THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

1 June 2007

Our ref: ICAEW Rep 47/07

Your ref:

Emma Smith
Companies Act Implementation Team
Department of Trade and Industry
5th floor
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London SW1H 0ET

By email to:
CompaniesAct2006-Consultation@dti.gsi.gov.uk

Dear Emma

IMPLEMENTATION OF COMPANIES ACT 2006

The Institute of Chartered Accountants in England and Wales ('the Institute') is pleased to respond to your consultation document on *Implementation of the Companies Act 2006*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 47/07

IMPLEMENTATION OF COMPANIES ACT 2006

Memorandum of comment submitted in May 2007 by The Institute of Chartered Accountants in England and Wales, in response to the Department of Trade and Industry (DTI) consultation paper on Implementation of the Companies Act 2006 published in February 2007

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INTRODUCTION

The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the DTI consultation paper *Implementation of the Companies Act 2006,* published in February 2007.

WHO WE ARE

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

MAJOR POINTS

<u>Audit Offence</u>
The consultation does not deal in detail with how the audit provisions are to be implemented. In relation to these provisions (Parts16 and 42) there is a need to determine whether these provisions are to be commenced:

- in respect of accounting periods beginning on or after the commencement date;
- in relation audit reports finalised after the commencement date; or
- from the commencement date, as a drop dead date.

We would be very concerned if any provisions that relate to audit work or audit reports were to be brought in from a drop dead date or with respect to reports signed after the commencement date, rather than reports relating to an accounting period commencing on or after that date, as some (or in some cases substantially all) of the audit work carried out in order to prepare such reports is likely to have been conducted prior to the enactment of those provisions, effectively giving them retrospective effect.

This is particularly the case in relation to the auditor criminal offence provisions in the Act where retrospective action would be inequitable. There are likely to be two aspects to audit work (including documentation) going forward: a) that necessary to obtain sufficient evidence to issue an audit report and b) additional work thought necessary to be able to resist inappropriate criminal prosecution. The former is unchanged by the new provisions. However, in view of the seriousness of a potential criminal prosecution to career and reputation, even if the prosecution fails to get a conviction, it is likely that in the absence of an assurance that inappropriate prosecutions will not occur, audit firms will need to devote resources to the latter.

This additional work will add cost but will not add to underlying audit quality (indeed if it diverts attention to 'box ticking' it may detract from it).

We have discussed the consequences of unnecessary and inefficient additional procedures with the DTI previously, and are assured that guidance reflecting the government's intent would be sufficient to persuade auditors that such measures are unnecessary. However, it will clearly be necessary for the guidance to be issued in sufficient time to be disseminated, considered and acted upon. As we understand that this guidance is not expected to be issued in the immediate future, we believe that any implementation measure that has immediate impact from April 2008 will leave firms no choice but to implement such new procedures as firms think necessary to enable them to resist inappropriate prosecutions in respect of audits for March 2008 year ends, as the preparatory work for such audits will be soon be commenced.

Similarly, we would be concerned if any provisions were brought in from the commencement date, as a drop dead date, if such provisions were to apply to audits that were being conducted prior to the commencement date. We also think that there would be major difficulties in seeking to apportion actions that relate to an audit being carried out at the commencement date, to periods before or after that date.

We would therefore urge the DTI to reconsider any proposal to implement any audit-related provisions from a drop dead date, or in relation to audit reports signed after the commencement date. As the law on fraud and the existing regulatory measures cover poor quality audit work anyway, we do not think that a gap is created by introducing these provisions in respect of accounting periods beginning on or after the commencement date and this would allow the implications to be addressed in an efficient and orderly manner.

RESPONSES TO SPECIFIC QUESTIONS

Chapter 2 – Secondary Legislation

PART A - Powers under the Act

We support the Government's proposal not to utilise the powers conferred on them by section 1277 to require disclosure of voting by institutional shareholders, as we believe that a market-led solution would be more appropriate.

We also support the proposal not to utilise the powers under section 535 to prescribe or proscribe terms of auditor liability limitation agreements (LLAs). Further, we note that the Financial Reporting Council proposes to issue some model terms in consultation with the accountancy profession and the investor community. We advocate that this consultation is expedited so that the Guidance is available before implementation of the LLA provisions, to facilitate the agreement of principle terms between auditors and investors.

We also note the Government's proposal not to utilise the powers conferred on them by section 493 (disclosure of terms of audit appointment). We note that a report from the *Audit Quality Forum* led to the power being included, but we also note that the preferred route in that report was for a best practice solution in corporate governance guidance and that we are aware that the matter was considered in the review of the Combined Code. We assume, therefore, that the DTI has consulted the FRC Corporate Governance Committee in respect of this item.

PART B - Company formation and re-registration (Q2.1-Q2.3)
We do not propose to comment on this section.

PART C - Company and business names (Q2.4-Q2.13)
We do not propose to comment on this section.

PART D - Trading disclosures (Q2.14-Q2.19)
We do not propose to comment on this section.

PART E - Addresses on the public record at Companies House (Q2.20-Q2.34)

2.20 Do you agree that the public authorities to whom protected information may be disclosed should be those contained in Appendix (a) to Chapter 2?
Yes.
Do you consider any public authority should be removed from or added to that list?
No.

2.21 Do you agree that public authorities should be able to use protected information only for the purpose of facilitating the carrying on of a public function?
We agree.

2.22 Do you agree that: credit reference agencies should be permitted to use protected information only:
(a) to vet applications for credit or applications that can result in the giving of credit or the giving of any guarantee, indemnity or assurance in relation to the giving of credit; and
(b) to meet any obligations contained in the Money Laundering Regulations 1993, the Money Laundering Regulations 2001 or any rules made pursuant to section 146 of the Financial Services and Markets Act 2000?
We agree.

2.23 Do you agree that:
(a) only directors or prospective directors should be able to apply for extra protection with respect to credit reference agencies?
(b) applications for extra protection should be made to the Registrar?
We agree, except we think this should extend to company secretaries (in addition to directors), and the regime should also extend to LLPs and their members.

