

## The Reform of British Company Law

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The last four years or so have been an exciting time for company lawyers in the UK, as the Company Law Review that started in March 1998 is approaching its conclusion and we now confidently expect to see the most fundamental reform since the start of modern company law some 160 years ago. There are three major parts to this paper — (1) some background to the reform process; (2) the themes and features of British company law which have formed the essential context for the Review; and (3) the process of the Review and the likely results. The paper will conclude with a few general observations.

### I. Background

British company law has always been dynamic since its inception in the early part of the nineteenth century.<sup>1)</sup> There have been major committees examining it at regular intervals and this has generally resulted in legislative changes.<sup>2)</sup> Further, the government keeps it under constant review. This has been more evident in recent years and a stream of papers continues to emanate from the Department of Trade and Industry, generally on very specific aspects of the subject. Some of these have emerged at the same time as the broader Review to which I shall refer in detail. For example, we have introduced a new corporate form — the limited liability partnership — that is available to any business that has more than one member and not just to professional firms, for whom it was originally conceived.<sup>3)</sup> On top of purely domestic concerns, since 1973, there has been the impact of the harmonisation process within the European Union<sup>4)</sup> and the move, which has now come to fruition, to create a European Company.<sup>5)</sup> Finally, as much of British company law has depended on the development of judge-made principles, new case law continues to evolve, although it has to be said that much of that is now concerned to explain the proper scope of the statutory law.

However, until relatively recently (around the 1950s), there was a notable lack of academic interest; company law was not taught in university law schools and tended to be dominated by practitioner interests. Further, until recently, company law was viewed as too political for the Law Commission, the statutory body charged with keeping the state of the law under review.

Both above factors have been reversed. There is now a great academic interest in the subject, as witnessed by the publication of many books on it and the creation of specialist journals.<sup>6)</sup> This work has at least three features — (1) in terms of the critical analysis of the body of law,<sup>7)</sup> (2) in terms of theoretical work on the nature of the company, what are the interests of the company and so on,<sup>8)</sup> and (3) some empirical work, especially on the needs of small businesses and the corporate form.<sup>9)</sup> The Law Commission has been involved in two company law reform projects — on shareholders' remedies and directors' duties. Two major Reports<sup>10)</sup> were produced that have fed into the broader Review of Company Law. These are briefly considered below.

We have also witnessed in fairly recent times much greater public interest in terms of the role of larger companies — especially regarding corporate governance.<sup>11)</sup> This has led politicians to acknowledge the need to ensure that there is proper control of directors, and to counter alleged short-termism in British markets and allegedly excessive remuneration for some company directors. More recently, we have seen concerns expressed about the role of auditors, especially in the light of what has happened in the United States concerning Enron and Worldcom.

But all this work was rather piecemeal until March 1998, when the new Labour Government announced their much more wide-ranging review under the title 'Modern Company Law for a Competitive Economy'<sup>12)</sup> This was established as a medium-term project involving very wide range of people and consultations. The original aim was for the Review to lead to a Government White Paper in 2001 and legislation in around 2002-3. The timetable slipped slightly, the Final Report of the Review being issued in July 2001<sup>13)</sup> and the White Paper in July 2002,<sup>14)</sup> but it is still to be hoped that legislation will be enacted by some time in 2003, although it may not be fully in force until 2004 or even a little later. There can be no doubt that this process was to be welcomed as the first proper official recognition of need for a broad review, rather than ad hoc reviews, even if some may disagree with aspects of the final outcome.

It is appropriate to quote from the Foreword to the 1998 Green Paper:

Company law lies at the heart of our economy. Although technical, and often left to be handled by specialists, it provides the legal basis for all companies, and is fundamental to our national competitiveness.

Our current framework of company law is essentially constructed on foundations that were put in place by the Victorians in the middle of the last century. There have been numerous additions, amendments and consolidations since then, but they have created a patchwork of regulation that is immensely complex and seriously out of date. The resulting costs and problems may not be obvious to all, but they are real and substantial nonetheless. (Margaret Beckett, President of the Board of Trade).

It is difficult to overstate the change in culture — previously, either a review of company law tended to work within the existing framework and look at fairly technical matters, or relatively small areas of the subject were looked at with no real thought for the broader context and overall picture — as the quote implies, this has not really been done since the 1840s when the first modern company law was introduced.

## II. Themes and Features of British Company Law

In this section, I review the principal features of current British company law and how they were addressed by the Company Law Review.

### 1. One body of law for all companies

For historical reasons, the UK has essentially one body of law which applies to all types of company, ranging from the large public companies, normally with a public listing of their shares and often multinational, down to the smallest business that has chosen to incorporate. It remains exceptionally easy and inexpensive to incorporate a registered company, or such a company can be purchased 'off the shelf'. There is no doubt that the registered company form was originally intended for medium and

large-scale enterprises seeking to raise capital from the public,<sup>15</sup>) but the form was adopted by even the small business and this was sanctioned in the famous case of *Salomon v Salomon*.<sup>16</sup>) Here a one-man business was incorporated with the six shareholders required by law other than the owner of the business being nominees. The House of Lords held that, as the formalities required by law had been complied with and there was no fraud, the company was properly incorporated and had an existence separate from that of its members.

