

# Modern Company Law for a Competitive Economy

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## Foreword

### **By the President of the Board of Trade**

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 which 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and consolidations since then, but they have created a patchwork of regulation that is immensely complex and seriously out of date.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.

Modern companies are one of the three key pillars of our approach to competitiveness; and we are determined to ensure that we have a framework of company law which is up-to-date, competitive and designed for the next century, a framework which facilitates enterprise and promotes transparency and fair dealing. That is why we are launching a thorough and wide-ranging review of our core company law. Many of the underlying principles have stood the test of time; and there is no desire to call everything into question where this is not necessary. But this will be a wide review, which will actively consider the current balance of obligations and responsibilities, and which will seek to ensure that they are clearly expressed for the non-specialist.

This Consultation Paper is aimed at the general reader, rather than the specialist company lawyer. It sets out the background to our present position, and sketches out the way in which the review will be handled. It will be an open review, with wide consultation. I want to hear from all parts of business, both large and small, what changes they believe would enhance their competitiveness or, still better, give them a competitive advantage. I want to be assured that reform will balance stability with future efficiency. Other interested parties will have important views to contribute and I hope they will play a key part as well. I want to ensure that any new arrangements which result enjoy wide support and confidence on all sides.

This review will be a complex and substantial undertaking. I am grateful to all those who will be participating in it. I want the review to play an important part in modernising the nation and ensuring that our economy is well placed for the challenges which lie ahead.

**MARGARET BECKETT**

## **1. Introduction**

**1.1** The Government has decided that the time is now right to embark on a fundamental review of the framework of core company law. Many of the key features of our current arrangements were put in place in the middle of the last century; and although there have been numerous changes and additions through the years, it is nearly 40 years since the last broad review of company law. The current framework has as a result become seriously out-dated in key respects, not least as the economy has become more globalised. In addition, the current pace of change in areas such as information technology means that in a number of areas the present arrangements are holding back rather than facilitating competitiveness, growth and investment.

**1.2** The object of the review will be to bring forward proposals for a modern law for

the modern world. The Government is determined that the nation should have an up-to-date framework which promotes the competitiveness of UK companies and so contributes to national competitiveness and increased prosperity.

**1.3** The Government is committed to ensuring that the review proceeds on the basis of the widest possible consultation with all interested parties. This Consultation Paper outlines plans for the handling of the review; these envisage the establishment of a Steering Group and Working Groups with broad representation, a Consultative Committee, and the publication for comment of key documents from time to time. The Government is keen to ensure that the new arrangements which result from the review enjoy wide support not simply

from business and industry but also in the community at large. This Consultation Paper is therefore directed at the non-specialist reader, not simply at experts in company law.

**1.4** The proposed review will be wide ranging; but business should not fear large-scale upheaval of familiar requirements. There is rightly a premium on stability, and the Government is conscious of the need to avoid gratuitous and unnecessary change and the cost this would impose. There will be no change for its own sake. Where change does result, careful thought will be given to transitional arrangements.

**1.5** The review outlined in this Consultation Paper is necessarily a substantial undertaking. Given that major reviews of this sort are - for good reason - infrequent events, it is right to take the time to do it properly, and to ensure that the resulting arrangements will stand the test of time. The aim is to publish a detailed White Paper towards the end of the present Parliament, probably in the year 2001; the resulting legislation will certainly be brought forward in the next Parliament rather than this.

**1.6** This Consultation Paper represents the starting point of the process. The DTI's Company Law and Investigations Directorate will welcome comments on any matter relating to the review: in particular on the proposed terms of reference and handling of the exercise. Submissions on matters of substance will also be welcome and will help to shape the review; alternatively, respondents may prefer to await the publication of particular consultation documents. Responses to the Consultation Paper should be sent by 30 June 1998 to:

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Company Law and Investigations Directorate  
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## **2. Background**

**2.1** There are about 1.14 million UK companies registered at Companies House. They range from the smallest of start-up businesses to large long-established companies operating internationally. There are relatively few companies at the larger end of the scale - only 2,450 or so have their shares publicly traded on the London Stock Exchange.

