

regime. Accountancies large and small have long argued that reform is needed because the unique unlimited liability regime meant that too often auditors were viewed as having deep pockets. Wrongly, as it happens, especially given the lack of insurance cover for the largest and most complex global audits. But it is a tempting angle if you are a lawyer surveying a corporate collapse or major corporate difficulty. It certainly seemed to drive those involved with Equitable Life and their failed attempts to sue Ernst & Young for several billion pounds. As the commentators' commentator Anthony Hilton put it: "Although a company failure may be 90% the fault of directors and only 10% down to the auditors, 100% of the damages fall on them if the directors have no money... This has to stop... Audit firms are no longer financially resilient, no longer have deep pockets and, most important of all, have for the most part been uninsurable since the mid-1990s."

Auditors argued that they should be able to limit liability to their share of any mistakes that happen during an audit. This position was supported by the Company Law Review and then reinforced by the responses to a DTI consultation at the end of 2003 on director and auditor liability. Once a consensus had been reached about the need to limit liability, differences arose about how. The Office of Fair Trading (OFT) was critical of a monetary liability cap, as were some of the smaller accounting firms and some vocal investors. In the summer of 2004, this was the tipping point for reform. It began to look like the campaign to reform the House of Lords – everyone wants reform, but a lack of consensus about what type of reform means that no reform takes place.

### A coalition of the willing

I remember well a holiday in France being interrupted when I had to join a string of conference calls to consider strategy to save reform. However, it was some fast footwork from Patricia Hewitt, Jacqui Smith and Roger Sharp that kept reform on track by challenging all the key stakeholders to agree a practical way to implement proportionate liability. The profession as a whole responded to the challenge by assembling a coalition of the willing, including corporates, investors and the government, who would work on the basis of proportionate liability by contract.

While this position rebalances the liability situation in a pragmatic way, it was subject to two important safeguards. Firstly, that any limited liability agreement has to be endorsed by shareholders at an AGM and, secondly, is subject to a 'fair and reasonable' test by the courts.

For companies, liability reform will not only help to keep the audit market fiercely competitive, it may well open up the market to more competition. There are a number of accountancy firms outside the so-called Big Four (KPMG, PriceWaterhouseCoopers, Ernst & Young

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and Deloitte & Touche) who have been deterred from bidding for some of the larger audits because of the unlimited liability regime. Therefore, limitation of liability may well ensure more choice within the market. This is certainly the case in Germany, which has a limited liability regime and where 67 of the leading 300 companies are audited by firms outside the Big Four.

Globally, the liability debate has been moving strongly towards reform. Canada, Belgium and Australia have recently introduced versions of liability reform and a majority of the main countries in the European Union are in the same position. Charlie McCreevy, an EU commissioner, has instituted a study to look at the practicalities of an EU-wide policy to promote the effectiveness of the EU capital markets. The key for the next stage of this debate is whether all of this puts pressure on the United States. The hope is that the all-powerful Securities and Exchange Commission will look again at the US liability regime and the impact that litigious environment has on global capital markets.

After eight years of consultation, drafting and debate, the end is in sight for company law reform. Company secretaries, general counsels, auditors and directors will be seeking to implement the many proposals contained within the reform. As a bill, it has something for everyone. To my mind, it is a carefully balanced package of measures that has addressed the range of stakeholder interests in a fair way. It cuts red tape for smaller companies in particular and sets a framework for all companies that fosters long-term investment and sustainability, rather than just chasing the next quarter's figures regardless of the damage to business fundamentals. ■

### Further reading

The following books are available to borrow from the Fellows' Library:

-  - *Tomorrow's Company: the role of business in a changing world*, RSA (1994)
- *The State We're In*, Will Hutton, Jonathan Cape (1995)
- *Who Runs This Place?* Anthony Sampson, John Murray (2004)

 For progress of the Companies Bill visit [www.publications.parliament.uk](http://www.publications.parliament.uk)