2.24 Do you agree that extra protection should be available to those who hold a Confidentiality Order and to those individuals whom the Secretary of State considers satisfy the following conditions:
(a) at least one of the companies of which the individual is, or will be, a director is likely to be subject to violence or intimidation; or
(b) that the director or prospective director is or has been employed or otherwise engaged to provide services to the security and intelligence agencies or the police?

We suggest this should extend to company secretaries (in addition to directors) and also to members of LLPs. Also, (a) needs to be rephrased to reflect that fact that it is the individuals associated with the company (not the company) who would be subject to violence or intimidation, and therefore protection should be given if (and applications required to demonstrate that) the individuals associated with the company are at risk of violence or intimidation, rather than the company itself.

2.25 Do you agree that the proposed information should be required with an application for higher protection?
We agree, except in relation to (g), which would require copies of pages from publicly available records showing the name and address of the individual, e.g. telephone directory, professional registers etc. We understand that proof of address is not currently required when registering at Companies House and so we do not understand why proof of address is required and we would therefore be grateful for

clarification from the DTI as to why the documents in (g) are required. Further, we fear that this requirement is inappropriate as those wishing to benefit from such protections may not necessarily appear on such public records (for instance, they are likely to be "ex-directory", and may not appear in a professional register).

2.26 Do you agree that the application for extra protection should be determined in a manner similar to regulations 3 to 5 of COR 2002?
We agree.

2.27 Do you agree that
(a) the extra protection should be effective unless the director or executors of his estate request that it be removed?
(b) the Secretary of State should have the power to remove the extra protection if the application is found to contain false or misleading information?
We agree with (a), but for (b) we think that exercise of the power should not be automatic. There should be a notification, and an appeal or re-application process, rather than the protection simply being automatically removed if the original application was false or misleading, to cover cases of simple error.

2.28 Do you agree that directors who are beneficiaries of confidentiality orders, at the point that COR 2002 is repealed, should be treated as having applied successfully for extra protection?
We agree (and as mentioned above we think this regime should be extended to company secretaries and to LLPs).

2.29 Do you agree that:
(a) whether companies are exempt from the requirement to supply addresses of all shareholders should depend on whether they are trade on EU regulated markets?
(b) companies that are traded on EU regulated markets should be required to provide addresses of shareholders who held 5 per cent or more of any class of shares at any time during the year in question.
We agree.

2.30 Do you agree that a director should be able to apply for addresses filed between 1 January 2003 and 1 October 2008 to be removed from the public record if the director has been granted extra protection?
We agree.

2.31 Do you agree that
(a) companies likely to be subject to violence or intimidation should be able to apply for the addresses of their shareholders filed with their Annual Returns since 1 January 2003 to be removed from the public?
(b) service addresses should not be required in substitution for addresses of shareholders removed from the public record.
We agree, although this should be rephrased to reflect the fact that it would be the individuals associated with a company (rather than the company itself) that would be subject to violence/intimidation.

2.32 Do you agree that there should not be any provision for the removal of a registered office from the public record?
We agree.

2.33 Do you agree that where a company is likely to be subject to violence or intimidation, a secured lender who has registered a company charge should be able to apply for its address to be removed from the public record?
We agree, although this should be rephrased to reflect the fact that it would be the individuals associated with a company (rather than the company itself) that would be subject to violence/intimidation.

2.34 Do you agree that the only restriction on a director's service address should be that it is a physical location?
We agree.

PART F - Control of political donations and expenditure (Q2.35)

2.35 Do you have any comments on the Government's proposed approach to the statutory instruments on political donations?
We are content with the proposed approach of

- retaining the existing requirements, while exempting companies that by the very nature of their business, will ordinarily prepare, publish and disseminate to the public material views or opinions relating to news and political affairs, such as any media or publishing related companies;
- rewriting the existing Order (The Companies (EU Political Expenditure) Exemption Order 2001 SI: 2001/445) in simpler language with no changes to the substance and to set the rate of interest payable by directors on the amount of any unauthorised donations or expenditure at 5% per annum, as this is consistent with the rate given elsewhere in the Act.

The consultation paper does not mention the Regulations to be made under section 416 of the 2006 Act, as to the matters to be disclosed in the directors' report, including provisions (such as disclosure of donations and expenditure) currently made by Schedule 7 to the 1985 Act. The disclosures that a company will be required to make for a financial year which straddles October 2007 will be affected by the fact that the definitions of donations and expenditure are extended by the 2006 Act to include donations and expenditure to independent candidates. The Regulations will need to take account of the changes being made to the requirements in Part XA of the 1985 Act. They should also contain transitional provisions to make it clear that where the disclosures are to be made for a financial year which straddles October 2007, for donations and expenditure made before October 2007 the definitions and provisions in the 1985 Act apply and for donations and expenditure made after October 2007 the definitions and provisions in the 2006 Act apply.

PART G - Accounting and reporting regulations (Q2.36- Q2.42)

2. 36 Do you agree with the proposal to set out a single set of regulations for small companies?
Yes.
If you agree with the proposal for a single set of accounting regulations for small companies, should it include the requirements for small companies that choose to prepare group accounts (the equivalent of Schedule 4A), or would it be easier for users if this was kept separate?
It would be preferable if the regulations for small company group accounts were self contained, either as a separate set of regulations or in a separate schedule (to a set of regulations for small company accounting generally), to avoid overcomplicating the regulations for small companies that do not opt to prepare group accounts. Otherwise, simplification for the many could be lost.

2. 37 Do you agree with the proposal to set out the requirements for other companies in a single set of regulations?
Yes, in principle we are content with the approach suggested in the consultative document i.e. that there should be a set of regulations for small companies, and another for all other companies, provided they are structured sensibly, with appropriate signposting for, eg, medium-sized company exemptions.

We also note that LLPs are becoming increasingly popular with smaller businesses, and suggest the DTI mirror their policy on the accounts regulations for LLPs, with separate regulations for smaller LLPs (see Part 5 below).

2. 38 Alternatively, would you prefer a different approach to setting out the regulations for either small or other categories of company? Please explain your alternative approach and your reasons for preferring it.
See 2.37 above.

