) is to refer both to specific procedures under mental health legislation and more generally to an order being made by a court having jurisdiction in matters concerning mental disorder for the director’s detention or the appointment of a receiver or other person to exercise powers with respect to his property or affairs. However, this could, for example, have the effect of removing from office a director who is admitted to hospital and detained there only for the purposes of assessment. The current draft adopts a more generic approach, avoiding specific references to mental health legislation that changes over time.

3.100 Previous versions of Table A have included failure to attend directors’ meetings for six consecutive months as a termination event. The June 2006 draft model articles for public companies shortened this period to three months, with a carve-out for cases where the director was prevented from attending by reason of illness, accident or some other cause which the directors consider sufficient.

3.101 A number of consultees suggested that it would be better to state that as well as the director being absent from meetings for a particular period of time, the directors should have to resolve that the absent director’s appointment be terminated. The range of responses received also suggests that it is difficult to generalise about what period of absence should constitute a termination event. The seriousness of any absence will depend, in practice, on how often directors’ meetings take place in a particular company. In some companies it may be common for three months to pass without any directors’ meetings taking place. Some consultees argued for fixing the termination event in terms of failure to attend a specified number of consecutive meetings, rather than failure to attend meetings over a particular period. But this might be unfair to a director who happened, for example, to be on holiday during a period when a lot of meetings happened in quick succession. As a result the Government has decided to include the notion of failure to attend meetings in the more general provision under which appointment terminates when all the other directors decide that a director should be removed from office.

Directors' remuneration (plc 22, pcls 18, clg 18)

3.102 Table A draws a distinction between the remuneration which directors receive simply for acting as directors and the further remuneration which they may receive as the holders of executive positions in the company. Many companies' articles maintain this distinction. Table A also provides for the remuneration which directors receive "as such" to be determined by ordinary resolution of the company, while any additional remuneration in respect of their executive responsibilities is to be decided by the board. Some companies follow this pattern; others provide for both elements of directors' remuneration to be determined by the directors.

3.103 It may not always be easy to distinguish between the remuneration for different elements of directors' responsibilities in this way. However, it does reflect the fact that in legal terms, directors are often simultaneously (and distinctly) officers of the company, by virtue of their appointment as directors, and employees of the company (under a collateral contract of employment). In addition, the exercise of determining what remuneration is appropriate for acting purely as a director is relevant in the context of non-executive directors' remuneration.

3.104 The traditional distinction between the two elements of directors' remuneration is therefore retained in the current drafts. However, they do not follow Table A as regards the setting of "pure" directors' remuneration by ordinary resolution. In practice, the bulk of virtually all companies' executive directors' remuneration is determined by the board, and it is not clear that much purpose is served in corporate governance terms by having a small element of remuneration subject to approval by the members. No distinction between the separate elements of remuneration is made in the statutory provisions relating to the reporting of directors' remuneration or the approval of directors' remuneration reports by the members of quoted companies.

3.105 The previous draft of this article provided expressly that directors could not provide audit services to the company. On further consideration it has been decided to delete this article in the light of the provisions of section 1214 of the Companies Act 2006 which prevent a person acting as auditor for a company of which he is a director.

Directors' expenses (plc 23, pcls 19, clg 19)

3.106 Regulation 83 of Table A only provides for directors to be paid travelling and other expenses which they incur in connection with their attendance at directors' meetings, general meetings and class meetings. The default provision on directors' expenses has been broadened to take account of the fact that many directors will have responsibilities extending beyond attendance at such meetings, and should be able to claim expenses properly incurred in exercising their powers and discharging their responsibilities in relation to the company.

Alternate directors (plc 24-26)

3.107 Table A has included provision for the appointment of alternate directors since 1985 (1986 in Northern Ireland). However, provision for alternate directors is included in the draft public company model articles only, as the Government considers it unlikely that the directors of most private

companies will want to appoint alternates. Any private company wishing to enable its directors to appoint alternates can adopt the relevant provisions from the public company model articles.

3.108 The main point of policy to emerge from the June 2006 consultation relates to the definition of the role of alternate directors. One possible view is that alternates should only act in relation to the formal decision-making function of directors (i.e. in relation to directors' meetings and written resolutions). A broader view is that directors' alternates should have all the same rights and responsibilities that their appointers have as directors.

3.109 It is in relation to formal decision-making processes that alternates are most likely to be useful, as this is probably the only context in which it is critical to have a particular number of directors involved. This is therefore the approach taken by the draft.

E Provisions about decision-making by members

3.110 Under previous Companies Acts (or Northern Ireland Orders), most of the detailed provision in respect of general meetings has been made in Table A, rather than in the main body of the Act. Part 13 of the Companies Act 2006, by contrast, includes much of what was previously in Table A, although in many cases it allows companies to vary the provisions set out in the Act by provisions in their own articles.

3.111 The Government does not believe that the model articles should extensively replicate or vary the provisions of Part 13 of the Act. However, there are a number of matters which are not provided for in Part 13, so that the model articles can usefully supplement what the Act says about general meetings.

3.112 Provision on general meetings in the model articles for private companies was not included in the March 2005 consultation draft. In response to feedback from consultees, the current draft of the model articles for private companies limited by shares (like the model articles for private companies limited by guarantee) contains a simplified version of the provisions on general meetings found in the model articles for public companies.

When members can call a general meeting (plc 27)

3.113 Generally, directors are responsible for calling general meetings – whether on their own initiative or as a result of a requisition from members (see sections 302 to 304 of the Companies Act 2006). If the directors fail to comply with a requisition, the members can call a meeting at the company's expense under section 305. However, a company may find itself without sufficient directors to call a meeting, and with directors who are unable or unwilling to do so.

3.114 This article enables members to call a meeting in such cases without going through the formality of a futile statutory requisition procedure. It has been redrafted in response to feedback from consultees and to take account of the removal of the model article on minimum numbers of directors.

Voting record date (omitted)

3.115 The June 2006 draft of the model articles for public limited companies contained a provision for record dates. The Uncertificated Securities Regulations 2001 [S.I. 2001/3755] already make provision for record dates in the case of a participating issuer. The Companies Act 2006 makes no provision for record dates. The Government does not consider that provision should be made duplicating provision already in the 2001 Regulations. Nor does it think it appropriate to make provision in model articles which could have the effect of disenfranchising those who are members at the time of a meeting, or of conferring the rights of member on those who are not members. This article has therefore been deleted.

Attendance and speaking at general meetings (plc 28, pcls 35, clg 22)

3.116 This part of the model articles has been revised to take account of feedback from consultees. The aim has been to retain the familiar language of “attending” and “speaking at” general meetings, while drafting with sufficient flexibility to allow for “virtual” attendance, voting by electronic means, and the participation of those who for one reason or another (e.g. disability or the technology they are using) might not be thought of as “speaking” in the conventional sense when they contribute to discussion at a meeting.

Adjournment (plc 32, pcls 39, clg 26)

3.117 There are a variety of reasons why it might be necessary or appropriate to adjourn a general meeting. The mechanics of adjournment set out in this article have been refined in the light of comments from consultees. When a meeting is adjourned, the draft states that the time and place for its continuation must either be fixed by the chairman of the meeting when he adjourns it, or be fixed subsequently by a decision of the directors. It is the intention that the drafting here should achieve the effect sought by those who advocated provision for “indefinite” adjournment. However, in either case, provision is generally made that X days’ notice of the continuation should be given to those entitled to receive notice of the company’s meetings where it is to take place more than Y days after the original time of the meeting.