Some commentators have argued that the law went drastically wrong when it allowed this state of affairs to develop, and that the lack of clear distinctions has hampered proper development of the law.<sup>17</sup>) For example, even the Law Commission's recent work on shareholders' remedies and directors' duties<sup>18</sup>) made only token reference to the vastly different types of enterprise with which the law is concerned. Reference can also be made to the UK's implementation of some of the EC Directives, which also perhaps failed fully to recognise the real functional differences between different types of company. There are difficult bodies of case law that are perhaps made more difficult by a failure to distinguish, for example regarding the nature of the constitution of a company.<sup>19</sup>) Sometimes the lack of real distinctions has frustrated attempts to reform. For example in 1948 the UK enacted a provision (section 210 of the Companies Act 1948), which was intended primarily to cure problems in small companies when minority shareholders might become 'locked in' but it was narrowly interpreted arguably because the courts were unable clearly to identify the type of company to which it was primarily devoted.<sup>20</sup>)

Perhaps as another consequence of this, we have not developed anything like a proper body of rules relating to groups of companies.<sup>21</sup>)

## 2. Sources of the law — an unwieldy mass?

The second feature to mention is the very nature of current British company law. Although we have a very large Companies Act with over 700 sections and 25 or so Schedules, it is not a complete code. From the early days, the method was to provide for the basic requirements for registration and incorporation, together with continuing obligations. The courts had to fill in the very large gaps and much of what they did remains effective today — particularly (1) regarding the capacity of companies and the authority of agents of companies, (2) concerning the duties and responsibilities of directors and promoters and other officers, (3) regarding the raising and maintenance of share capital and (4) regarding the rights of members or shareholders both as between a majority and a minority and as between members and the company. Most of these principles were derived from the law relating to partnerships, which had been previously applied to the unregistered joint stock companies that were the forbears of the registered company; in turn these partnership principles were forged by reference to areas such as trusteeship.

Even the statute is acknowledged by all to be cumbersome and complex, and perhaps unnecessarily so, although here we meet a potential difficulty — namely some of the EC Directives. This is further considered below. As well as complexity in the law, the traditional approach has been to prescribe criminal penalties for breach of many of the statutory rules — it may be questioned whether this is appropriate at least in as many cases as are covered at present.

### 3. Contract-based Law

Again reflecting its historical origins, British company law is essentially contract-based — the constitutional documents, the memorandum and articles of association, are declared to be contractual.<sup>22)</sup> More importantly, their contents, especially as concerns the governance of a company, can be drafted in many respects as the parties wish, although it is fair to say that in practice fairly standard models are followed.<sup>23)</sup> What is significant as far as smaller companies are concerned is the widespread use of other contracts, which are often more important in terms of the relationship between members than the formal memorandum and articles — these are often referred to as shareholder agreements. They can be kept secret, unlike the publicly registered memorandum and articles, cannot be altered unilaterally by the company and difficult questions as to the capacity in which rights are conferred do not arise.<sup>24)</sup>

### 4. The Interests of the Company

The fourth theme is a central issue, which has been much debated by academics and more widely in recent years. It governs the fundamental duties of directors, which are traditionally expressed as requiring them to act in the interests of the company. Some would say that the contract-based model dictates that the interests of the company are ultimately the interests of its members — it is an association in theory just like, for example, a club. This does not preclude other interests from being considered, only indicates the ones that in the final analysis must prevail. There has often been some misunderstanding here. Some commentators have attacked this — arguing, for example, that is based on the alleged ownership of companies by their shareholders, which is outdated at least in case of large public company.<sup>25)</sup> Whether this is a correct view or not, the issue is clearly a central one for consideration, and something which has a European flavour. Most of the UK? European partners have company laws that take a more ?takeholder?approach in their company law, and this has influenced some aspects of the proposals for harmonisation as well as the shape of the legislation governing the European Company.

### 5. Europe

One or two aspects of company law that are affected by the UK? membership of the European Union have already been mentioned. This is clearly a central issue today. By and large the UK has been rather lukewarm and implemented the harmonising Directives in a fairly half-hearted and unthinking manner. A number of illustrations can be used here. The UK made a mess of aspects of the first Directive (concerning

the capacity of a company and the authority of its directors) when we rushed through a reforming section on joining the EC in 1973,<sup>26</sup>) although things were improved much later.<sup>27</sup>) The second Directive on capital maintenance was implemented in a rather clumsy and over-elaborate way.<sup>28</sup>) The British reactions to the various proposals for a fifth Directive on corporate governance and, the proposed thirteenth Directive on takeovers were fairly extreme and hostile in the first instance, although they have softened somewhat over time.

That last comment illustrates some traditional fundamental philosophical differences between Anglo-American and European approaches. The same point relates also perhaps to the last heading regarding the interests of the company. Like the US, Britain has long had much more developed capital markets than most of our European partners, which has led to the phenomenon often described as the market for corporate control. A free takeover market clearly influences aspects of company law.<sup>29</sup>) However, it has to be said that certainly the biggest other European economies reveal increasing signs of a much more market-orientated approach.

#### 6. Self-regulation

This does lead quite neatly, though, into the last point under the heading of themes. Traditionally, British politicians and business have preferred self-regulation where possible to strictly legal regulation. Perhaps this is natural, but lawyers do not always think so. It has been seen regarding the control of takeovers in particular, where conduct is regulated by a code that only indirectly has the force of law in a number of ways.<sup>30</sup>) It was also perhaps the dominant theme concerning the broader regulation of financial services, but the UK has gone through a fairly fundamental change in that respect in recent years, culminating in the Financial Services and Markets Act 2000.<sup>31</sup>)

More recently, as far as company law in the strict sense is concerned, we have the introduction of the Cadbury Code and, subsequently, the Combined Code on Corporate Governance.<sup>32</sup>) However, in a sense these are not really self-regulatory. The Listing Rules<sup>33</sup>) require all quoted companies to state whether or not they comply with the Code.

Perhaps another example of self-regulation is the very common use in the case of small companies of shareholder agreements, as has already been mentioned — these operate outside the formal company constitution because of the restrictive nature of the law regarding that constitution.

