



# COMPANY LAW MEMO 2006

Newsletter Issue 8

January 2007

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Welcome to the *Company Law Memo 2006* newsletter, highlighting important recent developments in company and insolvency law. You can also access comprehensive updates to specific paragraphs via our online updating service. We always welcome suggestions from readers, so please contact us if you have any comments.

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### New example reports and statements by auditors

See CLM: ¶1158, ¶1177+, ¶1409+, ¶1625, ¶1634, ¶4314, ¶4340, ¶5609, ¶7034

On 1 January 2007, the Auditing Practices Board published revised example reports and statements by auditors under companies legislation in Great Britain (Bulletin 2007/1). The examples include:

- » report on abbreviated accounts;
- » report on summary financial statement;
- » statement of company's ability to make a distribution;
- » report when a private company wishes to provide financial assistance; and
- » Report on ceasing to hold office.

It supersedes Appendix 1 of Practice Note 8 published in August 1994 and Appendix 1 of Bulletin 1999/6 "The Auditor's Statement on the Summary Financial Statements". The example reports can be freely downloaded from the APB's website ([www.frc.org.uk/apb](http://www.frc.org.uk/apb)).

### EC consultation on auditors' liability

See CLM: ¶4301+

In response to concerns about the trend for litigation against auditors, the European Commission has launched a public consultation to see if the rules on auditors' liability in the European Union should be reformed. Whilst acknowledging that a single solution will not suit every member state given the difference between national markets, the consultation proposes four options for reforming auditors' liability:

- » introducing a fixed monetary cap at European level;
- » introducing a cap based on the size of the audited company, measured by its market capitalisation;
- » introducing a cap based on a multiple of the audit fees charged to the client; or
- » introducing a system of "proportionate liability" so that each auditor and audited company is only liable for the portion of loss that corresponds to his/its degree of responsibility.

The Institute of Chartered Accountants in England & Wales and the Institute of Chartered Accountants in Ireland have already welcomed the publication of the consultation paper.

The consultation paper is freely available at:

[http://ec.europa.eu/internal\\_market/auditing/docs/liability/consultation-paper\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/liability/consultation-paper_en.pdf)

Responses are invited by 15 March 2007.

### New FRSSE

See CLM: ¶4367

On 23 January 2007, the Accounting Standards Board published an updated version of the Financial Reporting Standard for Smaller Entities. It is effective for accounting periods commencing on or after 1 January 2007 and amongst other changes, it includes a major simplification of FRS 20 "Share based payment". The new FRSSE can be freely downloaded from the ASB's website ([www.frc.org.uk/asb](http://www.frc.org.uk/asb)).

# News



## NEWS ROUND-UP cont...

### New charters for court users

See CLM: ¶7115+

HM Courts Service has published a set of Charters setting out the standard of service that court users should experience, whether they attend as a claimant, defendant, witness, juror or a member of the public. There is a charter for each type of court, including the Royal Courts of Justice, civil courts and criminal courts.

The Charters deal with a number of matters, including:

- » practical information, such as the opening times for the hearing centres and public counters, and information about the other agencies court users may encounter;
- » standards for answering correspondence and telephones, and for dealing with complaints; and
- » special assistance, such as familiarisation visits, support for vulnerable witnesses etc.

The Charters are freely available at:

[http://www.hmcourts-service.gov.uk/infoabout/courts\\_charter/index.htm](http://www.hmcourts-service.gov.uk/infoabout/courts_charter/index.htm)

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### Consultation on Supreme Court Rules published

The Constitutional Reform Act 2005 will replace the House of Lords as the highest appellate court in the UK with a new Supreme Court. The Supreme Court is not expected to take over until October 2009 and so the relevant provisions of the Act have not yet come into force. In the meantime, consultation on the new Supreme Court Rules has begun. Draft rules, covering both civil and criminal appeals, have been published and are freely available at:

[http://www.parliament.uk/documents/upload/SupremeCourt\\_rulesconsultation.pdf](http://www.parliament.uk/documents/upload/SupremeCourt_rulesconsultation.pdf)

Responses are invited by 10 April 2007.

