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Modern Company Law for a Competitive Economy – Final Report from the Company Law Review Steering Group

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The Company Law Review Steering Group, set up by the Department of Trade and Industry in 1998, recently presented its final report to the Secretary of State. The report contains a blueprint for comprehensive reform and modernisation of company law in a wide range of areas. The following is a brief summary of the report's principal recommendations.

Small and private companies

- The rules on a company's internal administrative procedures should be simplified so that private companies:
 - (a) need not hold AGMs, lay accounts in general meeting nor appoint auditors annually unless they expressly choose to do so;

- (b) are no longer obliged to appoint a company secretary;
- (c) have access to a new, simpler model constitution to replace the existing memorandum and articles of association designed especially for small private companies.
- Simplification of formal decision-making procedures by:
 - (a) codifying and extending the existing common law 'unanimous consent rule' by stating expressly in statute that any decision which the company has power to make may be taken without observing any of the formalities of the Companies Act or the company's constitution where the members unanimously agree;
 - (b) making it easier for private companies to take decisions by written resolution without the need for a shareholder meeting.
- Encouraging mediation and arbitration as alternatives to litigation, in particular by creating an arbitration scheme aimed specifically at dealing with shareholder disputes.
- Reducing the burden of financial reporting and audit and improving the usefulness of small company accounts by:
 - (a) simplifying the format and content requirements for the accounts of small companies, but removing the ability of small companies to file 'abbreviated accounts' which are currently considered to be rather uninformative;
 - (b) increasing the threshold below which companies are exempt from the requirement to have their accounts audited;
 - (c) extending the small company accounting regime so that companies which meet any two of the following criteria are classed as 'small': turnover of no more than £4.8 million (currently £2.8 million); balance sheet total of no more than £2.4 million (currently £1.4 million); no more than 50 employees (as now);
 - (d) reducing the time limit for private companies to file accounts from the present ten months to seven months after their financial year end.
- Simplifying the capital maintenance regime for all private companies with, in particular, repeal of the present rules on financial assistance in connection with share acquisitions. In the context of private companies, and particularly where a group of companies is undertaking an internal reorganisation, the financial assistance rules are considered too complex and result in excess costs being incurred.

Directors

- The basic duties of directors should be clearly set out in the Companies Act rather than relying on common law.
- The current rules in the Companies Act on directors' conflicts of interest should be updated and clarified.
- Directors' contracts of employment should be limited to a period of three years on first appointment and one year for reappointments, unless shareholders approve a longer period.
- There should be improved disclosure requirements in relation to a director's training, qualifications and other relevant information.

Shareholders

- The law should be reformed to make it easier for investors who hold shares in nominee accounts to exercise shareholders' rights and communicate directly with the company.
- There should be more transparency about the role of institutional investors. In particular, companies should disclose in their annual report their major relationships with financial institutions. Institutional investors who manage funds on behalf of others should disclose how they have voted their shares, and the voting process on key company resolutions should be audited.
- Quoted companies should be required to circulate members' resolutions free of charge with the AGM papers where the resolution has the requisite level of support and is received by a specified deadline.

Company reporting and audit

- Most public companies and large private companies should be required to publish an operating and financial review (OFR) as part of the annual report; this would provide a review of the business, its performance, plans and prospects, and other information which the directors regard as necessary to give a full understanding of the business (eg relationships with employees, suppliers and customers). Quoted companies should make their annual report and accounts available on a website within four months of the year end; they should then be required to wait at least 15 days before finalising the AGM papers for circulation in order to allow sufficient time for shareholders to table resolutions for debate at the AGM.

- All public companies should be required to lay the accounts in general meeting and file them at Companies House within six months of their year end.
- The auditors' duty of care should not be extended by statute beyond that which develops through the courts.
- Directors and employees should have wider statutory duties to assist the auditors. Auditors should be entitled to limit their liability to the company and to third parties, but within appropriate limits to be set by the Secretary of State.

