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The new statutory liability regimes

Narrative reporting and periodic financial information

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2006 Act statutory liability regime for directors' reports

Section 463

- Section 463 of the 2006 Act brought in force from 20 January 2007 for all reports issued after that date (irrespective of year end)
- Covers statements in directors' reports and directors' remuneration report (and any information in a summary financial statement derived from them)
- Until the accounts provisions in the 2006 Act are brought into force, defined terms in section 463 including "directors' report" have the meanings given to them in the 1985 Act

2006 Act statutory liability regime for directors' report

The scope of the liability regime

- Director liable to compensate the company for any loss suffered as a result of an untrue or misleading statement or omission in a report but only if he knew or was reckless as to whether the statement was untrue or misleading or he knew the omission was a dishonest concealment of a material fact
- Safe harbour: directors not otherwise liable to company and not liable to any third party for the report
- But carve out for civil penalties and criminal offence e.g. market abuse

2006 Act statutory liability regime for directors' report

Effect of liability regime

- Extent of safeharbour? – creation of separate personal liability for directors in some circumstances: contractual/misrepresentation
- Note view is that can be a cross reference to other narrative reporting in document sent out at same time (e.g. separate OFR) in order to apply safeharbour to that reporting as well
- One of stated aims of safeharbour for liability for directors report is to facilitate full disclosure in business reviews, particularly as regards forward looking information

Business review and enhanced business review

1985 Act

- From 2006 report and accounts onwards, under section 234ZZB of the 1985 Act, all companies (except small companies) are producing a business review
- 1985 Act business review must include:
 - a description of the principle risks and uncertainties facing the company
 - an analysis of the development and performance of the business during the year and the position at the end of the year
 - an analysis using financial key performance indicators and (where appropriate) other key performance indicators including information relating to environmental and employee matters

Business review and enhanced business review

2006 Act

- Section 417 of 2006 Act includes the same requirement for all companies (except small companies) to produce a business review
- There is also in section 417 a new requirement for all quoted (that is listed in the UK or EEA or traded on New York Stock Exchange or NASDAQ) companies to produce an enhanced business review
- Section 417 will be brought into force on 1 October 2007 (expected to be for accounting years beginning on or after that date)

Business review and enhanced business review

The enhanced business review requirement

- In addition to requirements for basic business review, the enhanced business review must also include to the extent necessary for an understanding of the development, performance or position of the company's business:
- the main trends and factors likely to affect the future development, performance and position of the company's business
- information about
 - environmental matters (including the impact of the company's business on the environment)
 - the company's employees, and
 - social and community issues

including information about any policies of the company in relation to those matters and the effectiveness of those policies; and

- information about persons with whom the company has contractual or other arrangements which are essential to the business of the company

Business review and enhanced business review

- Carve out for matters in course of negotiation if disclosure would be seriously prejudicial to the company
- Carve out for contractual arrangements disclosure of which would be seriously prejudicial to the third party and contrary to public interest
- Purpose of the business review stated in the 2006 Act to be to help members to assess how the directors have performed their duty to promote the success of the company
- Therefore CSR link between factors to consider when performing duty and description of policies in relation to those matters and description of the effectiveness of those policies
- Directors should therefore regard it as an opportunity to demonstrate compliance with their new duties

FSMA liability regime for periodic financial information under Transparency Rules

The Transparency Directive requirements

- The new rules on periodic financial reporting for listed companies under the Transparency Directive are set out in DTR 4 and apply to financial years beginning on or after 20 January 2007 – annual reports, half yearly statements and interim management statements
- The Transparency Directive requires Member States to provide for liability to investors in relation to disclosures made under the Transparency Directive requirements
- There were concerns about the UK common law position in which a duty of care needs to be established before there can be any liability to investors in the market
- The Companies Act 2006 (section 1270) inserts a new provision (section 90A) into Part VI of the FSMA which creates a statutory liability regime for periodic financial information issued under the Transparency Rules

FSMA liability provision for periodic financial information under Transparency Rules

The new statutory liability regime

- Under section 90A an issuer is liable to compensate an investor who acquires securities and suffers loss as a result of an untrue or misleading statement or omission in periodic financial information issued under a requirement imposed by a provision implementing the Directive (or in a preliminary announcement containing the same information)
- The issuer is only liable if a director knew the statement to be untrue or misleading or was reckless as to whether it was, or knew the omission to be, a dishonest concealment of a material fact
- Except as specified in section 90A, an issuer is not otherwise liable to investors and nor is any other person
- But there is a carve out for civil penalties and criminal offence e.g. market abuse
- A company which is required to compensate an investor could then claim against the director(s) at fault (or investor could seek to use derivative action to force company to claim against director)

FSMA liability provision for periodic financial information under Transparency Rules

Issues

- Interaction with directors' responsibility statement in annual report and interims
- Extent of safeharbour? E.g. creation of contractual liability, individual misrepresentation by a director?
- Does it apply to quarterly reporting which exempts an issuer from an IMS?
- How does it compare to the *Caparo* case common law liability principles – more onerous test of blame (more than just negligence) but creates direct liability without having to show duty of care
- Still possibility of impact of laws in other jurisdictions when an overseas investor is making a claim or there is an overseas offer or listing
- Paul Davies review
 - Considering liability regime generally
 - Considering extension to other disclosures by listed companies