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### Proposed EC Directive protecting employees where their employer is insolvent

See CLM: ¶6423, ¶7754, ¶8473, ¶8830, ¶9266

The European Commission has proposed a new Directive on the protection of employees in the event of the insolvency of their employer (COM(2006) 657 - 2006/0220 (COD)). The purpose of the Directive is to codify the current EC Directive (1980/987) and subsequent legislation which has amended it. The new Directive will supersede the current one, but since no substantive amendments will be made to the law, it will be adopted using the fast-track process.

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# News



## RECENT CASES

### Interpretation of “relevant accounts” for purposes of dividend payment

See CLM: ¶1620+

*Re Logic Alliance Ltd; Re Logic Alliance International Ltd* Case No 25C of 2006 (Ch Bristol)

#### Thank you to Guildhall Chambers for a copy of this judgment

The court has found merit in the submissions of a company’s liquidators on two important points regarding the payment of dividends.

Firstly, the court thought it arguable that a company may only lawfully decide to pay a dividend by referring to its last annual accounts, provided those accounts:

- » were properly prepared;
- » referred to the last preceding accounting reference period; and
- » had been laid before the shareholders.

The defendant’s argument that the last annual accounts are the last accounts which were actually prepared and laid before the shareholders failed. This means that a company with an accounting reference date of 30 November could not lawfully decide in December 2001 to pay a dividend on the basis of accounts drawn up to 30 November 2000; it would have to prepare its accounts to 30 November 2001 first.

Secondly, the court thought it arguable that the accounts would have to actually be laid before the shareholders in accordance with the statutory provisions; the informal consent of all of the shareholders under the *Duomatic* principle may be insufficient.

The case concerned a company which was persistently late in preparing and filing its accounts. It was profitable according to its last prepared accounts (to 30 November 2000), but then lost a key customer and employee, resulting in it becoming insolvent and eventually going into liquidation in November 2003. The director/shareholders had declared and paid themselves dividends from February 2002 to October 2003 amounting to £249,000 which the company’s liquidators were seeking to recover.

**Comment:** The judgment is understandable on the facts of this case: an insolvent company seeking to evade the statutory safeguards surrounding the payment of dividends by relying upon its financial results in one profitable year. However, it imposes a significant restriction on the ability of a company to declare a dividend immediately after its year end. It is not clear whether interim dividends by the directors would be permitted either; the facts and judgment do not distinguish between these and dividends declared by the shareholders. It should be noted that the judgment related to an interim application and so a different decision may be reached at the full hearing. For example, in the alternative, the liquidators argued that the dividends were prohibited on the basis that the directors had a residual duty not to make a distribution when the company had no distributable reserves and was insolvent (see ¶1641).

A company may only pay a dividend if it has sufficient distributable profits by reference to its “relevant accounts”. These are the last annual accounts that were prepared and laid before the shareholders in respect of the last preceding accounting reference period (s 270(3) CA 1985). There are statutory provisions as to what should happen if those accounts do not show sufficient profits, but not if they do and the company’s financial position has subsequently declined.

Under the *Duomatic* principle, the consent of all of the shareholders entitled to attend and vote at a shareholders’ meeting is as binding as a resolution at that meeting, even if the formalities of a shareholders’ meeting have not been observed (¶3590+).

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## RECENT CASES cont...

### Availability of roll-over relief on exchange of shares for loan notes

See CLM: ¶5367+, ¶5428+, ¶5440+

*Snell v Commissioners for HMRC* [2006] EWHC 3350 (Ch)

The court has upheld Revenue and Customs' argument that capital gains tax roll-over relief on an exchange of shares for loan notes is not available if, at the time of the exchange, the seller intends to become non-UK tax resident before he redeems the loan notes, thereby avoiding the payment of capital gains tax altogether. This is because the main purpose of the scheme would be to avoid tax; roll-over relief is only intended to defer the payment of tax and that right of deferral is lost if it is to be used for the purpose of avoidance.

By analogy, the relief would also not be available:

- » in the same circumstances on an exchange of shares for shares;
- » in any other circumstances where at the time of exchange, the seller's main purpose in taking loan notes or shares was to avoid, rather than defer, tax.

