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A new route to reduce share capital

What is the new procedure?

On 1 October 2008, the Companies Act 2006 (the Act) introduced a new mechanism - the solvency statement procedure - for a private limited company to reduce its share capital without the need for court approval.

This new procedure presents significant advantages compared to the more traditional court approved procedure for reducing share capital or re-registering as an unlimited company. The new procedure is more streamlined and cost effective for private companies to use, particularly when compared with the court procedure. It should be noted however, that it is a criminal offence for a director to make a solvency statement without having reasonable grounds for the opinion expressed.

How does it work?

- Under the new procedure, private companies must pass a special resolution approving the reduction in capital. The resolution must be supported by a solvency statement signed by all the directors of the company confirming that the company has sufficient funds to meet its liabilities (including its contingent and prospective liabilities) at the date of the statement and during the 12 months following the statement. It is important to note that when making the solvency statement the directors must also consider their wider duties owed to the company under the Act. The reserves created on the reduction are treated as distributable.
- Share premium account and capital redemption reserve are treated as share capital for the purposes of a reduction of capital. Also, once the reduction has been effected both the issued and authorised share capital amounts will be reduced.
- The reduction of capital is effective on the date that the required documents are registered at Companies House. Companies House will register a reduction of capital under this procedure on a same day basis.

As the reduction is only effective upon registration of the required documents with Companies House, timing and process management will be of importance if the new procedure is to be used to facilitate a wider group capital structuring.

Action points:

Consider using the new solvency statement procedure to reduce share capital if any of following situations apply to your company:

- You are considering a corporate simplification programme.
- You have dividend blocks within the group.
- You have non distributable reserves that you wish to render distributable.

If you would like to use the solvency statement procedure, ensure your directors have sufficient financial information to enable them to make the statement and if in doubt, speak to your advisors.

Sole corporate directorships no longer allowed

From 1 October 2008 the Companies Act 2006 (the Act) no longer permits a company to have only corporate directors. At least one director who is a natural person is now required.

However, for companies that did not have a natural director on 8 November 2006 a grace period for compliance with this provision has been allowed until 1 October 2010.

Companies which do not appoint a natural person as a director by the required date will be liable to a fine and the Secretary of State may give the company an order to comply with the requirements of the Act.

Action point

- Check if you have any companies within your group with sole corporate directors appointed and ensure that at least one natural person is appointed by the required date.

Changes to rules on financial assistance

From 1 October 2008 the restrictions on the provision of financial assistance by a private company for the acquisition of shares in itself or its holding company were abolished in a deregulatory measure.

What was the position under the Companies Act 1985?

Under the Companies Act 1985 private companies were prohibited from providing assistance to a company for the acquisition of shares in itself or its holding company. The intention of the prohibition was to ensure that companies maintained their capital; however, the provisions were rather ambiguous and complex and caught a number of transactions which it was not intended to prohibit.

Private companies were permitted to apply a 'whitewash' procedure to a transaction which would otherwise be prohibited. In brief, the 'whitewash' procedure required the directors of the private company who wished to give financial assistance in connection with the acquisition of it own shares to sign a statutory declaration together with supporting documentation to confirm the solvency of the business for at least the next 12 months.

How do the changes under the Companies Act 2006 impact companies?

A public limited company will continue to be prohibited from providing financial assistance for the acquisition of shares in itself or in its parent which is either a public or private company.

A private company will also still be prohibited from providing financial assistance for the acquisition of shares in its public parent company.

Although the prohibition for private companies has been repealed it is still likely that lenders may include provisions in their loan agreements prohibiting financial assistance without their consent.

Consequences of breach of the statutory requirements

The sanctions for unlawful financial assistance include both criminal and civil liabilities. A person found guilty of an offence is liable for imprisonment or a fine. Transactions arising from the giving of financial assistance are void and unenforceable. A director who approved entry into the transaction may be personally liable for any loss arising from the transaction and also liable for a breach of his duties as a director.

