



# COMPANY LAW MEMO 2007

Newsletter Issue 8

October 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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## Disclaimer

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## NEWS ROUND-UP

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### ICSA guidance on multiple proxies and other developments

See CLM: ¶2032, ¶13727+, ¶13743, ¶13836+

In response to changes introduced by the new Companies Act on 1 October, the Institute of Chartered Secretaries and Administrators (ICSA) has published new guidance covering voting by multiple proxies, amongst other things. See *Issue 7* for details of the provisions of the new Act that were brought into force earlier this month.

The new Companies Act now allows shareholders with more than one share to appoint a proxy for each share (s 324 CA 2006). Since each proxy has the right to attend, speak and vote, this could clearly disrupt the results of a vote taken on a show of hands by increasing a shareholder's voting power. Therefore, ICSA recommends that the chairman should call a poll where multiple proxies have been appointed by any shareholder. Indeed, chairmen are under a duty to do so where it seems that the result on a show of hands would be different to that on a poll. This will still allow shareholders to appoint different proxies to exercise their voting rights in different ways where necessary, but will prevent a shareholder from trying to increase his voting power unfairly (which may be a risk where a dispute has arisen between shareholders, for example).

The new Act also allows companies to choose to include a provision in their articles enabling shareholders to nominate another person to enjoy or exercise their rights (s 145 CA 2006). The guidance recommends that companies doing so should ensure that:

- » the wording of the relevant article(s) is clear and precise, for example setting out how the shareholder is to inform the company that he wishes to exercise this right and what information he needs to provide; and
- » the company has the administrative facilities in place to monitor who is entitled to enjoy or exercise rights attached to its shares.

The guidance also highlights other provisions now in force which impact on the exercise of shareholders' rights:

- » the ability to exercise rights in different ways where they are held on behalf of others (s 152 CA 2006);
- » the ability of a beneficial shareholder to join in certain shareholder requisitions (s 153 CA 2006);
- » the appointment of more than one corporate representative (s 323 CA 2006); and
- » the right of shareholders in listed companies to nominate the beneficial holders to receive information from the company (ss 146-151 CA 2006). This is only relevant for listed companies.

This guidance note can be freely downloaded from ICSA's website:

<http://www.icsa.org.uk/index.php>.

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### Review of directors' reports by the Financial Reporting Review Panel

See CLM: ¶4245+

The role of the Financial Reporting Review Panel (FRRP), the UK's corporate reporting and governance regulator, has been extended to include reviewing the directors' reports of public and large private companies as well as their annual accounts. This change in the FRRP's remit applies to reports for accounting periods starting on or after 1 April 2006.

The FRRP will look at:

- » whether the business review is consistent with the accounts and any other material in the annual report;
- » whether the business review is balanced and comprehensive; and
- » whether the accounts and reports comply with the requirements of companies legislation and the applicable accounting standards. It will only look at whether the business review complies with the ASB's non-mandatory guidance "Reporting statement: operating and financial review" if the company states that it has voluntarily complied with that statement.

In the case of any breach of the legislation, the FRRP can require the accounts or reports to be voluntarily revised by the company. In the rare case of a company refusing to do so, the FRRP can apply to the court for an order that they are revised (s 245B CA 1985).

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# News



## RECENT CASES

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### Method of share valuation

See CLM: ¶1852+

*Doughty Hanson & Co Ltd v Roe* [2007] EWHC 2212 (Ch)

This case concerned a share transfer provision in the articles of a company. It required that the price to be paid was either the price offered by the would-be seller of the shares, or the price decided upon by an independent valuer. An accountancy firm was instructed to provide a valuation, but was alleged to have departed from its instructions. However, the court decided that the valuation had been reached by a fair process. It was not open to the parties to challenge the mechanisms used in the calculation because the point of instructing a valuer is to achieve certainty in a reasonably quick and inexpensive manner. The court would not encourage unnecessary analysis of how the result was achieved (*Morgan Sindall plc v Sawston Farms (Cams) Ltd* (1990) 1 EGLR 90).

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### Age discrimination in employment can be justified

See CLM: ¶2446/mp

*Bloxham v Freshfields Bruckhaus Deringer* [2007] ET Case 2205086/06

A former partner in a major law firm applied to the employment tribunal for damages for age discrimination. Under his firm's old pension scheme, a partner who was under 55 at the date of closure of the scheme would only receive a discounted pension. Those who were 55 or over would receive their full entitlement. The former partner in question was 54 at the relevant time and therefore received the lesser amount. He claimed £4.5 million in damages.