On a company share sale, it is common for the seller to be paid in paper (loan notes or shares) rather than cash because of the available tax reliefs (see ¶5426+). The main one is a type of "roll-over relief" which delays when the seller has to pay tax (s 135 TCGA 1992). This relief is subject to the condition that seller's acceptance of loan notes/shares should be for "bona fide commercial reasons and must not form part of a scheme for the avoidance of capital gains tax" (s 137 TCGA 1992). Where the seller intends to claim this relief, it is common for him to apply for advance tax clearance, that is, advance confirmation from Revenue and Customs that the relief will be available to him (see ¶5367+).

### Application for administration order dismissed for lack of detail

See CLM ¶8738

*Re Golf Innovations Ltd* [2007] All ER (D) 27 (Jan)

An administration application was dismissed by the court because it failed to provide the relevant information. Although the witness statement in support of the application stated that administration would allow a more effective and speedy distribution to the company's secured creditors, it did not give any information about the company's business in general, its assets and liabilities or what the administrator would do if the order were made. It was therefore impossible for the court to conclude that any of the statutory purposes of administration could be achieved.

The statutory purposes of an administration are to: rescue it as a going concern, achieve a better result than would be achieved on a winding up, or to realise the company's property for distribution to one or more secured and/or preferential creditors (para 3 Sch B1 IA 1986). For the contents of the application and supporting evidence, see ¶8736, ¶8737+.

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## LEGISLATION

### Disclosure of company information on websites and order forms

See CLM: ¶296+, ¶585

As part of the implementation into UK law of amendments to the First Company Law Directive, changes have been made to the requirements of companies to disclose their names and other vital information on important documents (SI 2006/3429). A company must disclose the following information on its websites as well as in its business letters and order forms (including letters and order forms sent in electronic form, e.g. by email):

- » its name;
- » its place of registration (e.g. "England and Wales");
- » its registered number;
- » its registered office address;
- » the fact that it is a limited company, if it has permission to omit "Ltd" or "Limited" from its name;
- » if it is an investment company, a statement that this is the case; and
- » if it is in liquidation, a statement that it is being wound up.

In addition, as with the existing requirements, if a company with a share capital refers to the amount of the share capital on its order forms or any of its websites, the reference must be to paid-up share capital.

Failure to comply will render the officer or agent of the company in default liable to a fine.

ss 349, 351 CA 1985 and s 188(1) IA 1986 have been amended. A company's name must also appear in its notices and other official publications, cheques and bills of exchange etc, invoices and receipts etc.

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### Directors' new liability for their report accompanying the accounts

See CLM: ¶4245

Under provisions in the new Companies Act which are now in force, the directors of a company are now liable to it for statements they make in their report to accompany the accounts and any summary financial statements derived from the report (s 463 CA 2006; SI 2006/3428). The new liability **applies to** statements made on or after on 20 January 2007.

Specifically, a **director is liable** to compensate his company for any loss suffered by it as a result of:

- » any untrue or misleading statement in a directors' report provided the director knew that the statement was untrue or misleading or was reckless as to whether it was untrue or misleading; or
- » the omission from a report of anything required to be included in it, provided the director knew that the omission was a dishonest concealment of a material fact.

This provision **does not allow** third parties to make claims against the directors; the directors are only liable to the company.



## COMPANY COMMUNICATIONS

The ways in which companies can send and receive information have been revised. The new rules aim to improve communication between companies and shareholders in particular, and should also mean substantial costs savings for companies.

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The government has brought various provisions of the new Companies Act 2006 into force early, partly to comply with requirements to implement European law and partly to enable companies to benefit from the new provisions aimed at making company management easier (SI 2006/3428; SI 2006/3429). The change that will affect companies the most is the implementation of the new Act's "company communications" provisions, which occurred as of 20 January 2007 (ss 1143-1148, Sch 4, Sch 5 CA 2006). The new rules **apply to**:

- » all companies;
- » everybody who communicates with companies; and
- » all types of communication, including general correspondence, notices and information required under companies legislation and legal documents such as court applications and orders.

However, it should be noted that if another statutory provision stipulates how a document should be sent to a company and these requirements contradict the new rules, the other statutory provision should be followed instead (s 1143 CA 2006).

### Sending information to companies

Documents can now be sent to a company in hard copy, electronic form or by any other method agreed between the company and the sender (s 1144, Sch 4 CA 2006).