### III. The Process of Reform and the Likely Results

Having announced the Review in March 1998, the Government set up a relatively small Steering Group to oversee the management of the Review and ensure that its outcome was clear in concept, internally coherent, well articulated and expressed and workable. The membership of the Steering Group was drawn from practitioners, business people

and a few academics. There was also a Consultative Committee with a much broader representation. This acted as a forum for the discussion of issues pertinent to the Review. The aim was to enhance the public consultation by channelling views and ideas into the Steering Group.

The Steering Group identified key areas and then appointed working groups to look at those. This involved yet more people in the whole Review. It issued nine formal Consultation Documents,<sup>34</sup>) to which a fair range of people and interest groups responded, and also made available background research that it commissioned as part of the Review.<sup>35</sup>) The result is that it can justifiably claim to have been the most comprehensive Review of UK company law in its history. This, as has been said, was one of the clear aims behind it.

#### 1. Objectives of the Review

The objectives of the Review were identified as the following:

- ✎ To maintain and increase the competitiveness of British companies
- ✎ To provide an attractive regime for overseas companies
- ✎ To achieve a proper balance of the interests of those concerned with companies in the context of straightforward, cost effective and fair regulation
- ✎ To promote consistency, predictability and transparency in company law.

#### 2. Terms of reference

The more detailed terms of reference are also worth citing in full. They were as follows.

- (i) To consider how core company law can be modernised in order to provide a simple, efficient and cost-effective framework for carrying out business activity which:
  - (a) permits the maximum amount of freedom and flexibility to those organising and directing the enterprise;
  - (b) at the same time protects, through regulation where necessary, the interests of those involved with the enterprise, including shareholders, creditors and employees; and
  - (c) is drafted in clear, concise and unambiguous language which can be readily understood by those involved in business enterprise.
- (ii) To consider whether company law, partnership law, and other legislation which establishes a legal form of business activity together provide an adequate choice of legal vehicle for business at all levels.
- (iii) To consider the proper relationship between company law and non-statutory standards of corporate behaviour.
- (iv) To review the extent to which foreign companies operating in Great Britain should be regulated under British company law.
- (v) To make recommendations accordingly.

### 3. The work of the Steering Group and the response of Government

The Steering Group issued its major Consultation Document in February 1999.<sup>36</sup> The principal features of this, which survived the subsequent period through to their Final Report in July 2001, were as follows.

Their overall approach was viewed as determined by the title given to the whole process of Review — Modern Company Law for a Competitive Economy. This imported modernisation and deregulation, where appropriate, and efficiency. The Review was not concerned with fairness, although the Steering Group believed that this would follow their work. Company law supported a system of free enterprise, but this had to be tempered by provisions to guard against abuse; high standards of conduct were important. This introduced the question of what should be the 'interests of the company.' The Steering Group was anxious to produce a comprehensive and coherent reform. Other factors that had to be borne in mind were globalisation, European influences, changing patterns of regulation, information technology, changing patterns of ownership, the modern asset mix, and the importance to the economy of small companies.

Following this, the Steering Group identified their guiding principles as being:

To facilitate transactions, with a presumption against prescription by the law

To make the law accessible, covering both ease of use and identification of the law

To establish clear regulatory boundaries and proper jurisdictions.

It was recognised at the early stage that the company legislation might need radical restructuring to recognise the separate needs of small and large companies. The Steering Group also recognised the importance of a comparative approach, comparing British law with other common law systems and with continental systems.

It would not be possible in the course of this paper to review in detail all the work of the Steering Group. However, it is worthwhile indicating what they identified as the key areas for examination and giving some idea of their thinking during the review process. Obviously it is now also centrally important to indicate the Government's response to these, as this gives a fairly clear indication of the contents of the next Companies Bill.

### 4. The interests of the company, the duties of company directors and corporate governance

The first key area is one that occupied much time in the early part of the review, and was viewed as controversial, but which was resolved very clearly and then dropped out of real consideration. This was the discussion of the interests that company law

should serve, an aspect of company law which has already been touched upon.<sup>37)</sup> The Steering Group recognised that company managers have regard, where appropriate, to the need to ensure productive relationships with a range of interested parties and have regard to the longer term. They drew a distinction between what they called the 'enlightened shareholder value' approach, which asserts that this can be achieved within present legal principles, but ensuring that directors pursue shareholders' interests in an enlightened and inclusive way, and the 'pluralist' approach, which asserts that co-operative and productive relationships will only be optimised where directors are permitted (or required) to balance shareholders' interests with those of others committed to the company.<sup>38)</sup>

Their final view was to reject any notion of enshrining pluralism in the law. However, they felt that the current law was not widely recognised as embracing an enlightened shareholder value approach, and that this should be incorporated in the legislation. This is almost certain to occur, as the Government has expressed its agreement with the Steering Group's conclusions. It will take the form of a statutory expression of the core duties of company directors, along the following lines. This is taken from the draft clauses published by the Steering Group and the Government, but it is an edited version.

A director of a company must act in the way he decides, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole and in deciding what would be most likely to promote that success, take account in good faith of all the material factors that it is practicable in the circumstances for him to identify.

The material factors are (a) the likely consequences (short and long term) of the actions open to the director and (b) the company's need to foster its business relationships, including those with its employees and suppliers and the customers for its products or services; its need to have regard to the impact of its operations on the communities affected and on the environment; its need to maintain a reputation for high standards of business conduct; its need to achieve outcomes that are fair as between its members.

