The Association of Corporate Treasurers Comments on DTI July 2002 consultation (CM 5553-I) on "Modernising Company Law" – November 2002

(Addressed to the Secretary of State for Trade and Industry)

I. Introduction

The Association

The Association of Corporate Treasurers was formed in 1979 to encourage and promote the study and practice of finance and treasury management and to educate those involved in the field.

Today, it is an organisation of professionals in corporate finance, risk and cash management operating internationally. It has over 3,000 fellows, members and associate members. With more than 1,200 students in more than 40 countries, its education and examination syllabuses are recognised as the global standard setters for treasury education.

Members adhere to the Association's ethical code and professional ethics are included as part of the membership examination syllabus.

The Association has published in its series "The business of finance" a number of guides on finance and treasury issues for directors, executive and non-executive, with an accounting or other, non-financial, background.

Members of the Association work in many fields. A number of members are on the boards of major companies in both executive and non-executive capacities. For example, certain former members of the Association's Council are Chairmen of some of the largest quoted European companies. The majority of fellows, however, are professionals working as senior executives below the board level in large public companies, responsible for the treasury and corporate finance functions.

Perspectives from the board and from senior management below the board inform our comments.

This Review

The ACT welcomes the opportunity to submit views on this important topic.

We would be pleased to further expand any point made herein or to assist the DTI in any other way

November 2002

II. Contents

III Summary of principal points

Generally we welcome the proposals for the updating of company law - which is much needed. However, we have reservations on some points.

a. Creditors

We believe that the privilege of limited liability is fundamental to commerce's flourishing, but that it means that the position of creditors must be a factor to be taken into account by directors both in policy making and in making disclosures. (Questions 2 and 58)

b. Corporate directors

We believe the proposed abolition of the corporate director to be an error, affecting both occupational pension funds and corporate finance structures. We suggest other ways of dealing with the issues. (Question 3)

c. Extension of the Bill's requirements beyond members of the board

We believe that certain conditions should be met before liability to criminal sanction may be extended. (Question 39)

d. The OFR

1. Consideration of risk in the company in the OFR

   We believe that directors should explicitly consider in the OFR the risk exposure of the company not just from the individual factors they discuss but, more importantly, looking at the overall situation. (Question 45)

2. Omission of material factors from the OFR on grounds of commercial sensitivity

   We believe that this should be available to directors, but subject to disclosure that something has been withheld – the consequences of which would greatly limit the use made of the exemption. (Question 55.)

3. "Safe harbour"

   As regards forward looking material in the OFR, we believe that protection for reasonable, good faith, matter is essential if these areas of the OFR are not to be reduced to a blandness which makes them of no use at all. (Question 57)

e. The company secretary in private companies

We believe that removal of the requirement for a company secretary in private companies should be reconsidered. (See section V.)

f. The (Accounting) Standards Board

As the Accounting Standards Board is developed into the Standards Board, we believe that the opportunity should be taken to review its funding and composition.

IV Comments/Responses to questions

Paragraph numbers in this section refer to question numbers in Part II (and Annex D) of the White paper

Directors' Duties

General duties owed to the company

1. Draft statutory statement of directors' duties

   The Association has already submitted comments on the draft statement.

   However, we would add one further comment. Many charities are companies limited by guarantee. It seems to us odd that such a guarantee company's directors have a duty to promote the success of the company *"for the benefit of its members"* – although we believe the wording is essential for other companies. Separate reference for such guarantee companies seems to be necessary[1].

Directors' duties in relation to creditors

2. Should mention be made of creditors among factors directors must take into account re Sch 2, para 2 duties?

   Yes.

   The note setting out the list of factors is non-exclusive. But creditors are crucial stakeholders no less important than those specified.

   That creditors are protected in insolvency circumstances by other legislation does not seem to be a reason to exclude them – employees too have some protections from other legislation. We do agree, however, that it would be inappropriate to import reference to duties under insolvency/approaching insolvency into this bill.

   Some financial creditors will have contractual protections in loan agreements or bond trust deeds/debentures. Others may be suppliers or employees for unpaid remuneration – both classes which are already explicitly included in the note to para. 2. But they cannot be harmed by any additional mention as creditors.

