**RESEARCH PAPER 06/30**
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# The *Company Law Reform Bill [HL]*

## Bill 190 2005-2006

The bill covers a very wide range of company law issues. It started in the Lords, where there have been over 1,400 amendments in Committee and nearly 500 on Report. It is not a consolidation measure, although some statutes are repealed as a consequence.

Its main innovations include a codification of directors' duties; measures to allow companies to limit the liability of their auditors; new reporting requirements, an enhanced Business Review; new criminal offences and protections for directors and auditors; and new opportunities for companies to make use of electronic methods of communication

This Paper describes the long consultation period up until the publication of the bill and outlines the main themes addressed by it. It includes a guide to commentaries on the bill produced by the Department, professional bodies and lobby groups.

Company law is a reserved matter, however, there are several areas where the Bill touches on devolved matters. A Sewel motion has been brought before the Scottish Parliament covering these areas. Company law is a transferred matter with respect to Northern Ireland. The Bill will extend GB company law to Northern Ireland.

This Paper should be read in conjunction with a detailed review of proceedings in a Library Standard Note – *Company Law Reform: Parliamentary Proceedings* which is currently available on the Parliamentary intranet. Here, more detailed, clause by clause commentary and explanation may be found according to the proceedings in the Lords.

Timothy Edmonds

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# Summary of main points

The Government launched a 'fundamental review of the framework of core company law' in March 1998, with the publication of a general consultation paper, *Modern Company Law: For a competitive economy*. It argued that forty years had passed since the last broad review, and that much of the structure of corporate law was a legacy of nineteenth century legislators.

The Review looked at the whole range of company law issues: companies themselves – how they are set up and run; their directors and auditors – what were their duties and responsibilities; and how companies interact with the outside world, from their shareholders to broader stakeholders. Successive Reports from the largely independent Steering Groups produced a huge number of recommendations for change. The Government accepted most but not all of these. Of those they accepted some were given legislative effect by the *Companies (Audit Investigations and Community Enterprise)* Act 2004; most of the rest have been incorporated into the current bill.

The bill is organised under three broad themes:

- Enhancing shareholder engagement and a long-term investment culture
- Making it easier to set up and run a company
- Ensuring better regulation and a "Think Small First" approach

A fourth category could be added: giving effect to EU directives. The existence or drafting of many clauses has been influenced by the requirements to give effect to various EU directives.

Of the subjects discussed during the Lords' proceedings the most contentious included the codification of directors' duties, directors' obligations outside their company, the rights of nominee shareholders and the use of electronic communications generally, the changed requirements for company secretaries, the audit liability 'cap', new criminal penalties for auditors and the security of the personal details of directors, auditors and shareholders in the face of action by political activists.

On two areas the Government has withdrawn original proposals. The first is the requirement for companies to produce an operating and financial review. The second was the fourth of the Government's original broad themes for the bill, namely to introduce a more flexible way of amending company law in the future. General powers to change the law without recourse to primary legislation have now been moved to the *Legislative and Regulatory Reform* Bill dealing with this subject which is currently going through Parliament. Specific regulatory proposals for simplified legal procedures have been introduced in the bill on Report instead.

One of the criticisms of the bill has been the fact that despite its length it is not a consolidation measure. Substantial sections of company law will still be found in other enactments, including the 1985 Companies Act after it comes into force.

# CONTENTS

# I Introduction

This Paper describes the history of the wide-ranging and lengthy review of company law set up by the Government in 1998 which has culminated in the current bill. The Review considered detailed points of law and practice as well as more philosophical issues such as the primary allegiance of a company. The Paper also gives a broad thematic review of the contents of the bill.

Readers might like to know that in addition to this Paper the Library has produced a standard note summarising Parliamentary proceedings to date on the bill in the Lords[1] and another note which provides a 'live' index to current clauses, the notes on clauses, parliamentary discussion in the Lords and a guide to the derivation and destination of clauses as they have been renumbered on successive printings of the bill.[2]

# II The Company Law Review

## A. Initial consultation and the Strategic Framework

The Government launched a 'fundamental review of the framework of core company law' in March 1998, with the publication of a general consultation paper, *Modern Company Law: For a competitive economy*.[3] It argued that forty years had passed since the last broad review, and that much of the structure of corporate law was a legacy of nineteenth century legislators. In a written answer, the then Secretary of State, Margaret Beckett said:

> The review is an important part of the Government's strategy to modernise the nation. While much of the relevant statute has stood the test of time, the review will ensure that company law statute can continue to underpin the growth, competitiveness and accountability of British companies into the 21 Century. It will, for example, consider whether, taking account of partnership law and the proposed Limited Liability Partnership, business has the right choice of legislative vehicles for growth. It will address the complexity of the current legislation, and ensure a structure that is clear to users; and it will seek a flexible framework of regulation which is cost effective for companies, and fair to all interests.[4]

The Review was carried forward under the sponsorship of the Department of Trade and Industry, but much of the work was done by a Steering Group which included representatives of the professions, business and the unions. A larger, more broadly-based Consultative Committee, was set up, and a number of Working Parties were delegated the detailed work on specific areas of company law.

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1 SN/BT/4052
2 SN/BT/4051
3 *Modern Company Law: For a competitive economy*, Department of Trade and Industry, March 1998
4 HC Deb 4 March 1998 cc636-7W

The Steering Group's first major publication was *The Strategic Framework*, issued in February 1999.[5] It described both the work already carried out by the Review, and the plans for taking that work forward. It also analysed some key areas for consultation. The principles it set out included presumptions in favour of minimising complexity and maximising the accessibility of rules; and of allocating jurisdiction to the most suitable body. There were presumptions against interventionist legislation and against creating criminal offences, unless necessary.

Key areas discussed included:

- what the scope of company law should be;
- the needs of small and closely (often family) held companies;
- the law on company formation;
- the complicated provisions requiring the maintenance of corporate capital;
- where the boundary between legal requirements and additional regulatory requirements should be set;
- UK company law in an international context, including its role in international competitiveness;
- the effect of changing information and communications technology, especially the use of electronic communications and storage within a company law context; and
- accounting and reporting requirements, including exemptions for small businesses, the form of company accounts and the liability of auditors.

## 1. Scope of company law

It is often argued that the law obliges companies to maximise shareholder value, and that this requirement leads to companies operating in a manner which is either short-termist, because directors feel obliged to maximise short-term shareholder value, or narrow-minded, since directors adopt a narrow, financial concept of shareholder value in order to satisfy the shareholders. The Review considered whether company law adequately reflected the expectations of society, and whether there was scope to amend the legal framework to secure various different aims. The Steering Group categorised the two main approaches to reforms under the headings of 'enlightened shareholder value' and 'pluralism'.

The powers of the directors usually derive from a company's memorandum of association and articles of association. These set both the bounds for the company's capacity, and within that, the bounds for the powers of the directors. A director will be further bound by the fiduciary duties established by case law which include a duty to act for a proper purpose, and a duty to act bona fide in the interests of the company. A company law encyclopaedia has summarised the growing expectations in society that the focus of company law requires revision:

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[5] *Modern company law: For a competitive economy: The Strategic framework*, A consultation document from the Company Law Review Steering Group, Department of Trade and Industry, February 1999 [URN 99/654]

> The view that the interests of the company are to be equated exclusively with those of its members is under challenge, and has, indeed, already been in part eroded. It has come increasingly to be recognised that there are other interest groups whose significance in relation to the company as an enterprise is in practical terms just as important as that of the shareholders, and in social and human terms perhaps even more so. These groups include the company's employees, its suppliers and customers, and its creditors (present and future). The case is sometimes also made for recognition of wider interests, such as the community at large, and the environment. Company law has not yet gone very far towards including these interests among those to which directors, in the exercise of their powers, are bound to have regard. In the main, the traditional view that focuses purely on the interests of shareholders has prevailed, apart from an acknowledgement that action which benefits one or more of these other groups can often be justified on the ground that it may, in the longer term, bring derivative benefits for the shareholders.[6]

## 2. Enlightened shareholder value

*The Strategic Framework* set out the case made by those who argue that what is required is a reformed definition of the concept of shareholder value. It calls this approach, 'enlightened shareholder value':

