Company law review

From Update 2001/1

The latest major consultation document on company law was published in November – just too late to be covered in the last *Update*. Our response was submitted on 15 February.
We have put a major effort into the Company Law Review over the last three years, submitting numerous lengthy responses to the consultations, petitioning MPs, attending the Review's quarterly Consultative Committee meetings as representatives of private shareholders and meeting with the Review team last autumn. It all finally appears to be paying off: the Review is adopting at least some of our ideas, as well as abandoning the proposals that have caused us most concern.

The AGM timetable and shareholder resolutions

Last year, we proposed that companies should be required to publish the Annual Report and Accounts on the internet first, and then to wait at least two weeks before sending out the Notice of AGM. This would allow shareholders (institutional or private) to see the company's results in detail and to submit their own resolutions in time to be sent out with the Notice of AGM.

We put forward this proposal because it is almost impossible for shareholders to submit resolutions under existing law: the annual report and the notice of AGM are usually published and sent to shareholders together, so that by the time shareholders have seen the annual report and know what state the company is in, what the directors are paying themselves and what their plans are, it is already too late to submit a resolution.

As a result, shareholders have to base their resolutions on information that may already be six months or a year out of date. It is not surprising that resolutions

from institutional shareholders are very rare, and resolutions from private shareholders are virtually non-existent.

Under our proposal, shareholders could read the new annual report as soon as it was published on the internet and would then have two weeks in which to gather the necessary signatures from fellow shareholders and to submit the resolution to the company. This is a challenging timetable, to say the least, but it does at least create a window of opportunity for shareholders that does not exist today.

Our proposal has not only found its way into the current consultation document: it appears to carry the support of the Review team.

In a few months we shall know if this proposal is popular enough with institutional investors to survive the consultation process. If it does survive, it will be our second major success in this area: the Review has already accepted our long-standing proposal that, when shareholders submit valid resolutions in good time, companies must not be allowed to demand that those shareholders cover the costs of circulating the resolution with the AGM notice.

Publishing institutional vote

At an early stage, we raised the question of conflicts of interest that discourage institutional shareholders from exercising their votes responsibly. Last year, we proposed that, where a financial institution held more than 3% of a company's shares, the company should be required to report how the votes had been cast.

Initially, the Review recognised that there was a theoretical problem, but doubted whether any action was needed. However, in the past year the Review has become convinced that this problem is very serious indeed, and that action is required: it is now clear that some company directors do indeed threaten to remove business from institutional investors unless they vote in favour of directors' resolutions and against hostile resolutions.

As a result, the current consultation puts forward various complementary ideas for tackling the problem – including our own proposal.

The emphasis is very much on disclosure – allowing shareholders and investors in institutional funds to judge for themselves whether conflicts of interest exist, and whether institutional votes are being cast responsibly.

Directors' employment contracts

The Review has decided in favour of limiting the notice periods in directors' employment contracts to an initial period of three years, reducing to one year after the initial term. Companies would only be able to award longer contracts to their directors if the shareholders had voted to approve a longer term.

Not surprisingly, this proposal was widely supported – a recognition that practices common a decade ago are no longer considered acceptable.

Scrapping the Report and Accounts

The proposal to force companies to send a short and basic preliminary report and accounts to all shareholders instead of the full annual report has been abandoned, after it became clear that there was strong resistance from many quarters as well as UKSA.

The new proposal is that companies will continue to be required to send either the full report or a summary financial statement. Shareholders who receive the summary statement will be entitled, as at present, to demand a copy of the full report.

However, the Review is still looking at the possibility of forcing some companies with large shareholder bases to produce a summary statement, and to send the summary statements to shareholders as the default document. Once again, we are opposing this aspect of the proposals.

Pre-emption rules (rights issues)

Last year, the Review asked whether pre-emption rules should be weakened or even scrapped, so that companies would be free to place large numbers of cheap shares with outside parties or favoured investors. Happily, it appears that there was overwhelming opposition to this proposal from institutional investors, and it has once again been laid to rest.

No doubt certain elements in the City of London will be pushing hard for this thoroughly discredited proposal to be resurrected yet again in a year or two, but it is at least off the agenda for the time being.

Nominee accounts

As we expected, the Review has decided in favour of removing various legal obstacles that prevent companies from recognising the rights of shareholders in nominee accounts. However, the Review is not prepared to force companies to recognise those shareholders' rights; instead, it will rely on stockbrokers and companies voluntarily working together to allow shareholders to receive company announcements, attend AGMs, vote and exercise their other rights. This is a very disappointing result, but we shall continue to argue the case for shareholders in nominee accounts whenever the opportunity arises.

Show of hands voting at general meetings

Last year, we pointed to a number of major cases in which companies, including BPAmoco,
British Aerospace and Rio Tinto, had unilaterally decided to ban show-of-hands voting at their AGMs, and we proposed that companies should be required to allow shareholders who were attending an AGM to vote by show-of-hands.

This proposal did not find favour. It will still be up to all of us to protest at every AGM where we are denied a show-of-hands vote.