   There will be others who are bare creditors. And a wide variety of parties may be contingent creditors.

   Society grants the privilege of limited liability through means of the Companies Acts. That privilege has been and remains fundamental to the growth of commercial activity. It is not a privilege to abuse creditors, however. That should be drawn to attention of all companies.

   We recommend that creditors be added to the list of factors.

[1] In the longer run, separate legislation on charitable object incorporations may render this redundant.

Corporate directors

3. Should corporate directors be prohibited?

No.

The mischief at which the proposal is directed seems to be that of the potential for persons to hide behind incorporation – to avoid potential liability or to obscure influence. In the cases we identify that is not in question.

3.1 Uses of corporate directors

We are aware of at least two very important, useful and valuable uses of corporate directors:

- As directors/trustees in occupational pension schemes
- As directors of companies created for the purposes of structured financings.

The availability of corporate directors in these areas seems to be an advantage under present UK law compared to that in most foreign jurisdictions.

We are unimpressed that Australia and New Zealand have recently abolished corporate directorships. That France requires appointment of a permanent representative of the corporate director seems perversely to deny one of the advantages of the corporate director.

In the case of occupational pension schemes, the corporate director/trustee provides long-term continuity and independence. This must improve security of arrangements. Furthermore, by being able to field an expert on the particular topic of any meeting (an expert on pension benefit structures or another on evaluation of investment managers), the corporate director/trustee surely brings additional value.

To add additional uncertainty to occupational pensions schemes seems, at least, to be ill timed.

In the case of structured financings – which may be used to enable companies to take advantage of the financing potential of their balance sheets – the presence of the experienced corporate directors to give continuity for the life of the financing, which can run to many years, is important in establishing confidence in the arrangements, which have to satisfy all the parties' advisors and, crucially, the rating agencies. The overall arrangements, disclosures, etc., of course, have to satisfy the listing authorities and, often, other regulators.

Where there have been problems with special purpose companies – certain notorious US cases come to mind – the issue has been fraud, not corporate directors.

3.2 Proposals re corporate directors

If we are right in our assumption of the reason for considering abolishing corporate directors, we can suggest other ways of tackling the issue without losing one of London's financial sector advantages:

- Disclosure: When a corporate director is appointed, the directors of the company which is the corporate director should be disclosed additionally in the notification to Companies House. Changes should also be notified.

- If further action were required
  - companies with one or more corporate directors could be prohibited themselves from acting as corporate directors
  - a reasonable minimum capital could be set for companies acting as corporate directors.

We would consider it a serious mistake to abolish corporate directors.

Improving governance: company reporting and audit

The accounting, auditing and reporting regime for smaller companies

4. Raising of consolidation exemption threshold?

   We have no comment on this in the range being considered.

Other ways of simplifying and streamlining the law

Restrictions on the use of companies' registers of members

5. Rights of access to the register of members?

   While the Data Protection Act provides some safeguards, we believe that private shareholders should have a level of privacy. Access to or copies of the register should be limited and should be at the discretion of the directors, subject to narrow powers of the court to order such access by an applicant.

Sanctions

6. Companies Act offences

   i. Would disclosure of convictions increase compliance?

      We believe it would.

   ii. Should such disclosure be by the companies or through a central register?

      We recommend that disclosure be by both methods.

      Disclosure by the company alone may risk undue delay or attempted burying of the fact of conviction among other material.

Disclosure on a central register would ensure timely disclosure in a method which would allow simple search to reveal it. However, a register alone would be unlikely to attract any widespread publicity in the majority of cases and may pass shareholders by.

Transitional regime

7. Should companies have to re-register to benefit from the Bills provisions?

   We believe it is desirable that all companies are as far as possible subject to the same regime. Accordingly we believe that, subject to necessary transition arrangements, the new provisions should apply automatically without re-registration.

8. Transitional arrangements

   i. Is it worth exploring the broad approach to transitional arrangements?

      Yes, very much.

   ii. Are there any changes you would suggest?

      No. The transitional arrangements can only really be considered when the final substantive provisions in the bill are known.

