

THE CITY OF LONDON LAW SOCIETY

COMPANY LAW SUB-COMMITTEE

**Minutes of the 227th meeting held at 1p.m. on Tuesday 27 March, 2007
at Slaughter and May, One Bunhill Row, EC1Y 8YY**

1. Introduction and apologies for absence

Apologies for absence were received from Neal Watson, Victoria Younghusband, Eileen Kelliher, Mark Curtis, Simon Jay and Christopher Pearson. It was noted that alternates attending were: Oliver Barnes (for Neal Watson), Tom Nicholls (Victoria Younghusband) and Paul Crook (Eileen Kelliher).

2. Approval of minutes

The minutes of the 226th meeting would be circulated for approval with the minutes of this meeting.

3. Matters Arising

3.1 Companies Act

Items 3.1(A) – (F) of the agenda were noted.

It was noted that the Davies Review (referred to at item 3.1(G) of the agenda) had been published on 26 March 2007 and that the consultation period closes on 27 April 2007. It was agreed to establish a working group to review and prepare a submission on the review. Members were asked to contact the Secretary if they wished to participate in the working party.

The Sub-Committee also noted the proposed wording from the DTI in relation to financial assistance (the principles of which had been discussed at the 226th meeting). The Sub-Committee agreed that the wording could benefit from further clarification. It was understood that the Law Society's Company Law Committee were reviewing this.

It was proposed that the Sub-Committee could usefully look at some of the practical issues arising from the change of law on financial assistance, in particular ways in which borrowers might address lenders' concerns regarding financial assistance. The Chairman agreed to contact the Banking Sub-Committee to propose establishing a joint working party to look at these points. Members were asked to contact the Secretary if they wished to participate in the working party.

Members were also of the view that it would be helpful to seek to establish a dialogue with the ABI in relation to the Companies Act 2006, in particular issues such as authorised share capital, e-communications and auditors' liability. It was noted that both

the ABI and PIRC had commented on the level of disclosure that they would expect in relation to transactions; these go beyond legislative and regulatory requirements. It was further noted that, if companies adopted these higher standards as common practice, law firms may wish to reconsider the carve outs included in confidentiality agreements/clauses, extending the usual carve out for legal and regulatory requirements to include language permitting disclosure to comply with market practice.

3.2 Prospectus Regulation

Items 3.2(A) – (E) of the agenda were noted.

3.3 Investment companies and ‘directive minimum’ listings

Items 3.3(A) and (B) of the agenda were noted.

3.4 Transparency Directive

Members noted the adoption and publication in the Official Journal of the final implementing measures of the Transparency Directive and agreed to discuss the matter at the next meeting of the Sub-Committee.

3.5 AIM Rules

Item 3.5 of the agenda was noted.

3.6 Shareholder Voting Rights

The European Parliament’s response to the Commission’s proposed Directive on Shareholder Voting Rights was noted. It was noted, in particular, that the European Parliament had addressed a number of the problems on the text of the proposed directive which had been identified by the Sub-Committee, including in relation to numbers of proxies. It was further noted that the European Parliament adopted text provides that the notice period for general meetings will generally be 21 days. Companies which provide for electronic voting by members may decide that extraordinary general meetings may be called on 14 days’ notice. This must be an annual authority given to the company by shareholders by at least two thirds majority vote.

4. New matters to be raised or reported

The Sub-Committee noted that the Takeovers Committee would review the DTI consultation on cross-border mergers (item 4.1 of the agenda) and agreed that it would not prepare submissions in relation to any of the DTI consultations on:

- implementation of the Directive on Company Reporting;

- implementation of the Directive on Statutory Audits of Annual and Consolidated Accounts;
- implementation of Amendments to the Second Company Law Directive,

or the European Commission's proposal to simplify the Third and Sixth Company Law Directives concerning mergers and divisions of public limited liability companies.

5. Discussions

5.1 Codification of Directors' Duties

The Chairman led a discussion on the codification of directors' duties, using the GC 100 paper prepared on this topic as a basis for the discussions.