Action point

- Ensure that all transactions involving public companies are carefully checked to avoid a situation where financial assistance is inadvertently given.
- Ensure that all transactions involving private companies are carefully checked to avoid a situation where financial assistance is given for the acquisition of shares in it's public parent company.
- Consult with lenders in case they require a procedure similar to the 'whitewash'.

New model articles released

On 16 December 2008 the new Companies Act 2006 model articles were made available by the Department for Business, Enterprise and Regulatory Reform (BERR). The Companies (Model Articles) Regulations 2008 will come into force on 1 October 2009 and will apply to the following companies incorporated on or after 1 October 2009, replacing the existing transitional Table A:

- Private companies limited by shares.
- Limited companies limited by guarantee.
- Public companies.

For companies incorporated on or after 1 October 2009 their articles may be based on the new model articles, or, if no articles are adopted, they will be adopted by default.

Existing companies incorporated prior to 1 October 2009 may choose to amend their existing articles of association to bring them in line with the new model articles, by special resolution.

What has changed?

The new model articles amend the provisions for private companies relating to:

- directors' indemnities and insurance to ensure that the provisions relate only to company directors and not other officers;
- decision making, allowing decisions taken other than at board meetings only to require the consent of eligible directors (those who would have been entitled to attend and vote on a decision if it had been taken at a meeting). In addition, decisions taken by directors of a private company may be taken other than by way of a meeting or written resolution of the directors;
- conflicts of interest, as new provisions have been introduced; and
- termination of directors' appointment, as the model articles no longer require retiring directors to notify the company of this fact.

The new model articles also amend the provisions relating to chairing meetings, proxy forms for public companies and the liability of members for private companies limited by guarantee.

Action point:

- Change your articles of association now to comply with the new legislation relating to directors' conflicts of interest and to be compliant with the changes being introduced in October 2009 under the Companies Act 2006.

Revised guidance on audit committees

For listed companies with financial years ending on or after 30 June 2009, the Financial Reporting Council (FRC) has published revised guidance on audit committees.

There are no significant departures from the previous guidance (the Smith Guidance), which was appended to the Combined Code. However, additional recommendations have been incorporated into the guidance in relation to the role and responsibilities of the audit committee and guidance on the factors to be considered if a group is contemplating employing firms from more than one network to undertake the audit.

The full guidance can be found at: http://www.frc.org.uk/CORPORATE/auditcommittees.cfm

What are the changes?

The internal audit process

The guidance has been updated to reflect the following:

- The need for an internal audit process will vary depending on company specific factors such as the scale, diversity and complexity of each company's activities. The audit committee may consider that other functions within their company provide adequate assurance and advice in relation to risk and control.
- When assessing whether an internal audit function is required, the audit committee must now consider trends and current factors relevant to the company's activities, markets and its external environment, which have increased or could increase the level of risk faced by the company, in addition to considering internal factors.
- If there is no internal audit function, the audit committee must assess whether the processes that are in place provide sufficient and objective assurance.

The external audit process

- When considering the appointment of external auditors, the audit committee must now consider the risk of withdrawal of their auditor from the market in their risk management assessments.
- The audit committee will now be required to assess the independence and objectivity of the external auditors, whereas previously there was only a recommendation that there be procedures in place to ensure their independence and objectivity.
- It is recommended that reassurance is sought from the auditors that their staff have no relationships with the company that could adversely affect the auditors' independence and objectivity and that information about the auditors' internal policies is sought.
- The audit committee section of the annual report should explain how the recommendation on the appointment, re-appointment or removal of the auditors was reached, including supporting information on tendering frequency, the tenure of the current auditor and any contractual obligations restricting the choice of auditor.

Revised guidance on use of audit firms from more than one network

- The guidance includes the recommendation that a company may wish to consider the use of audit firms from a single network, use of audit firms from more than one network or the use of joint auditors and considerations of the audit committee relevant to such decisions.

