COMMON SENSE – THE DARK MATTER OF BUSINESS LAW

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Introduction

Common sense - the dark matter of business law. When I started writing this paper last Autumn I thought it was just a catchy title but, as I hope you will see, it might be rather more than that. It has been suggested to me that this topic, particularly as it impacts on small and medium sized enterprises (SMEs), deserves greater prominence than it has been given up to now. What I would like to consider is whether "common sense" as a concept is too often forgotten in the preparation and implementation of new legislation. It may also (for various reasons) be ignored by those who are subject to that legislation. One of the results of failures of corporate governance over the last few years has been a substantial increase in discussions involving ethics and morality. I would like to suggest that there is also a place for common sense in this debate. It may be that there is no ability to combine "law" and common sense; however I think it is something worth investigating.

"Common sense", based on a strict construction of the term, consists of what people in common would agree on; that which they "sense" as their common natural understanding. Some use the phrase to refer to proposals that – in their opinion – most people would consider prudent and of sound judgment, without reliance on complex knowledge or study. Another meaning is good sense and sound judgment in practical matters. Whatever definition is used, identifying particular items of knowledge as "common sense" can become difficult. We will see this in some but certainly not all examples later on. It also applies on a number of levels. For example, it is required in running businesses, as well as drafting and implementing legislation.

I will consider several examples where it appears the concept of common sense is missing and principally as it affects owners and managers of SMEs. However, many of the same points often apply when looking at a wider group of companies and wider legal issues. One of the reasons I have focussed on the SME "constituency" is because while I understand there has been a considerable amount of research on regulation as it affects, in particular, the quoted company sector, I have been told the same degree of research on these issues has not been carried out in respect of SMEs. I have also found in discussions with various owners/managers of SMEs, as well as others, that topic is of genuine interest and considerable importance. My test will be to see whether you do as well.

Why this discussion?

I am a corporate lawyer and have advised most types of companies, from small and local start ups to major international trading groups operating on a world wide basis. I have seen
seemingly endless problems faced by companies and been involved closely with numerous groups of directors as they wrestle with the complexities of many aspects of business law. I started thinking about these complexities on a wider basis a few years ago when the enormity of the Companies Act 2006 (CA 2006) hit me (as no doubt it did many others).

A couple of years ago I wrote about four core inter-linked phrases, which will be repeated in whole or in part during this paper and which can be summarised as: too much law, too much complex law, law which is unenforceable; and law which is unenforced. To me these phrases suggest among other things an absence of common sense in the corporate/commercial legal process. They could, like many other themes of this paper, apply more widely to many other areas of law. I am concentrating on business law.

I was asked specifically to ensure this is a practical paper with real examples of where some of the current rules do not appear to be working. It is not however merely going to be a rant either on my behalf or on behalf of many others about the faults with the system.

As a start, here are various comments raised by some of those with whom I discussed the matter:

"Well, actually you need to change the attitude of the judiciary";

"It essentially boils down to too many lawyers trying to find loopholes in the legislation and the judges giving in to these tactics";

"There ought to be some form of moral code to which directors/shareholders should subscribe";

"I think what everyone agrees we need is a high level, principle base with appropriate sanctions for those who negligently or recklessly step off the field".

These comments lead me to believe the task I had taken on was rather greater in scope than could be covered by this paper. The words "common sense" (or lack of) are now applied to a vast number of everyday situations. For example I cite the following from numerous newswires (16th March 2011) because although we don't know the "rights" and the "wrongs", common sense makes me ask "how" and "why" did it even reach this position:

"UK rescue workers say they had to leave quake-hit Japan because they could not secure the necessary paperwork from the British embassy in Tokyo."
The International Rescue Corps said they were not given permission to work in Japan because it would have made the embassy legally responsible for them.

I have also noticed how often commentators bemoan the absence of the concept, often when discussing legal issues including, as I suppose we would expect, court judgments; for example Eleanor Mills in the Sunday Times earlier this year, when discussing a Supreme Court definition of domestic violence: "The judgment is so bizarre and against the rules of common sense and normal definitions of words, that it is one of those moments where you wonder whether the judges have disappeared up their own legally defined fundamentals".

Considering common sense in relation to "ambiguity", I note that a so called ambiguously drafted clause in mortgage documents of the "Halifax" subsidiary of Lloyds Bank Group lead to payments to borrowers by way of compensation of some £500 million.

Setting the scene

Last year Dr. Arad Reisberg gave a talk entitled "Corporate Law in the UK after recent reforms: the Good, the Bad and the Ugly". Many say that the truth hurts, it certainly should for those who were responsible ultimately for CA 2006. Dr Reisberg stated, and I agreed entirely, that CA 2006 was indeed full of ugly truths. More importantly for those who need to apply the rules in CA 2006 as well as those companies and individuals who it affects, he noted CA 2006 was deemed not fit for purpose. I thought, to put it at its most uncontroversial, that was a pretty sad state of affairs after more than 10 years of enquiries and debate and given the laudable aims of those who initiated the legislation.