Formation, status etc. of companies formed under this Act

Formation and status of a company

9. Issue of certificates of incorporation or entry on registers?

   We take the view that for most purposes, entry on the registers (with notification) should be sufficient. However, in some overseas jurisdictions a certificate may be required to be produced. Accordingly, certificates should be available, promptly, on request by the company and payment of a small fee.

10. Criminal liability on seeking of certificates (or entry on registers)

    In general, only if a statutory code for the (minimum) role/responsibilities of the secretary exists should the secretary risk penalties, other than on the same footing as other senior managers below the board as set out in draft section 208 – see comment on question 39, below.

11. Issue of trading certificates for public companies

    Our view is the same as for certificates of incorporation – see question 9.

Capital maintenance

Share premium accounting

12. Should a generic formula be used for expenses of issue?

    Yes.

13. Is the formulation "expenses of the issue" comprehensive?

    Yes, it seems to be.

Reduction of share capital

14. Will capital reduction by resolution, with a solvency statement, be attractive to private companies?

    Yes. But we would urge that the solvency statement be subject to auditor review – rather like a liquidity statement in a Class 1 circular for listed companied under the Listing Rules.

15. Is there no need to provide a right for creditors to object to capital reduction by this method?

    Creditors should be able to object. Private company creditors should be no worse off than comparable creditors to a public company.

16. Will capital reduction by resolution, with a solvency statement, be attractive to public companies?

    In principle, yes, but as obtaining a court order is in practice not hard compared to the rest of the process, it may not make a lot of difference. Again, we urge that the solvency statement be subject to auditor review (see 14 above).

17. Should reduction of capital be capable of being challenged after the event?

    Yes.

18. If the reduction can be challenged after the event, is the compliance statement of value?

    Yes. It shows a requirement for directors to undertake appropriate due diligence. And if it does not stand up to challenge, it may be the basis for establishing an offence.

19. If the reduction is not able to be challenged, is the compliance statement helpful as a way of helping ensure that all proper requirements have been complied with?

Yes – see answer to 18 above.

20. Do you agree with the abolishment of the right of creditors who were omitted from the court list to proceed against members to the extent of their liability on partly paid shares before the reduction if the company is insolvent after the reduction?

We express no opinion on this.

Auditors

21. Disqualification period for an auditor who shareholders have removed or declined to appoint?

Two years seems too short a period. And we suggest that any future appointment of such a person be required to be by ordinary resolution – i.e. not permitted under the directors' normal right to fill a casual vacancy.

22. Proposed non-re-enactment of provisions for what happens if no auditor appointment continuation (i.e. company will have to appoint new auditors).

We express no opinion on this question.

Laying financial statements, AGMs and auditors' automatic retirement

Annual general meetings

23. Relinquish power of Secretary of State to call an AGM where directors fail to do so?

We express no opinion on this question.

24. Should a single member have a right to requisition an AGM of an opted out company?

Yes, subject to a minimum shareholding requirement – perhaps 4%.

25. In what circumstances would an auditor wish to call a general meeting under clause 136 without having first resigned?

We can envisage circumstances where it should be the directors who should resign and the auditor can provide an element of essential continuity.

General meetings and resolutions: procedure

General meetings

26. Is 6 month period appropriate for aggregation of requests to call an EGM?

We express no view on this.

27. Notice of general meeting same for limited and unlimited companies?

Yes. We so no valid reason for different notice periods.

28. Provisions regarding circumstances for charging members for circulating matter to other members?

We express no views on this.

29. Should the statutory right to appoint a proxy also extend to companies without a share capital?

Yes. Members of a company limited by guarantee, for example, should be able to appoint proxies.

Resolutions in General Meeting

30. Should the right to demand a poll be contingent on payment up of share capital? AND

31. Should provisions for scrutiny of a poll apply to private as well as public companies?

We express no view on these two questions.

General provisions relating to resolutions and decisions

32. Apply ordinary resolution majority rules to qualifying resolutions even if proposed as special resolutions?

We express no view on this.