Action points:

- Ensure that the members of the audit committee are fully briefed in relation to the changes to their role and responsibilities and the new guidance on use of audit firms from more than one network of firms.
- Ensure that the audit committee considers if, and how, they are going to implement each of the additional recommendations incorporated in the FRC guidance.

Directors' powers to allot shares

The Association of British Insurers (the ABI) issued new guidance on 31 December 2008 relating to the issue of shares by listed companies.

Under the revised guidelines, in addition to the general authority to allot one third of the issuer's existing ordinary issued share capital or the amount of the issuer's unissued ordinary share capital (whichever is less), ABI members will now also regard as routine an additional request from the issuer to authorise a further third of the issued share capital provided:

- that the additional authority is only used for fully pre-emptive rights issues; and
- both the general and additional authorities expire on the date of the next annual general meeting (AGM) (if only a general authority is sought, an expiry date of up to five years is acceptable).

The ABI will review the guidance in three years' time but will monitor use of the additional headroom in the intervening period.

Action points

- If you wish to take advantage of the new limit ensure that a resolution is included in your 2009 AGM notice to seek shareholder approval.
- If you take advantage of the new limit ensure that all members of the board wishing to remain in office are put forward for re-election at the following AGM.

Shareholder rights directive

In October 2008 the department for Business Enterprise and Regulatory Reform (BERR) published a consultation document on the implementation of the EU Shareholders' Rights Directive (the Directive). The Directive is intended to improve corporate governance in EU companies traded on regulated markets by enabling shareholders to exercise their voting rights and rights to information across borders. UK company legislation in the large part already caters for a significant proportion of the proposed areas covered by the Directive.

The Directive is required to be implemented by 3 August 2009 and a draft text of the proposed regulations is included in the consultation document. The Government has also taken the opportunity to tidy up some of the existing inconsistencies relating to shareholders' rights following the implementation of the Companies Act 2006 (the Act).

What are the changes?

Some of the changes apply to all companies but many of the provisions will apply only to traded companies.

The key changes for traded companies are as follows:

Notice of Meetings for traded companies

An annual general meeting(AGM) will still require 21 clear days' notice and on the fulfilment of certain criteria other general meetings may be held on notice of at least 14 days. In order to hold other general meetings at 14 days notice a member's resolution will need to be passed and the company will need to offer electronic voting to all of its shareholders.

The Directive also proposes more stringent requirements for the information that must be included in the notice of meeting for traded companies.

Right to ask questions

The proposed regulations establish express rights for shareholders at meetings of traded companies to ask questions and, except in certain circumstances, have those questions answered.

Abolition of chairman's casting vote

The regulations make void any resolution passed at a meeting of a traded company by use of a casting vote and therefore effectively abolish the chairman's casting vote.

The key changes that will apply to all companies are as follows:

Voting by proxy

The proposed regulations provide that where a proxy is instructed by multiple members, they will have one vote if all the members intend to vote in one way. If however, the members wish to vote in different ways the proxy will have one vote for and one vote against the proposed resolution. With small companies it is important that the proxy realises that they must vote twice, rather than simply abstain.

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Shareholder rights directive - Cont'd

Corporate representatives

The regulations also seek to clear up the confusion surrounding the appointment of multiple representatives by corporate nominees to represent different beneficial owners. Section 323 of the Act provides that if those representatives vote in different ways they will be treated as having abstained from the vote. The proposed regulations allow for corporate representatives to vote in different ways if their votes are in respect of different blocks of shares.

Call for general meetings

The proposed regulations reduce the percentage of share capital for members to require the directors to call a general meeting from 10% to 5%.

What next?

Subject to the outcome of the consultation, it is intended that The Companies (Shareholders' Rights) Regulations 2009 will come into force on 3 August 2009.

Action points

- Traded companies wishing to be able to hold general meetings, other than AGMs, at 14 days notice will need to ensure that a resolution is included in their next AGM notice to allow this and ensure that electronic voting is offered to all members.

- Traded companies will need to ensure that they are complying with the increased disclosure requirements in their notices of meetings following implementation of the regulations.

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