

Companies Act 2006 Update

Loans to directors and connected persons

One of the key aims of the Act is to ensure better regulation for small, private companies. The Government takes the view that the current level of regulation regarding loans is unnecessary and excessive, particularly for private companies, and is therefore de-regulating in the Act.

This note (1) recaps on the current law regarding loans and (2) sets out the changes that are being made on 1 October 2007.

The current law

Currently, all companies are prohibited from making loans to their own directors, directors of their holding company or persons connected with such directors. This prohibition also prevents companies from giving security or guarantees in respect of third party loans made to such directors and connected persons.

There are various exemptions to this prohibition. Exemptions are generally more liberal for private companies that are not part of a group containing a plc.

Breach of the prohibition gives rise to criminal as well as civil penalties.

The new law

From 1 October 2007:

- All companies will be able to make loans to their own directors or directors of their holding company (or provide guarantees/security in respect of third party loans made to such directors) with shareholder approval.
- A plc or a private company that is part of a group containing a plc will be able to make a loan to a person who is connected to either its own directors or directors of its holding company, provided that shareholder approval is obtained.
- Companies should note that the definition of “connected persons” is being extended under the Act with effect from 1 October 2007.
- There is no longer any statutory provision preventing a private company, that is not part of a group containing a plc, from making a loan to a person connected with either its own directors or directors of its holding company and the Act does not require the company to obtain shareholder approval for such transactions.

- However, both the board and the director connected with the beneficiary of the loan or security/guarantee will need to be mindful of their duties as directors. In other words, the board should only approve the loan if they consider that it will promote the success of the company. Furthermore, from 1 October 2008, the director connected to the beneficiary of the loan etc will need to make sure that he makes a declaration of his indirect interest in the transaction. For more information, please see our earlier briefing note on directors' duties.
- Even where shareholder approval is required, an exemption may apply (for example, if the amount of the loan does not exceed £10K, if the loan is for expenditure on company business not exceeding £50K or if the loan is for expenditure in connection with defending civil or criminal proceedings or in connection with regulatory action or investigation).
- If shareholder approval is required but not obtained, there are civil consequences only. All criminal penalties are removed.

Connected persons

From 1 October 2007, such persons will include (in addition to those already covered under the Companies Act 1985):

- Civil partners
- Persons (whether of the same or a different sex) with whom the director "lives as partner in an enduring family relationship" (this term is not defined in the Act) unless the person is the director's grandparent, grandchild, sister, brother, aunt or uncle, nephew or niece
- The director's parents
- Children or step-children of the director who are over 18 years old (those under 18 are already covered); and
- Children or step-children of the director's unmarried partner (who are not children or step-children of the director) if they live with the director and are under 18 years old.

Contact us

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