#### Hard copy

A document is in "hard copy" if it is a paper copy, or in a similar form which is capable of being read with the naked eye (s 1168 CA 2006). It can be sent to the company by post or delivered by hand to:

- » an address specified by the company for the purpose;
- » the company's registered office; or
- » any other service address authorised under companies legislation (e.g. court documents can be served on a company registered in Scotland at its place of business in England and Wales, s 725 CA 1985).

If the sender can show that it was addressed, prepaid and posted properly, it will be **deemed to have been delivered** to the company 48 hours after posting, even if the company does not receive it (s 1147 CA 2006).

#### Electronic form

A document can be sent to a company in "electronic form" if the company agrees. This includes a document sent by electronic means (e.g. email or fax) or information in electronic form (e.g. on a CD ROM or disk) sent by post or hand delivered. The definition is even wide enough to include text messages.

The company can **consent** to receiving information in electronic form in three ways:

- » generally, where it agrees to all documents or information being sent to it in that form, specifying an address to which communications can be sent;
- » specifically, where it agrees that a specific document or piece of information can be sent to it in that form and specifies an address for that purpose; or
- » it can be deemed to have agreed by statute. For instance, a company is deemed to have consented to receiving electronic communications about a general meeting or proxies at the meeting if it included an electronic address (e.g. email address or fax number) on the relevant notice (s 333 CA 2006, which also came into force on 20 January 2007).

If the sender can show that information sent by post was addressed, prepaid and posted properly, or that information sent electronically was addressed properly, it will be **deemed to have been delivered** to the company 48 hours after posting, even if the company does not receive it (s 1147 CA 2006).

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## COMPANY COMMUNICATIONS cont...

### Companies sending information to shareholders and others

Companies can now send documents and other information in hard copy, electronic form, by posting them on a website, or using any other method agreed with the recipient (s 1144, Sch 5 CA 2006).

#### Hard copy

The definition of hard copy is the same as for communications sent to a company. A company can send information to its shareholders and others by post or delivered by hand:

- » to an address specified by the recipient for the purpose;
- » if the recipient is a shareholder, to his address in the register of shareholders;
- » if the recipient is a director, to his address in the register of directors;
- » if the recipient is a company, to its registered office;
- » any other service address authorised under companies legislation; or
- » if none of the above is available, to the recipient's last address known to the company.

If the company can show that the information was addressed, prepaid and posted properly, it will be **deemed to have been delivered** to the company 48 hours after posting, even if the recipient does not receive it (s 1147 CA 2006).

#### Electronic form

A company can send information in "electronic form" if the recipient agrees. The definition of "electronic form" is the same as for communications sent to a company. Where information is sent in electronic form, any shareholder or debenture holder receiving it has the **right to** request a **hard copy**, which the company must provide for free within 21 days (s 1145 CA 2006). Failure to do so renders the company and any officer in default liable to a fine.

A recipient can **consent** to receiving information in this way generally or specifically, or he can be deemed to have given his consent by the legislation. Each individual's consent is required; therefore, even if the articles state that the company can communicate with shareholders electronically, the company will still have to contact each shareholder for his consent and an address to use. Companies must ensure that the method of communication matches the consent given, for example if a shareholder has agreed to receive notices of meetings by email, the company will not be able to send him the annual accounts by email as well.

A company which currently relies on sending information to its shareholders by post which wants to be able to use email instead should contact each shareholder. If a shareholder does not respond or refuses to consent to this method of service, the company will have to continue to communicate with him as before. If the shareholders have already consented to this method and provided addresses for service, the company will not have to do so again.

If the company can show that information sent by post was addressed, prepaid and posted properly, or that information sent electronically was addressed properly, it will be **deemed to have been delivered** to the company 48 hours after posting, even if the company does not receive it (s 1147 CA 2006). Companies may want to include a more appropriate deemed service time in their articles for information sent electronically.

#### On a website

Companies can use their websites to make information available to shareholders and others, if the recipient agrees. If a document or other information is posted on a website, it must be possible to read it with the naked eye and take and keep a copy of it. Where information is sent in electronic form, any shareholder or debenture holder receiving it has the **right to** request a **hard copy**, which the company must provide for free within 21 days (s 1145 CA 2006). Failure to do so renders the company and any officer in default liable to a fine.