Supplementary

Communications

33. Definition of communications' forms? AND

34. Communications media? AND

35. Alternative communications media? AND

36. Limits on communications media? AND

37. Too many or too few restrictions on communications media? AND

38. Risk of communications loss in transmission and what should be the equivalent of a company's registered office address for electronic communication?

We express no view on these six questions.

Offences

39. In the context of penalties for breach of the bill's requirements, is the definition of "manager", when read in the context of the definition of a "responsible office-holder", likely to achieve effective extension of requirements to senior and influential executives in the provisions where it applies?

The S. 204 (4) definition, ""manager", seems successfully to limit the field to senior management.

However we are concerned at extending liability beyond directors without it being linked to relevant, explicit duties laid on the individual, acknowledged by them and with informed acceptance of the potential liabilities.

For company secretaries, such extension should be in the context of a statement of the basic duties of the secretary analogous to the statement of directors' duties in Schedule 2 which we advocate at the end of these comments. Otherwise the secretary should be in the same position as any other senior manager.

We have similar concerns about delegation. We believe that mere, informal, delegation should not transfer liability. Only if the delegate has proper notice of the precise duties, and acknowledges and gives informed acceptance of the statutory responsibilities should liability flow. We agree that the liability of the delegator should not necessarily be diminished by the delegation, unless it be to a suitably qualified, experienced professional reasonably expected to understand the responsibilities and to perform the role satisfactorily.

- The position is rather different as regards the general obligation regarding information given/to be given to auditors which applies to all employees. In this case, occasional educational programmes should be undertaken as background. The alternative, to require auditors to preface all discussions with reference to the statutory obligations of their interlocutors, would make relationships unnecessarily difficult.

40. Do you agree that the range of penalties in Schedule 4 is appropriate?

Yes. We believe that criminal sanctions against individuals are far more significant in influencing behaviour than fines against the company – although the latter, if material, may influence shareholders to raise the matter with directors. The requirements (see question 6) for ensuring publicity for any convictions can also be a useful influencer if the wider community takes these things seriously.

41. Do you agree that daily default fines should be dropped as proposed?

Yes, subject to comments re question 42.

42. Do you support the idea of exploring further the possibility of remedial orders?

Yes. It is important if daily default fines are to be dropped. Failure to comply with a remedial order should result in significant penalty.

The Operating and Financial Review

43. "Informed assessment". Will people of different experience need different information?

It must be recognised that the "informed assessment" of a qualified, experienced analyst will be different from that of "someone who invests only on advice". Too much information may serve only to confuse the latter. (In the extreme, too much information will handicap even the expert – see question 48.)

We recommend that a very brief, layman's summary of the OFR should precede the full text (to which it should cross refer). Perhaps the most important part of such a summary should be about the company's "future business strategies and prospects" – for which summarising will be a significant task.

Above all, the value of the OFR should not be devalued to address the layman – the summary (and any necessary discussion with his adviser) should take care of the layman.

44. Do you agree that the Bill should set a high level objective for the OFR?

Yes. This is very important.

45. Does the high level objective in clause 73(3) represent a useful starting point?

The three elements are necessary – the last being critical.

However a key requirement is missing. Companies should indicate what they think is happening to the overall risk of the company – doubling gearing, moving global product sourcing to one factory in Taiwan, increasing dependence on the US market alone, moving into a new type of product, leaving expected purchases of a main commodity unhedged, etc. etc. all change a company's overall risk.

Too few listed company boards seem to understand this, or ever consider it formally. Overall risk is rarely discussed in reporting – though some elements may be noted. Too often shareholders' hear first in reports of comments by credit rating agencies, rather than in anything from directors.

46. Is the approach to the content of the OFR in clause 73(4)(b) useful?

Yes.

47. Is the approach to rules on the form of the OFR in clause 73(4)(b) useful?

Yes.

48. What is the best approach to ensuring that members get all the information in the OFR as a single package, while recognising that other users may only be interested in part of the information?

The key is that the OFR should contain only information directly relevant to its objective. First, where a matter is fully dealt with in the report and accounts, or in other freely available corporate publications, only a summary/key points relevant to the purpose of the OFR should be in the OFR itself (with reference to the original location where fuller treatment with less directly relevant details may be found)[2].

