

## RESPONSE TO THE GOVERNMENT'S WHITE PAPER ON MODERNISING COMPANY LAW

### 1.0 SUMMARY

- 1.1 This paper sets out the Agency's response to the Government's White Paper on Modernising Company Law (Cm 5553 Vols I & II) with annexes on why we have a significant interest in company law and our policy on corporate environmental governance.
- 1.2 The Agency welcomes the White Paper and regards it as an important opportunity to embed the link that good environmental management and good company performance go "hand in hand" in Company Law because of the competitive advantage this will give UK business in wider international markets.
- 1.3 Better Company Law will also make it easier for us to do our job of regulating companies' environmental behaviour. By strengthening aspects of the draft Bill (see below) we believe we would be able to reduce our regulation of companies with good environmental performance, and target our efforts more on poor performance.
- 1.4 We also believe there are lacunae between aspects of company law and environmental law that need to be closed (e.g. company law allows company directors to walk away from their obligations in respect of environmental liabilities on insolvency through disclaiming an environmental licence from the Agency as onerous property). This Bill could provide an opportunity to remedy such situations.
- 1.5 We are pleased that some aspects of our previous responses to the independent Company Law Review team have been taken on board (e.g. reference to the environment as a key business issue in the new Operating and Finance Review (OFR) in Annual Reports and Accounts).
- 1.6 However we are disappointed that other, and more fundamental aspects, which would benefit the reputation of UK business that do not necessarily need to be onerous, unfortunately do not appear to have been taken on board such as
  - placing a statutory duty of care for the environment on Company Directors
  - compulsory reporting of companies' environmental risk management and environmental performance in the new OFR.
- 1.7 We would welcome a meeting with Ministers and the Bill Team to discuss our response and possible opportunities to assist and work with the DTI on refining and developing the Bill and associated secondary legislation and

company reporting standards where there is a need for input of environmental expertise.

## **2.0 COMMENTS ON SECTION 1 - WHY REFORM IS NEEDED**

2.1 We fully support the Government's desire to simplify and modernise Company Law, though we note the White Paper and draft Bill will only regulate the way companies are set up and run but

not law on how companies are listed and traded on the stock exchange

nor the taxes companies pay

nor the rules by which companies buy and sell goods and services.

nor insolvency law on how companies are wound up

nor how company directors can be disqualified from running another company

2.2 Thus this White Paper only partially deals with simplifying and modernising the overall legal regulation of companies' activities which all affect our overall economy and environment. We think the Government should also look at these other related laws so they are also reformed and modernised (either concurrently or in the near future) so that all company related law is based on "joined up" thinking and policies.

2.3 This view is based on our experiences in regulating both solvent and insolvent companies causing environmental problems, plus recent research of the incomplete disclosure of environmental considerations in a company's future strategy in its listing documents.

2.4 For example, at present company directors can legitimately walk away from environmental liabilities they have caused (e.g. polluting groundwater and public drinking water supplies) by forming a new company and leaving a financial liability with the insolvent old company (Hunts Refuse Ltd at Helpston). This has resulted in public funds having to be used to clean up the pollution and protect public health.

2.5 We welcome the fact the Government recognises the links between this White Paper and other concurrent EC and UK developments and consultations on

- implementing a new EU Directive on the application of International Accounting Standards in the UK from 2005
- several new draft EC Directives (Prospectus Directive, Company Disclosure Obligations, Corporate Governance Directive) on information that has to be published when a company issues shares, seeks a stock exchange listings, and reports to the stock markets.
- related reviews in the UK of company listing rules, the role of non-executive Directors, effectiveness of the regulation of financial reporting and auditing, the law on company charges, and Cabinet Office reviews on the disclosure of beneficial interests in unquoted companies, and reform of charity laws.

2.6 However, we note the contents of these have not yet been incorporated into the White Paper or draft Bill and that it also does not mention the recently agreed EC recommendations on environmental issues in company annual

reports and accounts, and corporate social responsibility which are also of importance and significance to future Company Law.

- 2.7 The latter two are of particular interest to the Agency and we suggest that as an EU member state these recommendations are incorporated into any future new UK Company Law. The draft Environmental Liability Directive will also have implications for some UK companies.

