



COMPANY LAW MEMO 2007

Newsletter Issue 2

April 2007

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Welcome to the *Company Law Memo 2007* 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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NEWS ROUND-UP

Consultation on proposed IFRS for SMEs

See CLM: ¶4212, ¶4360+

On 26 April 2007, the Accounting Standards Board (ASB) launched a consultation on the International Accounting Standard Board's (IASB) Exposure Draft of an International Financial Reporting Standard (IFRS) for Small and Medium-Sized Entities (SMEs).

The Consultation Paper provides an analysis of the significant differences between the proposed IFRS for SMEs and:

- » UK GAAP;
- » FRSSE; and
- » full IFRS.

The ASB is seeking views on three main issues:

- » Is the IFRS for SMEs suitable for a mid-tier of companies above the current range for the FRSSE but below those currently required to apply full IFRS?
- » Is the IFRS for SMEs an appropriate replacement for the FRSSE?
- » If the answer to either of those questions is yes, what changes will need to be made to the proposal?

A copy of the consultation paper may be freely downloaded from the ASB's website (<http://www.frc.org.uk/asb>).

Consultation on new ethical code for IPs

The Joint Insolvency Committee (JIC) has issued a **revised Insolvency Ethical Guide** for consultation, following its review of the existing guide which was introduced in 2004. The JIC intends the revised guide to be adopted by all authorising bodies so that all insolvency practitioners will be subject to the same code, in addition to the individual ethical standards of their authorising body.

The revised guide sets out five fundamental principles with which insolvency practitioners should comply:

- » integrity;
- » objectivity;
- » professional competence and due care;
- » confidentiality; and
- » professional behaviour.

It is designed to assist insolvency practitioners in identifying threats to the fundamental principles and put in place appropriate safeguards to combat them. It gives examples of specific situations which commonly pose threats to these principles, and suggests how insolvency practitioners and their firms should handle them.

The ICAEW is coordinating the consultation, which will close on 2 July 2007. A copy of the revised guide and consultation response form can be found at: <http://www.icaew.com/index.cfm?route=146325>

IPs' duty to provide information during insolvency procedures

See CLM: ¶7750, ¶8229, ¶8468, ¶9021, ¶9368

In January this year, changes were made to the requirement for the fact that a company is in liquidation to be stated on documents issued by the company (s 188 IA 1986). These changes implemented amendments to the First Company Law Directive, and extended the requirement to documents issued in electronic and any other form as well as to websites and order forms (EC Directive 2003/58). The Government intends to bring the administration and receivership provisions into line with these changes in October 2007 (respectively, para 45 Sch B1, s 39 IA 1986). In the meantime, the Insolvency Service recommends that insolvency practitioners apply the changes to these procedures as well, as a matter of good practice (*Dear IP* March 2007, Issue No 31). Therefore, a statement that the company's affairs, business and property are being managed by the administrator/receiver, including his name, should be included on any business documents issued in hard copy, electronic or other form, as well as on all of the company's websites.

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News



RECENT CASES

Damages for failure to issue shares under warrants

See CLM: ¶1902

Oxus Gold plc v Oxus Resources Corporation [2007] EWHC 770 (Comm)

In a recent case, the Court considered the damages payable by a company which failed to issue shares under a valid warrant.

Since there was an available market for the shares (they were listed on AIM), the **measure of damages** was the purchase price of the shares on the date they should have been delivered to the warrant holder less the contract price. Whether the warrant holder would have sold the shares upon delivery (and the profit or loss he would have made on that sale) was irrelevant. Since the warrant did not stipulate how quickly the shares should be issued following an exercise of the warrant, the delivery date was held to be the last date for delivery which would still qualify as delivery in a reasonable time.

As is usual, the warrant allowed for **adjustments** so that the warrant holder was not “disadvantaged” by a consolidation, sub-division, capitalisation, rights or other issue. In this case, there had been several intervening share and warrant issues. Most of these were to employees and investors, although there had been one rights issue.

The Court held that, in the absence of any specific wording to the contrary, the normal comparison was between the effect of an adjustable event on the economic value of the warrants and its effect on the economic value of the shareholdings of existing shareholders. It would not be correct to compare the position of the warrant holder before and after the event.

