# 4 Ensuring better regulation and a "Think Small First" approach

## 4.1 Improving accessibility

*Clearer structure and language*

Although the vast majority of UK companies are small, company law has been written traditionally with the large company in mind. The provisions that apply to private companies are frequently expressed as a tailpiece to the provisions applying to public companies. Examples of this include the frequently consulted current Part 7 of the Act (Accounts and Audit), which many users find hard to follow, and the provisions on meetings and resolutions, which are currently structured largely on the basis of the needs of larger (public) companies, with smaller (private) companies covered by way of additional provisions or exceptions.

The Government intends that the Bill should reset the balance and make the law easier for all to understand and use. The Bill will therefore be structured in such a way that the provisions which apply to small companies are very much easier to find. Where the law is hard to understand, there are significant costs, uncertainty and risks and compliance is reduced. The Bill therefore seeks to achieve much greater simplicity and clarity of language.

This policy runs as a thread through the drafting of all the provisions of the new Bill and, wherever possible, it is intended that the new law should be presented in an accessible and user-friendly fashion. In particular, where the Bill is making substantive changes with the effect of replacing entire portions of the existing Act, the opportunities for presenting the new law in a simpler and more coherent way are great and have been fully taken up. The Government believes that these areas, in particular those relating to company formation, and to meetings and decision-taking, are now more clearly and logically drafted. Reporting requirements for small companies have also been set out in a much clearer way. Consultation has confirmed that these areas are also those which smaller firms, in particular, find most important in their day-to-day operations, and the benefits of achieving more accessible law should be correspondingly significant.

*Better guidance*

Many parts of company law are nevertheless inherently complex and if we are to make it easier to understand for both companies and their advisors it is important that it is supplemented by clear and comprehensive guidance. Companies House already provides extensive and well respected plain English guidance both in booklet form and increasingly through their website. We intend to increase the coverage of this guidance. It will in future include aspects of company law that go beyond a company's responsibilities in relation to Companies House, for example, we will publish clear new guidance on the important area of directors' duties. Guidance will also follow the principles of "Think Small First." The great majority of companies are small and we will write the guidance to meet their needs so that they can easily identify the basic day-to-day requirements that apply to them.

*Improved website*

Since its introduction in 1997, the Companies House website has been used by a growing number of customers and is now accessed by 4 million customers monthly. Companies House are committed to further improvements to their website, including a wider range of web-based guidance, better links to related websites and on-line access to up to date companies legislation. Companies House will be offering web incorporation during 2007 and this will be supported by easier access to relevant material, for example, the new simplified private company articles of association.

### 4.2 Resolutions and meetings

Much of company law still assumes that the general meeting is the forum by which shareholder decisions are taken. The law is also written from the perspective of the public company with derogations for the small, private company. The Bill will include measures to streamline company decision-making processes and to bring them more into line with the realities of modern business life. Provisions relating to decision-taking will be restated in a form that should make it easier for the small, private company to understand the basic definitions and requirements for passing a resolution, with additional requirements for public and then quoted companies holding general meetings following on.

*Annual General Meetings*

Company law requires all companies to hold an AGM at least once a year and other meetings as required. Private companies may opt to dispense with AGMs, but only if all their members agree.

The CLR discussed the possibility of also enabling public companies to opt out of the requirement for AGMs, providing their members were unanimously agreed. In practice, further consultation suggests that there are unlikely to be many, if any, public companies in a position where not one single member wished to hold an AGM. There is thus likely to be very little to be gained by creating necessarily complex rules as to how a company might opt out of the requirement. The Government therefore proposes that AGMs should remain a statutory requirement for all public companies, as now.

However, it is clear that for many private companies, particularly smaller ones with very limited shareholdings, any obligation to hold an AGM is redundant and potentially burdensome. The CLR recognised this, and suggested that, as a default, private companies should not be required to hold AGMs, but that there should be a mechanism for opting into a statutory regime. Further consultation has indicated that it will be simpler, and equally effective, not to include any opting in or out mechanism for private companies. It follows that private companies will not be required to lay their accounts or to appoint an auditor, if they have one, at an AGM. No special statutory provision is needed for those companies which wish to continue to hold AGMs, to lay their accounts and appoint an auditor, if they have one, at the AGM. They will be able to incorporate the necessary provisions into their constitution voluntarily if they so wish.

*Written resolutions*

The Bill will make it easier for private companies to take decisions by written resolution. It will provide that in future, a simple or 75% majority of those eligible to vote will be required for a written ordinary or written special resolution to be passed, rather than unanimity. This reform should enable most small private companies to take decisions more quickly and efficiently and, together with the proposal to remove the requirement for private companies to hold AGMs, should relieve many small private companies from the burden of having to hold formal general meetings.

It should be noted however that shareholders will still have the right to call a general meeting if they wish. The 2002 White Paper sought views on whether a single member should be allowed to require an AGM, the laying of accounts and reappointment of an auditor. In light of the consultation and concerns that such a power might undermine the deregulatory purpose of these core reforms, the Bill proposes only to retain the existing provision whereby members holding 10% of the vote will be able to requisition a general meeting.

*Simplification of notice periods and short notice requirements*

At present, a minimum of 21 days' notice must be given for an AGM and 14 days for an Extraordinary General Meeting (except in the case of an unlimited company). The Bill will equalise the minimum notice period for all company meetings to 14 days. Companies may set a longer notice period if they wish and it is anticipated that listed companies subject to the Listing Rules will observe the Combined Code requirements on minimum notice periods for meetings.

