

**COMPANY INVESTIGATIONS:  
POWERS FOR THE 21<sup>ST</sup> CENTURY**

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# Company Investigations: Powers for the 21st Century

## Executive Summary

1. Officials within the Department of Trade and Industry have carried out a review of the powers available under company law to investigate the affairs of companies, and the further action which can be taken as a result of those enquiries. We believe that company investigations have a valuable continuing function in upholding standards of conduct of limited liability companies and in helping to counter crime and other wrongdoing, and thereby helping to make the UK an excellent place to do business. We make proposals in this report for modernisation and simplification of the legal powers to ensure the future effectiveness of investigations.
2. The opportunity exists to achieve a modernisation of the powers available as part of the legislation to implement the Government's response to the Company Law Review. This should ensure that powers are sufficient to meet the challenge of current and future needs, including changing commercial and employment practices, technological change and changing data handling practices. It should also provide a simplification of the law.
3. A clear distinction needs to be maintained between **inspections** that may be publicly announced and can lead to published reports (as those normally conducted under section 432 Companies Act 1985) and confidential, unpublicised **investigations** (as under section 447 Companies Act 1985). Inspections should be undertaken in cases of suspicion of unlawful, dishonest or improper conduct that is a matter of substantial public concern. Investigations should be undertaken where there is good reason to do so on the basis of information received, to see if there is any cause for concern or for further action.
4. However, the scope of the powers available for each should be harmonised. The scope of powers available for confidential investigations needs to be brought into line with the scope of powers available for publicly announced inspections, if these investigations are to become fully effective. Evidence of serious wrongdoing can be found in some investigations, just as in some inspections, and powers should be sufficient to bring it fully to light.
5. In both cases, there is a need to expand the scope of inquiries to include the business and/or financial affairs of individuals and partnerships associated with a company subject to inquiry, where this is necessary to allow company affairs to be fully investigated. This would enable full investigation of cases involving, for example, distribution of goods or services through self-employed sales agents, fulfilment companies or by

local franchises. Such cases are now common amongst those that need to be investigated.

6. In the case of confidential investigations, there is a need also to expand the range of persons who may be required to assist and the form of assistance that may be required. These should be brought into line with the scope of publicly announced inspections, and the scope should be enlarged to allow for reasonable assistance going beyond the current limitation to providing documents and explanations only.
7. Specific powers that allow inquiries to be initiated at the request of particular parties or to examine particular, narrowly defined, subject matter are unnecessary and should be subsumed within general powers of investigation and inspection under company law. The exception to this is the power to carry out an investigation to assist an overseas regulatory authority. Even in this case it should be possible to act through general powers of investigation, but in circumstances defined in statute.
8. Within the scope of these new powers, the focus and extent of each confidential investigation should be determined under authorisation procedures ensuring that these are no more than are necessary and appropriate in each case. In inspections, the inspectors should have the full range of legal powers available to enable them to fulfil their task, but should be subject to a duty to ensure that their use of these powers is necessary and appropriate. These requirements would ensure that the burden on business arising from an inquiry, as well as any intrusion on the rights of individuals, was kept to the minimum.
9. Statutory powers of investigation and inspection should continue to be based on compulsion for those required to assist. Without this requirement the powers would not be effective. There should be a certification procedure (as exists at present for section 432 inspections) for all inspections and investigations allowing the civil court to enforce compliance with an investigator's reasonable requirements. It is proposed that the criminal sanction against individuals failing to co-operate with an investigation should be repealed, but the criminal sanctions which relate to the destruction, mutilation or falsification of evidence or the provision of false information, should be retained.
10. The power to place restrictions on shares should be retained to deny the benefits of ownership in cases of failure to assist an investigation into the beneficial ownership of shares.
11. It is proposed that there should be a new power available to departmental officials to require information from a company (and a company should have a duty to supply it) in order to more effectively evaluate complaints against a company which may, as a result, be resolved without resort to a full investigation.

12. The powers to take action in the civil court to seek the winding up of a company or the disqualification of a director in the public interest should be retained. The Department exercises these on the basis of the results of investigations and inspections.
13. We are considering introducing the concept whereby these potential actions could be augmented by less draconian powers enabling the Secretary of State to seek restraining orders from the Court. Such orders could be sought (as currently done when applying for the appointment of a provisional liquidator) after an enquiry has been completed, as one of the possible follow-up actions which the Department can take.
14. In addition we are considering whether or not it would be viable to introduce a power allowing the Secretary of State to apply to the Court for a restraining order during the course of an investigation, but before it has been completed. We have suggested that these could be referred to as being 'Interim Restraining Orders'. These powers would allow the Department, on public interest grounds, to act quickly to counter the threat of harm to a company's creditors, customers or members, by seeking a restraint on the conduct of its affairs.
15. The power could also be used where an otherwise satisfactory business was adopting a harmful practice. At present, the only course available is to seek a winding up or disqualification. The new power would permit a company or a director to carry on trading, subject to abandoning the harmful practice. Examples of instances when such powers could be used are:-
  - (a) a multi-national conglomerate is operating a lottery as a promotional exercise without complying with the necessary legislation. In such an instance the Department would not wish to wind-up the entire company, but merely prevent it continuing an illegal practice. A restraining order would be more appropriate in this instance.
  - (b) a public relations company is as an adjunct to its normal business promoting a network marketing scheme, which after examination would not appear to be viable. The use of a restraining order would remove the objectionable conduct, whilst allowing the company to continue its public relations activities.
16. Where a director or shadow director was clearly responsible for the malpractice but there were insufficient grounds for disqualification, it should be possible to seek the dismissal of the director, and/or to restrain the individual from pursuing the harmful practice in any further trading activity.

# SUMMARY OF THE PROPOSED NEW LEGAL FRAMEWORK

## *Proposed grounds for confidential investigations*

1. It should continue to be possible to investigate any matter that relates to the affairs of a company where it appears to the Secretary of State that there is good reason to do so.

## *Authorisation procedure*

2. The Secretary of State should be subject to a duty to ensure that the exercise of powers is necessary and appropriate. The exercise of powers should be subject to an authorisation procedure confirming that this was the case.

## *What might be investigated?*

3. The proposed scope of investigatory powers is:
  - the nature, conduct or state of the business of the company;
  - the ownership or control of the company, including minority interests, and beneficial interests in its shares;
  - the activities of company officers, agents and shareholders (including activities of their family and others done on their behalf) as these concern the affairs, business or ownership and control (including interests in shares) of the company; and
  - any particular aspect of the affairs, business or control (including interests in shares) of the company or of activities of company officers and agents.
4. For associated and connected companies of the principal company already under investigation, and associated or connected partnerships, the investigation should be capable of covering the nature, conduct or state of the business affairs of a person who is or was: -
  - a company that is or was at any relevant time a member of a group (broadly defined, along the lines of section 421 of the Financial Services and Markets Act 2000 (FSMA))<sup>1</sup> of which the company under investigation is a member/part;

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<sup>1</sup> Subsection (1) defines a “group” in relation to a person A as meaning A and any person who is:- a parent undertaking of A; (b) a subsidiary undertaking of A; (c) a subsidiary undertaking of a parent undertaking of A; (d) a parent undertaking of a subsidiary undertaking of A; (e) an undertaking in which A or an undertaking mentioned in paragraph (a),(b),(c) or (d) has a participating interest; (f) if A or an undertaking mentioned in paragraph (a) or (b) is a building society, an associated undertaking of the society; or (g) if A or an undertaking mentioned in paragraph (a) or (d) is an incorporated friendly society, a body corporate of which the society has joint control (within the meaning of section 13(9)(c) or (cc) of the Friendly Societies Act 1992.

- a person who is or was at any relevant time, a member of a partnership of which the company under investigation is a member/part; or
  - a partnership of which the company under investigation is or was at any relevant time a member/part; or
  - a partnership or company carrying on at any relevant time some part of the business of the company under contract or as agent; or
    - a person who has or had at any relevant time a participating interest (see section 421 of FSMA )<sup>2</sup> in the company under investigation, or is or was financially interested in the success or failure of the company or able to control or materially influence its affairs (see section 443 of CA 1985)<sup>3</sup>.
5. For individuals, the investigation should be capable of being extended to cover the nature, conduct or state of the business affairs of an individual who: -
- is or was at any relevant time a director or shadow director of the company under investigation; or
  - has or had at any relevant time a participating interest (see section 421 of FSMA)<sup>4</sup> in the company under investigation, or was financially interested in the success or failure of the company or able to control or materially influence its affairs (see section 443 of CA 1985)<sup>5</sup>; or
  - is or was at any relevant time employed by the company under investigation to carry on its business as employee or agent or otherwise under contract.

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<sup>2</sup> Subsection (2) states that “Participating interest” has the same meaning as in Part VII of the Companies Act 1985...;but also includes an interest held by an individual which would be a participating interest for the purposes of those provisions if he were taken be an undertaking.

<sup>3</sup> Subsection (2)(a) defines such a persons as “all ... who are or have been, or whom the inspector has reasonable cause to believe to be or have been, financially interested in the success or failure of the company or any other body corporate whose membership is investigated with that of the company, or able to control or materially influence its policy (including persons concerned only on behalf of others).

<sup>4</sup> Subsection (2) states that “Participating interest” has the same meaning as in Part VII of the Companies Act 1985...;but also includes an interest held by an individual which would be a participating interest for the purposes of those provisions if he were taken be an undertaking.

<sup>5</sup> Subsection (2)(a) defines such a persons as “all ... who are or have been, or whom the inspector has reasonable cause to believe to be or have been, financially interested in the success or failure of the company or any other body corporate whose membership is investigated with that of the company, or able to control or materially influence its policy (including persons concerned only on behalf of others).

### ***Who can be required to assist?***

6. Investigation powers should be exercisable in the first instance in respect of :-

- persons with a past or present connection with the company, such as past and present directors, managers and controllers, employees, agents, shareholders/members and others with an interest in its success or failure (to include those individuals whose affairs the investigators are likely to be able to investigate).

Inspectors should be able to require the assistance of such persons in any investigation without specific authorisation.

7. If specifically authorised in addition, the investigation should also be able to require assistance from: -

- company advisers, including accountants, actuaries, auditors, legal advisers (but not of course in respect of matters covered by legal professional privilege) and bankers (to include those appointed to advise associated companies and connected persons); and

- any person who is transacting or has transacted business with the company.

8. Subject to proper authorisation, it should be possible to require assistance from: -

- any person whom the investigator considers is in possession of or is able to obtain information or material which the investigator considers relates to a matter relevant to the investigation

### ***What assistance might be required?***

9. An investigator should have the power:-

- to require provision of all relevant information and material if he considers that a person is in possession of information and/or material relating to a matter which he believes is relevant to the investigation...

10. In addition, an investigator should be able to require any person within the scope: -

- to give all assistance in connection with that investigation that he is reasonably able to give.

11. An investigator should be able to require assistance to be provided "forthwith."
12. An investigator should also have the right to enter onto company premises and inspect company record systems during working hours without needing a warrant. This right does not exist at present, which means that an investigator can be excluded from premises and record systems, even though a request for production of documents and records may be complied with. Such access should be available to an investigator provided he gives reasonable notice (minimum of 2 days) of the intended entry, and also a statement of the scope of the investigation as set out in the authorisation.
13. An investigator should have the power to access, inspect and copy the contents of any computer that is or has been in use by the company.

#### ***Proposed inspection powers***

14. Those appointed to carry out inspections in future should in all cases have available to them all of the powers that are potentially available for a confidential investigation without the need for further authorisation.

#### ***Proposed grounds for inspections***

15. The test of whether inspectors should be appointed in any case should be that: -
  - there are circumstances suggesting that:
    - the company was formed for an unlawful, dishonest or improper purpose; and/or
    - the affairs of the company, as these concern its members, creditors or any other person, are being (or have been) conducted in an unlawful, dishonest or improper way (or for such a purpose) ; and/or
    - persons concerned in the formation or operation of a company carried on unlawful, dishonest or improper conduct towards it or its members or creditors; and
  - this is a matter of such public concern that it is necessary and proportionate and in the public interest to do so.
16. The discretion to publicise appointments and publish reports should be retained for inspections.

