

Companies Act 2006 Update

Directors' service contracts

New provisions relating to directors' service contracts come into force on 1 October 2007. These deal with:

- Changes to the existing requirement for a company to obtain shareholder approval before entering into a long-term service contract with either its own directors or directors of its holding company.
- Additional requirements applying to all service contracts, regardless of the length of service.

Long-term service contracts

Currently, shareholder approval is required before a company enters into a long-term service contract with either its own directors or directors of its holding company (unless an exemption applies). A long-term service contract is defined as a contract for a term of more than 5 years, which cannot be terminated by notice within that period. Failure to obtain shareholder approval means that the contract is deemed to contain a term that the company may terminate it at any time on the giving of reasonable notice.

The new provisions restate the current law but subject to the following changes:

- Under the new rules, shareholder approval is required where the “guaranteed term” of the director’s employment is longer than 2 years (reduced from the current 5 year period).
- The concept of a “guaranteed term” is new and is intended to remove loopholes in the current law. It is defined as:
 - The period during which the director’s employment is to continue and cannot be terminated by the company by notice (as under the current law) or
 - (New) In the case of employment terminable by notice, the period of notice required to be given

(New) Where the director’s employment is to continue for an initial fixed period and thereafter until terminated by notice, the “guaranteed term” is the aggregate of the fixed period and the period of notice.

In addition to complying with any requirement for shareholder approval, both the board and the director concerned must continue to comply with their duties as directors. E.g. the board must be satisfied that entering into the service contract is likely to promote the success of the company and the director in question must make a declaration of his interest (although from 1

October 2008, it will no longer be necessary for the conflicted director to make a declaration of his interest in his own service contract). For more information on directors' duties, please see our earlier briefing notes.

Additional requirements applying to all service contracts

The current law provides that a company must keep all unexpired service contracts, with either its own directors or with directors of any subsidiary, open to inspection by the company's shareholders. There are, however, exemptions for contracts relating to overseas personnel and contracts that either have less than 12 months to run or which can be terminated within the next 12 months without compensation.

Under the new rules, this right of inspection is to continue but the period during which the service contract must be available for inspection is being extended to at least one year after the service contract has expired.

In addition to this right of inspection, shareholders have a new right to request a copy of any service contract on payment of a fee and the company must comply with any request within 7 days.

In order to remove loopholes in the current law, there is a new wide definition of a "service contract", which is defined as any contract under which:

- A director of a company undertakes personally to perform services (as director or otherwise) for the company or for a subsidiary of the company, or
- Services (as director or otherwise) that a director of the company undertakes personally to perform are made available by a third party to the company or to a subsidiary of the company.

This new definition will catch, for example, a contract between the company and another company, through which the director performs his services as director.

Both rights are exercisable in respect of any service contract, regardless of the length of service and whether or not terminable within the next 12 months. The exemptions for overseas contracts etc in the current law are being removed.

Contact us

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