Errors and disputes (plc 34, pcls 41, clg 28)

3.118 This article is based on regulation 58 of Table A. One respondent to the June 2006 consultation suggested it was possible that the power which it gives the chairman could be open to abuse (for example, as a way of removing a “troublesome” member from a meeting). The Government, however, has decided to retain the Table A approach in the interests of certainty.

Demanding a poll (plc 35, pcls 42, clg 29)

3.119 It has been suggested that the Table A rule that as few as two persons with the right to vote on a resolution may demand a poll on it sets too low a threshold. Since any number is likely to be arbitrary, the Government considers that default articles should retain the existing threshold.

Delivery of proxy notices (plc 38, pcls 44, clg 31)

3.120 It was suggested by one consultee that this article should state expressly that proxy notices may be delivered by fax. However, this point is

already covered by the use of the phrase “electronic form” (see the defined terms in the model articles and section 1168 of the Companies Act 2006).

Amendments to resolutions (plc 39, pcls 45, clg 32)

3.121 This article has been added in response to consultation.

Disenfranchisement for failure to comply with statutory notice (no provision)

3.122 Only one consultee suggested that the model articles for public companies should contain provision for members who fail to comply with a statutory notice requiring disclosure of interests in shares to have their voting rights in relation to the shares concerned suspended. The Government does not therefore propose to include such provision in the public company model articles.

F Provisions about shares and distributions

3.123 Both the public company model articles and the private company model articles contain provision about shares, dividends and other distributions. The model articles for companies limited by guarantee contain no provisions about shares because it is not possible to form a company limited by guarantee with a share capital. They also do not include provision for distributions: while it is possible for a company limited by guarantee to distribute its profits to its members even if it does not have a share capital, such companies do not usually do this and it does not seem appropriate to include default provision for such distribution in the model articles for private companies limited by guarantee.

3.124 The provisions in the model articles for private companies limited by shares are simpler than those in the model articles for public companies, as most small private companies limited by shares have relatively simple share capital structures. Private companies with more complex capital structures can of course use some or all of the provisions of the public company model articles.

3.125 In particular, the model articles for private companies limited by shares:

- (a) do not make any provision for shares which are not fully paid. If there are no partly paid shares, there is no need to provide for liens and forfeiture, and the drafting of a number of other provisions is simplified. The model articles for private companies limited by shares therefore provide in article 20 that all the company's shares are to be issued fully paid;
- (b) do not make any provision for uncertificated shares or share warrants, as it is very unlikely that a small private company would have "dematerialised" or "bearer" shares;
- (c) contain simpler provisions on share certificates than the public company model articles (as it is unlikely that most small private companies will issue a lot of share certificates, there is no need to make detailed provision about members' entitlements to consolidated, separate or replacement certificates);
- (d) contain simpler provisions on share transfers and transmission of shares;
- (e) do not provide for disposing of fractions of shares on a consolidation; and
- (f) contain simpler provisions on the procedure for declaring dividends.

Company not bound by less than absolute interests (plc 44, pcls 22)

3.126 This article replicates regulation 5 of Table A, to the extent that it is not replicated by section 126 of the Companies Act 2006. It has been suggested that it might conflict with Part 9 of the Act. However:

Part 9 is not about the company recognising interests in shares: it is about members nominating other persons to exercise specified rights in relation to their shares, so that there should be no risk of conflict between Part 9 and this article; and

any risk of conflict is removed by the opening words of the article: “Except as otherwise required by law or the articles”, since those words must cover Part 9 rights.

Share certificates and uncertificated shares (plc 45-49, pcls 23)

3.127 The draft model articles provide for share certificates to be executed in the ways contemplated in sections 44 and 50 of the Companies Act 2006.

3.128 Responses to the June 2006 consultation argued against any greater liberalisation of the execution process for certificates. However, amendments to the provisions on company seals later in the articles have sought to deal with the concerns raised by some consultees about the different techniques of applying seals which are currently in use, such as laser printing.

3.129 The provisions on consolidated and separate share certificates, on replacement share certificates and on uncertificated shares have been revised in the light of responses to the June 2006 consultation.

Partly paid shares (plc 51-62)

3.130 These articles make provision about the company’s lien over partly paid shares, calls on shares and forfeiture of shares. They are only relevant to a company which wishes to make provision for issuing partly paid shares, as liens, calls and forfeiture are all mechanisms for dealing with shareholders who fail to pay sums which are owing to the company. The policy remains largely that of the corresponding provisions in the 1985 (1986 in Northern Ireland) Table A; the drafting has been revised in the light of responses to the June 2006 consultation.

Transfer and transmission of shares (plc 63-68, pcls 24-27)

3.131 These articles are concerned with the mechanics of share transfers and with situations where entitlement to a share passes by operation of law (“transmission”) to a person who is not its registered holder (usually because the holder dies, becomes bankrupt, or is found to be incapable of administering his affairs). The model articles on transfer and transmission of shares have been revised in a number of respects to take account of consultation responses.

3.132 One respondent to the June 2006 consultation suggested that this part of the model articles should include provision on untraced shareholders. The only provision on shareholders who have “gone missing” which the Government thinks it appropriate to include in default model articles is set out in plc article 84.

3.133 Another respondent suggested that the model articles should state that the directors may refuse to register a transfer of shares over which the company has a lien. However, the model articles already provide that the directors may refuse to register a transfer of shares which are not fully paid, and that the company has a lien over all such shares.

3.134 Some difficulties have been pointed out in relation to the provisions on transmission. The difficulty of these provisions, and the corresponding provisions of Table A (regulations 29 to 31) is that they partly stated, or could be read as stating, substantive propositions of general law about property

rights in the event of death, bankruptcy and so on. The Government does not think that model articles should do this, so the provisions have been restricted to matters of company law procedure incidental to transmission.

Consolidation (plc 69)

3.135 The Companies Act 2006 provides companies with a general power to effect consolidations or divisions of their shares. This article enables the directors to make arrangements ancillary to a consolidation or division. An additional paragraph (3) has been added in response to consultation. One respondent to the June 2006 consultation suggested that the directors should be given additional powers under this article in relation to uncertificated shares. This comment has been taken into account in the revised drafting of the provisions on uncertificated shares.

Distributions and capitalisation of profits (plc 70-78, pcls 28-34)

3.136 The provisions on distributions and capitalisation of profits have been revised in the light of consultees' comments on a variety of technical and drafting points. The intention has been to ensure they make sufficient provision to enable a company to make a non-cash distribution, particularly in the form of bonus shares.

G Miscellaneous provisions

3.137 The last group of provisions in the model articles are procedural and ancillary provisions which supplement the substantive provisions on directors, general meetings, and shares and distributions. As elsewhere in the model articles, the provisions of the private company model articles are simpler than those of the public company model articles. No provision is made for the exercise of members' rights by nominated persons under Part 9 of the Companies Act 2006, and the provisions on destruction of documents and non-notification of members who have "gone missing" have not been included, as all these provisions are less likely to be of use to small private companies.

Exercise of members' rights (plc 79-81)

3.138 Part 9 of the Companies Act 2006 enhances the possibilities for those who invest in shares "indirectly" (for example, by having their shares held in a "nominee account", so that their name does not appear on the register of members, although they have the beneficial interest in the shares) to participate in company decision-making and generally be kept in closer touch with the companies in which they have invested.

3.139 Section 145 of the Companies Act 2006 enables companies to make provision in their articles for a member to notify the company that another person (or persons) is to be entitled to enjoy or exercise some or all of the member's rights in relation to the company. These articles aim to be a template for such provision.