> Those who adopt an approach of this kind argue that the ultimate objective of companies as currently enshrined in law - i.e. to generate maximum value for shareholders - is in principle the best means also of securing overall prosperity and welfare. Many who take this view point out as well, however, that in practice neither maximum value for shareholders, nor overall prosperity and welfare, may be achieved. This is said to be because management may fail to recognise that the way to success is in many cases through building long term relationships dependent on trust (and that, where this is so, this is what the law requires). It is argued that exclusive focus on the short-term financial bottom line, in the erroneous belief that this equates to shareholder value, will often be incompatible with the cultivation of co-operative relationships, which are likely to involve short-term costs but to bring greater benefits in the longer term. Thus the law as currently expressed and understood fails to deliver the necessary inclusive approach.[7]

The Steering Group argued that no fundamental change was needed to company law to secure this object, since if the pursuit of enlightened shareholder value is the best way of maximising overall welfare companies are already permitted and indeed required to act thus:

> It is in our view clear, as a matter of policy, that in many circumstances directors should adopt the broader and longer-term ('inclusive') view of their role. This is indeed now widely acknowledged. But we do not accept that there is anything in the present law of directors' duties which requires them to take an unduly narrow or short-term view of their functions. Indeed they are obliged honestly to take

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6 *Sweet & Maxwell British Company Law and Practice*, para 32-350

7 *The strategic framework*, para 5.1.12

> account of all the considerations which contribute to the success of the enterprise.[8]

Put another way, if it is in a company's best interests to manage its relationships with its employees, suppliers, customers and other stakeholders carefully, then directors are already required to do so as part of their legal obligation to run the company in the interests of the company. However, the DTI acknowledges that this interpretation is not deep rooted in the mainstream of company life. The *Strategic Framework* document asked whether this existing obligation should be made clearer in either primary legislation or in a non-statutory code of practice.

## 3. A pluralist approach

The DTI contrasted enlightened shareholder value with a pluralist approach:

> Others argue that the ultimate objective of maximising shareholder value will not achieve maximum prosperity and welfare. In their view company law should be modified to include other objectives so that a company is required to serve a wider range of interests, not subordinate to, or as a means of achieving, shareholder value (as envisaged in the enlightened shareholder value view), but as valid in their own right. This kind of approach inevitably involves a need to balance potentially conflicting interests. It envisages circumstances in which some sacrifice of the interests of shareholders will be needed in favour of some other interest. It is convenient to call this kind of approach 'Pluralist', because it argues that the interests of a number of groups should be advanced without the interests of a single group (shareholders) being overriding.[9]

Essentially this approach – seen through the framework of company law - involves viewing a company as more than its shareholders. So when the directors take a decision in the best interests of the company they would need to consider a wider community of interests than the shareholders alone. Such a change would have significant implications for the underlying principles of English company law:

> 5.1.30 At the minimum, implementation of the pluralist view would require a reform of the law of directors' duties to *permit* them to further the interests of non-shareholder participants - that is employees, customers and suppliers - even if this were to the detriment of shareholders. A possible variant would be a duty *requiring* them to promote the success of the company as a business enterprise in this way - i.e. with the interests of none of the participants, including the shareholders', being regarded as overriding. Such directors' duties would need to be expressed subjectively to confer a wide range of discretion, but we would not favour the contentious issues involved being litigable. At the same time we also see difficulties in merely enabling directors to diverge from the enlightened shareholder value objective, since there would be no formal remedy for abuse of the powers conferred (though the provisions against the directors furthering their own interests would remain in place). Arguably this would create a dangerously broad and unaccountable discretion, unless sufficient additional safeguards can be devised.

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8 *Ibid*, para 5.1.19

9 para 5.1.13

> 5.1.31 More extensive reform in a pluralist direction might require changes in the *shareholders' control* over the company through their ability to determine the composition of the board. This seems inevitably to raise the question of constituencies other than members having power to nominate board members, or of there being some self-electing or internally appointed component on the board tasked with securing broader objectives. Wider issues on board composition, the role of non-executive directors, etc, will be addressed at a later stage in our work. But we note here that arguments are not being strongly expressed currently for employee, or wider, representation on company boards as a mandatory requirement and that even in the most well developed version of employee participation, in Germany, ultimate control of the company does in fact rest in the hands of members, through the casting vote of the chairman (appointed by the members) of the supervisory board. There is however an argument that such arrangements for modifying board composition could be structured in a way which reduced to some degree the pressure of members on management and created a system of broader accountability.
>
> 5.1.32 Proposals to alter board composition to require wider representation as a mandatory requirement would represent a very radical change to British corporate culture and would be unlikely to command wide support. There must in any case be doubt whether their objective cannot be more satisfactorily achieved through a regime of enlightened shareholder value combined with improved information flow and greater disclosure.[10]

The Review anticipated that by widening the groups to which a company owed duties, problems could occur about how effectively the company could be held to account, and by whom. It might make companies less efficient. The Review also noted that there did not seem to be widespread pressure for such reforms, and that if implemented they would be unlikely to command widespread support. The tone of the document is more towards improving the regime of enlightened shareholder value by perhaps making the duties involved more explicit, and by improving information flow – which is a benefit to those who receive that information. The next major publication from the Steering Group, *Developing the framework*, announced that this approach would in fact be pursued.[11]

## B. Developing the framework

### 1. Detailed consultation papers

In October 1999 three detailed consultation documents appeared, containing proposals from the Steering Group on areas of the law on which the Review had made early progress.

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[10] para 5.1.30-2

[11] *Modern Company Law for a competitive economy: Developing the framework*, A consultation from the Company Law Review Steering Group, Department of Trade and Industry, March 2000 [URN 00/656]

- *Company General Meetings and Shareholder Communication*[12] The document asked whether the requirements on Annual General Meetings could be improved so that they better serve their purpose of allowing shareholders to hold the directors to account, or whether other ways of securing this aim can be found which would allow the requirement for AGMs to be dispensed with for public companies (private companies can already elect to not hold AGMs). The document also looked at other aspects of companies' communications with their shareholders, especially in the light of developments in technology.

- *Company formation and maintenance*[13]: newly-formed companies would have a single constitution document, based on the current articles of association. The memorandum of association would be abolished although information which is required to be on the public register would be disclosed in a new registration form. Private companies would no longer have stated objects. The concept of 'authorised' share capital (as distinct from 'issued' share capital) would be abolished. On capital maintenance, the law as it applies to public companies is constrained by EC directives, although some simplification was sought. Among the main proposals are that proposals to reduce share capital should no longer require court approval, but be validated by special resolution instead. The concept of par values for shares in private companies will be abolished.

- *Reforming the law concerning overseas companies*[14] The document proposed simplifications to the regime for overseas companies and the information which they have to make available on the UK register.

## 2. Developing the framework

The second strategic document from the Review was *Developing the framework*, published in March 2000.[15] In this substantial paper – over 450 pages long – some of the strategic conclusions on key areas of the Review were made known. It included proposals on the scope of company law, the duties of directors, and the accounting framework for both large and small companies.

The Steering Group rejected an out-and-out pluralist approach, and instead wanted to develop the concept of enlightened shareholder value, although it was reluctant to say so explicitly:

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12 *Modern company law for a competitive economy: Company general meetings and shareholder communication*, A consultation from the Company Law Review Steering Group, Department of Trade and Industry, October 1999 [URN 99/1144]

13 *Modern company law for a competitive economy: Company formation and capital maintenance*, A consultation from the Company Law Review Steering Group, Department of Trade and Industry, October 1999 [URN 99/1145]

14 *Modern company law for a competitive economy: Reforming the law concerning overseas companies*, A consultation from the Company Law Review Steering Group, Department of Trade and Industry, October 1999 [URN 99/1146]

15 *Modern company law for a competitive economy: Developing the framework*, A consultation from the Company Law Review Steering Group, Department of Trade and Industry, March 2000 [URN 00/656]

> We argue that the overall objective of wealth generation and competitiveness for the benefit of all can best be achieved through the twin components of:
>
> - an "inclusive" approach to directors' duties which requires directors to have regard to all the relationships on which the company depends and to the long, as well as the short, term implications of their actions, with a view to achieving company success for the benefit of shareholders as a whole; and
>
> - wider public accountability: this is to be achieved principally through improved company reporting, which for public and very large private companies will require the publication of a broad operating and financial review which explains the company's performance, strategy and relationships (eg with employees, customer and suppliers as well as the wider community).

