



COMPANY LAW

Director and auditor liability

A CONSULTATIVE DOCUMENT

DECEMBER 2003



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The Department of Trade and Industry invites comments, by **12 March 2004**, on the issues set out in this paper.

You are invited to send comments, together with supporting evidence, on any issue covered by this consultation, preferably by e-mail, to:

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Foreword



**Patricia Hewitt,
Secretary of State for Trade and Industry**

High quality company law is central to the UK's position as one of the best places in the world to do business. That is why we are committed to maintaining an effective system of corporate governance and company law, which provides market confidence, strengthens trust, and enhances the quality of company reporting and decision-making.

This means a pool of high-quality individuals, willing to assume the role of company director. It also requires an open, transparent and competitive market for audit services. The right principles on liability play an important part in this. There is an important balance to strike, and no consensus has yet emerged. We do not want regulations that are so stringent, complex or unclear that honest, capable people are put off being directors or auditors. Equally the law must be firm and robust to deal fairly with cases where something has gone wrong – as a result either of negligence or of dishonesty.

This is your chance to provide your views, together with supporting evidence, and help us get this framework right. I very much hope you will give us both evidence about the present position and ideas for practical, workable and effective solutions for the future.

A handwritten signature in black ink, appearing to read 'Patricia Hewitt', with a large, stylized flourish at the end.

Patricia Hewitt

1 Introduction

- 1.1 Over recent months there has been increasing interest in the civil liability of company directors and auditors. Some have expressed concerns that suitably qualified individuals may be deterred from accepting positions as company directors. Others have been more concerned about the position of auditors.
- 1.2 This consultation focuses on the civil law. It is not about any potential criminal consequences that might apply.
- 1.3 The right solution will involve balancing the interests of stakeholders, in particular:
 - investors, who wish to maintain the supply of competent, appropriately qualified individuals who are willing and able to lead companies;
 - other users of accounts, who want to maintain and, where possible, enhance the quality of the audit;
 - directors, who want to be clear about their responsibilities and liabilities;
 - auditors, who wish to ensure that the risks and rewards associated with their professional work are appropriately balanced;
 - regulators, who are anxious to maintain efficient, well-ordered and transparent markets.
- 1.4 Given these different perspectives it is perhaps not surprising that views vary as to the issues and the best way forward. This is your chance to have your say, and to provide evidence to support your views.

Why is the Government looking at this issue?

- 1.5 The key principles of director and auditor liability are not set out in legislation. Instead they have to be derived from a series of court judgements. Parliament has however legislated to deal with particular abuses, including in the Companies Act 1929, which restricted the ways in which directors and auditors can limit their liability. These provisions can now be found in the Companies Act 1985.

- 1.6 Developments in the last 70 years may mean these provisions are no longer appropriate, or are inadequate. There are growing concerns that the law does little to recognise that directors may face legal action for breach of duty (especially the duty of care and skill) even when they have acted in good faith and in the belief that their decisions were in the best interests of the company.
- 1.7 Furthermore, auditors are, under current law, exposed to unlimited liability for their mistakes. They are also concerned about the availability and cost of insurance, including self-insurance. The Government is determined to ensure that a competitive and high-quality market for audit services is maintained, and that shareholders have access to high-quality and reliable information, whilst maintaining an adequate system of redress.
- 1.8 Some investors have also proposed changes, including enhancing the scope of the audit and the audit report.
- 1.9 This consultation exercise builds upon the work of the Company Law Review (“CLR”) and of the subsequent review of the role and effectiveness of non-executive directors undertaken by Derek Higgs.

Your opportunity to comment

- 1.10 We have tried to present the issues as clearly as possible in non-technical terms. Please contribute comments and evidence, especially on costs and benefits, on both the present arrangements and potential changes. Please reply to James Carey at the Department of Trade & Industry by 12 March 2004.

2 Background to the Current Position

For what are directors liable?

- 2.1 Company directors' general duties to their companies are commonly divided into duties of loyalty and duties of care. This consultation is mainly about the latter, both in relation to the conduct and supervision of the company's affairs, and, specifically, the preparation of its accounts.
- 2.2 A director's duties are owed to the company rather than to individual shareholders. It therefore falls to the company to take action for breach of duty: in practice this usually means the board of directors (in some cases a new board of directors) or the liquidator.

For what are auditors liable?

- 2.3 Auditors can be held liable in relation to their audit of the company's accounts.
- 2.4 The scope of the auditors' common law duties to the company and to shareholders was set out by the courts in the case *Caparo Industries PLC v Dickman*. The courts found that the auditors' statutory report was prepared for the very specific purpose of enabling the members of a company to exercise their rights as members of the company (for example, to vote at a company meeting). This means that auditors have no automatic liability to anyone using their report for investment decisions (e.g. to buy or sell shares), or for decisions as to whether or not to extend credit to the company.

Exemptions from liability

- 2.5 The current prohibition on companies exempting their directors and auditors from, or indemnifying them against, liability in respect of any negligence, default, breach of duty or breach of trust in relation to the company dates back to 1929. It arose because individual company articles were beginning to relieve directors and auditors from the consequences of breach of their duties. This meant the shareholders were unable to obtain redress, especially as the courts then took a very relaxed approach to the directors' duty of care. Parliament therefore changed the law in 1929 so that these exemption clauses ceased to have any effect. The only significant legislative change between then and now was in 1989 when Parliament clarified the basis on which companies could provide liability insurance to directors and auditors. The key provision, namely section 310 of the Companies Act 1985, is set out in Annex A.

What did the Company Law Review propose?

Directors

- 2.6 One of the key recommendations of the CLR was that there should be a statutory statement of the general principles by which directors are bound (“directors’ duties”). The statement should include a statutory duty of care, skill and diligence.
- 2.7 The CLR considered the case for allowing companies to relax the proposed duty of care, skill and diligence in their articles. It decided “the community as a whole suffers if companies are run with less than objective standards of competence and it is appropriate to impose a universal mandatory standard”.
- 2.8 It has long been accepted that shareholders collectively may decide retrospectively to approve actions by the directors even when this breaches the duties of care and skill, provided that the company is solvent. This is called ratification. It means the company has no claim against the director. The CLR recommended this should continue. It also recommended that the validity of a decision by the members of the company to ratify a wrong on the company, or by the board not to pursue the wrong, should depend on whether the necessary majority was reached without the support of the wrongdoers or those under their influence.
- 2.9 The CLR also made some more detailed reform recommendations, including on indemnification, which are discussed in section 4.

