



Provisional Response to the Law Commission's Joint Consultation Paper

**Company Directors: Regulating Conflicts of Interest &
Formulating a Statement of Duties**

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The Consultation Paper invites responses on two matters: the reform of Part X of the Companies Act 1985 and the desirability or otherwise of formulating a statement of director's duties. It poses seven 'central general questions' (paragraph 1.13). It is convenient to take the two subjects in reverse order.

Directors' Duties Generally

1. In keeping with the observations made in the Fraud Advisory Panel's earlier response to the DTI Consultation Paper (paragraph 3.2 *et seq.*: "The role and responsibilities of directors are not well understood ...") I would support, in principle at least, the idea of attempting to compile, in one form or another, an authoritative modern statement of directors' duties. A copy of the Panel's earlier paper accompanies this present response.
2. From the specific point of view of fraud prevention such a statement could be of real practical value:
 - (1) in helping to deter from accepting directorships those who by training, experience and aptitude are unsuited, particularly those who may easily become little more than pawns of cavalier or unscrupulous co-directors;
 - (2) in helping to educate and fortify honest and conscientious directors, particularly when it comes to resisting improper pressure, asking appropriate questions and exercising proper judgement;
 - (3) in helping those who, although not fundamentally dishonest, may otherwise be tempted to take improper advantage of their position (initial improprieties often lead on to serious dishonesty);
 - (4) in helping to cultivate a stronger climate of fiduciary awareness at board level; and
 - (5) in helping to create a better understanding at board level of the respective roles and responsibilities of (i) the board and (ii) auditors as regards the prevention and detection of fraud.
3. A situation in which the law on a subject as important as that of directors' duties is as disparate and inaccessible as at present is wholly wrong in principle as well as being unsatisfactory in practice.
4. What form should any such statement take? My own suggestions are as follows:
 - (1) There is no point in attempting a comprehensive statutory codification. This alternative, albeit in a different context, has been recently considered and rejected: see paragraph 14.22 of the Paper (Option1).
 - (2) Partial statutory codification (Option 2, paragraph 14.23 *et seq.*) would be a bad idea, as only adding further to the present fragmented picture.
 - (3) A statutory statement, not replacing the general law (Option 3, paragraph 14.25 *et seq.*) is a possibility but could lead to confusion as to its status.
 - (4) A non-binding statement of main duties, to be used in certain prescribed forms (Option 4, paragraph 14.32 *et seq.*): again, notwithstanding paragraph 14.33, I think that there would be serious scope for misunderstanding about status.
 - (5) Authoritative pamphlets (Option5, paragraph 14.41 *et seq.*). This is my preferred alternative, though the word "pamphlet" gives the wrong impression.
5. I would like to see an authoritative statement under the auspices of one or more bodies of the kind referred to in paragraphs 14.42 and 14.43. This, I suspect, is as close to an ideal solution as one is likely to get, combining as it could authority, flexibility (to allow for new developments) and speed of production. As long as it is made plain that the statement is published as an authoritative guide, and not as a definitive statement of the law, I can see no disadvantages. Parallels with the statement of principle recently produced by the Committee on Standards in Public Life (see paragraph 14.41 and Note 54 of the Consultation Paper) are particularly apt.

6. As a content of the statement, I envisage:
- (1) first and foremost a summary overview of the principal obligations, their sources and the sanctions for, and other consequences of, non-compliance;
 - (2) a section summarising areas of recommended good practice over and above legal obligation;
 - (3) possibly in due course, more detailed statements of matters covered by (1) and (2).

New Legal Duties

7. Unlike statutory codification this approach would not, of course, cater for the formulation of any new legal duties, remedies or offences that might be thought desirable: they would require separate legislation. A number of important recommendations is made in the Fraud Advisory Panel's earlier paper. But, irrespective of whether the law itself is changed in the ways suggested, there should be a proper place for reference to, or increased emphasis on, these matters in the good practice section of any "statement" of the kind discussed above. This could include in particular the recommendations concerning the establishment of appropriate internal regimes for the prevention and detection of fraud.

Part X of the Companies Act 1985

8. Five of the seven central general questions apply to this part of the Consultation Paper (paragraph 1.13, Nos. (1) to (5)). I would need to spend more time on (1) to (3) in order to come to a firm conclusion, but would in any view be in favour in principle of rewriting Part X in simple language (Question (4), Part 9 and Appendix B of the Consultation Paper) even if nothing else were done.
9. As regards "decriminalisation" (Question (5) and Part 10 of the Consultation Paper) I am not persuaded at the moment that this is the right course to take generally. The subject needs, I suspect, to be considered in a wider context that also takes account of the regime of "civil fines" proposed in the draft Financial Services and Markets Bill and the responses to that proposal. The section of the Consultation Paper on "civil penalties" (paragraphs 10.34-36) is rightly cautious in tone on this subject. Decriminalisation could send out quite the wrong message unless it were replaced by a set of sanctions that one could be reasonably confident would act as an effective incentive to compliance. That said, I agree with the view expressed in paragraphs 10.5 and 10.6 of the Consultation paper that *proportionality* as well as *efficiency* is a relevant test; and the present consequences of some of the Part X offences may appear unduly severe when measured against shortcomings in other areas of corporate activity.