This method is likely to be mostly used by large companies to communicate with their shareholders, as they will benefit from the cost and administrative savings of using and maintaining a website. Again, recipients can **consent** to receiving information in this way generally or specifically.

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## COMPANY COMMUNICATIONS cont...

Companies can also obtain shareholders' "**deemed consent**", which will benefit companies with a large number of shareholders in particular. A shareholder will be taken as consenting to receiving information via a website if:

- » the company's articles provide or the shareholders resolve for information to be made available in this manner (any such resolution will have to be filed at Companies House within 15 days (s 380 CA 1985);
- » the shareholder has been asked individually to agree to receiving notice via a website; and
- » he has not responded to that request for at least 28 days.

The request must be clear, and can only be made once every 12 months in respect of the same or similar type of document or information.

A **debenture holder** can also be deemed to give his consent, if the instrument creating his debenture contained a provision to that effect, or if the debenture holders so resolved, and he has not responded to a request for his individual consent for at least 28 days. **Other non-shareholding recipients** cannot give deemed consent.

The intended recipient must be **notified** that the **information has been posted on the website** and it must be available for the whole of any applicable period, e.g. the notice period for shareholder meetings, or for at least 28 days if there is no such period (unless the website is unavailable for some of the period due to technical difficulties out of the company's control).

The information is **deemed to have been sent** on the date on which the recipient was notified that it was available, or on the date on which it was posted on the website, if later.

These new provisions should improve communication between companies and their shareholders in particular, making it easier for shareholders to obtain information about their companies and to join in decision making and other issues. Companies should benefit from time and costs savings, once they have the appropriate consents and procedures in place, and will therefore be more inclined to make information available to shareholders.

To take full advantage of the new rules, companies will need to:

- Review their current methods of communication, particularly with shareholders.
- Consider how this can be improved by using the new rules, taking the shareholders' views into account.
- Obtain any necessary consents to use electronic communication, websites or another method and update the company's procedures accordingly. Companies should review these procedures periodically, for example to monitor how popular the different methods of communication are, to ensure that they deal with requests for hard copies promptly and to check that the systems for recording which shareholders/others have consented to which methods of communication are effective.

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*Employment Memo 2007* has been significantly revised, covering all the developments that have occurred over the last year. It includes new commentary and practical advice on the new age discrimination legislation, changes to parents' and carers' rights, TUPE regulations and new rules relating to retiring employees as well as numerous case law developments.

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## COMPANIES ACT 2006: IMPLEMENTATION

The Companies Act 2006 received Royal Assent on 8 November 2006.

The final text of the Act, explanatory notes and tables of destinations and origins are now freely available to download at <http://www.opsi.gov.uk/acts/acts2006a.htm>

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### Brought into force this month

Several provisions of the new Companies Act are **now in force**, some of which will have a greater impact on companies than others. The online updates consider these changes in detail.

#### Communications

See CLM: ¶3651+, ¶3695+, ¶3732+

The provisions in the new Act relating to how companies communicate with their shareholders and others have been brought into force (ss 1143-1148, Sch 4, Sch 5 CA 2006). This far-reaching implementation is discussed in detail in this issue's *Focus on*. Some related provisions have also been brought into force which deal with communications in specific circumstances:

- » notices of shareholder meetings must now be given in hard copy, electronic form or on a website (s 308 CA 2006);
- » if notice of a shareholder meeting is to be made available on a website, notice of its availability must state that the notice concerns a shareholder meeting, give the time, date and place of the meeting and state whether the meeting will be an AGM (s 309 CA 2006); and
- » if the company includes an electronic communications address in the notice of a meeting or the proxy notice for the meeting, it is deemed to have consented to being contacted about the meeting or proxies (as applicable) in that manner (s 333 CA 2006).

#### Shareholders

See CLM: ¶2042+, ¶3990+

Shareholders in public companies are no longer required to disclose their interests in the company's shares over a certain threshold. Instead, they will have to provide this information when requested by the company (ss 791-807, 820-828 CA 2006). Shareholders can still require the company to issue a request. The requirements to keep a register of interests in public company shares have been altered accordingly (ss 808-811, 813, 815-819 CA 2006).