2. 39 Do you agree that companies need to report more effectively on the way in which they take pay and employment conditions elsewhere in the group into account in deciding directors' remuneration? If so, how do you think this could be done?
No. We strongly disagree with the suggestion of a legislative provision upon companies to report more effectively on the way in which they take pay and employment conditions elsewhere in the group into account in deciding directors' remuneration. We would be very concerned about the dangers inherent in too prescriptive an approach in legislation, and we believe this should instead continue to be dealt with under the Combined Code. We also note that the consultation and Q2.39 are not restricted to quoted companies, and we should point out that (whilst we would not support the introduction of legislative requirements), if any are introduced as a result of this consultation they should be restricted to quoted companies (and not other companies).

2. 40 Do you agree that the benefits of requiring small companies to disclose turnover in their abbreviated accounts would outweigh any additional burden? Please explain your reasons.
We welcome the decision of the DTI to consult again on this issue, which raises a number of difficult issues.

We agree that the information value of small company abbreviated accounts is not substantial, and that in the absence of a full profit and loss account, the disclosure of a turnover number would in some circumstances be of considerable interest to users of abbreviated accounts. However, in principle we support on deregulatory grounds the UK taking full advantage of exemptions available to UK companies under EU legislation unless there are compelling reasons in the public interest not to do so. We are not convinced that such reasons exist in this case. *Per contra*, the change may expose some very small companies in particular to new and serious competitive pressures – a potential unintended consequence of changing existing UK law that has not, to our knowledge, been subject to any rigorous evaluation.

We conclude that the case for this change has not been made.

2. 41 Do you agree that the benefits of requiring medium sized companies to disclose turnover in their abbreviated accounts would outweigh any additional burden? Please explain your reasons.
The arguments for requiring medium-sized companies to disclose turnover in their abbreviated accounts are stronger.

Recent and proposed increases in the accounting thresholds mean that 'medium-sized' companies are now, in many cases, very substantial businesses, in respect of which users are likely to welcome the availability of unabridged financial information. The threshold increases mean that a substantial number of companies formerly classified as large now satisfy the criteria for medium-sized, and accordingly are no longer required to disclose turnover in the accounts placed on the public record. Furthermore, medium-sized companies are now required to disclose their principal financial KPIs in their Business Reviews, which are filed in full at Companies House. This introduces an element of consistency in the reporting requirements applicable to medium-sized companies, as those KPIs will in many cases involve the disclosure of turnover information.

We accept the case for this change.

2. 42 Do you agree with the proposal to retain the reporting requirements relating to employment of disabled persons and in respect of employee involvement in company matters of concern to them? Please explain your reasons. We do not strongly object to the retention of this requirement, although we note this disclosure is of limited practical use, and that the Annual Report and Accounts do not seem the logical place for information that is unlikely to be useful to shareholders.

PART H - Audit and statutory auditors (Q2.43)

General comments
See our comments above on the timing of implementation of the audit provisions, and on note the Government's proposal not to utilise the powers conferred on them by section 493. We note that report from the *Audit Quality Forum* led to the power being included, but we also note that the preferred route in that report was for a best practice solution in corporate governance guidance and that we are aware that the matter was considered in the review of the Combined Code. We assume, therefore, that the DTI has consulted the FRC Corporate Governance Committee in respect of this item.

Regarding paragraph 2.144, please note our comments on the disclosure of auditor remuneration in our response to the separate consultation on implementation of the Statutory Audit Directive.

2. 43 Do you agree

> **(a) with the approach set out to guidance relating to the new offences, and**
> **(b) that the principal terms of limited liability agreements should be set out in notes to accounts?**

We are content with the proposal in (a) above, but in relation to the offence guidance for prosecutors, we note the importance that this guidance is finalised before the offence is brought in, and that it is important that the guidance is developed in consultation with the accountancy profession (including the APB and AIDB), to avoid unintended consequences. We also draw attention to the concerns expressed in our Major Comments above.

Regarding the disclosure of principle terms of LLAs under (b) above, we endorse the need for transparency in respect of the terms of the agreement, but we note that some companies may prefer to include this disclosure with the statement in the directors' report on reappointment of the auditors, which in future could refer to renewal of the LLA together with the customary reappointment and authorisation for directors to set remuneration. We therefore believe that the option should be permitted to include the information required in the directors' report, and we therefore suggest the regulations should be drafted to permit this flexibility as to where the disclosure appears in the annual report by providing that the LLA disclosure can be either in the notes to the accounts or in the directors' report.

PART I - Share capital (Q2.44 – Q2.51)

2. 44 Do you agree that the information on rights attached to shares should be as in the current requirements with the addition of information relating to terms or conditions of redemption of redeemable shares? (See 2.152 – 2.157)
Given the frequency with which these statements of capital are required to be filed, we query whether it is necessary that they repeat detailed information on share rights that are set out (sometimes at considerable length) in the articles.

2. 45 Do you agree that there should not be a requirement for the names and addresses of the allottees in the return of allotments? (See 2.162, relating to limited companies)
Yes.

2. 46 Do you agree that the return of allotment should not contain the names and addresses of the allottees? (See 2.163, relating to unlimited companies)
Yes.

Additional comment on paragraphs 2.165-2.171
We do not agree with the statement in paragraph 2.167 that sections 583 and 727 are not intended to be an exhaustive list of the cases in which shares are to be treated as paid up in cash or cash consideration for the purposes of disposal of treasury shares. Section 583(3) (a) to (e) set out what is meant by cash consideration, and it is only sub-category (e) that is open in that it includes provision for "payment by any other means … giving rise to … entitlement to a payment … in cash". The same is true of s727(2).

2. 47 With regard to a payment out of capital by a private company for the redemption or purchase of its own shares do you think that it is necessary or desirable for the directors' statement to include any information beyond that required by the Act itself? (See 2.181 – 2.183)
No, this is not necessary. If the Directors wish to include further information, that should be up to them.