Second, after the summary which we recommend under 43 above, there should be a "contents" for the rest of the OFR.

Finally, the OFR if it is published alone, or the document in which it is contained, should have a comprehensive index.

See also comment on question 50.

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[2] For example, companies use their publications on their environmental policies to achieve many purposes and to address many audiences. They are often long documents, well illustrated, seeking to persuade. Most of the matter in such a document has no place in an OFR. Permitting it in the OFR is an invitation to dilute the OFR with irrelevancy, making it less useful for achieving a balanced, informed view of the company.

49. Do you agree that the approach of clause 74 to the core elements – and in particular the element of objectivity – is appropriate?

Yes. The need for objectivity must be foremost in the writers' minds.

As the Standards Board gains experience, guidance will develop.

The greatest risk is that the non-historical aspects of the OFR become a sort of directors' fantasy or wish list. We comment further on this below.

50. Do you agree with this draft's approach to the Review's materiality test?

Yes. It does depend on the use of "fair" and there is a danger that companies will load up matter in order to make the important less obvious. Non-material matter has no business in the OFR. Mandatory inclusion would encourage a "tick box" approach, which is not at all what is needed. The rules/guidance of the Standards Board will be very important here.

51. Is the split between the core elements in clause 74 and those elements that the directors must consider in clause 75 clear? Are there other ways in which this policy could be expressed?

Yes. Matters referred to under clause 75 are only included to the extent that they are relevant to clause 74. This requirement for individual consideration should help avoid the standardisation of OFRs, which would seriously devalue them.

52. Does the list in clause 75 (2) strike the right balance between providing enough detail for the directors to consider the issues, while not encouraging boilerplate reporting?

Yes – subject to the Standards Board not getting too prescriptive. They could be a useful aide memoire of things which might be overlooked. But the main items about the business and risk strategy of the Board are dealt with under 73 (3) (c) and 74 (2) (c).

53. Does the approach in clause 75 (2) provide enough guidance to directors in deciding whether information on one or more of these factors is relevant to the achievement of the review objective?

Yes. Too much guidance on this would encourage a "tick box" approach. And the main issues to be dealt with are outside this list.

54. Can you identify any issues which would warrant inclusion in the OFR but were so sensitive that companies would legitimately wish to make no mention of them in even the broadest terms?

The most difficult area is the discussion of the prospects for the future.

Premature indication of plans for new products or to enter new markets, for acquisitions or disposals, or of litigation could risk destroying value. However if a reasonable opinion is to be formed about the prospects for the company or an assessment made of what is happening to risk these are often the key areas for consideration.

Directors will have to bear in mind their obligations under the FSMA 2000, under the take-over code, implications of current or prospective litigation, and so on. It is important that these interactions do not result in the OFR being too lacking in content. The guidance from the Standards Authority will be important in this regard. However, it is an important principle that a lack of information can be as misleading as misstatements.

A factor companies will have in mind is that competitors not facing similar disclosure obligations will have a material advantage.

See question 55.

55. If use was made of any exemption for information of such confidentiality or commercial sensitivity that its publication would materially prejudice the company's interests, how should the OFR make clear that information was being withheld?

Directors should be required to include a statement to the effect that some material information was withheld. (Their FSMA obligation not to mislead by omission has to be remembered here.)

In principle, the negative market impact of such a statement – and the very attention it itself draws to the company would ensure that directors minimised the use of the exemption. No doubt some would argue that the negative market impact of disclosure of omission would be a reason not to declare the omission. On the contrary, such effect is an important safeguard against unreasonable use of any exemption.

The danger is that including, as boiler plate, a statement that material information had been omitted could be seen as being a regular protection for directors which they would be foolish not to take even if they were not consciously aware of any particular omission.

A company's market position could be adversely affected while a material omission in its OFR was "outstanding". Accordingly, companies should be allowed to make a subsequent statement either: that the omitted has ceased to be relevant (e.g. a possible acquisition has been, in the event, decided against, etc.); or to state in announcing the matter (an acquisition is to go ahead) that it was the omission (or one of them) from the OFR

See question 56.