Auditors

- 2.10 The CLR considered the question of auditors’ liability in some detail, consulting a number of times. It concluded that auditors should be allowed in future to limit their liability contractually with the company, provided that:
- any such limitation secured shareholder approval; and
 - notice of it was included in the auditors’ report; and
 - there were formal guidelines on the extent to which auditors should be permitted to limit their liability, with a statutory presumption that agreements within such guidelines would be reasonable for the purposes of the Unfair Contract Terms Act 1977.

The CLR also considered the extent to which auditors should be liable to third parties.

The Higgs Review of the role and effectiveness of non-executive directors

2.11 Derek Higgs noted in his report that there was widespread concern about the potential liability attaching to non-executive directors. He therefore considered issues relating to the liability of non-executive directors in detail, and made some important recommendations:

- he provided guidance, now incorporated in the Combined Code, on the position of a non-executive director;
- he recommended that the Lord Chancellor's Department (now the Department for Constitutional Affairs [DCA]) should consider steps to promote active case management (see paragraphs 4.8 - 4.10);
- he supported the CLR's recommendation in respect of indemnification in advance against the cost of defending proceedings, subject to a suggested enhancement (see paragraph 5.6);
- he recommended that the Combined Code should make reference to the need to provide appropriate Directors' and Officers' (D&O) liability insurance (implemented as Code provision A.1.5); and that companies should supply details of their insurance cover to potential non-executive directors before they are appointed;
- he welcomed the agreement of the City of London Law Society and the Institute of Chartered Secretaries and Administrators (ICSA), together with the Association of British Insurers and the British Insurance Brokers' Association, to produce guidance on what insurance should be provided for directors. ICSA has subsequently published the guidance on its website: (http://www.icsa.org.uk/pdfs/guidance/030925_Dir_OffInsurance.pdf)

Current developments

2.12 The CLR recommended that the duty on directors to assist the auditors should be widened to require them to volunteer information where the normal standards of directors' care and skill require them to recognise that such information is needed. The CLR went on to argue that a breach of this duty should be attributed to the company for contributory negligence purposes, subject to normal principles.

2.13 The Companies (Audit, Investigations, and Community Enterprise) Bill, which was introduced into Parliament on 3 December 2003, includes a provision (clause 9) to the effect that the directors' report must contain a statement that the directors are not aware of relevant information which has not been disclosed to the company's auditors. The purpose of this clause is similar to the CLR idea of widening the duty of directors to assist the auditors by volunteering information. There have been a number of other significant developments since the publication of the CLR's Final Report. These are summarised in Annex B.

2.14 The Government will also need to have regard to any EU developments in the areas of company law and financial disclosure which might have a bearing on the issues raised in this consultation. These include the Transparency Directive, which is currently being negotiated and which will address the continuing obligations of listed companies to make information available to the market, and the EU Action Plan on company law and corporate governance.

The approach adopted by others

2.15 It is difficult to compare sections of one country's legal system with those of another. For example, in this area it is important to consider both the law imposing liability, as well as provisions that enable that liability to be excluded.

Directors

2.16 The law in some other countries provides more protection for directors, but that is often because they are more exposed to liability to start with. For example, in the case of the United States of America, there is both greater scope for shareholders to bring actions against directors and for corporations to eliminate or limit the personal liability of directors. In recent years, common law jurisdictions such as Australia and New Zealand have introduced a statutory business judgement rule. The legal position overseas is discussed in more detail in paragraphs 5.7 - 5.13 in relation to possible statutory options.

Auditors

2.17 Within the European Union, just three member states operate some form of statutory financial limit to an auditor's liability – Austria, Germany and Greece. A further four (Denmark, Luxembourg, the Netherlands and Spain) permit liability to be limited by contract.

2.18 Australia, Canada and the USA have begun to move towards some form of proportionate liability for economic loss generally, although the type of system introduced varies between countries to reflect the nature of the liability and local market conditions.

2.19 The European Commission undertook a study of the liability regimes in differing members states in 2001. It found that any move towards harmonisation was likely to be obstructed by the fact that national rules governing auditors' civil liability are inextricably linked to the fundamental rules of national legal systems. It concluded that, in general, harmonisation or capping of auditor liability is not desirable, believing liability to be a driver of audit quality.

3 Extending the duty of care

3.1 This section is about who should be able to rely on the financial statements of a company.

Key arguments for change

3.2 The CLR suggested that the key argument for change was to "... accord with the demands of a modern economy, where those who attach importance to the audit of financial statements include future investors/shareholders, suppliers, employees, and creditors (including banks), to name but a few".

3.3 It continued: "...there seems to be a strong case, if the law is to meet modern needs and expectations, that those who are responsible for, or who audit and/or review, information that companies publish, should owe a duty to those who may reasonably be expected to rely upon such information or review".

3.4 The CLR also initially suggested that the auditors' duty of care seemed unduly restricted and inconsistent with modern commercial expectations. However, it recognised that statutory extension of the scope of auditors' duties raises major difficulties. For example it would be logical that directors who prepare the accounts should have the same range of liability as auditors, so directors' liability would have to match any extension of liability of auditors.

Key arguments against change

3.5 The CLR felt that, while it was reasonably easy to define the categories of persons to whom a duty of care could be owed, "... the challenge is to ensure that the breadth of such a broadened duty does not become an unsustainable burden".

The Government's view

3.6 The CLR consulted twice on possible ways of resolving the issues identified, but in light of the results concluded "...we do not believe that the case has been made for the statutory extension of the duty of care of auditors".