2. 48 Do you agree that the theoretical conversion of the company's share capital (or part of it) should be carried out by reference to an exchange rate prevailing on the dates specified above (i.e. the date that the court sanctions a reduction of capital under section 650; or the date that shares are forfeited, surrendered or acquired, as the case may be, under section 662 of the Act? (See 2.191)
Yes, we agree with the DTI's interpretation that it is only on those subsequent dates that share capital falls to be tested against the statutory minimum and thus exchange variations at other times are irrelevant to the statutory test. For reasons of practicality, it would be logical to refer to the closing mid-market rate on the preceding working day.

This statutory conversion rule is applicable only to this statutory test, whereas there is a need for clarity and certainty on the more general topic of capital maintenance as a whole, where foreign currency share capital is involved. That wider issue is not specific to the 2006 Act, but nevertheless needs to be addressed at some stage.

2. 49 Do you agree that exchange rate fluctuations are irrelevant to the of whether a company continues to satisfy the authorised minimum in circumstances other than where a public company is proposing to reduce its share capital or is required to cancel shares under section 662? (See 2.191)

Yes, we agree that exchange rate fluctuations are irrelevant to the question of the satisfaction of the authorised minimum other than where a public company is proposing to reduce its share capital or is required to cancel shares under Section 662, as we do not think that companies are required to continually monitor exchange rate fluctuations and the impact on their compliance with minimum capital requirements.

If a company does not meet the minimum requirements, it should have a grace period in order to (for example) allot additional shares as the fluctuations in the exchange rate will not be within its control.

Additional comment on paragraph 2.190

We think the statement in paragraph 2.190, that keeping this £50,000 minimum capital requirement is "commensurate with the benefits that flow from PLC status", could be seen as disingenuous, as the UK would arguably not have imposed any minimum capital requirement in the absence of EU requirements.

2. 50 Do you agree that where the court approves a reduction of capital, the court should be free to order that the reserve arising should be distributable under Part 23 or otherwise, to the extent the court thinks fit? (See 2.199 – 2.207)

We do not believe that this question is framed in the correct way to address the point at issue. It is the current practice of the courts to accept in some cases undertakings from the directors that a reserve will not be distributed until certain conditions are met, and in some other cases to impose restrictions on the circumstances in which the reserve can be distributed. However, the wording of question 2.50 implies that the courts will be expected to make an Order in each case about whether or not the reserve is distributable. This would be a significant change of practice. We do not believe that this was intended.

The underlying issue to be addressed is whether the regulations to be made under section 654(2) should provide that a reserve arising from a court approved capital reduction is a realised profit. The existing position under TECH 7/03 is that the reserve will be a realised profit "except to the extent that, and for as long as, the company has undertaken that it will not treat the reserve arising as a realised profit, or where the court has directed that it shall not be a realised profit.". The default position is therefore that the reserve is a realised profit subject to any conditions agreed by the company or imposed by the court. We suggest that the regulations to be made under section 654(2) should preserve this position rather than reverse it, and thus provide that a reserve arising from a court approved capital reduction is a realised profit except to the extent that (i) the company has undertaken that it will not treat the reserve arising as a realised profit or (ii) the court has directed that it shall not be a realised profit.

2. 51 Do you agree that the use of a solvency statement in the way we have outlined above is a reasonable way to determine whether the amounts in may be distributable? (See 2.199 – 2.207)

We understand from the DTI that paragraph 2.206 of the consultation is intended to say that solvency statement surpluses are realised, but that if the company has brought forward negative reserves, the realised solvency statement surplus must firstly be used to set off any such brought forward deficit, with the excess to be treated as distributable. We agree with this principle, but note that if the reduction credit were a realised profit then such set off would happen as a matter of law (under section 830) in any event, and so should not be dealt with in the regulations, which should simply state that the surplus is realised. We therefore suggest that the regulations to be made under section 654(2) provide that a reserve arising from a capital reduction supported by a solvency statement is a realised profit (except to the extent that the special resolution approving the reduction provides otherwise).

We support the principle that these surpluses should be considered to be realised. In our view, the formalities for conducting a capital reduction supported by a solvency statement are fairly onerous, as the solvency test requires that regard is had to all liabilities including prospective and contingent liabilities, and attracts a criminal penalty. Where the capital reduction takes the form of an immediate repayment of capital to the shareholders, there is no need to consider whether it is a realised profit or to have regard to any accumulated losses. It is therefore logical for a surplus arising on a capital reduction to be treated as a realised profit and credited to a reserve, either to eliminate an existing deficit or to be available for future distributions. We note that when in the future considering a distribution, the directors will still need to have regard to their duties to the company and, if solvency at that time is an issue, its creditors before deciding to approve or recommend a distribution of those reserves.

Additional comment on capital reductions

We query why unlimited companies are not mentioned in the consultation document As a matter of public policy, capital reduction surpluses for unlimited companies should be treated as realised because such companies have unlimited liability and therefore there is no issue of creditor protection.. We therefore believe that unlimited companies should not be scoped out of Section 654 (by order under s654(2)(a)), but that the regulations under s654 should instead expressly provide that capital reduction surpluses for unlimited companies are realised (except to the extent that any resolution approving the reduction provides otherwise).

We note, for completeness, that the restriction included in TECH 7/03, which requires the shares to have been issued for qualifying consideration, should <u>not</u> be carried forward in the regulations. This restriction reflected the legal framework before the 2006 Act, but is of no relevance today because the regulations to be issued would not be constrained.

Additional comment on the draft Regulations published on the DTI website

We note that the DTI have recently published draft Regulations on Shares, Share Capital and Authorised Minimum. Regulation 9 of these draft Regulations deals with the issues set out above.

We note that this draft Regulation would deal with the issue we raise above in relation to unlimited companies, except we note that reference to any restrictions in the special resolution effecting the reduction probably needs to be added. The draft regulation also appears to be in line with our suggestions under Q2.50 above for court approved reductions, except we note that reference to any undertaking given by the company that it will not distribute the surplus probably needs to be added.

However, we are confused by the wording relating to the solvency statement route, and we would like to meet with the DTI to discuss this further as we don't believe it achieves their policy objectives as described in our response to Q2.51 above.

We think it is important that these draft regulations are available for comment for a reasonable period before being finalised to ensure that all of these issues have been appropriately resolved.