As now, companies can also hold meetings at shorter notice if holders of a sufficient majority of shares or voting rights agree. This majority is currently set at 95%, though private companies may elect to reduce the majority required to 90%. The Bill will make this figure the default for private companies, so that members holding 90% of voting rights should be able to agree to a meeting being held at short notice.

*Unanimous consent*

The Bill will not codify the principle of "unanimous consent". This common law principle provides that any decision taken (however informally) by all of a company's shareholders together constitutes a decision of the company. Unanimous consent is fundamental to our company law, and it has not been proposed that any alterations should be made to the substance. The CLR did suggest that it would be helpful to codify the principle in statute but, as discussed in the 2002 White Paper, work has suggested that the attempt to do so would risk constraining the flexibilities which the principle currently provides.

*Dispersed meetings*

The CLR also suggested that there was a case for clarifying in law what constitutes a "meeting" and that it should make clear that companies can use more dispersed forms of "meeting" involving real-time, two-way communication between all participants. However, common law already allows a valid general meeting to be held using overflow rooms with audio-visual links to enable participants to see and hear what is going on in the other rooms and to be seen and heard by those in other rooms. It is likely that, as new technologies allow, market practice on how general meetings are held will continue to develop, and case law will continue to develop. While it is clearly important that companies should be able to make use of new technologies where appropriate, there does not seem to be a need for new legislative provision in this area.

### 4.3 Company constitutions

A feature of GB company law is that the members are free, subject to certain legal constraints, to make their own rules about the internal affairs of their company. These rules are a key part of a company's constitution and can generally be found in a company's articles of association ("articles").

Although companies have considerable freedom to include whatever rules they see fit in their articles, in practice the articles tend to contain provisions on a relatively restricted range of matters, for example rules on decision taking by the members and directors and various matters connected with shares (such as the payment of dividends).

Since 1856, model articles have been provided for certain types of companies by law, for example, Companies Act 1985 Table A ("Table A") provides model articles for companies limited by shares. Table A operates as a "default" set of articles for all such companies: that is, the articles of a company limited by shares will be set out in Table A if the company does not register articles at Companies House, or to the extent that any articles which it does register do not exclude or modify the provisions of Table A.

*Table A – reasons why this is no longer an appropriate form of model articles*

Table A has been revised several times over the past 150 years or so, but it remains a product of the mid-19th Century both in terms of the language that it uses and in substance. It is drafted with what we would today think of as "public" rather than "private" companies in mind and successive revisions to Table A have tended to include increasingly elaborate provisions, designed to cover every conceivable event or set of circumstances that a company may find itself in (however unlikely it is that the majority of companies who are using Table A would ever find themselves in those circumstances).

The result is that the vast majority of the provisions in Table A are irrelevant to the vast majority of companies who are using Table A as their articles. In addition, whilst many new provisions have been added to Table A over the years, redundant provisions have rarely, if ever, been removed.

We are left with a "one size fits all" approach to the model articles, which has a number of problems:

- Table A is user-unfriendly, poorly laid out and often unintelligible to non-specialists;

- much of Table A is taken up with matters which are remote from the concerns of smaller companies (so that it is not unusual for private companies to have articles which are completely irrelevant to the owners and managers of such companies);

- Table A does not take account of relatively recent changes in the law, for example, the introduction of single member companies, and will need also to reflect further changes which are proposed in this White Paper.

Following the recommendations of the CLR, the Government considers that reform of Table A is an important part of making our company law fit for purpose in the modern economy. The Government proposes that in future there should be:

- a radically simplified set of model articles for private companies limited by shares, reflecting the way that small companies operate;

- a separate set of model articles for public companies limited by shares (similar in scope to the current Table A, but with clearer layout and drafting);

- (for the first time) a full set of model articles for private companies limited by guarantee; and

- comprehensive, clear and concise guidance for small companies who are using, or thinking of using, model articles.

For companies set up under the new legislation, the new sets of model articles will operate as default provisions for the types of company for which they are prescribed, in the same way as Table A now does. Existing companies will be able to replace their current articles (whether or not these are as set out in Table A) with the new model articles, if their members pass a special resolution to do so.

*The private company articles*

The Bill will contain a power for the Secretary of State to prescribe, by secondary legislation, stand alone model articles for public companies, private companies limited by shares and private companies limited by guarantee. Draft model articles for private companies limited by shares (the "private company articles") are set out in the White Paper.

The private company articles will replace Table A for those private companies limited by shares which are in future formed under the new Act and will play an important role in the simplification of the law for small companies. Like Table A the private company articles will apply by default where a company does not register its own articles at Companies House (to the extent that the company in question has not specifically excluded or modified the model articles). Table A will continue to provide the model articles for companies formed before the new model articles come into force.

The text of the private company articles follows the principles set out in the CLR's Final Report, for example, archaic and legalistic language has been avoided. In the interests of producing a "leaner" set of model articles and making the model articles more accessible to the directors and shareholders of small companies, we have omitted model articles on areas of law for which there are already procedural rules in the Companies Act (for example, the draft model articles do not contain any provisions on decision-taking by shareholders – see below).

*Will the private company articles be suitable for all private companies?*

The private company articles contain the minimum number of rules which it is envisaged that a typical private company limited by shares will need and which the shareholders will want to have. (There is little point having a default rule if the majority of companies will want to disapply it). They are primarily aimed at small, owner-managed companies.

Some or all of these rules may be suitable for less typical private companies, but if they are not, it will be open to any private company limited by shares which is using, or intends to use, the private company articles to add to, amend, or delete rules from the model articles as they see fit (as is the case with Table A), or to adopt completely different "bespoke" articles of their own.