Thus the warrant holder was not entitled to an adjustment on the basis that the share and warrant issues resulted in the dilution of his holding because the holdings of all shares were diluted by those events. The warrant holder was also not entitled to an adjustment because shares had been issued at a discount from the normal purchase price to employees and investors because these issues were not made to shareholders as such but for consideration which was provided by them in other capacities. The only event which could have resulted in adjustment was the rights issue, although on the facts no adjustment was found to be necessary.

Unfair prejudice remedies available to a shareholder/loan creditor

See CLM: ¶2117, ¶2128

Gamlestaden Fastigheter AB v Baltic Partners Limited and others [2007] UKPC 26

The court can order a company's directors to pay damages to the company for breaches of duty owed to it by way of relief from unfair prejudice, even where the petitioning shareholder would not benefit from the payment as a shareholder.

GF AB was a 22% shareholder in a joint venture company, BP Ltd. As part of the joint venture, GF AB agreed to advance a substantial amount of loan capital to BP Ltd. GF AB claimed to have been unfairly prejudiced by BP Ltd's directors' conduct of the company, and claimed relief accordingly. However, BP Ltd was insolvent and so the usual order to buy out the petitioner's shares at a fair price was not appropriate, nor were any of the four orders suggested in the legislation. The petitioner asked the court to order the directors to pay damages to the company, or to allow it to continue its derivative action against the directors for breach of duty (an action which had been adjourned pending the outcome of the unfair prejudice application. It would not have been appropriate to order fresh civil proceedings on the company's behalf to be commenced, as they would have been out of time). If the court made such an order, the petitioner would not benefit as a shareholder because the damages would not be enough to restore BP Ltd's solvency, but it would put GF AB in a better position in BP Ltd's insolvency as a creditor.

The Court looked at the purpose of the relevant provisions, which was to provide a means of relief to shareholders who were unfairly prejudiced by the management of their companies. It held that in cases such as this one, where the terms of a joint venture required the shareholder to provide working capital in the form of loans as well as to invest in the company's shares, it would be inconsistent with this purpose to preclude the shareholder from obtaining relief because he would only benefit from it as a creditor and not as a shareholder.

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This **Privy Council** case concerned a company incorporated in Jersey. The Companies (Jersey) Law 1991 provisions relating to unfair prejudice are substantially the same as the Companies Act 1985 provisions (ss 459, 461 CA 1985). Privy Council decisions constitute persuasive, rather than binding, authority for the courts in England and Wales.

Director's shares – Taxation of sale proceeds

See CLM: ¶847+, ¶2724+, ¶5338+

Company A v HMRC [2007] UKSPC SPC00602

The Special Commissioners have found in favour of Revenue and Customs in the first case testing the provisions in Chapter 3D, Part 7 ITEPA 2003. These apply income tax (and PAYE and NICs) to consideration received on the disposal of employment-related securities where the disposal proceeds exceed the market value of the securities at the time of disposal.

In this case, a director of Company A had subscribed for ordinary shares in its parent so that he held about 6.5% of that company's share capital. The subscription agreement (which was dated a few days after the board meeting at which the allotment was approved) contained a ratchet. Broadly speaking, in the event of a disposal, the director would be entitled to one third of the increased value of the parent company since he acquired his shares. The director's shares did not have any special rights under the company's articles of association.

The company was eventually sold on arms' length terms and the director received the enhanced consideration payment for his shares. Revenue and Customs argued that the director had received more than market value for his shares; that the excess consideration should be treated as a payment of income to the director and that Company A (as the director's employer) was required to account for tax under the PAYE provisions. Company A argued that the director had received market value for his shares, that the consideration received should be treated as a capital gain and the director should pay capital gains tax.

The Special Commissioners found that the value of the director's shares was the same as any other ordinary shares in the company. The subscription agreement was not relevant because it was entered into after the allotment and in any case did not take precedence over the articles. Accordingly, Company A was liable for income tax due on the disposal.

