

Company Law Reform Bill – Consultation on Draft Liability Amendments
A Submission by the Corporate Responsibility (CORE) Coalition and the Trade Justice
Movement to the UK Government Department of Trade and Industry
Friday 12 May 2006

I. Summary

1. This document represents the views of the Corporate Responsibility (CORE) Coalition and the Trade Justice Movement on the draft amendments to the Company Law Reform Bill on directors' liability issued for brief consultation by the Department of Trade and Industry on Wednesday 3 May 2006. CORE is a broad coalition of over 130 UK non-governmental organisations with a shared agenda in promoting sustainable development and corporate accountability. The Trade Justice Movement campaigns for trade justice – that the rules and practices relating to international trade be weighted to benefit poor people and the environment – and is made up of 80 member organisations that have over 9 million individual members.
2. We believe that the disclosure by company directors of high quality, meaningful information on the impacts of their business operations on communities and the environment is essential to ensure that investors are fully-informed of these impacts, a key criterion for the success of the 'Enlightened Shareholder Value' (ESV) approach to directors' duties. High quality narrative reporting is also critical for the achievement of greater corporate accountability and a corresponding improvement in corporate social and environmental performance.
3. CORE and the Trade Justice Movement are therefore supportive of a safe harbour provision for directors for statements, which are made in good faith but turn out to be misleading, as we believe this will help encourage more open and honest reporting.
4. However, we are concerned that the Government's proposed amendment to the Company Law Reform Bill on directors' liability for false or misleading reports does not provide directors with a sufficient incentive to ensure the truth and accuracy of their statements. We therefore propose a small but important change to the Government's draft amendment, which would require directors to take reasonable steps to satisfy themselves of the truth of any statement they make, or the potential for any omission to mislead. We urge the Government to adopt this change in the amendment that it lays before Parliament.

II. Background – CORE and the Trade Justice Movement's position on reporting and disclosure

5. The CORE Coalition and the Trade Justice Movement support the introduction of mandatory reporting by companies on social and environmental issues. We believe that this is critical to achieving greater transparency about the impacts of company operations, and that it is an essential first step towards the achievement of a wholesale improvement in corporate social and environmental performance.
6. If companies are to be held accountable for their wider social and environmental impacts, it is essential that shareholders, employees, communities and pressure groups are able to access reliable, forward-looking information about company activities. This will help drive more responsible business behaviour by making it easier for shareholders to hold directors to account, and also by necessitating improvements in internal corporate reporting and information management systems, hence making company boards more aware of the social and environmental impacts of their business operations.
7. The introduction by the Government in March 2005 of a requirement for quoted companies to produce an annual Operating and Financial Review (OFR) alongside their annual financial reports was regarded by CORE and the Trade Justice Movement as an important step towards better social and environmental reporting. Whilst it was disappointing that the OFR

requirements were watered down so significantly during the consultation process, and the target audience narrowed to just company investors, CORE and the Trade Justice Movement believed that the OFR would still have led to a significant improvement in non-financial reporting.

8. We were therefore extremely shocked and disappointed by the Chancellor's announcement in November 2005 of the Government's plans to abolish the OFR, and welcomed the announcement on Wednesday 3 May of the Government's intention to table amendments to the Company Law Reform Bill which would strengthen the Business Review, the narrative report required under the EU Accounts Modernisation Directive, with some of the provisions from the OFR, including the requirement for quoted companies to report on social and community issues and the impact of the company's business on the environment, as well as on the policies of the company in relation to these matters and the effectiveness of those policies.
9. CORE and the Trade Justice Movement remain concerned, however, that the Government has not sought to strengthen the audit requirements for the Business Review; that it is still only quoted companies which will have to report on the above mentioned issues; and, most importantly, that the Government does not intend to provide mandatory statutory reporting standards for the Business Review. The latter omission in particular, and an awareness of the need to balance transparency with reasonable protections for directors acting in good faith, informs our position on the draft liability amendments published by the Department of Trade and Industry for short consultation on Wednesday 3 May. This is set out in detail below.