The tribunal held that the changes to the pension scheme were in fact intended to remove age discrimination in the firm's pension arrangements. There had been extensive consultation beforehand. The aim was to make the scheme fairer for younger partners and more sustainable overall, which justified the policy. Therefore, the treatment was not discriminatory. In any event, the relevant parts of the Age Discrimination Regulations (SI 2006/1031) only came into force on 1 December 2006, which was after the partner had left his firm.

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### Insurance giant's directors disqualified and convicted of conspiracy to defraud

See CLM: ¶2577, ¶3012

Three directors of Independent Insurance Co Ltd and Independent Insurance Group plc (together, "Independent Insurance") have been sentenced for their part in the collapse of the insurance giant. The charges against them were for conspiracy to defraud, or alternatively for the Companies Act offence of defrauding creditors.

The prosecution's case focused on two particular frauds:

- » withholding claims data from the actuaries. The actuaries were engaged to advise on the reserves that Independent Insurance should have had available to pay valid claims. By failing to make all of the necessary claims data available to them, the actuaries were not able to make an accurate assessment; and
- » failing to disclose all of the contracts with the reinsurers. By disclosing only the contracts that were beneficial to Independent Insurance, the 2000 accounts recorded a profit instead of a loss.

Although these actions did not actually cause Independent Insurance to collapse, they concealed the truth about its financial position (to the tune of at least £200 million) and enabled it to carry on trading unprofitably. Independent Insurance went into liquidation in 2001. Over 1,000

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Case law



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employees lost their jobs, and many also lost their savings which were tied up in the company share schemes. Shareholders also lost their investments. Policy holders with the company were left with outstanding claims, in respect of which the Financial Services Authority has paid a total of £357 million out of its compensation scheme.

Michael Bright, former chief executive officer, was sentenced to 7 years in jail on both counts of conspiracy to defraud and disqualified from being a director for 12 years. Dennis Lomas, former finance director, was sentenced to 4 years' imprisonment (also on both counts) and disqualified for 10 years. Philip Condon, former deputy managing director, was sentenced to 3 years in jail on one count of conspiracy to defraud and disqualified for 10 years.

Having returned verdicts on the conspiracy to defraud charges, the jury was not required to do so in respect of the counts of defrauding creditors.

Conspiracy to defraud is a common law criminal offence. It may be abolished, depending on the results of a forthcoming review of the effectiveness of the Fraud Act 2006, which has been in force since January 2007. An outline of this legislation can be found in *Company Law Memo 2006 Newsletter Issue 9*. The Companies Act offence of defrauding creditors is now in s 993 CA 2006, but the applicable reference in this case is s 458 CA 1985. Where a director is convicted of an indictable offence relating to his company, the court has a discretion to disqualify him for up to 15 years (s 2 CDDA 1986).

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### Directors' right to inspect the accounts

See CLM: ¶4197+

*Oxford Legal Group Ltd v Sibbasbridge Services Plc and Millar* [2007] EWHC 2265 (Ch)

A company is obliged to keep accounting records which must be available at all times for directors and other officers to inspect (ss 221, 222 CA 1985). A director applied to court for an order compelling the company to allow him to inspect the accounts records, relying on the statutory right to inspect. The court found that this right was not enforceable by the civil courts. However, it was held that the company officers had a common law right to inspect a company's accounts, which existed in order to enable directors to fulfil their duties properly. So, on that basis the director in question had a right to inspect the accounts, and the court made an order enabling him to do so.

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### Director personally liable for litigation costs

See CLM: ¶7156

*Chantrey Vellacott v The Convergence Group Plc, Convergence Group International SA, Robinson and Robinson* [2007] EWHC 1774 (Ch)

A firm of chartered accountants sued two client companies (which were connected) for non-payment of its fees. The company in turn issued a counterclaim for professional negligence against the firm. During an adjournment of the trial, the directors put the companies into administration. The applicant then applied to add the two directors as defendants on the grounds that the two directors had controlled and funded the litigation.

The judge held that the counterclaim for professional negligence was not well based and should not have been brought. The companies were ordered to pay the firm's costs on the indemnity basis. In addition, one of the directors (who the court found to be an evasive and untruthful witness and who had controlled and managed the counterclaim throughout) was made personally liable, jointly and severally, for those costs. As the company was in administration, it seems unlikely that the company itself would have been able to pay any substantial part of the costs bill.