- 3.7 The Government is minded to accept the CLR's recommendation on this issue. It will not bring forward proposals for change unless you can identify a practical and effective solution to the problems that have been identified.
- Q1 Should investors in a company be able to claim against the directors and/or auditors? If so, on what basis and why?**
- Q2 Should potential investors in a company be able to claim against the directors and/or auditors? If so, on what basis and why?**
- Q3 Should an ability to claim in respect of a breach of duty of care in preparing accounts be extended to any other group? If so, who and why?**
- Q4 Should criteria be set by statute to determine whether an auditor owes a duty of care to a particular person?**
- Q5 Should any action seeking recompense for a loss be against the auditors, the directors, the company or some combination? Why?**
- Q6 (a) On what basis should any loss be assessed? For example, should liability be limited to the difference between the value of shares at the date of purchase and the value they might have had if the audit had been correct? Or should it be the total loss suffered?**
- (b) Is this a matter for legislation, or is it for the courts to determine in any particular case?**
- Q7 (a) What would be the implications of any overall limit of liability for the rights and obligations of third parties to each other? For example, would the first person who claims have to share any recompense with the last person to claim?**
- (b) If the company brings an action, should that rule out claims by others?**
- Q8 If the auditors' duty of care were to be extended, should the extension apply equally to all users? Or should it depend on how much else the claimant knows (or ought to have known) about the company? For example, in addition to the annual Report & Accounts, a bank or fund manager is likely to have access to a wide range of relevant research materials that might be used in support of an investment decision. In contrast a private investor might only have access to the historical Report & Accounts.**
- Q9 If the auditors' duty of care was to be extended, what would be the most effective way of preventing abusive actions (for example, seeking to recover losses from bad investment decisions)?**
- Q10 The directors are responsible for the contents of the company's Report & Accounts. Do you think therefore that any extension of the auditors' duty of care should be matched by an equal extension of the directors' duty of care in relation to the accounts? What would be the consequences?**

4 Directors – key issues

- 4.1 Sections 4 and 5 set out, and propose possible solutions to, issues relating to directors' liability to the company.
- 4.2 The Government has ruled out any possibility of exemption or indemnification for fraudulent or other illegal conduct. Nor is it possible to insure against such liabilities.

Exemption from, and indemnification against, liability

- 4.3 Issues relating to exemption and indemnification are far from straightforward. You may feel that the proposed statutory duty of care and skill would be undermined if companies could choose to eliminate or limit a director's liability for breach of the duty; equally, you may believe that there is little point in drafting a high-principled company law which reduces the willingness of able and well-intentioned people to act as directors.

Directors' and Officers' liability insurance

- 4.4 Derek Higgs considered this issue, and noted that "the cost of directors' and officers' insurance is increasing and the coverage appears to be becoming less comprehensive". As noted in paragraph 2.11, he also made some relevant recommendations, which have already been implemented.

Q11 Is there evidence that the cost of Directors' and Officers' (D&O) liability insurance is increasing in real terms and that coverage is becoming less comprehensive? If there is, is this a fair reflection of the market pricing in increased risk?

Q12 The Combined Code has been amended to refer to the need for companies to arrange appropriate insurance cover in respect of legal action against directors, and ICSA has published guidance for companies on what insurance should be provided for directors. Is there need for more to be done? If so what?

Non-executive directors

- 4.5 Derek Higgs commented in his report that effective and robust boards are an essential feature of successful companies; and that, within the unitary board, non-executive directors have a crucial part to play. The Government agrees. That is why it believes that it is very important that able people from a range of backgrounds should be willing to take on non-executive director roles.
- 4.6 The CLR considered a number of issues relating to the position of non-executive directors, including whether the monitoring role of non-executive directors should be clarified in legislation. It concluded that the case for intervention through law had not been made out, particularly given the loss of flexibility this would entail. Derek Higgs also noted very strong support for the concept of the unitary board and for the legal duties of executive and non-executive directors to be the same. The CLR did however recommend a statutory duty of care, skill and diligence, which, it believed, would impose a different standard on a non-executive director than on an executive director.
- 4.7 There have been suggestions that some able people may be reluctant to take on non-executive director roles because of concerns about potential liability. At the time of his report, Derek Higgs concluded that it did not appear that such concerns were having a significant effect in deterring people from putting themselves forward, at least in larger companies.

Q13 Is there evidence that suggests that issues relating to potential liability are affecting the recruitment of able non-executive directors?

Q14 Might it be appropriate to permit companies to indemnify non-executive directors even in circumstances where this is not considered appropriate in respect of executive directors? If so, in what circumstances?

Court procedures and case management

- 4.8 In his report, Derek Higgs noted that court procedures and case management are very important, not least because lengthy proceedings can be very detrimental reputationally as well as financially. He invited the Lord Chancellor's Department (now the DCA) to consider steps to promote active case management in cases applying to directors. In response to the Higgs Report, the DCA has confirmed that the Civil Procedure Rules (CPR) already provide for active case management by the courts and that applications for relief under section 727 of the Companies Act 1985 are covered by these rules (section 727 is set out in Annex A). The success of case management powers often depends on the complexity of the case and cases involving the liability of directors are likely to be complex and contested. Where a claim has been brought against directors, it is, of course, open to them under the CPR to apply to the courts to have the claim struck out if they consider that it is not properly grounded.

4.9 Some of the issues raised by Derek Higgs have been put into sharp relief by the judgement by Mr Justice Langley on 17 October 2003 in relation to the strike-out application by some of the former Equitable Life directors. His summary comments on section 727 were as follows:

- i) “The Section undoubtedly contemplates by its wording that an officer of a company may be negligent and yet may act sufficiently “reasonably” to justify a court excusing him from liability.
- ii) The Section also appears to contemplate the possibility of a court concluding that it should relieve an officer of liability without a full trial.
- iii) Nonetheless in my judgment it would require a quite exceptional case for a court to conclude on an application of the present kind that it was appropriate to grant relief. The Court, as a minimum, would have to be satisfied that the officer had acted “reasonably” and that it was aware of “all the circumstances” which enabled a determination to be made whether and to what extent it would be fair to relieve the officer of liability. It must be highly improbable that such a state of mind could be achieved on an interlocutory application.”

Q15 To what extent is the length of court proceedings adding to the concern of directors about their potential liabilities?

Q16 Does section 727 currently allow the courts sufficient scope to grant relief at an interim stage?

5 Directors – Possible reform options

- 5.1 The Government announced last year that it agreed with the CLR there should be a statutory statement of directors' duties; and it is considering how the CLR's draft text might be improved. For the purposes of this consultation, you are asked to provide comments on the basis that:
- the Government will introduce legislation which will provide a statutory statement of directors' general duties;
 - this will include a statutory standard of care, skill and diligence;
 - this statutory standard will be judged by a twofold test. That is, a director will owe a duty to the company to exercise the care, skill and diligence that would be exercised by a reasonable person in the same circumstances having both:
 - (a) the knowledge and experience that may reasonably be expected of a person in the same position as the director (thus imposing a different standard, for example, on an executive director than on a non-executive) and;
 - (b) that particular director's personal knowledge and experience (i.e. a qualified accountant would be expected to have a more detailed knowledge of accounting issues than a director who is not so qualified).
- 5.2 As the CLR explained, early cases in relation to the duty of care, skill and diligence were very lax, asserting that the only standards of care and skill required were those to be expected of an ordinary prudent person (with no objective standard by reference to the directorship) and that little was required in the way of diligence (for example, very infrequent attendance at board meetings was acceptable). More recently, the courts have adopted a stricter approach, in part influenced by the development of more demanding statutory standards for directors whose companies are facing insolvency. The CLR's draft statutory duty reflects this judicial development.
- 5.3 The Government believes that there are three main options on directors' liability and indemnification, which are set out below. It would welcome views as to which option should be followed.