**2.2** All companies are subject to the same broad framework of company law. The main piece of legislation is the Companies Act 1985, which brought together

or 'consolidated' previous legislation. Although some requirements vary according to the type and size of company, the same basic principles apply to all companies.

**2.3** Many of the principles of key importance (such as limited liability, registration on a public register, and disclosure of information about the financial state of the business) were put in place in the middle of the last century, and some mention of the historical background is helpful for an understanding of the present arrangements. Two reforms were especially significant:

The Joint Stock Companies Act of 1844<sup>(1)</sup>. This required all new businesses with more than 25 participants to be 'incorporated' - that is, to be set up as companies with a legal status and personality of their own, rather than as conventional partnerships.<sup>(2)</sup> Second, the Act said that such companies should be set up by the simple process of registration (rather than by Act of Parliament or royal charter), and created the post of Registrar of Companies which continues to this day. Third, it provided for 'publicity' - or, as we would say today, disclosure - in particular through companies' constitutions and annual accounts being filed with the Registrar of Companies.

The Limited Liability Act of 1855. This introduced the concept of general limited liability for shareholders - ie their liability for the company's debts, if it became bankrupt, was limited to the amount of share capital which they had invested. It was felt important that the company's creditors should be aware of the limited liability status of the company, and the requirement for companies to have 'limited' or 'Ltd' in their name dates from this time. It was the 1855 Act which, in the words of the late Professor Gower, 'finally established companies as the major instrument in economic development'.

**2.4** After this legislation, businesses mostly fell into two categories: incorporated companies and conventional partnerships. The numbers of incorporated companies increased steadily, in particular towards the end of the nineteenth century. By 1914 around 65,000 were registered; by 1945 about 200,000. Since the last war the number has increased greatly to the present level. The principal rules for partnerships were brought together in the Partnership Act 1890 and continue to govern partnerships to this day.

**2.5** Development of company law in this century comes mostly from reactions to scandals and mischiefs arising from the wide scope allowed by the Victorian legislation, which in general had only a light regulatory touch. The pattern was that the Board of Trade appointed a Committee at intervals of around 20 years to review company law. The resulting recommendations were introduced in an amending Companies Act. The old and the new law were then 'consolidated' into a new comprehensive Companies Act. Such consolidations took place in 1908, 1929 and 1948. The most recent major review was that of the Company Law

Committee - the 'Jenkins Committee' - which was appointed in 1960 and reported in 1962. A number of its recommendations were enacted piecemeal in the companies legislation of 1967, 1980 and 1981. As already pointed out, these reviews concentrated on current scandals and perceived deficiencies in protecting investors or preventing fraud. The net result was a constant addition of new rules and regulations to companies legislation without any re-examination of its fundamental principles. Company law thus grew in bulk and complexity, but there was no attempt to slim down the basic structure and remove sections designed to deal with practices and situations which, often, no longer happened.

**2.6** The complexity grew even more rapidly from 1972 as a result of the need to reflect in UK companies legislation EC Directives adopted under the EC company law harmonisation programme. This left the legislation, in the view of the late Professor Gower, 'in a worse state than at any time this century'.

**2.7** As noted in paragraph 2.2, the legislation up to 1985 was consolidated in the form of the Companies Act 1985. This was quickly followed by the Insolvency Acts of 1985 and 1986, and by the Financial Services Act 1986. These latter acts represented a major structural change in the legislation by removing insolvency law and securities regulation<sup>(3)</sup> from companies legislation and establishing them as distinct areas of law. This may be said to be the only major simplification, if that is the correct word, of companies legislation this century.

**2.8** A further Companies Act was passed in 1989. Its main aim was to implement the 7th EC Company Law Directive on Consolidated Accounts, and the 8th on Audits; but it also included some domestic reforms. The 1989 Act is the most recent Act in company law, though a number of parts of this Act and the 1985 Act have since been modified by the use of Order-making powers (ie powers to make minor changes without a new Act of Parliament). In addition the DTI has in recent years reviewed a number of those areas of current legislation which frequently give rise to difficulty, and has developed proposals to amend the present law when there is an opportunity.