Normally, directors are not personally liable for the debts of their company. In this case, it seems that the director in question had, by his conduct, gone so far as to make himself a party to the litigation in a personal capacity, with rather severe financial penalties for doing so.

Jointly and severally liable means that the person is liable for his own share of the sum and also liable for the other parties' share, if the other parties cannot pay. An indemnity costs order is more severe than the normal costs order (on the "standard basis"). It requires the paying party to reimburse the other party for his actual costs, rather than those which the court deems to be proportionate and reasonable.

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## RECENT CASES cont...

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### Payments that were both preferences and transactions at an undervalue

See CLM: ¶7811+, ¶7819+

*Re HHO Licensing Ltd (In Liquidation); Clements (Liquidator Of HHO Licensing Ltd) v Henry Hadaway Organisation Ltd* (2007) Ch D (Companies Ct) 10/10/2007

The liquidator of HL Ltd sought to set aside various transactions made by HL Ltd to HHO Ltd, with which it was connected. The key person in both companies had transferred money from HL Ltd to HHO Ltd under the guise of charging for administrative services. The liquidator alleged that these payments were grossly in excess of the value of the services provided.

It was held that the key person had failed to justify the charges for administrative services and that they were worth “significantly less” than the costs charged by HHO Ltd. The payments were therefore transactions at an undervalue (s 238 IA 1986). The intention of the key person had been to ensure that HHO Ltd was able to fund its own activities, using the money diverted from HL Ltd. The money in question was in fact owed to a third party under a licensing agreement for sound recordings. It was held that the desire to put HHO Ltd in a better position than other creditors constituted a preference (s 239 IA 1986). Therefore, the transactions in question fell into both categories of voidable transactions and could be reclaimed by the liquidator from HHO Ltd.

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# Case law



## LEGISLATION

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### Cross-Border Mergers Regulations published

See CLM: ¶6536+

The Cross-Border Mergers Regulations (SI 2007/2974) have been published, together with guidance from BERR. The regulations implement the EC Directive on this subject (EC Directive 2005/56). They are due to come into force on 15 December 2007 to comply with the implementation deadline set out in the Directive.

The regulations will provide a similar framework for cross-border mergers to the structure for domestic mergers set out in the new Companies Act. A “cross-border” merger means one that involves at least one UK company and at least one EEA company. The merger will be able to take one of three forms (reg 2 SI 2007/2974):

- » merger by absorption;
- » merger by absorption of a wholly-owned subsidiary; or
- » merger by formation of a new company.

As with domestic mergers, a cross-border merger will have to be sanctioned by the shareholders (and the creditors, if the court orders a creditors’ meeting to be held) and the court. The process will involve certain filings being made at Companies House, and separate guidance has been published by the Registrar (available on the Companies House website).

The regulations also set out detailed requirements for employee participation.

A UK company in administration will be able to participate in a cross-border merger, in which case the administrator’s consent will also have to be obtained before the pre-merger steps are taken. Appropriate amendments will be made to the Insolvency Act 1986 (reg 65 SI 2007/2974).

The regulations will refer to various provisions in the new Act, some of which will not be in force when the regulations are implemented in December. Therefore, the regulations will include transitional amendments changing those references to their CA 1985 equivalents until the provisions in the new Act come into force (Schedule 1 SI 2007/2974).

A copy of BERR’s guidance, as well as links to the regulations and the EC Directive can be found on BERR’s website:

<http://www.dti.gov.uk/bbf/eu-company-law/directives/page19528.html>.

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### Guidance on the Corporate Manslaughter and Corporate Homicide Act

See CLM: ¶2591, ¶7178

The Ministry of Justice has published guidance on the new Corporate Manslaughter and Corporate Homicide Act 2007, which is expected to be implemented on 6 April 2008. This legislation has been considered in detail in previous editions of *Company Law Memo 2007 Newsletter - Issue 6* and *Issue 1*.

Amongst other things, the guidance looks at who the Act applies to and how to judge whether it applies to a given situation. It indicates that the sentencing guidelines are expected to be finalised by the autumn of next year, following consultation. Publicity orders will not be imposed until the guidelines are published because they are a new form of punishment. However, fines and remedial orders will be imposed because the courts will be able to rely on comparable punishments for health and safety offences as a guide.

The guidance is available on the Ministry of Justice website: [www.justice.gov.uk](http://www.justice.gov.uk).

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## LEGISLATION cont...

