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Did you know that...?

Corporate newsletter July 2008

Welcome to the latest edition of *Did you know that ...?*, our regular briefing, which highlights key legal developments affecting companies and their advisers. We hope that you will find it useful and informative. If you think this publication may be of interest to any of your colleagues or acquaintances, please feel free to forward it to them and we will be happy to add them to our mailing list.

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Guidance on extent of contracting party's discretion

COMPANIES ACT 2006

FINANCIAL REPORTING COUNCIL PUBLISHES GUIDANCE ON AUDITOR LIABILITY LIMITATION AGREEMENTS

...the Financial Reporting Council (FRC) has published its long-awaited guidance on auditor liability limitation agreements (LLAs)?

Under sections 532 to 538 of the Companies Act 2006, which came into force on 6 April 2008, companies are for the first time permitted to enter into contractual arrangements with their auditors to limit the latter's liability, provided that shareholder approval is obtained. The auditors' liability may only be limited to an amount which is "fair and reasonable" in all the circumstances.

The new FRC guidance aims to provide practical assistance to companies and their directors on how to apply these new provisions. In particular, it aims to:

- Explain what is and is not allowed under the new Act



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- Set out some of the factors that will be relevant when assessing the case for a LLA
- Explain what matters should be covered in a LLA and provide specimen clauses for inclusion
- Explain the process for obtaining shareholder approval and provide specimen wording for resolutions and notices of general meeting.

The guidance does not attempt to determine whether particular arrangements will be considered “fair and reasonable”, as every arrangement will need to be assessed in the context of the particular circumstances.

The FRC has said it will review the impact of the guidance in the second half of 2010.

The Institutional Shareholders Committee (which includes the ABI and NAPF) has published a statement on what institutional investors are likely to expect from companies seeking shareholder approval for LLAs. The starting point is that investors are generally willing to support “agreements providing for proportional liability or those providing for liability to be at the level that is fair and reasonable”. However, they will not support agreements which include a fixed cap element, and are unlikely to support agreements after the audit work for the year has been completed. The ISC will expect companies to use the specimen principal terms for LLAs contained in the FRC guidance.

PIRC, however, has already said in its shareholder voting guidelines that it is not in favour of LLAs.

The FRC Guidance, together with the covering press release, is available on its website at www.frc.org.uk/press/pub1644.html. The ISC statement is available from the Institutional Shareholders Committee website at www.institutionalshareholderscommittee.org.uk/library.html

CORPORATE GOVERNANCE

REVISED COMBINED CODE ON CORPORATE GOVERNANCE PUBLISHED

...the Financial Reporting Council (FRC) has recently published a new version of the Combined Code on Corporate Governance?

The main changes in the new Code are that:

- It now permits an individual to chair more than one FTSE 100 company
- For listed companies outside the FTSE 350, it now allows the company chairman to be a member of, but not chair, the audit committee, provided he was considered to be independent on appointment (provision C.3.1)

Schedule C to the Code has also been updated to include the disclosure requirements under new Section 7.1 of the Disclosure and Transparency Rules, which implements EU requirements on audit committee and corporate governance statements. DTR 7.1 sets out the requirements regarding audit committees and their functions and DTR 7.2 the requirements for corporate governance statements.

The FRC has identified a number of Code provisions which overlap with the requirements of new DTR 7.1 and 7.2. These provisions are set out in an Appendix to the Code. The overlap has been dealt with in DTR 7 which states that, where a company has complied with these



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provisions of the Code, it will also be deemed to have complied with the relevant requirements of DTR 7. However, where a company chooses to explain, rather than comply, with any of these Code provisions, it will need to ensure that it nonetheless meets the requirements in DTR 7. This effectively means that the “comply or explain” approach no longer applies in respect of these Code provisions.

The revised Code, and DTR 7, apply in respect of accounting periods beginning on or after 29 June 2008. The Code can be obtained from the FRC website at www.frc.org.uk/corporate/combinedcode.cfm. DTR7 forms part of the FSA Handbook which is available from the FSA website at www.fsa.gov.uk.

CASE NOTES

REGUS (UK) LIMITED -V- EPCOT SOLUTIONS LIMITED

The Court of Appeal has recently provided guidance on the extent to which suppliers may limit liability under service contracts.

In *Regus (UK) Limited -v- Epcot Solutions Limited [2008] EWCA Civ 361* Rix LJ considered a limitation clause which contained fairly standard commercial terms. Regus agreed to provide serviced office premises to Epcot under the contract. The air conditioning in the premises failed and Epcot claimed against Regus for damages, including for loss of opportunity to develop its business. The clause in question excluded damages for loss of profits and consequential losses. There was a further contractual limitation, again in quite usual terms, limiting damages to £50,000 or 125 per cent of fees paid under the contract to the date of claim. The issue before the court was whether these limitations were sufficiently reasonable such that they satisfied the reasonableness test in section 3 of the Unfair Contract Terms Act 1977 (**UCTA**). The court held that the limitations were reasonable in the circumstances and did satisfy section 3 of UCTA. The Court of Appeal decision overturned the High Court’s finding that the limitations were unreasonable and in contravention of section 3.

The Court of Appeal placed particular emphasis on the following factors:

- The parties were of equivalent bargaining power
- Epcot’s managing director was aware of the limitations but did not seek to negotiate them
- There was specific wording in the limitation clause advising customers to insure against the liability excluded.

These factors are consistent with statutory aids to determining reasonableness in Schedule 2 of UCTA. Suppliers will be reassured by the *Regus* case - and can be more confident that standard exclusions and limitations in their service contracts will be upheld, if tested.

The full text of the judgment is available at www.bailii.org/ew/cases/EWCA/Civ/2008/361.html

SOCIMER INTERNATIONAL BANK LTD -V- STANDARD BANK LONDON LTD

...recent case law has provided guidance on the extent of a contracting party’s discretion when the contract is silent on the issue.

In *Socimer International Bank Limited (in liquidation) -v- Standard Bank London Limited [2008] WLR [D] 58* a securities trading agreement between two banks required the creditor bank to



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value certain assets of the defaulting debtor bank at the date of termination of the agreement. The court held that whilst the creditor bank was required to carry out the valuation honestly, rationally and not arbitrarily, there was no obligation to apply objective criteria in carrying out its valuation or to take reasonable care in determining a market valuation. The contract did not expressly require such an approach and the court held there was no necessity to imply a term requiring that approach. The decision reinforces established law that:

- a term will not be implied into a contract unless it is necessary to give the contract business efficacy; and
- at least in a commercial context, whilst courts will be careful to see that the exercise of a contractual discretion should not be abused, they will not prescribe how a discretion should be exercised.

While the case is helpful guidance in the areas of implied contract terms and limits on contractual discretion generally, it provides specific guidance on the applicable principles in interpreting contractual valuation provisions where the obligation is placed solely on one contracting party. In the absence of any obligation to apply objective criteria, the valuing party will be free to reach its own subjective valuation provided it acts rationally and in good faith. Whether there is any further limit on the party's discretion will depend on the provisions of the contract and, as usual, an assessment of the intentions of the parties.

The full text of the *Socimer* case is available at:
www.bailii.org/ew/cases/EWCA/Civ/2008/116.html

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