

Companies Act 2006: Sections in operation of interest to insolvency practitioners

The purpose of this article is to highlight a limited number of areas where the Companies Act 2006 – one of the largest pieces of codifying legislation ever produced – is already having an impact on the insolvency profession and/or where it is most likely to do so over the coming months.

On 20 January 2007, provisions for disclosure of a company's registered name and details on websites and in electronic communications came into force.

On 1 October 2007, sections **170 to 181** setting out the general duties of directors came into operation with the exception of the following, which were originally not due to come into force until 1 October 2008 but now may not come into operation until 1 October 2009, (we await further timing details in December):

- Section **175** – duty to avoid conflicts of interest
- Section **176** – duty not to benefit from third parties
- Section **177** – duty to declare an interest in a proposed transaction or arrangement

Section 170 scope and nature of general duties

Comments

- The general duties specified in sections 171 to 177 are owed by a director to the company
- The intention behind the codification of the general duties was to make clearer what is expected of directors. It is worth bearing in mind, however, that these general duties are not intended to be a definitive guide to all the duties of a director. There are, for example, other obligations on a director set out throughout the Companies Act 2006 and, of course, there are the responsibilities and obligations under the common law and the Insolvency Act 1986
- A director must comply with every duty although it is clear that the duties may overlap
- Only the company can enforce the general duties a director owes but members may also be able to enforce them on behalf of the company (see sections 260 – 264 below dealing with derivative claims and proceedings by members)
- The general duties set out how directors are expected to behave. The purpose is not to tell the director what decisions they should take in any situation

- Section 170(4) makes it clear that the general duties are to be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties
- Section 170(5) makes it clear that the general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles apply

Section 171 duty to act within powers

This section provides that a company must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred.

Section 172 duty to promote the success of the company

Under section 172(1) a director of a company must act in a way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (among other matters) to:

- the likely consequences of any decision in the long term
- the interest of the company's employees
- the need to foster the company's business relationships with suppliers, customers and others
- the impact of the company's operations on the community and environment
- the desirability of the company maintaining a reputation for high standards of business conduct and
- the need to act fairly between members of the company

Comments

- Essentially, this duty replaces the fiduciary duty to act in the best interests of the company having regard to the shareholders' interests as a whole
- The six matters listed above are not exhaustive. Accordingly, directors also have to have regard to other factors where relevant
- The decision about what will promote success, and what constitutes success, is left to the directors' good faith judgement
- Section 172(3) provides that the duty imposed by this section has effect **subject** (our emphasis) to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company. It seems clear, therefore, that the duties on a director when a company is insolvent will overreach this duty
- Parliament has indicated that 'success' in most cases relates to a long-term increase in value of the company and that this is a matter for the directors' good faith judgement
- Parliament has also suggested that the weight to be given to the different factors, where there may be conflict between them, is also a matter of the directors' good faith judgement and that the directors should give the factors proper consideration
- The Department for Business, Enterprise and Regulatory Reform (formerly the Department of Trade) has published guidance on directors' duties under this part (Part 10) of the Companies Act 2006. The guidance states that a director should:
 - act in the company's best interest, taking everything they think relevant into account
 - obey the company's constitution and decisions taken under it
 - be honest, and remember that the company's property belongs to it and not to them or to its shareholders
 - be diligent, careful and well informed about the company's affairs

- make sure the company keeps records of directors' decisions
- remember that they remain responsible for the work they give to others
- avoid situations where their interests conflict with those of the company. When in doubt, they should disclose potential conflicts quickly
- seek external advice where necessary, particularly if the company is in financial difficulty

Section 173 duty to exercise independent judgement

This section provides that a director of a company must exercise independent judgement. This duty is not infringed by the director acting:

- in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors or
- in a way authorised by the company's constitution

Comments

- It will be noted that this duty does not confer power on directors to delegate, nor does it prevent a director from exercising a power to delegate conferred by the company's constitution **provided** (our emphasis) it is in accordance with the company's constitution.

Section 174 duty to exercise reasonable care, skill and diligence

This section provides that a director must exercise reasonable care, skill and diligence. This means the care, skill and diligence that would be exercised by a reasonably diligent person with:

- the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company and
- the general knowledge, skill and experience that that particular individual director has

Comments

- The duties here are based on section 214 of the Insolvency Act 1986, namely it introduces an objective as well as the old subjective only test which was the position originally under the earlier company law legislation

Section 178 Civil consequences of breach of general duties

This section provides that the consequences of breach (or threatened breach) of sections 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied. The duties in those sections (with the exception of section 174 – duty to exercise reasonable care, skill and diligence) – are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.