III. CORE and the Trade Justice Movement's position on Safe Harbour

10. As mentioned briefly above, our central objective in relation to narrative reporting is the achievement of greater corporate transparency and accountability through the public disclosure of accurate, meaningful information on corporate social and environmental performance.
11. We believe that legislation in this area should be crafted so as to maximise the quality and quantity of non-financial information available by ensuring that directors' are able to make statements, which are accurate and meaningful. We are therefore sympathetic to concerns that, without certain protections for directors against liability for statements which are made in good faith but turn out at a later date to be misleading or untrue, then a legal requirement for narrative reporting may just lead to a 'box-ticking exercise', whereby fear of litigation prevents directors from reporting candidly and means that they only disclose information that can be legally corroborated.
12. However, our principle objective is to enhance business transparency, and we are therefore also concerned to ensure that directors remain liable where they have culpably failed to include relevant information in the Business Review. For instance, if a director fails to disclose significant risks of cost-cutting in health and safety as BP was found to have done in Texas in 2004 where such cost-cutting led to the direct deaths of employees and commensurate financial liabilities.
13. Our support for the introduction of a so-called 'safe harbour' provision to excuse directors from liability under certain circumstances for statements made in the Business Review is therefore contingent on this provision being drafted in such a way as to maximise openness whilst at the same time not undermining a director's accountability for the statements that (s)he makes. We believe it is essential that such provisions do not give directors a carte blanche to side-step or ignore their proper responsibilities.

14. CORE and the Trade Justice Movement believe that the Government's proposal in this regard, the draft amendment to be inserted after Clause 447 in the Company Law Reform Bill, is broadly satisfactory, but we believe that one further amendment is essential in order to achieve a greater balance between transparency and reasonable protections for directors acting in good faith. As currently drafted, the Government's proposed amendment provides too much protection for the ignorant director.
15. CORE and the Trade Justice Movement are of the view that the benefit of the safe harbour should only be afforded to the responsible director. In return for protection from liability, we believe that directors should at least pass the threshold of having made reasonable efforts to avoid acting in ignorance by satisfying themselves that the statements for which they are responsible in reports are not untrue or misleading. We therefore propose the replacement of subsection (3) in the new draft clause on liability with one, which places greater emphasis on the responsibility of the director to make reasonable efforts to make himself aware of the truth of his statements, or the potential for any omissions to mislead.
16. The text of our proposed new subsection (3) is included overleaf.

IV. Proposed Amendment to draft clause on directors' liability for false or misleading statements in reports

After Clause 447

THE LORD SAINSBURY OF TURVILLE

1 Insert the following new Clause –

“Liability of directors for false or misleading statements in reports

- (1) The reports to which this section applies are–
- (a) the directors report,
 - (b) the directors remuneration report, and
 - (c) a summary financial statement so far as it is derived from either of those reports.
- (2) A director of a company is liable to compensate the company for any loss suffered by it as a result of –
- (a) any untrue or misleading statement in a report to which this section applies, or
 - (b) the omission from a report to which this section applies of anything required to be included in it.

(Leave out: (3) “He is so liable only if –(a) he knew the statement to be untrue of misleading or was reckless as to whether it was untrue or misleading, or (b) he knew the omission to be dishonest concealment of a material fact.” and insert –

- (3) He is not so liable if, after having made reasonable efforts to satisfy himself of the truth of any statement or the potential for any omission to mislead,
- (a) he did not know the statement to be untrue or misleading or was not reckless as to whether it was untrue or misleading, or
 - (b) he did not know the omission amounted to dishonest concealment of a material fact.)
- (4) He is so liable only in respect of loss suffered by the company as a result of its relying on the report.
- (5) A director is not subject, in respect of the contents of a report to which this section applies --
- (a) to any other liability to the company than is provided for by this section, or
 - (b) to any liability to any other person.
- (6) The references in subsection (5) to a director being subject to a liability include references to another person being entitled as against him to be granted any civil remedy or to rescind or repudiate an agreement.
- (7) This section does not affect any liability for a criminal offence.”

V. Further Information

- Further information on the CORE Coalition is available at: <http://www.corporate-responsibility.org/>.
- Further information on the Trade Justice Movement is available at: <http://www.tjm.org.uk/>
- For further information on CORE and the Trade Justice Movement's position on the provisions on narrative reporting included within the Company Law Reform Bill please contact the CORE Coalition Coordinator, Hannah Ellis, on 020 7566 1665 or by email to: hannah.ellis@corporate-responsibility.org.

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