3.140 Provision made in a company's articles under section 145 is to be distinguished from the free-standing statutory right conferred by sections 146-151 of the Act on members of companies whose shares are admitted to trading on a regulated market. Members of these companies will be able to nominate third parties to enjoy a more limited range of "information rights". No provision is required in the model articles specifically to cover what is

contemplated under sections 146-151, because the Act itself contains all the provision necessary to make it work.

Communications and administrative arrangements (plc 82-88, pcls 46-50, clg 33-37)

3.141 These provisions have been revised in the light of responses to the June 2006 consultation on the public company model articles.

Directors' indemnity and insurance (no provision)

3.142 Regulation 118 of Table A provides directors with an indemnity for certain legal expenses. The June 2006 draft public company model articles contained an updated version of this provision. On further consideration, the Government has decided that it is not appropriate to make default provision for indemnification of directors in any of the model articles because there are so many possible variations as to what is appropriate for each company. Companies wishing to provide indemnities for directors should consider making special provision in the articles to suit their circumstances.

3.143 The June 2006 consultation also included an article permitting the purchase of insurance for directors. Again, as views differ as to how widely or narrowly such a power should be drafted, it has been deleted.

CHAPTER 4: TRANSITIONALS

Introduction

4.1. This chapter considers the extent to which express transitional or saving provisions are needed when the various provisions of the Act are commenced to ensure that it operates in a reasonable way for existing GB or Northern Irish companies, and for ongoing activities, processes or arrangements in which they might be involved around the time of commencement. The subject is of particular relevance in the context of company law because companies and their arrangements can continue in existence over long periods and, traditionally, the line has been taken in the UK that it is not for the state to alter arrangements which the members of what is essentially a voluntary association have established. The nature of a company is that these arrangements can be changed by the members and it is for them to decide whether to do so. UK company law is, for the most part, not regulatory but facilitative. Since company law essentially holds the balance between different interests any change may upset that balance and therefore operate adversely in some cases. It is unlikely that it will be possible to identify those cases and therefore it may be necessary to ensure that there is no change without the necessary agreement.

4.2. Many of the provisions in the Act will not require special treatment. For example, entirely new provisions will generally not need any transitionals, and nor will changes which permit members to agree to something which was previously not possible. And in certain cases, transitional provisions have been provided on the face of the Act. Even where there are significant changes, it is quite possible that the best thing to do is to commence the changes with no transitionals, relying on general principles of law and the normal practice of the courts. Appendix (a) to this chapter contains legal notes on the approach the courts will take in the absence of transitionals.

4.3. In some cases, transitionals will be appropriate or necessary, and there is wide power in the Act to make transitional or savings provisions in bringing any of its provisions into force.

4.4. Transitionals can be of various types:

- Savings of the earlier law: these can maintain the effect of elements of the pre-existing statute or common law, or of pre-existing agreements such as a company's articles, for certain purposes, typically to "grandfather" existing arrangements, that is to allow them to continue for all or some purposes.
- Transitionals to manage timing: where provisions change the law applying to processes or activities that take place over time, it may clarify the application to specify which examples will be treated under the old and which under the new law. For example:
 - New rules on accounts and reports will typically be specified to take effect in relation to financial years beginning on or after a certain date

- If there is a requirement to give certain information to the Registrar or some other body within a certain period (eg section 707, return to Registrar about the purchase of own shares), this period may straddle Commencement day. It will be important to make clear what happens in such a case.
- Transitional adaptations: the Act is being brought into force in stages. Certain provisions, such as those relating to electronic communications, have already been commenced. This required transitional adaptations – that is adaptations to enable provisions in the Act that are commenced before others to work with the predecessor provisions, generally in the 1985 Act (or the Companies (Northern Ireland) Order 1986). As the remainder of the Act is commenced, these transitional adaptations will be progressively revoked, and once the whole Act is in force, they will no longer be relevant. As they are required only for the short term, transitional adaptations are not discussed further below.

4.5. Although transitionals and savings are different (a saving can, in principle, last indefinitely) the distinction is not directly relevant to the issues explored below. They are techniques to ensure that the law that applies to any given set of facts at any given time is clear and produces the right result (remembering that neither can make the new law apply where it would not otherwise do so or alter what the law was previously.)

The Government's general approach

4.6. Our general approach to implementing the Act for existing companies is guided by three main objectives:

- The starting assumption is that the new law should come into force for existing companies and companies formed under the Act at the same time, and that it should apply to existing companies in the same way.
- At the same time we recognise the importance of decisions taken by members and directors and agreements entered into by the company (existing bargains). UK company law has always given companies a considerable degree of freedom to make their own rules as regards their internal arrangements. The second objective is therefore to ensure so far as possible that existing bargains are not overridden.
- The third objective is to make it as easy as possible for existing companies to take advantage of the new freedoms that the Act offers and to comply with its requirements.

4.7. There may be a tension between these different objectives.

August 2006 consultation

4.8. In August 2006, the Government issued a consultation paper¹ on a number of transitional issues related to the change in companies' constitutional documents, in order to assess whether changes would be

¹ <http://www.dti.gov.uk/files/file33125.doc>.

needed to the Bill as it was then before Parliament. No such changes were required, as we concluded that the required results could be achieved by transitionals in the commencement order. The Government announced its response to that consultation in December.².

4.9. In summary, the main conclusions on transitionals were:

- There is no need for further transitional provisions covering the change in the nature of memoranda and articles – because Section 28 of the Act does enough by providing that provisions in existing companies memoranda that would under the new Act be part of the articles will be deemed to form part of the company's articles
- A change of name by an existing company should have the effect of removing references to the name from its articles, and would therefore not require them to change their articles
- We shall preserve indefinitely the effect of existing absolute entrenchments
- For existing companies, the authorised share capital will be treated as a restriction in the company's articles, but the company will be able to remove this restriction by ordinary resolution
- Where the articles of an existing company do not contain an authorisation to make an alteration in its share capital, the company will continue to be unable to make such an alteration until the shareholders amend the articles to remove the restriction.
- Where a company has a subsisting authority under section 80 or section 80A of the 1985 Act to allot shares at the time that the Act comes into force, this authority should continue to have legal effect
- If a private company has express provision for holding AGMs in its articles the effect of this will be preserved. But indirect references to the AGM will be disregarded, so that where the articles provide for the directors or officers to retire by rotation at the AGM, their appointments will continue until terminated in accordance with the Act or other provisions of the articles
- Any references in the articles that directly require or assume the requirement for a company secretary will continue to have effect. This will not require transitional arrangements
- In relation to directors' conflicts of interest arising as a result of another position held by a director, transitional arrangements will require existing companies (private as well as public) to seek the approval of their members if they want to permit independent director authorisation of such conflicts
- In relation to directors' conflicts of interest arising from directors' transactions with the company, transitional arrangements will preserve

² <http://www.dti.gov.uk/files/file36130.doc>.

whatever provisions an existing company has for dealing with such conflicts.

New companies formed under the Act

4.10. New companies will only be able to be formed under the Act from 1 October 2008. New companies formed under the Act will benefit from all of the new provisions (including the relevant new model articles except to the extent that they choose to diverge from them). They will submit documents in the new format – ie new-style memorandum and articles, and a statement of initial capital.

4.11. We will need to provide how the move from old-style applications will work, by specifying the date after which Companies House will no longer action old-style applications, and the date from which new-style applications can be accepted and processed – this is likely to be a date somewhat earlier than 1 October 2008, though with issue of certificates starting on 1 October 2008.

Examples of areas where no transitionals are thought to be needed

4.12. As noted in the introduction, there are many types of provisions that do not as a rule require transitionals. These include new rules that can be applied without affecting existing bargains, and changes that are purely permissive.