Comment: This case illustrates that:

- » special rights attaching to shares which affect their value should be set out in the articles at the time of allotment; and
- » any employee who receives employment-related securities should be required to give an indemnity in respect of any PAYE or NICs liability incurred by his employer.

TUPE and share sales

See CLM: ¶5686, ¶5771+

Millam v The Print Factory (London) 1991 Ltd [2007] EWCA Civ 322

The Court of Appeal has decided that a TUPE transfer could occur after a share sale if control of the target's business passes to the buyer. The mere fact of control, which follows from the relationship between parent and subsidiary, is not sufficient: what must transfer is control of the business in the sense of how its day to day activities are run.

In this case, there was evidence that the buyer had taken control of the business after the share sale. Therefore, the Employment Tribunal was entitled to conclude, as it had, that a TUPE transfer had occurred.

This decision upholds the original Employment Tribunal decision and overturns the Employment Appeal Tribunal's decision (see *Company Law Memo 2006 Newsletter Issue 3*) in which it concluded that the original Tribunal had erroneously pierced the corporate veil. The Court of Appeal found that the issue of whether the corporate veil had been pierced only arises if the Tribunal had incorrectly attributed the target's activities, as a matter of law, to the buyer. Instead, what the Tribunal had correctly done was analyse the evidence and decide, as a matter of fact, that the target's activities were being carried on by the buyer.

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Case law



LEGISLATION

Income Tax Act 2007

The Income Tax Act 2007 came into force on 6 April 2007. For income tax purposes, it has effect for the tax year 2007-08 and subsequent tax years. For corporation tax purposes, it has effect for accounting periods ending after 5 April 2007.

The Act is the fourth Act of the Tax Law Rewrite project, whose aim is to rewrite UK primary direct tax legislation so that it is clearer and easier to use. It covers:

- » basic provisions about the charge to income tax, income tax rates, the calculation of income tax liability, and personal reliefs;
- » various specific reliefs, including relief for losses, the enterprise investment scheme, venture capital trusts, community investment tax relief, interest paid, gift aid and gifts of assets to charities;
- » specific rules about trusts, deduction of tax at source, manufactured payments and repos, and tax avoidance; and
- » general income tax definitions.

The Act itself, Explanatory Notes and a Table of Origins and Destinations are free to download from the Office of Public Sector Information's website:

<http://www.opsi.gov.uk/acts/acts2007a.htm>

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TAKEOVERS

An examination of this month's changes to the regulation of takeovers in the UK.

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The last year has seen a number of regulatory changes for public company takeovers prompted by the Takeovers Directive (EC Directive 2004/24). On 6 April 2007, the last set of changes came into force, namely the coming into force of Part 28 of the Companies Act 2006 and various changes to the City Code on Takeovers and Mergers. This article examines what this means for UK company takeovers.

Background

The Government had originally planned to implement the Directive through the Companies Act 2006. However, this was still going through parliament on the Directive's implementation date (20 May 2006). The Government therefore decided to implement the Directive on an interim basis through secondary legislation (the Takeovers Directive (Interim Implementation) Regulations 2006 (SI 2006/1183)). These regulations only applied to takeovers within the scope of the Directive, which broadly speaking, were takeovers of companies listed on regulated markets (such as the Official List of the London Stock Exchange but not AIM).

As a result, the UK takeover market was regulated by a two-speed system: takeovers within the scope of the Directive (Directive takeovers) were governed by the Code and the interim regulations; other public and private company takeovers within the scope of the Code (non-Directive takeovers) were governed by the Code alone.

On 6 April 2007, the interim regulations were repealed and replaced by Part 28 of the Companies Act 2006 (the Companies Act 2006 (Commencement No. 2, Consequential Amendments, Transitional Provisions and Savings) Order 2007 (SI 2007/1093)). The provisions in the 2006 Act apply to both Directive and non-Directive takeovers. The changes essentially harmonise the two-speed system, returning the UK to a single approach to takeover regulation based on the provisions of the Directive.

Changes with effect from 6 April 2007

This month saw three main types of change:

- » increased statutory powers for the Takeover Panel;
- » changes to the statutory squeeze-out and sell-out provisions; and
- » changes to the Code.

