

Summary

The prohibition on private companies providing financial assistance for the purchase of their own shares or shares in their private holding company was repealed as of 1 October 2008. This is one of the most important changes brought into effect so far by the Companies Act 2006 ("**2006 Act**").

Although the prohibition has been lifted, financial assistance still requires careful consideration. This update provides a brief summary of some of the matters a director of a private company should consider when the company proposes to provide financial assistance.

What is Financial Assistance?

Financial assistance is given where a company assists a third party in acquiring shares in that company or its holding company. Financial assistance may appear in a number of different forms, including gifts, guarantees, loans, or other types of assistance which would have the effect of reducing the company's net assets to a material extent.

As an example, one of the most common forms of financial assistance is the giving of security or a guarantee by a company in respect of loans taken out by a purchaser to acquire shares in that company or its parent.

Prohibition of Financial Assistance

Until 1 October 2008, the Companies Act 1985 generally prohibited the provision of financial assistance by all companies. There was, however, a procedure (called the "**Whitewash Procedure**") which private companies could use to provide financial assistance for purchasers of shares in such companies or in their private holding companies.

Under the Whitewash Procedure, all of the directors of the company were required to swear a statutory declaration in respect of the company's solvency and an auditor's report was required to support the directors' declaration. As a result of its complexity, some smaller companies found the Whitewash Procedure prohibitively costly.

Repeal of the Prohibition

As of 1 October 2008, the 2006 Act has repealed the prohibition that a private company may not provide financial assistance in respect of the acquisition of shares in itself or its private holding company. The repeal does not apply in relation to financial assistance for the acquisition of shares in public companies, which remains prohibited (including where the assistance is being provided by a private subsidiary).

While the intention of the repeal was to simplify corporate governance for private companies and make transactions involving financial assistance simpler and cheaper, the legal position remains complicated. Furthermore, given that the repeal has only been effective since 1 October 2008, the approach taken by companies, their shareholders and lenders is yet to be established and there is as yet little guidance from case law.

Below is a brief summary of some of the matters directors should consider when proposing to give financial assistance.

Issues for directors to consider

- a. Directors should check the company's constitutional and banking documentation for any prohibitions on giving financial assistance.

update

meeting legal
challenges
with solutions

- b. Directors should consider their duties as directors, including satisfaction that the transaction is likely to promote the success of the company for the benefit of its members as a whole. It is advisable for board minutes to document the directors' consideration of their duties. The directors' duties need to be considered from the individual company's perspective and not the group's perspective.
- c. It is generally advisable for directors to seek shareholder approval of the financial assistance and many lenders are requiring such approval. Shareholder approval can help reduce or eliminate the risk of a future shareholder challenge against the directors for breach of their duties.
- d. Directors should satisfy themselves that the solvency of the company will not be detrimentally affected as a result of the provision of the financial assistance. For example, directors may wish to seek confirmation of this from the company's auditors who will review the company's management accounts and forecasts.
- e. Directors should consider (and document such consideration in the form of board minutes) the net asset position of the company and whether the granting of the financial assistance will unlawfully reduce the company's capital. Examples of unlawful reductions of capital would be the gifting of money to a shareholder to fund a share purchase, other than by way of dividend, or the giving of a loan to a third party purchaser which has no reasonable prospect of being repaid.
- f. Directors should obtain professional advice on the legal and financial aspects of the transaction.

Furthermore, directors should be aware that a breach of their duties as directors or a breach of company law resulting from the financial assistance (albeit that financial assistance is itself no longer prohibited) may leave the transaction open to challenge by shareholders or creditors and could result in the directors themselves being at risk of criminal penalties, personal liability and/or disqualification as directors. Accordingly, it is advisable for directors to approach financial assistance with caution and to obtain professional advice before providing such assistance.

Further Information

For further information on the other reforms brought into effect as of 1 October 2008 please consult our update at www.mundays.co.uk/docs/updates.htm.

To find out about how these and other Companies Act 2006 reforms affect your business, or to obtain legal assistance, please contact your usual contact in the Corporate team at Mundays or alternatively call 01932 590500. Contact details of some of the lawyers in our team appear below:

Mark Andrew, partner - 01932 590575 mark.andrew@mundays.co.uk
 Neale Andrews, partner - 01932 590617 neale.andrews@mundays.co.uk
 Richard Powell, consultant - 01932 590569 richard.powell@mundays.co.uk
 Phil Walton, partner - 01932 590572 philip.walton@mundays.co.uk
 Alex Young, solicitor - 01932 590635 alexander.young@mundays.co.uk
 Nick Atkins, solicitor - 01932 590543 nicholas.atkins@mundays.co.uk

Mundays LLP
 Cedar House
 78 Portsmouth Road
 Cobham
 Surrey KT11 1AN

DX 36300 Esher
 tel +44 (0) 1932 590500
 fax +44 (0) 1932 590220
 email enq@mundays.co.uk
 web www.mundays.co.uk

For more information please contact

your usual contact in the Corporate team or one of the above.

This document is for general information only, it does not intend to provide legal advice. Mundays accepts no responsibility for loss which may occur from reliance on information contained in this document.