4.13. The e-communications provisions that were commenced in January are an example of new rules that do not affect existing bargains. No existing arrangements for communications between company and member are disturbed unless and until the company seeks the agreement of the members to change to greater use of e-communications.

4.14. The provisions in Part 9 that enable indirect investors to exercise voting and requisition rights are examples of a permissive change that does not require transitionals. The new right is only exercisable at the option of the registered member, who can choose to arrange the rights for some or all of the indirect investors on whose behalf he owns the shares.

4.15. As noted in the summary of conclusions of the August consultation above, section 28 deals effectively with the transfer into the articles of provisions from old-style memoranda. There are other examples where provisions on the face of the Act effectively manage the transition, including section 159 on under-age directors: the Act provides that a person must not be a director of a company if they are less than 16 years of age. This will clearly affect certain existing directors. Section 159 provides that, unless an exemption has been given to the particular circumstances, when the relevant provision comes into force, the person will cease to be a director and the company must make the necessary consequential alteration in its register of directors, but need not give notice to the Registrar of the change.

Continuity of law: replacement procedures or requirements

4.16. Much of the new Act is a re-expression of the existing law. Section 1297 ensures that when a procedure is begun under the old law and continues under the 2006 Act no gap will be created. So, for example, the

power of a public company to inquire about interests in its shares under section 212 of the 1985 Act has been replaced by the power in section 793. The information request will have to be fulfilled even though the power has been re-expressed (but without any legal difference). And there is no need have a transitional to achieve this, as this is the effect of the section 1297 rules on continuity of law.

Offences

4.17. As a rule, we do not expect to need to make specific transitionals in relation to offences. Where an offence is new, the courts will simply apply it to behaviour on or after Commencement day. There are a number of changed offences throughout the Act, including ones where those who may be liable are now company officers rather than the company or vice versa. We shall scrutinise each of these carefully to ensure that the effect on commencement will be clear and acceptable. If necessary, we shall introduce savings or transitionals.

Examples of areas where transitionals may be required

4.18. Sections 121 and 128 make two associated changes. Section 121 allows companies to remove information about former members from the register after 10 years have elapsed, rather than the current 20 years; and Section 128 prevents liability claims arising from a shortcoming in the register being made more than 10 years after the shortcoming, rather than the current 20 years. We envisage both of these changes coming into effect immediately on Commencement day. It seems clear that legally companies would be able to dispose of 10 years' worth of existing historical records relating to former members immediately; but does it also mean that people who could make a claim before Commencement day in connection with something that happened for example 15 years earlier will lose their ability to claim if they wait until Commencement day? The answer depends on whether, as a matter of construction, section 128 applies to liability incurred before commencement and whether that result is fair. If they could still claim, is it right that the company should be able to dispose of records which might be relevant to such a claim?

Question 4. 1 **Do you think that it is acceptable to reduce the right to claim in connection with a shortcoming in the register from 20 to 10 years immediately on commencement, so that companies can safely dispose of old records straight away?**

4.19. The Act allows private companies not to have a company secretary. This is permissive. There may of course be contractual obligations which the company has to respect in relation to their existing company secretary. The question arises as to whether if a private company has decided not to have a company secretary but neglects to remove his or her name from the register at Companies House, any transitional provision is needed in relation to execution of documents or other acts done by the person who was formerly the secretary.

Question 4. 2 **Do you believe that any transitional provisions are required in relation to acts done by a company**

secretary after a private company has decided not to have a secretary?

4.20. The Act provides that every company must have at least one director who is a natural person. The issue arises as to what the position is if an existing company does not have one such person. The Act allows the Secretary of State to order the company to make an appointment if he becomes aware of the breach. The question arises however as to whether the decisions taken by the board in such circumstances would still be valid. For any existing company none of whose directors are natural persons at Commencement day, it would be possible to introduce transitional provisions that will allow the board to operate as before up to some specified cut-off date, possibly two years after commencement.

Question 4. 3 Do you think that there should be a grace period for existing company boards that do not contain a natural person?

4.21. The changes in the law on political donations in Part 14 are mostly relaxations. Companies that have existing resolutions at Commencement day will be able to continue to rely on them. There is one extension of the control on donations, in that contributions to independent election candidates are now caught. Companies with a broad existing resolution, sufficient to cover donations to such candidates, will be able to rely on that resolution. It would be possible to defer the commencement of the new rule on independent election candidates for a further year in order to give companies time to pass a new or wider resolution.

Question 4. 4 Do you think there should be a transitional provision for political donations to independent election candidates?

4.22. These are just a selection of examples where transitional arrangements might be justified because existing bargains or rights might be affected. There are likely to be a number of others where there may be a case for transitionals or savings. We will be working with representative bodies to identify these. It would be very helpful to have contributions in the light of particular arrangements.

Question 4. 5 Do you have any other views on what provisions might have effects on existing bargains or rights such that a transitional would be justified?

Financial assistance

4.23. The Act repeals sections 151 to 158 of the 1985 Act (financial assistance by companies for acquisition of own shares) and does not restate them in respect of assistance by private companies.

4.24. Concern was raised during passage of the Bill that there might be room for doubt as to whether pre-existing case law might apply again to cases of financial assistance by private companies for purchase of own shares.

4.25. Lord Sainsbury said, at Lords consideration of Commons amendments, that the Government intended to make a saving provision to put the matter

beyond doubt. The text of the draft saving and a passage for the accompanying explanatory memorandum are at appendix 4b.

Question 4. 6 Do you have any comments on the text of the draft saving on financial assistance?

Question 4. 7 Do you have any comments on the passage on the financial assistance saving for the explanatory memorandum?

Derivative claims – Part 11

4.26. Part 11 of the Act provides a new statutory procedure to replace the existing common law right for a member to start a legal action against a director to recover damages for the company.

4.27. For England and Wales, and Northern Ireland, the changes are almost entirely procedural. There are a few changes in scope, as for example the new procedure can be used against directors who are negligent but have not acted for personal profit. Directors who were negligent in this way can be sued by the company already, and the only change would be that the case could be started by a member on behalf of the company. In Scotland there is not such a developed common law.

4.28. The Government believe that the new provisions should as a rule be used for all claims brought on or after commencement day. It would be possible to use the power to make transitional and savings provisions so as to maintain the existing approach for certain categories of claims, such as claims where all the events giving rise to the claim took place before Commencement day and there are no continuing issues. We invite views on whether to make such a provision and if so in what terms.

Question 4. 8 Do you think we should make transitional provisions in relation to derivative claims?

Provisions in articles or private contracts

4.29. There is an issue as to whether any difficulties which might arise from provisions in articles of association or private contracts which rely on concepts which are abolished or different under the new Act, and if so, whether it would be appropriate to make any transitional provision and if so in what form. Alternatively, even if such problems are thought likely to arise they could be left to the Courts to resolve, in the light of all the circumstances. We are grateful to the Law Society for their contribution on this issue, which is reflected in what follows.

4.30. As an example, the two expressions 'extraordinary resolution' and 'authorised share capital', are both concepts which do not feature in the 2006 Act.

4.31. Some articles of association provide for certain resolutions to be proposed as extraordinary resolutions. As the law currently stands, an extraordinary resolution is the same as a special resolution except that it requires only 14 days notice as compared with 21 days for a special resolution. It would be possible for a transitional provision to say how surviving references to extraordinary resolutions are to be interpreted, or we could

leave it to the courts. The proposed Shareholder Rights Directive (which is currently under discussion in the EU) may include provision relevant to this.