PART J - Company charges

There are no specific questions in this section, but we had the following comment. We suggest that it would be simpler to wrap the specialist registers (except for the land registry) into the one companies house register, so that the companies house register contains details of all the charges (with the exception of land charges) rather than cross references to specialist registers. This approach would actually preclude the need for the additional specialist registers, and would remove double registration of charges.

PART K - Overseas companies (Q2.52 – Q2.57)

2.52 Do you agree that we should base overseas company registration on the existing concept of branch? If you believe that “branch” is not an appropriate test for all overseas companies, what would you propose instead (mindful that we must apply the branch test to Community companies)?

We agree that overseas company registration should be on the existing concept of a branch. The position under the 1985 Act, where there are two separate regimes, is very confusing and it important that this is simplified.

2.53 Should different registration arrangements apply to third country companies who carry on business here? If so, what should be disclosed?

We do not believe that different registration requirements should apply to third country companies that carry on business in the UK. They should be subject to the same regime as EU companies to avoid the complexities of the current legislation.

We will not be commenting on **Q2.54-Q2.57.**

PART L - The Registrar of Companies (Q2.58 – Q2.63)

2. 58 Do you agree that the annotations should extend to confusing and misleading material?
We fully endorse the suggestion that the Registrar should have powers of annotation and suggest that these should extend to where a document has been filed obviously incorrectly and an amending document is received.

2. 59 Do you agree with the overall proposals under rectification of the register?
We agree.

2. 60 Do you agree that 30 days is a reasonable period to make any objections to rectification to lodged?
Yes.

2. 61 What documents should be accepted in a foreign language?
We believe that all documents should be permitted to be filed at Companies House in a foreign language provided they are accompanied by a certified English translation.

2. 62 Should we exercise the power to require translation of documents delivered under other enactments and, if so, to what extent?
See 2.61 above.

2. 63 Do you agree that we should not make provision at the present time for an alternative to the Gazette?
We should like the information to be on a web site, although we acknowledge the need for formal consultation before changes are made.

PART M - Company records (Q2.64 – Q.67)

2. 64 Do you agree that every company should be able to have somewhere other than its registered offices for public inspection of records for which there is a statutory public right of inspection of its statutory records?
If so, do you also agree that every company should be required to provide details of the place other than its Registered Office where it enables inspection of any of its records for which there is a statutory right of inspection and also to provide details of which records can be inspected at that place:

> **(a) in its Annual Return;**
> **(b) in its annual report and accounts;**
> **(c) on its website, if any; and**
> **(d) immediately, to anyone who asks for this information?**

We agree that companies should be able to have somewhere other than its registered offices for public inspection of records. However, we note that the majority of listed companies will have their register of members at their registrars (and will want inspection of this register to be handled by registrars at that location). It would seem unreasonable to effectively require such public companies to outsource to registrars the holding of all other records for which there is a statutory public right of inspection. There is of course a need to balance the convenience of the company against the convenience of those wishing to inspect the records, but on balance we think it would be reasonable for companies to be able to nominate <u>one</u> of their own offices (registered office or other) for access to these other statutory records.

For the ease of the company, inspection should take place where the statutory books are held. For the ease of the server, the address should be notified to Companies House in the manner currently used for the register of members under the 1985 Act s353(2); ie, it would be excessive to require regular, multiple notices as proposed in (a) to (d) above.

2. 65 Do you agree that

> **(a) the existing requirement should be retained to make records available for inspection for not less than 2 hours during period between 9am and 5pm on each business day for all companies with an exemption for private companies.**
> **(b) the requirement for private companies should be that:**
>
> > **(i) during the notice period for a general meeting and immediately following the circulation of a special resolution by the company, for at least two hours between 9 and 5pm on every business day; and**
> > **(ii) during all other periods, for at least two hours on a business day notified to a person seeking to exercise inspection rights where the notice must be given within 10 working days of receiving the request and the notified day must be within 20 days of that receipt.**

We are strongly of the view that all companies should use the private company system, ie that access should be by appointment. We note that numerous PLCs have their registered offices with company secretarial providers, and many have no other office in the UK. There are also PLCs where the registered office is at the home of the MD who might frequently be away on business. We think it is reasonable for appointments to be required to be made, rather than having a requirement for records to be available for inspection for at least two hours of every day. We should add that we think the current inspection regime for the register of members is very onerous. We think the notified day should be within 20 working days, and that weekends should be excluded for all purposes.

2. 66 A company should not be required to enable inspection by more than one person at a time?

If all companies can use an appointment system then the problem of more than one inspection at a time is less likely to arise (ie see out answer to 2.65 above). Nevertheless, we think that this limitation should be included. Even if the statutory books are held on computers the inspection can be disruptive.

2. 67 Those exercising their statutory right to inspect a company's record should be free to copy the record while the company should not be under any obligation to facilitate such copying?

We agree.

Chapter 3 – Model Articles of Association

General comments

We note that current Tables A-F deal with unlimited companies, which we think is useful in practice and we therefore think that model articles should be developed also to apply to unlimited companies.

3.1 Do you have any specific drafting comments on any of the model articles?

Comments on Model Articles for private companies limited by shares

<u>Article 8(3)</u>
Consideration should be given as to whether this might open up the possibility of non-consultation of cautious directors (this also applies to Article 8(3) for private companies limited by guarantee).

<u>Article 20</u>
This is only a question of language, but we wonder whether "issue" is the correct term. What we presume should be addressed is the entering into of commitments by the company, ie the "allotment" of shares – although we acknowledge that the typical reader perhaps does not appreciate the distinction. A number of other articles in this and the other models could be subject to the same query.

<u>Article 28</u>
This does not provide clarity as between what are customarily called interim and final dividends, which currently differ regarding their formalities and when they become a debt on the company. (However, we concur that the terms "interim" and final" are perhaps best left unused – not least to avoid any suggestion that the interim dividends might be what is referred to in article 15(2)(a) of the Second Directive.) We think it should differentiate, and make clear the formalities for each procedure for dividends; otherwise there will be uncertainty. At present Table A provides that a dividend may be paid on the authority of the directors (and under case law this does not become a debt until paid); and that a dividend may be declared by the members (with the effect that under case law it becomes a debt on the date of declaration).