## **Enforcement of powers of investigation and inspection**

17. Where a requirement to provide assistance relating to provision of information or material, or access to company premises, was not complied with, there would be powers to obtain a search warrant.
18. In cases of non-compliance with a requirement from an investigator for assistance, the investigator would have power to seek an order from the civil court enforcing compliance.
19. Powers to impose restrictions on shares in cases of difficulty in finding out relevant facts about any shares should be retained.
20. A power to direct a company to bring these records up to date within a specified period. The period should be determined by the investigator or inspector taking account of the size of the task it represents in each case, but subject to a statutory minimum of five days.

## ***Power to require information***

21. There would be advantage in providing a power to require reasonable information about the conduct of company affairs, with a reciprocal duty on the company and its officers to provide it.

## ***Assistance to overseas regulators***

22. The powers to assist an overseas regulator should be restated with such amendments as are needed to allow them to operate through the new powers of investigation now proposed, with provision for requirements to be complied with immediately (or “forthwith”). The powers should remain discretionary rather than compulsory.

## ***Company winding up and disqualification of directors***

23. The power of the Secretary of State to petition the court for an order should be retained for these outcomes.

## ***Proposed Restraining Orders***

24. The Secretary of State should have the power, after the completion of an investigation, to seek an order from the court restraining the company from carrying on specified activities that he considered to be contrary to the public interest.
25. The Secretary of State should also have power to apply for a restraining order during the progress of an investigation. Such orders, referred to in the discussion document as 'Interim Restraining Orders', would continue in force until the investigation had been completed or other substantive

action had been taken. Alternatively, in place of, or alongside, other action, a restraining order could be made permanent thereby restraining the conduct of part of a company's business.

26. A restraining order would need to be capable of binding individual directors including shadow directors of a company, as well as the company itself.
27. The Secretary of State should have the power to seek an order of the court removing a person from office as a director (preventing him also acting as shadow director) of a particular company (only), as part of a restraining order imposing conditions upon that company's trading, where this was considered to be in the public interest.
28. The new restraining power should also separately apply to activities of those who had previously been directors of a company subject to a restraining order.

### ***Enforcement of Restraining Orders***

29. A breach of a restraining order should be punishable as if it were contempt of court. We would also seek to amend the law to make a breach grounds for winding up or disqualification. We also suggest that a director or other company officer responsible for a breach of an order could be made personally liable for the relevant debts of the company.
30. The Department would place a notice on the company's file at Companies House alerting potential creditors to the making of a restraining order and its terms. There would also be a register of orders open to public inspection.
31. There should be a requirement for the company to include on company documents and stationery a statement that it was subject to a current order

# COMPANY INVESTIGATIONS: POWERS FOR THE 21<sup>ST</sup> CENTURY

## A Discussion Document

### *Introduction*

The Company Law Review has taken a fundamental look at the framework of core company law. There is in company law a range of measures designed to ensure that company affairs are conducted with probity, and that when this is not so, matters of concern are brought to light and action taken. This includes powers of investigation and inspection currently available to the Secretary of State and appointed inspectors. These powers were not included within the review's terms of reference; the DTI consultation document that launched the review said:

**“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.”**

On 30 March 2001, the then Secretary of State, the Rt. Hon. Stephen Byers MP said, when he published the inspectors' report on Mirror Group Newspapers PLC :

“  
**The inspection has taken nearly nine years to complete and has so far cost £8.5 million. Other section 432 and 442 inspections have also been lengthy and costly. I do not regard this as an acceptable state of affairs. I have therefore begun a review of the operation of sections 432 and 442 of the Companies Act 1985.”**

A review of these powers of inspection, and of other company law powers of investigation, is a largely self-contained exercise. DTI is conducting such a review, drawing upon lessons learned in exercising current powers over the period of some decades since these powers were last reviewed and amended on any significant scale. This will permit proposals to be included in any legislative package that may result from the Company Law Review.

The Company Law Review has confirmed that it sees a continuing need for powers to be available under company law to allow intervention in company

affairs, where this is in the public interest.<sup>1</sup> We are addressing the question of whether there are beneficial changes in these powers that can be identified, based on experience of their operation, at the same time as our review of the powers of inspection and investigation on which, in our view, they depend.

This paper presents the emerging thinking on modernisation by the senior management of Companies Investigation Branch who have been greatly assisted by their legal advisors working groups of their staff and informal consultation with a number of interested parties; it is now presented as a basis for discussions with key contacts outside Government. We intend subsequently to conduct full public consultation on the basis of draft clauses that we shall produce to reflect the policy developed in those discussions.

Written comments should be addressed to:-

**Roger Watson  
Director of Policy  
Companies Investigation Branch  
Company Law and Investigations Directorate  
Department of Trade and Industry**

**Preferably by e-mail to: [Roger.Watson@dti.gsi.gov.uk](mailto:Roger.Watson@dti.gsi.gov.uk)**

When submitting views by e-mail please do not send these also on paper.

Comments on paper may be sent to: -

**Room 613  
10 Victoria Street  
LONDON SW1H 0NN**

Or by FAX on: - **020 7215 3484**

Telephone enquiries: - **020 7215 3017**

**Comments are sought by 31 January 2002. However please note that it would assist us very considerably to receive comments even if in incomplete form, or an indication of likely comments, by 4 January.**

**Department of Trade and Industry  
London  
October 2001**

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<sup>1</sup> See Consultation Document No 8 "Completing the Structure" paras 13.56 and 13.57, published November 2000 and Final Report Vol. 1 para 15.24.

## ***Policy Context***

1. Within the DTI Strategic Framework for 2001-02, the third objective of the Department is stated to be: -

**“to develop strong, competitive markets within a regulatory framework which promotes fairness and sustainability”**

Part of a key priority within this objective is stated to be to: -

**“...investigate promptly and effectively wrongdoing under the ... Companies ... Acts and when appropriate prosecute offenders or seek to disqualify them from being company directors”**

2. The DTI publication “Investigations – how they work” reflects this priority in the following text: -

**“In a free market, all those who deal with companies whether as investors, suppliers or consumers should be protected from unscrupulous or fraudulent practices. The Secretary of State has powers of investigation where fraud or other misconduct is suspected, where shareholders have been denied reasonable information, or where he considers it in the public interest. Depending upon what an investigation finds, the Secretary of State can prosecute offenders or take other action where necessary.”**

3. In Great Britain, the limited liability company has proved over some one and a half centuries to be a very successful vehicle for commercial enterprise. Its numbers have continued to increase progressively, so that there were over 1.5 million such companies registered here in March 2001<sup>2</sup>. The Secretary of State has exercised powers of investigation under company law for many years. Inevitably there have been changes in business practices over the years, and the Secretary of State’s powers have needed to be reviewed from time to time to ensure that they remain a match for current commercial (mal)practice.
4. There were some changes in 1981 to the “gateway” provisions in statutory bars to disclosure to increase the usefulness of information arising from company investigations by wider disclosure, and to provide specific powers relating to investigation of interests in shares. The power to use investigations to assist overseas regulators was reformulated in 1989. Otherwise the powers of investigation have remained essentially unchanged since the Companies Act 1967, which implemented the recommendation of the Jenkins Committee in favour of a power of the Secretary of State to require production of documents and information, and explanation of these. This is one reason why DTI objectives have

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<sup>2</sup> See “Companies in 1999-2000” Table A1

reflected a commitment to improve, as well as to enforce, the commercial framework. This review helps to fulfil that commitment.

5. The position of this review in relation to the Company Law Review has already been outlined. That Review has the objective of bringing forward proposals for a modern law for the modern world, so that the nation should have an up-to-date framework that promotes enterprise and the competitiveness of companies in Great Britain. Similarly, any future powers of inspection, investigation and resulting action under company law must remain consistent with the Government's concerns to promote **competitiveness** and to minimise **regulatory burdens upon business**. There are difficult judgements to be reached here. On the one hand the desire to promote enterprise implies the minimum appropriate regulatory burden. On the other hand, the more free the overall framework, the greater the risk of abuse and the more important it is that there are efficient mechanisms for tackling fraud and malpractice.
6. There is therefore a balance to be struck between objectives. For example, a concern to eliminate unnecessary regulatory burdens has resulted in an increased turnover threshold for company audit requirements. Investigative powers provide assurance that the conduct of company affairs can nevertheless be examined where there is reason to do so. It will remain important that there should be effective powers to detect and pursue companies and their directors who breach the responsibilities that flow from the privilege of limited liability. To be effective, these powers must enable inspectors and investigators to have rapid and ready access to all relevant information and other material. Where findings indicate a need to take remedial steps against a company or its directors in the public interest, there must similarly be powers to do so and to restrain conduct that puts at risk the legitimate expectations of investors, customers and creditors. It should be remembered that any action taken by the Department can only be reactive
7. In Chapter 15 of its final report the steering group of the Company Law Review sets out its views on the framework of sanctions needed to enforce company law in the future. The group favours retention of a strong framework of criminal offences ranging from fraudulent trading at one extreme to minor offences for failure to comply with procedural obligations such as filing requirements, in order to promote compliance with the law by deterrence. A place is also seen for administrative penalties in encouraging timely compliance. The group has also emphasised the importance of proportionate enforcement, particularly for procedural obligations subject to criminal offences. In our view, without powers of inspection and investigation, it would be impossible in many cases to obtain sufficient evidence of wrongdoing to reach a view on the need for criminal investigation.
8. As noted already, the steering group has confirmed that it sees a continuing role for intervention in company affairs by public authorities where this is in the public interest. In our experience, the civil powers that

allow follow up of the outcome of an investigation by seeking the winding up of a company or the disqualification of a director also depend indirectly but crucially upon powers of inspection and investigation for the evidence needed for civil proceedings.

9. Companies Act powers of inspection and investigation are not routine powers of inspection, such as exist under other legislation, giving rise to supervisory visits. Equally, company law makes no provision for active monitoring such as is appropriate in some sectors, for example, insurance business. Inspection and investigation under the Companies Acts should not be confused with such enforcement. Only a tiny minority of companies is investigated, where there is good reason<sup>3</sup>. This pattern of enforcement is entirely consistent with a philosophy of leaving the vast majority of businesses, who are reputable, free to trade under the law, while ensuring that any matters of concern are properly examined.
10. The **Financial Services and Markets Act 2000** will come fully into force very soon. It includes powers of investigation and intervention for the Financial Services Authority (FSA) in financial services markets and businesses. Once the Act is in force, primary responsibility for exercising powers of investigation and other wider supervisory powers for financial service businesses will lie with the FSA.
11. The role of the Secretary of State under company law will remain very different from that of the FSA under the new Act. The FSA is a sectoral regulator exercising close supervision and control over the financial service sector in very many ways, requiring detailed knowledge of its operations. Company law provides a broad framework for commercial activity undertaken through limited liability companies: it does not provide close regulation of the sort that is appropriate for banking, insurance and other financial services companies.
12. Such an approach in company law is the most effective and least burdensome regulatory strategy for promoting a reputable market place. Also, the vast majority of inquiries under company law are conducted on a confidential basis, in order to ensure that the commercial reputation of a company is not damaged unjustifiably; and this too helps to ensure that they do not impose unnecessary or disproportionate burdens. The Department receives complaints about companies that turn out to be unjustified or occasionally even mischievous: it would be wrong if any of these were allowed to damage the reputation of a soundly run company.
13. The proposals in this paper have been developed with a proper concern for regulatory burdens on small businesses in particular, adopting the philosophy “**think small first**”. This provides a continuing justification for powers that are very largely “complaints driven” and which depend upon a test of good reason being met before any inquiry can proceed, so

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<sup>3</sup> In the year to 31 March 2001 some 4,000 complaints against companies were considered by Companies Investigation Branch.

that none is embarked upon without proper consideration. In other respects, this equates with a concern to keep the scope of each inquiry to the minimum that can be justified in the particular circumstances of each case. The use in future of powers of inspection and investigation will also continue to be subject to best enforcement practice.