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### CPR amendments

See CLM: ¶7118+, ¶7674+, ¶7683

Various changes were made to the Civil Procedure Rules on 1 October 2007 as part of the 45th update. Of particular relevance to company law are:

- » the amendments to Part 19 and the new practice direction 19C dealing with derivative claims under the Companies Act 2006; and
- » the changes to Part 49 and the associated practice directions dealing with applications under companies legislation. Practice direction 49 now sets out the general rules for these applications (such as requiring them to be made by Part 8 claim form unless otherwise stated) as well as giving special rules that must be followed when making particular applications (e.g. for sanction of a scheme of arrangement). Practice direction 49B now only deals with applications under the Insolvency Act regarding dispositions of the company's property after a petition has been presented. It also states that shareholders should not petition to wind a company up as an alternative to applying for relief from unfair prejudice unless he genuinely wishes to put the company into liquidation.

Details of the 45th update to the CPR can be found on the Ministry of Justice's website: [www.justice.gov.uk](http://www.justice.gov.uk).

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# Legislation



## EXTRADITION OF COMPANY DIRECTORS

Spending time in the US: with an appeal to the House of Lords on new extradition procedures pending, this issue's *Focus on...* looks at why this issue is so contentious

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The retired chief executive of Morgan Crucible plc, Ian Norris, is appealing to the House of Lords against an order to deport him to the United States on charges of price fixing (*Norris v Government of the United States* [2007] EWHC 71 (Admin)). The allegations concerned arrangements between companies in Europe, so any involvement in the US was incidental. His appeal is expected to be heard in November. This is the first appeal on proceedings under the Extradition Act 2003 to have reached the House of Lords. However, it is not the first use of this Act against British company directors. Potential future targets include the directors of BAE Systems, BA and four medical equipment companies.

The legislation was passed in 2003 under the guise of making it easier to extradite terrorist suspects. A particular issue has arisen out of extradition applications by the US. Most of these applications concern allegations of white-collar crime, and are nothing to do with terrorist activity. The problem is that some foreign countries, including the US, do not need to provide even a good arguable case to a UK court in order for the extradition application to be successful. The British court has very little discretion to refuse these extradition applications.

An example of a businessman who has been convicted in the US after extradition is Mr Nigel Potter, a former managing director of Wembley plc. It was suggested to him by a US business contact, in the course of assessing an opportunity in the US, that his company should pay a "bonus" to a third party in the US in order to gain regulatory approval for gaming machines. He and his company sought legal advice and declined to follow this course of action: the bonus was neither offered nor paid. The US federal authorities subsequently investigated the matter and applied for his extradition. Mr Potter went to the US, believing he had done nothing wrong. He was convicted of three charges of "wire fraud", and is serving three years in a low security jail in Pennsylvania.

Wire fraud is a US federal crime and is aimed at offences which cross state boundaries within the US but it also includes international transactions. It is designed to catch people communicating any scheme to defraud or obtain money or property by practically any possible means. So, use of email or the telephone could trigger this offence, even if the person concerned never entered the US.

Although the offence is aimed at dealing with criminal behaviour across internal state boundaries in the US, it is now very easy for the US authorities to extend the remit of this offence to business people in the UK because of the UK extradition legislation. As Mr Potter's case demonstrates, the US Department of Justice is adopting an aggressive approach to white collar crime. Also, the penalties in the US system are much more severe than in the UK (e.g. the maximum sentence for the US wire fraud offence is 30 years). The US system makes extensive use of plea bargaining to induce a guilty plea in return for a lesser sentence, although a defendant is still likely to face a jail term.

Perhaps the best-known case of British businessmen who have been extradited to the US is that of the so-called "NatWest three" (*R (on the application of Bermingham and others) v Director of the Serious Fraud Office; Bermingham and others v Government of the United States of America* [2006] EWHC 200 (Admin)). They have now made a preliminary appearance in court in Houston. They have been granted bail totalling \$3 million, but even then only on condition that they reside separately in the Houston area, and that they do not meet together except in the presence of a lawyer. They are also electronically tagged. Their trial is expected to start in January 2008, some 18 months after they were extradited. They are accused of involvement in a financial deal with an Enron executive. Most of the relevant witnesses and documents are in the UK, which hinders the preparation of their defence. If they are convicted, they face a maximum sentence of 35 years in prison. A recent press report indicates that they are entering negotiations for a plea bargain.

Since the case of the NatWest three originally came to public attention, there have been some new developments, in that the US Senate finally ratified the extradition treaty with the UK on 30 September 2006.

