C/M/S/ Cameron McKenna

Directors' digest

Small bites on the big issues

April 2006

"Demise of OFR sparks premature celebrations"

"Reporting rules unclear after farcical U-turn"

"Brown's presidential style revealed in Treasury papers"

November 2005 – Sir Humphrey visits the DTI

"Minister, as you know, we have been thinking very seriously about how we can reduce business red tape. After extensive consultation, the Chancellor has decided that the OFR is exactly the kind of goldplating of European Directives that places an unnecessary burden on business."

"Extensive consultation? Who did you talk to?"

"Well, Hermes said it was colossally over-engineered and unpopular".

"But, Sir Humphrey, the DTI has been working on the OFR for over four years – long before Europe got involved. We've consulted extensively, there's a new reporting standard on what should go in the OFR, and we've told everyone it will make large companies more socially responsible."

"Ah, but now *the Chancellor* has got involved things will be much simpler and better organised. It needed someone with the Chancellor's experience to really get a grip on things."

"So what are you going to tell DEFRA? – they've had a big campaign to encourage companies to report on their environmental and social impact. What did the rest of the Cabinet say?"

"Nothing – they don't know yet. But they'll be told tomorrow what the Chancellor is going to announce next week."

"Don't you need to do a public consultation before repealing rules we introduced a few months ago?"

"I don't think we should worry about that – all the major quoted companies will welcome the decision."

"But about 80% of quoted companies already produce some form of OFR voluntarily – and most major investors are keen on more transparent, informative reporting. Some directors have also told us that the discipline of preparing an OFR and selecting the most important KPIs should help improve corporate governance."

(continued right)

Contributors: Sandra Rafferty, Corporate partner;
and Peter Bateman, Corporate professional support lawyer.

Quote of the quarter

"It is not a level playing field …US citizens enjoy a considerable advantage over their UK counterparts in this vital area."

(Alistair Graham, solicitor to Ian Norris, former chief executive of Morgan Crucible, on the current disparity between the degree of evidence required in the UK and US for extradition. Unless and until a 2003 Treaty on Extradition is ratified in the US, US prosecutors need only provide a statement that the person is accused of an extraditable offence – no prima facie evidence is required. By contrast, UK prosecutors must show "probable cause". Earlier this year, Mr Norris, and the so-called 'NatWest three', failed to persuade the Courts to overturn the Secretary of State's decision to allow them to be extradited. The cases are apparently being appealed to the House of Lords. According to the Home Office, there are 23 white collar suspects awaiting extradition to the US.)

Sir Humphrey visits the DTI *(continued)*

"But Minister, that's just it – it won't be more transparent or informative; it won't give any of the really important information or tell you what's going to happen in the future."

"Well, directors might be cautious, because we didn't create any safe harbours for forward-looking information. But the OFR would have included lots of useful non-financial information about things like the company's objectives and strategies, its resources, capital structure and the trends and factors underlying its performance and prospects."

"All large and medium-sized companies will now just have to publish a more detailed business review – in line with the rest of Europe – although of course they can do a full OFR if they want."

"But, Sir Humphrey, it was because company reporting is currently inconsistent that we brought in the OFR in the first place…"

"Minister, I'm sure that business will find the best way to deal with this – it's important that Government doesn't tell them what to do."

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In the pipeline

Company Law Reform Bill

The Bill was introduced to Parliament on 1 November. Running to 855 clauses and 15 schedules, it will repeal about two-thirds of the Companies Act 1985 and amend other parts, and will pave the way for further changes to be introduced through secondary legislation. Learning from its experience with the equally lengthy and complex Financial Services and Markets Act 2000, the Government has started the Bill in the House of Lords to ensure that it receives detailed expert scrutiny before reaching the Commons.