4.32. As noted above, following the August 2006 consultation, we propose that any statement of a company's authorised share capital in a company's articles of association shall continue to operate as a restriction on the number of shares and nominal amount of share capital which the directors may allot. Contracts, such as joint venture agreements, may contain restrictions on the company increasing its authorised share capital. There may also be some contracts where a right to subscribe for shares, or a conversion right, is fixed by reference to a given percentage of a company's authorised share capital. It would be possible for a transitional provision to say how such references to authorised share capital are to be interpreted in articles, resolutions, or private contracts, or we could leave it to the courts.

Question 4.9 **Views are invited on whether it would be helpful to make transitional provision in relation to private contracts for references to extraordinary resolutions or authorised share capital or other matters, or whether such matters should be left to the courts.**

APPENDIX (A), CHAPTER 4

Legal notes on the approach the Court will take to commencement in the absence of transitionals

4.33. It is important to have in mind the fact that the Court exercise (in the absence of transitional commencement provisions) is an exercise in statutory construction. The Courts will apply the usual presumption applicable to statutory construction: i.e. - that, absent contrary intention, an enactment is presumed not to alter the law applicable to past events and transactions in a way that is unfair to those concerned in them (see Secretary of State for Social Security v Tunncliffe [1991] 2 AER 712 at 724). However, for the purpose of this exercise, the starting point will be what is the effect of the provisions as a matter of ordinary language. If this "ordinary language" approach produces a result that is considered by the Courts to be prima facie unfair, the question then is whether that conclusion is required by the language used, or is there any other permissible construction that would avoid that unfairness.

4.34. Bennion (see Fourth Edition sections 97 and 98, respectively), identifies two specific presumptions: the first applicable to substantive changes - effectively as stated above; the second applicable to procedural changes which is to opposite effect. The latter is to opposite effect - i.e. that procedural changes will apply to all claims considered by the Courts on/after the commencement date - because it rests on an assumption that procedural statutes will not ordinarily alter the law applicable to past events in a way that is unfair to the persons involved in them. For this reason it is probably better to treat both as parts of a single principle of interpretation that militates against the conclusion that a later change in the law alters retroactively the past legal effect of an act or omission. This is the way in which the issue is considered in Craies on Legislation (Eighth Edition at pp. 389 - 399), and this appears to be consistent with the approach of the Courts in recent instances (see in particular, L'Office Cherifien, and Wilson v First County Trust (No. 2) below).

4.35. The consequence of this analysis is that whether or not a court will apply a statute retrospectively (i.e. to events and transactions prior to its date of commencement) cannot always be decided simply by attempting to classify the statute as either procedural or substantive. Bennion makes this point in his Example 98.1, at p. 270, Fourth Edition. That example is based on dicta of Lord Brightman in Yew Bon Tew [1983] 1 AC 553 at 562 - 3. In that case Lord Brightman stated that the proper approach was to consider whether the statute, if applied retrospectively would impair existing rights and obligations (That case concerned a limitation provision: a new Act substituted a 3 year period, for the previous 1 year period; the Act was passed 26 months after the date on which the cause of action accrued; the claimant sought to contend that the new 3 year limitation applied when bringing a claim that had been time-barred prior to the date of the new enactment.) The conclusion of the Privy Council in that case was that the new legislation should not be read so as to deprive the defendant of the plea that the claim against him was time-barred: thus the mere fact that limitation periods are ordinarily regarded as procedural did not determine the way in which the statutory provision was to

be construed (either as having, or not having retrospective impact) since the right to plead a time-bar was "in all senses a right" even though it arose under a statute that was procedural. Since, having regard to the relevant legislative provision as a whole, there was no imperative to give the provision a retrospective impact, the PC did not read it as having such effect.

4.36. In L'Office Cherifien des Phosphates v Yamashita [1994] 1 AC 486 the House of Lords stated that the basis of the presumption against retrospectivity was fairness; that there was no absolute rule; and that the question in each instance was whether the consequence of reading the statute with the suggested degree of retrospective effect was so unfair that Parliament could not have intended the words to be read in such a manner: see specifically, per Lord Mustill at 524G - 525C. Lord Mustill described this question as one to be answered "largely as a matter of impression", but by reference to considerations such as (i) the extent to which the statute, as a matter of language has a retrospective effect; (ii) the value of the rights affected if retrospective effect is given; (iii) the clarity of the statutory language; and (iv) the purpose of the statutory provision (the point here being that if the statute is designed to promote a purpose that is clearly a matter of strong public interest which would be undermined by the conclusion against retrospective effect, a court will be less likely to conclude that such retrospective effect is unfair. One example of such a situation is R v Field [2003] 1 WLR 882 at [60] - [61]). The approach in L'Office Cherifien was also adopted by the HL in Wilson v First County Trust [2003] 3 WLR 568 see per Lord Nicholls at [18] - [19], Lord Hope at [98], Lord Scott at [153] - [154], and Lord Rodger at [186] - [202].

4.37. In Wilson, Lord Rodger made the point that not all statutes that alter existing rights and duties are to be regarded as retrospective (in any pejorative "unfair" sense). He stated that the presumption against retrospectivity applies in relation to vested rights: the difficulty in the case law concerns the definition of what is a "vested right" for this purpose (see at [193] - [196]).

APPENDIX (B), CHAPTER 4

Financial assistance by private companies for acquisition of own shares: repeal of sections 151 to 153 and 155 to 158 of the Companies Act 1985 (and equivalent Northern Ireland provisions)

Proposed saving to be included in commencement order bringing repeal into force

(1) This paragraph applies to any thing which would have been unlawful by reason of any rule of law if that rule had not ceased to have effect, or had not been modified, as a consequence (in either case) of the enactment of—

any provision contained in section 151 to 153 or 155 to 158 of the 1985 Act or Article 161 to 163 or 165 to 168 of the 1986 Order (prohibition of financial assistance for acquisition of shares), or

any former statutory provision substantially similar in effect to any provision so contained.

(2) The repeal by this Order of those sections and Articles shall not cause any thing to which this paragraph applies to be rendered unlawful by reason of any rule of law which had so ceased to have effect or so been modified.

Proposed passage in Explanatory Memorandum laid before Parliament with commencement order

- (1) The purpose of the saving in *[ref]* is to dispel doubts that have been expressed about whether the repeal of sections 151 to 153 and 155 to 158 of the Companies Act 1985 (and their Northern Ireland equivalents) in relation to the giving of financial assistance by a private company for the acquisition of shares in itself or another private company might fail to have its intended effect because of the application to transactions involving such financial assistance of the rule of law derived from the decision of the House of Lords in *Trevor v Whitworth*³ and other cases.
- (2) In the Department's view the effect of the saving is no more than the Department considers would be the consequence of the repeal in any event.
- (3) Abolition of the prohibition in section 151 renders redundant for private companies the exceptions contained in section 153 and the relaxation from the prohibition contained in sections 155 to 158 (known as the "whitewash" procedure).
- (4) In the Department's view, abolition of the prohibition will mean that a transaction which is currently prohibited by section 151 (but would otherwise be lawful) will not be prohibited by any statutory provision, or by reason of any rule of law relating to the giving of financial assistance by a private company for the purpose of the acquisition of shares in itself or another private company, irrespective of whether or not the transaction falls within section 153 or is capable of being subject to "whitewash".
- (5) In particular, the repeal will not lead to the revival, or the renewed application, of case law (or any rule of law derived from case law), so far as it relates to financial assistance for purchase of own shares, in any case to which the prohibition in section 151 would have applied, whether "whitewash" would have been available in that case or not. The enactment of the predecessors of sections 151 to 158⁴ caused any previously applicable rule of law derived from case law to the effect that financial assistance by a company for

³ (1887) 12 App Cas 409.