#### Directors

See CLM: ¶4245

Directors can now be held liable for any loss suffered by the company as a result of him making an untrue or misleading statement, or omitting to include required information, in the directors' report, remuneration report (in the case of listed companies) or in any summary financial statement derived from either of these reports (s 463 CA 2006). See *Legislation* for further details.

#### Management

See CLM: ¶3907, ¶4049, ¶4069+, ¶4090

Certain provisions relating to Companies House have been brought into force. Their implementation will not have a significant effect on companies or other persons dealing with Companies House, as it already had procedures in place to facilitate electronic communication and filing.

- » Documents subject to the First Company Law Directive disclosure requirements (art 3 EC Directive 68/151) can be filed at Companies House electronically (ss 1068(5), 1078 CA 2006). These documents include constitutional documents, information about directors, accounts etc. Related requirements on Companies House to advertise this information in the *Gazette* and keep it electronically have also come into force (ss 1077, 1079, 1080 CA 2006).
- » Any person may inspect the register and obtain copies of an entry (subject to certain information not being available to the public, e.g. a director's address where a confidentiality order has been obtained, passwords etc) (ss 1085-1087, 1089-1092 CA 2006).

# CA 2006



## COMPANIES ACT 2006: IMPLEMENTATION cont...

- » Companies House can set out rules as to how requests to inspect or copy the register should be made, but applications to inspect or copy documents subject to the First Company Law Directive disclosure requirements must be able to be made in hard copy or electronic form. Certified copies must be provided of any document requested as a hard copy, unless the recipient waives the requirement; if a copy is provided in electronic form, it only has to be certified if the recipient requests (regulations as to how it can be certified have been set out, SI 2006/3429). As regards certified copies of documents to be sent to Companies House, Companies House can stipulate how they can be certified (s 1111 CA 2006). Regulations have already withdrawn the requirement for office copies to be delivered to Companies House under some provisions (ss 54(7), 425(3), 427(5) CA 1985 and s 201(4) IA 1986; SI 2006/3429).
- » Applications can be made to Companies House for an address to be unavailable to the public (s 1088 CA 2006). Regulations will be set out in due course in this regard. Meanwhile, the provisions of CA 1985 relating to confidentiality orders are still in force (ss 723B-F CA 1985; with the exception of s 723C(1)(a) which relates to a repealed part of CA 1985).
- » Provisions relating to translations of Companies House filings have also been brought into force (ss 1102-1107 CA 2006). Documents submitted to Companies House in Welsh must be accompanied by a certified English translation, unless they are on one of the pre-printed Welsh forms. Certain other documents (e.g. constitutional documents, copy group accounts and charges) can be filed in other languages with an English translation, but all other documents must be submitted in English. Translations into any of the official languages of the EU can be filed in respect of any of the documents subject to the First Company Law Directive disclosure requirements.

### Coming into force on 6 April

See CLM: ¶2247+, ¶2735, ¶2931, ¶3379+, ¶3494, ¶3958+, ¶7232

The following provisions of the new Act will be brought into force on 6 April, with further related repeals and amendments of CA 1985 to be made on the same date:

- » the provision enabling regulations to be made setting out Companies House fees (s 1063 CA 2006);
- » the secretary of state will no longer have the power to take court action on a company's behalf following a CIB investigation (s 1176 CA 2006, which repeals s 438 CA 1985 and makes consequential amendments to related provisions);
- » some of the restrictions on directors will no longer apply (s 1177, Sch 16 CA 2006):
  - the prohibition on tax-free payments to directors (currently in s 311 CA 1985);
  - the requirements for directors to disclose their interests in shares and for companies to keep a register of such disclosures (in ss 323-329, Pt II-IV Sch 13 CA 1985); and
  - the restrictions on directors of public companies being in office past the age of 70 (in ss 293, 294 CA 1985);
- » the secretary of state will no longer have to report to parliament on companies legislation matters (s 1179 CA 2006, repealing s 729 CA 1985); and
- » the provision relating to how a document can be authenticated by the company is also to be repealed (in s 41 CA 1985).

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