Option A – Retain the substance of current sections on exempting directors from liability

- 5.4 You might prefer this option if you believed that, even if there were a statutory statement of directors' duties, the 1985 Act would strike a reasonable balance between the concerns of directors about their personal liability and protection of the interests of the company and of its shareholders.

Option B – Implementation of the CLR's recommendations

- 5.5 Under this option, the Government would seek to implement some or all of the CLR's recommendations set out below, but would not introduce more radical reform.
- 5.6 These reforms would only apply in relation to areas such as negligence and exploitation of corporate opportunities; they would not apply in relation to fraudulent or illegal conduct by a director.

(a) Limit application of section 310 to directors' general duties

The current prohibition in section 310 applies in respect of any negligence, default, breach of duty or breach of trust of which a director may be guilty in relation to the company. The CLR said that this wording was very general and lacked clarity. It recommended that section 310 should apply to liabilities under the general duties of directors.

(b) Indemnification by a third party

There is some uncertainty as to whether section 310 applies to indemnities given by third parties. In particular, it is uncertain whether a parent company can give indemnities to directors of a subsidiary company and whether a subsidiary may provide an indemnity for a director of a holding company. The CLR recommended that the prohibition should only apply to indemnities given by the company (with appropriate anti-avoidance provisions to deal with cases when the same effect is achieved indirectly) and to provisions in the company's constitution that seek to limit the directors' liability. The CLR argued that it is only these that directors are in a position to influence unduly; and that there should be no objection to such contracts being negotiated with a holding company, another member, or a third party.

(c) Indemnification in advance against the cost of defending proceedings

Section 310(3) permits directors to recover their defence costs, but only if the directors have been successful in court. The CLR recommended that a company should be allowed to give a director an indemnity in advance against the cost of successfully defending proceedings, or of a section 727 relief application. Under the

CLR recommendation, such advance indemnification could be provided only if the decision were made by the disinterested members of the board on the basis of appropriate legal advice that the prospects of success were good; moreover, if the director lost the case, he would be bound to reimburse the company.

As noted in paragraph 2.11, Derek Higgs subsequently recommended that a company should be able to indemnify a director in advance against the reasonable cost of defending proceedings from the company itself without trying to establish in advance the prospects of success of the case.

(d) “Excess of loss” requirement on a liability insurance policy

The CLR recommended that that section 310(3)(a), which permits the company to buy D & O liability insurance, should be amended to enable the company to indemnify a director against a reasonable *bona fide* excess of loss requirement on a liability insurance policy. At the moment, a director is generally expected to pay a limited amount of any claim himself.

(e) Broaden scope of section 727 relief

Under section 727 a director may apply to the court for relief from actual or potential liabilities. The court may grant relief if it appears that the director “acted honestly and reasonably” and that “in all the circumstances he ought fairly to be excused”.

The CLR felt this provision, while little used, was still of value. It suggested that there is doubt as to the extent to which it allows relief for negligence, because it is hard in logic to regard a director as having acted reasonably if he is liable in negligence (i.e. as having failed to exercise reasonable care or skill). The CLR nevertheless concluded that in such cases the court should grant relief if it believes the director ought fairly to be excused. It suggested that this could be achieved by deleting the requirement that the director must have acted reasonably, while retaining the other conditions.

Option C – Reforms based on the US model

- 5.7 The litigious nature of business life in the USA has resulted in much greater legal protection for honest directors. (As with Option B, the US model does not provide protection in relation to fraudulent or illegal behaviour.)
- 5.8 Protection against personal liability in the US must be considered in the context of a director’s legal obligations. The federal securities regime is applicable across the US. While each US state has its own corporate law, a Model Business Corporation Act (“Model Act”) is maintained by a committee of the American Bar Association. This provides that directors must discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances. The baseline standard in the US is therefore lower than that proposed by the CLR.

5.9 In many states of the US this duty is subject to the *business judgment rule*. This is a judge-made standard used in analysing director conduct to determine whether a board decision can be successfully challenged or a director should be held personally liable. The court will look only to determine whether the directors – at least those directors making the decision – were disinterested in the matter, appropriately informed themselves before deciding, and acted with a good faith belief that the decision was in the best interests of the corporation.

5.10 Both Australia and New Zealand have introduced a statutory business judgment rule. Supporters argue that this reflects the position at common law that the courts are loath to review the merits of a decision on a matter of business management. It also, unlike the common law, provides a clear presumption in favour of a director's judgment where such decisions have been taken in good faith and in the company's interest.

5.11 The CLR considered the case for a statutory business judgment rule. It acknowledged that there is a danger that the courts will apply hindsight in cases relating to the duty of care and skill and reach unduly harsh conclusions. Nevertheless, in the light of its proposals for section 727, it opposed such a rule on the grounds that:

- British courts have shown a proper reluctance to enter into the merits of commercial decisions;
- such a provision would be likely to add complexity, and be inflexible and unfair, being too harsh in some cases and allowing too much leeway in others.

5.12 The main provisions in the Model Act on limitation of liability and indemnification are as follows.

- *Limitation of liability*

In the US, a majority of the state corporation laws and the Model Act permit the corporation to eliminate or limit the liability of directors to the corporation or its shareholders for money damages for breaches of certain duties, most frequently the duty of care. For instance, the Model Act permits, with shareholder approval, inclusion of a provision in the articles of incorporation eliminating or limiting directors' personal liability for money damages, except liability for the receipt of a financial benefit to which the director is not entitled, the intentional infliction of harm on the corporation, an unlawful distribution or an intentional violation of criminal law. Protection from liability generally applies only to monetary liabilities to the corporation and to its shareholders.