This would replace the existing case law and the current statutory provision<sup>39)</sup> that requires directors to have regard to the interests of employees. Whether it will have any real impact on decision-making, as opposed to some educational value, is perhaps open to question.<sup>40)</sup>

There are three other important factors that should be mentioned. A provision of the sort quoted will be part of a general codification of company directors' duties, which is intended to replace the existing common law rules in their entirety. This is not

uncontroversial and it seems likely that much attention will be paid to the drafting of the final provisions as they appear.<sup>41)</sup> The second point is that as far as large companies are concerned, the Steering Group and the Government view a key part of how company law recognises various interests as being satisfied by enhanced reporting or disclosure. The proposed new law will require companies above a certain size to produce an annual Operating and Financial Review, which is intended to be fuller and more helpful than the existing accounts and directors' report. A little more is said about this below.

The third factor concerns how UK company law legislates for corporate governance. Its traditional permissiveness, requiring only that a company have a director but leaving it to the constitution to prescribe how the directors operate and what their functions are, is certain to be maintained. Listed companies will have to continue to comply, as now, with a Code of Corporate Governance,<sup>42)</sup> but this will not be part of the legislation. In this respect, the British preference for a form of self-regulation where possible, which I have mentioned earlier, is likely to prevail. However, questions are still being considered about the role of non-executive directors, required of quoted companies by the Combined Code. It is events such as the collapse of Enron in the US that have stimulated this, and the government has commissioned an independent review of their role and effectiveness.<sup>43)</sup> The White Paper confirms that self-regulation rather than the imposition of legislative requirements is preferred, but the possibility of legislation is not completely ruled out.

As regards corporate governance in quoted companies, both the Steering Group and the government have rightly paid attention to the role of institutional investors. A key theme of the review has been 'transparency in decision making' and it is believed that this is fundamentally dependent on the responsible, diligent and active exercise of their powers by such investors. There is concern that investors should exercise their control of quoted companies in an open way, but at the same time it is acknowledged that there may be conflicts of interest that inhibit this. An example would be the potential conflict between the institution owing duties to its beneficiaries to ensure the best rate of return for them and its duties as a shareholder, as opposed to its position as a supplier of financial services to the company. This is a difficult area. Many financial institutions are of course 'multi-function' these days, one department acting as a fund manager and institutional investor, another providing advice in many ways to the companies in which the first department invests. It seems clear that there will be legislation to compel the disclosure by companies of the results of polls at general meetings, both in annual reports and on companies' websites. There will be a new right for members to require the scrutiny of any poll. The Steering Group recommended that companies should disclose their suppliers of financial services, so that there was appropriate transparency and potential conflicts were lessened. The

Government is unlikely to accept this particular recommendation, although it may require institutions to disclose how they have voted in respect of their shareholdings. The problem may be how actually to enforce this through legislation. Perhaps in the end this may be the subject of some form of self-regulatory code.<sup>44)</sup>

It has already been stated that the Government agrees with the recommendation for a statutory codification of the core duties of company directors. A particular driving force for this is that it is felt to be necessary in order to educate company directors of all sorts and of all types of company. How far the complexities of those duties, especially the fiduciary duties, can be fully encapsulated in an exhaustive code in a way that is intelligible to the director of a small business as well as the chief executive of a large quoted public company remains to be seen.<sup>45)</sup> It is clear that there will still be detailed rules governing particular situations where there are potential conflicts of interest,<sup>46)</sup> and it is noteworthy that the government has just legislated to require quoted companies to produce a report on directors' remuneration.<sup>47)</sup> This will have to be the subject of an approving resolution at the annual general meeting, although an adverse vote would not upset any existing legally binding arrangements. The pressure for this has come from a number of widely reported instances of what appear to be exceptionally generous remuneration packages for directors, and it has been a matter on which politicians from all the major political parties have expressed concerns.

As regards company directors, it is also worth noting that the legislation is expected to prohibit the possibility of a company acting as a director of another company.

##### 5. Deregulation and the needs of small companies

The second key aspect considered by the Review, in line with their terms of reference, was the needs of small and closely-held companies. Assuming that the limited company continues to be freely available to the smallest businesses, which was not an assumption that was ever open to serious question, they are not well served by the present Act, either in substance or form. The merits of new freestanding legislation for such companies, as opposed to an integrated rewrite of existing law, were examined, but this was rejected at an early stage. Instead a major theme became that the legislation should be rewritten on a 'think small first' basis, with appropriate flexibility to suit the needs of small companies, but retaining one Companies Act that provides for all.

The Government has accepted this, indeed it was the major thrust of the July 2002 White Paper, and the shape of the new law will be some common provisions that apply to all companies, with succeeding provisions applying only to public and large companies. Some distinctions will depend on that between private and public, others, especially relating to accounting and reporting, on the size of a company regardless of

its exact legal status.

As far as private companies are concerned, the need to hold the annual general meeting, a cornerstone of company law since its inception,<sup>48</sup>) will be abolished, subject to a safeguard for members who wish one to be held. The provisions that allow for written resolutions to take the place of formal resolutions<sup>49</sup>) will be simplified. The unnecessary distinction between the memorandum and articles of association will be abolished and replaced for all companies by one constitutional document, with clear provisions as to its enforceability. Private companies will have their own model form of constitution. Work is continuing on how to provide for alternatives to the courts for the resolution of disputes in small companies. Currently the statutory procedure<sup>50</sup>) provides a fairly comprehensive mechanism for dealing with when minorities are unfairly treated, but this is very expensive to use.

A further proposal of both the Review and the Government, which has attracted considerable comment, is to abolish the requirement for private companies to have a company secretary.<sup>51</sup>) It is likely that this proposal will continue to provoke some opposition as it proceeds to legislation.