### 3.0 COMMENTS ON SECTION II – THE GOVERNMENT’S POLICY

#### The right approach

- 3.1 We note and agree in principle that new company law should consider the large number of smaller largely private companies first with different provisions for the fewer larger public companies.
- 3.2 However, in practice, we have concern about institutionalising lighter touch corporate regulation of small companies because the majority of pollution incidents are caused by SMEs. If smaller companies activities (some of which are exempted from environmental regulation) are only lightly regulated by new company law as well, it is likely to be impossible to seek tougher environmental regulation of them, which will make our job harder, and may result in the EU taking infraction proceedings against the UK Government.
- 3.3 We would recommend that new company law should require both small and large companies to account for and report to a minimum standard the following - the volume of raw materials, water and energy used, plus waste and emissions produced. This would help reduce waste production and pollution, and increase their productivity, resource efficiency, competitiveness and profitability. This would also help the Government achieve other wider sustainable development policy and economic objectives.

#### Improving governance : Directors

##### General duties (question 1)

- 3.4 While we welcome Clause 19 and Schedule 2 in Vol. 2 of the draft Bill - that Directors should cover the short and long term consequences of their action, where relevant, and take into account, where practicable relevant matters, such as their relationships with employees and the impact of the business on the community and on the environment, we do not think the qualifiers where relevant or practicable are necessary as we do not consider there are any real life circumstances or examples of companies which are not affected by some environmental influences on their activities - which all company directors should be aware of - such as the
- impacts of natural events such a droughts, storms, and floods,
  - availability of raw materials and energy from coal, gas, nuclear sources
  - impact of EU environmental legislation
  - impact of climate change
  - environmental impact of their supply chain
  - the disposal of their waste products.

- 3.5 Therefore, we recommend that Company Directors should be given a statutory duty of care towards the environment in the same way as they have to their employees and customers. This then removes any ambiguity and makes the law crystal clear. Company Directors should be made liable for any negligence or wilful misconduct in relation to the environment.
- 3.6 We also support the proposal that Companies House should send Directors of both public and private companies a leaflet summarising the main legal requirements on them by various laws – and we recommend this is also extended to cover laws relating to the environment, as well as health and safety etc. We would be happy to assist and support the drafting of such guidance. Our “NetRegs” webpages are facilitating this for SME’s.

### **Duties in relation to creditors (question 2)**

- 3.7 We support the proposal that the law should make reference to companies’ obligations to their creditors – as we regard the environment as being a creditor - damage to it should be made good by the company causing it.
- 3.8 Under current law a company director can set up and move the assets from an existing company to a new company, leaving the original company insolvent with various liabilities such as contaminated land or polluted groundwater which subsequently has to be cleaned up using public funds to protect public health. The White Paper and draft Bill are silent on this issue and the restructuring of companies generally so liability ownership is transferred and not orphaned.
- 3.9 Also even where financial provisions have been made in company accounts to meet post closure environmental obligations for up to 30 years (so that there is no further pollution risk) the availability of this money to meet environmental licence conditions can be called into question as being onerous property by company liquidators.

### **Company reporting and audit**

- 3.10 We support the Government’s view that “good reporting is essential for shareholders, as well as creditors, employees, and others who may have an interest in companies and their activities – and improving the quality of reporting rather than the mere quantity of reporting”
- 3.11 However, we recommend that Government should extend this policy statement and make it explicit that “others” include all the key company regulatory bodies like the Financial Services Authority, Companies House, the various OF-bodies, and Environment Agency, as well as wider stakeholders such as institutional investors like Pension Funds, NGO’s, and public.
- 3.12 We consider there may be scope to simplify the various company reporting requirements of the EU, Government, the Agency, and the OF-bodies so information is collected just once. For example it might be possible to combine the information requirements of several EC environmental directives into one electronic proforma. (e.g. environmental emissions data collected under the IPPC Directive and environmental expenditure data collected under Business Statistics Directive). This would reduce data handling costs and help

companies, the Agency, and Government. There should also be an obligation on utility suppliers to provide this information.

3.13 We note the proposal that the form and content of company annual report and accounts will not be in the Bill but will be devolved to a new Standards Board. We recommend that disclosure requirements that are in the wider public interest such as company reporting on environmental issues should be included in the Bill and detailed in mandatory statutory guidance.

3.14 In this respect we recommend that key environmental issues are summarised in the proposed new OFR and that specific issues relating to the environment should be disclosed in supplementary statements or reports which should be subject to independent audit and verification.