14. Ministers are seeking at present to increase the effectiveness of action to counter “**rogue traders**”. Many company law inquiries already serve as an effective basis for action by the Secretary of State to wind up companies and disqualify (or prosecute) directors in the public interest, in cases where a substantial part of the public interest case involves protecting the public as consumers. Similar action should continue on an enhanced scale in future on the basis of using either company law or consumer protection powers (or both). We are therefore aiming to develop powers under the two bodies of law, and to operate these, with the intention of making these more mutually supportive and as effective as possible.
15. The **Limited Liability Partnerships Act 2000** makes available yet another form of legal entity able to carry on trading with limited liability. The legislation includes provisions for investigations similar to those available under the Companies Act. There is no experience of using powers of investigation in respect of limited liability partnerships. Our assumption is that changes discussed here for investigation of companies would apply in due course to investigation of limited liability partnerships. Any investigations will be concerned essentially with identifying abuse of limited liability. This review is essentially concerned with such abuses and does not address the trading activities of partnerships and individuals who trade with unlimited liability, except in so far as these may be relevant to the conduct of the limited liability business.<sup>4</sup>
16. The Government is committed to a **vigorous campaign against fraudulent conduct and organised crime**. Globalisation of trade and other economic activity, together with the growth of international information exchange and trading through the internet, are having an enormous impact, and are increasing the scope for fraudulent conduct. Company law powers of inspection and investigation have a vital place amongst the range of measures available to counteract such conduct. Money laundering is a part of this problem that can involve some abuse of the privilege of incorporation. Company law investigations have the potential to be used in order to lift the corporate veil and discover what is going on through the medium of a company that is doing business in the UK.
17. There is every reason to use investigative powers in this way: and to attack fraudulent conduct by effective co-operation between enforcers,

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<sup>4</sup> Company law powers of investigation apply also to companies that do not have limited liability, but these are a tiny minority, and their inclusion in the scope of powers does not invalidate the argument that, for the vast majority of companies, the main benefit of incorporation as a company is limited liability.

both within the UK and between the UK and overseas. There is already a substantial history of use of UK company law powers in support of overseas regulators, and UK regulators benefit from being able to call upon the use of similar powers in many other countries.

18. Any review of legal powers to inspect, investigate and intervene must take into account the requirements of the European Convention of Human Rights, to the extent that they apply. Under the **Human Rights Act 1998** a statement must be made in relation to any Bill introduced in Parliament either certifying that it is compatible with Convention rights or indicating that, though compatibility cannot be confirmed, the Government nevertheless wishes the Bill to proceed. But equally the operation of powers in practice must take full account of the rights enshrined in the Convention where applicable. There is a need to take a balanced view recognising that the law does not always simply outlaw infringement of specified human rights. Infringement of certain rights can be justified on public interest grounds. Investigation and intervention by the public authorities may be instrumental in righting wrongs that have been done in connection with trading activities of companies, or at least preventing a repetition of the wrong. It must also be borne in mind that the principal focus of investigations is the conduct of the affairs of companies, and that companies are distinct legal persons.
19. The European Court of Human Rights has had occasion to scrutinise DTI company law investigations. In *Fayed v United Kingdom*, the Court held that Article 6(1) of the ECHR (“right to a fair trial”) did not apply to company investigations because they are fact-finding exercises and that the relatively limited access to the courts afforded by judicial review was in context justified. As a result, there is no objection to individuals and companies being compelled to answer questions, but the answers cannot usually be used as evidence in criminal proceedings against the individuals giving the answers.

### ***Current arrangements and their value***

20. General powers of inspection and investigation have existed for many years in company law, aimed at uncovering facts and identifying any need for further action, and depending upon statutory powers of compulsion for those required to provide documents and other information. These powers are essentially concerned with establishing the facts of a matter that is a cause for concern. A separate criminal investigation is always necessary to establish whether criminal proceedings should be brought in relation to any facts or events uncovered. This does not mean that there is unnecessary duplication of activity between a company law investigation and a subsequent criminal investigation. The two sorts of investigation have differing objectives and are subject to differing procedural and other requirements<sup>5</sup>. There is no wish to change this.

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<sup>5</sup> For example, the Police and Criminal Evidence Act 1984 does not apply to company investigations.

21. Without powers to investigate and inspect that are specific to companies:-
- it would be very difficult to establish the facts about the conduct of company affairs (the company is a separate legal person from its owner(s), directors and employees with separate obligations and rights);
  - many complaints and allegations could not be investigated, because there would be insufficient access to evidence to justify immediate criminal investigation, and much wrong-doing would go undetected; and
  - regulatory action, winding up and disqualification of unfit directors would be hampered for lack of evidence.
22. Implementation of the Company Law Review will result in some liberalisation of the accountability requirements for companies. Maintenance of the effectiveness of company investigations in future should provide under-pinning assurance for those changes, thereby helping to keep British companies honest, to protect the public and making the UK a good place to do business. If such powers did not exist in company law there would be need to devise alternatives, which are unlikely to be as simple or effective.
23. Statutory powers requiring disclosure of information under compulsion are justified for such company law inquiries (in other words, there should continue to be penalties for non-co-operation). The limited liability company is an artificial entity. In exchange for the benefit of limited liability, the company operates within a framework of accountability laid down by statute. The law provides the company's rights to confidentiality and its obligations to disclose information. Thus a company is compelled to disclose information relating to ownership of shares and trading results to the Registrar of Companies, so that this may be available to those with whom the company does business.
24. Compulsion to disclose information to an investigator or inspector is simply another form of accountability of the company that is enforced when the circumstances require it. If no power of compulsion existed to secure the disclosure of information about the affairs of a company, there would be no means of being certain of obtaining necessary information. The company itself is often the best and sometimes the sole source of information about the conduct of its affairs. If disclosure could not be compelled, the effectiveness of company law powers of investigation, and the integrity of the market, would be greatly undermined.
25. Compulsory disclosure under company law does not threaten the rights of individuals. Individuals carry on the business of the company and it is individuals who take action to satisfy a requirement for information or

explanation arising in an investigation. While company members, officers and associates who are natural persons have human rights recognised by law, including a right to privacy, their rights cannot extend to the affairs of the company, which is a separate legal person. It is now well established (and enshrined in statute) that evidence relating to statements made under compulsion by an individual may not be adduced against that person in most criminal proceedings.

26. The existing law includes: -

- wide general powers for full inspections of company affairs;
- narrower general powers for confidential investigation of complaints;
- very specific powers for particular types of investigation, in particular into the ownership of shares.

The current general powers of inquiry under the Companies Act 1985 provide for: -

**“inspections” under section 432(2) based on wide and strong investigative powers under section 434; and**

**“investigations,” based on more limited, document-based, powers under section 447.**

27. Inspectors are appointed under section 432(2) in practice when there are circumstances suggesting malpractice<sup>6</sup> and a strong public interest in uncovering the extent of that malpractice. Inspections are normally undertaken in cases where there is already widespread public concern

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<sup>6</sup> Under section 432(2), the Secretary of State may appoint inspectors if it appears to him that there are circumstances suggesting

- (a) that the company's affairs are being or have been conducted with intent to defraud its creditors or the creditors of any other person, or otherwise for a fraudulent or unlawful purpose, or in a manner which is unfairly prejudicial to some part of its members, or
- (b) that any actual or proposed act or omission of the company.....is or would be so prejudicial, or that the company was formed for any fraudulent or unlawful purpose, or
- (c) that persons connected with the company's formation or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards it or its members, or
- (d) that the company's members have not been given all the information with respect to its affairs which they might reasonably expect.

In such cases, under section 434, it is the duty of all officers and agents of the company.....whose affairs are investigated

- (a) to produce to the inspectors all documents of or relating to the company.....which are in their custody or power,
- (b) to attend before the inspectors when required to do so; and
- (c) otherwise to give the inspectors all assistance in connection with the investigation which they are reasonably able to give.

If the inspectors consider that an officer or agent of the company.....or any other person is or may be in possession of information relating to a matter which they believe to be relevant to the investigation they may require him to

- (a) produce any documents in his custody or power relating to the matter,
- (b) to attend before them, and
- (c) otherwise to give them all assistance in connection with the investigation which he is reasonably able to give.

about the conduct of the affairs of a company and where there has often already been damage to the company. These factors provide the justification for the appointment of inspectors with relatively strong powers and the commitment of substantial resources. They also normally justify putting knowledge of the start of an inspection and its findings in the public domain.

28. Although such inspections are infrequent, they have a valuable part to play in the enforcement machinery of company law. Such inspections can reveal the true nature and extent of malpractice, and thereby can provide lessons for the corporate sector in the exercise of vigilance, as well as providing a possible basis for regulatory action by public authorities. If powers to appoint independent inspectors did not exist, it would be necessary to set up some form of inquiry to get to the bottom of such cases as Mirror Group or Guinness. The appointment of inspectors is relatively simple.
  
29. Section 447 provides for confidential fact-finding investigations. The power is, in the overwhelming majority of cases, exercised without publicity, because the reputation or share price of a company would often be severely damaged by publicity. This is clearly to be avoided at the outset of an investigation, because it cannot be known then that the company is in any way at fault. Under the power, the investigators may require disclosure of specified documents relating to the company and may call for an explanation of these<sup>7</sup>.
  
30. The power provides for a valuable type of inquiry that can serve as a fact-finding investigation leading to criminal investigation or other action against the company or its directors. The value of section 447 investigations in uncovering malpractice has been demonstrated over many years by the successful prosecutions, disqualification of directors, winding up of companies and other outcomes that have followed. Their value has also resulted in successive widening of the disclosure gateway provisions to develop the uses for information obtained by these investigations. These changes have allowed closer co-operation with other regulatory and enforcement agencies. As a result section 447 has become the main power by which the DTI initially investigates suspected malpractice in companies. The table below sets out the numbers of such investigations that have been undertaken in recent years.

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<sup>7</sup> Under section 447, the Secretary of State may, at any time, if he thinks there is good reason to do so, give directions to a company requiring it ...to produce such documents as may be specified or authorise an officer or other competent person to require the production of documents. He has the like power to require production of those documents from any person who appears ...to be in possession of them. He may also require that person or any person who is a present or past officer of the company to provide an explanation of the documents.

31. Completed Investigations under section 447 CA 1985

	1996/97	1997/98	1998/99	1999/2000	2000/01
<b>Total</b>	216	218	214	167	173
NB Figures are taken from Companies annual report and are for the numbers of cases completed.					

32. In addition, the Secretary of State has a duty to appoint inspectors when a court orders that a company's affairs ought to be investigated (section 432(1)) and has other rarely-used, specific powers:-

- to appoint inspectors to investigate company affairs on the application of the company or specified proportions of its members (section 431, no appointments since 1990);
- to appoint inspectors to investigate the ownership or control of a company (section 442, no appointments since 1992);
- to require information about interests in shares in order to investigate the ownership of a company (section 444, one case since 1992), and
- to appoint inspectors to investigate whether directors or their families have contravened restrictions on share dealings or requirements to notify the company of their interests in shares (section 446, no appointments since 1993).

33. The Secretary of State also has more frequently used powers to assist overseas regulatory authorities (sections 82-91 of the Companies Act 1989, ten cases in 1998/99).<sup>8</sup>

***Weaknesses of current powers***

34. Current experience of inspections and investigations suggests a need for changes to address specific weaknesses outlined below; and to reflect technological development and changes in data handling and commercial and employment practices; and thereby enhance the efficiency and effectiveness of inquiries into companies.