- *Indemnification*

The Model Act and most US state corporation statutes specify the circumstances in which a corporation may indemnify its directors against liability and related

reasonable expenses incurred in connection with their service as directors of the corporation. The Model Act's generally applicable standard for indemnification is that the individual director has acted in good faith and with a reasonable belief that his or her conduct was in the best interests of the corporation.

In derivative actions brought against directors by minority shareholders in the name of the corporation itself, indemnification is allowed for expenses (including attorney's fees), but when a director has been found liable, indemnification is allowed only with court approval.

The Model Act provides that indemnification for reasonable expenses (including court costs and fees) is mandatory if the director has been wholly successful in the defence of any action, on the merits or otherwise.

● *Advance for expenses*

Similarly the US Model Act and most US state corporation statutes specify the circumstances in which corporations may advance funds to directors to pay or reimburse reasonable expenses incurred by them in defence of a matter prior to the final disposition of the proceedings and before final determination of their right to indemnification for those expenses. Directors generally must provide the corporation with an undertaking to repay any funds advanced by the corporation if it is ultimately determined that they are not entitled to indemnification.

5.13 One important issue raised by the US model is whether it might be appropriate to permit the limiting of liability or advance indemnification. As explained above, the US Model Act permits limitation of liability for money damages with shareholder approval, and advance indemnification under certain circumstances by the board without shareholder approval. This would be a very radical step in the context of British company law.

Q17 Which of the three main options for reform of director's liability should the Government adopt?

Q18 In relation to the CLR's ideas:

- (a) are there particular aspects of the CLR's recommendations that you believe are either especially important or that should not be pursued?**
- (b) do you support the recommendation by Derek Higgs that a company should be able to indemnify a director in advance against the reasonable cost of defending proceedings from the company itself without trying to establish in advance the prospects of success of the case?**

Q19 In relation to the US model:

- (a) is there a case for the introduction of a statutory business judgment rule?**
- (b) should any other of the US provisions be considered further? If so, should they be subject to shareholder approval?**
- (c) Should any such shareholder approval need to be renewed (for example, every year or every 5 years), and should the same requirement in respect of shareholder approval apply to all types of company?**

6 Auditors – key issues

6.1 Sections 6 and 7 set out, and explore possible solutions to issues relating to auditors' liability.

Is the audit market sufficiently competitive?

6.2 Amongst the largest companies, the market for audit services is currently highly concentrated. All FTSE-100 companies are audited by one of four firms, and these firms also audit about 90 per cent of the FTSE-350.

6.3 The largest auditors are concerned that the number of firms able to undertake an audit in key sectors is already limited and might decline further. It is important to recognise that the cause of such a reduction might be due to events overseas, as well as to those that originate in the UK. Competition in the market for audit services is a matter for the independent competition authorities. During 2002 the Office of Fair Trading undertook a preliminary inquiry into whether there were competition problems in the audit and accountancy services sector. It found no evidence to suggest that firms have acted to prevent, restrict or distort competition, nor at that stage had it received any complaints that the incumbents may be doing so. Nevertheless, some market participants have expressed fears that a further reduction in the largest audit firms would be unwelcome.

6.4 While therefore this is not directly a matter for DTI, it would be helpful to know if you have any concerns about the current state of the market that should be drawn to the attention of the relevant competition authorities. Relevant comments will be shared with the appropriate competition authorities, which have indicated their willingness to keep this market under review.

Q20 (a) Do you see substantive barriers to entry to, and expansion within, the audit market? If so, what are they?

(b) If such barriers are perceived to exist, what steps might be taken to remove them?

(c) When commissioning audits, do you feel that you have sufficient genuine choice between firms? If not, why not?

Q21 Is the only way to maintain competition to legislate (such as through reform of section 310 of the Companies Act 1985), or are there other options that can be pursued? If the latter, please describe them.

Proportionate liability

- 6.5 At present, any fault by an auditor can result in full liability, as the effect of insurance and the law of joint and several liability has given rise to auditors often being singled out as the sole, or main, target for legal action. The auditors argue that this can be unfair, as a minor fault can give rise to full liability. Consequently, the largest audit firms have argued for a change in the law, to replace the current regime of joint and several liability with a proportionate system.
- 6.6 The question as to whether the UK should adopt a system of proportionate liability has been explored on several occasions recently:
- in 1996, a team from the Law Commission undertook a feasibility study into the adoption of full proportionate liability, whereby concurrent defendants would be liable to plaintiffs only for the amount of damages equal to their proportionate share of liability in relation to each other. The study also considered three forms of modified proportionate liability. The study ruled out all these approaches. However, it took the tentative view that section 310 of the Companies Act 1985 should be reformed, so as to enable auditors to limit their liability, but only if great care were taken to provide adequate safeguards for shareholders;
 - during its first term, the present Government also rejected the arguments developed by the major accountancy firms for fundamental reform of the principle of joint and several liability. It concluded that there was "... no sufficient basis identified, of either principle, commercial or economic interest, for a fundamental reform of the law affecting professional liability". However, it did invite the CLR to consider this issue further, and brought forward the Limited Liability Partnerships Act 2000. This enabled businesses such as audit firms to retain the organisational structure and tax treatment of a partnership without putting at risk the personal assets of partners who were not personally negligent;
 - the CLR rejected, as contrary to principle, the proposal that a proportionate liability system should be adopted, whereby the liability of auditors could be capped absolutely at the share attributable to them as compared with that attributable to others. It did so because "... the effect of the proportionality approach would be to impose on a plaintiff who is wholly innocent the risk that a party in the wrong may be unable to satisfy a claim, rather than imposing that burden on another party (the auditor) whose fault caused the loss".
- 6.7 The Government does not believe it right to consider the adoption of proportionate liability solely in respect of the audit industry. Any introduction would need to be part of major reform of the law of negligence. This is clearly a matter that potentially touches every industry and company in the UK. It lies, therefore, beyond the scope of this consultation exercise.

Arguments for change put forward by the largest auditors

6.8 The auditing profession has long argued that the current law is, increasingly, making the statutory audit unattractive as a business activity. The largest audit firms have proposed that section 310 of the Companies Act 1985 should be reformed, so as to allow auditors to limit their liability by contract.

