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LONDON, WC2A 2LL

18 October 1979

01-405 7641 Extn 3201

The Rt Hon John Nott MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
LONDON S W 1

Dear John.

*This letter not
Copied to No.10.*

COMPANIES BILL
DIRECTORS' DUTY TO HAVE REGARD TO THE INTERESTS OF EMPLOYEES

Thank you for your letter of 11 October. I have since had further information from your officials and yesterday had a conference with them and Parliamentary Counsel. My advice is as follows on the draft clause in the version sent with your letter.

2. At least in the English courts I do not think that employees could successfully argue that the duty imposed on directors by the clause is enforceable by them. In other words they could not sustain legal proceedings if they were employees but not members. In my view the wording of the clause precludes any action by employees in that capacity. I understand that the position in Scotland may be different but the Lord Advocate will advise on this.
3. It would, of course, be possible for an employee who was also a shareholder to mount an action under the clause but one should bear in mind that it is possible under the present law for such a person to bring proceedings alleging conduct by the directors which is oppressive to a minority of the members.
4. From this I infer that the real question is whether an action by an employee member under the clause, or by a member who was not an employee but nevertheless alleged a breach of the duty by directors, would be likely to succeed in circumstances where such an action would not be likely to succeed at present.
5. I cannot give you a categorical "no" in answer to this question but I think the practical consequences of the clause would be slight in terms of directors' existing general duty to act bona fide in the interests of their company, in terms of the factors they have to take into account in discharging that duty, and hence of the rights which minorities currently have to restrain oppressive conduct by them.

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6. In particular, I do not think the new clause would enable a member to bring a successful action where the interests affected were solely his as an employee, or if he was not an employee, those of other employees in that capacity. It would be necessary to show (as it is at present) that some legitimate interest of the company, expressed as the interests of a prejudiced minority of the members, had been affected. But as I understand it, this would satisfy the objectives you have in mind in introducing the new clause.
7. You go on to ask whether, even if there is no prospect of successful litigation by employees to enforce the duty, there might still be vexatious claims that would disrupt the management of companies.
8. It follows from what I have said that any action by employees who did not hold shares would be likely to be struck out at the interlocutory stage in legal proceedings. This might not be sufficient to avoid disruption, especially to small companies, but I think such actions would probably be confined to a short period following the enactment of the clause, after which the lesson would have been learnt.
9. There is also, of course, the possibility of members' actions having no substantial merit, which could not so easily be defeated in limine. I cannot advise you that there would be no such actions, because nuisance litigants are a fact of life, but I think the most likely outcome of the clause would be test cases designed to show that it confers no appreciable benefits on employees. Such test cases would be likely to go on appeal and to that extent cause prolonged disruption, but once the scope of the clause had been established by them litigation would probably not be frequent. Test cases could, of course, bring pressure for further changes in the law, but that is not a matter for me at this stage.
10. My general conclusion is this. In the proper performance of their functions directors have in law to bear in mind a variety of factors, and these will include the interests of employees in cases where the relationship between them and the company in which they work cannot be separated from the interests of the company as a whole. This is the case at present. I see the clause as doing little more than giving statutory expression to this principle and I doubt whether, save in the most exceptional cases, it will alter the balance of considerations which is relevant to the duty of directors

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to act bona fide in the interests of the company. The duty imposed by the clause is, in any event, weak as it is only a duty to have regard to the interests of employees and not to act in accordance with those interests.

11. Here I must add that as a Law Officer I always dislike legislation which on proper analysis appears to have no substantial effect, and is enacted for reasons which all too soon become apparent, not only to the Opposition but also to the courts who have to construe it.

12. Furthermore in giving this advice I am conscious that I may be called upon to explain to the Commons what are the legal effects of this clause. It will be apparent from this letter that I shall not be able to reject criticism that these effects are small and that the clause confers very little additional benefit on employees; in other words that the clause may properly be described as cosmetic. These are obviously factors which you will have to take into account in deciding whether to introduce the clause, but I would at least be able to say something on the lines of paragraph 10 of this letter without drawing attention to the more negative aspects (though this will undoubtedly be done by the Opposition).

13. Finally I should say that I see very little difference in substance between the first and second versions of subsection (2) of the clause, but I prefer the second version for the reasons already given by Parliamentary Counsel. In my view he has performed extremely well the unenviable task of drafting a clause which appears to confer benefits on employees but on analysis does not change the law significantly.

14. This is copied to the Prime Minister, Jim Prior, James Mackay, Sir John Hunt and Parliamentary Counsel.

Yours Av. Michael.

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