Dr Reisberg looked at CA 2006 through a fictitious character setting up business in the UK. I want to consider some related issues, but in a rather different way. Some time after his lecture, I was asked to consider the rules from the point of view of the very wide "constituency" of SMEs. I gave a short talk, which was based on two questions I asked of more than 40 of my clients and contacts; "on a scale of 1-10 how much do you know, firstly about corporate governance and secondly, about directors' duties". I received about 25 replies, which I thought was a good response rate. Although most replies came from SMEs, some came from directors of listed companies as well as the head of legal of an international manufacturing group. Most were fairly negative about the questions asked. By that I mean that on a scale of 1-10 for each question, almost no-one gave a satisfaction level of more than six. I do not want to delve into the psychology of surveys but I believe more people tend to respond when they are unhappy and have an issue with the current system. When reasonably happy or indifferent, few people respond as they have no strong feelings. Mostly the comments received were as I expected.
What I was surprised about were the words forming part of the heading for this paper "common sense". Several people raised this issue and they tended to be the more experienced owner/managers. Here are three sample quotes from people who replied to my questions:-

"...a director of a small company is far too busy keeping his head above water to worry too much about regulations. I would say that the attitude towards all this is to ignore it, fear it, hope it goes away and hope you won't be caught doing something you didn't know was wrong in the first place. I would also say that most directors of small companies run their businesses using common sense and by hard work and a desire to make money, grow the business, employ the people and so on. Regulation is a barrier to this".

"I raised the issue of the [new] Companies Act at a recent business forum at my accountants and, to be honest, the eyes glazed over. Nobody had really taken any interest, they mostly felt that sound common sense, openness and integrity would cover 99% of the legal thousands of pages and they have far more important decisions to deal with than the minutiae of the new Act [This comment was made by a long-time serial non-executive director who is also a business angel investor and has owned and sold several private companies in the past.]

One final comment from a partner in a major firm of accountants:

"Entrepreneurs set up and run businesses and they are the lifeblood of corporate Britain, they make mistakes and people learn from mistakes so we shouldn't prevent that; some entrepreneurs, as in every walk of life, are crooks, but we shouldn't over-regulate companies and boards to capture the small minority of crooks and fraudsters for the sake of costing too much money and time in respect of the other 99% of boards of directors who are doing their best..."

I wondered about the "disconnect" between those who decide on the framework of the rules and those who then draft them, and the "users" of those rules. Could common sense have any part to play in the drafting of legislation? Why? Because as one of the statements makes clear, and it isn't the only one I received on this point, if people don't or can't understand the law, they might ignore it. They might do the same, inadvertently or not, if it makes no "sense". Perhaps CA 2006, a piece of legislation which, we are often told, is the longest ever enacted outside taxation legislation, is more than likely to be ignored by many of its core constituents.

Lawyers may think this process of people "getting on with things and hoping for the best by taking a common sense approach", is of concern, but is that always correct? Does it depend
on the view taken on the usefulness and indeed acceptance of the relevant legislation? Do I understand it; does it, on the whole, work and does it benefit those for whom it was intended? In the case of CA 2006, does it make the life of an SME owner/director any easier? From my discussions the short answer to this last question is quite simply 'no'.

In discussing these issues with people involved with SMEs, and many larger companies, the more I felt, whether by deliberate omission or perhaps inertia, even if their views had been heard, that they had not been acted on. Was there a communication breakdown between what was wanted and/or intended and what was finally enacted? Before I go on, this is not I should make clear intended to be an academic paper. And, with respect to some of those involved in preparing much of the law affecting SMEs is that a relevant point... did they ask the wrong questions of the wrong people?

The Dbis Report

In December 2010 an evaluation of CA 2006 report was prepared on behalf of Dbis (Department for Business Innovation and Skills). The core of this 300 plus page report was a survey conducted by ORC International of a random sample of about 1000 companies of all sizes, supported (i) by a series of company case studies, and (ii) interviews with several stakeholders such as business representative groups. Overall, the report found that 80% of companies are aware of changes brought in by the CA 2006. Even amongst small companies, where awareness was anticipated to be lower because of their reliance on advisers, 40% of companies know that changes have been made. [This means, of course, 60% -the majority - don't know]. [My italics in each case]

The report found that on the whole the changes are not seen as overly burdensome by companies and in particular, key deregulatory measures such as the removal of the requirement for private companies to hold Annual General Meetings and the greater use of written resolutions (instead of formal meetings) were particularly welcomed by companies and stakeholders and were seen as increasing flexibility.

The report recognised that CA 2006 was enabling in nature and that awareness and adoption levels are likely to rise over time as familiarisation with the new legislation increases [although implementation started in early 2007] and the flow of new companies formed under CA 2006, with many of the new flexibilities such as the new model articles already in place, grows.

Although disappointed that respondents to the company survey were unable in many cases to quantify savings from the various changes introduced by CA 2006, [I am not sure how that could be done and on a day to day basis whether there will, in reality, be savings; if anything costs may well increase] the report makes clear that it is still quite early after final
implementation [but not that early after initial implementation as noted in the previous paragraph]

Despite the fact individuals from 1000 companies were interviewed, many of the conclusions do not seem to agree with the views of almost everyone to whom I have spoken. I mentioned earlier that this is, and will remain, a talk and not a tirade. However feedback from my clients, numerous professional contacts as well as a regular review of a wide range of press reports does lead me to the view that the reality is somewhat different. Did Dbis ask the right questions – can they, themselves, assess objectively the progress and results of CA 2006?