*Articles on decision-taking by members*

The private company articles do not include equivalent articles to the Table A provisions on general meetings. It is envisaged that the majority of private companies will want to take advantage of the new written resolution procedure and as such the majority of private companies limited by shares are unlikely to need detailed rules on the procedure for calling, and the conduct of, meetings of the company's members.

If the members of a private company want or need to have a meeting (for example, the written resolution procedure cannot be used for resolutions to remove auditors or directors), all of the provisions necessary for the conduct of such meetings will be in the Act (although it should be noted that the provisions in the Act will be different from the current default position in Table A in a number of respects).

The public company articles will make detailed provision for meetings and private companies will be able to incorporate these provisions into their articles if they find them useful.

*Draft guidance notes on the private company articles*

By the time that the private company articles come into force, guidance on the new model articles (and other linked areas, for example, conflicts of interest and special resolutions) will be available from Companies House. An illustration of the types of things that will be set out in the guidance on the model articles is at Annex B.

The draft guidance has been drafted with the benefit of informal consultation with Companies House and small firms advisory bodies. In line with feedback received from consultees the draft guidance seeks to explain, in plain English, what articles of association are and how the private company articles work (rather than giving a detailed commentary on each of the individual model articles – which are written in plain English and are intended to be self-explanatory).

*The public company articles*

Separate model articles will be provided for public companies (the "public company articles"). In terms of content, these will be similar to the existing Table A (that is, the public company articles will include more detailed rules to cater for more complex circumstances), but will be drafted in plainer English and updated to reflect changes in the law. Private companies which find that the new private company articles fail to address their needs will be able to import provisions from the public company model on a voluntary basis.

### 4.4 Dematerialising share certificates

It has been possible since 1996 for quoted company shares to be held in secure electronic form, and shares representing around 85% of the value of the UK equity market are now held this way. However, around ten million retail shareholders continue to hold their shares in paper form. An industry working group has suggested that there would be long term cost savings for everyone

– including retail shareholders – if all quoted company shares were held electronically, and that such a move would help to maintain London's pre-eminence as a European financial centre. The Government therefore wishes to make sure that company law requirements do not stand in the way of a move towards a fully dematerialised securities market, and has invited all interested parties to develop the ideas further. The Government would be willing in principle to include provisions in the Bill which would permit companies to stop issuing paper share certificates. Such legislation would not prevent retail shareholders from continuing to hold their shares directly, with their names on the company's register of members.

### 4.5 Company secretaries

The Government agrees with the CLR's recommendation that it should no longer be a requirement for private companies to appoint a company secretary. Shareholders will of course continue to be able to require that a company secretary be appointed, if they so wish, or they may choose to let their directors decide. However, for the vast majority of companies (particularly those which only have one shareholder), a company secretary is almost certainly unnecessary.

### 4.6 Offences

The approach to sanctions in the Bill will follow closely the suggestions made by the CLR for a clearer, more accessible, and more consistent approach across the legislation. Key elements of the proposed approach include refinements to the "officer in default" framework, to make it clear which individuals in which circumstances may be liable for a breach, and a shift towards the removal of criminal liability from the company itself in certain circumstances.

The approach to the overarching "in default" framework – in other words, the question of which individuals should generally be liable for breaches of legal requirements in which circumstances – is very much in line with the CLR and the previous White Paper.

*Officer in default*

In essence *directors* should normally be liable where they authorise, participate in, permit, or fail to take active steps to prevent (including monitoring failures where appropriate) a default. *De facto* directors will be covered on the same basis.

*Secretaries* should be liable, if directors have properly charged them with the relevant function (or if the function has been conferred on them by the articles), where they authorise, participate in, permit, or fail to take active steps to prevent the default.

The CLR recognised the importance of ensuring that those whom they termed *managers* (a further category of company officer, beyond directors and secretaries) did not escape potential liability. In simple terms, these should be those who a) are relatively senior employees, with a policy and decision-making role which can affect the enterprise substantially and b) have responsibility for the function which is the subject of the breach. The draft clauses give effect to this policy by using the term "senior executive" which it is felt more accurately describes the category of person envisaged. This category of senior executive will generally cover senior employees within the company, but not (on the whole) external third-parties.

The CLR also suggested that a further category, *delegates*, should have liability on a case by case basis. By delegates is meant individuals to whom a particular function has properly been delegated, by or under the authority of the directors or secretary. Consultation suggested that the previous White Paper drafting may not have been sufficiently clear on the circumstances in which a delegate might be liable. The new draft clauses are designed to make clear that, for delegation to be "proper", it must be reasonable in all the circumstances.

It is also important to be clear that delegation will not be the same as assignment. In other words, even a "proper" act of delegation will not remove potential liability from those delegating, albeit they would be able to adduce the delegation as evidence of their having taking reasonable steps to secure compliance. Decisions on whether delegates should be targeted in a particular offence can only be decided on a case by case basis. For example, if a statutory function is one which many companies often and reasonably outsource to informed third-parties, it may well be appropriate that those third parties should be brought within the frame of liability for breach. Offences where it is suggested that delegates should potentially be liable are noted in Annex D.

*Liability of the company*

The CLR also suggested that there should be a presumption against liability falling on the company itself where (for certain types of offences) the criminal act was capable of seriously damaging the company, and liability on the responsible individual would provide a sufficient deterrent; or where meaningful and effective alternative sanctions exist. This would ensure that liability was better targeted, and would avoid imposing a penalty on the company, and thus the shareholders, where the fault was entirely that of specific company officers. Offences for which it is suggested that the company itself (as opposed to its officers) should no longer be liable are also noted at Annex D.