#### 6. Other corporate governance issues and the use of technology

As already stated, the Government intends to legislate on directors' duties, but leave the question of corporate governance structures largely to self-regulation. However, the legislation will continue to provide for general meetings of public companies and in a way that improves the rights of shareholders. For example, the rights of proxies will be enhanced, and examination is being given to the rights of beneficial owners of shares. Current law largely gives rights to members of companies, that is those who hold the legal title to shares.<sup>52</sup>) It is increasingly common for shares in public companies to be owned through the medium of a nominee, and in law the latter is the only recognised member of the company. The system that allows for computerised dealing in public company shares and other securities<sup>53</sup>) depends on the use of nominees, as do the tax-efficient ways of investing in shares that have been encouraged by recent British Governments. Giving beneficial owners rights as if they were members will be a complex task, and from a technical legal point of view it will be interesting to see what emerges.

The Steering Group and the Government lay great emphasis on the possibilities of information technology to aid disclosure and decision-making. There has already been legal change to allow, for example, for the electronic publication of accounts and reports,<sup>54</sup>) and further possibilities, for example allowing electronic voting, are likely to emerge.

#### 7. Disclosure

Disclosure, in the sense of public disclosure by companies, has been a key theme of

British company law since its inception.<sup>55)</sup> It is one of the prices to be paid for the benefits of limited liability. The intervening years have in general seen increased disclosure obligations imposed mainly, until fairly recently, on companies of all sizes. Deregulatory moves over the past 20 years in particular have lessened the burdens on small companies.<sup>56)</sup> Following the Review's recommendations, the Government proposes to confirm and indeed strengthen the policy of fairly minimal disclosure for small companies, but with increased disclosure obligations on the largest companies, probably around 1,000 in total. There is also likely to be a change in the structure of company law in this respect, with only the basic obligations being set out in the statute and the detailed requirements being devolved to a rule-making body, provisionally called a Standards Board, developed from the existing non-statutory Accounting Standards Board. This body will also be charged with responsibility for monitoring and updating the Code on Corporate Governance. At the same time a Reporting Review Panel is likely to be established to police the disclosure obligations on larger companies. In many respects these proposals seem to mirror the regime established under the Financial Services and Markets Act 2000, which established the statutory but independent Financial Services Authority to police securities regulation.

Perhaps there are two key issues here. The first concerns the question of auditing the accounts that small companies are required to prepare and publish. At present, companies with a turnover of up to £1m per annum do not have to have an audit. The Review made a case for increasing this threshold to almost £5m, but it seems unlikely that the government will agree with this. On balance that seems right on the basis that limited liability might still be regarded as a privilege in some respects and dispensing with an independent check of the accounts of quite sizeable companies could be thought to be going rather too far.

The second issue concerns the proposed Operating and Financial Review for larger companies. This has been mentioned earlier. It is likely to be a significant requirement, replacing the current directors' report<sup>57)</sup> and providing a great deal of quantitative and qualitative information. It is seen as the principal way of satisfying those who call for company law to be more stakeholder-orientated. The detail will include information about the company's workforce, its business relationships and future opportunities and strategies. The White Paper pays particular attention to the information that will be required about the company's impact on the environment.

#### 8. Formation of companies and capital maintenance rules

The Review spent a considerable time examining the technical rules concerning the law relating to company formation and maintenance of share capital.<sup>58)</sup> They made a number of fairly uncontroversial recommendations for modernising and simplifying the law in these respects, which the Government seems certain to accept. These include the abolition of the requirement for an authorised share capital, allowing capital

reduction pursuant to a statutory statement of solvency as an alternative to court approval, removing the prohibition of private companies providing financial assistance for the acquisition of their own shares and simplifying the regime for public companies, and clarifying the rules allowing distributions of profits.

#### 9. Institutional arrangements

As already mentioned, there are proposals to establish statutory bodies to be concerned with the detail and enforcement of reporting requirements. The Steering Group also recommended the establishment of two further statutory bodies — a standing company law commission and a private companies' committee, both of which would be responsible for keeping the appropriate aspects of company law under regular review. The Government does not seem minded to accept these particular recommendations, which is probably a reflection of the way the British Civil Service views its role.

#### 10. Registration of company charges

This is a very special matter that has been the subject of varying proposals for reform for 30 years.<sup>59)</sup> Indeed the Companies Act 1989 contained provisions on this that were never brought into force.<sup>60)</sup> It is a highly technical but very important area. The current UK system provides for the public registration of most, but not all, charges and other security devices given by companies to lenders, but, when there are questions as to the priority of competing lenders' claims to the same assets, relies basically on common law rules. Many commentators have long thought that a system of notice filing, similar to that which operates in North America, would provide a fairer and simpler solution. The Law Commission is currently examining the matter again,<sup>61)</sup> and it is to be hoped that their recommendations are included in the forthcoming Companies Bill.

### IV. Conclusion

Although this paper has not been able to examine all the changes likely to UK company law, it is hoped that a flavour of what the most significant of these are likely to be has been given. While some may still disagree with some of the detail, there seems little doubt that there will be significant change, modernisation and simplification. In concluding there are a number of general matters to which reference should be made.

#### 1. Europe

The first concerns how the forthcoming UK Companies Bill will relate to European company law. The Steering Group made fairly full reference to European matters, both as regards Directives and to what has been happening recently in other European countries. But, perhaps naturally, there was also much reference to other common law jurisdictions, especially North America and Australia. Recent years have witnessed the UK company law system having a greater influence within Europe, and there may be some interesting times ahead. It is noteworthy that the European Commission has set up a group to look at company law whose first published document on general

company law matters<sup>62</sup>) reveals evidence of having been strongly influenced by the work of the British Review. For better or worse, it is thought that most European countries recognise the dangers to themselves of not being prepared also to move to a rather less complex and more market-orientated company law. This is partly because recent rulings by the European Court of Justice have confirmed that nationals of one member State can form a company in any other member State and then use that for business in their home State.<sup>63</sup>) There is some evidence that this has led to a trend for other Europeans to form companies in the UK, which can only be accelerated if our company law is simplified while that of other member States is not. The UK could become the 'Delaware' of Europe, Delaware of course being the favoured State of incorporation of most US corporations.

