

THE CITY OF LONDON LAW SOCIETY

COMPANY LAW SUB-COMMITTEE

Minutes of the 231st meeting held at 9.00am on Tuesday 27 November, 2007
at Slaughter and May, One Bunhill Row, EC1Y 8YY

1. Apologies for absence

Apologies for absence were received from Mark Curtis, Lucy Fergusson, Simon Jay, Kevin Tuffnell and Victoria Younghusband. It was noted that alternates attending were: Mary Leth (for Kevin Tuffnell), Edmund Tyler (for Victoria Younghusband), Steven Turnbull (for Lucy Fergusson) and Michael McDonald (for Simon Jay).

2. Approval of minutes

The minutes of the 229th and 230th meeting were approved.

3. Matters arising

3.1 Companies Act 2006

(A) It was noted that DBERR had held a meeting in the week commencing 19 November 2007 to seek the views of various stakeholder groups regarding timing of implementation of the Companies Act 2006. Areas discussed included conflicts of interest, financial assistance and reductions of capital-

- Conflicts of interest: The GC 100 was, on balance, in favour of implementation in October 2008, although many others preferred October 2009. All parties agreed that the most important requirement was to know the implementation date early.
- Financial assistance: It was suggested that the repeal of section 151 be bought forward to April 2008. As there were no representatives from the British Bankers' Association at the meeting, DBERR undertook to seek separate representations from them on this issue. Some concern was expressed that there has not been sufficient focus on the *Trevor v Whitworth* issues and, furthermore, that banks have not reached a view yet on the processes they will require in relation to the giving of the financial assistance.
- Reduction of capital: The ICAEW suggested the reduction of capital regulations be implemented in October 2008. This proposal was supported by the Law Society. It was thought that the changes needed to the Companies Act to effect this should not be significant. DBERR would however, need to discuss with Companies House.

- (B) The Committee considered the ICSA draft guidance, proxy card and poll card circulated in advance of the meeting and the two opinions of David Mabb Q.C. provided to Allen & Overy (and provided to members of the Committee on a private and non-reliance basis).

Several members of the Committee considered the view expressed by Mabb, that a number of corporate representatives of one registered shareholder could vote in different ways on a poll provided the votes cast in different ways were conferred by different shares, was a credible and proper interpretation of section 323 of the Companies Act 2006. Others were not convinced. Some were concerned that this approach could require the company to make an assessment of underlying beneficial holdings and was not, therefore, viable or consistent with the legislation. The Committee agreed, however, that it was important to settle on a practical approach. They unanimously supported the ICSA solution (which provides for multiple corporate representatives to be deemed to have appointed the senior corporate representative as their agent on a poll) as a pragmatic solution, albeit recognising that it requires companies to undertake a relatively cumbersome procedure which, if implemented incorrectly or only partially, could be open to challenge.

The Committee debated whether it would be better to instigate the ICSA solution or defer the relevant meeting to enable custodians to complete proxy forms before a poll is held, the latter approach having been required by the ABI to date. The Committee concluded that the ICSA solution was preferable, enabling votes to proceed immediately without the additional timing and cost implications related to adjournment.

The Committee considered whether it should support the ABI's request for changes to the Companies Act 2006 in this area. It was considered unlikely that the Government would be willing to look at further changes. If the Committee were to support a call for legislative change it would be as part of a wider review of voting given the difficult interpretative issues which also arise in relation to voting on a show of hands.

The Committee discussed the ABI approach to "red topping" or threatening to "red top" on this issue if appropriate undertakings were not given to the ABI. The Committee considered that the ABI should be encouraged to publish guidance and only red top if companies did not comply with that guidance, i.e. adopting the same approach taken in relation to pre-emption rights.

- (C) The Committee discussed the different approaches being taken to adoption of amendments to articles of association to reflect the Companies Act 2006. It did not appear that there was a settled practice. Some companies seemed likely to implement changes in two phases while others would do it in one. Members noted that one reason to make changes sooner rather than later would be if the conflicts provision were introduced in October 2008 (which suggests two rounds of changes) the other amendment which it would be prudent to make would be to change the notice period for special resolutions to 14 days. Companies may

also wish to make changes to the directors indemnities and defence funding provisions, although from a presentational perspective they may prefer to include this as part of a more general updating of their articles of association.