Form filling

Let me move on to a couple of concrete examples and start with forms, company forms, boring to almost all I suspect, but the law says, fill them in or you could get a fine.

Core forms requiring completion under CA 2006 including those dealing with company incorporation, annual returns, which is a standard form to be completed by all companies each year, and returns of allotment to be completed on any issue of shares. Harking back to simpler times, pre CA 2006, it was, as I recall, easy to complete the standard form for incorporation, it was about six pages long and almost anyone could understand it. I, like many others, have completed hundreds of these forms over the years.

What do we now find? The incorporation form has grown to some 18 pages. I assume if someone had thought about it, it could have been longer (or, of course, shorter!). Where is the true economic or practical benefit and to whom in this extended document? One of the issues enacted as a result of CA 2006 was the ability of directors not to have to show their residential addresses, for fear as I recall of possible attacks by animal rights campaigners. But as Companies House does not actually check any of the details on the form anyone could fill in any name or address they wish. The complexities involved by adding several sections may or may not be worthwhile. How many people has this really affected? I am aware that the Dbis report cites this as one of the most useful changes introduced by CA 2006 - but what is the real use to the great majority of directors or third parties? Is it accountability, transparency or something else? As has been noted by others, the process of company formation and indeed administration by non-professionals is much simpler in many other jurisdictions.

For example, when I asked a lawyer in New Zealand how easy it was to register a company there, he replied, and this is my summary:
“First, need name approval. Generally get approval within one hour of application – rarely rejected, only if same as existing company or offensive word, etc. All done online. Once get approval apply for paperwork for directors (must have at least one) and shareholders (must have at least one). Need to get the consent forms signed; file the same and registration certificate e-mailed to you within one hour. Can register same day. Time really only how long client takes to get consents signed. No constitution required. Can have one if want one. Forms to sign = one pagers by directors/shareholders.

Again I accept it is easy for lawyers and for many others used to dealing with these issues, but perhaps not for someone starting a new company without much help. Although one answer is that people should always seek advice in some way before setting up a company, I am not convinced that should necessarily extend to the actual form process of form filling. Annual returns and returns of allotment are also cases in point. How hard should it be to complete an annual return when a company has one shareholder and one issued share? One of my clients gave up after about 15 minutes because as the electronic form he was trying to complete gave no real guidance and kept rejecting his input. Why? Partly I suspect, because those who drafted this and various other forms, forgot to ask the users; and if I am wrong here, then again did they ask a very selective group? The time and effort spent by a small company needing, by law, to complete this and other forms cannot be underestimated. The process of completing a form online is not necessarily the same as completing a paper one, although it should be.

I asked one of my colleagues to write me a note on this point:

“When completing a hard-copy Form SH01 for a return on the allotment of shares, one is required to fill in the details of the shares allotted before the revised statement of capital. It would therefore seem reasonable to expect that you should follow the same process online when confronted with two separate pages to fill in the required information. However, if you complete the allotment before updating the issued share capital you will be confronted with a warning sign stating that the number of shares issued does not match the number of shares allocated to shareholders. This occurs even though both sets of details are provided before the “submit” button is pressed, and no guidance is given to explain that a particular order must be followed.”

I suggest this encapsulates many of the points I am trying to make.

CA 2006 introduced a new requirement for companies to file a "Statement of Capital". CA 2006 also requires a company to supply any member with a current statement of capital on request. The statement of capital is, as appropriate, a stand-alone form (for example, on a
reduction of capital) or an integral part of a larger form (the annual return, for example). It must include:

- The total number of issued shares of the company;
- The aggregate nominal value of those shares;
- Prescribed particulars of the rights attaching to each class of share; and
- The amount paid up and the amount (if any) unpaid on each share, whether on account of the nominal value of the share or by way of premium.

Dbis commented in 2010:

"We are aware that one of the details required to be included in the statement of capital can cause problems for certain companies that have a complex history of allotting shares and managing their capital structure. In particular, we understand that in certain circumstances it may not be possible or meaningful for a company to identify the amount of premium paid upon each share.

The Department for Business Innovation & Skills is working with the Institute of Chartered Secretaries and Administrators (ICSA), who first drew this to our attention, and with other stakeholders to seek a resolution of this problem.

In the meantime, [my emphasis] we hope that companies with complex capital histories will do what they can to provide numbers in their statements of capital that provide a pragmatic allocation of their share premium reserve between shares or classes of shares. ICSA has published guidance on this, explaining the problem and outlining a recommended approach. When completing a statement of capital, in the annual return form or elsewhere, it is important that a company does not leave blank the field for the amount paid up on each share, or the form will be rejected by Companies House’s system”.

Let us remember Companies House asked for significant additional time to get its systems ready, so further delaying implementation of part of CA 2006. But it had several years to prepare. It has been suggested by some commentators that all that can be done at the moment (because there is no other way) is to somehow “fudge” the form. However people rely on these forms, and I suggest the annual return is actually quite important to many who carry out company searches.