56. If there is an exemption for information of such confidentiality or commercial sensitivity that its inclusion in the OFR would materially prejudice the company's interests, should the directors be able to invoke this directly themselves?

Generally yes. But we would require that in case of such an omission or omissions, the auditor be required to agree that the omission is on reasonable grounds. This would ensure that a proper record of the omitted items and their consideration, would be maintained.

This would also safeguard against inclusion of an omission statement as boiler plate.

57. Do you agree that the draft Bill should not include a "safe harbour" provision in relation to statements made as part of the OFR?

No. It is appropriate to provide a safe harbour for those who after reasonable enquiry believe a statement to be true (or reasonable in case of a projection) at the time it is made. FMSA obligations for the company to avoid a false market in its shares where applicable would be sufficient to ensure that corrective information was put out if statements/projections turn out to be wrong/unreasonable.

The protections in Schedule 10 of the FMSA 2000 are a possible model as the White Paper suggests.

Indeed, great care is required in developing the requirement for forward-looking disclosure and comment. Without measures of protection for directors who act reasonably and in good faith, these aspects of the OFR will be bland and, in practice, quite useless.

58. We would also welcome any more general comments on the draft's possible approach to implementing the OFR.

i. We have already referred above to the importance of an assessment of the overall risk in the company and the impact on it of the board's strategy and expectations.

ii. We believe that auditors have an important role over and above that of certifying the suitability of the process of producing the OFR and compliance with any rules (presumably established by the Standards Board). That is, that in respect of the non-historical, forward looking matter included, they should certify that such matter is "reasonable" although they should be able to comment that certain specified matter is "speculative" if they did not think it should be excluded altogether. The purpose of this requirement for auditor involvement would be to stop the discussion of prospects becoming just a "wish list".

   This would be an important safeguard when linked with our proposal that the auditor agree the reasonableness of exclusion of any material matter on commercial sensitivity grounds.

   The test of "reasonableness" in both these cases should be a *prima facie* test only. It should not require extensive review or testing or expose the auditor to suits from any third parties (each of which would both add cost and over-constrain the directors in preparing the OFR).

iii. Required publication of information is generally referred to in the White Paper as being to or for members. However, we believe that as part of the privilege of limited liability, companies have an obligation to publish similar information to a wider public. That obligation should be recognised in company law and more inclusive language be used.

   We note that in those jurisdictions where subsidiary companies are allowed not to file reports and accounts, this is usually subject to their operating under a parent company guarantee – which implicitly recognises the informational value of reports and accounts to general creditors.

The OFR, like the normal report and accounts, is an important source of information for a creditor or potential creditor, not all of whom will have agreed an obligation to disclose information in their contract with the company.   This should be born in mind when phrasing the OFR requirements.

V Comments/Other matters for which no question for consultation was included.

A. Company secretaries

1. We deprecate the proposal to abolish the requirement for company secretaries in private companies.

   The Cadbury report stressed the importance of the company secretary. Even Indonesia has recently mandated the appointment of company secretaries. . Public companies, indeed the public in general, deal with many private companies and have an interest in their good governance.

   The statutory requirement for the appointment of a Secretary gives substance for what could often otherwise appear to be mere bureaucratic requirements or airy fairy ethical positions. The formality of appointing a company secretary is a concentrator of minds, even for company start-ups.

   Some private companies are large and there is no question of the requirement to appoint being any kind of burden.

   In small companies, the appointment is not necessarily an incremental burden or cost – it need not be a separate appointment in a small company. It is however a useful help in securing adherence to proper observation of formalities in an important area.

2. Indeed we would go further and extend to large private companies the requirement that the appointment in any public company be required to be of a person with "the requisite knowledge and experience".

   In smaller public companies, of course, the appointment can be of a specialist provider who services a number of such companies.

3. As commented above, we would urge that the opportunity be taken to set out a schedule of the necessary and recommended duties and responsibilities of the Company Secretary as part of ensuring good governance.

B. The Standards Board

1. As the importance of the OFR becomes clearer, with the Accounting Standards Board's existing custodianship of the Combined Code and the extension of its remit in developing it into the Standards Board, we believe that the remit, funding and composition of the ASB should be subject of new consultation.

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