Two proposals associated with this broad aim require comment. First, the duties of directors, which are currently covered by diffuse case law, would need to be codified into a statutory statement of principles. Although this statement is expressed at a high level of generality, it explicitly calls for directors to have regard to a wide range of interests when they carry out their duties. The draft statement includes:

> 1 Compliance and Loyalty
>
> a. A director must exercise his powers honestly and for their proper purpose, and in accordance with the company's constitution and decisions taken lawfully under it.
>
> b. Subject to that requirement, he must (so far as he practically can) exercise his powers in the way he believes in good faith is best calculated in the circumstances, taking account of both the short and the long term consequences of his acts, to promote the success of the company for the benefit of its members as a whole.
>
> c. The circumstances to which he is to have regard for that purpose include, in particular, (as his duties of care and skill may require):
>
> aa. the company's need to foster its business relationships, including those with its employees and suppliers and the customers for its products and services;
>
> bb. the impact of its operations on the communities affected and on the environment; and
>
> cc. its need to maintain a reputation for high standards of business conduct.[16]

The Steering Group commented on principle 1(c):

> 3.55 Principle 1c carries out our preference for spelling out the "inclusive" nature of this duty. It lists a number of considerations to which directors are likely to need to have regard in order effectively to carry out the core duty in paragraph b. The list includes all the main considerations which we believe are likely

[16] *Developing the framework*, para 3.40

> commonly to be relevant in a well managed company – i.e. the company's dependency on employees and participants in the supply chain (including suppliers of finance and customers, direct and indirect), community and environmental policies and its reputation. These are matters to be considered in order to reach the properly considered, or "calculated", view required in the core part of the duty in principle 1b. These considerations are thus subordinate to the objective of success on behalf of shareholders and to be regarded as of value to the extent that they contribute to that objective.
>
> 3.56 The list is not exhaustive: the core duty will require directors to consider other factors if they are to be regarded as relevant. Nor will all the interests which are listed be equally, or even at all, relevant in every case. In deciding whether and how to consider such interests the director will be required to exercise the care and skill required below, as explicitly stated in the draft. This ensures that the list does not have absolutely to be considered in every case, but only when a reasonably careful and skilful director would do so.[17]

The second important new requirement was a proposed Operating and Financial Review (OFR). Public and the largest private companies would have to produce this statutory document, which to some extent would replace the current directors' report. It would discuss the prospects for the company, and where appropriate give an account of other qualitative factors in its performance including its key relationships (such as with employees and suppliers), its corporate governance policies and its environmental policies. (This proposal was brought forward by virtue of the *Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005* which came into force on 22 March 2005.[18] The Government subsequently changed their mind, the regulations were repealed and the references in the bill removed.)

The document sought views on a number of other governance matters, including:

- whether the role of non-executive directors should be set out in law;
- how the remedies available to minority shareholders could be improved;
- simplifying the law, accounting and reporting obligations for small companies; and
- removing the present bar on allowing statutory auditors to limit their legal liability for the audit.

## C. Completing the structure

The next major publication from the Review was *Completing the Structure* in November 2000.[19] It followed the pattern of *Developing the framework*, combining a mixture of policy decisions, new proposals and ideas for consultation. Like its predecessor, it was also a very substantial document at nearly 400 pages. The discussion below focuses on two broad initiatives in the paper: simplifying the legal requirements for smaller companies and developing a new framework of institutions to develop and apply company law in the future.

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17 *Developing the framework*, paras 3.55-56

18 SI 2005/1011

19 *Modern Company Law for a competitive economy: Completing the structure*, A consultation document from the Company Law Review Steering Group, November 2000 [URN 00/1335]

## 1. Deregulation for private companies

The overwhelming majority of companies on the register are small. Much of the Review's work aimed to simplify company legislation for such companies, since they typically neither merit many of the legal restraints which larger companies do, nor are they well-placed to understand the complexities of the current legal framework. In *Completing the structure*, conclusions surfaced on the legal obligations which small companies routinely face. Some time-honoured concepts disappeared, while aspects of the corporate timetable were also radically revised.

Although some distinctions are based on size (determined by turnover, financial strength and the number of employees), company law also distinguishes between 'public' companies and 'private' companies. There is no definition in law of a private company's positive characteristics: it is a company whose memorandum of association does not say that it is a public company.[20] Public companies have higher required levels of capital, and are permitted to offer their shares to the public.

At this stage, the Review was proposing that:

- general meetings at private companies would require a standard notice period of 14 days, irrespective of the purpose of the meeting and the types of resolution which are to be tabled[21]
- written resolutions at private companies would no longer require unanimity: the default majorities will now be the same as for ordinary (50 per cent) and special (75 per cent) resolutions[22]
- restrictions on financial assistance for the purchase of shares would no longer apply to private companies[23]
- private companies would no longer be required to appoint a company secretary although they may choose to do so.

This proposal aroused much opposition when it was published and continued to do so throughout the bill's proceedings. The Institute of Chartered Company Secretaries and Administrators (ICSA) made a preliminary observation:

> 'The proposal that a private company can choose whether or not to appoint a company secretary completely ignores the fact that an effective company secretary will be a major influence in keeping otherwise errant directors on the straight and narrow. It would not be unreasonable to conclude that the organisations that are most likely to take advantage of the proposed 'flexibility' will be those where the directors do not want someone looking over their shoulder, i.e. the very companies where the protection provided by the secretary is most needed.

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20 CA 1985, s.1(3)
21 para 2.10. See also *Developing the framework*, paras 7.6-7.9
22 para 2.11. See also *Developing the framework*, paras 7.10-7.15
23 para 2.14. See also *Developing the framework*, paras 7.16-7.27

> The proposal is put forward as a point of deregulation, with no other justification being given. If it is seen as de-regulation, then it is plainly at odds with the Government's objective of minimising corporate impropriety. Questions will publicly be asked why, at a time when there is a spotlight on corporate behaviour, the Government has withdrawn a prime protection for shareholders and stakeholders. When the Fraud Advisory Panel has recognised that "*the Government has set out a number of proposals which have the potential to make a significant impact on fraud*", the Government will be asked to explain why it is removing a constraint against, and by association appear to be encouraging, fraud, money laundering and other abuses.'[24]

- the definition of a small company, which entitles a company to prepare simpler accounts, would be raised to the maximum permitted by EC law.[25]
- requirements as to the form and content of small company accounts would be no longer set out in statute (i.e. Schedule 8 of the Act). Instead this would be a matter for accounting standards. The advantage is that companies would be able to turn to a single source for their accounting obligations, rather than the current mixture of statutes and accounting standards.[26] Similar proposals were made for larger companies.
- the option for small companies to file 'abbreviated accounts' at Companies House would be removed. While they have the advantage of preserving some confidentiality, they also involve small companies' preparing two sets of accounts. Instead, the accounts filed at Companies House would be the same as those sent to the companies' members.[27]
- the period allowed for private companies to file accounts at Companies House would be shortened from ten months to seven. Public companies would also see their filing period shortened.[28]
- private companies can currently opt out of the requirement to hold an annual general meeting at which the accounts are laid. The position would be reversed: AGMs will no longer need to be held unless the company has opted to do so.[29]

## 2. New institutional structure

When the *Companies Act 1985* was first passed it amounted to 747 clauses and a further 25 schedules. There are obvious problems with primary legislation on this scale: it is difficult for company law users to assimilate; it is hard to distinguish the most significant provisions from others that are more technical in nature; and, perhaps most important from a practical perspective, changes to the rules require either primary or, where provided for, secondary legislation. This is typically slow-moving and unresponsive to commercial changes because of competing demands on government and parliamentary time.

