

Companies Act 2006 – Final Deadline

The changes brought about by the Companies Act 2006 (the “Act”) have been the subject of debate and comment in huge proportions. Not surprising given that it is the largest piece of legislation ever passed by Parliament.

February and October 2009 sees the final implementation of the Act. In our winter briefing we discussed how the implemented changes could simplify a private company’s administrative affairs. In this spring briefing we consider some of the final areas of the Act to be implemented this year that are most likely to affect our clients. We also look at the new procedure for derivative actions and the impact it has had since its incorporation in October 2007.

Late filing penalties

A tougher stance has been introduced with regard to the late filing of company accounts for both private and public companies. These changes affect all accounts that are delivered late from 1st February 2009.

The penalty for filing accounts not more than one month late is now £150 for a private company and £750 for a public company. The rate of increase in the penalty for those companies that file the accounts more than a month late has been increased so there is a sharper jump. For



example if a private company files the accounts more than one month, but less than three months late, the penalty is £375 and for a public company £1500. For accounts filed more than 3 months but not more than 6 months late, the fee is £750 for a private company and £3,000 for a public company. For any delay over 6 months the penalty is £1,500 for a private company and £7,500 for a public company.

In addition to this, should a company file late having filed late in the previous year, their penalty will be doubled.

Previously a company may have been granted a 14 day concession period to re-submit accounts, should they have initially submitted illegible ones (for example if the accounts were not capable of being read).

continued overleaf

company commercial

The Act does not provide for this concession and therefore from 1st October there will no longer be this 14 day rule.

Incorporation

After an initial period to process applications to incorporate companies made under the Companies Act 1985 (the "1985 Act"), changes will be implemented to make it easier to set up a company.

Under the new process an incorporation form will be submitted (Form IN01) and this replaces form 10 and 12, with articles of association and the relevant fee. There will be four types of articles available and these will now include the company's liability, assets and objects (matters which were previously included in the memorandum). Authorised/nominal share capital will no longer be required on incorporation and accordingly there will not be any limit in the memorandum on the number of shares a director can issue on behalf of a new company.

Director's Service Address

There has been continuing debate regarding directors having their residential addresses on the public record. From October 2009 directors will be required to submit two addresses. One must be their residential address and one a service address. The service address can be any address where documents can be delivered and received. A director could, for example, use their residential address or the registered office address of the company. Directors cannot use a PO Box or DX number.

The residential address will be on a non-public record, but the service address will be public information. Therefore a director wanting to keep his residential address confidential should provide an alternative for his service address. Should a director only have his residential address available to use he will have to place this on the public record, although there will be nothing to indicate that this is his residential address.

Companies Act 2006 – Derivative Actions in Practice – Necessary Strengthening Of An Important Shareholder Right Or A Green Light To Activist Shareholders?

Not only have the duties placed on directors become stricter and more far reaching, but the Act has made it easier for shareholders to bring a claim against a director for breach of their duties. These actions are known as derivative actions.

Derivative actions are not an invention of the Act. They have been governed by common law since the 1800's. The Act has simply widened the scope for a shareholder to be able to bring such an action.

It is helpful to understand what the law was prior to the Act, so as to fully appreciate the scale of the changes implemented.

Foss v Harbottle – position pre 2006 Act amendments

The rule in Foss v Harbottle (1843) 2 Hare 461 had two key threads, firstly the principle of majority rule and secondly that where a wrong was done to a company, it is the company (as the injured party) who has the

right of action in that regard.

The Principles

Majority rule has long been a fundamental of English company law. It provides that a company should not have to act at the command of minority shareholders and if the company is acting within its powers the court will not interfere with its internal affairs. This did not leave shareholders without any cause of action however. The view of the courts was that should the shareholders believe the Board should be taking certain action and the Board refused, the shareholders could call a meeting to either change the Board, or pass a resolution forcing the Board to act.

Such resolutions would usually require a majority of the shareholders, thereby coining the phrase "majority rule".