It was noted that the GC 100 paper was, in part, based on papers produced by the Law Society about a year previously. It was further noted that the GC 100 had invited approval of the document but was not inviting comments. The Law Society was considering the terms of its response and the Sub-Committee may wish to do likewise. The Sub-Committee noted that the paper was a useful contribution to the debate, even if there were certain elements of the paper with which some may not completely agree.

The Sub-Committee agreed that focusing on producing a paper trail to evidence that directors had given due consideration to all relevant factors in their decision-making was not necessarily the whole answer. To give substance to the new statutory provisions, the most important point would be to embed the right decision-making philosophy in the company. This could be done a number of ways but a useful starting point would be for boards to consider how they comply with the new rules on directors duties and the factors which they are obliged to take into account in their decision-making (environmental issues, impact on the community etc.) at their annual strategy away days, or as part of their corporate and social responsibility review. This could be supplemented by training for directors and senior management. Adopting this approach would set the platform for ensuring that boards do in fact consider the statutory factors when they make their decisions and, over time, allow the decision-making philosophy of the board to permeate through the company.

The Sub-Committee unanimously agreed that a "box-ticking" approach to drafting of board minutes was not the answer. Minutes should be drafted accurately to reflect those factors that have been taken into account in the decision-making. Adopting a practice where each of the factors set out in the legislation is recited *verbatim* as a matter of course in board minutes was considered unhelpful.

Furthermore, it was noted that the GC 100 paper almost inevitably focuses on larger corporates which have more resources to be able to establish a paper trail for their decision-making. There was concern that small, more entrepreneurial companies would not have the resources to document their decisions in the ways suggested by the GC 100 and that this could leave them vulnerable to a presumption that they had not in fact

taken such decisions into account if the GC 100 approach was adopted as a “gold standard”.

The Sub-Committee also noted that companies should seek to ensure that they are consistent in the approach that they take to documenting their compliance with directors’ statutory duties. It may be evidentially unhelpful if board minutes and papers focus on how the board has taken decisions with a view to promoting the success of the company but is silent on consideration of other factors.

The Sub-Committee agreed to discuss the scope of the implementation provisions on other directors duties and the timing for such implementation at its next meeting.

5.2 Accounting for contingent liabilities

James Palmer led a discussion on the proposed amendments to IAS 37. The Sub-Committee noted the background paper circulated in advance of the meeting.

It was noted that the IASB had published an exposure draft of its proposed amendments to IAS 37 in June 2005. The exposure draft has been the subject of ongoing debate with the Institute of Chartered Accountants in England and Wales and with equivalent bodies across Europe. The GC 100 are also involved in the discussions and have prepared a submission to the IASB.

The exposure draft proposes that the concept of “contingent liabilities” should no longer be used and that something should simply be either a liability or not: the appropriate test is “what do the directors think the value of the risk is at [the relevant date]?”, i.e. moving away for the current “more likely than not” test. It seems almost inevitable that this new approach will be adopted in relation to financial liabilities such as guarantees. However, there are a myriad of issues, both technical and practical, that could arise if this approach was adopted in relation to disputes. The more significant of these, from the Sub-Committee’s perspective, are the practical consequences. By way of examples:

- If a company recognises a liability in its accounts in respect of a dispute, when will the other side settle for less?
- Will companies end up being less likely to fight claims because they have had to make a provision in their accounts in any event?
- Will adopting this accounting standard lead to an increase in the tactical steps used in disputes, for example, enlarging claims or delaying settling a claim until a company’s accounts have been published?
- Could this standard simply lead to an increase in “greenmail”?

The Sub-Committee also noted that there could be potential effects on realised profits. This has been raised with the IASB.

The Sub-Committee agreed that it would draft a short letter of support of the GC 100 letter. The Sub-Committee understands that the Law Society is doing likewise. Furthermore, the Sub-Committee has been invited to send representatives to the ICAEW meeting on this topic in April. Members were asked to contact the Secretary if they wished to attend.

6. Current problems and recent developments

6.1 Company law and legislation

Nothing to report.

6.2 FSMA

Items 6.2(A) and (B) of the agenda were noted.

6.3 LPD Rules and practice, LSE admission and disclosure standards, AIM and ICs

Items 6.3(A) – (C) of the agenda were noted.

