Comments on behalf of The Association of Corporate Treasurers on:

Company Law Reform White Paper

A consultative document from the DTI March 2005

Introduction

The Association of Corporate Treasurers (ACT)

Established in the UK in 1979, The Association of Corporate Treasurers (ACT) is a centre of excellence for professionals in treasury, risk and corporate finance operating in the international marketplace. It has over 3,300 members from both the corporate and financial sectors, and its membership includes representatives from 95 of the FTSE 100 companies.

The ACT has 1,500 students in more than 40 countries. Its examinations are recognised by both practitioners and bankers as the global standard setters for treasury education and it is the leading provider of professional treasury education.

The ACT promotes study and best practice in finance and treasury management. It represents the interests of non-financial sector corporations in financial markets to governments, regulators, standards setters and trade bodies.

Contact details are provided on the last page of these comments.

Response to questions:

Chapter 3: Enhancing Shareholder Engagement and a Long-Term Investment Culture

3.1 Improving shareholder dialogue

The proposal to impose a shortened deadline for the AGM, combined with the 15 day proposal referred to below, would appear to squeeze the time available for the audit and consideration by the Audit Committee. Given that for listed companies it is really the preliminary results announcement that is critical to investors we wonder if there really is a need to shorten the deadline for the AGM from 7 to 6 months.

The use of modern communications methods and media is a sensible move that recognises the widespread take up in e-communications. Hence we support in principle the move to require quoted companies to put their preliminary announcements of annual results and their full reports and accounts on their websites. However, we are concerned that such information, freely available to the public (as opposed to being addressed to shareholders individually), could open the company and its officers to liability in countries that assert extra-territorial jurisdiction. Presumably a suitable certification by users of this section of the website could be used to limit liability. If there is doubt about this, we would oppose such a requirement. (Such a potential liability would, among other things, tend to contribute to a culture of making the OFR a detailed prospectus-type document.)

The move to allow shareholders a 15 day period to propose a resolution to be included at the meeting where the accounts are laid is theoretically good for shareholder dialogue but we would ask that the practical logistics be carefully considered in that it does introduce an additional lead time into the normal process of AGM and approval of accounts and dividends. (See above).

The proposal for an independent scrutineer of a poll suggests that this does not already happen. Does the Government not consider the auditors to be independent (they being the usual scrutineers)?

The White Paper states that the government will continue to explore the proposal that institutional shareholders should be required to disclose how their voting rights have been exercised. It is assumed that the objective here is to make institutional shareholders who are investing as fiduciaries for their own investors more accountable to those end investors. That being the case we would wish to see that the obligation to disclose should fall on the institutional shareholders themselves rather than on the companies in whom they are invested. Even then this is not going to be a straight forward matter. By comparison one would not expect a funds manager to report back to his investors on the rationale for every sale and purchase, nor should they do so on every vote they exercise. A statement of general policy and strategy for voting on their investments may make sense, but this does not seem to be an essential reform to be included in the Companies Act.

We strongly support the move to make e-communication the default position with an option for shareholders to request paper communication if they so wish.

3.2 Enfranchising indirect investors

The ACT supports the moves proposed to help indirect investors to be more involved with the companies in which they have invested. The proposals will involve considerable cost for companies. It is not just a case of substituting in the register of members the name, etc of the "indirect" investor for the registered shareholder. The former will have

to be included in addition, in relation to a particular shareholding, possibly for different purposes one compared with another. This will give rise to significant software and administration costs.

Therefore an alternative might be to encourage the intermediary to take responsibility for passing on information, accounts etc to the indirect investors and this could most easily be done with electronic copies. We believe that it should be recognised that compelling companies to provide information to be passed on by the intermediary to the ultimate shareholders in paper form would be expensive. In this situation we recommend that the indirect shareholder should only have the right to electronic copies and thus if they are not comfortable with this they should change so as to own their shares directly.

3.3 Directors

Duties

We believe that the codification of directors' duties is helpful and that the balance between the various interests has been struck at the right level. The formulation that in exercising this duty the directors should have regard to the interests of other stakeholders is in our view the right degree of recognition of those interests.

We are glad to see that the directors' duties will continue to be owed to the Company.

We have some concern with draft Clause B3(3)(c) – "the need to act fairly as between members … who have different interests". We think the word "need", indeed the whole sub-paragraph, is too strong and could imply a duty to enquire about, or at least take note (if aware) of, differing interests of shareholders, which could be myriad. For example, different jurisdictions within the share register could mean different shareholder consequences from a given corporate proposal. The company should not have to worry about such matters. The old principle of a company being deemed not to have notice, even if it happens to have actual knowledge, of anything in relation to shareholders other than what is on the register is correct and should be maintained. The Government is already proposing a controlled and progressive inroad into that principle – section 3.2 of the consultation document, discussed above – and it is inappropriate that a possible further inroad should be made "by mistake". We suggest that sub-paragraph (c) be deleted altogether. Shareholder minorities are looked after elsewhere in company law.