In December 2010 Dbis confirmed (and this is a summary only):

"The Government has considered the scope to simplify the financial information requirements in Companies Act statements of capital which were the subject of the consultation. We have also considered concerns, raised by stakeholders but not covered by the consultation, that
the requirements to set out the prescribed particulars of the rights attached to shares in statements of capital are particularly costly and duplicative.

The Government believes that there is a good case to simplify the financial information requirements for companies, in all statements of capital, except those required on formation and in the Annual Return. At the same time we believe there is scope to simplify the information requirements on the rights attached to the shares to address the issues companies have raised.

But what is the nature of the consultation process which lead to such a major administrative burden being introduced only to be found wanting within such a short period? Why was it introduced in the first place? Practitioners as well as companies themselves will be pleased that the Government has acknowledged in this case the rules haven't worked.

If the forms are "incorrect", they will be rejected. But how many SMEs have the time to work out what is right? I know that many will say, "they can use advisors of some description or other". But now we arrive at another of my core points, the nature of the "constituency" of SMEs. If there are, as we are told, millions of SMEs, and a lot of those are very "S" indeed, who will advise them? How can many of them afford to pay to get right "things" including what ought to be very basic forms which they should be able to complete themselves? Why were they required to complete forms, which as noted above are not fit for purpose?

Another difficulty which the CA 2006 and those who administer it have brought into play is the inability to amend and correct forms such as annual returns which have been submitted with the wrong number of shares, the wrong designation or inaccurately worded voting rights. The only way to correct this is by submitting a further form with the correct details (which will then inadvertently, but automatically, change the "made up to" date for the next annual return). This can be a problem for companies wishing to retain certain dates in their calendar to match that of incorporation and the submission date for annual returns. Not too long ago the company was able to send in a corrected form and merely write at the top of the page of the form that was to be submitted as a correction/amendment to replace the previous one. So no common sense here any more.

As part of a survey by Jordans, the company administration firm, following the introduction of the CA 2006, more than a third of participants (36%) saw benefits in private companies no longer having to have a company secretary but a larger number in the survey – 41% – saw this as a backward step.

Although this change was supposed to be beneficial, will the removal of the requirement for a company secretary pave the way for an increasing number of SMEs to fall into default with
their filing obligations? It would appear to make sense for a defined person to deal with keeping registers, filing annual returns and other forms, filing accounts and ensuring that simple company law procedures are properly followed when changes occur. Despite the Dbis survey it is difficult to believe there are genuine benefits in removing the necessity for a company secretary. For many companies a person to carry out the specific functions of the secretary will often be necessary. It has also been suggested that I am making matters more complex by suggesting a continuation of the role of the company secretary for SMEs. The alternative, as put to me, is that those in need of guidance have access to the helpline at Companies House.

Why have I spent much time looking at something as mundane as the completion of company forms? I suggest that while it might be hard to explain to any director the rules relating to the abolishing of Slavenberg registrations (it is, I've tried), or the meaning of "success of the company" under CA 2006 section 172, a point to which I will return, it ought to be, or made to be, easy or at least easier than it is now, for directors to be able to complete these three core forms (as well as numerous others) without needing to seek external advice. If this is not the case, why not? The same questions, to my mind, keep arising during this discussion. As stated, I believe either the process of implementation was not followed through properly or the end user was not consulted in an appropriate way. In either case one of the Dbis aims "to deliver reductions in the regulatory burdens for business" has failed. I would suggest that rather than Dbis now looking at a "review of whether a new corporate form for single person business could reduce costs for small entrepreneurs", they sort out first, what we all have to live with at the moment, although I have one idea which I will come to later, which could help.

If we look at the actual language of CA 2006 and indeed the further 150 plus related regulations, we get perhaps to another core issue, which is complexity of the language of the legislation itself. Those who attended Dr Reisberg's lecture may recall his comments on interpreting a difficult section of CA 2006, section 443. The section is a new provision which sets out how to calculate the periods allowed for filing accounts. It is, to my mind incomprehensible. Again as I have noted, common sense should result in rules and their interpretation which are understood by those to whom they are intended to apply. For example does this help?

"In general this is the same date the relevant number of months later. So, for example, if the end of the accounting reference period is 5th June, six months from then is 5th December. However, as months are of unequal length, there can be confusion as to whether six months from say 30th June is 30th December (exactly six months later) or 31st December (the end of the sixth month). Under the rule laid down in this section, six months from 30th June will be 31st December. This reverses the "corresponding date rule" laid down by the House of Lords in Dodds v Walker [1981] 1 WLR 1027."
In the previous sentences I have more or less quoted the wording used by many of the commentaries which looked at this section. But reading the wording of the section itself doesn't help much either:

s. 443 Calculation of period allowed

(1) This section applies for the purposes of calculating the period for filing a company's accounts and reports which is expressed as a specified number of months from a specified date or after the end of a specified previous period.

(2) Subject to the following provisions, the period ends with the date in the appropriate month corresponding to the specified date or the last day of the specified previous period.

(3) If the specified date, or the last day of the specified previous period, is the last day of a month, the period ends with the last day of the appropriate month (whether or not that is the corresponding date).

