

Problems with the law - how much is too much?



The following is an extract from on-going discussions which started in October 2008 between Nick Gould, a corporate partner at Ince & Co, and several other interested parties. The matter has gained particular prominence this week following an article by Sir Kenneth Mac Donald a previous director of Public Prosecutor in The Times.

Introduction

I am a partner in the City law firm noted above, although I should start by saying the opinions below are entirely mine. I have spent much of the last two years or so gaining some understanding of a major piece of commercial legislation entitled "The Companies Act 2006" ('the Act'). This piece of legislation is the largest ever brought into UK law, consisting of some 1,300 sections, 16 schedules and, for those of us who need greater guidance, 200 pages of explanatory notes as well as numerous Ministerial statements, written statements, 'Regulatory Impact Assessments', briefs and dozens of statutory instruments to date. The Act took more than eight years of review, research and lobbying to produce, finally reaching the statute books in late 2006. It will take the best part of three years to become fully effective, mainly because Companies House was not able to implement all necessary actions required of them under the legislation's original time frame.

I have been writing papers on this piece of legislation for several years and have recently put together some fairly detailed notes on directors' duties and liabilities. In light of the current economic and financial chaos, I have been prompted to put down some further thoughts below. I would also note one of the main objectives of the Act is to bring companies' legislation into line with best current practice and respond to today's business needs.

Is this legislation relevant?

One important question for me is whether the several hundred pages of rules contained in this legislation can ever be fully enforced. Personally I have my doubts. An analogy with the vast amount of financial services legislation seems clear. I also wonder whether this type of primary legislation should be used to do any more than set out core principles? Is it necessary for the draftsman to try and cover every eventuality? Recent past events tend to show that this latter approach does not normally work.

I have noted the size and scale of the Companies Act, above. What do its intended users think of it? According to a recent survey carried out by Jordans Limited, a large provider of business services in the UK, less than 20% of professional advisors have detected a marked increase in interest and action from company directors about the Act and its relevance to their businesses. More than half the advisors surveyed say that although they think that directors may be more aware of the Act, they have seen little evidence of this in their dealings with clients. More than 80% of the respondents said that although the relevant part of the Act came into force in October 2008, most directors were unaware of one of the fundamental changes to the Act; "their duty to promote the success of the company for the benefit of members as a whole, having regard to staff interests, the environment and the community". Almost 60% of advisors said that in their experience, the changes in directors' duties under the new provisions (which might have the effect of enabling members or even perhaps liquidators - to sue directors), had not made boards more cautious or risk averse when taking decisions. The reason for this appears to be that directors were not fully aware of these new provisions. Only 7% said they found that board members were aware of the changes and were/felt affected by them.

One of the core questions I raised in my papers is how did the legislators expect SMEs (who may not have large support teams or be able to employ firms of experts to deal with these matters) to cope with this enormous tower of legislation? The point has been well put to me as follows:

"One of the problems with current overload in legislation generally is that I am probably a criminal every time I go out of my front door ... Small businesses do not have the funds to arrange processes and documentation to cover everything."

My own view is that most general advisors may have neither the time nor the skills to deal with this vast piece of new legislation. Most companies have neither the time, the money, nor, being realistic about it, much interest in complying with the numerous technical changes to the law which the Act introduces. The timing, in many ways, could not be less opportune. Many companies are struggling to stay profitable or even to survive in what are agreed to be extremely harsh economic times. The continuous flood of rules affecting them, with the significant burdens of extra costs and time, can hardly be seen as helpful.

How much legislation is too much?

As several commentators have noted, the thousands of pages of primary legislation and secondary rules relating to financial services have done nothing to prevent a collapse of the UK banking system nor I would suggest, in many cases, to make the regulators more aware of their duties. So, I had some very simple initial questions which I hoped might lead to further discussion:

1. Do we have too much legislation relating to commercial organisations and, in particular, private companies, and if so, why? Having read various commentaries relating to the Act, and indeed related legislation, I don't believe this was the intention of Parliament. However, in producing such a massive piece of technical law what did those responsible for it think would be the result?
2. Is that legislation, in any event, focusing on the relevant areas of risk? Does it attempt to deal with or really address future areas of concern for business?
3. Are laws passed to be enforced, or is there some sort of standard which presumes people (in this case, companies, their directors and their shareholders) will follow the legislation? As a lawyer, I have to believe that laws require some level of enforcement, otherwise what is their point? However, to cite one obvious example, the UK Financial Services Authority may as well not have existed in the last year or so for all of the good it has done in policing effectively the financial system. Regulations need to be both enforceable and enforced. I appreciate these questions don't lend themselves to easy, or perhaps any, universal answers, but shouldn't practising lawyers as well as academics be debating them more widely?
4. Is the UK legislative process merely a system which churns out more and more laws merely for the sake of it? This is not in itself beneficial to anyone and indeed seems to me to be positively detrimental.

"Something must be done"!

Had I have stopped here, life might have been easier. Perhaps a specific set of questions relating specifically to UK company law might have been a wide enough topic to debate. Unfortunately, my discussions continued as below, which I appreciate opens up a much more complex, topical and indeed sensitive debate affecting many, both in private practice and in financial regulation. My first postscript was that as a shareholder in HBOS, I of course received my 346 page Lloyds/TSB merger document. Multiply that by several million shareholder recipients and it adds up to a lot of trees.

I wondered why HBOS couldn't have sent a shorter document to all those millions of shareholders required to receive it? In addition, could not those who put it together have thought about preparing a short summary which might have been intelligible to a non expert in banking, accountancy or financial services? Recipients could then have chosen to request the full document either in hard copy or through an on-line download. I suspect though, however we look at it, the route chosen by more than 99 per cent of shareholders, would have been to do nothing further. If the law requires such a document to be sent, as I have just described, don't we need to ask some very basic questions as to the real reason for such a process. Should we not focus on what and how to report rather than on the package itself? Although it might be a difficult question, we could perhaps ask whether real purpose for such a document is really for the benefit of the shareholders or the protection of the directors and others?

A further and much more depressing end of year postscript involved the enormous fraud apparently carried out over many years by Bernard Madoff. The US system appears to have failed in a most dramatic way, a point already noted by the chairman of the SEC. How long before the out-going financial tide reveals similar disasters in the US or indeed in the UK? I would dare anyone to say it couldn't happen here!

I have a major concern that public opinion as well as the scale of the recent financial problems may well lead many government and regulators to feel they have to be seen to "be doing something – now". This is of course another "hot topic". I suspect the "doing" will be an attempt to pass even more legislation. Do we also need to get ready for a European "super-regulator"? I would much rather people began asking why the existing rules were not satisfactory. Some time spent reflecting carefully on exactly what happened, how and why, would I believe be time well spent. But here I am straying into territory which is now the subject of numerous debates.

I assume someone, somewhere will instigate a serious discussion on these and related issues, involving all interested parties, be they academics, professionals and those involved in day-to-day business, across the spectrum. Perhaps by broadening this into a much wider debate we could stop merely playing around at the edges of the system and look at some truly core issues, a few of which I have touched on above. I started this note by using recent Companies legislation as an example of where I think we are going wrong. The questions raised are applicable to numerous other areas, including as noted briefly, financial services.

As noted above I don't necessarily want, nor do I believe we need, yet more legislation. I do want relevant, understandable and effective legislation. I want it to be enforceable and, when appropriate, enforced.

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