**2.9** The history of company law since the great reforms of the last century can thus be seen as a series of additions to the existing legal framework resulting from the need to tackle perceived deficiencies and shortcomings. For long periods this process may be enough. But recent years have seen increasing concern that the framework is becoming obsolescent; and it is clear that piecemeal reform cannot significantly reduce the amount and complexity of current arrangements. The following Chapter sketches out some of the problems, and the reasons why the Government now believes that the time has come for a thorough and wide-ranging review.

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(1) The term 'joint stock' is no longer used. It refers to the fact that companies are set up by a number of 'members', or shareholders, who jointly hold the company's stock, or shares.

(2) Although partnerships may be described as 'firms', they do not have a legal status or personality separate from that of their partners.

(3) In particular, the rules governing the basis on which companies can offer their shares to the public.

### 3. Current issues

**3.1** The structure of company law is not just outdated; it can also contribute to problems and costs for business. The Government is keen to emphasise that this is not just an academic exercise to 'tidy up' a complex area of law, and there is no desire for change for its own sake. The test for new arrangements must be that they establish a more effective, including cost-effective, framework of law for companies to improve their competitiveness and so contribute further to national growth and prosperity. The new arrangements should be based on principles of consistency, predictability and transparency. They should also compare favourably with the company law framework of other developed economies.

**3.2** One problem is that of sheer complexity. Arrangements cannot be fully effective if companies and their directors cannot clearly identify and understand their legal responsibilities. The problem is particularly acute for small companies without ready access to legal advice. Difficulties may arise for a variety of reasons: -

- *Over-formal language.* For example, Table A to the Companies Act sets out a model memorandum and articles of association and provides the basic constitutional framework for most companies. Providing such models is widely regarded as helpful. But Table A is written in technical, legalistic language and would be of more practical use if it was re-written in Plain English.
- *Excessive detail.* There are many small points which make the legislation more complicated than it needs to be - just one example is the distinction between special and extraordinary resolutions at general meetings. There is a real problem in understanding the legislation due to such excessive detail.
- *Over-regulation.* Difficulties also arise from the overall approach of the legislation. For example, a major part of the Act is concerned with rules to ensure that companies maintain their capital (ie the finance raised from the issue of shares). This is an important area of the Act designed to reduce the risk of insolvency, but it is too detailed, and widely thought to increase the cost, and reduce the flexibility, of companies' management of

their capital. Comparison with other countries, such as Canada, suggests that a framework that was easier to operate and gave greater general freedoms would be possible. Some things, for example the requirement for shares to have a nominal or 'par' value, could be abandoned. Among other advantages this would enable a simpler statement of share capital in companies' accounts. There is also a case for reform of the complicated and costly court procedures that companies must go through if they are to reduce their share capital. It should be recognised though that the EC Second Company Law Directive contains rules on the maintenance of share capital and that some of these changes - such as abandoning the 'par' value of shares - could not be made unless amendments to the Directive were negotiated with all the other members of the EU.

- *Complex structure.* One difficulty is that of understanding all the specific rules in the Companies Act directed at particular classes of company, such as small private companies. Some parts of the Act, such as that on the disclosure of who owns shares, apply only to public companies (ie those usually larger companies whose name ends with 'plc'). Other parts of the Act, such as those on capital maintenance and the enforcement of fair dealing by directors, contain rules which are different in their application for public and private companies. These different rules are often mixed together in a way which makes it difficult to identify those which apply only to private companies. The review will consider how best to set out companies legislation so that it shows clearly the legal responsibilities of small companies and their directors.

**3.3** An immediate consequence of the complexity is that companies often have to incur substantial costs in terms of management time and professional fees. A good example is provided by the rules which forbid companies from giving financial assistance to another person to buy their shares. These rules are notoriously difficult, and legal and auditing fees are often incurred to ensure that innocent and worthwhile transactions (eg deals to bring new capital into companies, which involve the payment of fees to those who provide that capital) do not breach the rules. Fees can exceed £10,000 in individual cases and are estimated at some £20 million a year in total.