⁴ Section 151 was first enacted as section 16 of the Companies Act 1928; section 155 as section 43 of the Companies Act 1981.

acquisition of its own shares was unlawful to cease to have effect in respect of such assistance. This was in accordance with the general principle under which case law ceases to apply (unless Parliament decides otherwise) in cases falling within the scope of application of a statutory provision; and in accordance with section 16(1)(a) of the Interpretation Act 1978⁵, the repeal of those statutory provisions does not revive that case law.

- (6) The rule of law in question is said to have been derived from cases not directly concerned with financial assistance for purchase of own shares, such as *Trevor v Whitworth*, in which the House of Lords decided that a company might not (as the law then stood) purchase its own shares, on the ground that “neither the paid-up nor the nominal capital of the company shall be reduced otherwise than in the manner permitted by [Act of Parliament]”⁶.
- (7) The saving does not affect the application of any statutory provision remaining in force or being, or to be, bought into force, including particularly Chapter 10 of Part 17 (reduction of share capital), Chapter 2 of Part 18 (financial assistance for purchase of shares in a public company) or Part 23 (distributions) of the Companies Act 2006.

⁵ “16.–(1) where an Act repeals an enactment, the repeal does not, unless the contrary indication appears, (a) revive anything not in force or existing at the time at which the repeal takes effect;”.

⁶ Lord Watson at p 423.

CHAPTER 5: LIMITED LIABILITY PARTNERSHIPS (LLPS)

Background

5.38. The Limited Liability Partnership Act 2000 (the LLP Act) created a new corporate vehicle, adding to the choice of legal organisations available for businesses in Great Britain. An LLP gives the benefits of limited liability as for a company, but allows its members the flexibility of organising their internal structure as a traditional partnership. The LLP is a legal entity separate from its members and, while the LLP itself will be liable for the full extent of its debts, the liability of the members will be limited (except to the extent that the members agree otherwise). Any two or more persons can incorporate as an LLP.

5.2 An LLP is unlike a company in a number of ways. For example, it does not have shares or shareholders and is not therefore subject to the same provisions concerning the relationship between a company, its shareholders and its directors. It is not subject to rules about capital maintenance. It does not have directors – only members. Its members are generally taxed in the same way as if they were partners in a partnership. It is however subject to similar accounting and disclosure provisions.

5.3 The LLP Act sets out the basic structure and formation provisions for LLPs. The LLP Regulations 2001, made under the LLP Act, create the detailed provisions for LLPs by applying large parts of the Companies Act 1985 (the 1985 Act) and the Insolvency Act 1986 to LLPs. Some provisions are applied exactly as they are in the main Acts; other are amended to reflect the particular characteristics of an LLP.

5.4 Since its creation about six years ago, the LLP structure has appealed to firms of all sizes and sectors. Most of the large accountancy and legal firms are LLPs, but the form is also used by a number of small firms. Currently there are approximately 22,000 LLPs on the Companies House Register.

General approach

5.5 The detailed provisions for LLPs are based largely on the 1985 Act. With the advent of the Companies Act 2006 (the 2006 Act), we need to consider how those provisions should change to reflect the 2006 Act. We are therefore seeking views on the following alternative approaches:

- apply the 2006 Act for LLPs only as far as necessary to ensure that LLPs are not subject to more stringent provisions than companies and that Companies House is not required to run separate systems for companies and LLPs; this would mean preserving the existing policy and provisions in the 1985 Act beyond these changes; or
- take a broader approach and apply the changes made to company law under the 2006 Act as far as possible; under this approach we would need to update all the provisions currently applied to LLPs, and consider which of the provisions of the 2006 Act are appropriate to be extended to LLPs, particularly new provisions (for example directors' duties may be relevant for the LLP's "designated member");

5.6 The first option would mean less change for LLPs, which may be attractive to them. However, it may prove difficult to disentangle provisions and change some but not others. LLPs may find it more challenging to operate within a system that was more complex because it was based on two different company law regimes. The second option would mean more change for LLPs. On the other hand, it would give LLPs a more up to date structure and provide greater coherence and clarity in the LLP regime. And LLPs may wish to benefit from some of the new policy areas in the 2006 Act.

Question 5.1 Which approach do you prefer? Please explain your reasons.

Question 5.2 Are there specific changes to the provisions for companies under the 2006 Act which you believe either should or should not be extended to the law on LLPs? Please explain your reasons.

Timing

5.7 We aim to implement most changes for LLPs in October 2008, to tie in with the main implementation of the 2006 Act for companies.

5.8 We believe that parallel implementation of the 2006 Act for LLPs and companies has several benefits. It would be neater all around and it would avoid difficulties for Companies House in having to introduce new systems and procedures for companies while maintaining existing ones for LLPs. It would allow LLPs to benefit from any cost savings at the same time as companies and it would ensure that neither type of business vehicle benefited or suffered unduly from differences in the timing of implementation.

5.9 However, parallel implementation will not be possible in all cases. Where parts of the 2006 Act have already been implemented for companies (in particular the provisions on electronic communication) and it is decided that they should be applied to LLPs, we would not propose early implementation. If it is decided that these provisions should be applied to LLPs, we think it is unlikely that they would provide sufficient benefits to justify early implementation.

5.10 And although earlier implementation is proposed for Parts 15 and 16 of the 2006 Act (accounts and audit) for companies, we are not proposing to implement these parts at the same earlier time for LLPs.

5.11 However, there is one aspect of Part 15 of the 2006 Act that we do propose to implement in parallel for LLPs and companies. This is the reduction of the filing deadline from 10 months to 9 months, and the proposed changes to the late filing penalties regime. (Companies House will be consulting on this separately). If these changes were not implemented in parallel, Companies House would have to operate different systems for companies and LLPs, which would impose significant additional costs.

5.12 Because of the work still to be done in deciding how to apply the 2006 Act to LLPs, it would not be possible to lay implementing regulations for LLPs as early as those for companies. Parallel implementation in October 2008 would therefore mean that LLPs had less time than companies to prepare for the changes.

Question 5.3 **Do you agree with the proposal to implement the 2006 Act for LLPs in October 2008? Please explain your reasons.**

Question 5.4 – Do you agree with the proposal to implement the changes in the filing date and the late filing penalties regime at the same time as for companies? (You will need to refer to the separate consultation by Companies House on the proposed changes to the late filing penalties regime.) Please explain your reasons.

Question 5.5 **Do you believe it would cause difficulties for you if the rest of Parts 15 and 16 of the 2006 Act were not applied to LLPs at the same time as companies? Please explain your reasons.**

Investigation powers

5.13 The investigation provisions in Part 14 of the 1985 Act were amended by sections 21 to 24 of, and Part 3 of Schedule 2 to the Companies (Audit, Investigations and Community Enterprise) Act 2004 (“CAICE”). This introduced more extensive powers for companies investigators. The unamended provisions in that part of the 1985 Act had been applied to LLPs. However, the amendments made by CAICE were not expressly applied to LLPs. We propose to bring forward regulations to apply those amendments to LLPs as soon as we are able to.

Question 5.6 **Do you see any reason why the amendments to the 1985 Act made by sections 21 to 24 of, and Part 3 of Schedule 2 to CAICE should not be applied to LLPs? Please explain your reasons.**

Overseas LLPs

5.14 LLPs formed in Great Britain and Northern Ireland are required to register with the Registrar of Companies and to disclose specific information. However, there is at present no regulation requiring overseas LLPs with branches in the UK to register or disclose information (unlike overseas companies with branches here who have both registration and disclosure requirements placed upon them). We will consider the position of overseas LLPs as part of the broader consideration of how to apply the 2006 Act to LLPs.