Comments

- There has been no attempt to codify the **remedies** (our emphasis) available for breach of the fiduciary duties even though there had been a recommendation that remedies should be codified as well
- The Solicitor General summarised the position as follows: "the consequences of a breach of the fiduciary duty can include damages, compensation, restoration of a company's property, rescission of a transaction or a requirement of a director to account for any profits made as a result. They may also include injunctions or declarations, although those methods are primarily employed when a breach is threatened but has not yet occurred. The consequences of a breach of the duty of care may include the court awarding compensation or damages"

Section 179 cases within more than one of the general duties

This section provides that except as otherwise provided, more than one of the general duties may apply in any given case.

Section 180 consent, approval or authorisation by members

Comments

- If the duties under sections 175 or 177 (which will not come into operation until 1 October 2008) have been complied with, namely by authorisation by or declaration of an interest by the directors, there is no requirement to obtain shareholders' approval (unless the articles provide for it).
- This section also makes it clear that in addition to complying with the general duties, a director also has to comply with the requirements set out in Chapter 4 of Part 10 of the Companies Act 2006 which deals with those transactions requiring approval by members.

Section 181 modification of provisions in relation to charitable companies

Comments

- This section applies to charitable companies and reverses certain relaxations made to the 'no conflict' rule under the previous law
- By section 181(4) a new section 5A is added to the Charities Act 1993 to enable the Charity Commission to authorise acts which otherwise would be in breach of the general duties

On 1 October 2007, sections 190, 191 and 193 came into operation.

Comments

- Section 190 provides for members' approval in respect of substantial property transactions
- Under section 191 a substantial non-cash asset now means its value exceeds 10% of the company's asset value and is more than £5,000 or, exceeds £100,000
- Under section 193 approval is not required under section 190 if the company is being wound up (unless the winding up is a members' voluntary winding up) or the company is in administration within the meaning of Schedule B1 to the Insolvency Act 1986. This change will save the often last minute rush to obtain members' approval, in relevant circumstances, prior to completing a sale of business and/or assets from a company in administration

On 1 October 2007, sections **260 to 264** came into operation. These sections provide for derivative claims and proceedings by members.

Comments

- These sections provide for proceedings by a member of a company in respect of a cause of action vested in the company, and seeking relief on behalf of the company. For these purposes 'member' includes trustees in bankruptcy and other people who have been transferred shares by operation of law
- Under section 261 a member of a company who brings a derivative claim must apply to the court for permission to continue it
- Section 262 deals with the application to the court
- Section 263 provides the criteria to be taken into account as to whether permission is to be given

- Section 264 provides for the application for permission to continue a derivative claim brought by another member. This applies where a derivative claim has been brought by a member but has not been pursued diligently

On 1 October 2007, sections 281, 282 and 283 came into operation.

Section 281 resolutions

Comments

- Section 280(1) provides that a resolution of the members (or a class of members) of a private company must be passed as a written resolution in accordance with Chapter 2 (of Part 13) (written resolutions), or at a meeting of the members (to which the provisions of Chapter 3 (of Part 13) apply) (resolutions at meetings)

Section 282 ordinary resolutions

Comments

- This section provides a definition of an ordinary resolution, whether of the members generally or of a class of the members and whether as a written resolution or as a resolution passed at a meeting. A simple majority is required
- A written resolution need now only be signed by a simple majority of eligible members to pass as an ordinary resolution rather than the previous position which required 100%

Section 283 special resolution

Comments

- This section provides a definition of a special resolution, whether of the members generally or of a class of the members and whether as a written resolution or as a resolution passed at a meeting. A majority of not less than 75% is required. If a resolution is proposed as a special resolution, there is a requirement to say so
- There is no longer a requirement for 21 days notice where a special resolution is to be passed at a meeting (but see section 307 (1) below)
- A written resolution need now only be signed by 75% of the members to pass as a special resolution rather than the previous position which required 100%

On 1 October 2007, section 307, which deals with notice required in respect of a general meeting, came into operation.

Comments

- Section 307(1) reduces the notice requirement for the meeting of a private company at which a special resolution is to be proposed from 21 days to 14 days unless, under section 307(3), the company's articles of association specify a longer period
- Section 307 (5) and (6) provide that meetings may only be called on shorter notice where a majority of the members which holds 90% of the voting rights agrees (previously it was 95%). The company's articles of association can specify a higher percentage

On 1 October 2007, section 84(1)(c) of the Insolvency Act 1986 was repealed.

Comments

- The ability to pass **extraordinary** (our emphasis) resolutions has now gone and any winding-up resolution will need to be passed as a special resolution under section 84(1)(b), whether the company is insolvent or not.

On 1 October 2007, references in section **165 of the Insolvency Act 1986** to **extraordinary** (our emphasis) resolutions were replaced by references to **special** (our emphasis) resolutions.

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