### **Operating and Financial Review (OFR) (questions 43-58)**

3.15 We welcome the Government's proposal that in the new OFR Directors should report on their "company's policies on environment issues relevant to the company's business"- which the Government believes every Director needs to "consider" as "first amongst equals". However we would recommend this should not be left to the discretion of individual directors and companies to "consider" what are "material environmental issues" and whether to report on or not to their shareholders, and wider public interests – and it must also include performance against these policies.

3.16 We recommend that reporting on their risk management and performance in relation to the environment should be a compulsory part of the OFR, as we do not know of any real life circumstances where companies are not affected by significant environmental influences on their activities that their directors should be aware of - such as the importance and impact of :

- natural events such a droughts, storms, and floods,
- availability of raw materials, water and energy
- their supply chain
- EU environmental legislation
- climate change
- the disposal of their waste products.

3.17 We think this would also help the Government achieve other wider sustainable development policy objectives in these areas, which could be achieved without being to onerous through use of simple generic and specific sectoral performance indicators agreed with business to generate consistent and comparable reporting.

3.18 We note it is the Government's intention to devolve to an independent "Materiality Advisory Group" of experts to help provide guidance to the proposed new Standards Board on how to assess whether an item is material to their company, and hence if it should be included in OFRs. This which only need to be produced by the 1000 economically largest companies (0.1% of registered companies covering just 25% of corporate economic activity).

3.19 We consider that this requirement should not simply relate to the 1000 largest companies in terms of economic materiality (ie public companies with a

turnover greater than £50million or more than 500 employees and private companies with a turnover greater than £500 million and 5000 employees).

- 3.20 We recommend it should be based on the environmentally most significant companies defined by consumption of raw materials/energy and/or production of waste/emission of pollutants and apply to all companies with more than 250 employees, as these are better proxy measures of environmental significance.
- 3.21 Given we are the main environmental regulator of UK companies we are disappointed to have been advised by DTI officials we are too specialised to be on this group and only asked to submit written evidence to it. We look forward to doing this in early 2003.

### **Keeping the law up to date – institutional arrangements**

- 3.22 We welcome the Government's proposal that the law should be kept up to date and respond to the changes in the environment in which companies operate, especially in view of the predictions of climate change.
- 3.23 We note the Government's proposal to retain the Financial Reporting Council as an "umbrella body" to oversee the Standards Board (responsible for standard setting for financial reporting, the content of the OFR including non-financial information, and reviewing the Combined Code on Corporate Governance) and a new Reporting Review Body (responsible for their enforcement) along with Government itself. We note this complex triangular regulatory structure is to be funded by Government grants, accountancy bodies, and the City, and we agree that these bodies will need very broad independent membership to reflect their broad remit and wider public interests.

### **Other ways of simplifying and streamlining the law (question 6)**

#### **Disclosure of convictions**

- 3.24 We think that Companies should disclose their directors' criminal convictions in their Annual Report and Accounts, including those for offences relating to wildlife and environmental legislation. In addition to information on prosecutions and fines for criminal offences by companies made public by the Agency and Health and Safety Executive, we consider there should also be an electronic public register of convictions for offences under Company Law maintained by Companies House.

## **4.0 CONCLUSIONS**

- 4.1 The Agency believes the Company Law Review is an opportunity for Government to integrate sustainable development into future Company Law which need not be onerous.
- 4.2 This will help increase the long-term competitiveness of UK companies by reducing environmental risks, wastage and lost productivity, and improve UK companies' profitability and reputation.
- 4.3 The Agency hopes that Ministers will consider our recommendations, and we would be happy to discuss our response or provide further information to the

Bill Team, especially on those points on which they are not inclined to accept the Agency's advice.

- 4.4 We would also welcome the opportunity to provide environmental expertise (for example on environmental risk assessment, environmental assets and liabilities, and non-financial performance measures) to either the Bill Team and/or the Materiality Advisory Group and Standards Board drafting the new company law and associated company accounting and reporting standards.

## **FURTHER INFORMATION**

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## **ANNEX 1 – OUR INTERESTS IN COMPANY REGULATION**

### **General background**

The Agency is a non-departmental public body sponsored by Defra and the NAW. We are responsible under the 1995 Environment Act for protecting and improving the environment, and contributing towards the aim of achieving sustainable development, across England and Wales.

We currently regulate around 300, 000 companies who are required to apply for and comply with various Agency “licences to operate” to legally carry out their business. New EU measures will extend the number of companies who we regulate to around 1,000,000 in 5 years time. We also provide advice on environmental management to thousands of SME’s, and issue flood warnings to all companies with buildings situated on flood plains.