*Enforcement*

Targeting sanctions on a company's officers will make it essential that every company complies with the requirements to have officers, and the new requirement that at least one director be a natural person. Every week, Companies House writes to over 800 companies that do not meet the present requirements. In most cases, either the company is defunct and is subsequently struck-off the register or the company rectifies the omission. But there is a continuing problem with companies that continue to carry on business despite having no director, or at least none notified to Companies House. The Government proposes to give the Registrar of Companies power to issue a notice requiring a company to comply with the requirement within a specified period. There will be a criminal sanction, falling on the company, for failure to comply with the notice.

*Other sanctions changes*

As recommended by the CLR, the Secretary of State's power to bring proceedings on a company's behalf (Companies Act 1985 Section 438) will be repealed, and the penalty for fraudulent trading (Section 458) will be increased from seven to ten years.

## 4.7 Register of members

Companies' registers of members are an integral part of their constitutional apparatus. They are necessary to ensure that the members can be contacted, whether by the company, by other members, or by others such as those wishing to make a takeover bid or otherwise wishing to influence the members in their exercise of their rights as members. Company law therefore requires companies both to maintain registers with essential contact details and, for companies with share capital, information about size of holdings, and also to make these registers publicly available. The Bill will make some deregulatory changes to the requirements to make it easier for companies to maintain their registers without affecting their usefulness.

The Bill will keep the public right both to inspect and to obtain a copy of a company's register of members, supported both by the ability to apply for a court order if the company refuses. There have been instances where these rights have been abused, for example using intimidation of shareholders to force a company to withdraw from a contract. The Serious Organised Crime and Police Bill includes measures to address such intimidation directly.

Companies’ registers of members are also on the public record as their Annual Return to Companies House must include either the current register or, if a register has been returned in one of the 2 preceding years, the changes to it since the last return. The CLR recommended that for public companies this requirement should be reduced to details of only those members with significant holdings: this will be implemented through the existing power to make Regulations changing the content of the Annual Return.

Information about past members is of great importance to the people concerned. Therefore the register of members will continue to be prima facie evidence of the information it contains. At present, companies have statutory immunity from claims relating to entries after 20 years; the CLR recommended this period be reduced. The Bill will provide that the period be 10 years in keeping with the Law Commissions recommendation on the statute of limitation.

It also makes the same reduction to the period for which companies are required to keep past members’ details, while making clear that this old information may be kept separate from information on current members.

### 4.8 Capital maintenance and share provisions

Companies limited by shares have traditionally been seen as a mechanism by which the owners of such companies (the shareholders) limit how much of their money is at risk (generally speaking, if a company is insolvent and unable to pay its debts the creditors have no claim against the shareholders). But a company is also a way of protecting creditors and the rights of minority shareholders, in so far as money paid into the company by its shareholders (the company’s capital) belongs to the company and can only be paid back to the shareholders in certain circumstances. This makes life easier for creditors (and shareholders who do not have a controlling interest in the company). The rules that give effect to these general principles are sometimes referred to as the capital maintenance rules.

Whilst it is obviously important to protect the interests of a company’s creditors, the current provisions give rise to some of the most complex and technically challenging provisions of the current Act – 94 sections of detailed rules in total. These are capable of catching a number of potentially beneficial or at least innocuous transactions and as a result companies, and their advisors, can spend disproportionate amounts of time and money ensuring that they do not inadvertently fall foul of the rules.

*Deregulation for private companies*

Capital maintenance is largely irrelevant to the vast majority of private companies and their creditors. This is recognised by the current Act, which carves out a number of exceptions to the capital maintenance rules for private companies only. However because the provisions which are of most interest to private companies are drafted as exceptions, private companies have first to understand all of the rules and then identify that an exception applies to them, and if so how it works. Moreover the exceptions, while useful, do not simplify the law as much as is possible.

The Bill will therefore introduce a number of deregulatory measures targeting requirements that now appear unnecessary and burdensome for private companies.

*Abolition of financial assistance provisions for private companies*

The provisions on financial assistance are designed to protect creditors and shareholders against the misuse and depletion of a company's assets. The CLR concluded that it was inappropriate for private companies to continue to carry the cost of complying with the rules on financial assistance as abusive transactions could be controlled in other ways, e.g. through the provisions on directors duties which will be included in the Bill, or through the wrongful trading and market abuse provisions that have come into force since the Companies Act 1985. Private companies will therefore no longer be prevented from providing financial assistance for the purchase of their own shares.

*Capital reductions by private companies*

The current Act provides a means by which both private and public companies limited by shares may reduce their share capital (which includes share premium and any capital redemption reserve). The procedure can be time consuming and expensive as it involves confirmation by the court.

The Bill will introduce a new and simpler mechanism for capital reductions for private companies. This will be available as an alternative to the current court approval procedure. The new procedure will require a special resolution of the company's members, based on a solvency statement made by the directors. The solvency statement will require the directors to confirm that the company is solvent and will be able to pay its debts at all times within a year of the capital reduction. It will be a criminal offence for a director to make a solvency statement without having reasonable grounds for the opinion expressed in it. The introduction of the solvency statement procedure for capital reductions will render the private company rules on the purchase of the company's own shares out of capital redundant. The Bill will repeal these rules.

The CLR had proposed that the solvency statement procedure for capital reductions should equally be available for public companies, but the response to this proposal in the 2002 White Paper was mixed. Whilst many respondents were in favour of simplifying the procedure for capital reductions, concern was expressed that the proposed additional safeguards built into the procedure for public companies – to meet unavoidable EU requirements – meant that few public companies would use the solvency statement procedure in practice. The Government therefore does not propose to introduce this change at present for public companies.