6.9 Key arguments put forward by the larger audit firms include:

- there is insufficient commercial professional indemnity insurance available to the Big Four, compared to their scale of exposure. Thus, the firms themselves are left carrying very considerable uninsurable risk at a time when there is a worsening in the claims environment;
- unlimited liability is an illusory concept. In reality, there is a limit to how much firms can pay out and, if one large claim swallows up a firm's resources, there is nothing left for any subsequent claims, regardless of unlimited liability;
- increased capital requirements demanded of partners could have an adverse effect on the ability of audit partnerships to attract and retain the highest quality people. The audit firms claim that they are in intense competition with other employers who make no capital requirement of their directors or employees;
- it cannot be assumed that international networks will come to the aid of a partnership in difficulties in another country;
- the UK is out of step with other major economies, notably the USA, Canada, Germany and Australia, in that its company law prohibits any limitation of auditor liability;
- there is a risk of a move towards negative, defensive auditing that will intensify if change is not forthcoming and – without reform – the trend to exit from high-risk companies will accelerate;
- there is a risk that the number of major accountancy firms capable of bidding for the audit of a major public limited company might fall below a minimum appropriate for the maintenance of competition as some of the big firms might decide to cease providing audit services.

6.10 Others have suggested that there is real concern that many capable mid-tier audit firms are currently unable to take on listed company audit work as they would be extending their potential liabilities beyond the point at which they would be able to secure insurance.

6.11 These views are not necessarily shared by all other audit firms.

6.12 Historically auditors had to be partnerships, and hence bear unlimited liability. However this is no longer the case. For example auditors can now be Limited Liability Partnerships, which broadly combine the tax treatment of a partnership with the limited liability associated with a company. Auditors can also be companies with limited liability. Nevertheless, provided satisfactory evidence is forthcoming, the Government is in principle prepared to consider whether some of the rules that govern auditors' liability when conducting the statutory audit of the company should be reformed.

- Q22 (a) Can you provide any evidence as to whether the prohibition on limitation of liability set out in section 310 is interfering in the proper operation of the market?**
- (b) Would reform of section 310 improve, worsen or leave unchanged the operation of the market?**
- Q23 What evidence is there that appropriate levels of insurance cover at competitive prices is increasingly difficult to obtain?**
- Q24 How is the current law on liability affecting recruitment to the profession and retention of appropriately qualified individuals?**
- Q25 (a) Are you aware of, or do you anticipate, a trend towards defensive auditing?**
- (b) Would defensive auditing have a detrimental impact on the quality of the audit and/or its commercial viability?**
- Q26 Given that no audit firm has yet collapsed as a result of a claim successfully made against it in the UK, how real is the threat to the largest firms?**

7 Auditors – possible reform options

- 7.1 The Government wishes to see a competitive and efficient audit market. Clearly any reduction in the number of firms providing audit services to the largest clients could adversely affect the supply of audit services. This is not to say that audit firms should not be allowed to fail. There is an important difference between a failure caused by an auditor being sued because the claimant perceives it to have the deepest pockets and a failure caused by gross negligence or criminal activity, and which results in clients no longer wishing to use a particular auditor.
- 7.2 If the Government were to consider reform, it is likely that the CLR's findings should form the basis of any package of proposals. You are invited to comment on the relative attractiveness of three options. In summary these are:
- minimal law reform (that is, retain existing legislative arrangements, only making any changes necessary to implement future EU directives);
- or
- reform existing legislation to allow the substantive changes as recommended by the Company Law Review, with parameters being set by the market and the general law;
- or
- reform existing legislation to allow the substantive changes as recommended by the Company Law Review, within parameters being set by the Secretary of State.

In either of the last two options, there is a further question as to whether the arrangements should be disclosed and/or shareholder approval required.

Option A – Minimal law reform

- 7.3 No initiatives, except in so far as necessary to keep in line with any future EU developments.

Q27 Would you favour minimal law reform? Why?

Option B – Reform existing legislation to allow auditors to limit their liability contractually, subject to market forces

7.4 Under this option, auditors would be permitted to contract with their client to limit their liability. The extent of such liability would be determined through negotiation between the relevant parties

Q28 Would you favour simply allowing auditors to limit their liability contractually? Why?

Option C – Reform existing legislation to allow auditors to limit their liability contractually, subject to rules being set by the Secretary of State

7.5 This differs from Option B in that there would be rules to establish the extent to which liability can be limited by contract. Key options include fixing the lowest permissible contractual cap:

- as a multiple of the audit fee;
- as a multiple of total fees paid by the company (or group) to the auditor and any parent and/or associated undertakings in a given year;
- as a multiple of the turnover of the auditor;
- at an arbitrary level (for example, setting the hurdle for Big Four firms at say £500m, for second tier firms at £100m and so on). How often should such hurdles be reviewed?

Q29 Do you favour allowing auditors to limit their liability contractually, subject to rules made by the Secretary of State? If so, what should be the basis of the rules made by the Secretary of State?

7.6 In relation to each of the options described above, it will be necessary to consider questions of contributory fault and (in the case of third party claims) contribution, and how they may impact on the extent of auditors' liability in particular cases. A brief discussion of some of the issues is at Annex B.

Q30 Is the existing law on contributory fault and contribution adequate or is specific provision required to deal with these issues? If so, what?

Disclosure and/or shareholder consent

7.7 If the law were to be changed to allow limitation of liability, a key issue is whether shareholders should have a say in whether the directors enter into a liability-limiting agreement with the auditors, and, if so, how this might be done. For example:

- such agreements might not be binding without the prior agreement of shareholders; or
- such agreements might have to be disclosed in the annual report and accounts; or
- it could be left to individual companies to make whatever provisions they thought necessary.

There are important practical issues here, given that the shareholders normally agree that the remuneration of the auditors should be agreed by the directors. Would prior shareholder approval of some minimum limitation of liability each year be practical? But equally without such annual approval is there a risk of a return to the pre-1929 position, and its associated problems?

Q31 What arrangements would you like to see for disclosure and/or shareholder consent? Why?

8 The consultation process

- 8.1 The Government's code of practice for written consultations applies the criteria set out in Annex D to all national UK public consultations on the basis of a document in electronic or printed form. The complete code is available at the Cabinet Office's website address – www.cabinet-office.gov.uk/servicefirst/index/consultation.htm.
- 8.2 This consultation seeks to comply with the code of practice. If you have any complaint or comment about the consultation process, you should contact:

Phillip Martin
Departmental Consultation Co-ordinator
Room 723
1 Victoria Street
London
SW1H 0ET
Tel: 020 7215 6206
Fax: 020 7215 0480
E-mail: phillip.martin@dti.gsi.gov.uk

- 8.3 As well as answers to the specific questions asked, we would welcome any further evidence you have on costs and benefits in relation to both the present arrangements and potential changes.