The Committee noted the UKLA's confirmation in List! 17 that circulars sent to shareholders in order to amend their articles to accommodate the recent changes under Companies Act 2006 will not require vetting, unless the circular requires unusual features. The Committee confirmed that a copy of the pro forma circular on articles changes prepared by an informal working group of certain City firms, and discussed at the Committee's October 2008 meeting, should be posted on its website.

- (D) It was noted that the FRC is planning to consult on its guidance on auditor liability limitation agreements shortly. It would not be possible to propose one approach for all companies to take to determine a reasonable limit on liability. This was partly due to the ABI's publicly stated position that it will only support a proportionate limit on auditors' liability. There are a large number of companies who are not influenced by the ABI who may consider it appropriate to impose limits based on, for example, a fixed amount or a multiple of fees.

Practical issues on timing were also noted. The draft regulation on liability limitation agreements states that the agreement must be referred to in the accounts to which it relates. Thus, from a timing perspective, any agreement must be entered into before the relevant accounts are audited. The Committee assumes that companies will wish to negotiate these agreements as part of an auditor's overall remuneration package. This may lead to changes in the timing for negotiating audit letter terms.

3.2 Cross-border mergers

Items 3.2 (A) - (D) of the agenda were noted.

3.3 Reform of Second Company Law Directive

The FEE proposal to move the test for determining the amount of profits available for distribution away from distributable reserves towards solvency was noted. The Committee agreed that such a change seemed appealing. However, there was a potential concern that requiring a solvency statement in every case might increase the procedural requirements (e.g. as to external review of internal workings supporting the statement). It was agreed that the Committee should submit a response and a working party would be established for that purpose.

4. Discussion: Interim management statements ("IMSs")

The Committee considered the various GC 100 papers circulated to it and available on the PLC website. It commented on the GC 100 note of issues arising from the IMS obligations under the Disclosure and Transference Rules ("DTRs"), as follows:

General approach

The Committee was of the view that companies should consider IMSs in the context of the whole of the annual reporting cycle of the business reporting it already undertakes. IMSs provide an opportunity for issuers to explain to the market how their financial performance compares with the analysis and reporting set out in its OFR and half yearly statement. The amount of detail appropriate in an IMS is likely to be influenced by the amount (and quality) of information provided at other times during the reporting cycle.

Will an IMS which contains no financial data meet the requirement of providing a suitable description of the financial position of the company?

The Committee was of the view that it was not necessary for financial data to be provided, if a narrative comment (taken together with other information provided by the issuer) could be understood by investors. It was noted that a distinction should be drawn between financial performance (which relates to revenues and profits) and financial position (which relates to indebtedness and the balance sheet).

Could the disclosure of profit figures amount to a profit forecast for the purposes of the Takeover Code?

The Committee agreed that both historic profit information (e.g. for the first quarter) or prospective profit forecasts or targets may be regarded by the Panel as profit forecasts (or estimates) and agreed that this issue should be followed up with the Panel by the Takeovers Working Group.

At what date should information be provided? Will trends and/or figures given at the end of the 1st/3rd quarter be adequate?

The Committee acknowledged that this would be a matter of what is practical in the circumstances, bearing in mind companies' obligations to announce inside information immediately. Issuers might be expected to time their IMS around the availability of information.

Will the IMS be expected to comment on whether there has been a change in Key Performance Indicators (KPIs)?

The Committee suggested that whether comment on KPIs should be included in an IMS will depend on the statements made around them in the company's OFR. A company may need to mention divergences, although there may be circumstances where even this is not appropriate, for example, where the relevant KPI should be measured over a longer period.

Although the window within which IMSs are to be issued runs from approximately 2 weeks before the end of the 1st/3rd quarter, are companies planning to base the IMS on the financial performance of the 1st/3rd quarter?

The Committee noted that as an IMS would be based on the information available (and there was an advantage in publishing as soon as the information was known), it was likely that it would most often relate to the relevant quarter. It was noted that some companies have published a reporting timetable, which seems to be a helpful approach.

Should/will companies be looking to their auditors to review IMSs?

