



Companies Act Update 2006

Changes to capital maintenance rules

You will be aware from our previous circulars that the following provisions come into force on 1 October 2008:-

New provisions governing conflicts of interests between a company and its directors (and in some cases, persons connected with such directors)

New provisions requiring all companies to have at least one director who is a natural person and providing a new minimum age for appointment as a director of 16 years

The new trading disclosures regime, which will replace the current requirements in the Companies Act 1985 and also, for companies trading under a business name, in the Business Names Act 1985

New provisions making it possible to require a company to change its registered name if it was chosen to exploit another's reputation or goodwill.

The remaining provisions coming into force on 1 October 2008 make some substantial changes to the current capital maintenance rules. These rules prevent certain operations that have the effect of returning capital to shareholders before a company is properly wound up, except as is permitted by the rules. The changes are to the rules dealing with financial assistance and reductions of share capital.

Financial assistance

The current position is that all companies are prevented from providing financial assistance in relation to the acquisition of their own shares. However, there is an exemption for private companies provided that a procedure, known as the "whitewash procedure", is complied with. Briefly, this procedure involves the directors being satisfied that the company has net assets or, if not, sufficient distributable profits out of which to provide the financial assistance, the company's shareholders passing a special resolution authorising the transaction and the directors making a statutory declaration of solvency, which is supported by an auditor's report. Since the definition of "financial assistance" is very wide, even fairly innocuous transactions have to be whitewashed and it is estimated that private companies spend in the region of £40 million annually on legal and accountancy fees in complying with the whitewash procedure. The aim of the new legislation is to de-regulate even further the current position for private companies, thereby reducing these costs.

Accordingly, the new provisions in the Act dealing with financial assistance prohibit only a public limited company from providing financial assistance in relation to the acquisition of its own shares. There is no similar prohibition in relation to a private company except where a private company provides financial assistance in relation to the purchase of shares in its parent company, which is a public limited company. Since the prohibition is not continued for private companies, the whitewash procedure is also abolished. A further statutory provision in regulations made pursuant to the Act also makes it clear that any financial assistance provided by a private company in relation to the purchase of its own shares cannot be attacked under the old common law capital maintenance rules preventing financial assistance.

These changes ought to mean that private companies can provide financial assistance and avoid the substantial costs associated with the whitewash procedure. However, the fear is that, at least where banks are involved in transactions that have traditionally been whitewashed, they will still insist on solvency statements from directors, backed up by an auditors' report and some sort of shareholders' resolution supporting the transaction, in order to protect themselves (and in particular, the validity of any security they take) in the event of the transaction being attacked later by one or more of the company's shareholders or, more importantly, by an administrator or liquidator in the event of the company's subsequent insolvency. Further, the transaction can still be attacked for breach of any of the other capital maintenance rules, meaning that directors will still need to be satisfied in many cases that the company has net assets/distributable profits. This could mean the continuance of the whitewash procedure in all but name together with the associated costs.

Reduction of share capital

Currently, all companies can reduce their share capital provided that this is authorised by the company's Articles and sanctioned by a special resolution of the company's shareholders. However, the Court also has to approve the reduction and it will only do so if it is satisfied that the company's creditors are adequately protected. This can involve the Company having to create a special reserve.

In order to reduce the costs for private companies associated with having to make an application to Court, the Act includes new provisions enabling them to reduce their share capital without having to go to Court. This new out-of-Court procedure involves the company's shareholders passing a special resolution and the directors making a declaration of solvency. Private companies will be able to prevent the use of the out-of-Court procedure in their Articles if they wish to do so.

The Court procedure will still be available to private companies and it continues to be the only way in which a public company can reduce its share capital. A slight change to the Court procedure is being made in that the requirement for the Articles to authorise capital reductions is removed. If companies want to restrict or prevent capital reductions, then the Articles will have to include express provision to this effect.

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