(4) If—

(a) the specified date, or the last day of the specified previous period, is not the last day of a month but is the 29th or 30th, and

(b) the appropriate month is February,

the period ends with the last day of February.

(5) "The appropriate month" means the month that is the specified number of months after the month in which the specified date, or the end of the specified previous period, falls.

I remain unconvinced it is possible for anyone who doesn't have some real knowledge of why the section is there, to understand it. Perhaps the answer is that those who need to understand it are the auditors or accountants who advise companies. However it may well be that many SMEs don't want to use auditors for this type of question. If so and they get it wrong, or do nothing, the fines will start arriving.

By way of another example, in an earlier paper I cited briefly those sections in CA 2006 which deal with company names and wondered why 32 sections and additional regulations are required to legislate for this area. Do these meet the common sense test or not?
CA 2006 introduced a new system for dealing with company names and the process for obtaining clearance of certain words and phrases was streamlined. The rules for name changes were also altered. CA 2006 retained the previous process by which companies could change their name by shareholders’ resolution. The novelty is the inclusion of a facility which allows companies to change their name by any means specified in their Articles (so essentially by board resolution) and to notify the Registrar of Companies of the name change and the fact that it has been affected in accordance with the Articles (s.79 CA 2006). One benefit of the provisions is to make name changes easier for companies, particularly perhaps for those in the midst of a re-organisation [not likely for most SMEs]. The downside is that they may encourage name changes with the evasion of creditors in mind. Again, we need to look at the “common sense” issue in respect of these clauses. Can we say that most companies work within the law and should we assume that those companies will not use the new procedure as a partial method of avoiding creditors? Should we accept it will benefit the vast majority of users in the way intended? In this case perhaps the answer is a qualified yes. One slight annoyance is that pre CA 2006, filing the resolution to effect the name change with the fee was enough. Now the company is also required to file a form on change of name.

How did we all manage, as we did, before the arrival of the Company Names Tribunal? Is this of true benefit generally to companies and their directors? If so, how many and which ones? In brief this seems to have been how the Tribunal has been working.

Undecided applications: December 2008 to December 2010: more than 100.


Will the owner of the small company in Birmingham have the “energy” to pursue an action against someone operating a company with a similar name either in Norwich or in Plymouth or indeed defend against a much larger organisation? In any case the decision of such adjudicators can be appealed to the High Court, so where does this really take us? By way of example: a recent adjudication of MB Inspection Ltd’s request for an order under section 73 CA 2006 that Hi-Rope Ltd change its name. I do no more than note that adjudication itself is twenty pages long. What were the costs involved both financial and management? How many SMEs could afford them? Names of applicants consist almost entirely of major international groups – ranging from Barclays plc to Intel Corporation. There is nothing wrong with name protection but, again, where is the promised help for the SMEs?

Is there any merit in considering whether initial drafts of technical legislation could be prepared by relevant practitioners? I believe such an idea was previously considered and rejected. I think it should be considered again on a case by case basis. I also note (only because as I wrote at the time “so, it’s not just me then”), that in the annual report of the Court
of Appeal published in December 2010, Lord Justice Judge, was unimpressed by “the continuing burden of comprehending and applying impenetrable legislation.”

As mentioned, most people to whom I spoke considered there is too much company law. The majority is over-complex and as I have suggested often unenforceable and unenforced. I have seen commentary in this regard in respect of both the Corporate Manslaughter and Corporate Homicide Act 2007 and the Bribery Act 2010. In respect of the former there has only been one case tried so far. It was against a small company with one director and judgment was given in favour of the prosecution. The company has been fined £385,000 payable over 10 years. This legislation arose as a result of major disasters such as the Herald of Free Enterprise and the Paddington Rail crash. Companies and organisations can now be found guilty of corporate manslaughter as a result of serious management failures resulting in a gross breach of duty of care. Perhaps the law has indeed served its purpose or are there other reasons for the lack of cases having been brought. Do we need to give it more time?

The complexities of the – [at least until a few weeks ago] shortly to come into effect - Bribery Act are well documented: the legislation has an admirable aim to modernise British anti-corruption laws; but at what cost to British business, both financially and commercially? I will not repeat the differing views on that legislation here, but note that if such legislation (by way of example) is criticised by MPs, professional advisers and trade associations as well as numerous companies, including multinationals which may have subsidiaries operating in the UK, even before it is in force, perhaps that suggests we have currently an inappropriate system for passing and implementing laws concerning business. The fact implementation has been delayed until so late in the process makes it look as if the rules are not being well thought out. Lack of clarity and uncertainty does nothing to assist those who are required to interpret and understand the legislation, which in this case could lead to companies in breach having to pay very considerable fines.

Even in this instance I have seen some advisers say common sense got lost somewhere along the way, while others suggest the complete opposite. So, I have to acknowledge, as noted at the start of the paper, this is an excellent example of the difficulties of even those who understand a specific matter, coming up with a consensus. At one extreme the true story of a public sector administrator who refused recently to let her private sector host pay a total of about £15 for lunch, as she was concerned about the possible effects of the bribery rules could be said (at least by me) to have shown as little common sense as the organisation which wanted to fly half a dozen potential clients to watch a Test Match somewhere on the other side of the world.
A government which has made it clear that it wishes private business to provide the momentum for economic growth appears to have some difficulty in understanding why the current morass of over-complex legislation does anything but. As suggested by several commentators, what would happen in practice if no new rules (primary or secondary) affecting the management of companies were passed for six months?