Takeover Panel's powers

The Takeover Panel is now the statutory regulator for all public company takeover activity in the UK (s 942 CA 2006). This means that the extra powers which it had under the interim regulations in respect of Directive takeovers now also apply to non-Directive takeovers.

These include the power:

- » to order the payment of **compensation** when particular Rules in the Code are breached (s 954 CA 2006; Intro para 10(c) City Code);
- » to apply to court for an injunction or **enforcement order** to secure compliance with the Code (s 955 CA 2006, Intro para 10(d) City Code). Note that such applications may only be made by the Panel, not by another party such as a rival bidder or the target.
- » to require the **disclosure of documents and information** (s 947 CA 2006; Intro Para 9(b) City Code), although this is subject to the privilege against self-incrimination (s 962 CA 2006) and there are restrictions on disclosures without the consent of the relevant individual or business (s 948 CA 2006).

These powers apply to all transactions within the scope of the Code, even those which began before 6 April 2007 (Intro para 2(d) City Code).

Squeeze-out and sell-out provisions

New squeeze-out and sell-out provisions apply where the date of the offer is on or after 6 April 2007 (ss 974 - 991 CA 2006). These replace the provisions in the Companies Act 1985 (for non-Directive takeovers) and the interim regulations (for Directive takeovers). The provisions apply

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TAKEOVERS cont...

when the bidder's takeover offer has succeeded but it has failed to acquire 100% of the target's shares. The squeeze-out provisions allow the bidder to acquire the shares of the remaining minority shareholders. The sell-out provisions allow the remaining minority shareholders to require the bidder to buy their shares.

The main changes from the old provisions are:

- » changes to the meaning of a takeover offer;
- » a new dual threshold test to determine whether squeeze-out or sell-out rights have been triggered;
- » a new exercise-period;
- » new forms; and
- » changes to the shareholder objection procedure.

Meaning of takeover offer

The squeeze-out and sell-out rights are only triggered if a takeover offer is made. The new rules contain the following subtle changes to the meaning of a takeover offer:

- » the offer may be one which some shareholders are unable to accept because of restrictions in the country in which they reside (s 978(2) CA 2006);
- » the offer may not be communicated to shareholders without a UK address in order to avoid contravening the law of another country (although the offer must be published instead) (s 978(1) CA 2006);
- » different consideration may be offered for shares which are sold cum or ex dividend (s 976(2) CA 2006); and
- » shares which the bidder has acquired under conditional as well as unconditional contracts will be treated as already held by the bidder and therefore outside of the takeover offer (s 975(1) CA 2006).

New dual threshold test

In order to trigger the squeeze-out or sell-out rules, the bidder must reach a particular threshold of acceptances. The new rules contain a dual threshold test: the bidder will have to acquire both 90% by value of the shares to which the offer relates and 90% of the voting rights carried by those shares (except where the shares are non-voting) (ss 979, 983 CA 2006). Conditional acceptances of the bidder's offer will not count in determining whether the 90% threshold has been reached for squeeze-out rights, but they will for the purposes of sell-out rights.

Exercise period

In the case of a Directive takeover, the bidder will have to exercise its squeeze-out rights within 3 months after the last day on which the offer can be accepted (s 980(2)(a) CA 2006). In the case of a non-Directive takeover, the bidder will have 6 months from the date of the offer, if this period ends earlier than the 3-month period after the offer (s 980(2)(b) CA 2006).

Sell-out rights will also have to be exercised within 3 months after the later of (s 984(2) CA 2006):

- » the last day on which the offer can be accepted; or
- » the date on which the bidder notifies the minority shareholders that the 90% threshold has been met.

New forms

New Companies House forms apply in respect of the squeeze-out and sell-out provisions (SI 2007/1093):

| Form | New number | Old number |
|--|-------------|-------------|
| Bidder's notice of exercise of squeeze-out rights | Form 980(1) | Form 429(4) |
| Bidder's statutory declaration | Form 980dec | Form 429dec |
| Bidder's notice to minority shareholders that sell-out rights may be exercised | Form 430A | Form 984 |

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Shareholder's objection

When a shareholder exercises his sell-out rights, either the bidder or shareholder may apply to court if they cannot agree the terms of sale. Under the new rules:

- » a shareholder will have to promptly notify the bidder if it makes an application (s 986(6) CA 2006);
- » a bidder who makes an application or received notice of an application will have to notify any shareholder who is being squeezed out or who is exercising his sell-out rights (s 986(7), (8) CA 2006); and
- » the court will no longer be able to reduce the consideration below that offered in the bid (s 986(4) CA 2006).