*Distributions and intra-group transfers of assets*

So as to protect the interests of the creditors of a company, company law contains restrictions on when companies can pay dividends. The current Act lays down technical rules which determine what is a lawful distribution by a company to its members. These statutory provisions operate alongside the common law which is expressly retained and which remains an essential component in the regulation of improper distributions.

The 1989 decision in the case of *Aveling Barford v. Perion Ltd* (which was decided by reference to common law rules on distributions and maintenance of capital rather than the statutory rules) is widely considered to have cast doubt on the validity of intra-group asset transfers conducted by reference to book value rather than by reference to market value. It is understood that such transactions are often carried out by reference to book value rather than market value for a variety of business, administrative or tax reasons. The Bill will make clear that where the transferring company has distributable profits, its assets can be transferred at book value. This will remove any uncertainty about the current law, and also avoid the need for companies to carry out complex asset revaluations requiring significant professional advice and fees to advisors.

*Application of share premium account*

Amounts transferred to the share premium account where shares are issued at a premium (i.e. for an amount more than the shares' nominal value) can only be used in specific, limited circumstances. In line with the CLR's recommendations, the Bill will provide that the share premium account can no longer be used to write off a company's preliminary expenses (i.e. on formation).

*Further capital maintenance reform*

The Government believes that it would be beneficial to introduce greater flexibility into the capital maintenance regime for public companies. However,

in advance of significant amendments to the EU legislation it would not be possible to make major changes to our capital maintenance regime in respect of public companies at this stage. Thus, for example, the financial assistance rules will continue to apply to public companies. While the CLR recommended a number of further technical changes to these rules, the Government is seeking to give priority to the CLR's overarching recommendation for fundamental reform of the capital maintenance regime through reform of the 2nd Company Law Directive. The Government very much welcomes the proposals in the Company Law Action Plan for a review of the 2nd Directive and is committed to working with the Commission and other Member States to take this forward as rapidly as possible. The proposed company law reform powers will provide a mechanism for effecting reform for all classes of British company as and when appropriate.

*Miscellaneous provisions on shares*

At the moment all companies with shares are required to have a limit on the maximum amount of shares they can allot– called the authorised share capital. This limit can be raised with shareholder agreement. In practice it is normally set at a level that is much higher than it is anticipated the company will need.

This means that authorised share capital normally serves no useful purpose. As recommended by the CLR, the Government proposes to remove the requirement on the basis that it is an unnecessary piece of regulation. It will of course continue to be possible for shareholders to include provisions with a similar effect in a company's articles if the special circumstances of that company make such restrictions important to the shareholders.

Linked to this, for private companies, will be the removal of the requirement for shareholder approval of allotments of shares (except where the company has or will, as a result of the allotment, have more than one class of shares); and the removal of the requirement for authorisation in the articles to issue redeemable shares.

Both public and private companies will be free to issue redeemable shares without the need to specify the terms and manner of redemption of those shares in their articles. Shareholders will therefore be able to approve an allotment of redeemable shares on terms that the directors determine. The terms and manner of redemption will need to be provided to the Registrar of Companies in the return of allotments. This return will in future contain a statement of the company's total allotted share capital.

The Bill will permit the direct issue of warrants to bearer in respect of fully paid shares (that is, there will be no need for the shares to first be issued in registered form and then converted to bearer form).

Trustees in bankruptcy and personal representatives of deceased members will have the right to be registered as a shareholder notwithstanding any contrary provision in the articles. In addition, where a company has refused to register the transfer of a share, the directors must provide the transferee with such information about the reasons for the refusal as the transferee may reasonably request.

*Redenomination of share capital*

At the moment a company may issue new shares in any denomination it wants (e.g. euros, dollars, sterling or other). What it cannot do is convert its existing share capital into another currency without cancelling or buying back its existing shares (the shares it wants to redenominate) and issuing a fresh batch of shares in another currency.

This is cumbersome and unnecessary and we are introducing a simplified procedure to enable companies, if they wish, to easily convert their share capital from one currency to another, and to renominalise their shares, after conversion, to achieve round share values (i.e. avoid having shares with a value expressed in fractions of a currency after conversion).

*Notice period for pre-emption rights*

In line with the CLR's recommendations on pre-emption rights, and as supported by Paul Myner's recent review of pre-emption rights, the present statutory minimum period of 21 days for acceptance of rights offers will be retained, but we will take a power, in the Bill, to vary this period (upwards as well as down but to no less than 14 days). This power will require an affirmative resolution of both Houses of Parliament.

### 4.9 Companies House

A number of changes will be made to ensure that the system for companies to file information with Companies House is kept efficient and business-friendly. Many of these will focus on encouraging and exploiting new forms of e-communication, and the Registrar (i.e. Companies House) will have greater powers to specify the form and manner in which companies must submit information.

There will also be measures to help ensure the accuracy and timeliness of information on the public register. These will include:

- the law will state with greater clarity what information will appear on the register, and what will not;

- the ability for Companies House simply to telephone companies who have provided incomplete information, so that they can easily obtain the missing element without having formally to reject the incoming form;
- the ability to remove items from the public register which have been erroneously placed there or which are "surplus" and unnecessary;
- where information has been properly placed on the register, but subsequently proves to be inaccurate or misleading, there will be a new and simple court-based procedure for ensuring that it can be removed.

These measures will be coupled with a new offence, making it unlawful knowingly or recklessly to deliver to the Registrar material which is misleading, false or deceptive in a material particular.

*Company strike-off and restoration*

At present, only private companies are able to request voluntary strike-off from the register. This will be extended to public companies.

Other measures will make it easier to restore companies to the register where they should not in fact have been removed. Companies House will be able to do this by administrative means (in more straightforward cases), and simplifications will be introduced to current statutory court procedures to cater for other cases.