**3.4** Apart from poorly laid out and complicated law, there are more concrete problems, because so many changes were made to meet short-term needs and problems rather than to lay sound foundations for likely future developments. Sometimes too the law just fails to achieve its purpose. A few examples will show what we mean.

### **Obsolescent or ineffective provisions**

- Companies are required to keep on their register of members not only the name and address of each member, but also the date on which he or she became or ceased to be a member. This provision dates back to 1856. It

- may well have been useful at a time before limited liability became widely used, when shareholders could still be personally liable for all the debts of the company and it might be important to establish when a person became a shareholder for that reason. However, in modern times, in relation to listed companies, and the modern capital markets, recording these dates appears to serve little purpose. It may be that the requirement can be safely discarded, or at least replaced by an up-to-date provision more suitable for companies' current administrative needs.
- Section 3A of the Act concerns the statement of the 'objects' or purpose of the company. Such a statement is required in the memorandum of association. Those setting up companies are often anxious to make sure that no constraints are placed on the future direction that their company might take, and hence describe its 'objects' at great length in order to allow for every conceivable circumstance. In order to avoid the need for such 'boilerplate' statements, section 3A was inserted in the Act to allow companies to describe themselves as a 'general commercial company', but it has been little used because it is still not regarded as covering every eventuality.

### **Obstacles to progress**

- Because the Companies Act is essentially backward looking - seeking to deal with problems that have arisen in the past rather than to facilitate modern practices - it risks impeding efficiency. For example, it limits the use of information technology in company administration. Reform is needed so that Companies House can pursue its modernisation plans aimed at allowing filing electronically rather than in the paper form currently required. (Indeed the Department has already consulted on proposals to reform the Companies Act which would achieve this.) Rules on annual general meetings could be adapted too, for example to allow votes to be registered electronically by those not attending in person. The impact of developments in information technology on financial reporting requirements will also need to be examined.

**3.5** A further major issue is the relationship between company law and corporate governance. Corporate governance is defined as 'the system by which companies are directed and controlled' and concerns issues such as the composition and structure of boards of directors (eg the role of non-executive directors and of the audit committee) and the accountability of boards to shareholders. It can have a major impact on the overall direction of the company and thus its commercial prospects. Three Committees have carried out major studies of corporate governance in recent years. The first, under Sir Adrian Cadbury, was set up to look at corporate governance practices in the light of the unexpected collapse of several major companies in the late 1980s. The second, chaired by Sir Richard Greenbury, focused on directors' pay. The third, under Sir Ronald Hampel, reviewed progress and reported in January 1998.

**3.6** The report of each Committee set out recommendations as to what is best practice. These are currently being combined into a single set of principles and Code of Practice. Companies listed on the London Stock Exchange will be required by the Stock Exchange's rules to state in their annual accounts how they apply the principles and comply with the Code, and to justify any significant variations.

**3.7** In general, the issues dealt with under the new Code are more suitable for best practice than legislation. Best practice is more flexible: individual companies can apply it in the way that best fits their own circumstances and it can be kept up-to-date more easily. The Government does not intend to replace the use of best practice by legal rules, provided best practice is seen to be working. There may however be a need for legislation in certain areas which are not covered by the new Code, or where experience shows that some legal underpinning is needed. Some examples are as follows:

- *The duties of directors.* Directors have a 'fiduciary' duty to act in the interests of their company, rather than in their own interests, and they also have a duty to exercise care and skill. These basic duties are found in case law - ie decisions in individual court cases over the years - rather than the Companies Act. The Law Commissions are currently examining whether they should be put into statute, so that they are more widely known and understood. A wider issue for the review is whether directors' duty to act in the interests of their company should be interpreted as meaning simply that they should act in the interests of the shareholders, or whether they should also take account of other interests, such as those of employees, creditors, customers, the environment, and the wider community. The subject has been widely discussed in recent years in a range of studies and articles, including the Tomorrow's Company inquiry by the Royal Society of Arts and the report Promoting Prosperity by the Commission on Public Policy and British Business. The latter concluded 'Certainly it is important not to constrain directors to do anything against the long-term interests of shareholders; rather, they should be free from an excessively narrow interpretation of their fiduciary responsibilities which could actually work against the company's interests'. It went on to recommend that the Government should clarify directors' duties to enable directors to take a broader view of their responsibilities. The review hopes to stimulate wider discussions of such concerns to see if there is common ground on whether and how they need to be further addressed - whether they just represent interesting philosophical ideas and ideals or whether they lead to concrete proposals that should be pursued.
- *The conduct of annual general meetings (AGMs).* There are existing Companies Act rules on AGMs covering matters such as shareholder resolutions and voting procedures. The Department has consulted on changes to the present rules designed to make it easier for shareholders to table resolutions, and to attend and vote at AGMs if they do not hold

- shares in their own name. Other commentators have called for more substantial changes to enable shareholders to play a more active role. These issues too will be considered as part of the review.
- *Shareholder control over directors' pay.* Directors' pay continues to be a controversial issue, and there have been many calls for pay to be made subject to the specific approval of shareholders. The Government has made plain that it is watching developments closely. The review will provide an opportunity to examine the responsibilities of shareholders in this and other areas.

**3.8** For all these reasons, the Government has decided that the time is now right for a thorough review of core company law. The stripping out of obsolescent and over-complex provisions and the repair of defective ones will not be easy or straightforward. But we need clear and simplified arrangements which, starting from first principles, better capture the balance of obligations, protections and responsibilities which are required to underpin the modern marketplace so as to ensure that the participants can be confident about fair dealing. They must make it easier to promote competitiveness in the modern commercial and technological environment rather than act as a brake; and be sufficiently flexible to cater for future developments - through for example secondary legislation to enable easier updating. An up-to-date company law framework, based on principles of consistency, predictability and transparency, is particularly important in the context of a globalised economy, in terms both of competing for inward investment, and producing internationally competitive companies.

## 4. The international picture

**4.1** Space does not permit a full review of international practice in company law, but it may be helpful to sketch out the wider picture.

**4.2** The company law framework introduced by the Victorians (see Chapter 2 above) had an immense influence world-wide. Other countries, both within the British Empire and beyond, often followed the UK to introduce similar arrangements. Thus for the bulk of the last 150 years, though often with substantial time lags, broadly similar frameworks were put in place in many countries around the world.

**4.3** In more recent years however the UK's framework of company law has been seen as out-dated. Major reviews of company law have occurred in Canada, South Africa, Australia, New Zealand and, most recently, Hong Kong. Commonwealth countries are increasingly developing their own model of company law, tailored to local circumstances, and no longer looking to the UK for their inspiration.

**4.4** In today's increasingly globalised economy, the national framework of company law cannot be considered in isolation. It represents part of the nation's basic infrastructure. This can best be seen in relation to business mobility. Naturally many reasons affect the decisions of internationally mobile businesses as to the country in which to locate, and it is worth emphasising that the UK scores extremely highly in general in this area; surveys repeatedly confirm that a wealth of features make the UK an excellent place in which to do business. But the security and predictability of the business environment is a key element. The Government is determined to ensure that the nation's framework of company law does not through increasing obsolescence become a disincentive to establishing business in the UK.

**4.5** British enterprise has not shown itself slow in the past to make use of legal structures and institutions in other countries when what has been required has not been available in domestic law. The final push to the granting of general limited liability in 1855, according to the speech of the Vice-President of the Board of Trade when moving the Bill, was that British businessmen were seeking to set up companies under French and American laws so as to give their shareholders limited liability when operating in this country. It seemed also that those doing this in France were somewhat unhappy with the costs involved. They clearly wanted a cheaper British option.

**4.6** A more recent example is provided by the absence of a legal structure in this country under which professional partnerships can limit their liability. This was leading a number of businesses to consider setting up under the law of other countries, where limited liability vehicles are available. The Government is currently preparing proposals for a new structure, which will be known as the Limited Liability Partnership.