Changes to the Code

In response to the coming into force of Part 28 of the Companies Act 2006, the Panel announced various changes to the Code. Many of these were a substitution of a reference to the Companies Act 2006 for the old reference, although there were some substantive changes regarding the Panel's jurisdiction (see Update CLN07/01 item 58).

What next?

The changes this month are the culmination of almost a year of regulatory changes in this area, most of them fairly subtle in nature. However, any perceived uncertainty that these changes invoked has not dampened the takeover market which continues to be buoyant.

This was perhaps to be expected given that the Directive was largely based on the UK regulatory model and so few substantive changes were required. Even the most fundamental change, that is putting the Panel and Code on a statutory footing, is unlikely to have a significant practical impact. The Panel is expected to continue with its peer-review approach to regulation where possible, rather than relying on its new statutory enforcement powers.

However, further changes cannot be ruled out. The European Commission has recently reported that many member states have implemented the Directive in a protectionist way which could bring about new barriers in the EU takeover market, rather than eliminate existing ones (Commission Staff Working Document: Report on the implementation of the Directive on Takeover Bids (SEC(2007) 268) 21 February 2007). The Commission intends to closely monitor the way in which the Directive's rules are applied and work in practice and may bring forward the revision of the Directive scheduled for 2011.

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COMPANIES ACT 2006: IMPLEMENTATION

The final **text** of the Companies Act 2006, explanatory **notes and tables** of destinations and origins are now freely available to download at: <http://www.opsi.gov.uk/acts/acts2006a.htm>

The Act received Royal Assent on 8 November 2006. To see when specific sections of the Act will or have come into force, check the **implementation timetable** on the FL Memo Ltd newsletter homepage (follow the link to "Companies Act 2006 implementation timetable"). This document will be updated as new secondary legislation is passed.

The Government is currently consulting on some secondary legislation and transitional arrangements: see *Issue 1* for details.

Also see *Company Law Memo 2006 Newsletter Issue 9* for a summary of ICOSA's guidance on the new company communication provisions.

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Brought into force this month

On **6 April 2007**, various provisions of the new Act came into force as a result of the First and Second Commencement Orders (SI 2006/3428 and SI 2007/1093).

Community Interest Companies

See *CLM*: ¶62

The Second Commencement Order brought section 1284(1) of the new Act into force. This extended Part 2 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 to **Northern Ireland**, making the CIC corporate vehicle available in Northern Ireland for the first time.

Directors

See *CLM*: ¶2247+, ¶2735, ¶2931, ¶3536

The First Commencement Order repealed the following provisions relating to directors:

- » the rules regarding appointing or reappointing a **director** of a public company or its private subsidiary who is **aged 70 or more** (i.e. ss 293, 294 CA 1985); and
- » the prohibition on companies making **payments to directors** under their service contracts which are **tax free**, or calculated by reference to income tax rates (i.e. s 311 CA 1985).

Company management and decision making

See *CLM*: ¶3379+, ¶3494, ¶3958+

The obligation on directors to **disclose** their **interests in the shares** in or debentures of their companies and associated companies, and companies' related obligations to keep a register of the interests disclosed, have been repealed by the First Commencement Order (i.e. ss 324-326, 328, 329, Pts II-IV Sch 13 CA 1985).

The provision stating that a **document** can be **authenticated**, or certified, by a director, the company secretary or another officer with authority to sign documents has also been repealed by the same Order (i.e. s 41 CA 1985). However, the board will still be able to authorise any person to do this, using its general power to delegate.

Section 1063 CA 2006 allowing the secretary of state to make regulations relating to the **fees payable to Companies House** for services such as receiving, copying and allowing inspection of documents has also been brought into force by the First Commencement Order. This provision does not extend to Northern Ireland for the time being. The general provisions describing the Registrar and his functions are also in force as far as necessary to bring section 1063 into force (ss 1060, 1061 CA 2006).