The Exceptions

There were some exceptions to provide for situations where the principle of majority rule would not provide sufficient protection for the company and/or power to the shareholders as necessary:

- Where the act complained of was illegal or ultra vires and could not be ratified by the company;
- Where the parties at fault were controlling the company and there was a risk that strict enforcement of majority rule could result in fraud on the minority;
- Where either a special or extraordinary resolution would have to be passed to sanction the act and this could not be fulfilled;

- Particular personal rights of the shareholder had been infringed;
- Where a shareholder raised an action based on Section 459 of the 1985 Act where they believed that the company's affairs were being conducted in a way that was unfairly prejudicial to the interests of its shareholders (or some part of its shareholders).

Current Position

Founded on the Government's principles of achieving better levels of flexibility and accessibility to derivative actions, on October 1st 2007 Part 11 of the Act came into force. Part 11 governs derivative actions and (subject to the transitional provisions) applies to all derivative actions commenced on or after October 1st 2007.

Where the claim is based on acts/omissions pre October 1st 2007, the court is only permitted to hear the claim to the extent that the claim would have proceeded under the old common law.

Basis of a derivative claim

There are three parts to a claim as defined in Section 260 of the Act:

1. The proceedings must be brought by a shareholder (including those people who are not themselves shareholders, but who have had shares transferred or transmitted into their name by law).

The fact that an action could now be raised by one individual raised concern that there would be a sharp influx in the number of applications being made. It was thought that there was a danger



of those particularly opinionated or activist shareholders raising vexatious litigation. To date these concerns appear to be groundless however, as there has not been any notable rise in the number of cases.

It is worth noting at this stage that the Government has provided for these concerns. Procedural safeguards are in place and the courts also have the power to make a costs order against the applicant, which should dissuade all but those who believe they have a case with a good likelihood of success.

2. The basis of the action must be in the company.
3. The shareholder must be seeking the relief on behalf of the company.

Both points 2 and 3 address the issue in *Foss V Harbottle* that only the company should bring an action as they are the injured party. Points 2 and 3 embody the principle of this in

that the action by the shareholder is for the benefit of the company that has been injured, as if brought by the company itself.

Causes of action

An action (save for those for unfair prejudice) can be brought against a director and/or another person (in limited circumstances) for an alleged act or omission on the basis of negligence, breach of duty, default or breach of trust.

A shareholder can bring the action whether or not they were a shareholder on the date of the action or omission complained of. This is the same as the position was under common law. This important provision reflects the fact that the action is being brought for the company's benefit and not the individual shareholder, therefore it is irrelevant as to when the individual became a shareholder.

2 Stage approach

The shareholder must seek leave of the court to continue their claim and

continued on page 4

the court will decide whether to grant the application, based on the evidence the shareholder provides.

There is a two stage process to bring a claim:

1. Shareholder to establish a prima facie case with evidence
2. Evidence from the company may be requested by the court

Should the court find that the shareholder has not established a case, then they can dismiss the application and make such other order as they think fit. If however they grant the application, they can direct the company as to what information it must produce.

The two stages do, on the face of it, seem to be very simple hurdles for a shareholder to overcome and potentially open the way to extensive litigation “in the name of the company”. However, the Act does state that there are certain issues the courts are to consider when making their decision, which would look to put a red light on any would be activist actions.

What will the court consider?

The shareholder must be acting in good faith in seeking to continue the claim, therefore those with a personal “vendetta” against the company would be prevented from bringing an unfounded claim.

Secondly the courts will consider what importance someone acting in accordance with section 172 of the Act would attach to the action continuing. Section 172 is

the duty placed on directors to promote the success of the company.

The court will look at whether the act or omission (whether or not it has occurred yet) has the potential to be ratified by the company and whether the company has decided not to pursue the claim. To this end the court is directed to have particular regard to the opinion of the shareholders of the company with no personal interest in the matter.

There is strong argument to suggest that these considerations and the courts freedom to make a costs order against the claimant have so far prevented a heavy stream of derivative actions. Indeed, this proposition is supported by the fact that over a year has passed since the changes were implemented and there has not been a sharp increase in actions.

The basis on which a derivative action can be brought has been widened and there may well be shareholders who propose such an action, however the hurdle of achieving court approval and the matters the court must consider should see any unfounded actions being refused.

For further information on any aspect of the topics covered in this note or for advice on any aspect of Company or Commercial law, please contact David Little on 0207 495 3003 or david.little@magrath.co.uk or Abigail Nevill on 0207 495 3003 or abigail.nevill@magrath.co.uk