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8. The following are not within the scope of this paper: - powers relating to criminal investigations (including a power in regular use which permits those involved in criminal investigations, including DTI prosecutors, to obtain a court order requiring the production and inspection of books where a criminal offence is suspected (section 721, CA 1985); powers of investigation under insolvency law; the Insurance Companies Act 1982; Trading Schemes regulated under the Fair Trading Act.

35. Generally speaking, section 432(2) inspection powers have not been found to have major weaknesses in uncovering facts: the inspectors' powers include the power to require documents to be produced relating to any matter which the inspectors believe is relevant to their investigation. This requirement may be imposed on anyone who the inspectors consider is or may be in possession of relevant information, but relates only to documents in that person's custody or power. "Document" is very widely defined<sup>9</sup>, covering information recorded in any form. The inspectors can also require any person to attend before them and provide all reasonable assistance if they consider that he or she is or may be in possession of relevant information, and they can examine on oath.
36. However, sometimes inspections can be very lengthy and costly, as the then Secretary of State noted on publication of the report of the inspectors on Mirror Group Newspapers. The duration and cost of section 432 inspections that have been completed in the period since May 1990<sup>10</sup> are set out in Annex A. Being normally in the public domain, inspections are particularly susceptible to delay by challenge in court on procedural or substantive legal grounds, or because a related criminal prosecution leads to suspension of all or part of an inspection. This, together with their potentially high cost, strongly suggests that inspections under section 432(2) in its current form are likely to serve the public interest in future only in limited circumstances. Changes need to be introduced with the aim of ensuring a timelier conclusion to inspections, but without compromising the inspectors' independence.
37. Past changes made to Section 447 have not altered the fact that investigations under it can relate only to "specified documents", even though "document" is again widely defined<sup>11</sup> to include information recorded in any form. The effectiveness of the power depends on the existence of such documents and the range of people from whom explanations of documents can be sought is relatively limited. These are significant weaknesses in the effectiveness of this power. It does not provide an investigative tool with a sufficiently high probability that it will uncover the required factual information. If malpractice is detected, the limitations inherent in the power may also mean that its full extent may not be discovered.
38. Also, the development of information technology has resulted in many changes of practice within companies and in investigatory techniques. While the powers to require the production of documents apply to documents held on computer, electronic storage has made it more difficult to discover what documents exist that may be relevant to an investigation. Storage practices vary greatly, and company documents are often stored

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<sup>9</sup> Section 434(6), Companies Act 1985.

<sup>10</sup> The details of inspections published before this date were included in the Report of the Trade and Industry Committee of the House of Commons on Company Investigations, published on 2 May 1990.

<sup>11</sup> Section 447(9), Companies Act 1985.

alongside other material, in ways that were less common with paper-based information. The development of the paperless office may help to overcome this difficulty or may further hamper the effectiveness of investigations dependent on these powers, unless they can be modified to reflect current and future needs.

39. There is a need to provide sufficient flexibility within company law powers of investigation to enable these to keep up with technological change: it is for consideration if this might be done for example by developing primary legislative provisions that can be brought up to date by secondary legislation.
40. The powers listed above and categorised as specific powers have either been provided in order to allow an investigation to be initiated in a particular way (for example, on the request of a part of the membership) or have been designed to underpin particular obligations of company law and thereby assist enforcement of those obligations. The latter powers generally came into being at different points in the past as part of packages of measures designed to counter a particular abuse. Once the matter had been dealt with, the powers have become very little used. The provisions lay down rules for the conduct of each narrowly focused type of investigation or inspection that are for the most part unnecessarily specific. Those provisions that relate to the initiation of an investigation or inspection also seem unnecessarily specific, and the reasons for the precise formulations are also of historical but not current interest.
41. The Department routinely considers over 3000 complaints a year from minority shareholders, customers, creditors and employees of companies (and others), and is able to reach a conclusion in each case on whether an investigation (usually under section 447) is justified. It also at times initiates an investigation without formal complaint. It is not apparent that specific powers are needed to initiate investigations when these are sought by particular parties, and there appears to be no case for the secretary of State to be obliged to initiate an investigation in such circumstances. Instead there should simply be provision that allows a complaint to be investigated regardless of its origin, provided of course that investigation is justified. Also some powers that relate to specific company law provisions might be subsumed within more general powers, although this might be impracticable. Powers to investigate restrictions on share dealings by a director and his family, and requirements relating to the disclosure by a director of shareholding in his own company are one example of specific powers for which it might be argued there is a continuing need.
42. Specific powers enabling assistance to overseas regulators will continue to be needed to ensure that assistance given is within the bounds of what Parliament considers appropriate, although they too might usefully operate more by reference to general powers, for the sake of simplicity and consistency. It will also be necessary to ensure that general powers, and the provisions for enforcement that underpin these, are fully capable

of supporting investigations that have a specific focus, such as beneficial interests in shares.

### ***Proposed powers of investigation and inspection***

43. We propose to replace existing general and specific powers with new general and specific powers of investigation and inspection, capable of covering everything that can be done under existing powers and more. This is because existing powers of investigation have proved inadequate or unnecessarily constrained. Also this is an opportunity to simplify the law. We would not provide expressly for the appointment of inspectors where the court orders it or on application of others. We do not propose that the Secretary of State should be obliged to appoint inspectors in any circumstances. In the case of confidential investigations, we would specify the range of powers using a graduated approach, which would allow for the powers available to be controlled as outlined later. The controls would prevent excessive use of powers by ensuring that only those powers that were necessary and appropriate for a particular investigation were made available from the range of powers potentially available.
44. We have considered whether the defects identified above in general powers exercisable under sections 432 and 447 should best be remedied within the existing framework of distinct inspection and investigation powers, or whether a single unified set of powers would better serve the present need. The changes required to section 447 would bring it into line with sections 432, 442 and 446 as regards the matters that may be inquired into, the information and assistance that may be required and the persons who may be required to provide assistance. Although section 432 powers are generally invoked in more serious cases that are the cause of some public concern, serious wrongdoing can also be uncovered by a confidential investigation, and it is important that the powers for these should permit this to be investigated effectively. The scope of powers available for confidential, unpublicised investigations needs to be brought into line with the scope of powers available for publicly announced inspections, if these investigations are to become fully effective.
45. However this is not enough to make the case for a single set of powers. Aspects of inquiries other than scope must be taken into account. In particular, the question of whether an inquiry is announced publicly and intended to lead (or capable of leading) to a published report, or is conducted on a confidential and unpublicised basis, remains a key distinction between different types of inquiry. The publicised inspection is carried out in order to reveal the true facts in cases where there is strong suspicion of malpractice in the public mind, while the unpublicised investigation is done in order to establish if there is any case to answer. A key conclusion of this review is that a clear distinction needs to be maintained between inspections that are publicly announced and can lead to published reports and confidential, unpublicised investigations.

46. The different character of inspections and investigations should remain distinct, even though the scope of the powers under which they are carried out should be harmonised. The inspection should normally lead to a published report, and should retain the ability to pursue such lines of inquiry as the independent inspectors decide upon and to produce findings going as wide as necessary.
47. The confidential investigation should remain highly focused and tightly managed, aimed at getting to the truth of particular complaints and establishing what if any further action is justified. We believe that it is necessary to preserve the confidentiality of investigations of complaints against companies. It would be inappropriate to announce the start of an investigation, as to do so would risk unnecessary damage to reputation and share price. The complaint might prove to be groundless or even malicious. It might be argued that there are some advantages in announcing the outcome of an investigation, in terms of giving the Department's work greater visibility.. However, we are concerned that much valuable information that is volunteered during investigations would be withheld if there were a possibility of it being publicly disclosed.

### ***Confidential Investigations***

48. In this section of this paper, and the sections immediately following it, we examine proposals for the definition and operation of powers to replace those in sections 444 and 447 of the Companies Act 1985. The needs for confidential, unpublicised investigations in future are to expand the range of material that may be required by investigators to embrace all relevant material, and to broaden the range of those who may be required to assist an investigation, and the form of their assistance. These needs arise from experience of the limitation of existing powers to allow investigations to explore all necessary avenues, including all aspects of material held on computer. This would allow for a selective approach, whereby a package of powers necessary to carry out a particular investigation was tailored to that investigation and might be varied to fit the needs of the investigation as it progresses.
49. The consequences of a decision to investigate would change. Instead of a uniform statutory formula, there should be a gradation of powers defined by reference to the breadth of the investigation and the range of persons who could be required to assist. Authorisation procedures would relate the powers to be made available in each case to the evidence available of possible criminal conduct, breach of company law, or other wrongdoing. Thus the adoption of such broader powers would allow, and require, a greater degree of control when exercising the powers. Such new powers would provide a more effective basis for investigation in contemporary circumstances, and the tailoring of powers available to the circumstances of each case would serve to avoid any unnecessary burden on business or intrusion on human rights.

## ***Authorisation and conduct of confidential investigations***

50. We propose to control the use of the proposed powers by developing the existing authorisation discipline requiring scrutiny by senior officers to ensure that their use is necessary and appropriate. Each proposed use of additional powers in an investigation would need to be authorised in this way.
51. The powers of the Secretary of State to authorise investigations under section 447 are at present exercised by the Inspector of Companies, or one of the Deputy Inspectors, in line with normal principles of delegation. The authorising judgement is exercised separately from the initial vetting of the “good reason” to investigate, and involves the authorising officer satisfying himself/herself that the case is a proper one for investigation, taking account of all relevant factors. If the authorising officer is unable to confirm this, s/he sets out the argument for the vetting decision to be reversed. The authority given takes the simple form of authorising a named individual or team to undertake an investigation using section 447 powers into the affairs of a named company. Authorising officers also separately authorise every decision to seek a search warrant from a magistrate, and every decision to seek information from a banking source.
52. The use of proposed powers of investigation in any case should be subject to authorisation procedures developed to take account of the scope for greater administrative control that would be available to relate the powers available to the needs and circumstances of the investigation<sup>12</sup>. On behalf of the Secretary of State, an authorising officer at not less than the level of seniority currently required to authorise an investigation would have to confirm that the investigation proposed was necessary.
53. The authorising officer would also need to be satisfied that the proposed investigation was proportionate. That is to say, the officer would need to assess the proposed scope of the investigation in terms of powers needed, defined subject of investigation, persons to be interviewed and information and assistance to be sought and confirm that this was no more than was necessary in view of the substance of the complaint or allegation of wrongdoing and any evidence of this. The exercise of company law powers, like any other administrative activity, is already subject to the scrutiny of the courts and would remain so .. It would be a sufficient safeguard that the legality and reasonableness of any requirement imposed by an investigator could be challenged in court.
54. Human rights considerations, where relevant, would apply throughout the vetting, authorisation and investigation procedures. The authorisation assessment would provide the basis for showing that the conduct of the

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<sup>12</sup> The Regulation of Investigatory Powers Act 2000 (RIPA) has provided a means for ensuring that the exercise of certain investigatory powers is justified under the ECHR.

investigation had been subject to a properly balanced scrutiny in relation to human rights and law enforcement objectives, if the use of powers were challenged on human rights grounds.

55. The provision of a graduated, selective power of investigation would not mean that all investigations would have to begin with the exercise of only the narrowest powers. Rather it would be open to the authorising officer to decide in each case on the appropriate powers to be authorised. This assessment would be made at the outset of the investigation, and could be reassessed at any later stage, if justified by further evidence coming to light during the investigation.
56. The authority provided for an investigation in force at any time would be available as a written statement to be given on demand to the company and to each person required to assist the investigation. There would be a requirement to give reasonable notice of an intended exercise of the right to require access to company premises, with exceptions, as discussed below. However there would be no other obligation to serve advance notice of the investigation to the company subject to investigation or any of its officers, as this would risk inviting pre-emptive action such as tampering with evidence, and could seriously compromise the effectiveness of the powers of investigation. For fact-finding investigations the need to act quickly to secure reliable evidence is of paramount importance.
57. The disadvantage of such an authorisation regime is that it could impede effective investigation if applied too rigidly. Company law investigators would become adept at anticipating lines of enquiry that might emerge and seeking authorisation for these at the earliest time when sufficient evidence had been accumulated to make the case for the powers required to pursue these.