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[24] ICSA, 'Company Law Review: Company secretary in private companies', Position Paper, February 2002 (www.icsa.org.uk)
[25] para 2.39
[26] para 2.43
[27] para 2.46
[28] para 2.47
[29] para 2.49

The Review therefore proposed a new balance of legislation. Key requirements would be set out in primary legislation, further rules that have high public policy significance would be contained in secondary legislation, while other rules that are more technical and which provoke lesser public policy concerns might be made by a specialist external rule-making body.[30]

It also proposed a new institutional framework which would see the oversight and revision of company law requirements carried out to a greater extent outside of government. The lead body would be a 'Companies Commission' which would have oversight of the new regulatory structure, appoint members to a number of subsidiary boards (see below) with more specific functions, have responsibility for keeping company law under review, and publish an annual review of company law.[31]

In *Developing the framework*, it was suggested that many of the detailed accounting rules in the CA 1985 could be delegated to a standards-setting body leaving only core provisions in the primary legislation. There was widespread support for this division. *Completing the framework* picks out those requirements which would appropriately be kept in the main statute. They include for example the duty to keep accounting records, stipulations as to the frequency and timing of specific reports and the requirement that these reports present a true and fair view.[32] A new standards-setting body, the Standards Committee, based on the activities of the Financial Reporting Council (FRC), the Accounting Standards Board (ASB) and the Financial Reporting Review Panel (FRRP), would issue both the required standards and guidance on compliance for financial accounts and the new OFR. It would also have responsibilities for keeping the Combined Code (the corporate governance code for listed companies) under review and for making substantive rules on the conduct of annual general meetings and communications by companies with their shareholders.[33]

A 'Monitoring and Enforcement Committee' would build on the work of the Financial Reporting Review Panel (FRRP) which monitors the compliance of companies with the reporting rules and can require the correction of defective accounts.[34]

Finally, a 'Private Companies Committee' would champion the interests of smaller private companies. It would act in an advisory role, with other bodies such as the Standards Committee being obliged to consult it on issues which affect private companies.[35]

This proposed institutional structure was subsequently adjusted as a result of responses to *Completing the structure*, although the overall scheme was largely preserved and given partial effect by the *Companies (Audit Investigations and Community Enterprises)*

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30 See for example para 12.36
31 See para 12.59 and paras 12.62-66
32 See para 12.42
33 See paras 12.67-74 below
34 See para 12.59 and paras 12.75-7
35 See paras 12.78-81

*Act 2004*.[36] However, as will be seen below, this is an area on which the Government decided not to accept all the Review's proposals particularly in its rethink over the OFR.

## D. Final Report

The Review concluded in July 2001 with a *Final Report* which it submitted to the Secretary of State for Trade and Industry.[37] The document, in two volumes, also includes a selection of draft clauses for the new *Companies Bill*, part of the purpose of which is to show how the new Bill could be drafted more clearly than its predecessors.

The *Final Report* reported on most of the areas on which the Review had previously consulted, and explained the principles behind the final recommendations. The Review classed its final recommendations under three broad headings which are also adopted here:

- simplifying and modernising the law for small companies
- providing a legal framework for companies which reflects the needs of the modern economy
- ensuring a flexible and responsive institutional structure

Note that not all of the recommendations were accepted by the Government in its White Paper and further substantial revisions occurred after the bill was published.

### 1. Small companies

The key recommendations on small companies were:

- the 'unanimous consent rule' which already exists in the common law would be codified and extended. The effect is that any decision which a company has the power to make would be valid even if it had not observed all the required legal formalities, provided all the members of the company gave their consent.[38]
- written resolutions at private companies would no longer require unanimous endorsement. Instead, the normal thresholds for special and ordinary resolutions would apply to written resolutions. This would allow small companies to take certain decisions more easily, without the obligation of holding a general meeting.[39]
- the 'elective' regime, under which private companies can resolve to dispense with some of the Act's formalities (holding an AGM, and laying of accounts and the annual appointment of auditors at the AGM) will become the default for such companies. If a company wishes to be bound by these requirements (e.g. it wants to hold an AGM), then it would have to make an election to do so. In other

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36 See *Final Report*, Chapter 5

37 *Modern Company Law for a competitive economy: Final Report*, The Company Law Review Steering Group, 2 volumes, July 2001 [URN 01/942]

38 *Final report*, para 2.14

39 para 2.15

words, the default regime will be that no AGM need be held unless the company makes a positive decision to be covered by that obligation.[40]

- private companies would no longer need to appoint a company secretary, although they may still choose to do so.[41]
- alternative dispute resolution would be promoted for settling disputes between shareholders in private companies as an alternative to the courts, and in particular a special arbitration scheme for shareholders would be created.[42]
- financial reporting and audit for small companies would be simplified. More small firms would be able to prepare simpler 'small company accounts' as a result of raising the thresholds in the UK to the maxima permitted in EC law.[43] The turnover threshold below which a statutory audit need not be prepared would be raised to £4.8 million also (the EC limit again). And, while statutory accounts for small companies will be simplified, the additional facility of small companies to file 'abbreviated accounts' for public disclosure would be removed.[44]
- private companies would have to file their accounts within seven months of their financial year-end, rather than the ten currently allowed
- the rules which restrict the ability of companies to offer financial assistance for the purchase of their own shares would be abolished for private companies.[45]

## 2. Governance framework

Within a broadly-defined field of corporate governance:

- the duties of company directors, which chiefly arise outside of statute law, would be codified into a statutory statement. The statement would both define the principles which directors must observe and the standards to which these duties must be fulfilled. In addition to duties of obedience to the company's constitution, of loyalty (which would oblige a director to act to serve the purposes of the company), to exercise independent judgement and to exercise care, skill and diligence, there would be duties to have regard to the interests of creditors (where there is a risk of insolvency) and to control conflicts of interest.[46]
- as part of the principle of acting in good faith to promote the success of the company, the proposed statement requires a director to take account in good faith of all practicable material factors. Notes in the draft statement included among material factors, the need for the company to foster its business relationships with employees, suppliers and customers; the need to have regard to the impact of its operations on communities and the environment, and the need to maintain a reputation for high standards of business conduct.[47]

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40 para 2.16-9
41 para 4.6
42 para 4.11
43 To prepare small company accounts, a company must satisfy two of the following three criteria (proposed new limits appear in brackets): turnover not more than £2.8 million (£4.8 million); balance sheet total not more than £1.4 million (£2.4 million); not more than 50 employees (50, as now).
44 paras 2.32-3
45 para 2.30
46 paras 3.5-11
47 See Annex C to *Final* report for the draft statement.

- the Combined Code would remain as the key governance code for quoted companies. As now it should require companies to comply with its requirements or explain why ('comply or explain'), rather than create binding obligations.
- it would be easier for shareholders who hold their shares in 'nominee' accounts (where the identity of the beneficial shareholder is not clear from the register of shareholders) to exercise their rights. While the Review recommended voluntary measures, it also called for the Secretary of State to have reserve powers to enforce mandatory ones.[48]
- listed companies would have to circulate members' resolutions free of charge with the AGM papers. This removes a potential cost-barrier to shareholder participation.
- institutional investors, who typically own more than half the shares in major companies, would have to disclose how they have exercised their rights as members (e.g. on company votes) if they manage funds on behalf of others. Companies would have to disclose their main relationships with financial institutions in their own annual reports. Voting on important company resolutions would be audited.[49]
- large companies would have to disclose broad strategic information about their business in the new OFR.
- to improve disclosure at quoted companies, the annual report and accounts would have to be filed within six months of the end of the financial year (currently seven months is allowed; at an earlier stage, the Review was proposing a five month period). The documents would be available earlier on the company's website, where they would have to appear within four months. Fifteen days would have to elapse between the website publication and the circulation of notice of the AGM, to allow shareholders time to table resolutions.[50]
- directors and employees would be under stricter obligations to provide information to auditors. Directors would have to volunteer information where they should recognise that such information is needed for the audit. A criminal sanction will apply to a director's failure to supply information which he knows is material.[51]
- the duty of care owed by auditors would not be extended beyond its current common law boundary (set in the *Caparo* [52] case). Auditors would be able to limit their liability in contract (by agreement with the company) and in tort (through notice in the auditor's report, which would bind those who rely on the report).[53] Any limitation would have to be reasonable, within the terms of the *Unfair Contract Terms Act 1977*.