**4.7** These examples show that a failure to provide the right form of company structure for carrying on business will, in time, be reflected in a drift towards those countries which offer what is required. Any migration of British business to vehicles established under foreign law will tend to impose costs on those businesses, make harder the application of our own law, reduce the business available to British professional advisers and cause a drift of head office functions to those other countries. Conversely we may hope to increase business for UK professional advisers, and attract head office functions to these shores, if UK legislation offers foreign businessmen attractive vehicles for business. The Government sees a cost effective and competitive company law framework as an essential part of a successful economy.

**4.8** The DTI's Company Law and Investigations Directorate has kept itself informed about developments in other countries. There is much to be learned from the experience of others; and the Directorate has been grateful for the ready responses of a number of those who have been involved in reviews elsewhere. The review will take account not only of the progress of reforms in those

countries mentioned in paragraph 4.3 above; it will also pay attention to the approach taken in other member states of the European Union. The Government is determined to ensure that this modernisation exercise is well informed about developments world-wide.

## **5. Objectives; terms of reference**

**5.1** The DTI's objectives in undertaking this review are to promote a framework for the formation and constitution of British businesses which through an effective combination of law and non-statutory regulation:

- supports the creation, growth and competitiveness of British companies and partnerships;
- promotes an internationally competitive framework for business, so that the UK continues to be an attractive place to do business;
- provides straightforward, cost-effective and fair regulation which balances the interests of business with those of shareholders, creditors and others;
- promotes consistency, predictability and transparency and underpins high standards of company behaviour and corporate governance.

**5.2** The proposed terms of reference for the exercise are 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.

**5.3** It is worth making a number of comments about these proposed terms of reference.

**5.4** As already noted, the present framework of company law is common to businesses of all sizes. Certain requirements are added or subtracted, depending on the type and size of the company. For example small companies are exempt from certain financial reporting, audit and filing requirements, while at the other end of the spectrum listed companies face additional requirements which are laid down in the Stock Exchange Listing Rules. In essence, however, the same basic principles apply to all. The question may be asked whether these arrangements are sufficiently well adapted for the needs of individual companies.

**5.5** Some have argued that it would be preferable to differentiate much more fundamentally between small companies and large companies and, in particular, that it would be desirable to have a small company statute which assembled in one place the particular requirements for small firms. The Government looks to the review to bring forward and consult on proposals on this sort of question.

**5.6** The Government fully accepts that different standards will apply in different cases. For example, listed companies whose shares are widely held by the public rightly face specific requirements which are not needed for small start-up operations with a small number of shareholders, all actively involved in the business.

**5.7** The Government believes that those responsible for managing a business enterprise should be given the maximum freedom to select the business vehicle which is most appropriate for their business. Companies are one option - including 'partnership companies' in which a large proportion of the shares are held by the employees.

Partnerships are another. Partnership law is already under review by the Law Commissions and the results of their review will inform the main exercise. The Government has also announced its intention to bring forward proposals relating to Limited Liability Partnerships, and expects to publish draft clauses shortly. In short, the review will examine the relationship between company law and other legislation to ensure there is enough choice of legal vehicle for business of all types.

**5.8** The review will also consider the right structure for regulation. While the basic framework of company law is rightly a matter for primary legislation, some parts of it will appropriately be set out in secondary legislation, which permits greater flexibility and scope for change to meet evolving requirements and expectations. Beyond that, the Government believes there is clearly a role for codes of practice, in particular in the corporate governance field, as well as for requirements implemented through the Stock Exchange Listing Rules and elsewhere. However the Government believes that the broad picture in this area requires a fresh look. There may for example be scope for greater use of 'default' provisions - those which will apply where the shareholders do not explicitly agree alternatives. (A good example of legislation of this type is Table A to the

Companies Act which sets out a model memorandum and articles of association.) It is essential to ensure that the overall structure is coherent; equally it is important to ensure that the use of different mechanisms does not unnecessarily complicate requirements, for example for the directors of small companies.