The Committee thought there was no need to adopt a different approach from that already taken in relation to trading statements, although the approach may depend on the nature of the information included in the IMS. If it included only a narrative similar to that included in a conventional pre-close trading statement, it would be less likely that auditor input would be required. The liability position is the same for the IMS as for a conventional trading statement.

A separate but linked question is whether the audit committee should review IMSs?

It was noted that the Smith Guidance suggested that audit committees should review trading statements prior to their publication, although practice seems to be mixed. The Committee was of the view that companies should be encouraged to introduce some formality around the publication of trading statements.

Will companies continue to release trading statements?

It was thought that many companies were still intending to issue pre-close trading statements. The motivation for doing so (to allow companies to keep quiet during the pre-announcement period) was not affected by the publication of an IMS.

Should there be a mandatory close period for IMSs?

The Committee had no strong views as to whether a company should impose a close period prior to publication of its IMS, although it was thought that it may be better to restrict only those who actually have access to inside information.

5. Current proposals and recent developments

5.1 Company law and legislation

Items 5.1(A) - (D) of the agenda were noted.

5.2 FSMA/FSA

The insider trading review section of Market Watch 24 was noted. It was noted that, for DTR purposes, an adviser's insider list should consist of the deal team only. However, for investigative purposes the FSA required details of the deal team and any others within the firm with access to information, such as support staff. This gives rise to practical difficulties, including under data protection legislation, because it may be necessary to seek specific consents to disclose an individual's details to the FSA without a clear obligation to disclose that information. Accordingly, some firms are

tending towards the view that the DTR insider list should be a wider list than the deal team only. It was suggested that Committee liaise with the Financial Services working party on this issue.

Items 5.2(A), (B), (D) and (E) of the agenda were noted.

5.3 Listing Rules, DTRs and Prospectus Rules

Items 5.3(A) – (C) of the agenda were noted.

5.4 AIM – nothing to report

5.5 EU/US overseas securities law and practice

Item 5.5 of the agenda was noted.

5.6 Accounting

Items 5.6 (A) and (B) of the agenda were noted.

5.7 Mergers and acquisitions (public) – nothing to report.

5.8 Mergers and acquisitions (private) – nothing to report.

5.9 Current cases (not otherwise reported)

(A) The Committee noted the case of *Doughty Hanson and Co Ltd v Bruce Patrick Rowe* [2007] EWHC 2212 (Ch) where it was held that an accountancy firm's valuation of a shareholder's shares in a company, which was a non-speaking valuation, was not open to challenge as any ground of attack required an impermissible inference as to the mechanism of the valuation. It was also not open to the shareholder to withdraw a transfer notice offering shares for sale to the other shareholder on a true construction of the articles of association. Mann J's comments regarding the drafting of the articles of association were noted in particular. The Committee agreed that the drafting of drag and tag provisions often gives rise to difficulties. This might be an area the Committee could return to to see whether a more uniform approach could be encouraged.

(B) The Committee noted the September judgement in *Mann Nutzfahrzeuge AG & Anor v Freightliner Ltd* [2007] EWCA Civ 910 where it was held that the auditors of a subsidiary had not assumed responsibility to the parent company for the use of which the subsidiary company's financial controller made of the audited accounts in the context of his dishonest assurance to the purchasing company that the accounts were accurate. It was noted that one interesting feature of the case was the observation that, if it had been necessary to determine the point, the court would have decided that, because the audit was undertaken at the same time as the sale, there was a special audit duty owed by the auditors to the purchaser to protect the seller from the consequences of representations

and warranties made in the share purchase agreement, including representations and warranties which had been made fraudulently. This approach to the existence of a special duty was perhaps wider than many would have expected. It was noted that the decision would be appealed.

- (C) The failure of the entire agreement clause in *Quest No. 4 Finance Ltd v John M Maxfield John Carter & Michael John Chesney* [2007] EWHC 2312 (QB) to protect the party relying on it (in circumstances where it was clear it did not reflect the facts) was noted.

6. Any other business

The dates for the Committee in 2008 were noted.

It was noted that the time qualifying for CPD credit would be 2 hours.

7. Close

There being no further business, the meeting closed.

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Chairman