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48 para 3.51
49 paras 3.52-5
50 para 3.47
51 paras 8.118-122
52 *Caparo industries v Dickman* [1990] HL
53 para 8.143

### 3. Institutional structure

*Completing the structure* had set out a proposed set of institutions to oversee the development and detailed operation of company law. While the main elements of that framework (see page 18 above) are carried forward into the final report, some alterations were made to the names of the bodies and their respective responsibilities.

- the Company Law and Reporting Commission (CLRC- which was originally to be called the Companies Commission) would keep company law and governance under review, reporting annually to the Secretary of State. The government would be obliged to consult the CLRC on proposed secondary legislation, and the CLRC would also issue authoritative guidance within its field of reference.[54]
- the Standards Board (which was originally called the Standards Committee) would make detailed substantive rules on accounting and reporting disclosures, including the standards for the new qualitative report, the Operating and Financial Review. It will also keep the Combined Code under review and have powers to make rules about the disclosure of governance matters under the Code and other forms of corporate disclosure.[55] The Board will not however have the power to make the Code's provisions substantive obligations.
- a Private Companies Committee would have an advisory role on areas of company law and reporting which are of relevance to private companies.[56]
- a Reporting Review Panel (originally the Monitoring and Enforcement Committee) will take on the Financial Reporting Review Panel's task of monitoring compliance with reporting requirements.

### 4. Other recommendations

- a new form of corporate entity reserved for charities would be developed (this became Community Interest Companies set up under the 2004 Act)
- companies would have to disclose any criminal sanctions against the company in their annual reports
- the incidence of criminal sanctions on officers and employees for defaults in company law would be clarified and more precisely targeted

## E. White Paper

The Government published its first detailed reaction to the Review's recommendations in a White Paper, *Modernising Company Law*, which was issued on 16 July 2002.[57] Unlike a conventional White Paper, the document did not represent final, settled, policy. Instead further consultations were promised. The document included some draft clauses on a number of areas, others being dependent on the outcome of the further consultation.

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54 see para 5.21 and following
55 paras 5.57-
56 paras 5.74-5
57 *Modernising Company law*, Department of Trade and Industry, 2 volumes, Cm 5553, 16 July 2002 ['White Paper']

Although the Company Law Review Steering Group was chaired by and included a number of senior DTI staff, the Group had a majority of external members, including the chairman of the Financial Reporting Panel, the former Chairman of the Law Commission, and professors of law from Bristol and the LSE. The Review was characterised as independent and indeed, a number of its key recommendations were not taken up despite the extensive and specific consultations which persuaded the Review in its deliberations.

The Government accepted the Review's key focus on tailoring company law to the needs of smaller companies, with specific additional requirements for larger and listed companies.[58] It also accepted the need to structure the legislation so that in future company law can be more responsive to change and be more easily revised.[59] However, it did not accept the need for a Company Law and Reporting Commission, which it felt was unnecessary.[60]

For convenience, the main decisions of the White Paper are collected under the same headings used earlier for the Review's *Final report*.

### 1. Small companies

- while the Government endorsed the Review's recommendation that the 'unanimous consent' rule should be preserved, it did not favour codifying it.[61]
- the Review's proposals on reversing the 'elective regime' were accepted. Private companies will no longer be required to hold AGMs, and to lay accounts and appoint auditors at that meeting unless they elect to do so.
- private companies would no longer be required to appoint a company secretary, as recommended.[62]
- private companies would be able to pass written resolutions using the normal majorities (i.e. unanimous approval will no longer be required), as recommended.[63]
- the Government would explore the scope for an arbitration scheme for shareholder disputes, and carry out a cost-benefit analysis on proposed schemes.[64]
- entitlement to prepare small company accounts would be raised to the EC maximum in line with the Review's recommendations.[65] Its call for the abolition of 'abbreviated accounts' for filing at Companies House was also accepted.[66] The audit exemption limit, however, will remain at £1m pending further evaluation. The idea of an 'Independent Professional Review', which could have applied as

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58 White Paper, para 1.6
59 para 1.8
60 paras 5.25-7
61 para 2.35
62 para 6.6
63 paras 2.26-7
64 para 2.36
65 para 4.19
66 para 4.26

an interim stage between exemption and an audit, was ruled out by the Government.[67]

- as recommended, private companies would have seven months from their year-end to file their accounts.[68]

## 2. Governance framework

- the Government accepted the proposal to codify directors' duties, and largely adopted the Review's recommended text (although it disputed the desirability of including the obligations to creditors, that are currently in s.214 of the *Insolvency Act 1986*, in that statement).[69] On the key issue of the scope of directors' duties, and hence of company law, the White Paper commented:

> This approach…..balances a number of different elements. In particular, the duty in paragraph 2 of the Schedule to the draft Bill makes clear that directors must consider both the short and long term consequences of their actions, where relevant, and take into account where practicable relevant matters such as their relationships with employees and the impact of the business on the community and on the environment. At the same time the reference to practicability recognises that business decisions are often constrained by time limits or by the availability of information. In addition, the draft duties make clear that a director must exercise the care, skill and diligence of a reasonably diligent person with both the knowledge, skill and experience which may reasonably be expected of a director in his or her position and any additional knowledge, skill and experience which the particular director has.[70]

- the Combined Code would remain as a primary governance code for listed companies, but will not be provided for in legislation.[71]
- As recommended, a body of shareholders would be able to require that the conduct of any poll be scrutinised by a registered auditor.[72]
- Shareholders with the necessary support would be able to have a statement prepared by them, which relates to a proposed resolution for an AGM, circulated at the company's expense, as recommended.[73]
- the Government accepted that the law should be changed to allow companies to recognise the rights of beneficial owners of shares, on a voluntary basis. It promised to consider further the practicality of a reserve power to compel such recognition.[74]
- on institutional investors, the Government was not attracted by the recommendation that companies disclose their relationships with suppliers of

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67 para 4.22
68 para 4.24
69 paras 3.5, 3.8
70 para 3.6
71 paras 3.28, 5.11-14
72 para 2.19
73 para 2.24
74 paras 2.40-1

financial services.[75] It endorsed the principle, though, that institutions should disclose how they have voted, but envisaged possible practical difficulties. It promised to clarify its position fully later.[76]

- the Government proposed to prohibit companies (which are 'legal persons') from acting as directors of other companies (i.e. corporate directors). This issue was not addressed by the Review.[77]
- companies which are economically significant (according to a size-based test) would have to prepare an OFR. This, with a new 'supplementary statement' (required for all companies), would replace the directors' report. The OFR would be subject to a review by the auditors (as it turned out, one of the chief criticisms of it by the Government). These proposals endorsed the Review's recommendations.[78] The White Paper said:

> A reporting requirement in these terms would also be a major benefit for a wider cross-section of a company's stakeholders. The new requirement to report, for example, on material environmental issues would be a major contribution to both corporate social responsibility and sustainable development initiatives. The Government has long recognised, and promoted, the business case for these and sees the OFR as the opportunity for directors to demonstrate their response to this business case.[79]

- public companies must both file their annual report and accounts and lay them before shareholders within six months of their year end.[80] The Government also accepted the Review's recommendation that quoted companies must place their reporting documents on the internet within four months.[81]
- the Government accepted the extension of the role of auditors to include the preparation of the OFR, and the extension of auditors' rights to information. At this stage the Government had yet to tackle the controversial area of auditor liability.[82]

## 3. Institutional structure

While the Government agreed with the 'thrust' of the Review's institutional recommendations, its proposed structure is less ambitious and perhaps less devolved:

- the Government rejected the creation of a Company Law and Reporting Commission, which it considers might itself become outdated and may be less necessary when company law is more easily amendable.[83] However, the