I fear much of the difficulty is a result of attempting to micro-manage the entire business regulatory process. This in turn has lead to the production of a vast number of rules in most all areas of law affecting companies. I am by necessity limiting my paper to some core areas of company law. It could easily be expanded to include rules on banking, health and safety, insurance and taxation in respect of which I do no more than note, we now apparently have more rules than any other country. Those laws causing the most difficulties cited by those I have spoken to include in particular the complexities of employment law and its impact on SMEs. This is another extremely "hot" topic. In summary, directors are overwhelmed by a plethora of rules and duties.

That takes me on to duties of directors and section 172 CA 2006 which sets out some of those duties. In this case I don't want to discuss it in any detail, I want rather to mention a few relevant points. First, whether or not this part of CA 2006 has clarified and made the rules easier to understand remains open so far as many people are concerned. I can do no better than remind you of two of the quotes mentioned earlier.

This part of CA 2006 was brought into force on 1 October 2007, just as the credit crunch was gaining momentum, the United Kingdom having experienced in September 2007 the first run on a bank within living memory. Could there have been a better time to have introduced reform of the law relating to directors' duties?

The amount of analysis since the introduction of this part of CA 2006 and the relatively small, number of cases heard to date (less than 20 - although severable are not strictly on the "point" of directors' duties, but on related issues) leads me to suggest the following. Statutory interpretation of this (presumably) key area of company law has not been made any easier for the vast majority of directors of SMEs -- I would suggest most directors have little idea the sections exist let alone how to interpret them. The Dbiis report as noted above, states "although awareness of the codification of directors' duties was high (79% of those interviewed), but for just under half of companies interviewed, the codification had not prompted a change in how they carry out their duties). Of those companies not initially aware of the changes relating to directors' duties, over one-third indicated that they would now take advice from the company's accountant on the nature of their requirements. Does that lack of knowledge matter? Again I am not sure that it does. The likelihood of a director of an SME being sued in the civil courts for breach of section 172 and subsequent sections is. I
believe, unlikely at least at the moment. Has anything positive been produced to assist directors in trying to understand these rules? In this instance I think it has. The comments by the then Minister, Margaret Hodge MP and set out on the Dbios website, gives some genuine common sense guidance to those who want to do so. She states at the outset:

“For most directors, who are working hard and put the interests of their company before their own, there will be no need to change their behaviour.”

She goes on to give a common sense guide as to how directors should carry out their duties. I suggest nothing much has changed at this common sense level and most are likely to carry on in the same way as they have done previously. A competent director should:

1) Act in the company’s best interests, taking everything you think relevant into account;
2) Obey the company’s constitution and decisions taken under it;
3) Be honest, and remember that the company’s property belongs to it and not to you or to its shareholders;
4) Be diligent, careful and well informed about the company’s affairs. If you have any special skills or experience, use them;
5) Make sure the company keeps records of your decisions [and to my mind this is the most important point];
6) Remember that you remain responsible for the work you give to others;
7) Avoid situations where your interests conflict with those of the company - when in doubt disclose potential conflicts quickly; and
8) Seek external advice where necessary, particularly if the company is in financial difficulty.

Her language is clear and unambiguous and unlike many of the other rules mentioned in this paper, I see no reason why any director shouldn’t be able to understand them. If a director then wants further advice, that is a different issue. Compared with some of the complexity of debate in the Grand Committee stages of the passage of the Companies Bill through Parliament, these comments are a breath of fresh air. I do not now believe it assists the group of directors we are considering today to be told constantly how complex this area is – for most that is irrelevant.

Is the approach taken by Mrs Hodge too simplistic - I don’t necessarily think it is. As we will see, in many areas of business law one size decidedly does not fit all. This perhaps is one of those areas. I would suggest that what the directors of the FTSE 250 companies need to know about this part of the legislation is not what a director of a local family run greengrocer needs to understand. I am probably in the complex territory of legal theory if I ask, does that mean a different set of legal standards for these two groups? I don’t think it does. It means
a different common sense interpretation of those standards, which I am not sure is the same thing. To date, I believe, none of these sections have helped anyone formulate a claim against any of those directors of banks and other financial institutions involved in the 2007/8 crisis. I suggest that common sense, if it tells me nothing else, does tell me (not as a lawyer but as someone wearing a common sense hat) that if those sections don’t allow a right of action against some of those directors, they (the sections) probably aren’t fit for purpose. Therefore why should my greengrocer director be too concerned? Is that a cavalier approach – I don’t think so.

The courts’ role in interpreting and applying the statutory duties is unlikely to be much easier now even though such duties have been codified, because the statutory duties are expressed in very general terms. An important and sometimes difficult role therefore remains for the courts in determining, for example, whether a director has placed himself in a position of conflict.