### ***Proposed grounds for confidential investigations***

58. It should continue to be possible to investigate any matter that relates to the affairs of a company where it appears that there is good reason to do so. The test of “good reason” already applies under section 447 (and section 444 which gives powers to obtain information about those interested in shares). It is not statutorily defined. It is possible to take account of all relevant factors suggesting that there is a need for investigation in the public interest. This is the proper basis for an investigation by public authorities, whose powers are not available simply to resolve private disputes between different parties involved in companies. We do not propose any change to the test of good reason as the basis of confidential investigations.

### ***What might be investigated?***

59. There is no suggestion that the subject of investigations under company law should be other than, broadly speaking, the conduct of

company<sup>13</sup> affairs. However, in order to provide effective powers to establish the nature and extent of any malpractice, it will be necessary define such affairs widely. The proposed scope of investigatory powers is:

- the nature, conduct or state of the business of the company;
- the ownership or control of the company, including minority interests, and beneficial interests in its shares;
- the activities of company officers, agents and shareholders (including activities of their family and others done on their behalf) as these concern the affairs, business or ownership and control (including interests in shares) of the company; and
- any particular aspect of the affairs, business or control (including interests in shares) of the company or of activities of company officers and agents.

60. We intend that these categories should not exclude anything that can be investigated under the existing provisions of Part XIV of the Companies Act 1985. This includes possible contraventions of restrictions on directors' share dealings and obligations of directors to disclose shareholding in their own company. The categories are intended to provide the comprehensive coverage that is required for powers of investigation that can embrace wide-ranging or closely focused investigations, as each case requires.

61. The proposed powers would include the possibility (as section 433 allows for section 432 inspections) of extending an investigation from one company to another company associated with the first<sup>14</sup>. But it is necessary to go further to meet current needs. Changes in commercial and employment practices have resulted in many companies distributing goods and services through self-employed agents, or franchising arrangements. Also, the increasing complexity of business structures allows these to be manipulated so as to avoid detection of malpractice. Where the affairs of a company are intermingled with business undertaken by individuals or partnerships, it should be possible for a company law investigation to pursue a line of enquiry that extends to the business affairs of those individuals or partnerships, but only to the extent that this is necessary to allow company affairs to be fully investigated.

62. For associated and connected companies of the principal company already under investigation, and associated or connected partnerships, the investigation should be capable of covering the nature, conduct or state of the business affairs of a person who is or was: -

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<sup>13</sup> Limited Liability Partnerships would continue to be covered by their own legislation that allows them to be treated in the same way as companies for these purposes. We make no proposals in respect of other partnerships (including those with one or more partner that has limited liability), except where these are associated with a company (or Limited Liability Partnership) under investigation. Partnership law follows company law in some respects but is a distinct field of the law.

<sup>14</sup> In the case of investigations any expansion of an investigation to cover an additional company would need a separate authorisation.

- a company that is or was at any relevant time a member of a group (broadly defined, along the lines of section 421 of the Financial Services and Markets Act 2000 (FSMA))<sup>15</sup> of which the company under investigation is a member/part;
- a person who is or was at any relevant time, a member of a partnership of which the company under investigation is a member/part; or
- a partnership of which the company under investigation is or was at any relevant time a member/part; or
- a partnership or company carrying on at any relevant time some part of the business of the company under contract or as agent; or
- a person who has or had at any relevant time a participating interest (see section 421 of FSMA )<sup>16</sup> in the company under investigation, or is or was financially interested in the success or failure of the company or able to control or materially influence its affairs (see section 443 of CA 1985)<sup>17</sup>.

63. For individuals, the investigation should be capable of being extended to cover the nature, conduct or state of the business affairs of an individual who: -

- is or was at any relevant time a director or shadow director of the company under investigation; or
- has or had at any relevant time a participating interest (see section 421 of FSMA )<sup>18</sup> in the company under investigation, or was financially

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<sup>15</sup> Subsection (1) defines a “group” in relation to a person A as meaning A and any person who is:- a parent undertaking of A; (b) a subsidiary undertaking of A; (c) a subsidiary undertaking of a parent undertaking of A; (d) a parent undertaking of a subsidiary undertaking of A; (e) an undertaking in which A or an undertaking mentioned in paragraph (a), (b), (c) or (d) has a participating interest; (f) if A or an undertaking mentioned in paragraph (a) or (b) is a building society, an associated undertaking of the society; or (g) if A or an undertaking mentioned in paragraph (a) or (d) is an incorporated friendly society, a body corporate of which the society has joint control (within the meaning of section 13(9)(c) or (cc) of the Friendly Societies Act 1992.

<sup>16</sup> Subsection (2) states that “Participating interest” has the same meaning as in Part VII of the Companies Act 1985...;but also includes an interest held by an individual which would be a participating interest for the purposes of those provisions if he were taken to be an undertaking.

<sup>17</sup> Subsection (2)(a) defines such persons as “all ... who are or have been, or whom the inspector has reasonable cause to believe to be or have been, financially interested in the success or failure of the company or any other body corporate whose membership is investigated either that of the company, or able to control or materially influence its policy (including persons concerned only on behalf of others).

Subsection (2) states that “Participating interest” has the same meaning as in Part VII of the Companies Act 1985...;but also includes an interest held by an individual which

interested in the success or failure of the company or able to control or materially influence its affairs (see section 443 of CA 1985)<sup>19</sup>; or

- is or was at any relevant time employed by the company under investigation to carry on its business as employee or agent or otherwise under contract.

64. The investigation of personal business clearly would extend the scope of investigation available under company law. It will be important to provide real assurance of a check on the excessive or arbitrary use of powers. Use of this additional scope would need to be properly authorised in each case for the purposes of the investigation. We consider that the authorisation procedure should in every case require the name to be stated of each individual whose personal business is to be investigated. If the authorisation were instead conferred only by reference to one or more of the classes of individuals set out above, this would provide less precision than when identifying the principal subject of the investigation (i.e. the company whose affairs are to be investigated), which would not be acceptable.

#### ***Who can be required to assist?***

65. The range of persons who might be required to assist an investigation should be defined progressively according to the degree of “connectedness” with the company. Investigation powers should be exercisable in the first instance in respect of :-

- persons with a past or present connection with the company, such as past and present directors, managers and controllers, employees, agents, shareholders/members and others with an interest in its success or failure (to include those individuals whose affairs the investigators are likely to be able to investigate).

Inspectors should be able to require the assistance of such persons in any investigation without specific authorisation.

66. If specifically authorised in addition, the investigation should also be able to require assistance from: -

- company advisers, including accountants, actuaries, auditors, legal advisers (but not of course in respect of matters covered by legal professional privilege) and bankers (to include those appointed to advise associated companies and connected persons); and

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would be a participating interest for the purposes of those provisions if he were taken to be an undertaking.

<sup>19</sup> Subsection (2)(a) defines such persons as “all ... who are or have been, or whom the inspector has reasonable cause to believe to be or have been, financially interested in the success or failure of the company or any other body corporate whose membership is investigated either that of the company, or able to control or materially influence its policy (including persons concerned only on behalf of others).”

- any person who is transacting or has transacted business with the company.

The extent to which each of these categories would need to be included would be a matter for judgement when an investigation was first authorised and subsequently.

67. There should be additional powers to compel assistance from persons unconnected with the company subject to investigation, where necessary. Subject to proper authorisation, it should be possible to require assistance from: -

- any person whom the investigator considers is in possession of or is able to obtain information or material which the investigator considers relates to a matter relevant to the investigation.

68. By exercising this power, an investigator would be able to make enquiries of any person using, having charge of or operating a computer that is being or has been used for company purposes. This would include for example owners and/or employees of a computer bureau that might have provided information management services to a company under investigation. Persons holding shares as nominees would also be obliged to disclose what they knew of the underlying beneficial ownership of those shares, if required to do so as part of an investigation properly authorised to cover such matters.

69. Here again the authorisation procedure would need to define the scope of an investigation precisely. Different considerations arise in defining the scope of the investigation as this relates to persons from whom information and assistance may be required from those explored above when considering the matters that might be investigated. Those required to assist could be required to provide information only about the affairs of the company and the involvement in these of themselves and others. They would not be exposed to an examination of their personal business, unless they were also named as a person whose personal business could be investigated under the procedure outlined above for defining what could be investigated. We therefore consider that it would be acceptable for the persons who might be required to assist to be specified for the purposes of authorisation as a class (for example, all of the creditors of a company).

70. However, a requirement for information from the lawyer, accountant, auditor or banker of a company or of a connected company, partnership or individual might involve a considerable intrusion upon privacy or confidentiality and it would probably be necessary to specify such persons by name to overcome any reluctance to assist. The law should make provision for a requirement to be specified in either way, and should leave it to the judgement of the authorising officer which was appropriate in each case.

### ***What assistance might be required?***

71. The answer to this question takes a different form from the gradations of access identified for defining scope under the last two questions. A person within the defined scope of those who may be required to provide assistance should be obliged to disclose all relevant information and to provide all relevant material available to him. An investigator should have the power:-

- to require provision of all relevant information and material if he considers that a person is in possession of information and/or material relating to a matter which he believes is relevant to the investigation..

72. Wholly document-based powers would thus be replaced by a less restricted approach. This would still include production of documents including computer records, and would also extend to information held in any form, as at present. In addition, persons required to assist would also be required to provide any other relevant material, such as product samples. Where information and/or material was not within the possession or control of a person required to produce it, he would be required to state where it might be obtained, if this was within his knowledge, as applies under the law at present.

73. In addition, an investigator should be able to require any person within the scope: -

- to give all assistance in connection with that investigation that he is reasonably able to give.

74. This would include the provision of explanations of documents, as at present, and of other material, and provision of wider explanations relating to such matters as the conduct of individuals<sup>20</sup>. It would also include requiring persons to attend before the investigator at a stated time and place to provide information, material or explanation.

75. An investigator should be able to require assistance to be provided "forthwith" (as applies to the provision of documents under existing powers) i.e. with immediacy. The emphasis to be given to immediacy should be determined by the investigator, depending on the circumstances, but there needs to be the power to enforce immediate assistance. Such immediacy is often important in fact-finding investigations, because it can deny those with something to hide the time they would like to have to arrange information and material to coincide with a version of events they wish to present.

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<sup>20</sup> The opportunity might be taken if necessary to reflect in statute the decision of April 1999 of the Court of Appeal in Attorney General's Reference (No. 2 of 1998) that the meaning of "explanation" in section 447 for the purposes of these provisions is wide.