6.4 EU/US overseas company and securities law and practice

Michael Hatchard noted that on 21 March 2007, the Securities and Exchange Commission (“SEC” or “Commission”) adopted new Rule 12h-6 and related Form 15F that will enable a foreign private issuer meeting specified conditions to terminate its Securities Exchange Act of 1934 registration and reporting obligations under Section 12(g) regarding a class of equity securities and its Section 15(d) reporting obligations regarding a class of equity or debt securities. The Commission also adopted a rule amendment that will apply the exemption from Exchange Act registration under Rule 12g3-2(b) to a class of equity securities immediately upon the effective date of the issuer's termination of registration and reporting obligations under new Rule 12h-6, instead of waiting 18 months after deregistration. The final rule is not changed substantially from the SEC proposal discussed at the previous meeting of the Sub-Committee. In particular, the SEC retained the requirement for a 12-month waiting period before a company may deregister following delisting from a national securities exchange or automated inter-dealer quotation system in order to reduce U. S. trading volume to below the threshold level and following termination of an American Depositary Receipt facility.

The conditions are, in summary:

- US trading volume for the class of equity security must have been not greater than 5 per cent. of worldwide trading volume during a recent twelve-month period,
- The issuer must: (a) have had SEC reporting obligations for at least one year before deregistration, have filed at least one annual report, and be current in its reporting obligations; (b) not have made sales of its securities in the US in a

registered public offering during the year before deregistration; (c) have maintained for at least one year a listing of the equity securities on a foreign exchange that constitutes the primary trading market for the security to ensure that the issuer is subject to regulatory oversight outside the United States after deregistering its securities. The "primary trading market" for a class of securities (whether equity or debt) is deemed to be a foreign jurisdiction in which at least 55 per cent. of the trading in the security took place in, on or through the facilities of a securities market during a recent twelve-month period. The company must agree to post material information in English on its website so that U.S. investors will continue to receive a minimum level of information about the company.

6.5 Accounting standards and practice

Items 6.5(A) - (F) of the agenda were noted.

7. Cases (not otherwise reported)

Corporate Development Partners LLC v E-Relationship Marketing Ltd [2007] EWHC 436 (Ch) was noted.

The applicant company (C) applied for summary judgment for fees allegedly due under an agreement with the respondent company (E), which E asserted was unenforceable under section 151 of the Companies Act 1985 (the "Act"). Under the agreement, C was engaged by E to provide consultancy and introduction services aimed at facilitating E's acquisition of other companies. C was to be paid a monthly fee, expenses, and a transaction fee that was contingent upon the success of a transaction. One company (R) was a possible target for acquisition, but R then made an offer to E's shareholders by which R would acquire E. Because of that, E tried to negotiate lower fees with C. When C declined to agree immediately, E terminated their agreement. A new agreement was reached whereby E would be liable to pay a transaction fee of half that provided for under the original agreement in respect of any subsequent transaction involving R. Subsequently, R acquired all shares in E, but E refused to pay C the success fee as it had been advised that the fee was unlawful financial assistance under section 151 of the Act and was therefore not enforceable. C submitted that the section 151 argument was mistaken, as the payment claimed under the agreement was no more than part of the consideration payable by E to C for the overall corporate development services that C provided, and that had been described in the narrative to the first agreement. C further relied on the "larger purpose" defence of section 153(1) of the Act. E submitted that, at the time of the second agreement, R was already proposing to acquire E, so the facilitation of that acquisition brought the case within section 151(1) of the Act.

It was held that it was necessary to identify whether, as matter of commercial reality, E's commitment to pay C a transaction fee if R acquired E had amounted to the provision of relevant financial assistance to anyone, i.e. assistance that either directly or indirectly was "for the purpose" of that transaction, *British & Commonwealth Holdings Plc v Barclays Bank Plc (1996) 1 WLR 1* and *Chaston v SWP Group Plc (2002) EWCA Civ 1999, (2003) BCC 140* applied.

8. Any other business

It was agreed that the Sub-Committee would trial a change to its meeting time. The next meeting would start at 9 a.m. on 22 May.

9. Close

There being no further business, the meeting closed.

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Chairman