Q32 Is there any further evidence on other issues which you wish to provide?

Annex A

Sections 310 and 727 of the Companies Act 1985

A1 Section 310 was introduced in 1929 in response to a practice for companies to include in their articles widely drafted exemption clauses relieving their directors, officers and auditors from liability arising from breaches of their duties, save in the case of wilful negligence or default. It reads:

“(1) This section applies to any provision, whether contained in a company’s articles or in any contract with the company or otherwise, for exempting any officer of the company or any person (whether an officer or not) employed by the company as auditor from, or indemnifying him against, any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company.

(2) Except as provided by the following subsection, any such provision is void.

(3) This section does not prevent a company:

(a) from purchasing and maintaining for any such officer or auditor insurance against any such liability, or

(b) from indemnifying any such officer or auditor against any liability incurred by him:

(i) in defending any proceedings (whether civil or criminal) in which judgement is given in his favour or he is acquitted, or

(ii) in connection with any application under section 144(3) or (4) (acquisition of shares by innocent nominee) or section 727 (general power to grant relief in case of honest and reasonable conduct) in which relief is granted to him by the court.”

A2 Section 310(3)(a) permits companies to purchase directors’ and officers’ liability insurance, although the wording of the section does not allow the company to meet the cost of any excess on the policy which must be met personally by the director or officer;

- A3 Under section 310(3)(b), directors and officers may be relieved from liability by the company when proceedings have been successfully defended or relief successfully obtained from the court.
- A4 Furthermore, although the company is prohibited from relieving an officer of the company of any liability in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company, the court has discretion to do so, on an application from the officer under section 727 of the Companies Act 1985.
- A5 Section 727 reads as follows:
- “(1) If in any proceedings for negligence, default, breach of duty or breach of trust against an officer of a company or a person employed by a company as auditor (whether he is or is not an officer of the company) it appears to the court hearing the case that that officer or person is or may be liable in respect of the negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, that court may relieve him, either wholly or partly, from his liability on such terms as it thinks fit;
- (2) If any such officer or person as above-mentioned has reason to apprehend that any claim will or might be made against him in respect of any negligence, default, breach of duty or breach of trust, he may apply to the court for relief; and the court on the application has the same power to relieve him as under this section it would have had if it had been a court before which proceeding against that person for negligence, default, breach of duty or breach of trust had been brought;
- (3) Where a case to which subsection (1) applies is being tried by a judge with a jury, the judge, after hearing the evidence, may, if he is satisfied that the defendant or defender ought in pursuance of that subsection to be relieved either in whole or in part from the liability sought to be enforced against him, withdraw the case in whole or in part from the jury and forthwith direct judgement to be entered for the defendant or defender on such terms as to costs or otherwise as the judge may think proper”.

Annex B

Contributory Fault

- B1 It was outside the CLR's remit to consider the general law of attribution of civil liabilities and fault. However, based on the law as it stood at the time, the CLR was concerned that there should be a fair allocation of loss between auditors, the company and directors. Their main concern was what they described as the *Hampshire Land* rule, which appeared to them to enable the company to avoid liability for a fraud committed by its agents if committed in whole or part against the company. This, in their view, would prevent auditors raising the fraud to reduce their liability.
- B2 Against this background, the CLR recommended that directors and employees should have a duty to assist the auditors, and that as well as criminal consequences, breach of this duty should give rise to civil liability, and that the fault would be attributed to the company for contributory negligence purposes, subject to normal principles.
- B3 There have been a number of significant developments since the publication of the CLR's Final Report. In particular, the courts have considered the questions of contributory fault and auditing in *Barings v Coopers & Lybrand*, taking account also of the conclusions in the appeal in *Standard Chartered Bank v Pakistan National Shipping* which the CLR had noted was in progress at the time of its Final Report. The Government is still considering the *Barings* decision, which is also under appeal, but, in general terms, the courts appear to have taken the following view.
- (1) The company is vicariously liable for fraudulent misrepresentations to the auditors by an employee in the course of his employment.
 - (2) The auditors' liability to the company is triggered by negligent failure to detect the falsity of fraudulent representations, rather than their signing of the audit certificate on the strength of those representations. This is based on the principle that the very conduct the auditors are under a duty to detect should not operate to negative the causal connection between the breach of that duty and the loss.
 - (3) If they are negligent, the auditors will be liable for foreseeable loss resulting from their negligence, but not for loss (e.g. resulting from cumulative management failure) for which their negligence is not the operative cause.

- (4) When considering contributory fault it is necessary to look at the company and those to whom the functions of its directors and managers are delegated. In this context it is possible to take into account fraudulent conduct attributed to the company. However, because of the principle described in (2) above it is not possible to attribute to it the overwhelming causative influence which it might otherwise have.
- (5) Section 727 applies to auditors who are negligent: they may have acted reasonably for the purposes of the section even though they were negligent if they acted in good faith and their negligence was minor or technical rather than pervasive.

Annex C

Summary of Questions

We would welcome your views on all aspects of this consultation and, in particular, on the following questions. Where appropriate, please supply evidence in support of your views.

Extending the duty of care

- Q1** Should investors in a company be able to claim against the directors and/or auditors? If so, on what basis and why?
- Q2** Should potential investors in a company be able to claim against the directors and/or auditors? If so, on what basis and why?
- Q3** Should an ability to claim in respect of a breach of duty of care in preparing accounts be extended to any other group? If so, who and why?
- Q4** Should criteria be set by statute to determine whether an auditor owes a duty of care to a particular person?
- Q5** Should any action seeking recompense for a loss be against the auditors, the directors, the company or some combination? Why?
- Q6** (a) On what basis should any loss be assessed? For example, should liability be limited to the difference between the value of shares at the date of purchase and the value they might have had if the audit had been correct? Or should it be the loss suffered?
- (b) Is this a matter for legislation, or is it for the courts to determine in any particular case?
- Q7** (a) What would be the implications of any overall limit of liability for the rights and obligations of third parties to each other? For example, would the first person who claims have to share any recompense with the last person to claim?
- (b) If the company brings an action, does that rule out claims by others?