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75 para 2.46. The Review called for the disclosure of relationships with major suppliers only, but the Government is concerned that lengthy or irrelevant information might be disclosed as a result.
76 para 2.47
77 para 3.34
78 para 4.28 and following
79 para 4.32
80 paras 4.49, 4.52
81 para 4.50
82 para 4.47
83 para 5.26

Financial Reporting Council remained as the lead body for the replacements to the ASB and the FRRP (see below), and could develop a 'soft' role in keeping company law under review.[84]

- a Standards Board will be set up to make detailed recommendations on accounting, reporting and disclosure requirements. The Board has responsibility for making disclosure obligations for quoted companies about their compliance with the Combined Code (currently handled by the UK Listing Authority). It will not have a statutory duty to review the Code, but it is anticipated that it will keep the Code under review.[85]

- a formal Private Companies Committee will not be set up, but the other bodies are expected to set up committees to address the interests of smaller companies.[86]

# F. Post White Paper: events & legislation

## 1. Responses to the White Paper

The length and breadth of the Review and the fact that consultation did not follow the typical Green Paper - White Paper route has been mentioned previously. This departure from tradition extended post White Paper. Several of the issues dealt with in the Review have been legislated upon outside of the current *Reform Bill*. The most significant, post White Paper, legislation has been the *Companies (Audit Investigations & Community Enterprise) Act 2004*.[87]

This legislation addressed most of the institutional changes proposed in the White Paper concerning the system of regulating auditors by imposing independent auditing standards, monitoring and disciplinary procedures on the professional accountancy bodies. The first part of the Act established a new independent professional body – the Financial Reporting Council (FRC) – and subsidiary bodies funded by industry, the accountancy profession and by the Government.

The second part of the Act provided the framework for Community Interest Companies (CICs) which, it is hoped, will be useful for the voluntary sector. These were followed by regulations – *The Community Interest Companies Regulations 2005 (SI 2005/1788).* The relevant part of the 2004 Act and these regulations came into force on 1 July 2005.

The Government also used the 2004 Act to address the difficult issue of auditor and director liability. In a written Ministerial Statement on 7 September 2004 the Secretary of State, Patricia Hewitt announced the Government's conclusions on whether each group should receive legal immunity or a degree of protection from potentially damaging law actions. On directors she said:

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84 para 5.27
85 para 5.7 following. The Board is broadly a successor to the Accounting Standards Board.
86 para 5.29
87 Cap 27

> It is essential for British competitiveness that we have a diverse pool of high-quality individuals willing to become directors, and that directors are willing to take informed and rational risks. But it is also important that directors act in accordance with their duties, and that negligent directors can be held to account by their companies.
>
> The consultation built on the recommendations both of the Company Law Review and of Sir Derek Higgs' study on non-executive directors. It identified two particular concerns:
>
> exposure to liabilities arising from legal action against directors by third parties. The sharp rise in the number of class actions by groups of shareholders in the US has made this a particular concern for directors of British companies with a US listing;
>
> the cost of lengthy court proceedings. Companies are currently permitted to indemnify a director against the cost of defending legal proceedings, but only when judgment has been given in the director's favour or he has been acquitted. For many directors, such indemnification comes too late and the prospect provides cold comfort.
>
> The consultation indicated these issues are affecting the recruitment and behaviour of directors. I therefore intend to introduce a balanced and proportionate package of reforms, by tabling amendments to the Companies House (Audit, Investigations and Community Enterprise) Bill at its Commons Committee stage. The proposals will in particular introduce two important relaxations of the current prohibition on companies exempting their directors from, or indemnifying them against, liability:
>
> they will permit, but not require, companies to indemnify directors in respect of proceedings brought by third parties (covering both legal costs and the financial costs of any adverse judgement, except for the legal costs of unsuccessful defence of criminal proceedings, fines imposed in criminal proceedings and penalties imposed by regulatory bodies such as the financial services authority);
>
> they will permit, but not require, companies to pay directors' defence costs as they are incurred, even if the action is brought by the company itself. The director would still be liable to pay any damages awarded to the company and to repay his defence costs to the company if his defence were unsuccessful (except where the company chooses to indemnify the director in respect of his legal costs in civil proceedings brought by third parties).
>
> The amendments will also require disclosure in the directors' report by companies that indemnify directors. Shareholders will also have the right to inspect any indemnification agreement. Companies that do not indemnify directors will not have to make any disclosure.

On auditors she said:

> The Government wish to see a competitive and high-quality market for audit services, shareholders using high quality and reliable information, and an adequate system of redress for when things go wrong. There must also be an appropriate degree of transparency and accountability for the audit process.

> The Government are actively pursuing this agenda. The Bill already extends the powers of auditors to obtain information, and contains new provisions for each director to confirm there is no relevant audit information of which he is aware but the company's auditors are unaware.
>
> In line with the company law Review's recommendations, and as supported in the consultation, I have decided not to bring forward amendments to the current Bill to extend an auditor's duty of care.
>
> The consultation showed a wide variety of views both as to whether reform of the law on liability of auditors was needed, and if so what form it should take. Some investors also had concerns about whether the audit process was serving them sufficiently well. It was also a matter of concern that the leaders of some of our largest companies were worried their choice of auditor was limited.
>
> I have considered carefully whether there is a case for a change in the law on auditor liability. I am grateful to the Office of Fair Trading for looking at the competition implications of enabling shareholders to agree in advance a maximum amount for which the auditor would be liable. In the light of the consultation responses, and the OFT's advice that introducing a cap would not significantly enhance competition, I have concluded against proposing changes to the law on this.
>
> The Government remain committed to improving the operation of the audit market and will continue to consider any proposals, including the possibility of limiting liability on a proportionate basis by contract, which can be demonstrated significantly to enhance competition, and to improve quality, in the audit market. The Government intend to look closely at this option and actively call upon auditors, business and investors to work together to examine whether proposals for a system of proportionate liability via contract are practical and/or desirable.[88]

The small - firm 'friendly' amendments to the requirements for audits were effected as promised in the White Paper by virtue of the *Companies Act 1985 (Accounts of Small and Medium – sized Enterprises and Audit Exemption) (Amendment) Regulations 2004.*[89] These came into force in January 2004. Companies may now file abbreviated, or 'short form' accounts if they meet at least two of the following three criteria:

| | Small | Medium |
|---|---|---|
| | *less than or equal to:* | |
| Annualised turnover | £5.6 m | £22.8 m |
| Balance sheet total | £2.8 m | £11.4 m |
| Average monthly number of employees | 50 | 250 |

[88] HC Deb 7 September 2004 Wms c107
[89] SI 2004/16

## 2. Draft clauses

Subsequent to the publication of the 2002 White Paper, the DTI published *Company Law Reform* in March 2005.[90] This included responses to consultations held since the 2002 White Paper. It was followed by a series of themed draft clauses during the summer of 2005 which covered the subjects discussed previously above and which, in due course, formed the bulk of the first printing of the bill.

[90] *Company Law Reform,* Cm 6456 available at http://collections.europarchive.org/tna/20060715183806/http://dti.gov.uk/files/file13958.pdf

# III The Bill

## A. Introduction

The *Company Law Reform Bill* [HL] Bill 34 2005-06 was introduced into the Lords on 1 November 2005. It had 885 clauses and 15 schedules on first printing. The explanatory notes were published a week later at 309 pages long. There is a lot of documentation. This Paper only outlines the key issues. The bulk of the Library material can be found in a Standard Note (SN) available on the intranet: '*Company Law Reform Bill: Parliamentary proceedings*' together with a spreadsheet index tracing the course of the debate and destination of clauses.[91] The key resources can be found on the internet and are set out in part C of this section.