This article, on the other hand, uses the term "declare and pay" in relation to directors and "pay" in relation to members. It then goes on to state that the members may resolve to pay "such" dividends, which would appear to be a reference back to the directors' decision to declare and pay. Does this mean that all directors' decisions are subject to members' approval? Overall, we find the situation to be unclear.

<u>Article 32</u>
Article 32 contemplates transfers of non-cash assets, with bonus issues being mentioned at paragraph 3.136. However, it is difficult to view own, unallotted shares as assets (this also applies to Article 76, PLCs).

We also find article 32 not easy to follow and thus it does not achieve a "plain English" standard, ie, readers may not immediately grasp that "shares … in any company" covers bonus issues.

Comments on Model Articles for private companies limited by shares

Article 8(3)
Consideration should be given as to whether this might open up the possibility of non-consultation of cautious directors (this also applies to Article 8(3) for private companies limited by shares).

Comments on Model Articles for PLCs

We note the articles relating to directors' powers and responsibilities, decision-making and appointment are sensibly constructed and take into account the increasingly international nature of business. For example, we welcome the omission of the reference for it not to be necessary to give notice of a meeting to a director who is absent from the UK (previously included in Article 88 of Table A). UK PLC board membership is increasingly comprised of foreign directors and technological advances can now facilitate efficient meetings regardless of where the director is based.

Article 20
We support the change related to directors' reappointments to treat directors as individuals rather than rely on a specified proportion (i.e. moving away from the current overcomplicated provisions in Articles 73 and 74 of Table A that one third be reappointed each year). This allows for greater accountability in corporate governance, although we also recognise that directors can ultimately be removed by special resolution at an EGM by shareholders at any time.

Articles 62 & 71
These deal with advanced payments on shares prior to calling up of amounts unpaid. Section 547 of the Act re-enacts the equivalent section in the 1985 Act and provides that such amounts count as called up share capital. However, Articles 62 and 71 purport to provide that dividends cannot be paid on such shares but that interest may be paid. This appears to open up the possibility of a company's issuing shares with payment made and then to make returns on that payment outwith the distribution rules (unless the article 62 interest is meant to be counted as a distribution (other than a dividend) and be controlled by Part 23). We would like to request clarification of the DTI's policy behind this.

Article 70(4)
It is unclear which of "pay" and "declare" relate to which of the members and the directors' resolutions.

Article 76
This contemplates transfers of non-cash assets, with bonus issues being mentioned at paragraph 3.136. However, it is difficult to view own, unissued shares as assets (this also applies to Article 32, private companies limited by shares).

Article 76(3)(a) refers to the directors' fixing the value in the case of every distribution-in-specie whereas the old Table A required this only in the case of difficulties. There is a concern that this may be mis-read as an invitation to fix an arbitrary or convenient value, whereas the value of a distribution-in-specie is a matter of fact as to the actual value of the asset in question (subject to the rule in s845) and all the directors' can do is to make a good faith judgment as to what that is.

Articles 79-81
We think these articles should be published as optional (rather than default) articles, as the extension of other rights (beyond the statutory information rights) should be considered carefully by companies on a case by case basis.

Articles 82-84
It would be useful if the DTI could publish an optional article that covers the point in paragraph 10(2)(b) Schedule 5 (article provision to enable the 28-day notice for individual member's agreement to website communication).

3.2 Do you have any comments in particular on articles 79 to 81 of the model articles for public companies? (These articles supplement Part 9 of the 2006 Act which acquired its final shape at a relatively late stage in its passage through Parliament and we would welcome any comments.)
We note that not all of the shareholders rights can be delegated by way of a nomination notice; for example, section 145 (4) precludes delegation of the right to enforcement action against the company. We believe Article 79 should make this clear.

Chapter 4 – Transitional issues for existing companies

4. 1 Do you think that it is acceptable to reduce the right to claim in connection with a shortcoming in the register from 20 to 10 years immediately on commencement, so that companies can safely dispose of old records straight away? (See 4.18)
Yes.

4. 2 Do you believe that any transitional provisions are required in relation to acts done by a company secretary after a private company has decided not to have a secretary? (See 4.19)
We do not think that any transitional arrangements are necessary. There are no such arrangements in respect of acts carried out by directors after they have been removed from office but have yet to be removed from the public register and we see no reason why such provisions should be necessary in respect of company secretaries.

4. 3 Do you think that there should be a grace period for existing company boards that do not contain a natural person?
Yes, we believe there should be a grace period. This new requirement could affect the residency and structuring of some companies or groups. Residency considerations and tax issues can have long term consequences and some groups may need to unwind existing arrangements over a fairly lengthy period of time. There should, therefore, be a reasonable transitional period to preserve existing legitimate expectations and avoid disrupting existing business structures. Given the possible long terms consequences brought about by this change, we recommend a five year transitional period, which should provide sufficient time for this change to be managed by those who are affected..

We also note that formation agents may benefit from a grace period, to enable them to use up their existing ‘stock’ of on the shelf companies that do not have natural persons as directors.

4. 4 Do you think there should be a transitional provision for political donations to independent election candidates?
Yes, we think there should be transitional provisions for political donations to independent election candidates. We suggest that the transitional provision should apply to any existing companies as at 1 October 2007 and be for a one year period i.e. until 1 October 2008. This would give companies time to hold an AGM at which the relevant resolution can be passed.

4. 5 Do you have any other views on what provisions might have effects on existing bargains or rights such that a transitional would be justified? (See 4.22)
Provisions may be required to clarify whether certain capital reductions and permissible capital payments (“PCPs”) fall to be governed by the 1985 or 2006 Act. In order to determine which regime is the appropriate one, the trigger event that must fall before or after commencement date could be, for example, the board resolution (possibly too early and too easily withdrawn), the notice of meeting/resolution circulated to shareholders, or the court hearing (possibly too late in the process).
We note that, following the DTI’s previous consultation on transitional issues, transitional arrangements are to be made to provide that subsisting authorities under Section 80 (authorisations for issuing shares) continue to have legal effect. Unless this would be automatic under the section 1297 ‘continuity of law’ provisions, we think that transitional provisions should also preserve existing authorities for dis-application

of pre-emption rights. Similarly, the transitional provisions should provide that own share purchasing authorities existing on Commencement Date are carried forward so as to be valid under the 2006 Act. If these authorities are covered by the continuity of law provisions, this should be made clear in the explanatory material in the relevant commencement orders.