## 2. What is company law for these purposes

The whole Review has been concerned with what can be described as core 'company law' and indeed the White Paper makes it clear that matters relating to the insolvency of companies and general investor protection are not relevant to the issue of company law reform. While at one level this is understandable, it does not seem wholly satisfactory. The emphasis on making life easier for small companies in particular could be thought to fail to take account of the fact that there are instances where the operation of company law principles, particularly the fundamental principles of corporate personality and limited liability, can operate to the disadvantage of creditors and consumers. There are provisions in British insolvency legislation that do seek to control the misuse of the limited company form,<sup>64</sup>) and it is true that that legislation continues to be the subject of regular review, but there still seems to be a case for making sure that the two work properly in tandem.

## 3. The range of business entities

That leads neatly to another general point. Some commentators have expressed the view that anyone reading the many documents issued as part of the Review process might think that the company is the only vehicle the law provides for small businesses. It is not, of course. There are more than twice as many unincorporated sole proprietorships in the UK as companies of any sort, and partnerships number around 80 per cent of the number of active companies. The registered company is indeed a 'minority interest.' It has to be said that the Review barely acknowledges this, and it is noteworthy that, as mentioned earlier, while the Review was continuing, legislation introduced the new form of the incorporated limited liability partnership. The Law Commission is also currently reviewing partnership law.

While none of this clearly does not detract from the need to modernise company law, it does perhaps rather put into perspective claims that have sometimes been made that such reform is one of the panaceas for making British business generally more competitive.

## 4. Transitional arrangements

Accepting that indeed the next Companies Bill is likely to be substantially different from any of its predecessors, the difficult question then arises of how the many existing companies will be governed by it. There will be no difficulty in applying many of the new provisions, for example on share capital, directors' duties, meetings and disclosure. But, for example, will the improved regime for the corporate constitution apply? Will existing companies be forced to keep their memorandum and articles of association, subject to the existing law, or will they be able or indeed forced to change, for example to reregister? There are some difficult questions here. It seems that compulsory reregistration will be ruled out, but, before the next Companies Bill is finally on the statute book, there will be very difficult policy and drafting issues that will have to be resolved.

Indeed, despite the fact that many draft clauses for the next Companies Bill have been published,<sup>65</sup>) much work remains to be done. As said towards the beginning of this paper, it will be some little time yet before this major reform project is finally concluded.

1) The Joint Stock Companies Act 1844 first allowed for the incorporation of joint stock companies by registration. Previously, incorporation could be obtained only by royal charter or a special Act of Parliament, and businesses other than those involving sole traders were in law all partnerships.

2) Following the 1844 Act (see the previous footnote), limited liability for members was allowed by an Act of 1855, and the first modern companies legislation was the Joint Stock Companies Act 1862. This was revised and then re-enacted in the Companies Act 1908. Subsequent entire Companies Acts were those of 1929 and 1948. The latter was then amended by various legislation including the Companies Acts of 1967, 1980 and 1981 before the whole was consolidated in the Companies Act 1985. This remains the principal Act today, but it has been amended quite substantially by the Companies Act 1989 and other legislation and secondary legislation. For a detailed history of British company law, see Davies, Gower? Principles of Modern Company Law, 1997, chapters 2 and 3.

3) See the Limited Liability Partnerships Act 2000. The limited liability partnership has corporate personality and limited liability for its members, but in a number of respects it is required to comply with the companies legislation; for a critique, see Finch and Freedman, 'The Limited Liability Partnership: Pick and Mix or Mixup?' [2002] Journal of Business Law 475.

4) See Gore-Browne on Companies, Jordans, loose-leaf, Part VIII, Wolff, 'The Commission? Programme for Company Law Harmonisation: the Winding Road to a Uniform Company Law?' in Andenas and Kenyon-Slade (eds) EC Financial Market Regulation and Company Law (1993), 22, Dine, 'The Community company law harmonisation programme?' (1989) 14 European Law Review 322, Andenas, chapter 16

in *The Corporate Dimension* (ed Rider) (Jordans, 1998), Andenas, 'European company law reform and the United Kingdom' (2000) 21 *Company Lawyer* 36. See also [http://europa.eu.int/comm/internal\\_market/en/company/company/index.htm](http://europa.eu.int/comm/internal_market/en/company/company/index.htm).

5) See Council Regulation 2001/2157/EC and Council Directive 2001/86/EC.

6) As far as books are concerned, see especially Boyle & Birds' *Company Law*, 4th edition, Jordans, 2000, Farrar' *Company Law*, 4th edition, Butterworths, 1998, Ferran, *Company Law and Corporate Finance*, OUP, 1999, Davies, Gower' *Principles of Modern Company Law*, 6th edition, Sweet & Maxwell, 1997, Mayson, French and Ryan, *Company Law*, 19th edition, Blackstone, 2002, Gore-Browne on Companies, 44th edition, Jordans, loose-leaf, Palmer' *Company Law*, Sweet & Maxwell, loose-leaf. Specialist journals are *The Company Lawyer* and *The Journal of Corporate Law Studies*.

7) See the texts cited in the previous footnote.