Institutional arrangements

- A Company Law and Reporting Commission should be established to keep company law continually under review, prepare an annual report on the state of company law and corporate governance, and on any need for reform and issue guidance and advice on proposed secondary legislation.
- A Standards Board would be set up to make detailed rules on accounting and reporting; make disclosure rules in areas such as information to be provided to shareholders; make rules on matters such as the conduct of AGMs; and publish guidance on other issues within its remit.
- A Private Companies Committee would also be established to examine the impact of company law and reporting requirements on private companies, with the Company Law and Reporting Commission and the Standards Board being required to take account of its advice.

Conclusion

As can be seen from this brief summary, the report is extremely wide ranging and if its recommendations are taken forward it will have significant implications for companies and their directors and officers.

The requirement that directors must be properly qualified for the board places a significant onus on the chairman in forming the board and creates significant potential for future liability. On the one hand, there are the objective measures of suitability such as academic and professional qualifications, while on the other, there are more subjective measures such as the suitability of a director's previous

business experience. The task is to reconcile these objective and subjective measures into a judgement that can stand the test of law. It is probable that few chairmen would feel totally confident in doing so, recognising that most business appointments bring with them an element of risk arising from the human dimension that falls under that most uncomfortable risk category labelled 'intangible'.

When things go wrong, disappointed shareholders and their legal advisers may be more than ready to adduce that a lack of positive performance on the part of a director necessarily arises from unsuitable qualification, and therein lies the danger of an otherwise apparently benign proper qualification requirement.

Before the last General Election, the Government made a manifesto commitment to increase company accountability and transparency. The new OFR has been proposed as one way of increasing accountability by requiring directors to produce a narrative that sets out a structured account of how the company is generating shareholder value. Up until now, companies have been required to do no more than produce a set of historic accounts with limited interpretation of the future prospects of the company. The OFR is intended to change this. The extent to which it will be in the interests of a company, possibly in competition with larger businesses, to disclose its key business drivers is one possible issue. Stakeholders in the business will certainly benefit from having a better understanding of the company's affairs than has been available up until now from a review of audited accounts. So far so good, but it may not be in the interests of the company to make such a public disclosure in what are, after all, competitive markets. Certainly, competitor analysis will be easier than ever before, but this is in the interests of the competitors themselves and not the company. Perhaps language can be used in the OFR that protects the confidentiality of key business initiatives, but if this happens, shareholders will be no better informed than they are now and the purpose of the law will have been frustrated. This means that directors will have to manage the potential conflict between the confidential interests of the business and the duty to complete a proper OFR. A high level of judgement is going to be necessary in order to achieve this, tempered by the knowledge that it is a criminal offence for a director or officer of a company to knowingly or recklessly provide misleading, false or deceptive information.

The broad direction of the Company Law Review Steering Group's final report is an extension of directors' duties. Directors' duties will

continue to be solely to shareholders, but there is increasing emphasis on the importance of maintaining good relationships with those who have a legitimate interest in the company's activities. The proposed code of directors' duties states that directors should have regard to relationships with their employees, customers, suppliers, communities and the environment. The extent to which directors are seen to be successful in doing so will probably determine the shape of future rules. In effect, companies are increasingly being required to serve a social function beyond the generation of shareholder value, and to ignore this aspect at this point in history would no doubt prove a big mistake. Companies must increasingly meet the social expectations of the wider society within which they operate or expect to face 'big government' policies and red tape at some future date.

There is no doubt that business is expected to be increasingly accountable. The proposed Companies Commission would serve to keep company law under constant review and would be constituted from business leaders, investors and professional advisers. The Commission's role would potentially include giving guidance on the OFR, but in its widest context, the Commission would be expected to report annually to the Government on proposed changes in business legislation. The broad intention of the Commission would be to reduce the amount of legislation that business faces and, if this can be achieved, then most people would view it as a positive development, provided that there is no sacrifice of broader or deeper business or social interest in the process.

It remains to be seen whether the proposals of the Company Law Review Steering Group will become law either in whole or part, but the proposals represent an imaginative reforming vision which it is hoped will increase the attractiveness of the United Kingdom as a place in which to do business.