The extradition treaty between the UK and the US was originally signed in 2003, and replaced an

**Focus on...**



## EXTRADITION OF COMPANY DIRECTORS cont...

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earlier treaty. The new treaty required ratification by the legislatures of both countries before it could come fully into effect. The UK brought the treaty into effect in 2003 but there were internal political problems in the US which delayed ratification until 2006. Amongst the problems were that, initially, there was no need for the UK to show that there was a good arguable case against the defendant, the UK does not have a law limiting the time after which a prosecution can be made, and special interest groups in the US argued that the new treaty could allow for political extradition.

The formal signing by the UK and US governments took place in April 2007. Prior to this, the treaty was not effective in the US. However, it is still not a level playing field. The UK has to provide a good arguable case to a US court in order to secure extradition of a US citizen. On the other hand, the US only has to show "probable cause" in order to secure extradition of a UK citizen. This could be in the form of an official's opinion.

The treaty defines an extraditable offence as one punishable by a sentence of 12 months or longer, in both countries. Also, the "rule of specialty" can be waived. This allows a person who has been extradited for one offence to be prosecuted for another offence, provided that the country from which he was extradited consents.

The issue for the House of Lords to decide in Mr Norris' case, referred to above, is whether his alleged conduct was a criminal offence in the UK at the relevant time. The High Court held that the alleged conduct could have amounted to the common law offence of conspiracy to defraud (the alleged conduct predated the introduction of a "cartel offence" covering price fixing in UK law, see ¶651). If it is in fact conspiracy to defraud, then the requirement of a minimum sentence of 12 months would be met. However, dishonesty is a component part of conspiracy to defraud and it is not clear that price fixing comes within this definition. (By contrast, the price fixing offence in the US does not require dishonesty.) The House of Lords will have to decide whether the alleged behaviour could amount to the common law offence.

In January 2007, the then Attorney General, Lord Goldsmith, announced guidelines on whether an individual should be tried in their own country or extradited. However, these seem primarily to concern the need for early communication between UK and US prosecuting authorities, and the resolution of any disagreements between the governments at senior level.

In October, the government announced that there would be new powers for the Home Secretary to veto extradition applications. From November, the Home Secretary is to have powers with the "option to enact" the new veto power. She will be able to make such an order if she decides that a significant part of the alleged conduct occurred in the UK. Alternatively, she could be forced to make such an order by a vote in parliament. This is seen in some quarters as symptomatic of a different attitude to relations with the US being taken by the current government under Gordon Brown.

Do these developments indicate an end to the problems surrounding extradition? The answer depends on how the Home Secretary exercises this power, but it seems unlikely that anything short of an amendment of the 2003 Act would work.

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**Focus on...**



## COMPANIES ACT 2006: IMPLEMENTATION

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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 and further announcements are made. The implementation timetable is up to date to the Fourth Commencement Order.

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### Provisions in force on 1 October 2007

Various provisions of the Companies Act 2006 come into force on 1 October 2007. This is the subject of the *Focus on...* in *Issue 7*, which looks at each of the areas affected, giving details of the provisions coming into force and the related paragraphs of *Company Law Memo 2007*.

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### Draft reduction of capital regulations and consultation

See *CLM* ¶1453+

On 11 October 2007, BERR published the draft Companies (Reduction of Capital) Regulations 2008, together with a consultation paper.

In effect, the regulations will shift the burden of proof when objecting to a reduction away from the company and on to the objecting creditor. The creditor will have to show that there is a real likelihood that his claim would be placed at risk by the proposed reduction of capital. The regulations are expected to come into force on 6 April 2008, ahead of the rest of the provisions on this topic which will come into force on 1 October 2008. The regulations will implement part of the Second Company Law Amendment Directive (EC Directive 2006/68) and will amend the relevant provisions of the Companies Acts 1985 and 2006.

The consultation paper including the draft regulations is available on the BERR website: <http://www.berr.gov.uk/files/file41627.PDF>. Comments are invited by 9 November 2007.

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### Table A transitional amendments

See *CLM* ¶9915

Transitional amendments to table A were made to reflect changes implemented by the CA 2006 on 1 October 2007 (see *Issue 7*). Further amendments were brought in at the last minute (SI 2007/2826). They amend the chairman's right to a casting vote in shareholder meetings (reg 50) and amend the rule on voting to allow proxies to count on a show of hands (reg 54). Like the other changes, they apply to companies incorporated on or after 1 Oct 2007 and which adopt Table A articles.

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# CA 2006