## **6. Scope of the review**

**6.1** This review concerns the modernisation of core company law. That is to say in the first place that it will not be reviewing the Insolvency Acts or the regulation of Financial Services. The boundaries are not precise, however, and care will be taken to ensure that the implications for other areas of changes which are being considered in relation to company law are taken fully into account. Care will also be taken to avoid unnecessary duplication.

**6.2** Broadly speaking, the task of the review will be to develop a legal framework, based on the principles reflected in the Companies Act, which covers the requirements for the birth, existence, and death of companies. Thus it will identify the fundamental rules governing the procedures for incorporation, the basic constitutional structure, and cessation of existence. It will examine the rights and responsibilities of the entity and its participants and identify in which areas there should be mandatory rules to protect the interests of shareholders, creditors, employees, and other participants.

**6.3** Any consideration of a modernised framework of company law will clearly need to address questions of sanctions and enforcement. So far as civil sanctions are concerned, the Law Commissions have made a valuable contribution in their recent report on shareholder remedies. One issue for the review will be the balance between civil and criminal sanctions: it is commonly suggested that the existing Companies Act too readily invokes criminal penalties, when civil remedies would be more appropriate.

**6.4** The current arrangements for enforcement and investigation are complex, with responsibility shared between the DTI and a variety of other agencies including the Financial Services Authority, and, on the criminal side, the Serious Fraud Office, and the Crown Prosecution Service. The review will address those enforcement issues that are raised by the proposed new framework of core company law. Wider questions relating to the DTI's present powers of investigation and enforcement will be considered separately.

**6.5** The review will not extend to charity law. Many charities are however incorporated under the Companies Act, and the implications of changes for charitable companies will not be overlooked.

**6.6** The review will also not extend to Co-operatives, which are not covered by the Companies Act but by the Industrial and Provident Societies legislation. Co-operative enterprise has experienced a resurgence in Britain in recent years, and the Treasury is currently considering proposals put forward by the UK Co-operative Council to modernise the legislation in this area.

**6.7** A number of EC directives have an impact on company law; and the review will of course take these into account. Indeed more generally the approach taken by European countries on major issues will be an important factor. One particular concern of the Government is that existing directives - like domestic legislation - should not over time become an increasing source of inflexibility. Accordingly, where provisions in directives are identified as representing an unwelcome constraint - for example, that in the Second Company Law Directive which requires shares to have an 'accountable par' - the Government will enter into discussions with the Commission and other member states about those provisions when the opportunity arises.

## **7. Process for the review**

**7.1** The Government wishes to ensure that the review process is handled with maximum openness and independence and on the basis of wide consultation. It wishes the outcome of the review to enjoy the widest possible support. Equally, however, it is essential that the process of the review is managed effectively so as to ensure that it delivers results on a reasonable timescale.

**7.2** A Steering Group will oversee the management of the project and ensure that its outcome is clear in concept, internally coherent, well articulated and expressed, and workable. The Steering Group will be small, comprising senior lawyers, representatives of business (large and small), a Scottish representative, Chairs of Working Groups and the Project Director. The Steering Group will be chaired by the Director, Company Law and Investigations at the DTI.

**7.3** There will be a widely-based Consultative Committee, under the chairmanship of the DTI's Director General, Corporate and Consumer Affairs. The Consultative Committee will include members of the Steering Group, but will also include wider legal representation, for example from the Law Society, key groups such as the CBI, TUC and the accountancy bodies, as well as other Government Departments. Care will be taken to ensure that wider interests such as those of small business and shareholders are also well represented.

**7.4** Much of the detailed work will be carried out in Working Groups but it will be essential to ensure that all individual Working Groups take forward their work within a common framework. There will therefore initially be just one Working Group, whose primary task will be to bring forward proposals for the overall

strategic framework. It is envisaged that its proposals will tackle not just substantive issues - as described at paragraph 6.2 above - but also the structure and style of new legislation and how it might be made more accessible to non-specialists.