On 11 January the Bill received its second reading in the House of Lords, and was sent for review by a Grand Committee of the House. Here, the Bill is being scrutinised clause by clause and amendments considered. Many amendments, particularly those concerning technical and drafting issues, have been proposed by the Law Society, firms of solicitors, business representatives and other interested parties. A minority of amendments are more 'political'. In some cases, the opposition simply wants to get the Government to put on record the thinking behind a clause, particularly where the Bill changes the wording of the existing Act but no actual change to the law is said to be intended. By convention, amendments are not formally voted on, so amendments that are unlikely to be accepted are withdrawn. Most amendments have been withdrawn.

By 15 March, the Grand Committee had debated the Bill on nine (non-consecutive) afternoons and reached clause 558. Debate over the statutory statement of directors' duties has taken up around five hours – more than 10% of the total time. Nearly all of the proposed amendments were withdrawn, so this part of the Bill is unlikely to change much in the House of Lords.

We will report in more detail on the Bill once it has been through Parliament and the wording of the clauses has been finalised.

Directors' toolkit

See back cover for recent additions to the Directors' Toolkit on Law-Now.

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Q&A "In good faith"

In our contracts and letters of intent should we oblige both parties to act "in good faith"?

It mainly depends on the type of contract, the relationship between the parties, and what exactly you want the good faith obligation to achieve. Often it may be better not to include a good faith obligation.

But doesn't "in good faith" have an accepted legal meaning?

There are lots of cases about what acting in good faith means in the context of peculiar types of relationship – such as where two people are in partnership, one is providing insurance, or one is acting as an agent or fiduciary for the other. But in 'ordinary' commercial relationships - such as between parties to a shareholders' or joint venture agreement, or a customer/supplier contract - it is uncertain whether, or how, a court will enforce an obligation to act in good faith.

Why is that?

Largely because "good faith" is a subjective matter, and because generally parties in an arm's length relationship are entitled to act selfishly in their own interests. Also, unless the contract actually sets it out, it is difficult to decide exactly what such an obligation entails. As a result, it is often hard to assess the amount of damages that would flow from a breach. By contrast, courts are happy to enforce an agreement to act "reasonably", as this imports an objective test of what the reasonable man in that situation could be expected to do.

So is a good faith obligation effectively unenforceable?

Not necessarily. In the recent *Petromec* case, the Court of Appeal was willing to enforce an obligation to negotiate in good faith over the extra costs of upgrading an oil platform according to an agreed specification. In this, the court was influenced by the facts that the obligation formed part of a wider, complex agreement that had been drafted by City solicitors, and that the matter left for negotiation was something that could if necessary be decided by the court, using evidence of what the upgrade would reasonably have cost.

What if the matter left for negotiation is less specific?

An obligation to negotiate in good faith over the terms of a proposed contract is much less likely to be enforceable, because it would involve the court deciding what terms the parties would have agreed. The more complex the contract, the more difficult this will be.

What about a clause obliging parties to deal with each other in good faith?

Although rejecting such a clause may prompt accusations of bad faith, for legal purposes it is usually better not to include one, because its meaning is uncertain. It could also colour a court's interpretation of more specific clauses in the agreement, thus 'muddying the waters'. If you are concerned about the other party acting in bad faith, it is better to include specific protection - such as a right to claim damages for breach of warranty or behaviour undertakings, or to rescind the agreement for misrepresentation.

Don't some other countries take a different approach?

Yes. Under New York law, for example, and in some continental jurisdictions like France and Germany, courts are more willing to award damages for breach of a good faith obligation – reflecting either the costs incurred in reliance on the promise, or sometimes even loss of profits. In some jurisdictions, a good faith obligation may even be implied in some types of contracts. An overseas party may therefore have different expectations about what a contract will say, and what an express or implied good faith obligation actually entails. Equally, though, some parties may prefer their contracts to be governed by English law because the absence of any implied good faith obligation is perceived to offer greater certainty.

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Directors' toolkit

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- Corporate manslaughter - latest update
- Late delivery of accounts: no more three-month extensions
- The Transfer of Undertakings (Protection of Employment) Regulations 2006
- The Company Law Reform Bill: Auditors' Liability and Audit Quality
- Marks & Spencer: A win for the taxpayer or a win for the Government?
- The Company Law Reform Bill

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