Could the courts ever, in interpreting CA 2006, exchange the “proper purpose rule” (to the extent we have one) for common sense? That would be quite a result – although I would suggest an unlikely one. Decisions taken by directors may well be justified commercially, perhaps in order to prevent a large company from supporting a hostile takeover which they honestly believe will harm the company’s business and shareholders’ interests - but where the power is nevertheless improperly exercised because it would deprive the shareholders of rights conferred by the articles. In such an example the simplicity of common sense could not be applied.

CA 2006 has made these duties clearer at one level but for the advisors difficulties remain. We are back to my earlier comment about too many laws, complex, unenforceable and unenforced.

Think small first.............. or at least “think” first.

As we have been told, almost by way of a mantra, one of the overall objectives of CA 2006 “was to simplify and modernise company law so that it better met today’s business needs and provided flexibility for the future”. The reform process aimed to ‘think small first’. CA 2006 itself was to be written in simplified language, focusing on small business. I have explained earlier why I do not feel it has achieved its objectives to date. Therefore another question I have is this. Why after an extensive consultation period and then a further implementation period altogether spanning more than 10 years, only in December 2010 has Dbis stated “Our priority is to focus on those areas which have the potential to further simplify the business environment and deliver reductions in regulatory burdens for business. Specifically:
• Proposals to modernise and simplify the current system for the registration of company charges; as an aside, when these changes were attempted in the Companies Act 1989 the whole matter was later dropped as being impossible to implement. I agree entirely we do need a more effective system of security registration. However whether now is really the time to start on this process, I am not convinced.

• A review of whether a new corporate form for single person businesses could reduce costs for small entrepreneurs. At present there are hundreds of thousands of limited companies that are owned and run by a single person, and that person has to comply with extensive rules designed to balance the interests of multiple shareholders and directors; [see below]

• A range of options to simplify accounting and audit requirements, especially for small and medium enterprises.*

I have mentioned my "four problems" with the law. I have also given some examples of administrative matters arising from CA 2006, which although might be considered mundane in some instances, show even at that level can be over complex and have no regard to common sense. This complexity invariably leads to additional costs, both monetary and in management time which cannot be ignored. A large company might have internal systems in place to deal with these matters; alternatively it will have the comfort of knowing the work can be passed to outside advisers, be they lawyers, accountants or others. What of our constituent group? Another comment from Government is the idea that the SMEs are going to be the economic driver to pull the country out of the current downturn.

How can this be reconciled with various of the matters raised in this paper? I hear continuously views on these topics from numerous trade organisations which represent the smaller businesses. That said, I await to hear their practical proposals for reducing the burdens noted above. Several were asked to contribute to the ideas behind this paper. None responded to my requests.

Here is my practical idea and it isn't really a particularly novel one. All I have done is read the statements about simplifying company law, and I will tell you what these suggested to me. If you only take one point away with you when you leave, let it be my idea of a new Companies Act. I know that Dbis has recently had the same idea, and I hope the next few paragraphs might assist.

If Dbis does consider a simpler route to incorporation for a defined group of companies could they grasp the problem, go the whole way and produce a "Companies (Smaller Companies) Act" applying to that group. Dbis itself acknowledges that the constituents affected are "hundreds of thousands of limited companies". Perhaps they could copy from CA 2006, then
simplify even further, those provisions which apply entirely to “smaller companies” however we define them. One definition might be of “smaller companies” as these are applied by accounting provisions of CA 2006. However they could be much more radical and consider including companies with (i) a turnover of £260,000 per year or less, and (ii) no more than five employees. Is the numbers of directors and shareholders relevant? I am not sure either way. Perhaps to keep it simple, the position could be that any person who is a director must also be a shareholder and the maximum number would be two. For any action to be binding on the company it would require a piece of paper signed by both people (this rather follows the point made by Mrs Hodge in the earlier list at point (5). It would, I suggest, be a relatively straightforward exercise to pull together many of the pertinent provisions and simplify them at the same time. This would serve a number of purposes. First the core rules relating to Smaller Companies could be found in one place, so relieving many of the relevant owner directors of the need to plough through the morass of current legislation. The default position could be as set out in CA 2006 if rules are not included within the new legislation.

It would also put those companies in a stand alone group. This might then assist, if we took the idea forward, into areas such as taxation. The benefit in saved time and costs might then give credence to the wish expressed earlier as to one or more of the purposes of CA 2006. Common sense suggests that rules should be not only relevant but also appropriate to those who need to use them. The current complexities of CA 2006, as noted means this is often not the case. Provided those who wish to take advantage of the simplified regime were made aware of its restrictions, are there any real downsides? It has been suggested that some companies would deliberately stay below the threshold mentioned above to benefit from this regime. Somehow I find that an unrealistic proposition. It is not part of this paper to attempt to develop this theme in detail, but I hope this is something for discussion and some real progress.

In the same way as we might consider a possible statute to make doing business easier and less complex for a defined group, we should also note the difficulties, put to me as “one size is meant to fit all, but doesn’t”, in respect of many types of agreements. I suggest that common sense leads us to consider that usually one size doesn’t fit all and that common sense is not so common.