Extension of GB law on LLPs to Northern Ireland

5.15 Northern Ireland currently has its own separate LLPs regime, which is very similar to the LLP regime in Great Britain. In line with the approach taken in the 2006 Act, the LLP regime in Great Britain will be extended to LLPs. This will be done when the 2006 Act is implemented for LLPs.

Other entities

5.16 Companies Act legislation is also referenced in legislation covering other forms of entity such as Open Ended Investment Companies and Industrial, Provident and Friendly Societies. Such references may need to be amended to refer to the 2006 Act. However, subject to review by legal

advisors, it is not anticipated that significant changes will be made in respect of these entities.

What happens next?

5.17 The Government intends to consult later this year on more specific policy proposals for application of the 2006 Act to LLPs in light on the responses to this consultation, and then at a later date on draft regulations.

CHAPTER 6: THE EUROPEAN PICTURE – MEETING OUR COMMUNITY OBLIGATIONS

Overview

6.1. Recent years have witnessed considerable activity within the EU in many of the key areas dealt with in the 2006 Act – ranging from audit and accounting to cross-border restructuring. This has been driven principally by three factors:-

- a) the renewed push to complete the Single Market following agreement to the Financial Services Action Plan in 2000;
- b) the response to Enron and other financial collapses earlier this decade; and
- c) a new emphasis on better regulation and simplification of EU legislation.

6.2. This section of the consultation document deals with the implementation into UK law of EU Directives that have already been adopted or, in one case, will be adopted in the near future. In the longer term, there will be some new EU legislative proposals, but it is expected that these will be limited in number, and will focus on measures to reduce administrative burdens or to increase flexibility for EU business. The Commission recently consulted on the future priorities for EU company law and corporate governance. That consultation closed at the end of March 2006 and the outcome was announced by Commissioner McCreevy during a speech to the European Parliament on 21 November 2006⁷. Commissioner McCreevy committed himself to legislation on a Directive to make it easier for companies to transfer their registered office from one Member State to another (this is presently expected in the spring). In addition, he is carrying out studies on two other possible measures (relating to the capital maintenance regime laid down by the Second Company Law Directive and the issue of shareholder democracy (or “one share/one vote”)), and will carry out a feasibility study into a possible European Private Company. The Commission will also publish in spring/summer 2007 a Communication on a major simplification programme for company law, which has been identified as a priority area under the EU programme to reduce administrative burdens.

6.3. The DTI, in partnership with UK business and investor representatives, worked hard before and during the UK Presidency in 2005 both to promote the review of the company law agenda and to persuade the Commission and other Member States that EU measures should be pursued only where necessary to further competitiveness or better regulation principles. We believe that the Commissioner’s statement represents a sensible way forward.

⁷ A link to Commissioner McCreevy’s statements is available on the website of the EU Commission: <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/720&format=HTML&aged=0&language=EN&guiLanguage=en>.

Implementation of EU Company Law Directives

6.4. Alongside implementation of the provisions of the 2006 Act, there are a number of EU company law measures that also have to be implemented. We are determined to ensure that there is a coherent approach to consultation and implementation to maximise the involvement of stakeholders and achieve the best outcome. The EU measures required to be implemented are as follows:-

Directive and subject matter	Implementation Date and Current State of Play
<p>Takeovers Directive (lays down minimum standards related to takeover regulation)</p>	<p>20 May 2006 <i>Already implemented. Interim implementing regulations (The Takeovers Directive (Interim Implementation) Regulations 2006) came into effect on 20 May 2006. Subject to Parliamentary approval, these will be revoked and replaced with effect from 6 April 2007 by bringing into force Part 28 of the 2006 Act.</i></p>
<p>Amendment of First Company Law Directive (electronic filing, disclosures, etc. by companies)</p>	<p>Before 31 December 2006 Already implemented. The relevant provisions are given effect in the 2006 Act or in accompanying regulations (The Companies (Registrar, Languages and Trading Disclosures) Regulations 2006). (Transitional amendments have been made to the 1985 Act).</p>
<p>Cross Border Mergers Directive (lays down legal framework to facilitate cross border mergers between companies in the EU)</p>	<p>15 December 2007 <i>Consultation document on implementation to be published in March 2007.</i></p>
<p>Amendment of Second Company law Directive (“simplification” of capital maintenance)</p>	<p>16 April 2008 No implementing action considered necessary. Details of the provisions of the Directive are set in this section of the present consultation</p>

	paper.
Directive on Statutory Audit of Annual Accounts and Consolidated Accounts (which replaces the 8 th Company Law Directive)	29 June 2008 Consultation document on implementation to be published in March 2007.
Amendment of 4 th /7 th Company Law Directives /Bank Accounts and Insurance Accounts Directives (new accounting and disclosure provisions, SME thresholds)	5 September 2008 Consultation document on implementation to be published in March 2007.

Shareholder Rights Directive

6.5. In addition to the above Directives, which have already completed the EU legislative process, there are presently ongoing negotiations on a proposed Shareholder Rights Directive. The Commission proposal was published in January 2006 and aims to enhance the rights of shareholders in relation to company meetings, in particular by ensuring there are no restrictions on cross-border voting.

6.6. The Directive proposal covers four key areas:

- the abolition of share-blocking⁸;
- advance notice and information requirements for meetings;
- removal of legal obstacles to electronic participation;
- the ability to vote without attending the meeting.

6.7. The UK has been supportive of the basic aims of the proposed Directive. The proposal has just been agreed by the European Parliament Plenary. Our current expectations are that the proposal will complete the EU legislative process later this year and will need to be implemented during 2009. The main impacts of the proposal as regards provisions of the 2006 Act are anticipated in the following areas:-

- *time periods, and related disclosure for Annual and Extraordinary General Meetings;*
- *thresholds for shareholder resolutions;*
- *voting by post (in addition to proxy voting).*

⁸ Share-blocking is a process where, on a specific date prior to a company meeting (usually a number of weeks), shareholders are required to notify the company of their identity and intention to vote. After the date the shares involved cannot be traded. This affects the ability of equity markets to operate efficiently and increases financial risks.

Implementation of Directive 2006/68 EC Amending the Second Company Law Directive on Capital Maintenance and Share Capital

Background

6.8. On 29 October 2004 the European Commission published its proposal for a directive of the European Parliament and of the Council to amend Council directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital (The Second Company Law Directive). The amending Directive⁹ has now been agreed and was published in the Official Journal on 25 September 2006. Member states are required to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive by 15 April 2008.

6.9. In view of the fact that the provisions of the amending Directive are integrally linked to matters contained in Parts 17 and 18 of the 2006 Act, it is appropriate that discussion of these provisions be taken forward alongside implementation of the Act. Parts 17 and 18 are due to be commenced in October 2008. Accordingly, any implementing measures put in place by 15 April 2008 (the deadline for implementation of the Directive) would need to be founded, on an interim basis, on existing provisions contained in the 1985 Act.

The Amending Directive

6.10. The Second Directive deals with the formation of public limited companies and the maintenance and alteration of their capital. The overall objective behind the amending Directive, which sought to simplify certain provisions in the Second Directive, was to improve the efficiency and competitiveness of companies by making it easier for them to react more promptly and at less cost to developments in the markets.

6.11. The amending Directive contains the following four elements:-

- a) Valuation of non-cash consideration for the allotment of shares/acquisition of assets from those involved in the formation of a company – This removes the requirement for independent valuation of assets in certain circumstances;
- b) Acquisition by a company of its own shares – aims to make more flexible the circumstances in which a company can purchase and hold in “treasury” its own shares;
- c) Financial assistance – this prescribes rules allowing the company to provide financial assistance to third parties for the purchase of its own shares (in general terms, financial assistance is presently prohibited by the Directive); and
- d) Safeguards for creditors in the case of a reduction in subscribed capital – this places an express burden on creditors to “credibly demonstrate” that their “claim is at stake” when objecting to a proposed reduction in the capital of a company.