76. An investigator should also have the right to enter onto company premises and inspect company record systems during working hours without needing a warrant. This right does not exist at present, which means that an investigator can be excluded from premises and record systems, even though a request for production of documents and records may be complied with. This restricts considerably the information available to the investigator.
77. The inspection of activities in the place of business can be a valuable source of information. For example, a claim that a person disqualified from acting as a director is not involved in the management of a company may be called into doubt if his office on company premises contains company documents and files. The law should provide a legitimate basis for observation of such arrangements, provided that this is authorised as necessary and proportionate for the purposes of the investigation. In the event of denial of the investigator's right to carry out such inspection, the law should provide for its enforcement by search warrant. It is for consideration if the exercise of this right of access in respect of a private residence where company business is carried on should always require a warrant in addition to proper authorisation.
78. The right to enter and remain on company premises would not be a power to secure entry where this was refused. This would require a search warrant. Such access should be available to an investigator provided he gives reasonable notice of the intended entry, and also a statement of the scope of the investigation as set out in the authorisation. We consider that the Competition Act 1998, which includes similar powers, provides a good precedent. Accordingly we propose that a minimum period of notice of two working days should be required. The requirement for notice should not apply if the investigator has taken all reasonable steps to give notice but has not been able to do so, or if it appears likely to the investigator that giving notice would prejudice the investigation. Waiver of the notice requirement for either reason would need to be properly authorised.
79. An investigator should have the power to access, inspect and copy the contents of any computer that is or has been in use by the company, regardless of whether that computer may have been used for other purposes than those of the company, or may contain information not related to the subject of the investigation, or information that does relate to the subject of investigation that is subject to legal professional or other privilege. The objective of this power is to extend existing powers in such a way that a requirement to disclose information could not be resisted on the grounds that any of these conditions applied. The exercise of this power would also be subject to proper authorisation.
80. Current forensic computing techniques enable a copy to be made of the entire content of a computer hard disk or other electronic storage medium. This has the advantages of facilitating searching of information and providing a strong audit trail when seeking to establish the authenticity of material presented as evidence in court. However, it also leaves the

investigator open to the objection that he/she is accessing information that is irrelevant, or relevant but protected by privilege, and this may sometimes be used as a basis for trying to resist the requirement. The requirement is however a reasonable one in current circumstances, provided it is imposed only when necessary and proportionate for the purposes of an investigation.

81. It is current experience that an investigation or inspection can be seriously delayed where the accounting or statutory records or the basic underlying records of trading activities of a company are not up-to-date. The investigator or inspector may require production of documents containing or based upon these records within a certain period, but be told that the period is unreasonable because the records are not up-to-date. We therefore intend that the power to require all relevant information should be able to be exercised in respect of information that has not yet been compiled or recorded. This could include further processing of information. This would apply not only to information that would have been recorded, compiled or processed if the company had been complying with its statutory duties to maintain records, but also to information that it was reasonable for the investigator to require, such as a list of creditors where no such list existed.
82. The investigator would require the company to provide such information within a specified reasonable period, taking account of the size of the task it represented in each case. The requirement for information to be brought up-to-date and/or compiled according to the investigator's requirements is not unreasonable. In many cases, it would merely seek adoption by the company of good business practice and, in the case of accounting records, compliance with its legal obligations.
83. Information that is subject to legal professional privilege or banking confidentiality would continue to be protected to the extent that it is at present. However, where such information was contained within the content of a computer hard disk or other electronic storage medium, and where it was impractical for this to be distinguished from other material held on that medium, the investigator would have the power to access the storage medium and copy its content in its entirety. He would then be entitled to search this material for relevant information on or away from the company premises. The company under investigation would be entitled to be represented during this search and to object to the use of any material that it considered to be privileged or irrelevant. The investigator would then have to respect that privilege and hold information securely in a way that denied any use of the privileged or confidential material, or alternatively dispute the status of the material in court. Similar provisions in relation to searches under warrant are contained in the Criminal Justice and Police Act 2001.
84. As for other aspects of the proposed powers, the exercise of powers relating to the form of assistance required should be subject to an authorisation procedure.

### ***Reporting of confidential investigations***

85. Under section 447 there is no statutory obligation to report to the Secretary of State. Similarly, there is no obligation to report on information obtained under section 444 (power to obtain information as to those interested in shares). In practice, there may be more than a single report on the outcome of an investigation, depending upon how many parties have a legitimate interest in its conclusions. There may in fact be no report at all in the conventional sense ; for example there may be just a short note of the action taken and the reason for curtailing the investigation. There is no need for any change in the legal arrangements for reporting on confidential investigations. These have been defined already as not involving publicity at the outset or when findings are available.

### **Proposed inspection powers**

86. This section of this paper, and those immediately following, examine the definition and operation of proposed powers for company inspections to succeed those that currently exist in section 432 of the Companies Act 1985. As noted above, there will continue to be a need for company inspections that are announced at the outset and undertaken with a view to the inspectors' report being made public. It is a strength of the inspection system that those appointed to carry out an inspection have considerable independence to decide how to manage their task and conduct inquiries. Inspectors appointed under section 432 have very considerable freedom to pursue inquiries as seems most fitting to them in the light of developments during the inspection.

87 Those appointed to carry out inspections in future should in all cases have available to them all of the powers that are potentially available for a confidential investigation without the need for further authorisation. In other words the subject matter of inspections under the new powers should continue to be as it is under the existing powers, with the extensions already outlined in this paper. This will ensure that inspectors on appointment have the full range of company law powers of investigation without further reference to the Department.

### ***Control of inspections***

88. The duration and cost of the inspections most recently completed is set out in Annex A. We have also estimated the extent to which inspections have been delayed by factors beyond the control of inspectors or the Department, which can be considerable. Annex A also includes details of some section 442 inspections of company ownership, which are particularly susceptible to delay. The most serious cases of delay have been caused by related criminal investigations and proceedings. The other significant cause of delay is the necessity for action in court to overcome the resistance or refusal of a witness to provide information. The Mirror Group inspection was an extreme case of delay arising from such causes.

89. There are no grounds for complacency. Protracted inspection periods tend to cast some doubt on the usefulness of the process. However, when allowance has been made for extrinsic factors and unavoidable delays, it is clear that the duration of complex company inspections is not significantly out of line with the sort of period involved in comparable activities, such as preparing complex commercial litigation, or investigating complex commercial criminal cases. The inspections that have been of most public concern and interest have involved enormous complexity, and have inevitably also been time-consuming.
90. We do not propose to subject inspections to supervision through the authorisation procedure proposed above for confidential investigations. Nevertheless, we recognise that inspections can take a long time. Experience might suggest that the proposed powers would need to allow for a greater degree of control over inspectors by the Secretary of State than is currently possible under Section 432. There might still be cases in future when inspectors take longer to pursue an inspection or wish to pursue it to greater lengths than the Department considers appropriate. There might also be reluctance on the part of inspectors to report the outcome of an inspection if they consider it incomplete. Also, it is true that some inspectors are simply more expeditious than others.
91. There are already powers in the Companies Act 1985 that allow the Secretary of State to limit the scope of some inspections (sections 442(2) and 446(2) and to give directions to inspectors to report or to take specified steps in particular circumstances (sections 437(1B) and (1C)). We have considered whether a more explicit set of powers of direction, such as those contained in section 170(7) and (8) of the Financial Services and Markets Act 2000 would be an acceptable means of controlling inspections under the Companies Acts.
92. However, we fear that stronger or more specific powers of direction would impair excessively the independence of inspectors, which is beneficial for the credibility of findings with business, and vital in any inspection perceived to have any party political dimension. Companies Act inspections serve some purposes that are different from those of regulatory inspections under the FSMA 2000. Also, the Financial Services Authority is itself a statutory body exercising responsibilities at arm's length from Government.
93. We consider that any powers to give directions to inspectors after an inspection has begun are bound to impair the independence of inspectors. The only exception is in the very specific and narrow circumstances of section 437 of the Companies Act 1985, where evidence of a criminal offence arising during the inspection has been referred to the appropriate prosecuting authority. However, this criticism cannot be made of powers to direct inspectors on appointment as to the matters that they should address.

94. We consider that it is possible at this stage only of an inspection to give directions that will not impair independence, but may serve to set helpful bounds for the inspection. It is already departmental practice to issue such guidance in the terms of appointment of inspectors in appropriate cases. It is for consideration if there would be any benefit in terms of controlling the cost and duration of the inspection in putting such guidance on a statutory basis. It is current departmental practice to maintain a close relationship with inspectors, but one that does not impair their independence, and it is intended that this practice will continue.
95. So far as the costs of inspections are concerned, these can be considerable. However, inspectors are paid at significantly reduced rates for such legal and accountancy professionals. It is not clear that the duration of inspections would be significantly reduced if we were to ask inspectors to devote themselves exclusively to their task, because there are inevitable waiting times, for example, while witnesses prepare evidence, and consult their advisers. If inspectors had no other source of income throughout an inspection it is clear that costs would have to increase very significantly. Some marginal improvement in costs below what these might otherwise be should be expected as a result of the proposal set out above.

### ***Proposed grounds for inspections***

96. The existing scope of the grounds for appointing inspectors under section 432 of the Companies Act 1985 cover a considerable range of circumstances ranging from the serious (e.g. circumstances suggesting fraud or misfeasance) to internal matters (such as members not being given all information they might reasonably expect). This scope reflects the origins of the power and its development over many decades. What normally characterises the inspection, as distinct from the confidential investigation, is that the former is a response to public disquiet, while the latter is a response to one or more specific complaints.
97. In practice, in current circumstances, inspectors are appointed usually in those cases in which suspicion of fraud or other wrongdoing is a matter of public concern. There is need for a public authority to conduct an inquiry to establish the true facts, in order that these should be in the public domain and as a basis for deciding upon any further action. The objective is to assuage public disquiet and maintain confidence in limited liability companies. It is proposed that the test of whether inspectors should be appointed in any case should be that there are circumstances suggesting that:-
- the affairs of the company are being (or have been) conducted or managed in an unlawful, dishonest, fraudulent or improper way (or for such a purpose), whether in relation to the company itself, any part of the membership or any other person ; and/or

- the company was formed for an unlawful, dishonest, fraudulent or improper purpose; and/or
- persons concerned in the formation or operation of a company have carried on unlawful, dishonest or improper conduct towards it or its members or creditors; and
- this is a matter of such public concern that it is necessary and in the public interest to do so.

98. The formulation in legislation will be for Parliamentary Counsel. Our intention would be to distil into concise form complex provisions that have come into being over a long period, and which have been successively amended and added to. We intend to re-enact only those provisions that are relevant to current practice for the appointment of inspectors. Some existing provisions that are no longer used provide for inspectors to be appointed on particular grounds. We do not propose to retain (in specific terms) the ground for inspection that a company's affairs have been conducted in a way which is unfairly prejudicial to some part of its members, or that its members have not been given all of the information about its affairs that they might reasonably expect (because these would be grounds for appointment under the criteria above –improper conduct towards members – provided these were also a matter of sufficient public concern). We also do not propose to re-enact the obligation of the Secretary of State to appoint inspectors if the court by order declares that its affairs ought to be investigated. If requests were made in future relating to such grounds for inspection, they should be treated either as a request for an inspection under the new criteria outlined above, or if they did not meet these criteria, as a request for a confidential investigation, applying the test of "good reason". It is for consideration whether the tests of necessity, proportionality and public interest referred to above should be reflected in the legislation.

99. At present section 442, which gives powers for inspectors to inquire into company ownership, requires only the grounds of "good reason" for an inspection to proceed. However, the test proposed above would be acceptable for any future inspections involving company ownership under the general powers proposed. It is reasonable to believe that inspectors would be appointed only if there were some grounds for suspicion of wrongdoing amounting at least to impropriety. If there were only uncertainty about ownership, this could be the subject of a confidential investigation. However, it would be important to ensure that an inspection that was based on unlawful, dishonest or improper conduct in other areas of company affairs could inquire into company ownership, if uncertainty about this became an issue during the conduct of inquiries.

100. Inspectors may also be appointed at present on the basis that their report will not be published, under section 432(2A). This power has been used in a few cases where wider powers were required to bring to light the facts of a case. However these powers are only available in cases that meet the current statutory grounds for appointing inspectors. If the powers for conducting confidential investigations are developed as outlined above,

there will be no need for this type of inspection in future. The changes proposed above for extending the scope of powers available for confidential investigations are based upon a harmonisation of the scope of the powers available under the existing law for investigations and inspections, so that all of the powers available to inspectors would be potentially available to investigators, subject to there being good reason to investigate and proper authorisation.