I acknowledge some legal duties or obligations are so core that we would require them to be applied to all companies whatever their size. For example, rules relating to employees' health and safety. But do they need to be applied in the same way to oil major and the local newsagent? Comments following the publication of Lord Young’s report last year include, "Putting Common Sense back into Health and Safety" perhaps too much of a soundbite, but more helpfully, one idea behind the report "was wanting to free business from unnecessary bureaucratic health and safety burdens and apply common sense to everyday decisions."
A further example of one size not fitting all is found in the preparation of loan documents. I think it is obvious that if I advise a non-financial lender, who is making, let us say, a £5,000 loan to an SME, neither will thank me for preparing a five page loan facility. Most of the key issues required to be included in such a document could be written in a few pages. Of course I could keep adding more and more clauses which in turn might add clarity and/or give greater protection to one party (probably the lender). But is that really what is required?

What is important? Is it the nature of the lender, the borrower, the size of the loan, its purpose, or a combination? Is it about, in this case, risk versus common sense (rather than the usual "risk versus reward"). Or "know your client", in the true sense and not the rather trite sense in which that phrase is often used today. I understand that when a major lender is making a billion pound loan to a major international oil group it would equally be non-sensical to think the parties would want to rely on a five page document.

I am, however, reminded that one of the counter-arguments in favour of ever longer documents is the wish to be protected against the possibility of litigation, because too often people look at "exploiting" loose wording or omissions in a document. Again this is a much wider issue than falls within the scope of this paper.

I am trying to find words to explain in this case what it is which characterises this process. How do the parties get to the point where each of them feels comfortable with what has been drafted? Is it no more than using the phrase "Well, each had a common sense review of the document and felt in the circumstances, it was as good as we could get". I go back to the definition of common sense at the start of this paper. Somehow each party has arrived at equality or a sharing of risk or they believe that is the position they have reached. We then end up with a piece of paper which completes the process and means the parties can complete their deal.

Where do the lawyers fit into this process? I have never forgotten the comment from the head of legal at a FTSE 100 company many years ago. Your job, she said, isn't to remove every risk. Your job is to get me about 90 per cent of the way there and tell me what is left to worry about - my job is to decide whether or not to bear those remaining risks or to ask you to give me greater protection. This to my mind is a concrete example of common sense, perhaps sometimes forgotten by some advisors. Of course, returning to the example above, if the facility agreement is long enough it ought to be capable of covering 99 per cent of lender's risk. But is the cost and time of doing so worth it? How will it help the relationship between the parties? We have to work on the basis, as also put to me by several people who have provided their comments, that business people want to get on and do business unhindered by rules which in their minds don't do much to help them. Could we therefore say that the rules hinder the vast majority of businesses while "protecting" a very few from the acts of a very few
— see the comment earlier, quoted at the start of this paper. Common sense is therefore thrown out, to be replaced by what exactly? Fear perhaps or a lack of understanding of key issues by those whose very role is to do so, or an inability of enough people to stand up against what they are remorselessly told must be the case.

As recent history has shown us, a take-over document of several hundred pages explaining in minute terms, why bank A’s take-over of bank B is a good thing and the board’s recommendation that all shareholders should vote in favour, can so easily flatter to deceive. How hard it would be for someone to say to the management and its advisors during a recommended bid, which is no doubt also supported by the non-executive directors, "this is from a common sense point of view a bad thing and as a shareholder I will vote against"? Who could possibly have disagreed with the RBS takeover of ABN - Amro, or the Lloyds takeover of HBOS - indeed, who did? These of course are two extreme examples of common sense just disappearing and being replaced by anything but.

It is why I have previously suggested that while I understand entirely the current vogue for courses in ethics and morality, perhaps one should be run on the basics of common sense. As a small digression, but I think a relevant one, I have been told that when the US investment bankers turned up in a country far far away to explain to the CEO of a large commercial bank why his bank should open the door to CDOs, CLOs and the like, he asked his own team to work out what it all meant. They came back and told him they just couldn’t do so. Rather than follow the herd instinct, the CEO politely waved goodbye to the investment bankers and I am sure, although perhaps not in the short term, was ultimately thanked by shareholders who kept their shares. And indeed kept their bank. In that case I think we can say “Common sense ruled – OK”.

Some Conclusions

As I began by suggesting, common sense could be said to be to do with ideas and proposals which involve sound judgment but without reliance on complex knowledge or research. It might relate to ideas and knowledge held by people in common.

Many of the issues raised here are more complex and varied than I imagined. Ultimately, to deal with some of the concerns raised in this paper, we would need to look again at the whole legislative process or perhaps go back even further and understand why certain laws are suggested and how they end up being what they are.

To summarise some of my observations and conclusions:-
In respect of SMEs, as well as many other groups, there are far too many rules, most of which are too complex for their constituents to understand without help;

If laws are going to be passed there should be an acceptance that they will whenever possible be clear for their core constituents;

One size generally does not fit all companies/constituents and we should stop trying to draft laws as if it does;

Too often the wrong people appear to have been consulted during the discussion stage of the legislative process, when that process applies to smaller businesses;

Legislators should not try and micro-manage the regulations of every sort of business—some need it more than others;

If those who wish to encourage SMEs, and economic growth through that part of the private sector are serious about doing so, then not only do we need less complex legislation, we need appropriate legislation; and

If a halt to legislation is not possible, appropriate rules need to be introduced; in the case of some SMEs, a Smaller Companies (Companies) Act.

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