- Q8** If the auditors' duty of care were to be extended, should the extension apply equally to all users? Or should it depend on how much else the claimant knows (or ought to have known) about the company? For example, in addition to the annual Report & Accounts, a bank or fund manager is likely to have access to a wide range of relevant research materials that might be used in support of an investment decision. In contrast a private investor might only have access to the historical Report & Accounts.
- Q9** If the auditors' duty of care were to be extended, what would be the most effective way of preventing abusive actions (for example, seeking to recover losses from bad investment decisions)?
- Q10** The directors are responsible for the contents of the company's Report & Accounts. Do you think therefore that any extension of the auditors' duty of care should be matched by an equal extension of the directors' duty of care in relation to the accounts? What would be the consequences?

Directors

Directors' and Officers' liability (D&O) insurance

- Q11** Is there evidence that the cost of Directors' and Officers' (D&O) liability insurance is increasing in real terms and that coverage is becoming less comprehensive? If there is, is this a fair reflection of the market pricing in increased risk?
- Q12** The Combined Code has been amended to refer to the need for companies to arrange appropriate insurance cover in respect of legal action against directors, and ICSA has published guidance for companies on what insurance should be provided for directors. Is there need for more to be done? If so what?

Non-executive directors

- Q13** Is there evidence that suggests that issues relating to potential liability are affecting the recruitment of able non-executive directors?
- Q14** Might it be appropriate to permit companies to indemnify non-executive directors even in circumstances where this is not considered appropriate in respect of executive directors? If so, in what circumstances?

Case management

- Q15** To what extent is the length of court proceedings adding to the concern of directors about their potential liabilities?
- Q16** Does section 727 currently allow the courts sufficient scope to grant relief at an interim stage?

Directors – possible reform options

Q17 Which of the three main options for reform of director’s liability should the Government adopt?

Q18 In relation to the CLR’s ideas:

- (a) are there particular aspects of the CLR’s recommendations that you believe are either especially important or that should not be pursued?**
- (b) do you support the recommendation by Derek Higgs that a company should be able to indemnify a director in advance against the reasonable cost of defending proceedings from the company itself without trying to establish in advance the prospects of success of the case?**

Q19 In relation to the US model:

- (a) is there a case for the introduction of a statutory business judgment rule?**
- (b) should any other of the US provisions be considered further? If so, should they be subject to shareholder approval?**
- (c) should any such shareholder approval need to be renewed (for example, every year or every 5 years), and should the same requirement in respect of shareholder approval apply to all types of company?**

Auditors

Is the audit market sufficiently competitive?

Q20 (a) Do you see substantive barriers to entry to, and expansion within, the audit market? If so, what are they?

(b) If such barriers are perceived to exist, what steps might be taken to remove them?

(c) When commissioning audits, do you feel that you have sufficient genuine choice between firms? If not, why not?

Q21 Is the only way to maintain competition to legislate (such as through reform of section 310 of the Companies Act 1985), or are there other options that can be pursued? If the latter, please describe them.

Q22 (a) Can you provide any evidence as to whether the prohibition on limitation of liability set out in section 310 is interfering in the proper operation of the market?

(b) Would reform of section 310 improve, worsen, or leave unchanged the operation of the market?

Key questions arising from the auditors' arguments for change

Q23 What evidence is there that appropriate levels of insurance cover at competitive prices are increasingly difficult to obtain?

Q24 How is the current law on liability affecting recruitment to the profession and retention of appropriately qualified individuals?

Q25 (a) Are you aware of, or do you anticipate, a trend towards defensive auditing?

(b) Would defensive auditing have a detrimental impact on the quality of the audit and/or its commercial viability?

Q26 Given that no audit firm has yet collapsed as a result of a claim successfully made against it in the UK, how real is the threat to the largest firms?

Auditors – possible reform options

Q27 Would you favour minimal law reform? Why?

Q28 Would you favour simply allowing auditors to limit their liability contractually? Why?

Q29 Do you favour allowing auditors to limit their liability contractually, subject to rules made by the Secretary of State? Why? If so, what should be the basis of the rules made by the Secretary of State?

Q30 Is the existing law on contributory fault and contribution adequate or is specific provision required to deal with these issues? If so, what?

Q31 What arrangements would you like to see for disclosure and/or shareholder consent? Why?

Consultation process

Q32 Is there any further evidence on other issues which you wish to provide?

Annex D

The Consultation Criteria

- 1 Timing of the consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left at each stage.
- 2 It should be clear who is being consulted, about what questions, in what timescale and for what purpose.
- 3 A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.
- 4 Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others) and effectively drawn to the attention of all interested groups and individuals.
- 5 Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for a consultation.
- 6 Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and the reasons for decisions finally taken.
- 7 Departments should monitor and evaluate considerations, designating a consultation co-ordinator who will ensure that the lessons are disseminated.

The complete code is available on the Cabinet Office's website, address

www.cabinet-office.gov.uk/servicefirst/index/consultation.htm

Annex E

Glossary of key terms

The “Big Four”	The four largest audit firms in the UK (Deloitte; Ernst & Young; KPMG and PricewaterhouseCoopers).
The CLR	The Company Law Review, launched in 1998 and which reported in 2001.
“Deep pockets”	A reference to the party most able to pay damages. “Deep pocket” defendants might therefore find themselves being targeted by plaintiffs where they are one of a number of those responsible for damage and where other defendants are uninsured, insolvent or otherwise unable to pay damages.
Directors’ and officers’	Insurance policies indemnifying individuals against liability insurance personal liabilities or legal expenses incurred in their capacity as directors or employees.
Exemption from liability	The effect of a provision, for example, in a contract between a company and a director that the director will not be liable if he fails to comply with his obligations to it.
ICSA	The Institute of Chartered Secretaries and Administrators.
Indemnity	An agreement under which, for example, a company agrees to pay to a director who is sued by a third party whatever he has to pay out as a result of that action (whether by way of costs or damages).
Joint and several liability	Where two or more persons are liable to another person, they may be liable individually (severally) or together (jointly). If they are jointly and severally liable, the other person may sue one or more of them individually or together for the whole amount of his loss. If one defendant pays the whole amount, he will be able to claim a contribution from the others, but, if they have no assets, this may be of little comfort to him.
Proportionate liability	Under a system of proportionate liability, where two or more persons are liable to another, the extent of their liability is divided or apportioned between them according to their responsibility. This means that a claimant can only claim a proportion of his total loss from each person who has caused it. If one or more of them have no assets, the amount the claimant will actually receive will be reduced.