### ***Publication of inspection reports***

101. The discretion to publicise appointments and publish reports should be retained for inspections so that they can be used in cases where the Secretary of State has decided that the facts need to be in the public domain. In practice it can be difficult for the Secretary of State to be sure of getting the judgement on publication correct at the outset of an inspection. It is possible to decide finally upon the need for publication only when the report intended for publication is available. This strongly suggests that the power to publish an inspector's report should remain permissive rather than obligatory
102. Under existing arrangements any person whom it is proposed to criticise in a published report must first be given a fair opportunity to correct or contradict the allegations made against him<sup>21</sup>. This requirement is the result of case law and would continue in future unless legislated away. However the requirement is a sensible precaution and it makes good sense to keep it: it does not require the investigator to amend the report unless s/he considers the representations justified. Also, the existence of this requirement is an important safeguard for human rights. It was a significant factor in the decision of the European Court of Human Rights in *Fayed v UK* that there had been no breach of the requirement of access to a court under Article 6(1) of the ECHR.. The procedures involved can be time-consuming, even if they are carefully managed. They are always likely to delay the completion of a report somewhat, but will not be allowed to become a means for those criticised to delay this unduly.
103. It is not possible to switch the status of an inquiry from a confidential investigation to an inspection producing a publishable report. Those required to assist with an inquiry are entitled to know when they provide information on what basis it is given and they should be able to have confidence that this cannot change. If all confidential investigations were conducted in future on the basis that information provided might be included in a published report, this would seriously reduce the effectiveness of this sort of inquiry. Those required to assist would be understandably reluctant to disclose as fully as they would if information was given in confidence, and much valuable testimony offered under current arrangements on a voluntary basis would be likely to be withheld.

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<sup>21</sup> This procedure is known as "maxwellisation".

### ***Disclosure of information arising in investigations and inspections***

104. As noted above, the confidential nature of unpublicised investigations is important to maintain. It will not be in the public interest for these to be publicised, because of the risk of damage to the reputation and/or share price of the company under investigation. In cases where investigators are authorised to obtain information and documents from persons unconnected or no longer connected with the company identified in the authorisation, who do not therefore owe the company any duty of confidence, there may be an increased risk that an unpublicised investigation might become public knowledge. It is for consideration whether it should be a criminal offence for anyone to disclose the fact that an investigation is being or has been carried out: if so, there would need to be exemptions for the Department acting in the public interest, and for the company itself.
105. In the Freedom of Information White Paper of December 1997, the Government stated that it intended, where appropriate and consistent with European Community legislation, that the Freedom of Information Act 2000 (the "FOI Act") should repeal or amend the many existing statutory bars to disclosure first identified in the 1993 Open Government White Paper, bringing them into line with the harm and public interest tests now contained in the FOI Act. Exemptions under sections 22, 30, 31 and 41 of the FOI Act will apply to company investigations on a case by case basis. However, there is a concern that, without the retention of a statutory bar, those required to furnish information and provide assistance might perceive that there was not a sufficiently strict level of confidentiality and might limit the assistance given to the minimum. Without a sufficient guarantee of confidentiality, the effective operation of compulsory powers in future might be in doubt. If so, the view of officials in Company Investigations Branch would be that it should remain a criminal offence for anyone to disclose information provided under the exercise of compulsory powers of investigation (except as provided for in statutory gateways). However, no recommendation has yet been put to Ministers on this issue. At this stage we simply invite comments.
106. At present the statutory bar does not apply to information disclosed with the consent of the company, and it is for consideration as to whether this should continue to apply. It must be emphasised that this is a very limited exemption and if the exemption were retained it would remain the case that the company could not compel disclosure and any disclosure would still be subject to other considerations such as third party rights to confidentiality, would not extend to the comments and opinions of the investigators and would certainly not as is frequently falsely claimed authorise publication of "the statutory bars were retained, it would be for consideration if there should be a new statutory bar on the disclosure of information obtained by the exercise of compulsory inspection powers. This might be in line with the bar against disclosure of information obtained in confidential investigations, with limited gateways for law enforcement

and regulatory functions only, but would also need to take into account that in most cases information obtained would be made public in the inspectors' report.

### ***Standing of investigators and inspectors***

107. We propose no change in arrangements for appointing inspectors, who may be drawn from Departmental staff or from elsewhere. Considerations leading to appointment can include the availability of in-house resources, and the need for specialist knowledge. Also, it remains true that where an individual under investigation is associated with, or opposed to, the Government of the day, an external appointment may offer assurance that no conflict of interest will be permitted.

### ***Enforcement and sanctions: investigations and inspections***

108. Where a requirement to provide assistance relating to provision of information or material was not complied with, there would be powers to obtain a search warrant. The grounds for seeking a search warrant would be largely unchanged from the present law, including the provisions of the Criminal Justice and Police Act 2001 for information held on a computer hard disk or other electronic medium. Refusal on the part of the company or its officers, servants and agents to allow access to relevant information or other material held on computer, on any grounds, would provide grounds for application for a search warrant allowing material to be seized and searched elsewhere than on the company premises. The safeguards for privileged material outlined previously would also apply in these circumstances. As at present we would expect that the use of search warrants would be a rare last resort.

109. Non-compliance with the requirements under the new powers should be subject to a certification procedure, similar to that already in existence in section 436 in relation to section 432 inspections, whereby the investigator or inspector would notify the civil court of instances of non-compliance with his requirements. This would allow for non-compliance to be considered by the court, which can punish non-compliance as contempt of court.

110. This would be in place of the criminal sanction for investigations currently provided for by section 447(6). This form of enforcement is preferable to criminal sanctions because it provides a means of overcoming unreasonable non-compliance effectively and thus ensures that an investigation can proceed. Existing powers of this sort are used for this purpose. Criminal sanctions for non-compliance are in practice rarely invoked. The Company Law Review has accepted in principle that there should continue to be a criminal penalty for not keeping adequate accounting records. In the event that a company and its officers did not comply with a requirement to bring its information up to date or provide

information in a required form, the power to certify failure to comply to the court would also be available.

111. There would also be a need to retain powers as currently contained in section 445 of the 1985 Act to impose restrictions on shares in cases of difficulty in finding out relevant facts about any shares. We invite views on the retention of criminal penalties for failure to disclose information about interests in shares to an investigator (as at present in section 444 CA1985).
112. Criminal sanctions assist the progress of an investigation where they have a deterrent effect and therefore constitute a real incentive to compliance. Criminal sanctions akin to those contained in sections 450 and 451 relating to the destruction, mutilation or falsification of evidence or provision of false information would be retained, and extended to apply to all investigations and inspections. Section 450 might benefit from recasting so that it clearly targets information and other material that may be demanded or have been demanded by investigators.
113. At present inspectors may examine witnesses on oath but investigators may not. We consider that it will remain appropriate for inspectors to continue to be able to do so in future. This is the normal basis on which evidence is given during an inspection, and it accords with the nature of the inspection as a form of inquiry leading to a published report that evidence should be given on this basis. However, there are also instances during investigations when there might be advantage in taking evidence on oath if this were possible. This might be, for example, if evidence was being taken from an individual with a known history of perjury or other dishonesty. It is for consideration whether to make the power to examine on oath available to both investigators and inspectors. In the case of investigators this might be used only where properly authorised as being necessary and appropriate for the purposes of the investigation.

#### ***Proposed “pathfinder” power to require information***

114. In addition to the powers of investigation outlined above, there would be advantage in providing a “pathfinder” power for the Secretary of State to require reasonable information about the conduct of a company’s affairs, with a reciprocal duty on the company and its officers to provide it. The objective would not be to move towards a more regulatory role towards companies in general. Rather, this power would be confined to the purpose of establishing whether or not to investigate.
115. This would allow the Department to consider complaints that might be resolved without resort to full investigation. There are already cases in which some contact occurs with the company and/or its advisers as part of vetting a case. At present, any information provided as a result is on a voluntary basis, without statutory backing. While the possible threat of investigation means that most companies are willing to assist, there are some that refuse. The “pathfinder” power would be exercisable where the

Secretary of State considers it necessary to do so in order to enable her to decide whether to appoint inspectors or investigators or to facilitate the making of such a decision.

### ***Assistance to overseas regulators***

116. The existing powers to assist an overseas regulator under sections 82 to 91 of the Companies Act 1989 should be restated in new legislation with such amendments as are needed to bring them into line with the revised powers of investigation. This should ensure that other deficiencies, such as the lack of provision for requirements to be complied with immediately (or “forthwith”) are addressed. The powers would remain discretionary rather than compulsory, and so it would be a matter for judgement whether to provide assistance in any particular case.

### ***Protection of the public interest – existing follow up powers***

117. The remainder of this paper considers the provision of powers to follow up inspections and investigations. Both section 432 inspections and section 447 investigations may lead to a variety of follow-up actions. Findings will be referred for further investigation to prosecutors in DTI or elsewhere, where there appear to be criminal offence(s). Statutory gateways exist (as exceptions to statutory and common law bars to disclosure) which allow information to be passed to other regulators and Government Departments. Investigations can also provide a basis for further action by the Secretary of State in the civil court to seek the winding up of a company or disqualification of a director, where she considers that there is evidence that this would be in the public interest. This review has considered the effectiveness of the current arrangements for such follow up action.

118. The existing powers of the Secretary of State to petition the court for the winding up of a company or the disqualification of a director in the public interest, on the basis of the findings of investigations and inspections, are powerful weapons for putting an end to undesirable activities. They have proved to be some of the most effective powers available for protecting creditors and consumers. If it were left to private parties to resolve private conflicts of interest in the conduct of company affairs, this would not provide a satisfactory resolution of all instances of misconduct. There is a continuing need for such powers to safeguard the wider public interest and we propose to retain them.

119. The current powers normally invoked are the issuing of a petition to wind-up the company concerned under section 124A Insolvency Act 1986, and/or an application to disqualify a director of the company under section 8 of the Company Directors Disqualification Act 1986. This provides a means for bringing to an end any case in which there is a significant risk of detriment to the general public. If there is a criticism to be made of the power to seek the winding up of a company it may be that it is a blunt

instrument that destroys any good that may coexist within the company alongside the bad.

### ***Proposed restraint orders***

120. The Department seeks to minimise the interference with company rights and property resulting from action that is justified in the wider public interest. It is for consideration if, in cases where there was a business worth salvaging, it would be beneficial for the Secretary of State to have the option of seeking an order from the court restraining the company from engaging in a specified business activity or carrying on all or part of its business in a specified way. This could provide the Secretary of State and the court with an alternative to winding up, and thereby help to ensure that any action was proportionate to the circumstances of the case. We therefore invite views on a possible new power of the Secretary of State to seek a court order restraining the conduct of company affairs, where this is expedient or necessary in the public interest. As with winding up, the court would have to decide whether such an order would be just and equitable
121. A restraining order might have the potential to become an effective method of getting a company to mend its ways, instead of bringing about its demise. This form of “corporate rehabilitation” could take the place of a winding up order in a significant minority of cases where under existing powers the only action available might be winding up but where this might be disproportionate. On the other hand, it may be that enforcement would prove difficult. However, it is not the intention to place the continuing business under supervision. The objective would be to safeguard the legitimate business of the company while curtailing the detrimental conduct and to try to promote the preservation of that part of the business of the company under all or part of its previous management. It would not therefore make sense to ask the court to appoint a receiver to administer the running of the company.
122. The next step available to the Secretary of State would be to seek a winding up order, and so there would be considerable incentive for the remaining management of the company to comply with the terms of the restraining order. If there were a need for additional assurance as to compliance, the appointment by the company of an additional director (or directors) with the approval of the court, rather than the appointment of an independent supervisor could provide such assurance. This would help to strengthen the management of the company and thereby help to promote its continuation. Some may be sceptical that an additional director could be found to fill such a need, but this would depend on the circumstances of each case
123. A restraining order would clearly be most appropriate as an alternative to a winding up order where there was likely to be a viable business left after the end of the detrimental conduct, and where there was full acceptance by the remaining management of the imposition of the order. It is for debate whether the Secretary of State should also be empowered to

accept undertakings as an alternative to seeking a court order, in those cases where there were sufficient grounds for confidence that these would be fulfilled. This would avoid the need for court proceedings, and would therefore reduce potential company costs but raises difficult questions of monitoring and enforcement.

