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Company Law Reform Bill

Notes on Points that UKSA considers warrant further attention

This note provides some commentary on the Company Law Reform Bill as first introduced into the House of Lords in November 2005. This list has been compiled to cover all the points that the UKSA working group consider to be deserving of further attention whether or not they are of direct importance to UKSA. We have referred to the Explanatory Notes published by the DTI where they add information relevant to our comments.

Part 5 – A Company's Name

This is the Part that puts restrictions on choice of names for example requiring approval for use of a name that appears to indicate a connection with Government. It also gives power to object to a name in which a person has goodwill. However, the let-outs in S.70(4)(b), (c) and (d) seem so wide that one might wonder what point there is in giving protection – for example one let-out is that the company is proposing to operate under the name “and has incurred substantial start-up costs in preparation.” So if you throw enough money at it there is no protection for the existing holder of the name!

Part 8 – Members of a Company

The Bill follows the White Paper as regards the public nature of the register. It requires companies to either comply with a request for inspection of the register or provision of a copy within five days or to apply to the court. The court can authorise refusal of the request if it is not sought for a “proper purpose”. The Company Law Review (“CLR”) attempted to define “proper purpose” but this has not been followed through. The Explanatory Notes simply say *“The clause does not attempt to define what are proper purposes but provides a procedure by which the company can refer the matter to the court.”* This is clearly unsatisfactory. What, for example, is the position of someone who buys a list in order to circulate to try to sell investment services? Which company is going to be the first to go to court to establish some case law?

This clause is of particular concern to UKSA as we sometimes obtain a copy of a share register so that we can bring matters of public concern to the attention of the shareholders in a company. Not only is it not clear to us whether all our activities might be covered by the phrase "proper purpose", but we risk substantial legal costs in contesting such proceedings if the company disputes our rights to receive a copy (including paying the company's costs if the court decides we have no such right).

Part 9 – Exercise of Members' Rights

This is the part about enabling companies to enfranchise holders through nominees. Our comments first made in response to the White Paper remain unanswered. As we said then: "We are not clear why the chosen route towards enfranchisement is the complicated one of (partially) enabling nominees to assign 'all or any specified rights', instead of the more direct route of legislating that the beneficial holders through the nominee accounts of registered brokers are ipso facto enfranchised, with all the rights of an on-the-register shareholder". Thus the Bill's progress to enfranchise nominee shareholders simply comprises giving companies a voluntary right to allow nominees a voluntary right to assign such rights as they choose in respect of their nominee accounts to a third party of their choice (which would hopefully be the beneficial owner). But not including anything that gives a right of action against the company. UKSA will be pressing strongly for the legislation to go much further towards giving rights to holders in nominee names.

S.137 contains the reserve powers to make regulations but these only extend to receiving documents and information so it would seem that further primary legislation would be needed to give nominee holders rights to go to meetings and to vote. Hence, even if we have to accept that compulsion will only be included as a reserve power, the section needs to be considerably widened.

Part 10 – Directors

Section 147 requires the residential address to be shown in the register unless a non-disclosure certificate is in force. The only requirements to get such a certificate are to apply and to pay any fee. The residential address then becomes a protected address, the director gets a unique identifier and the register will only show the service address, the identifier and the country, state (or part of the UK) in which he is usually resident. There is no indication of how narrowly part of the UK must be defined and this should be made clear. The registrar may disclose a protected address to a public authority and to a credit reference agency. The court may order disclosure if it is satisfied that the service address is not effective for the service of documents. The general feeling seems to be that this is acceptable but it may be worth keeping in view. It is said to follow the CLR's recommendation.

The Explanatory Notes also say "in fulfilment of a Government commitment given in 1998 the particulars no longer include details of other directorships held." The reasoning behind this escapes us.

The provisions on duties generally follow the draft although they have been changed to the third person. In 154(3) there is a reference to "certain common law rules and equitable principles" and reference is made to these at some length in the Explanatory Notes. We are, however, not convinced that referring to them in the Bill is helpful.

Despite the recent comments in the Sunday Telegraph, we still think the general duties in S. 156 strike a reasonable balance i.e. the requirements to have regard to other stakeholders are qualified and do not override the prime objective of promoting “the success of the company for the benefit of its members as a whole”.

In S.159 the Directors can still authorise a conflict of interest situation (if the constitution allows) without telling the shareholders – we objected to this and still think that any such occurrence should be reported in the next Annual Report. The Explanatory Notes say: *“The CLR were concerned that this strict requirement might stifle entrepreneurial activity; and therefore recommended that, in the case of a private company, it should be possible for conflicts to be authorised by independent directors unless the company’s constitution prevents this.”* Either there is a misprint or they have gone further than the CLR in extending this to public companies.

S.171 provides that a director may not be guaranteed a service contract longer than 5 years without a resolution of the members. We would like to press for a shorter period – say 2 years.

S.195 to S.202 came as a surprise requiring loss of office payments in excess of £200 to be approved by the members. This also applies to payments on take-overs etc. Exceptions include settlements of legal obligations or damages, settlement or compromise of claims and pension for past service. The exceptions in S.200(1) for compromise and pension items seem to give quite a lot of scope to get round this and may be worth pursuing – the Explanatory Notes do not help. In general, however, this is a group of sections that we welcome.