8) On theoretical issues, see especially Cheffins, *Company Law: Theory, Structure and Operation* (OUP, 1997), Stokes, 'Company Law and Legal Theory' in Twining (ed), *Legal Theory and Common Law* (1986), 157, Axworthy, 'Corporate Directors: Who needs them?' (1988) 51 *Modern Law Review* 273, Parkinson, *Corporate Power and Responsibility* (OUP, 1993), Parkinson, Gamble and Kelly (eds), *The Political Economy of the Company*, Hart, 2001, Wheeler, *Corporations and the Third Way*, Hart, 2002, Royal Society of Arts, *Tomorrow' Company: The Role of Business in a Changing World* (1995), Ireland, 'Corporate governance, shareholding and the company: towards a less degenerate capitalism' (1996) 23 *Journal of Law and Society* 287, Grantham, 'The doctrinal basis of the right of company shareholders' [1998] *Cambridge Law Journal* 554, Ireland, 'Company law and the myth of shareholder ownership' (1999) 62 *Modern Law Review* 32, Kelly and Parkinson, 'The conceptual foundations of the law: a pluralist approach' [1998] *Company and Financial Law Review* 174, Goldenberg, 'Shareholders v stakeholders: the bogus argument' (1998) 19 *Company Lawyer* 34, Roach, 'The paradox of the traditional justifications for exclusive shareholder governance protection: expanding the pluralist approach' (2001) 22 *Company Lawyer* 9, Dean, 'Shareholding and company law' (2001) 22 *Company Lawyer* 66, Dean, 'The future of UK company law' (2001) 22 *Company Lawyer* 104, Worthington, 'Shares and shareholders: property, power and entitlement' (2001) 22 *Company Lawyer* 258 and 307, Hill, 'Public beginnings, private ends — should corporate law privilege the interests of shareholders?' chapter 2 in MacMillan (ed), *International Corporate Law Annual*.

9) See especially Freedman, 'Small business and the corporate form: burden or privilege' (1994) 47 *Modern Law Review* 555, Hicks, 'Reforming the law of private companies' (1995) 16 *Company Lawyer* 171, Hicks, 'Corporate form: questioning the unsung hero' [1997] *Journal of Business Law* 306.

10) *Shareholder Remedies*, Law Com No 246, Cm 3769, 1997; *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties*, Law Com No 261, Scot Law Com No 173, 1999.

- 11) Recent UK academic writing includes Sheikh and Rees (eds), *Corporate Governance and Corporate Control*, Cavendish, Ellett, 'Australia and the UK on the quest for best corporate governance practice?' chapter 10 in MacMillan (ed), *International Corporate Law Annual*, Dignam, 'Exporting corporate governance: UK regulatory systems in a global economy?'(2000) 21 *Company Lawyer* 70, Yavasi, 'Shareholding and board structures of German and UK companies?'(2001) 22 *Company Lawyer* 47.
- 12) Department of Trade and Industry, *Modern Company Law for a Competitive Economy*, March 1998.
- 13) Company Law Review Steering Group, *Modern Company Law for a Competitive Economy*, Final Report, July 2001. The earlier consultation papers issued by the Steering Group are *Modern Company Law for a Competitive Economy — The Strategic Framework*, February 1999, URN 99/654, *Modern Company Law for a Competitive Economy — Company General Meetings and Shareholder Communication*, October 1999, URN 99/1144, *Modern Company Law for a Competitive Economy — Company Formation and Capital Maintenance*, October 1999, URN 99/1145, *Modern Company Law for a Competitive Economy — Reforming the Law Concerning Oversea Companies*, October 1999, URN 99/1146, *Modern Company Law for a Competitive Economy — Developing the Framework*, March 2000, URN 00/656, *Modern Company Law for a Competitive Economy — Completing the Structure*, November 2000, URN 00/1335.
- 14) *Modernising Company Law*, 2002, Cm 5553.
- 15) See the valuable accounts by Ireland, 'The Triumph of the Company Legal Form, 1856–1914?' chapter 3 in *Essays for Clive Schmitthoff*, ed Adams (Professional books, 1983) and Freedman, 'Limited liability: large company theory and small firms?'(2000) 63 *Modern Law Review* 317.
- 16) [1897] AC 22.
- 17) A classic text based on this assumption, which set out the law by reference to three types of company — the very small often one-person company, the large private company and the quoted public company — was Hadden, *Company Law and Capitalism*, 2nd ed, 1977, now significantly out of date. See also Birds, 'Some brief reflections on the state of company law?' chapter 6 in *The Corporate Dimension*, ed Rider (Jordans, 1998).
- 18) See note 10.
- 19) A problematic area arising from what is now section 14 of the Companies Act 1985, a provision that has existed in its current wording for over 150 years. The courts have found it difficult to decide the exact extent to which that provision gives the memorandum and articles of a company contractual force as between the company and its members and as between the members themselves. For reviews of the case law, see especially Wedderburn, [1957] *Cambridge Law Journal* 193, at 210–215, Goldberg, (1972) 33 *Modern Law Review* 362 and (1985) 48 *Modern Law Review* 121, Gregory, (1981) 44 *Modern Law Review* 525, Drury, [1986] *Cambridge Law Journal* 219.

20) See, for example, Rajak, (1972) 35 Modern Law Review 156 for a review of the case law on section 210, which was replaced in 1980 by what are now sections 459 to 461 of the Companies Act 1985. These provisions, which provide relief when a member has been 'fairly prejudiced' now provide substantial protection to minority shareholders in private companies.

21) For a particularly valuable survey, see Ferran, *Company Law and Corporate Finance*, pp 26–43 and the references cited therein.

22) Section 14 of the Companies Act 1985. This contract is quite a problematic one, though, as not all rights vested in members are in fact enforceable and it is a contract of a very special kind: see *Bratten Seymour Service Co Ltd v Oxborough* [1992] BCLC 693 and, generally, Boyle and Birds, chapter 4 and the articles cited in note 8.

23) The companies legislation has long prescribed standard models. That for the articles of association of an ordinary company limited by shares is known as Table A, and the regulations therein are in practice often as important as the statutory provisions themselves.