Once Part 15 is commenced in April 2008, the 'relevant accounts' required to support distributions (which will still be made under the 85 Act) must include accounts drawn up under the 2006 Act (even though the 2006 Act distributions provisions will not be enacted until October 2008). If section 1297 does not provide for this then a transitional provision may be required.

We note that audits are an ongoing processes culminating in an audit opinion, and so a 'saving' may be needed in respect of any provisions that relate to an audit or audit report that are brought in from commencement date (as opposed to in respect of accounting periods commencing on or after the commencement date). See also our General Comments above regarding how the audit provisions should be implemented.

4. 6 Do you have any comments on the text of the draft saving on financial assistance? (See 4.23 to 4.25)
No.

4. 7 Do you have any comments on the passage on the financial assistance saving for the explanatory memorandum? See 4.23 to 4.25
We think the proposal in the consultation document is not clear, and we therefore believe strongly that the wording in the explanatory memorandum should be clarified to avoid widespread confusion. If the explanatory memorandum does not clearly set out the position as to which transactions will continue to be prohibited, and those that will no longer be prohibited, then the costs associated with the old financial assistance regime are likely to be retained, with directors and banks continuing to seek 'whitewash' comfort from audit firms, thus negating the benefit of the abolition.

In particular, we think that readers may believe that the explanatory memorandum is saying that the rule in *Trevor v Whitworth* can never be relevant to something which would have been prohibited by Section 151 once Section 151 has been abolished. We support the proposal put forward by the Law Society, that it would be helpful to add the following at the end of (6):

"*However, the rule in Trevor v Whitworth is wider than the prohibition contained in section 151 and therefore may still, in some cases, be relevant to a transaction which would also previously have been prohibited by section 151. An example is where a company which has no (or insufficient) distributable reserves makes a gift of money to a shareholder with which to purchase further shares in the company. This transaction would still be prohibited, notwithstanding the repeal of section 151, because it would result in an unlawful reduction of capital by the company. Similarly, if a company with no (or insufficient) distributable reserves made a loan to a shareholder with a view to the shareholder purchasing further shares in the company and the company was aware when the loan was made that there was no reasonable prospect of the borrower being able to repay it, so that the company would be required to make an immediate provision in respect of the loan, this would similarly continue to be prohibited because it would give rise to an unlawful reduction of capital.*"

In addition, we also think that a more positive example should be included in the explanatory memorandum, clarifying that where a loan is recoverable, it is no longer unlawful, nor prohibited.

4. 8 Do you think we should make transitional provisions in relation to derivative claims?
Yes, we believe there should be transitional provisions for derivative claims, such that any claims brought after Commencement day but where all the events giving rise to the cause of action took place prior to Commencement day (and there are no continuing issues) should continue to be dealt with under the old, common law rules.

4. 9 Views are invited on whether it would be helpful to make transitional provision in relation to private contracts for references to extraordinary resolutions or authorised share capital or other matters, or whether such matters should be left to the courts. See 4.29 to 4.32
We see no reason why issues that have been identified prior to commencement should not be dealt with by transitional provisions (rather than being left to the courts).

Chapter 5 – Limited Liability Partnerships

General comments

This consultation highlights a general problem with LLP legislation, which is very difficult to read/use as it is so heavily cross-referenced to companies legislation, and this difficulty was pointed out at the time LLPA 2000 was going through Parliament. The Government's answer was that it was unavoidable in the light of the desire to avoid needing to amend primary legislation to mirror any subsequent changes in CA85. We accept the need for this cross-referenced structure, so that changes to companies legislation could flow through to LLPs, but we note this hasn't happened in practice. For instance, the Government are consulting on whether to simply retain the references to the 1985 Act (as mentioned below, we would not support this), which would prevent changes flowing through to LLPs; and we also note that the 2004 changes to the investigations provisions have yet to be applied to LLPs. From a user's point of view, it is important that LLP law is accessible and therefore it is important that consolidated text is available when the 2006 Act becomes Applicable to LLPs. Therefore, it is important that such consolidated text is produced and, if no commercial publisher has issues such text then the DTI should publish a consolidated text. [mention smaller -

We also note that LLPs are becoming increasingly popular with smaller businesses, e.g. medical practitioners, smaller firms of lawyers, small investment businesses and even farms are increasingly adopting this legal form. We therefore think the DTI should mirror their policy on the accounts regulations for LLPs (see Q2.37 in Chapter 2 Part G above), with separate regulations for smaller LLPs. As with the legislation, it is also then important for consolidated text of the accounts regulations for LLPs to be made available.

We also draw attention to our suggestions in Part E above that the protected information regime at Companies house be extended to the members of LLPs.

We note that the DTI is not currently consulting on the regulation of overseas LLPs, and we would support the comments made by the law society on this. At present overseas LLPs are regulated by section 693 of the 1985 Act as applied to LLPs by Schedule 2 to the Limited Liability Partnership Regulations 2001. However they are not covered by the other requirements of Part XXIII of the 1985 Act which apply to overseas companies. Hence the level playing field which applies as between UK companies and overseas companies with a UK establishment does not apply as between UK LLPs and overseas LLPs with a UK establishment. This seems anomalous.

5.1 Which approach do you prefer – Apply the 2006 Act for LLPs only as far as necessary or apply the changes made to company law under the 2006 Act as far as possible? Please explain your reasons.

We believe that, so far as necessary, cross references in the LLP legislation should be updated to refer to the relevant 2006 provisions, to avoid effectively 'grandfathering' the 1985 Act. However, where the wording of the relevant company law provisions has changed, or where provisions have been introduced or subject to fundamental reform, careful consideration should be given to whether any such changes should also apply to LLPs, to avoid unintended consequences as LLPs are different entities and thus company law provisions may not be appropriate. We therefore believe this should be the subject of a separate detailed consultation.