Although being in favour of the principle of codifying directors' duties we note that the Law Society in its response to the DTI has expressed concerns over the exact drafting and the way in which the old common law is in a way to be used in interpreting the new statutory provision. The point made about the requirement to promote the "success" of the company "for the benefit of its members" is of particular importance. The success of a company might be difficult to interpret for example in the case of a charity. In the past the directors have had to act in the interests of the company as an entity separate from the

members. We see nothing to be gained from moving away from this concept and it would seem an odd move given that the directors' duties continue to be owed to the company rather than the members.

There is one area where there is to be a significant change from the present regime and that is the procedure when a director wishes to exploit a business opportunity that might be exploited by the company. Rather than needing consent from the members the new Act would provide that the board could waive the company's rights. This is a sensible and practical step which will give cost and time savings but without any real prejudice to the members, provided that it is eventually reported to members in the directors' report.

We note that the statement of duties will enable the law to respond to changing business circumstances and needs and will therefore leave scope for the courts to interpret and develop its provisions in a way that reflects the nature and effect of the principles they reflect. Recognition of the court's discretion is a good feature, and is welcomed.

On page 22 of the consultation document it states that the Bill will give shareholders the right to receive copies of directors' service contracts on payment of a fee. Elsewhere in the white paper there is good recognition of the widespread use of e-communications. We recommend that that the payment of a fee only be applicable for paper copies and that e-mail copies be provided free of charge.

We note that the Government is continuing to consider whether shareholders should be allowed, if they so wished, to limit director's liability for negligence. We accept that this might be a useful flexibility.

We note that the Bill includes the requirement that at least one director of a company must be a natural person, and support this. We are also pleased to see that the government recognizes that an outright banning of corporate directors would not be a good move, given that there can be many who wish to make use of the current flexible set up for perfectly legitimate reasons.

3.5 Auditor Liability and audit quality

The ACT welcomes and generally supports the proposals covering auditor liability and audit quality. The proposals are largely consistent with the reactions fed back by the ACT on previous consultations.

However we are not in favour of the move to include the lead partner's signature on the audit report, with the implication that there will be some sort of person liability. An audit is a complex, collaborative exercise carried out under a firm's procedures, not those of an individual partner. Past cases amply show that if an individual Partner is negligent then

his firm can still be pursued. However, as a point of principle the stakeholders should look to the firm not the individual.

There are proposals to extend the rights of shareholders to question the auditors. We do not believe that changes are needed here, or that if there are to be changes there should be a limited and well defined scope for the questions allowed.

We have concerns about the new criminal offence of knowingly or recklessly giving an incorrect audit opinion. The current civil regime seems satisfactory. We note the Law Society's concerns in this area.

Chapter 4; Ensuring better regulation and a "Think Small First" approach

We welcome the overall intent to make the law accessible and user friendly, especially for smaller companies. We are not commenting on the detail of this section, save on the proposals regarding offences.

It is proposed that the existing occasions when a director of officer of a company can face criminal sanctions are extended to cover managers, under the "officer in default" provisions contained in part J of the draft clauses. We do not support this extension of liability to "senior executives".

If any extension in those to be covered by the Act is to be included then the proposed wording is far from clear and is arguably too wide and with little recognition of reasonableness. Quoting from the draft clauses, any "contravention of an enactment in relation to a company" will mean that "an offence is committed by every officer of the company who is "in default"". "Any such person is in default for the purposes of the provision if he authorises or permits, participates in or fails to take all reasonable steps to prevent the contravention."

Although the draft wording is defined to take in senior executives "whose functions include securing compliance with the enactment" we believe that there is insufficient recognition of any standards of reasonableness in the executive's actions and in their function and authority within the company. The proposed provision puts undue pressure on a mere employee who is obliged by his contract of employment to follow orders and who does not, in contrast to a director, owe fiduciary duties to the company.

We see no compelling reason for extending liability to delegates.

4.8 Capital maintenance and share provisions

We note the proposals to simplify for private companies many of the provisions on capital maintenance and share. We welcome these steps. One element of particular note is the move to basing capital reductions for private companies on a solvency statement. In the ACT's response to the recent DTI consultation on European Company Law which covered similar ground we noted that the UK rules and accounting for distributable and non distributable profits had become highly complicated, and would become even more so with the advent of IFRS accounting where revaluations are more widespread. We argued that the UK should revisit this area to assess the benefits of a change to a solvency basis. We repeat that observation here and urge the DTI to review this whole area and consider the merits of moving to a solvency based regime for dividends and capital maintenance.

Many elements applicable to the Companies Act provisions over capital maintenance and shares by their nature involve complex legal niceties. We have reviewed the comments being made by the Law Society and generally endorse the views expressed therein.

4.17 Transparency Directive

HM Treasury is consulting on the major shareholdings notification implications from the Transparency Directive and that consultation asked some specific questions. The responses to those questions which have been sent to HM Treasury are reproduced here.

1. Do you agree with the proposal that the principal obligation of disclosure should be changed from the current 'interest in shares' under the Companies Act 1985 to control of exercisable voting rights under the Directive?