24) A shareholders' agreement can bind the members as to how they will exercise their voting rights, but cannot fetter the company itself in the exercise of its statutory powers under the Companies Act: *Russell v Northern Bank Development Corporation Ltd* [1992] 1 WLR 588.

25) See, for example, the articles by Ireland and Grantham cited in note 8, above.

26) Section 9 of the European Communities Act 1972.

27) By the new sections 35, 35A and 35B introduced into the Companies Act 1985 by the Companies Act 1989.

28) See, for example, the comments in Boyle and Birds, chapter 7 and Ferran, 'creditors' interests and 'core' company law' (1999) 20 *Company Lawyer* 314.

29) See, for example, Bradley, 'Corporate Control: Markets and Rules' (1990) 53 *Modern Law Review* 170.

30) The City Code on Takeovers and Mergers: see Prentice, 'take-over bids and the system of self-regulation' (1981) 10 *Oxford Journal of Legal Studies* 406, Alexander, 'take-overs: the regulatory scheme' [1990] *Journal of Business Law* 203, Calcutt, 'the work of the Takeover Panel' (1990) 11 *Company Lawyer* 203, Morse, 'the City Code on Takeovers and Mergers — self regulation or self protection?' [1991] *Journal of Business Law* 509, Morse, 'controlling takeovers — the self-regulation option in the United Kingdom' [1998] *Journal of Business Law* 58.

31) This is a major enactment of a modern system of securities regulation, which is supplemented by a very large volume of secondary rules and regulations. For overviews, see Alcock, *The Financial Services and Markets Act 2000: a Guide to the New Law*, Jordans, 2000, Perry (ed), *The Financial Services and Markets Act: A Practical Legal Guide*, Sweet and Maxwell, 2001.

32) The Cadbury Code was first agreed in 1992 following some well-publicised corporate scandals. The Combined Code consolidated and updated the Cadbury Code

and subsequent modifications. See Boyle and Birds, chapter 11, Dine (1994) 15 Company Lawyer 73, Finch [1994] Journal of Business Law 51, Riley (1998) 19 Company Lawyer 179, Dignam (1998) 19 Company Lawyer 140.

33) Now made by the Financial Services Authority under the powers vested in it by the Financial Services and Markets Act 2000.

34) Cited earlier in note 13.

35) All of this is available at <http://www.dti.gov.uk/cld>.

36) This is the document known as The Strategic Framework, see note 13.

37) See especially the text around note 25, above, and the theoretical writing on company law in recent years, the principal examples of which are cited in note 8.

38) See especially the discussion in chapter 5.1 of The Strategic Framework.

39) Section 309 of the Companies Act 1985.

40) For a fuller discussion of this and other aspects of reforming company directors' duties, see Birds, 'The Reform of Directors' Duties' chapter 7 in The Reform of UK Company Law, ed De Lacy (Cavendish, 2002).

41) See Birds, *ibid*, and Worthington, 'Reforming directors' duties' (2001) 64 Modern Law Review 439.

42) See note 32, above.

43) This is being conducted by Sir Derek Hicks. It is expected that his report will be published by early 2003.

44) An existing code is The Responsibilities of Institutional Shareholders and Agents — Statement of Principles, produced by the Institutional Shareholders' Committee, which represents the insurance companies, pension funds and investment trusts that are the principal British institutional investors.

45) See the comments earlier and the writings referred to in note 41.

46) At present these are contained in Part X of the Companies Act 1985.

47) The Directors' Remuneration Report Regulations 2002, SI No 1986.

48) Currently section 366 of the Companies Act 1985.

49) Sections 381A to 381C of the Companies Act 1985.

50) Section 459 of the Companies Act 1985 (see note 20).

51) Currently section 283 of the Companies Act 1985.

52) So Part IX of the Companies Act, which is entitled Company Administration and Procedure, refers almost exclusively to members. This is not entirely surprising as the company with a share capital is by no means the only form of registered company, even if it is the dominant form.

53) This is known as CREST, and is regulated by the Uncertificated Securities Regulations 2001 SI 3755, made under section 207 of the Companies Act 1989 and replacing earlier 1995 Regulations to the same effect.

54) See the Electronic Communications Act 2000 and the Companies Act 1985 (Electronic Communications) Order 2000, SI 2000/3373.

55) See Sealy, 'The disclosure philosophy and company law reform' (1981) 2 Company

Lawyer 51 and Sealy, *Company Law and Commercial Reality*, 1984, especially chapters 1 and 2.

56) See especially the reforms introduced by the Companies Act 1989.

57) Required by section 234 of the Companies Act 1985, with the detail prescribed in Schedule 7.

58) As to the current law, see Boyle and Birds, chapter 7.

59) See the Report of the Committee on Consumer Credit, 1971.

60) See Part IV of that Act, which was intended to replace Part XII of the Companies Act 1985.

61) See *Registration of Security Interests: Company Charges and Property other than Land*, Law Commission Consultation Paper No 164, 2002.

62) *A Modern Regulatory Framework for Company Law in Europe: A Consultative Document of the High Level Group of Company Law Experts*, 2002.

63) See especially *Centros Ltd v Ehrvervs- og Selskabsstyrelsen* [2000] 2 WLR 1048, [1999] BCC 983, and the comments by Micheler, 'The impact of the Centros case on Europe? company laws?' (2000) 21 *Company Lawyer* 179 and Xanthaki, 'Centros: is this really the end for the theory of the siege reel??' (2001) 22 *Company Lawyer* 2.

64) Especially sections 213 and 214 of the Insolvency Act 1986, which impose liability for fraudulent and wrongful trading, and section 6 of the Company Directors Disqualification Act 1986, which allows for the disqualification of unfit company directors.

65) As an Appendix to the White Paper published in July 2002.