5.2 Are there specific changes to the provisions for companies under the 2006 Act which you believe either should or should not be extended to the law on LLPs? Please explain your reasons.

Where the 2006 Act introduces substantively new provisions in relation to companies, these should only be extended to LLPs where this can be justified in the light of the different nature and structure of LLPs as compared with companies. We strongly believe that some of the more fundamental reforms made in the 2006 Act should not be applied to LLPs. For example, it would not be appropriate for the provisions on directors' duties to apply to the designated members of LLPs. Designated members have mainly administrative (rather than managerial) responsibilities. LLP members are currently subject to an agent's fiduciary duties, but are able to contract out of them, and it is not appropriate for duties to be mandated on them by legislation; the LLPA 2000 international gives freedom to the LLP and its members to make whatever governance and managerial arrangements they wish.

5.3 Do you agree with the proposal to implement the 2006 Act for LLPs in October 2008? Please explain your reasons. Do you agree with the proposal to implement the changes in the filing date and the late filing penalties regime at the same time as for companies? (You will need to refer to the separate consultation by Companies House on the proposed changes to the late filing penalties regime.) Please explain your reasons.

We think it is appropriate for the remainder of the Act to be brought in for LLPs from October 2008. We note that LLPs will need as much time as possible to assess the impact of any changes and to make any necessary consequential changes to their members' agreements. However we accept that it would be unsatisfactory to delay extending the 2006 Act to LLPs beyond October 2008.

5.4 Do you agree with the proposal to implement the changes in the filing date and the late filing penalties regime at the same time as for companies? (You will need to refer to the separate consultation by Companies House on the proposed changes to the late filing penalties regime.) Please explain your reasons.

We note there are often small groups containing both an LLP and a company (e.g. a small legal practice with a company as its investment business subsidiary, or a small estate agency/surveyor LLP with a company as its mortgage advice subsidiary). We therefore agree with the proposal to implement the changes in the filing date and the late filing penalties regime at the same time as for companies, as one set of deadlines will be much more straightforward to work within both for these smaller "mixed" company and LLP groups, and for the auditors/tax advisors thereof. We also note the Companies House consultation on the late filing penalties regime has not yet been issued.

5.5 Do you believe it would cause difficulties for you if the rest of Parts 15 and 16 of the 2006 Act were not applied to LLPs at the same time as companies? Please explain your reasons.

Making changes from the 1985 Act to the 2006 Act at different times for LLPs in terms of reporting format/content would be very unhelpful for the smaller "mixed" company and LLP groups mentioned at Q5.4 above, and for their auditors/tax advisors. We therefore believe that those sections of Parts 15 and 16 that restate provisions already applicable to LLPs should be implemented at the same time for LLPs as for companies.

As we mention above, where there are substantive changes or new provisions in Parts 15 and 16, unless they are required to be applicable to LLPs under EU law, the extent to which these new provisions or changes should be applied to LLPs should be the subject of a separate detailed consultation.

Question 5. 6 Do you see any reason why the amendments to the 1985 Act made by sections 21 to 24 of, and Part 3 of Schedule 2 to CAICE should not be applied to LLPs? Please explain your reasons.

We see no reason why the amendments to the 1985 Act made by sections 21 to 24 of and Schedule 2 to the Companies (Audit, Investigations and Community Enterprise) Act 2004 should not be applied to LLPs.

Chapter 6 – The European Picture – Meeting our Community Obligations

Question 6.1 Do you agree that no further action should be taken to implement the Directive amending the Second Company Law Directive? If not, which elements of the Directive do you consider should be implemented and why?
We believe that, as a general principle, the UK should implement the maximum relaxation and flexibility afforded by EU legislation. However, in some cases, this should be balanced by the need to avoid unnecessary complication of the regime; for instance, the non-cash assets option may be too obscure and complex to be thought worthwhile. We also note that this potential new ability for PLCs to provide financial assistance may give rise to an issue of double counting for distributable profits purposes. We would like to continue to work with the DTI to try to resolve this issue. However, if it cannot be resolved then we note this double counting would make this procedure even less likely to be utilised by companies, making it less likely that the additional flexibility would justify the additional complexity.

We think that the 10% limit of qualifying shares that a company should be permitted to hold in treasury should be removed, subject to there being at least one remaining non-treasury share as a question of law. This is because the position of shareholders is protected as a shareholder resolution is required, and the capital maintenance rules protect creditors. We also note that any market to which the shares are admitted can set such tighter limits as it thinks fit for this purpose.

With regard to the safeguards for creditors in the case of a reduction of capital, it would be helpful for the law to state expressly that a creditor must be able to demonstrate that the satisfaction of its claim would be put at risk by the reduction in order to able to object to the reduction. The Directive shifts the burden onto the creditor to show this. This is not the current position under English law. We do not think that the fact that there is an EU study on the Second Company Law Directive is a good reason not to implement this aspect of the Directive now.

General comment
We also note that the Second Directive is only applicable to public companies, and that the UK has currently gold plated the EU requirements by applying the capital maintenance regime to private companies. The Act would have been an ideal opportunity to rectify this, but instead included a reform power (to enable subsequent change by secondary legislation), which was then lost at the eleventh hour when the Bill was before Parliament.

We note the DTI has nevertheless agreed to continue to review the position for private companies and is still open to comments on this. We therefore continue to strongly urge the DTI to consider introducing a solvency-based regime for private companies.

The current regime imposes limits on company distributions by reference to the historical amounts contributed by investors. These rules can fail to achieve the objective of protecting creditors, impose unwarranted burdens on business and impede the development of financial reporting. We believe a solvency-based regime, under which distributions would be determined by reference to the effect of distributions on company solvency and the need to preserve the company as a going concern, would be simpler and more cost effective, whilst also protecting creditors and allowing investors appropriate returns.

We also hope the DTI will continue to encourage the EU to further accelerate its timetable for a review of the feasibility of an optional alternative regime for public companies based on solvency requirements with a view to amending the Second Directive.

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