### 4.10 Reports and accounts

The Government's plans for a modernised company reporting and accounting system include a number of important changes which have already been effected. These include the raising of the audit thresholds for turnover and balance sheet totals to £5.6m and £2.8m respectively, taking some 69,000 companies out of the requirement to have accounts professionally audited; and the introduction of the OFR for all quoted companies, a key plank in promoting more effective dialogue between companies and investors and helping to maintain trust and confidence in capital markets.

*Simplification of Part 7*

The accounting, auditing and reporting sections of the current law (Part 7 of the Companies Act) are amongst the most relevant of all provisions in that Act to companies in the normal course of their business. A number of consultees, particularly smaller firms and their advisors, have said that it is hard for them to find and understand the requirements which relate to them because in the interests of brevity the approach has been to express some provisions as modifications of those which apply to larger companies.

The Government has therefore looked very carefully at possible ways in which the provisions could be restated in a more coherent way, making it clearer to users which provisions affect which categories of company. One approach is to set out sequentially a separate, comprehensive "code" for each of the different sizes of company, starting with small, private companies, which can be read independently. The indicative clauses published in this document are drafted on this basis. However, this approach has disadvantages in terms of length and there may be some scope for setting out separately the limited number of provisions that are common to companies of whatever size.

*Time limits*

The bill reduces the time limit for private companies to file their annual reporting documents at Companies House after the year end from 10 months to 7 months and for public companies from 7 months to 6 months. These changes, recommended by the CLR following external consultation, reflect improvements in technology and the increased rate at which information becomes out of date, as well as filing times in other countries which tend to be less generous than in the UK.

*Abbreviated accounts*

Small and medium sized companies can currently file abbreviated accounts at Companies House. This enables them to keep some information confidential (for example on profit margins). The CLR recommended that the option be abolished in the interests of greater transparency and that instead companies should file their full statutory accounts. Consultation showed that there were both proponents and opponents of abolition of this option. The Government has decided that the option, which is currently popular with a great many companies, should be retained, but that both small and medium sized companies should be required to disclose the amount of turnover for the relevant financial year.

*Disclosures in the directors' report*

It was a recommendation of the CLR that once the OFR was in place the DTI should consider what current directors' report requirements remained necessary, both for companies required to produce OFRs and for others, and remove those that were no longer required. The Government agrees that it is in the interests of more effective company reporting to remove ineffective or otiose disclosure requirements, whilst maintaining any requirements for which there is a clear public policy interest.

Following review on this basis, its proposed to remove requirements for disclosures in respect of **the employment of disabled persons, and employee involvement.** The requirement for companies with over 250 employees to state their policy on the employment of disabled persons has been completely overtaken by substantive requirements under the Disability Discrimination Act. Retention of the requirement is effectively doing no more than asking companies to state that they are complying with the law, and is therefore uninformative. The requirement for companies with over 250 employees to state action taken to inform and consult employees has been overtaken by more substantive requirements under the European Works Council Directive and, from March 2005, the Information and Consultation Directive.

It is also proposed to amend, but not remove entirely, the requirement to disclose political and charitable donations. Companies of all sizes are required to make a disclosure relating to political donations and charitable donations if aggregate donations in either case exceed £200. In the case of political donations, the recipient must be named and the total amount given to that recipient disclosed; and prior shareholder authorisation is required for donations which in aggregate exceed £5,000 in the course of the year. It has long been recognised that a director may face a conflict of interest when the company makes a political or charitable donation, and it would be wrong to remove this important disclosure requirement entirely. However, the £200 threshold for disclosure now appears very low, and it is proposed to raise it in both cases to £2,000.

*Disclosure of criminal convictions*

The CLR also suggested that companies should in addition be required to disclose any criminal convictions in their annual report and accounts, and the 2002 White Paper discussed options for implementing this underlying idea.

Responses to the White Paper on this point were divided, with little evidence provided that publicising convictions (beyond what already happens in, for example, the local press) would encourage compliance. Proposed options appeared to be either very difficult to enforce (if the law were to require directors to admit guilt in their published report and accounts) or disproportionately expensive (if, say, Companies House were to be required to maintain a web-based register, as mooted in the 2002 White Paper). The Government therefore does not propose to proceed with this suggestion.

### 4.11 Public/private split

The Government wishes to ensure that a private company (defined as any company that is not a public company):

- is prohibited from offering its shares or debentures to the public, or colluding in any such offer made by another person; and
- is required to re-register as a public company if it does anything that facilitates the transfer of its shares or debentures, by any person, to persons other than those to whom the company, as a private company, would be allowed by law to offer such securities.

The first of the limbs set out above is not novel. Section 81 of the Companies Act 1985 currently prohibits private companies from offering their shares and debentures to the public. However, the second limb will be new, and will be enforceable by a power for various persons (including the Secretary of State) to apply to the court for an order that the company must re-register as a public company.

These proposals will take forward, so far as is feasible, the CLR recommendations that:

- company law should continue to prohibit private companies from offering their shares to the public;
- the meaning of offer to the public for the purposes of that prohibition (and in particular the related exemptions) should be aligned as far as possible with the exemptions which apply in relation to an offer to the public for the purposes of securities regulation; and
- private companies should be prohibited from admitting their shares to trading on a prescribed investment exchange, or from assisting in any way an application for admission of their shares to trading made by any other person.

### 4.12 Jurisdictional migration

The Government's proposals regarding jurisdictional migration encompass two conceptually distinct provisions:

- to enable a company registered in Great Britain to transfer its registered office between England and Wales, and Scotland;
- to enable:

  i) a company registered in Great Britain either to migrate to a jurisdiction other than Great Britain (including another EEA State, or a third country); and

(ii) a company formed under the law of a jurisdiction other than Great Britain to migrate to Great Britain

without, in either case, forming a new company in the 'incoming' jurisdiction.