Before using our formal enforcement powers and the courts, the Agency prefers to encourage companies to adopt best practice environmental management techniques, and we provide waste minimisation and pollution prevention advice to licence applicants as part of our broad approach to regulation.

We are also seek to influence company boardrooms and financial institutions investment decisions through our annual “Spotlight on Business Environmental Performance” league tables, that highlight good and bad environmental performance.

In 2001 we found it necessary to pursue and obtain nearly 2000 criminal convictions against companies and individuals for illegal acts under various statutes. While the highest fine awarded was £100,000 the average fine imposed by the courts on companies was only £6,400. Both these figures are extremely low in relation to many companies financial turnovers. This makes it cheaper for companies to budget for polluting the environment than to prevent it happening.

### **Companies and sustainable development**

The Agency believes that the principles of sustainable development and good environmental management, which are widely supported throughout the world and by the Government, should be incorporated into new Company Law. We think that the UK should lead the world in its approach to corporate environmental governance.

The Agency believes that the Company Law Review offers the Government an important and timely opportunity to reform and modernise UK company law, so that the internationally agreed principles of sustainable development are embodied into the heart of corporate governance at the start of the 21<sup>st</sup> Century.

The growing awareness both locally and globally of the need to protect the environment for future generations is leading to stricter regulatory standards and increasing costs for the use of limited natural resources. Therefore, it will be companies that treat the environment as a key business issue who will be the most sustainable and competitive in the future.

There is an opportunity for the Government to demonstrate leadership by creating a new statutory framework for corporate environmental governance that will be respected and emulated across the globe as one of the best means of protecting the planet for use by future generations.

## **The environment and UK business**

Some enlightened businesses are recognising that how they treat our natural environment is an important issue that affects their profitability, reputation, employees, customers, and investors. Looking after our planet and its natural resources for current and future generations makes good economic and environmental sense, especially as we approach (or exceed) sustainable levels of use for some of these resources.

Although due to pressure from Government more FTSE 100 companies are now voluntarily producing environmental reports than several years ago, it is notable that only 2% of companies in the FTSE All Share Index mention environmental policy in their Annual Reports and audited Accounts. Recent research indicates that relatively few companies are paying sufficient attention to the likely impacts of climate change. Furthermore over 99% of companies are SME's which accounts for the majority of pollution incidents and pollution in the UK.

It is also disappointing to note that out of 2.9m registered companies only 3000 companies in the UK with accredited certification to the ISO14001 environmental management system and less than 100 are registered under the EU EMAS scheme. These figures are low compared to other countries such as Germany in the EU and Japan in Asia.

This is giving companies in these countries a growing competitive advantage over UK companies, which is bad for our economy and the environment. Compliance with environmental legislation and a good reputation for environmental responsibility can add significant financial value to companies and produce competitive advantage.

The Agency believes there could be real opportunities to increase the competitiveness of UK business if more companies treated the environment as a key business issue and actively reduced their consumption and expenditure on natural resources, and waste disposal. Any wastage of raw material, production of waste, or creation of an environmental liability is a loss of productivity and profitability and is bad for the environment and economy.

## **Companies and environmental regulation**

The Agency's view is that both "carrot" (soft, voluntary) and "stick"(hard, mandatory) regulatory policies are needed to achieve better environmental performance by business.

The Agency much prefers to help prevent pollution and environmental damage rather than to prosecute companies after pollution and damage has occurred. Consequently, we regret that last year we found it necessary to obtain nearly 2000 prosecutions and £2.7m fines for pollution offences. The courts gave 9 custodial sentences of 1-6 months to individuals for serious environmental crimes that caused real damage, affected people's health, and took away business from legally compliant competitors. The average fine for prosecuted companies was around £6,500. The Agency is campaigning to have fines increased according to the real environmental and economic damage they cause, and alternative penalties such as disqualification, lengthy probation and mandatory community service if Company Directors or other officers of the company are successfully prosecuted.

We believe that the majority of confirmed pollution incidents, where we are unable to determine the exact source of pollution, can be attributed to non-regulated sites, many of which are likely to be associated with small and medium-sized companies. We are very concerned by this. While we actively encourage these to companies to minimise their waste production to prevent pollution some additional regulatory controls may be needed.

