



# **Modernising Company Law: Response to the White Paper**

**Local Authority Pension Fund Forum**

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### **1. Introduction**

The Local Authority Pension Fund Forum brings together 25 public sector pension funds with combined assets in excess of £40 billion. The Forum's mission statement is to 'promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest, commensurate with statutory regulations.'

With this focus on the collective use of shareholder rights and on social responsibility and governance, the Forum has taken a close interest in the work of the Company Law Review and is supportive of new legislation on the issues raised by the Review.

We base our comments on issues where we have particular experience as practitioners within the current legal framework.

### **2. Summary of main responses**

- The Forum supports a more integrated approach to OFR content that ensures consistent reporting on both performance and stakeholder issues on a mandatory basis.

- The Forum supports discussion of the concept of an independent Companies Commission charged with bringing together the various company regulatory functions, and determining detailed rule making.

- The Forum supports the extension of notice periods for general meetings from their current levels rather than seeing them reduced.

- The Forum strongly considers that ownership thresholds for the requisition of shareholder resolutions should be lowered significantly.

- The Forum considers that companies should bear the costs of circulating any shareholder resolution properly submitted.

- The Forum supports the view that all voting at company general meetings should be by poll rather than by show of hands.

- The Forum supports the view that companies should be required to recognise persons other than registered holders as being entitled to exercise voting rights.

- The Forum supports the view that all shareholders acting in a fiduciary capacity should be required to report to their clients or beneficiaries on how they have exercised their voting rights.

### **3. Directors' duties**

The Forum notes that a further consultation on the detail of the draft statement of directors' duties is expected. Pending this, we support the approach outlined in terms of the general duties. However, we are of the opinion that there should be a legal distinction between the roles of executive and non-executive directors. There are clearly differences in knowledge, experience and function between an executive and a non-executive director that affect their roles and responsibilities. While it might be argued that the way these differences may impinge in liability are dealt with in the proposed clauses on 'care, skill and diligence', we think that a separate codification of non-executives' duties would be helpful.

We note the CLR proposed that directors should be required to sign the statement of duties, as a way of underlining to directors the seriousness of their duties, though signature would have no legal implications. The White Paper rejects this in favour of sending new directors a leaflet explaining their duties. The Forum supports the CLR's previous position.

### **4. Company reporting**

The Forum welcomes the government's support for the introduction of a requirement for an Operating and Financial Review (OFR). We support the concept that detailed rules about the content of the OFR should be made by the Standards Board. It is important that issues of content can be reviewed and amended regularly in the light of experience.

We note the distinction between the 'core' elements and the issues, which must be considered. A key problem is how to ensure that the non-mandatory items are given full consideration by directors, in other words how to ensure that directors properly consider their materiality in order to produce an objective OFR.

We consider that there is a real danger that this distinction between compulsory and non-compulsory OFR items could lead to under-reporting of important reputational and stakeholder issues, as is the case now, leading to lack of consistency and comparability. We consider that the Bill should contain an integrated list of OFR items required for inclusion.

An omission is that corporate governance structures are currently not cited as either a compulsory or non-compulsory item.

## **5. Rule-making bodies**

The Forum considers there is a case for reviewing whether a self-regulatory approach in relation both to rule-making and enforcement is adequate. Specifically, we believe that consideration should be given to the need for an independent 'companies regulator' at least for listed and large private companies. It should be noted that in other markets (the USA for example), these functions are carried out by a statutory agency (the Securities and Exchange Commission) and are not left to self-regulation.

We recognise that this would constitute a major departure from present and proposed arrangements. However, we believe that the level of public concern about company regulation, the potential adverse impact of inadequate regulation on the economy, and the complexity of current regulatory structures with responsibility split between DTI, FRC, FSA and various self-regulatory bodies, provide powerful arguments in favour of a fundamental rethink about the structure and objectivity of regulatory structures.

A further argument for this is that the White Paper is rejecting the CLR's proposal for a statutory Company Law Review Commission, charged with keeping company law under review and with whom the Secretary of State would be obliged to consult. The proposal that the FRC will continue to offer advice on company law changes is a retrograde move as it appears to leave both high-level review and detailed rule-making in the hands of a self-regulatory body, albeit part-funded by the government.

## **6. AGMs: notice periods**

It is recommended that the notice period for an AGM or EGM be reduced to 14 days, from the current statutory period of 21 days for an AGM. Although we assume that listed companies will still have to give 20 working days notice in order to comply with the Combined Code, this is not a statutory requirement. We therefore consider that the reduction in statutory notice period is potentially detrimental to shareholder interests in providing inadequate time for consideration of proposals and exercise of voting.

We support the proposal for early web-based reporting and the 15 day 'window' before publication of the notice of meeting, allowing for the submission of shareholder resolutions based on the accounts. To retain the current statutory notice period, or ideally, extend it, would not overly delay AGMs.

## **7. AGMs: voting**

We welcome the fact that the White Paper has gone beyond the CLR in proposing a right to demand scrutiny of a poll at any resolution, rather than just shareholder resolutions.

However, scrutiny will only be possible if backed by sufficient shareholders to meet the same thresholds as are currently required to requisition a shareholder resolution (i.e. 5% of the shares or 100 shareholders with £10,000 nominal capital). Thus it would be impossible for a significant shareholder who believed there to be grounds for an enquiry to demand scrutiny. For example, a notifiable holder with 3% would be so prevented.

Additionally, as the White Paper makes no recommendations on moving to poll voting for all resolutions, the number of resolutions open to scrutiny would anyway be extremely limited since most resolutions are passed on a show of hands only.

We recommend that the numbers of shareholders required to demand a scrutineer's report should be lowered in line with the Forum's proposal for lowering the shareholder resolution threshold (see below).

## **8. Shareholder resolutions**

We note that the White Paper endorses the CLR's view that ownership thresholds for submitting a shareholder resolution should remain unchanged. The Forum has argued before that these thresholds act as a major barrier to the legitimate exercise of a fundamental shareholder right. The difficulties experienced by shareholders in submitting resolutions undermine accountability to shareholders and is a major failing of the current AGM system.

We consider that the thresholds should be set at a level that enables responsible shareholders with a significant financial commitment to the company to put resolutions for debate, while still inhibiting frivolous or opportunistic use of the resolution process.

We suggest a more democratic level would be to allow resolutions to be put by EITHER any single shareholder with 1% or more of the shares OR a group of 10 or more individual shareholders holding in aggregate 0.1% or more of the company's shares, all such shares to have been held for a period of at least one year.

We would also draw attention to an apparent discrepancy between the White Paper that states that the company should bear the costs of circulating any shareholder resolutions received before the circulation of the notice of meeting,

and the draft Bill which suggest that shareholders are liable for the costs of circulation, as at present. We are strongly of the view that the company should bear the costs of circulating any shareholder resolution properly submitted.

## **9. Institutional investors**

We note that the White Paper discusses the issues raised by the CLR surrounding the potential conflicts of interest affecting the exercise of voting rights by institutional investors, and shortcomings in the proxy voting process. However, it leaves the former to the Myners process, and makes no recommendations on the latter.

We believe the current framework of accountability for institutional investors to their clients is inadequate and that the tools available to investors as part of the proxy process need reform.

In order to facilitate a more effective operation of the proxy process, we recommend that

- all voting should be by poll rather than by show of hands,
- there should be a requirement on companies to recognise persons other than registered holders as being entitled to exercise voting rights,
- all shareholders acting in a fiduciary capacity should be required to report to their clients or beneficiaries how they have exercised their voting rights.

We hope these comments are useful.