⁹ Directive 2006/68/EC is available from the website of the European Commission: http://ec.europa.eu/internal_market/company/official/index_en.htm.

6.12. The first 3 elements listed above are optional whilst the fourth is a requirement which must be met by Member States. A description of each of the respective elements and the changes introduced by the amending Directive are set out below.

6.13. Secondary legislative powers set out at sections 657 and 737 of the 2006 Act or section 2(2) of the European Communities Act 1972 could be used to modify provisions in UK law to implement the provisions in the amending Directive.

Valuation of non-cash consideration for the allotment of shares/acquisition of assets from those involved in the formation of a company

6.14. The amending Directive provides an option for Member States to permit companies to dispense with the requirement for an independent expert's report in certain circumstances when issuing shares for non-cash consideration, such as shares (for instance, when the consideration has been subject to a recent independent expert's report or valuation for the purpose of audited accounts). Under UK law non-cash considerations must be valued by an independent expert, a report produced and sent to the registrar of companies. The independent expert's report helps to reduce the risk of inflated values being placed on non-cash considerations. The risk of abuse clearly diminishes where there has been a recent professional valuation.

6.15. Although the provision in the amending Directive relaxes the requirement to have an independent expert report in limited circumstances, the Directive nevertheless requires publication of various matters (including a description of the consideration, its value and, where applicable, the source of valuation, a statement that no new "qualifying circumstances" affecting value have occurred since the valuation, etc.). In addition shareholders holding at least 5% of issued share capital can still request an independent expert's report.

6.16. Similarly, the amending Directive provides an option for Member States to permit companies to dispense with the requirement for an independent expert's report in certain circumstances where the company has acquired assets from persons or firms in whose name the instruments of incorporation have been signed. The permitted relaxations (and the conditions that apply where these are exercised) closely mirror those in relation to non-cash consideration for the allotment of shares.

Acquisition by a company of its own shares

6.17. The provisions in the amending Directive provide an option to relax the requirements relating to the purchase of its own shares by a company where authorisation is given at the general meeting. The Directive permits authorisation by a general meeting for purchase of own shares to be extended for a period of up to 5 years, rather than 18 months (as at present under both the Second Directive and UK law).

6.18. The provisions in the amending Directive also extend the facility for companies to hold "treasury shares". At present, UK law permits companies to purchase shares to be held in treasury. Treasury shares are treated as issued but they cannot be used for voting purposes; they pay no dividend and

are subject to an upper limit of 10% of subscribed capital. The amending Directive allows Member States to raise, or abolish completely, the 10% cap on the holding of treasury shares.

Financial assistance for the purchase of shares by a third party

6.19. The provisions in the Directive provide an option for Member States to relax prohibition on financial assistance by companies to third parties for the acquisition of shares in the company. Under UK Law, it is not lawful to give financial assistance, directly or indirectly, for the purpose of the acquisition of shares in public companies, subject to very limited exceptions. This is in line with existing requirements of the Second Directive. (The law for private companies is less restrictive but not considered here because the Directive applies only to public companies.)

6.20. The amending Directive allows Member States to permit companies to provide financial assistance for the purchase of their own shares, provided stringent conditions are met. These are as follows:-

- Transactions must take place under responsibility of the administrative or management body at fair market conditions especially with regard to interest received by the company and with regard to the security provided to the company for the loans and advances. The credit standing of the third party must be investigated
- Transactions must be submitted to general meeting for prior approval in the form of a written report indicating the reasons for the transaction, the company's interest, the conditions attached and risk for liquidity and solvency.
- The aggregate financial assistance granted to third parties must at no time result in the reduction of the net assets below the amount of subscribed capital plus undistributable reserves. The company shall include among the liabilities in the balance sheet, a reserve, unavailable for distribution, of the amount of the aggregate financial assistance.
- Where a third party by means of financial assistance acquires shares from a company such acquisitions should be made at a fair price.

Safeguards for creditors in the case of a reduction in subscribed capital

6.21. The amending Directive changes the provisions concerning the rights of creditors to object to capital reduction schemes entered into by companies. At least those creditors whose claims antedate the publication of the reduction shall be entitled to have the right to obtain security for claims which have not fallen due by the date of that publication. Member States may not set aside such a right unless the creditor has adequate safeguards or unless the latter is not necessary in view of the assets of the company. Member States shall ensure that creditors are authorised to apply to the appropriate administrative or judicial authority for adequate safeguards provided that they can credibly demonstrate that due to the reduction the satisfaction of their claims is at stake.

6.22. Under UK law, subject to confirmation by the court a public company may reduce its share capital. (The 1985 Act also requires the company to be authorised by its articles of association before it can reduce its capital: but this is not a requirement of the 2006 Act.) Under section 646 of the 2006 Act, any creditor of the company is entitled to object to a reduction. The amending Directive requires creditors be given the right to seek relief in respect of a capital reduction scheme “where they can credibly demonstrate that due to the reduction in subscribed capital the satisfaction of their claim is at stake”. If the right of creditors to object were limited to this case, companies engaged in capital reduction schemes would benefit as fewer creditors would be able to apply to the courts to object. (The 2006 Act makes different provision for private companies: but this is not considered here because the Directive applies only to public companies.)

Conclusion

6.23. The first three elements of the amending Directive (valuation of non-cash consideration for the allotment of shares/acquisition of assets from those involved in the formation of a company, acquisition by a company of its own shares and financial assistance) are optional for Member States to adopt within the limits specified in the Directive. Although these provisions in the Directive appear to relax existing requirements it is not always clear that this is the case. Implementation of these provisions will not simplify legislation in respect of the capital maintenance regime. For example, in the case of the relaxation of the requirement to produce an independent expert’s report for non-cash considerations, new additional reporting requirements, and rights for shareholders to object, are imposed. Furthermore, although implementation of these relaxations might provide some additional degree of flexibility for companies, it will increase legislation in an already complex area of company law.

6.24. The fourth element (safeguards for creditors in the case of a reduction in subscribed capital), although not optional, is already considered to be satisfactorily dealt with in UK law. UK law already allows creditors to object to capital reduction schemes through the courts. The amending Directive requires that a creditor must be granted relief at least where it can demonstrate that its claim is at risk. Even without such express provision in UK law, it is difficult to conceive of circumstances in which a significant creditor could not object if it could credibly demonstrate to the court that its claim was at stake due to a reduction in capital. The notion of capital maintenance holds that capital is a reserve that underpins the security of the claims of creditors. If the company reducing capital is concerned that a creditor cannot demonstrate that a reduction would affect the satisfaction of its claim, it can ask the court to take this factor into consideration.

6.25. As additional background, the European Commission has awarded a contract for a feasibility study on alternatives to the capital maintenance regime established by the Second Directive. The contract was awarded to KPMG (Germany) in October 2006. KPMG are due to report in summer of 2007.

6.26 In view of the ongoing EU study and implementation of the 2006 Act, it would not seem appropriate to move forward currently with implementation of

the relatively limited amendments permitted by the amending Directive. It is, therefore, not proposed to take any further action to implement the amending Directive as UK law is considered to be wholly consistent with its provisions.

Question 6.1 **Do you agree that no further action should be taken to implement the Directive amending the Second Company Law Directive? If not, which elements of the Directive do you consider should be implemented and why?**