Since the publication of the CLR's *Final Report*, the European Commission has consulted on outline proposals for a company law directive on the cross-border transfer of the registered office of a limited company. A formal proposal for such a Directive is expected shortly from the Commission.

The provisions of the directive would, of course, supersede the CLR recommendations in respect of the migration of companies between England, Wales and Scotland and other EEA States. The CLR recognised this in their report, and, in line with spirit of their thinking, the Government does not propose to pre-judge the outcome of the EU negotiations by seeking express provision at this stage enabling migration between Great Britain and other EEA States.

The Government would envisage exploring the possibility of using regulations to implement the directive and to extend the directive regime, insofar as its further intention is that the Bill should contain a power for the Secretary of State to make the necessary provision for migration between Great Britain and non-EEA jurisdictions. It also wishes to make provision, by secondary legislation, to enable companies registered in Great Britain to transfer their registered office between England and Wales, and Scotland.

### 4.13 Overseas Companies

Changes will be made to the current framework in respect of overseas companies, in line with the substance of the recommendations of the CLR. Under the current Act, there are in effect two parallel regimes, one applying where a company is incorporated outside the UK and Gibraltar, but has set up a branch in Great Britain; the other where a company is incorporated outside GB and establishes a place of business in GB. The Bill will enable a single regime to apply to all overseas companies, i.e. all companies which are incorporated outside GB and which establish *a place of business* in GB. This regime will, as the CLR recommended, be based on the requirements of the 11th Directive, in other words it will generally reflect the existing provisions applying to non-UK companies setting up branches in GB.

The provisions relating to overseas companies appear a good candidate for removal from primary legislation and placing into subordinate legislation because of their relatively self-contained nature, and because it seems largely possible to ensure that all necessary provisions can be set out in one place.

### 4.14 Arrangements and reconstructions

The Bill will make a number of generally technical changes, generally in line with CLR recommendations, to ensure that, on application by the company or other proposer of the scheme, the courts will be able to determine what constitutes a "class" of creditors or members; and to ensure that, even where a class is wrongly constituted, court approval should stand where the court is satisfied there was no effect on the outcome. The courts will also be able, on request, to direct the manner in which meetings should be called, held and conducted.

The CLR had suggested that there might be a case for the introduction of a non-court based statutory merger procedure. However, in the light of the other changes being made as noted above, and in the absence of any clear business demand emerging from previous rounds of consultation, the Government does not propose to take these ideas forward.

### 4.15 Authorisation of political donations

The Political Parties, Elections and Referendums Act 2000, which implemented the Committee on Standards in Public Life's recommendations on the funding of political parties in the UK, introduced a requirement for prior shareholder authorisation of political donations by companies above an annual threshold of £5,000. This recent reform appears to have been widely supported, and no substantive changes are proposed. However, certain technical changes are proposed to the current requirements in order to remove unnecessary burdens and make them more business friendly. These are:

- to make it clear that certain non-contentious "donations" (e.g. paid time-off for elected local councillors, or the provision of a meeting room for trade union officials) are not caught by the requirement for shareholder approval; and

- to allow companies greater procedural freedom in obtaining the necessary shareholder authorisation, in particular by permitting them to seek separate authorisation for donations to political parties and donations to other political organisations.

In addition, as noted in 4.10, the threshold for disclosure of political donations will be raised to £2,000.

### 4.16 Company charges

Many companies use their assets as security for loans. The Companies Act provides that these transactions are invalid in the event of the company's insolvency unless they have been properly registered. Under the Act, the system of registration is based on transactions that have already been completed. The CLR consulted over changes to improve the present system; they also sought views on whether it should be replaced with a different system.

Following this consultation, the CLR were concerned lest the provision that a charge is invalid if not registered (i.e. the sanction of invalidity) contravened the European Convention on Human Rights. This sanction underpins the present system. As about half of their respondents had favoured developing a system of notice-filing, they recommended that the Law Commissions be asked to make recommendations for reform to both company law and security over property other than land in both England and Wales and in Scotland. Because of the fundamental differences between Scots law and English law with regard to the law of property and of rights in security, the Government made separate requests to the two Commissions.

In its Report on Registration of Rights in Security by Companies (Scot Law Com No 197) the Scottish Law Commission recommended that the validity of rights in security granted by companies should cease to be dependent on particulars of the right in security having been registered in the Register of Charges at Companies House. As respects floating charges in Scotland, the principal recommendation of the Scottish Law Commission was that registration of the floating charge in a new Register of Floating Charges, to be kept by the Keeper of the Registers of Scotland, should be the means whereby the floating charge would be created or constituted, with priority being dependent on the date of registration. The Scottish Law Commission also suggested that the annual return submitted by a company should contain short details of outstanding rights in security granted by the company and that, on payment of a prescribed fee being made to it by an inquirer, a company should be under a statutory duty to meet a request for the same details respecting any rights in security granted since the date of the last annual return. The current requirement to maintain a register of charges at the company's registered office would cease. These recommendations span both matters devolved to the Scottish Executive and also those reserved to Westminster.

The Law Commission for England and Wales, which was asked to carry out a more fundamental review (including the kinds of transaction that should be registered and the rules that govern priority), has consulted extensively over fundamental changes. The balance of informed opinion shifted considerably during this process. Therefore the Commission has not yet made its recommendations.