A1: No. The consultation notes that back in 1995 the majority of respondents favoured a move away from disclosure obligations by large shareholders based on their 'interest in shares' to a narrower definition based on the 'control of exercisable voting rights'. Since 1995 the holdings of derivatives of shares, stock lending and other arrangements have become much more common. Accordingly it can be important for a company to be aware of who is holding a stake in its shares in a wider sense eg. owns, controls or has certain rights over the shares, rather than just who happens at that instant to have the legal voting rights. We believe that leaving the definitions unchanged would be beneficial because of their wider reach. This would still be consistent with the needs of the Transparency Directive which refers to 'major holdings in issuers'.

It is interesting to see that the Takeover Panel in their consultation on "Dealings in Derivatives and Options – detailed proposals relating to amendments proposed to be made to the Takeover Code" PCB 2005/1 published on 13 May, recognised the

importance disclosure of "interests in shares" during a takeover. Their definition of interests in shares is drawn very widely and includes:

- owning them or having the right to direct the voting rights
- having the right to acquire, or obligation to take delivery, under any agreement to purchase, or under an option or derivative
- being party to a derivative whose value is determined from the share price or creates a long position in the shares

The complexity of the ownership and derivative arrangements can even mean that there could be an element of double counting for example when a shareholder grants a call option to another person.

John Sunderland, Chairman, Cadbury Schweppes plc & President, CBI, speaking at the Investor Relations Society Conference on April 21st reportedly drew attention to the lack of transparency resulting from interests in shares not arising from direct ownership of shares and that that it is laborious and expensive to disentangle even the primary layers of ownership, especially outside the UK. The issue is raised with greatest salience during take-overs but companies may want to keep track of who has interests in their shares routinely or at times of pressure, for example when a "hostile" party takes a significant shareholding – as happened to John Sunderland's company, Cadbury Schweppes, with US greenmailer General Cinema in 1987. Accordingly it seems to be a move in quite the wrong direction for the UK to change from routine reporting based on interests in shares to the narrow control of voting rights basis.

We recognise that the financial services industry and those who regularly advise or represent them are in favour of the restrictive voting rights concept in the directive, but feel strongly that transparency in this area in important for the overall market and for issuers.

2. Do you agree with the proposal to remove non-traded public limited companies from the scope of the disclosure regime?

A2: No. The transparency directive requires that all companies that are traded on a regulated market be brought within the disclosure of interests rules. You explain that the UK government intend to go beyond this and include all issuers whose shares are traded on any market in the UK, but that public limited companies whose shares are not traded on a market would be excluded from the disclosure regime. We think that this is unhelpful for companies and believe rather that all public companies should be able to make use of the disclosure requirements placed on shareholders. For example there are occasions under the money laundering regulations when a bank will need to know its customer and who owns or is standing behind it. The company itself therefore needs compulsory obligations on holders to disclose large shareholdings much as under section 212 notices as present.

It is essential that the existing section 212 rights entitling companies to seek information from persons as to whether they have an interest in the company's shares, be maintained.

3. Do you agree with the proposal to give the FSA powers to make issuers admitted to trading on non-regulated markets in the UK (and those with qualifying holdings in those issuers), subject to the regime where appropriate for market transparency reasons?

A3: Yes. The Transparency Directive is narrower in scope than the existing Company Law disclosure obligations and therefore for the reasons given in Q2 above we would support the government intent to go beyond the basic TD requirements. This is consistent with our view that all Public Limited companies should be within the scope of the disclosure regime, whether traded on a regulated market, non regulated market, or even no market at all.

4. Do you agree with the proposal to repeal the current criminal sanctions for breach of notification obligations and give the FSA powers to deal with breaches of notification obligations equivalent to those it has to deal with breaches of rules under FSMA?

A4: We believe that some strong method of enforcement is required and are content if this is handled through the FSA.

5. Do you agree with the proposal to maintain the scope of the current Companies Act regime and give the FSA equivalent powers to require disclosures in respect of holdings of financial instruments?

A5: Yes. As noted in A1 an ever growing variety of derivatives exist so we agree that it is appropriate to give the FSA suitable powers to cover disclosure of interests held via financial instruments. However as noted in A1 if the definition of major holding is defined based on the wider 'interests in shares' many financial instruments will already be picked up.

6. Do you have any comments on the likely costs of implementation of the major shareholdings notification provisions of the Directive?

A6: Our expectation is that the costs of implementation are likely to be trivial, particularly if electronic notifications are accepted and encouraged.

7. Do you have any comments on the impact on competition of implementation of the major shareholdings notification provisions of the Directive?

A7: There may exist marginal competition issues arising from the disclosure regime, but in all probability these will be too remote to be of any great significance.

8. Do you have any comments on the impact on small business of implementation of the major shareholdings notification provisions of the Directive?

A8: We do not see any special implications for small businesses

Chapter 6 Flexibility for the future

The proposal that future changes to Company law could be carried out through secondary legislation has alarmed some commentators. However we feel that the process and safeguards in the Regulatory Reform Orders are sufficient, for example the need for scrutiny by committees of the Commons and the Lords and for the approval by both Houses. We welcome the element of flexibility that this process can bring.

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