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LEGAL UPDATE

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We are pleased to present our latest legal update.

COMPANIES ACT 2006: HIGHLIGHTS

Parts of the Companies Act 2006 ("the 2006 Act") were brought into force on 8th November 2006 and when the 2006 Act will be adopted in its entirety, it will almost completely replace the Companies Act 1985. The 2006 Act is adopting most of the recommendations made by the Company Law Review Steering Group and its aim is to:

- improve the UK's position as "one of the most attractive places in the world to set up and run a business";
- make it easier to establish and develop a business;
- encourage shareholder-confidence; and
- increase shareholder engagement

A summary of the main issues of the 2006 Act is set out below.

1. Director's Duties and Obligations

The 2006 Act has introduced the following obligations for directors:

- **To act in accordance with the company's constitution**
This means that the director should only exercise his/her powers for the purposes for which they are conferred.
- **To act with reasonable care, skill and diligence**
In assessing whether a director has complied with this obligation, the court must consider the case in question both objectively and subjectively, comparing both "the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company" and "the general knowledge, skill and experience that the director has".
- **To "promote the success of the company"**
This requires the director to act in a way that he in good faith considers would be most likely to promote the success of the company for the benefit of its shareholders as a whole. These matters are noteworthy as they impose an obligation on directors to consider the company's long-term sustainable growth. In order to understand what these duties mean in practice, the Government is set to publish plain English

guidance notes explaining what directors must do in order to comply with these new codified duties.

- **To avoid situations in which their duties to the company may conflict with their own interests or their duties to third parties**
This duty is said to apply, in particular, “to the exploitation of any property, information or opportunity”.

2. Shareholders’ Rights

The main aim of the Company Law Review Steering Group was to ensure greater transparency and accountability within a company’s operations and greater opportunity for all shareholders to play an informed role in the company’s business. In particular, the following sections of the 2006 Act should be noted:

- Ss. 324-331 make it easier for shareholders to use proxies. It provides that a proxy cannot have fewer votes on a show of hands than the shareholder who is being represented would have had were he/she present.
- Part 9 contains provisions that allow shareholders to confer various rights on third parties. For example, a shareholder may nominate another person or persons to enjoy or exercise all or any of the shareholder’s specified rights in relation to the company. Furthermore, a third party nominated by a shareholder of a company trading on a regulated market entitled to receive shareholder information from the company.
- Ss. 260-264 expand and introduce statutory rights for shareholders to bring derivative claims on behalf of a company in which they hold shares. Indeed, the circumstances in which a derivative action may be brought have been clarified and the procedure for bringing a derivative claim has been rationalised.
- S. 116 restricts the circumstances in which information about shareholders can be obtained from the register of shareholders as a person seeking information must now make a “request” to the relevant company.

3. Institutional Shareholders

Institutional investors hold over half of UK equities. One of the main aims of the 2006 Act is to place such investors under an obligation to explain the manner in which they have exercised voting rights attached to the shares they hold and those held on their behalf.

4. Deregulation

The 2006 Act seeks to simplify the law applicable to small companies.

Firstly, it paves the way for the introduction of new model articles to be used by private companies limited by shares and by guarantee as well as by public companies. They have yet to be published, however the Government stated that they will be concise and easily comprehensible.

Secondly, private companies are no longer required to appoint a company secretary.

Thirdly, the 2006 Act retains the requirement of a unanimous vote in relation to resolutions to remove directors and auditors from office. However, it removes the unanimity requirement in relation to all other resolutions. See in particular s. 282 to 299.

Fourthly, the 2006 Act abolishes the requirement to appoint auditors or lay accountants at the Annual General Meeting of a private company.

Finally, the capital maintenance rules for private companies are significantly relaxed by removing the prohibition on a private company from giving financial assistance for the purchase of its own shares.

5. Auditors' Liability

Part 16 of the 2006 Act contains detailed provisions relating to auditors' liability. The introduction of liability limitation agreements (LLA's) outlines provisions that:

- define the permissible scope of LLA's;
- prohibit auditors from excluding their liability or obtaining an indemnity from a company where they have acted improperly; and
- impose criminal sanctions for knowingly or recklessly inserting misleading details in an auditors' report.

6. Implementation of the 2006 Act

Unfortunately, as of yet, the question as to when the entire 2006 Act shall come into force remains unanswered. The majority of Parts 43, relating to transparency obligations relating to the Transparency Directive (2004/109/EC) came into force when the 2006 Act received Royal Assent. However, it is the Government's intention to bring all remaining parts into force by October 2008.