The definition of “connected person” in S. 231 and 232 has got a lot more complicated because of treating *“any other person (whether of a different sex or the same sex) with whom the director lives in an enduring family relationship”* as if they were a spouse. This necessitates excluding specified relatives who were not “connected” in the 1985 Act. However, it provides the opportunity to review these – in particular we can’t see any justification for excluding siblings. In fact the Explanatory Notes say that the Law Commission recommended the inclusion of siblings but *“this has not been implemented”*. We note that “partner” is used in two different senses in successive clauses but, more important, is how “enduring” can be defined and who decides if it applies.

Part 11 – Derivative Claims and Actions

In our comments at the consultation stage (letter 5 September 2005) we took up strongly the fact that it appeared that a company could ratify an action and thus exclude it from the possibility of a derivative action. S.242(2) carries forward the wording that we criticised, unchanged. The Explanatory Material issued with the original draft clauses said: “The Department is considering whether there should be substantive changes to the general law on ratification in the light of the responses to the White Paper clauses on directors.” The Explanatory Notes now issued say: *“The intention is that any decision by a company to ratify conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be taken by the members, and without reliance on the votes of those members with a personal interest in the ratification.”* There is no indication how this is to be achieved but if it were clearly expressed our objection would be met.

In what is now S.241(2) we asked for "or" to be added at the end of (a) so that (a) and (b) become alternatives but this has not been done . As the Bill stands, the company must have both abused the process of the court and failed to prosecute the claim diligently before the claim can be continued as a derivative claim. We also said that it would be important that expense should not be a barrier to court clearance and there is no sign that this has been considered.

Part 13 – Resolutions and meetings

The Bill has changed from the draft in requiring 21 days notice for public company AGMs rather than the 14 days proposed at consultation. 14 days is retained for other General Meetings. This appears to be acceptable although we noted (and the Minister too in introducing the Bill) that the European Commission's consultation proposed 21 *business* days.

In our evidence we pressed for the votes of the members present at meetings to be taken and announced before the proxies are taken into account. We seem to be losing the battle on this one.

Part 14 Control of political donations and expenditure

In our letter of 5 September we suggested that the definition of political expenditure (now S.337) was so wide that it could catch expenditure on a single issue directly affecting a company. We suggested a small change in the wording but this has not been adopted.

Part 15 Accounts and reports

S.406 to S408 require accounts and reports to be made available on the company's website but only until the next year's accounts and reports are made available. This contrasts with S.327 which requires results of polls to be kept on the website for 2 years. We see no justification for removing reports and accounts after only one year. Moreover, at the consultation stage we pressed for a wide range of other information to be required on websites e.g. Regulatory News Announcements, communications to shareholders, prospectuses. This has been ignored.

Part 16 Auditors

S.506 to S.510 deal with statements to be given by auditors on ceasing to hold office. At the consultation stage we pointed out that the issue of such a statement is price-sensitive information and yet a number of parties would see it before the members, especially if application was being made to the courts. No change has been made as a result of our representation. There is, however, a problem here in that one of the reasons cited in the Explanatory Notes for going to the court is that the statement might be defamatory – maybe the members' interests in seeing it should take priority.

S.512 to S.515 ostensibly deal with the rights to raise audit concerns at accounts meeting. However, in fact they are mostly about website publication of audit concerns. It seems that the only extension of rights at meetings is in relation to any statement that has had to be published on a website. It is not clear to us how the members are supposed to know that there is anything worth having published on the website. At the consultation stage (letter of 5 September 2005) we asked for rights to question auditors at meetings and protested at the convoluted nature of the quorum requirements for requiring publication on the website.

We also expressed concern that the risk of having to pay both sides' costs might be an undue deterrent and sought a safe harbour procedure. None of these points has been addressed.

S.516 to S.523 deal with agreements to limit auditors' liability. At the consultation stage we said that these provisions were made ambiguous by the reference to "such amount as is fair and reasonable" in S.520(1). We also responded to the DTI's request for views in relation to the Caparo judgment which we believe has limited the duty of auditors in a way that causes problems. Neither of these issues has been addressed.

Part 17 Private and Public Companies

Re S.529 we commented at the consultation stage that the courts are offered no alternative to winding-up the company if it cannot be re-registered as a public company. We suggested that the courts should be given some discretion but no change has been made.

Part 18 Allotment of shares

S542 gives power to make regulations reducing the period for communication of pre-emption offers. We made the point at the consultation stage that for any company the period should only be reduced to 14 days if a substantial majority of the members agreed. We still hold that view. Since this is a regulation-making power, it would be desirable to include in the power the ability to include such conditions as to member agreement as the Secretary of State thinks fit.

Part 22 Takeovers

At the consultation stage we welcomed the giving of statutory powers to the Takeover Panel (letter 5 September 2005) but regretted the absence of a level playing field as regards Europe and suggested that a robust stance from the Government in this area would be welcome. We still hold to these views. S.628 dealing with failure to comply with rules about bid documentation seems to be new since the consultation. We believe that S.628 (2)(b) is ambiguous and need to be changed to make it clear that "who" relates to "director, member, agent or employee" and not to "person making the bid". Otherwise an innocent party could be held to be committing an offence. The intention is clear in the Explanatory Notes but not in the Bill.

Part 34 Miscellaneous Provisions

S.866 gives the power to require disclosure of voting by institutions. At the consultation stage we commented that (a) a *de minimis* rule should be included and, (b) the clauses should be drafted so as to give the flexibility for the disclosure to come from other sources. Neither of these suggestions have been adopted.