



The Companies Act 2006: the changes to political donations

The rules on UK companies making political donations and incurring political expenditure are due to change on 1 October 2007 when relevant provisions of the Companies Act 2006 come into force. This note explains how and why. It was first issued in May 2007 but has now been updated to reflect implementation of the final law.

What is the current political donations regime?

The Companies Act 1985 controls donations by companies incorporated in the UK and their subsidiaries to any EU political organisation and also EU political expenditure.

Broadly, a company may only make restricted political donations or incur restricted political expenditure if it has been authorised in advance by a shareholders' resolution. If it is a subsidiary, resolutions of its holding company and any intermediate holding companies are also needed. There are detailed requirements for the form and content of the resolutions. A breach of the legislation can be enforced by proceedings brought by the company and also by an authorised group of shareholders. There are disclosure requirements once restricted political donations or expenditure have been made or incurred.

The scope of the current legislation is wide. Potentially, it could cover donations to bodies which do not fall within the everyday meaning of a political party and other activities which companies would not normally classify as political expenditure. This has led to many companies seeking protective qualifying shareholder resolutions annually not with the intention of making political donations but to avoid technical breaches.

While using different language, the new rules replicate much of the existing system. They offer greater flexibility in the passing of approval resolutions but do not shed significant new light on the meaning of political donations or expenditure.

Authorising resolution still required

Members must still approve restricted political donations or expenditure. The Government rejected a suggestion that directors should be able to approve political donations as the rules are designed to avoid conflicts of interest at board level.

Written resolutions expressly permitted

The current rules say approval resolutions have to be passed in a general meeting. This casts doubt on the ability of companies to use written resolutions for this purpose. The new rules make it clear that written resolutions are permitted for private companies.

Resolutions for subsidiaries

Under the new system, restricted donations and expenditure by a subsidiary will have to be approved by its members and its ultimate holding company. Intermediate holding companies will no longer be involved. If the company's ultimate parent is foreign, the UK registered holding company highest up in the corporate chain will have to pass an approval resolution instead. Finally, a wholly owned subsidiary will not itself need to pass an approval resolution although its ultimate UK holding company must still do so.

Composite resolutions permitted

Perhaps the most significant change is that a holding company will be able to pass one composite resolution covering restricted donations and expenditure by itself and its subsidiaries. The resolution can either cite specific subsidiaries or all subsidiaries from time to time during the life of the resolution or just those in existence at the date of the resolution.

Aggregation

Companies will be able to seek separate approval resolutions for political donations on the one hand and political expenditure on the other or, as now, to deal with both heads in one resolution. However, resolutions will have to specify a separate total for one or more of the following (a) donations to political parties and independent election candidates, (b) donations to political organisations other than political parties and/or (c) political expenditure. Where the resolution covers more than one company it will have to specify an aggregate sum (under each head covered by the resolution) for all the companies together.

Non-GB subsidiary undertakings

Under the existing regime, a parent of a subsidiary undertaking established outside Great Britain must take reasonable steps to secure that the undertaking in question does not make or incur any restricted political donations or expenditure except as authorised by the parent company. A subsidiary undertaking includes a body corporate, partnership or certain unincorporated associations. Under the new regime, there are no separate obligations for parents of non-GB registered subsidiary undertakings.

Which political donations and expenditure are covered?

The categories of restricted political donations and expenditure will not change significantly. They will still be drawn from the Political Parties, Elections and Referendums Act 2000 although loans made on non-commercial terms will be capable of amounting to political donations despite no longer qualifying as such under that Act.

Independent election candidates

Under the new rules, the definitions of political donation and political expenditure will include donations to and expenditure in relation to independent election candidates but only with effect from 1 October 2008.

Trade unions excluded

There will be an exemption for donations made to trade unions (including non-UK trade unions) unless a donation is made to a trade union's political fund. There will also be an exemption for political expenditure incurred in relation to unions. So, for example, companies will not require prior authorisation for providing meeting rooms for trade union use but would require authorisation if they wanted to donate to a union's political fund.

Similarly, no prior authorisation will be required for allowing employees paid leave for engaging in union activities unless doing so amounts to a donation to the union's political fund, for example, because the activities in question would otherwise have to be paid for out of that fund.

Local councillors

At one stage, the Government said it would provide a new exemption for granting paid leave to employees who are local councillors. This exemption was not adopted because paid leave for an elected local councillor does not amount to a political donation in the first place if it relates only to public duties performed as a local councillor. The position would be different if the paid leave was intended to permit the councillor in question to campaign for re-election.

Directors' liability

Under the current rules, if illegal political donations or expenditure occur, the directors are personally liable to reimburse the company for the amount of the donation or expenditure in question and to pay damages for any associated losses. This must be formally approved by shareholders before directors can be absolved from any further responsibility.

Under the new regime, both the directors of the company and, if it is a subsidiary, the directors of its ultimate UK registered holding company will be liable. Concerns have been raised that holding company directors will be liable for decisions made by the boards of subsidiaries which, from a legal point of view, they cannot control. The Government says this is the trade off for streamlining the holding company approval mechanisms. It points out that this is not a case of strict liability as holding company directors will only be liable for illegal payments by subsidiaries if they fail to take all reasonable steps to prevent them. This will include putting in place checks and balances to ensure holding company directors are aware of political donations and expenditure by subsidiaries. Ultimately, the Government says if there is any doubt the remedy is to have all the necessary approvals in place.

Finally, under the new regime, shareholders will be able to ratify unlawful payments after the event. Directors will also have the opportunity to seek statutory relief from liability where they have acted honestly and reasonably. The Government says shareholders will be able to employ the new provisions to ratify breaches of both the new and existing law.

Disclosure

The threshold for disclosing political donations or expenditure once they have been made will be raised from £200 to £2000 and disclosure will also have to cover donations to independent election candidates in each case for financial years commencing on or after 6 April 2008.

Practical implications

The new rules will continue to apply the wide definitions of political donations and expenditure. The Government has promised to consider further with the Electoral Commission whether additional guidance might be provided for companies on the definition of political donation. Even so, the widespread practice of seeking protective approvals from shareholders for the making of otherwise prohibited political donations and expenditure is likely to continue.

Groups which have been seeking protective approval on an annual basis for selected subsidiaries will no doubt use the composite resolution approach under the new law. It will be interesting to see whether they continue to name individual subsidiaries or instead seek protective approvals for the whole group. Even groups which have not so far sought protective resolutions at subsidiary level may be encouraged to do so using the composite resolution approach.

The new rules generally relax the current regime. So, when the new law is in force, companies will be able to rely on approval resolutions granted under the old law before the commencement date. However, those authorities will relate to the slightly narrower definition of political donation which does not cover independent election candidates. So, companies which want to make donations to independent election candidates on or after 1 October 2008 will need to table an approval resolution at the 2008 annual general meeting under the new law unless they have already anticipated the new regime in this year's approval resolution.

- **If you have any questions or require specific advice on any matter discussed in this publication, please contact Annabel Evans (DDI: +44 (0)20 7782 8858 or E-mail: aevans@mayerbrown.com or your regular contact at Mayer Brown.**

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