FINANCIAL ASSISTANCE FOR THE ACQUISITION OF SHARES BY THIRD PARTIES

Corporate Development Partners v E-Relationship Marketing Ltd, 9 March 2007 (Chancery Division)

As a general rule, it is unlawful for a company or any of its subsidiaries to provide financial assistance directly or indirectly to a person seeking to acquire the company's shares. Furthermore, where a person acquires shares in a company and incurs a liability for the purpose of that acquisition, the company or any of its subsidiaries is not permitted to give financial assistance to reduce or discharge such a liability.

In this particular case, the Claimant was appointed by the Defendant to handle any acquisition, joint venture or strategic alliance on the defendant's behalf (the "First Agreement"). A company was identified by the Claimant as a potential acquisition target for the Defendant. Subsequently, for commercial reasons, the first agreement was replaced by a second agreement (the "Agreement") which contained an express provision for a deal with the target company, halving the fees payable to the Claimant by the Defendant. The target company was then acquired by the Defendant.

The Claimant sought payment for having brought about the deal between the Defendant and the target company. The Defendant argued that such payment would constitute illegal financial assistance and that the provision contained in the agreement was unenforceable.

The court held that in this instance, no financial assistance arose. Although the Claimant's referral of the target company to the Defendant had contributed to the acquisition taking place, the eventual payment commitment did not facilitate the acquisition. This was because, having effected the introduction for the Defendant to acquire the target company, the claimant played no further role in the negotiations and was not expected to.

Indeed, it was highlighted that such a payment was intended to be a form of financial reward to the Claimant for having introduced the defendant to the target company.

It is important to note that if the Claimant and the Defendant had negotiated and replaced the First Agreement with the Agreement for reasons other than good commercial reasons, arguably there could have been financial assistance. The courts viewed it as highly significant that the parties had discharged the existing commitment in favour of a new agreement, leading to the conclusion that claims of financial assistance are particularly sensitive to the facts.

TAX ISSUES FOR UK PROPERTY INVESTMENTS

January 2007 saw the introduction of the UK's real estate investment trust (REIT) regime. For investors seeking the most appropriate arrangement through which to hold an investment in UK land, the REIT will be an addition to the range of possible vehicles available.

REITs are property investment vehicles aimed at enabling tax efficient investment in a professionally managed portfolio of real estate. They were initially developed in the US as a way of combining the advantages of indirect property ownership with the tax efficiency of direct investment in property assets.

In order to convert to REIT status, companies will need to satisfy certain conditions and once converted, the company will be exempt from UK corporation tax on the profits and gains of its qualifying property rental business. In return, REITs pay an extra 2% of the market value of the properties involved in their qualifying business immediately before conversion.

The table below briefly outlines how the REIT compares with other vehicles for investing in UK land from a tax perspective:

		Vehicle	UK individual investor (higher rate taxpayer)	UK company investor	Non-UK investor
REIT	Income	Nil	40%	30%	22% (40%) (a non-resident individual is liable at up to 40%)
	Capital Gains	Nil	40%	30%	22% (40%) (assuming that the REIT distributes its gains (which, unlike in the case of its income, it is not bound to do))
	Stamp Duty	0.5%			
UK company	Income	30%	Effective 25%	Nil	Nil
	Capital Gains	30%	Effective 25%	Nil	Nil
	Stamp Duty	0.5%			

Offshore company	Income	22%	32.5%	30%	Nil
	Capital Gains Stamp Duty	Nil Nil	32.5%	30%	Nil
UK authorized unit trust	Income	20%	Effective 25%	Nil	Nil
	Capital Gains	Nil	Effective 25%	Nil	Nil
	Stamp Duty	0.5%			
Offshore unit trust	Income	Nil	40%	30%	22% (40%) (a non-resident individual is liable at up to 40%)
	Capital Gains Stamp Duty	Nil Nil	40%	30%	Nil
Partnership	Income	Nil	40%	30%	22% (40%) (a non-resident individual is liable at up to 40%)
	Capital Gains Stamp Duty	Nil 4%	40%	30%	Nil

NB: In the case of an offshore unit trust or a partnership, a distribution is not necessary to trigger the stated tax treatment for income, because these vehicles are transparent as to income (and a partnership, unlike an offshore unit trust, is also transparent as to capital).

Pini Bingham & Partners
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