

To Our Clients:

English Company Law Reform Proposals

A White Paper issued on July 25, 1973 contains proposals for fundamental changes in the English Company Law. The main theme is to implement the concept that corporations have social responsibilities to employees and the public at large that temper the basic profit-making purpose. A number of specific proposals are designed to assure corporate integrity and full disclosure so as to maintain public confidence in the free enterprise system.

Social Responsibilities. The White Paper accepts the basic profit-making purpose of corporations. It reaffirms the social desirability of the free enterprise system which enables capital to be accumulated and invested in risk-taking corporations, which create economic expansion, provide jobs and produce goods and services. However, it points out that a corporation must behave as a responsible part of society and the directors must reconcile the main profitability objective with responsibility to employees and the public. The White Paper notes that in addition to specific proscriptions against such public matters as fraud, monopolization and pollution and regulation of such internal matters as severance pay and financial reporting, corporations have a more general and moral kind of social responsibility which is difficult to define and cannot be translated into specific laws. Several suggestions are put forward.

A Code of Conduct with some external sanction is suggested, modeled in part on the City Code on Take-Overs which is administered by a self-regulatory agency, the City Take-Over Panel. To protect directors against possible shareholder claims, it is suggested that corporations add to their charters a provision allowing directors to take social responsibility into account when exercising business judgment. In addition it is suggested that corporations be required to include in their annual reports information on specific aspects of their response to the social environment. Disclosure is viewed as a major part of the enforcement of corporate social responsibility.

The details of increased employee participation in corporate affairs is left to a separate recommendation to be published later this year. The trend is clearly in the direction of greater employee participation. "The role of the employees in the conduct of the company's affairs is a matter to which the Government attach the greatest importance and which they have under urgent examination. The Government believe that it is in the interests of all concerned, including those who provide the capital, that the employees should have an appropriate opportunity of influencing decisions which can closely affect their own interest."

Shareholder Responsibility. The White Paper rejects the two-tier board of directors (a supervisory board representing the shareholders over a management board) in use on the continent as being more suited to the continental pattern of large public companies being closely tied to financial institutions, than the English public ownership pattern which is similar to that in the United States. The White Paper notes the role of the outside director and it is indicated that consideration is being given to requiring that all public corporations have outside directors on their boards.

Institutional Investors. The concentration of institutional ownership of the larger public companies in England has been parallel to the experience in the United States. The White Paper notes the situation but does not propose any special responsibilities for institutional investors in relationship to their portfolio companies. There is a suggestion that responsibility to deal with mismanagement or poor management, rather than merely sell out, should be an obligation of institutional investors.

Disclosure. The White Paper embraces disclosure as an essential part of the working of a free and fair economic system. "Obviously there are limits--imposed for example, by the need to preserve commercial confidentiality in a competitive situation. But the bias must always be towards disclosure, with the burden of proof thrown on those who defend secrecy. The more people can see what is actually happening, the less likely they are to harbour general suspicions-- and the less opportunity there is for concealing improper or even criminal activities. Openness in company affairs is the first principle in securing responsible behaviour."

The directors' report to the shareholders, the English equivalent of our annual report, is to be expanded. The

White Paper sets forth a number of specific proposals. "As possible examples of further disclosure in the directors' report, the directors may be required to report on the performance of their company in regard to the safety and health of the company's employees, on the number of consumer complaints and how they were dealt with and on the conduct of industrial relations. The directors will be required to include in their report certain particulars of their own contracts of service; of their other interests; of any dealings they have in the company's shares; and of transactions by the company and other companies in which they have any significant interest. . . . It may also be desirable to require the directors to disclose, more fully than is now the case, details of significant material acquisitions, realizations and contracts since the previous year." The NYSE is presently considering similar proposals in a soon to be issued white paper.

Inside Information. The White Paper shows that England is having the same problems of insider trading abuses that we are having. The present method of dealing with insider trading, through the rules of the Stock Exchange, and in tender offers, the Take-Over Panel, is to be supplemented by both civil and criminal liability. The proposal treats nonpublic market information - such as an intended take-over bid - the same as inside corporate information. This issue is still unsettled in the United States, with the SEC presently seeking comment and preparing rule proposals. The White Paper describes the underlying principles of the legislation as follows: "The object of legislation on insider dealing must be to ensure that anyone who is in possession of information which would be likely, if generally known, to have a material effect on the price of the relevant securities refrains from dealing until the material has properly been made generally available. . . . [D]ealing in a company's securities by anyone who, by reason of his relationship with the Company or with its officers, has information which he knows to be price sensitive, should be a criminal offence unless he can show that his primary intention in dealing at that particular time was not to make a profit or avoid a loss."

The present 14 day period for directors to report transactions in their companies' shares is to be shortened to the "shortest practicable period" and the Stock Exchange will make immediate public disclosure of the reports.

Take-Over Bids. England is experiencing the same problems as we are under the Williams Act with respect

to creeping tender offers and warehousing. In addition to strengthening the insider trading rules, the creeping tender offer problem will be attacked by lowering the reporting threshold, now 10%, to not more than 5% and probably 3%. The report will be due in the shortest practicable time after the threshold ownership is reached. To reach the warehousing problem it is proposed that corporations which have reason to fear a take-over bid, or that a warehousing situation may be developing, have the right to require nominee holders to disclose the identity of the beneficial owners of the corporations' securities.

Multinationals. Multinational companies operating in England are to be made subject to substantially the same disclosure requirements applicable to English companies.

Directors Fiduciary Duties and Qualifications. The White Paper proposes a statutory restatement of a director's fiduciary duty to his corporation. In addition, to meet the conflict of interest problem, it is proposed that insider transactions be divided into those that can be dealt with through full disclosure and shareholder approval and those which are absolutely proscribed.

The Companies Act of 1948 empowers the court to disqualify a person for up to five years from being a director, or concerned in the management, of any company, if he is convicted of any criminal offence connected with promotion, management or liquidation of a company. The White Paper proposes to broaden director disqualification to conviction of any offence involving fraud or dishonesty whether or not in connection with a company, persistent default in complying with the Companies Acts, or improper or reckless action in connection with the affairs of a company. Disqualification for incompetence was rejected on the ground that it cannot be easily defined in law or readily determined by a court.

Other Matters. The White Paper covers a number of other proposals and matters under consideration. Timely reporting is to be enforced strongly. Minority shareholder actions are to be made more widely available. Under consideration is a suggestion to distinguish more clearly between private and public corporations with only the latter subject to the full disclosure requirements. Public corporations would have to have minimum paid up capital of \$25,000 and there would be a new "small man" form of incorporation stopping short of limited liability.

Also under consideration are whether to liberalize the existing restrictions on a corporation lending money for the purchase of its shares and prohibiting limited voting or nonvoting shares.

M. Lipton