## B. Main themes

The DTI has set out four main objectives for the bill and then identified the parts of the bill that corresponded to each theme.[92] This section follows this classification system and looks, very briefly, at some of the issues raised, in the Lords or elsewhere, to do with each. The reference to the relevant pages of the Standard Note on parliamentary proceedings is given at the end of each section. It does **not** provide a full explanation of each clause on a clause by clause basis, this is best done with the help of the Department's Notes on Clauses an index to which can be found in a Library Standard Note. The Department, following previous practice, outlined the following themes:

### 1. Enhancing shareholder engagement and a long-term investment culture;

> Shareholders are the lifeblood of a company, whatever its size. We want to promote wide participation of shareholders, ensuring that they are informed and involved, as they should be. And we want decisions to be made based on the longer-term view and not just immediate return.[93]

The provisions in the bill highlighted by the Department which implement this theme are the following parts:

#### *a. Part 9: Exercise of Members' rights*

The main clause (clause 136 in Lords Committee): Enjoyment or exercise of members' rights, has been contentious as the issue of nominee accounts and the rights of nominee shareholders has been the subject of a campaign outside of the House. Groups representing small shareholders want shareholders who invest through such mediums as ISAs or PEPs, to have the same rights (particularly voting rights) as shareholders who hold their shares directly. [SN pages 18 -23]. One argument is that with almost half of all shareholdings now held by nominee accounts (and growing) there is no longer the

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91 See Bill pages on Library intranet

92 In a no longer readily available version of their website

93 http://digbig.com/4hsqt (see note on removal of note by DTI)

'golden thread' of accountability between company and shareholder as these people are effectively disenfranchised and do not receive much of the information that other shareholders expect to receive. A counter argument is that most people are perfectly happy to buy shares through funds in their high street and not then receive lots of 'junk mail' that appears irrelevant to them. The Government insists that severe administrative burdens would result if companies had to distribute information to thousands of individuals instead of tens of fund managers.

### *b. Part 10 Company directors*

The bill introduces a huge range of provisions to do with directors. The big issues dealing with directors have been

- *Codification of duties*: currently directors' duties are common law duties, for the first time they will be written into statute. There has been considerable debate as to whether the bill has in fact extended these duties or not, possibly inadvertently [SN pages 27 to 29]
- *Extension of duties beyond the narrow remit of company profitability*: this is really a subset of the above, but has become the focus for interest of various lobby groups such as trade justice, development and environmentalists. [SN pages 34 to 37 & 70 to 73] They argue for much higher levels of accountability for company directors and a higher level of responsibility on companies for actions committed in their name abroad. Other commentators however, argue that the clause went too far and will distract directors from their main task and even dissuade directors from taking office.
- *Security of names and addresses*: The issue of public access to and abuse of directors' personal details is addressed in the bill and was the subject of considerable debate during the Lords' proceedings [SN pages 46 to 47, 140 and 162]. In balance was the historical rights of the public and enforcement authorities to know who was managing a company, and the activities of political activists or 'terrorists' who use such information for their own purposes.
- *Directors' liabilities*: the bill gives directors some protection from legal actions against them. The issue here is that companies need directors and increasing legal activism is likely to dissuade individuals from coming forward unless there are robust protections. Against that, acts of negligence and dishonesty by directors should be capable of punishment. [SN page 45 and 46]. This issue also arose with respect to the reporting requirements under the 'narrative reporting' duties of directors, when the issue of 'safe harbours' was discussed [SN page 73]

### *c. Derivative claims and actions by members*

Clauses in this section set out the means by which members (shareholders) can take legal action against their own company. In the Lords the argument was whether the bill made it too easy for actions to be taken. A 'double whammy' is how it was described, directors have more responsibilities and the new bill will make it easier for shareholders to take action against them. The Government argued that there was no reason to expect that the incidence of legal action would increase to US levels as had been predicted by some Peers. Peers also raised the issue about 'activists' buying shares and then using the procedure for their ends. [SN pages 50 to 55].

### *d. Part 15: Accounts & Reports*

This part of the bill includes a mass of highly technical accounting clauses [SN pages 68 to 83] of these the most high profile proved to be those concerning the Business Review (BR) and the Operating and Financial Review (OFR).

For some considerable time the OFR had been the preferred vehicle for delivering the requirements of forward looking, non financial, company information. On the back of extensive consultation, regulations establishing the OFR for quoted companies had been passed[94], and the clauses in the CLRB had been published (clauses 393 to 395). Then, in November the Chancellor announced, at a CBI dinner, that the OFR was to be abolished in favour of the BR. Regulations repealing the original regulations were introduced in December and approved of[95] and therefore the proceedings on the bill's clauses saw government ministers arguing, largely on the grounds that it was a deregulatory measure, against legislation that had been twice introduced by them and had been defended on several previous occasions[96] [SN pages 69 to 74]. Following the abandonment of the OFR the BR received considerably more attention than it might have, as this is now the sole, statutory, channel for 'narrative reporting'.

This section also includes clauses on the use of websites as a means of communication by companies [SN pages 77 to 79].

### *e. Part 16 Audit*

This part of the bill includes highly detailed legislation affecting the requirement to have accounts, the appointment, functions, removal and regulation of auditors and, one of the major innovations in the bill, a section on auditors' liabilities.

Put briefly, there are only four audit companies in the UK who are generally accepted as being big enough and have the resources to be able to carry out audits on the biggest companies. This may have some competitive considerations but also it does raise the issue that it is harder for companies to maintain independence from their auditors when there are so few alternatives. The experience of Anderson, auditors of Enron, where the company was dissolved due to subsequent financial claims made against it, suggests that UK auditors too are vulnerable to such actions.[97] The Government, and the profession, feel that it is highly undesirable that the big four should become the bigger three. However, such protection as might be introduced has to be set against considerations akin to those of directors: negligent or dishonest acts should be subject to punishment and redress. The bill provides means by which companies and their auditors can negotiate liability limiting agreements, although comments in the Lords suggested that the provisions were less than effective in achieving their intended aim [SN pages 98 to 101].

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94 *The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005* (SI 2005/1011)

95 *The Companies Act 1985 (Operating and Financial Review) (Repeal) Regulations 2005* (SI 2005/3442)

96 Further background to the changes is included in a Library Standard Note: *Operating & Financial Review* SN/BT/3857

97 The case by Equitable Life against its auditors illustrates this.

### *f. Information about interests in company's shares*

This part of the bill restates existing requirements with respect to the notice of and disclosure of share interests. It also introduces certain new requirements such as the keeping for inspection of a Register of interests [SN pages 122 to 124].

### *g. Takeovers*

This part of the bill confers, for the first time, statutory powers on the Takeover Panel and thus to give its rules statutory backing. This was required by the EC's Takeovers Directive[98] [SN pages 125 to 130].

### *h. Statutory auditors*

The bill extends the remit of the statutory auditors, such as the Auditor General in England, Scotland and Wales, such that they could audit a wider range of bodies. In response to a prior report by Lord Sharman[99] it had been recommended that the Auditor General take responsibility for the auditing of companies that are owned by local government. The argument for extending the audit capabilities of the Auditor General is that parliamentary scrutiny is similarly extended in step.[SN pages 150 to 152]

## 2. Making it easier to set up and run a company

According to the DTI "We want to remove unnecessary burdens to directors and preserve Britain's reputation as a favoured country in which to incorporate".[100]

### *a. Company formation*

Where the new clauses in the bill differ from existing law the tendency is for there to be greater flexibility for companies to incorporate and to make it easier to effect change. One of the big differences is the downgrading in significance of the Company's Memorandum to that of an 'historical record' and the consequent rise in importance of its Articles of Association and other documents that need to be registered with the Registrar [SN pages 8 & 9].

### *b. A company's constitution*

Similar to the above section, various changes have been introduced to the procedures to be followed when, for example a company wishes to change its constitution. The clauses were uncontroversial in committee.

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98 More information on the Takeover Directive can be found in the Library Standard Note SN/BT/1489

99 *Holding to Account: The review of Audit and Accountability in Central Government*, published 2001, H Dep 2001/52

100 Op cit DTI webpage

### *c. A company's capacity and related measures*

Again a series of relatively uncontroversial clauses some of which facilitate the ease with which a company can make contracts. The longest debate was over the use by companies of a 'common seal' which opposition peers argued was out of date [SN 10 pages to 11].

### *d. A company's name*

The controversial section in this part was the new power given to ministers to make changes to what is not permitted in a company's name. Authorisation for the regulations comes after they have been made; something the Government accepted was 'an unusual formulation'. There is an emphasis on government being able to take speedy action to prohibit names or the use of symbols. This may have been influenced by the forthcoming Olympics and related legislation to limit exploitation of the Olympic 'brand' [SN pages 11 to 15].