CA 2006



COMPANIES ACT 2006: IMPLEMENTATION cont...

Company accounts

See CLM: ¶4249

The Second Commencement Order repealed paras 2, 2A, 2B of Schedule 7 CA 1985. As a result, any **directors' report** which is approved on or after 6 April 2007 does not have to disclose the directors' interests in shares or debentures of the company and its group companies. This is consistent with the fact that, from the same date, directors will not have to disclose these interests to the company either (above).

Takeovers

See CLM: ¶6675+

Broadly speaking, the new provisions place the regulation of public company takeovers on a statutory footing, and set out new squeeze-out and sell-out rights. These changes are discussed in detail in this month's *Focus on...*

Certain other provisions of the new Act have been brought into force by the Second Commencement Order as far as necessary for the new takeover provisions to take effect:

- » the definitions of allotted and issued share capital in section 546;
- » the definition of when shares are allotted in section 558;
- » provisions relating to offences (ss 1121-1123, 1125-1133);
- » provisions relating to company records (ss 1134, 1135, 1138);
- » provisions relating to the service of documents by or on a company, and the meaning of "hard copy", "electronic form" etc (ss 1138, 1140, 1168); and
- » the definitions of "body corporate", "the Gazette" and "regulated market" in section 1173.

These provisions have also been brought into force as far as necessary for the definitions of "Companies Acts" and "EEA State" and the provision relating to unregistered companies to come into force (see "Other changes", below).

DTI investigations

See CLM: ¶7231+

The secretary of state's power to bring proceedings in a company's name following an investigation has been repealed by the First Commencement Order (i.e. s 438 and the relevant parts of ss 439, 452 CA 1985).

Other changes

The Second Commencement Order has brought the definition of the "**Companies Acts**" for the purposes of CA 2006 fully into force, with changes to include those sections of the 1985 Act still in force within the definition for the time being (s 2 CA 2006).

The same Order has brought into force the provision relating to **unregistered companies** (s 1043 CA 2006), which allows the secretary of state to make regulations applying certain provisions of the Companies Acts to these companies. Regulations under this section also came into force on 6 April 2007, applying the new takeovers provisions and related consequential changes to unregistered companies (SI 2007/318).

The Second Commencement Order also repeals the definition of "**EEA state**" at section 744 CA 1985 and brings into force the definition at section 1170 of the new Act. Accordingly, the term now refers to a state which is a Contracting Party to the Agreement on the European Economic Area signed at Oporto on 2nd May 1992 (as it has effect from time to time).

The First Commencement Order has brought section 1281 CA 2006 into force, adding a new section 241A to the **Enterprise Act** 2002 that allows public authorities to disclose information they have obtained about individuals and companies in exercising their powers and functions under that Act in connection with civil court proceedings.

The First commencement Order has repealed the following **miscellaneous provisions** of CA 1985:

- » sections 343 and 344, which relate to disclosures of transactions in the accounts of banks and the holding companies of credit institutions (s 1177 CA 2006);

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- » section 720 and Schedule 23, which require insurance companies and deposit, provident and benefit societies to make a periodical statement of certain matters (s 1178 CA 2006); and
 - » section 729, which requires the secretary of state to lay an annual report of matters within the Companies Acts before parliament (s 1179 CA 2006).
-

Political donations and expenditure

See CLM: ¶3204

The Government has published **draft regulations** exempting companies which publish or disseminate news material to the public in their ordinary course of business from the obligation to obtain shareholder approval for this “political expenditure”. Without this exception, **media companies** would have to obtain authorisation to spend money on publishing material which could be regarded as affecting public support for a political party, for example, which would clearly be impractical.

A copy of the draft regulations can be found on the DTI website (<http://www.dti.gov.uk/bbf/co-act-2006/index.html>). They will replace the existing regulations, which grant the same exemption (SI 2001/445). The regulations are due to come into force on 1 October 2007, along with the relevant provisions of the Companies Act 2006 (ss 362-379).

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