**7.5** Simplification and rationalisation will be key themes at the heart of the review from the beginning. The Government is also determined to ensure that the new arrangements will support business activity and promote growth and competitiveness within a balanced framework rather than to act as a brake or unnecessary constraint.

**7.6** The outcome of the first Working Group will be published as a basis for wide consultation. Subsequent Working Groups will then be set up to consider detailed aspects identified in the strategic framework. It would be premature to set out here the detailed structure of subsequent Working Groups; that will be a matter for the Steering Group. But by way of illustration, Working Groups might cover finance and external relations (matters relating to shares, external financing and protection of creditors), corporate governance (matters relating to directors' duties and accountability to shareholders, and the internal constitution of the entity), administration of the regime (including the role of Companies House) and disclosure and financial reporting. A Working Group might also consider the impact of information technology on matters like financial reporting and the annual general meeting. It is anticipated that the output of each Working Group will be published for full consultation, and that a final report will then draw together the work of the review. This is likely to be published in conjunction with a White Paper outlining the Government's proposals before the end of the present Parliament.

**7.7** It will be important to the success of the overall review that Working Groups are able to draw on a wide range of legal expertise and business advice. It is intended to invite both the Law Commission and the Scottish Law Commission to participate in Working Groups, and it is possible that specific remits will be made to the two Commissions as the review progresses. The two Commissions are currently conducting a review of the law of partnership, which will make an important contribution to ensuring that there is a range of legal vehicles available to meet the needs of small business. The Law Reform Advisory Committee of Northern Ireland will also be kept informed of progress and involved as appropriate.

**7.8** It will also be important to involve Parliamentary draftsmen, both at early stages (when the structure and style of new legislation will be considered) and at later stages when subsequent Working Groups will be concluding their work.

**7.9** The DTI expects to appoint a Project Director dedicated to the review, and to provide adequate administrative and secretarial support. It will also be important to ensure that there is a sufficient research capability.

## 8. Timetable

**8.1** It is not possible to fix a detailed timetable for all aspects of the work, but it might be helpful to outline a broad indicative timetable.

**8.2** The review is being announced and launched in March 1998, the date of this Consultation Paper. The Steering Group and Consultative Committee will start work shortly thereafter; and the first Working Group will also start on its task. The subsequent timetable will be along the following lines:

December 1998:

January 1999:

June 1999:

December 1999:

June 2000:

Autumn 2000:

March 2001:

The first Working Group will publish its proposals in order to consult on the strategic framework.

Subsequent Working Groups start work. (It will not be necessary to complete the process of consultation on the strategic framework before this happens; the timetable means that changes resulting from consultation can readily be accommodated at later stages.)

The first Working Group will complete its report on the strategic framework, following wide consultation.

At around the end of 1999 the subsequent Working Groups will consult on their draft proposals, under the overview of the Steering Group.

The Working Groups will complete their reports, following wide consultation.

The final report will be drafted.

The final report will be published in conjunction with a White Paper. As noted, the resulting legislation will fall to the next Parliament.

**8.3** There is no doubt that the details of this timetable will need to be interpreted flexibly; but the Government's firm intention is that a White Paper should be published in the year 2001. This will outline the Government's proposals for legislation in the light of the outcome of the review.

## **9. Summary and conclusions**

**9.1** This Consultation Paper has outlined the broad approach which will be taken to review and modernise the framework of core company law. Although company law may reasonably be regarded as a specialist area, the issues which it addresses are in fact of wide public interest; and the Government is committed to handling the review in an open and consultative way.

**9.2** This Consultation Paper has therefore been published in order to provide information widely about the review, and to invite comments and responses on it. Comments will be welcome on all aspects of the review.

**9.3** If you have comments on the draft terms of reference, or on the proposed handling of the review, please provide them to the address given in paragraph 1.6 by 30 June 1998. More general comments and responses on matters of substance - including comments on the broad framework which respondents would like to see put in place - would be welcome by the same date; equally such comments may be appropriate at a later stage, for example when particular consultation documents are published.

This consultation document was produced by [Company Law and Investigations Directorate](#) part of [Corporate and Consumer Affairs](#).

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