### ***Directors under restraining orders applying to companies***

124. For a restraining order to be effective it would need to bind individual directors including shadow directors of a company, as well as the company itself. Otherwise, it would be open to the directors to carry on the conduct by a means other than the company.

125. Much of the analysis set out above in respect of winding up a company applies also to an application to disqualify a director following the investigation of a company (under section 8 of the Companies Directors Disqualification Act 1986). This too is a very powerful weapon against wrongdoing and experience suggests that there could be cases in which a less severe restriction might be appropriate.

126. We therefore invite views on whether the Secretary of State should have the power to seek an order of the court removing a person from office as a director (preventing him also acting as shadow director) of a particular company (only), as part of a restraining order imposing conditions upon that company's trading. This would be useful where it could be shown that a particular director of a company was largely responsible for the particular conduct of a company that was detrimental to the public interest. Such a restriction would be less severe than disqualification and might apply in cases where it would be disproportionate to seek the disqualification of the director. Again this would involve a more challenging assessment than is required of the Department when it assesses the case for seeking a disqualification on public interest grounds. We are particularly interested to have views on whether others can identify a category of conduct that would justify the dismissal of a director from his current employment, but fall short of being grounds for disqualification to act as a director. It may be that this is a logical but not a practical proposition.

127. We also invite views on whether it would be desirable that a new restraining power should also separately apply to activities of those who had previously been directors of a company subject to a restraining order. Thus it would be available to restrict the activities of a director who had been required to give up office under a restraining order applying to a company. It could extend the restriction on the objectionable conduct to that former director, whether acting in future as a director of another company or as a sole proprietor, if the consequent risk to the public would be unacceptably large. This might offer an additional means of addressing the problem of undesirable "phoenix company" practices.

128. In many cases disqualification will remain the most appropriate course to pursue. There may also be cases in which disqualification was not enough in itself to prevent any prospect of a repetition of detrimental conduct, and in which the Secretary of State would want to pursue disqualification and a restraining order.

### ***Enforcement***

129. While some restraining orders might be made in cases where there were reasonable grounds for believing that the company would comply with the terms of the order, there would be others where this did not apply. As already outlined, the appointment of suitable additional directors might be a device for improving the prospects of successful compliance. In some cases compliance of the company might be in doubt, but there might be insufficient grounds for seeking winding up or disqualification. We propose a range of sanctions to maximise deterrence against non-compliance. First, breach of an order would be punishable by the court as contempt of court. We would also make a breach grounds for winding up or disqualification, thus increasing the likelihood that a non-compliant company would be wound up and/or its directors disqualified. In addition we propose that any director or other company officer responsible for a breach of an order should be made personally liable for the debts of the company, as applies under section 15 of the CDDA 1986 to persons who act while disqualified.

### ***Publicity***

130. If this idea were implemented, it is for consideration if there should be appropriate publicity for an order. While this might assist enforcement, it equally might put at risk the survival of the company. In order to warn potential creditors, particularly in the case of interim orders, the Department could place a notice on the company's file at Companies House alerting potential creditors to the making of a restraining order and its terms, including the names of any past or present directors or shadow directors included in the order, or a related order. There might also be a separate register of such orders held at Companies House and available for public inspection, along the lines of the existing register of disqualifications and other legislation. This might be in addition to appropriate publicity for an order and a requirement for the company to include on company documents and stationery a statement that it was subject to a current order under the relevant statutory power and describing the effect of the order.

### ***Interim orders***

131. There has been criticism of the time taken to complete investigations and obtain the appointment of a provisional liquidator or a winding up order against a company. It is therefore open for consideration whether or not a process for interim relief should be made available, e.g. where early

in an investigation it becomes apparent that a company should be restrained from conducting a specific activity, but that some time will elapse before the investigation can be concluded, or where there is a perceived need to prevent a company from carrying out a specific action such as issuing a catalogue or seeking further investment funds from clients for an investment scheme which is seen to be objectionable. Any suggestions as to the method through which this can be achieved, or comments relating to this concept would be greatly appreciated..

### ***Consumer protection***

132. The Government is determined to deal with the rogue trader and to improve the general protection of consumers. The current test of the public interest that applies as a basis for winding up a company or disqualification of a director already has the potential to take account of consumer detriment. The test of “good reason” for embarking upon an investigation under section 447 is similarly capable of embracing consumer detriment.
133. The Department has frequently investigated and taken enforcement action in cases giving rise to consumer detriment, using existing company law and related powers. Cases in the past have involved for example pyramid selling schemes, timeshares, franchises, and ostrich farms. The effectiveness of action in these cases has been considerable and has derived principally from the power to petition for winding up, or disqualification, in the public interest. Such cases typically include allegations of fraudulent trading, but it may be difficult to prove this to the criminal standard.
134. The new restraint order power would similarly take its place alongside the new consumer protection “stop now” powers, and would apply to all conduct of all companies. It would be available in cases involving consumer detriment, and others too. This proposed new power would ensure that company law powers developed in a way that was consistent and coherent with developments in consumer protection law
135. It is for consideration. if company law and consumer protection law needs to be amended to allow disclosure of information between CIB and trading standards authorities for the purposes of action under civil powers.

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## S432 INSPECTION CASES

## ANNEX A

SUBJECT	TOTAL COST (£)	DATE APPOINTED	DATE COMPLETED	DATE FINAL REPORT PUBLISHED	PERIOD FROM APPOINTMENT TO REPORT PUBLICATION	ESTIMATED PERIOD INSPECTION DELAYED	REASON FOR DELAY
<b>Mirror Group Newspapers Plc</b>	<b>9,637,686</b>	<b>08/06/92</b>	<b>05/03/01</b>	<b>30/3/01</b>	<b>8Y 10M</b>	<b>4Y 10M</b>	<b>(1) The criminal trials by the SFO (about 16 months delay) and (2) inability to obtain evidence from witness and related certification proceedings (about 3½ years delay).</b>
<b>Chancery Plc</b>	<b>696,047</b>	<b>05/08/93</b>	<b>30/09/98</b>	<b>17/12/98</b>	<b>5Y 4M</b>	<b>1Y</b>	<b>Maxwellisation delayed due to the illness of one of the principal directors criticised.</b>
<b>Guinness Plc</b>	<b>3,206,309</b>	<b>28/11/86</b>	<b>21/07/97</b>	<b>27/11/97</b>	<b>13Y</b>	<b>6Y 6M</b>	<b>Interim report on 24 November 1988. Completion of investigation then delayed by SFO investigations and subsequent trials and appeal hearings from Feb 1990 to Nov 1995. ECHR Article 6 proceedings re Ernest Saunders 1988-1996.</b>
<b>Barlow Clowes Gilt Managers Ltd James Ferguson Holdings Plc</b>	<b>6,435,728</b>	<b>04/07/88 10/06/88</b>	<b>28/03/95</b>	<b>06/07/95</b>	<b>7Y</b>	<b>2Y</b>	<b>Principal delay of 2 years due to SFO prosecution and consequent inability to interview defendants. Also difficulties in obtaining information from Switzerland [procedures now different].</b>

SUBJECT	TOTAL COST (£)	DATE APPOINTED	DATE COMPLETED	DATE FINAL REPORT PUBLISHED	PERIOD FROM APPOINTMENT TO REPORT PUBLICATION	ESTIMATED PERIOD INSPECTION DELAYED	REASON FOR DELAY
Atlantic Computer Systems Plc Atlantic Computers Plc	6,609,377	15/06/90	22/04/94	21/07/94	4Y 1M	NONE	Large and complex case: no delay quoted by inspectors.
The Bestwood Plc Atlanta Fund Managers Ltd	2,726,067	23/06/89	26/03/91	20/01/94	4Y 7M	2Y 8M	Delay of 2½ years between completion and publication due to SFO prosecution. A witness going missing caused a further 2 month delay.
London United Investments Plc C R Driver & Co Ltd (in liquidation)	2,284,093	31/10/90 02/11/90 22/01/92	27/07/93	01/09/93	2Y 10M	NONE	No delay mentioned by inspectors although witnesses spread world-wide. Interim information on criminal offences to SoS on 3 occasions prior to report.
Astra Holdings Plc	2,360,845	16/08/90	07/04/93	17/06/93	2Y 10M	3M	Related enquiries by LJ Scott may account for overall delay of about 3 months.
National Westminster Bank Plc	2,578,703	12/03/92	01/12/92	14/01/93	10M	NONE	
Norton Group Plc	997,982	07/01/91	30/11/92	11/03/93	2Y 2M	NONE	There was a SFO prosecution but inspectors mention no delay in their report. No delay in publication.
Edencorp Leisure Plc	14,222	09/10/91	07/10/92	18/02/93	1Y 4M	NONE	

SUBJECT	TOTAL COST (£)	DATE APPOINTED	DATE COMPLETED	DATE FINAL REPORT PUBLISHED	PERIOD FROM APPOINTMENT TO REPORT PUBLICATION	ESTIMATED PERIOD INSPECTION DELAYED	REASON FOR DELAY
Blue Arrow Plc	3,581,457	26/05/89	04/06/91	24/09/92	3Y 4M	1Y	Delay in publication due to SFO prosecution.
BOM Holdings Plc	1,185,341	06/02/90	02/08/91	27/02/92	2Y 1M	NONE	
The Milford Docks Company	626,531	30/06/89	30/09/91	16/01/92	2Y 6M	NONE	
Rotaprint Plc	864,453	16/08/88	08/03/91	24/07/91	2Y 11M	NONE	
Sound Diffusion Plc	987,681	09/03/89	25/02/91	01/05/91	2Y 2M	NONE	
The Animal Defence Society Ltd	56,109	20/11/87	31/12/89	17/04/91	3Y 4M	1Y 3m	Delay in publication due to DTI prosecution.
Aldermanbury Trust Plc	971,660	01/09/88	11/12/90	20/03/91	2Y 7M	NONE	
House of Fraser Holdings Plc	1,512,504	09/04/87	23/07/88	07/03/90	2Y 11M	1Y 6M	Publication delayed by SFO investigation 1988-1990.

**SECTION 442 INSPECTION CASES**

<b>SUBJECT</b>	<b>TOTAL COST (GROSS)</b>	<b>DATE APPOINTED</b>	<b>DATE COMPLETED</b>	<b>DATE FINAL REPORT PUBLISHED</b>	<b>PERIOD FROM APPOINTMENT TO FINAL REPORT</b>	<b>ESTIMATED PERIOD INSPECTION DELAYED</b>	<b>REASON FOR DELAY</b>
<b>Consolidated Gold Fields Plc</b>	<b>3,799,000</b>	<b>20/10/88</b>	<b>30/03/94</b>	<b>29/09/94</b>	<b>5Y 11M</b>	<b>1Y 6M</b>	<b>A large number of investors in many jurisdictions. Substantial amount of painstaking reconstruction work and extensive use of computer technology required to establish trading patterns and discover the connections. Contemporaneous s177 FSA (insider dealing) investigation delayed matters. Interim reports to MMC (Jan 89) TO Panel (Apr 89).</b>
<b>James Neill Holdings Plc Francis Industries Ltd F H Lloyd Holdings Plc The Mersey Docks and Harbour Company Metal Closures Group plc Winchmore plc</b>	<b>254,000</b>	<b>22/07/88</b>	<b>01/10/92</b>	<b>21/01/93</b>	<b>4Y 6M</b>	<b>NONE</b>	
<b>Wace UK Holdings Limited European Colour Plc Tinsley Robor Plc</b>	<b>Minimal</b>	<b>21/02/92</b>	<b>21/06/00</b>	<b>31/08/00</b>	<b>8Y 4M</b>	<b>2Y</b>	<b>(1) Enquiries outside jurisdiction (2) Non-co-operation from key witnesses</b>