## **ANNEX 2 – OUR POLICY ON CORPORATE ENVIRONMENTAL GOVERNANCE**

### **General**

The Agency considers that companies that actively reduce environmental risks and impacts are more sustainable, profitable, valuable, and competitive. This is good for the economy and the environment (the win-win situation). Those that ignore environmental risks and impacts are less sustainable in the long-term. Exploitation of resources for short-term gain is detrimental both to the economy and the environment (the lose-lose situation). The Agency will praise good environmental performers and seeks to change the behaviour of poor performers.

### **Directors duties**

We believe all Company Directors should have a statutory duty of care for the environment in the same way they have a duty of care towards their employees and customers. This should not be an optional or voluntary requirement. We think this necessary not only to protect natural resources for future generations but because it is good for the planet, good for employees, good for the public, and good for the long-term sustainability and reputation of the company.

Company Directors should consider the merits of having a Health, Safety and Environment Committee to review and improve their performance. They should also include an item on environmental performance at their AGM to demonstrate their commitment to sustainable development, and enable shareholders to raise any issues about their environmental performance, as well as economic and social performance.

### **Environmental Policy**

The Agency considers that companies should have an environmental policy covering all aspects of their business activities and that the Directors of the company should promote this to their employees, contractors and customers as part of their staff training and management procedures.

Companies should set targets and report on historic trends for key indicators of environmental performance that includes raw material and energy consumption and emissions of waste to air, land and water. They should also include any serious pollution incidents, damage to wildlife, enforcement action and prosecutions or fines against the company in their published Annual Report.

Companies should also explain how they are positively seeking to continually reduce their consumption of raw materials and energy consumption, emissions to air, land and water and their other environmental incidents and impacts to improve overall company performance. Companies should also report on positive actions to improve environmental performance.

### **Eco-efficient goods and services**

The Agency considers it makes good economic and environmental sense for companies to use their financial and other management information systems to track the cost and input of raw materials, energy and labour, and output of goods/services and waste products, to understand, and then to improve, their resource productivity and eco-efficiency. Any waste is loss of productivity and profit, as well as an

environmental concern, and is bad both for the firm and the UK economy. We support and encourage companies to re-use and re-cycle both waste and final products

### **Environmental management systems**

We recommend that companies should use recognised quality management systems to help them reduce minimise environmental risks, report on their environmental performance and add value to the company. Large companies should adopt internationally recognised environmental management systems such as ISO14001 and EMAS. SME's should consider signing up to the DTI/DETR Project Acorn concerned with simpler EMS's and use the Agency's NetRegs web-pages to help them understand their environmental responsibilities.

### **Environmental accounting**

We believe companies should also use their financial systems to manage revenues and value derived from the environment. For example by developing a simple environmental profit and loss statement and green balance sheet within their published annual accounts. These should cover income from and value of environmental assets, services and by-products, expenditure on natural resources, licences/permits to operate, capital investment in anti-pollution equipment, payment of green taxes and court fines, and any provisions made for contingent liabilities such as remediation of contaminated land.

### **Environmental reporting**

Directors of companies with over 250 employees should be required to report on how they have assessed and managed environmental risks and describe their environmental performance in their statutory Annual Report and audited Accounts. This is to enable shareholders, stakeholders, investors, employees, customers, and the general public to be assured that environmental risks have been properly managed and reduced.

The Annual Report and audited Accounts should also disclose whether the Company or any of its Directors has ever been previously prosecuted for any environmental or wildlife offence that resulted in enforcement action, prosecution, a fine, or other punishments including disqualification or imprisonment. This is to enable shareholders and stakeholders to assess if they are competent to run the company.

Both financial and non-financial environmental performance statements should be audited and verified to recognised accounting, reporting and auditing standards, and their audited Annual Report and Accounts lodged at Companies House and placed on an Internet web site. In this way they will be available to the Government, shareholders, stakeholders, and the general public to assess the company environmental performance alongside its economic and social performance.

Companies in the FTSE All Share Index should also voluntarily produce a more detailed Environmental Report for their stakeholders and shareholders, and operate site reports for local communities on businesses with high environmental impacts. They should be prepared to agree standards and be audited and verified.

## **Implementation**

The Agency is seeking to apply these principles to its own corporate governance, to those companies it regulates, and companies in which its Pension Fund Managers invest. Our Pension Fund Managers will vote against the approval of Annual Report and Accounts at the AGM's of UK companies that do not comply.