### *e. A company's registered office*

Several provisions affect Welsh companies. Welsh companies are now defined in the legislation and have a procedure by which they may de-register from being Welsh and may be registered in England & Wales [SN pages 15 to 16].

### *f. Re registering as a means of altering a company's status*

This section is concerned with the means by which companies can change their status from limited to unlimited. Some clauses, such as clause 89, introduced new requirements, many simply restated the previous legislation. It was an uncontroversial section of the bill in the Lords [SN page 16].

### *g. Company investigations*

The bill gives new flexible powers to the Secretary of State to intervene in a company investigation. He can curtail it or change the inspectors. The clauses were uncontroversial in committee.

### *h. Business names*

One example of law consolidation can be found in this part which largely repeals or replaces the *Business Names Act 1985* and incorporates legislation from the 1985 Act. New powers are granted, such that the Secretary of State may revoke approval of a name in certain circumstances [SN 148 to 149].

## 3. Ensuring better regulation and a "Think Small First" approach

The Department said that it wanted to "reset the balance" between large and small companies in the way that the law affected them.

### *a. Members of a company*

This chapter of the bill largely restates existing law. It did address the issue of the security and integrity of the shareholders register and tightened up some requirements on companies [SN pages 16 to 18].

### *b. Company secretaries*

Under the bill private companies are no longer required to have a company secretary. The argument in favour of this is that for many small companies, company secretaries do not add anything to the 'governance' of the company, sometimes, for example, they are members of the family. Against that, the argument was put that an independent company secretary is the officer most likely to be able to promote adherence to corporate governance responsibilities. Further, the distinction between private and public companies should be replaced by one based upon size [SN pages 56 to 58].

### *c. Resolutions and meetings*

Most of this part restates provisions in the 1985 Act. However, it does ease requirements on private companies; they no longer need to hold an AGM and many decisions that would have been taken there can now be made on the basis of a written resolution of the company [SN pages 58 to 62].

### *d. Control of political donations and expenditure*

Legislation controlling donations to political parties was changed by the *Political Parties, Elections and Referendums Act 2000*. The clauses in the bill restate this legislation but with changes to reflect the new dispensations for private companies and new provisions for holding companies and their subsidiaries [SN pages 63 to 68].

### *e. Private and public companies*

This part sets out the distinctions between the two main types of company, public and private and dealt with the technical matters such as distributions of shares in private companies [SN pages 101 to 104].

### *f. Allotment of shares*

This part, which is highly technical in nature, relaxes current rules, in some cases, for private companies when they wish to allot shares [SN pages 104 to 110].

### *g. Share capital*

Share capital is often seen as the ultimate financial protection for customers and creditors in their dealings with a company; if the company goes 'bust' the share capital may provide resources for redress. Thus company law, which this part largely restates, imposes conditions on how share capital is defined, manipulated and in what circumstances it may be reduced [SN pages 104 to 121].

### *h. UK companies not formed under the Companies Acts*

This part applies to a relatively minor category of enterprise such as companies under Royal Charter or those formed by a private Act of Parliament. Provisions set out how such companies might register as companies 'proper' [No significant comment in Committee].

### *i. Oversea companies*

This part sets out registration, reporting and disclosure rules on companies registered abroad. Currently the regulation of oversea companies is highly complicated by the interaction between UK law in the 1985 Act and the subsequent EU Eleventh Company Law Directive.[SN pages 136 to 137]

### *j. The Registrar of Companies*

This part restates the basic duties and powers of the Registrar at Companies House. It gives the Registrar some greater flexibility in levying fees for core and non-core activities [SN pages 136 to 141].

### *k. Offences under the Companies Act*

The bill introduces many changes to criminal liability, including several new offences. One principle that the bill tries to follow is that where the 'victim' of the offence is only the company or its shareholders, there is little point in punishing the shareholders twice by levying penalties on the company. The bill also looks in detail at the appropriate level of responsibility for offences [SN pages 141 to 142].

### 4. Providing flexibility for the future.

The Government's 'new reform power to allow updating and amendment [of company law] as circumstances dictate' was one of the major innovations of the new legislation. During the course of the Committee proceedings, however, the Government withdrew all of its original clauses to this effect [SN pages 145 to 148] but introduced some more targeted proposals on Report.[101]

# IV Internet links

The following are a selection of internet resources related to the bill.

All internet links were current on 30 May 2006. Some are compressed links. If these do not automatically take you to the internet site, place cursor over the link, hold Ctrl key down on the keyboard and click with the principal mouse button.

[101] HL Deb 10 May 2006 cc1004-6

### *a. Official links*

Company Law Review
http://tinyurl.com/ritkd

Responses to the Company Law Reform White Paper. Available as a zip file located at the Department of Trade and Industry website:
http://webarchive.nationalarchives.gov.uk/20070603164510/http:/www.dti.gov.uk/bbf/co-law-reform-bill/clr-review/page22794.html (Please note that this is a compressed zip file due to the quantity of material it contains.)

Parts of Bill and Accompanying Explanatory Notes
http://tinyurl.com/orteg

Regulatory Impact Assessment
http://tinyurl.com/epqlx

Small Business Summary
http://webarchive.nationalarchives.gov.uk/20070603164510/http://www.dti.gov.uk/bbf/co-law-reform-bill/bill-and-notes/page22823.html

A list of respondents to the Northern Ireland DETI consultation on proposals for modernising company law, launched in September 2005, can be found at:
http://web.archive.org/web/20060622204802/http://www.detini.gov.uk/cgi-bin/downutildoc?id=1272

### *b. Links to outside bodies and groups.*[102]

Association of Chartered Certified Accountants (ACCA)
http://hcl1.hclibrary.parliament.uk/Other_orgs/ACCA/company_%20law2005.pdf

Association of Investment Trust Companies (AITC)
http://web.archive.org/web/20060304115651/http://www.aitc.co.uk/press_centre/default.asp?id=4326
and
http://web.archive.org/web/20060314035437/http://www.aitc.co.uk/files/technical/CompanyLawwhitepaperresponse.pdf

Association of British Insurers (ABI)
http://web.archive.org/web/20070618173532/http://www.abi.org.uk/Newsreleases/viewNewsRelease.asp?nrid=12213

Association of Corporate Treasurers (ACT)
http://hcl1.hclibrary.parliament.uk/Other_orgs/ACT/company_law2005.doc

Business & Human Rights Resource Centre ("an independent organisation in partnership with Amnesty International Business Groups & leading academic institutions")
http://tinyurl.com/mpcya

Confederation of British Industry (CBI)
http://tinyurl.com/gv43g

Deloitte (one of the "Big Four" accountancy firms)
http://tinyurl.com/gclps

Institute of Chartered Accountants in England & Wales (ICAEW)
http://tinyurl.com/el73p

Institute of Chartered Secretaries and Administrators (ICSA)
http://www.ICSA.org.uk/images/0511%20position%20statement.pdf

Institute of Directors (IOD)
http://press.iod.com/newsdetails.aspx?ref=171&m=2&mi=62&ms=

Labour Finance & Industry Group (LFIG)
http://web.archive.org/web/20060211120957/http://www.lfig.org/study-groups/1_co_law_reform.htm

Law Society
http://tinyurl.com/z5zdg

Law Societies Joint Brussels Office
http://www.eyba.org/downloads/Company%20Law%20Reform%20Update-May2006.pdf

London Stock Exchange
http://tinyurl.com/zl9f7

PriceWaterhouseCoopers LLP (one of the "Big Four" accountancy firms)
http://tinyurl.com/mryyj

SustainAbility ("An Independent think tank and strategy consultancy)". Membership includes experts from the Chartered Institute of Public Relations, Local Authority Pension Fund Forum and Which?)
http://tinyurl.com/o3nh3

Trades Union Congress (TUC)
http://tinyurl.com/rn875

Trade Justice Movement (A coalition of over 75 UK organisations including development agencies, campaign groups, trade unions, student groups, faith groups and environmental organisations)
http://tinyurl.com/e6pcd