The Government is considering with interest the recommendations of the Scottish Law Commission, noting that those relating to devolved matters are for the Scottish Executive. It looks forward to receiving the recommendations of the Law Commission for England and Wales.

### 4.17 Transparency Directive

*Transparency Directive Implementation*

The Transparency Directive[1] is an important part of the Financial Services Action Plan. The Financial Services Action Plan has been the European legislative framework for developing the Single Market in financial services. The purpose of the Transparency Directive is to enhance transparency in EU capital markets. It does this by establishing rules on periodic financial reports and disclosure of major shareholdings for issuers whose securities are admitted to trading on a regulated market in the EU. The Directive completed the European legislative process on 15 December 2004 and must be implemented into national law by all Member States no later than 20 January 2007.

Most of the requirements of the Transparency Directive can be implemented by secondary legislation using powers under Section 2(2) of the European Communities Act 1972. The Treasury will consult on proposed regulations to be made under the European Communities Act in due course. However, the proposed approach for those parts of the Transparency Directive relating to the disclosure of shareholdings – historically part of company law – requires primary legislation. The Government therefore proposes to include the necessary provisions in the Bill.

*Disclosure of shareholdings*

The Directive requires Member States to impose obligations on:

- *issuers* of securities, which are traded on a regulated market in the Member State, to disclose certain information; and

[1] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004.

- *shareholders*, and certain parties able to exercise control of voting rights, to disclose certain information to the issuer of the shares in question.

Member States also have to appoint a competent authority to supervise these obligations. In the UK this will be the Financial Services Authority (FSA). For the majority of the Directive's provisions, the FSA already has sufficient powers under the Financial Services and Markets Act 2000 (FSMA) to permit implementation by way of regulations made under the European Communities Act 1972. However, the FSA currently has no powers under FSMA to make rules in respect of disclosure of shareholdings and hence the requirement for primary legislation to implement the Directive's provisions in this area.

The existing requirements for shareholders to disclose substantial shareholdings are set out in Part 6 of the Companies Act 1985. In order to bring together supervision of all Transparency Directive obligations under one competent authority, the Government proposes to transfer this responsibility to the FSA. Part 6 of the Companies Act 1985 will be repealed in so far as it relates to a shareholder's continuing disclosure obligations.

*Scope of the new FSA disclosure regime*

In relation to mandatory disclosure of interests in shares, the Bill will establish the scope of the new disclosure regime and give the FSA powers to make rules with regard to shareholder notification. Before the FSA can make rules, it must, under the provisions of FSMA, undertake extensive consultation with stakeholders and publish a cost-benefit analysis of its proposals for public comment.

It is proposed that the scope of the FSA regime would be broadly similar to the scope of the regime under Part 6 of the Companies Act 1985, which imposes disclosure obligations in relation to an "interest in shares". However, in order to reduce burdens, the Government is proposing to make a number of deregulatory changes to the current disclosure regime.

- **Basis of disclosure obligation.** The obligation of disclosure under Part 6 of the Companies Act 1985 relates to "interests in shares". The obligation of disclosure under the Directive relates to "major holdings in issuers". In broad terms, this is best understood as a holding of voting rights. The holding of voting rights is currently only one of the "interests in shares" whose acquisition or disposal is required to be disclosed under the present Part 6. The Government considers that it would be less burdensome to investors if a disclosable interest were redefined in terms of the "control of

exercisable voting rights". This change was favoured by the large majority of respondents to a consultation on company law reform undertaken by the DTI in 1995.

- **Issuers subject to the regime.** The current notification regime applies to interests in all public companies as defined by the Companies Act 1985. The Transparency Directive requires disclosure in relation to holdings of shares of an issuer, including those incorporated outside the UK, whose shares are admitted to trading on a regulated market and to which voting rights are attached (Article 9). The Government believes that it is desirable, in the interests of market transparency and the investing public, to retain a slightly wider scope in UK legislation than that required by the Transparency Directive. This would allow the FSA, following consultation, to apply disclosure requirements to those with control of exercisable voting rights in shares of particular issuers. At a minimum, this would include those with control of exercisable voting rights in shares of issuers whose shares are *admitted to trading on a regulated market in the UK*. At a maximum, this could also include those with control of exercisable voting rights in shares of all issuers whose shares are *admitted to trading on other markets in the UK*. The FSA is committed to only going beyond the minimum requirements of European legislation if extensive consultation with stakeholders shows that the benefits exceed the costs. In either event, public limited companies whose shares are not traded on a market in the UK would be excluded from the scope of the disclosure regime.

- **Sanctions for breach of notification obligations.** Part 6 of the Companies Act 1985 imposes criminal liability on shareholders in breach of the notification rules. The Government has concluded that it would be appropriate and proportionate to repeal the criminal sanctions and to give the FSA equivalent powers to those it has to deal with breaches of rules under FSMA.

The Government proposes to maintain the flexibility of the current regime in respect of the **disclosure of holdings of financial instruments**. The Directive requires disclosure in respect of holdings of a particular class of financial instruments: financial instruments that result in an entitlement to acquire shares with voting rights "under a formal agreement" and "on such holder's own initiative alone" (Article 13). Under Section 210A(1) of the Companies Act 1985, the Secretary of State has the power to amend by regulation the provisions as to what is taken to be an interest in shares. In order to retain the ability to require wider disclosure, where appropriate, the Government proposes to maintain the scope of the current regime and give the FSA equivalent powers to require disclosures in respect of holdings of financial instruments.

Part 6 of the Companies Act 1985 also provides, under section 212 and related provisions, for certain companies to require disclosure of information about interests in their shares. The Government is considering whether or not these provisions should remain in legislation, and if so whether it should be possible for all companies with shares to use them.