COMPANY LAW REFORM IN THE UK

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Abstract

The UK has embarked on a fundamental review of company law. The first stage of the process was completed in July 2001 and reform proposals are now being considered by the government. Modernisation of company law is part of a drive to facilitate enterprise and enhance the attractiveness of the UK as a location in which to do business. This chapter, which was first prepared for the 9th Singapore Conference on International Business Law, considers how well the proposed new legal framework measures up as a regulatory product that will be attractive to business and foster business competitiveness. Proposals in three areas are examined closely: simplification so as to promote business creation and growth; corporate governance and directors’ duties; and the institutional framework of regulation. I suggest that if the proposals are implemented in their current form UK company law will become much clearer and more comprehensible. Greater clarity should ensure some competitive advantages. In the area of corporate governance and directors’ duties, the strong, continuing preference for detailed legal rules suggests that policymakers are sceptical about the ability of the market to put in place effective corporate governance controls without significant state intervention. Whether the preference for detailed rules supported by tough (often criminal) sanctions strikes the right balance between managerial freedom and investor protection is open to question. With regard to the institutional framework of regulation, my assessment of the proposals to expand the regulatory responsibilities of accounting bodies so as also to cover general company law is that these seem likely to promote a shift away from self-regulation towards greater public institutionalisation of corporate regulation, a result that sits uneasily with the presumption against state intervention which was adopted as a guiding principle at the outset of the reform initiative.

Setting the Company Law Reform Initiative in its UK Context

DEVELOPING AN ENTERPRISE CULTURE

Developing an enterprise culture has become a major policy initiative in the UK. According to the Chancellor of Exchequer in June 2001 the goal is to ‘create in Britain a true enterprise culture where the chance to start and succeed in business is genuinely open to all’. A target that the government has set itself is for the UK to become ‘the best place in the world to start and run a business’. To achieve this goal the UK will, of course, have to overtake Singapore which, according to a recent ranking by leading business magazine Forbes Global, ranks...
second only to the USA as the best place in the world to start a business.³

Modernisation of company law is part of this drive to facilitate enterprise and enhance the attractiveness of the UK as a location in which to do business.⁴ Limited evidence considered in the context of the UK’s company law review supports the view that fiscal, operational and macro-economic considerations rather than company law are the major considerations in the decision whether or not to locate business in a particular state.⁵ But whilst company law on its own may be relatively insignificant, it is appropriate to look at the reform of company law in the context of a bigger package of regulatory reform initiatives in the UK. This package is intended to provide incentives for business activity and investment that will, in the government’s view, have a significant cumulative impact on productivity and economic growth.⁶

Much of the UK’s legislative programme relating to business is presented in language that emphasises how it has been designed to encourage enterprise and innovation. Company law reform is particularly closely related to initiatives on financial services and insolvency law. So it is to aspects of the bigger picture in those areas – in particular, the powers of the Financial Services Authority (‘FSA’) under the Financial Services and Markets Act 2000 and the moves to make insolvency laws more debtor-friendly – that reference will be made in this account of UK company law reform proposals.

WILL THE REFORMS FOSTER ENTERPRISE AND PROMOTE COMPETITIVENESS? AN INTERIM ASSESSMENT

In this paper I offer a tentative assessment of how well the proposed new legal framework that is emerging from the review of company law that has taken place in the UK over the past few years measures up as a regulatory product which will be attractive to business and foster business competitiveness. At this point in the reform process, it would be unwise to arrive at definitive conclusions but matters are sufficiently advanced for it to be possible to identify certain defining features of the proposed new regime and to highlight key

⁴ ‘The Government is determined to modernise company law so that it is up-to-date and promotes enterprise and productivity’: ibid., para 2.41. See also Modern Company Law for a Competitive Economy: Final Report, London, DTI, 2001, paras 1.12-1.14.
⁶ Whether or to what extent government intervention can increase productivity and economic growth is debatable. According to the OECD, government policy can foster productive enterprise which, in its view, is ‘now one of the main drivers of economic growth’: Enhancing the Environment for Business and Industry, OECD Policy Brief, February 2001 at p 2. For a review of literature on the proper role of government in promoting the wealth of nations from Adam Smith onwards see TK McCraw, Government, Big Business and the Wealth of Nations in AD Chandler Jr, F Amatori and T Hikino, Big Business and the Wealth of Nations, Cambridge, CUP, 1997.
Current discussions in the UK tend to focus on whether, accepting that government intervention can make a difference, the government has selected the right package of measures to achieve the desired effect. On this there is considerable scepticism amongst commentators: eg, ‘It is possible, in sum, that Mr Brown will succeed in promoting an American-style enterprise culture. But would this new culture really transform Britain’s productivity and long-term growth? That remains far from certain’. See A Kaletsky, ‘Brown’s Timetable Falls Short on Urgency’ Times, 19 June 2001; ‘The measures set out…will improve the climate for business. But they are unlikely to result in a permanent shift in Britain’s productivity performance. To have the best chance of achieving that, Mr Brown should have a bolder agenda: a radical simplification of the taxation and regulation of business’, Editorial, Financial Times, 19 June 2001.
developments and likely controversies. I concentrate on three areas that I consider to be particularly relevant to the question of whether the legal framework relating to companies is likely to promote competitiveness. Received wisdom would say that a favourable corporate legal environment should offer:

1. easy access to the corporate form,
2. minimum interference with management, and
3. appropriate investor protection.

There is an interaction between managerial freedom and investor protection. Managers can be expected to accept interventionist rules designed to protect investors so long as the loss of autonomy is outweighed by the greater availability of capital or reduction of its cost that results from the boost to investor confidence attributable to those rules. The task for those charged with the task of drawing up a competitive corporate regulatory product for an individual state is thus to strike the right balance between managerial freedom and investor protection. So a key question here is, on the basis of the proposals to date, how well are the UK authorities doing in setting this balance?

**Setting the UK Reform Initiative in a Broader Context: Regional and International Developments**

**OBLIGATIONS AS A MEMBER OF THE EUROPEAN UNION**

As a member of the European Union, the UK’s options with regard to law reform are bounded by its obligations to implement Community rules in its domestic law. There are significant signs of change at the European level and here, again, developments in corporate law are best looked at as part of a wider reform programme. The strategic aim adopted by the European Council at Lisbon in 2000 is to make the Union by 2010 ‘the most competitive and dynamic knowledge based economy in the world’. The creation of an integrated financial market is seen to be central to the achievement of this goal. Shortcomings in regulation have been identified as a major factor in hampering progress towards market integration and so since 1999 the European Commission has been actively following a Financial Services Action Plan that is intended to provide by 2005, a comprehensive legislative framework for a single market. Recent proposals and initiatives that have been put forward with a view to establishing within this time frame the basis of an efficient internal market in financial services include:

1. a proposed directive on market abuse;
2. a proposed new prospectus directive;

8 Final Report of the Committee of Wise Men on the Regulation of European Securities Markets (February 2001) at pp 11-12 (the ‘Lamfalussy Report’).
11 Proposal for a Directive of the European Parliament and of the Council on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading COM/2001/280.
(3) fundamental review of the directive governing the provision of investment services;\(^\text{12}\)

(4) consultation on the transparency obligations of companies whose securities are traded on regulated markets;\(^\text{13}\)

(5) continuing consultations and studies relating to cross-border clearing and settlement arrangements within the European Union; and

(6) modernisation of the accounting directives and development of a new mechanism to give international accounting standards ("IAS") legal endorsement for use within the European Union.\(^\text{14}\)

However, the pace of change, with regard both to the adoption of new measures and the revision of existing ones, slows up considerably the closer one gets to those areas that are conventionally regarded as being, or being near to, ‘core’ EU company law. The fate of the proposed Takeovers Directive provides a clear illustration.\(^\text{15}\) After some 12 years of discussions, this directive was finally rejected by the European Parliament in July 2001, after intense lobbying by the German business sector and the European Trade Union Confederation.\(^\text{16}\) This ‘lamentable decision’\(^\text{17}\) demonstrates how the legislative processes within the European Union can still allow national interests to triumph over the rhetorical visions of competition and dynamism emanating from EU summit meetings and from policy statements.\(^\text{18}\) It remains to be seen whether the revised draft rules on takeovers, which the European Commission expects to publish in early 2002, will prove more palatable to all Member States.\(^\text{19}\)

As part of the compromise arrangements that were formulated with a view to securing adoption of the Takeovers Directive, in June 2001 the Commission announced that it intended to ask a group of company law experts to assist it in identifying the priorities for a more detailed harmonisation of company law. Despite the failure of the Takeovers Directive, an expert group has been established to advise the Commission on takeover rules and on company law more generally.\(^\text{20}\) Is it likely that the experts’ report will be radical and that the Commission’s response will result in the swift adoption of new measures? History suggests that we should not be overly optimistic. The European Commission has already been considering the question of reform in the area of company law. In particular, the company law directives relating to formation of companies and legal capital requirements were reviewed as part of the Simpler Legislation for the Single Market ("SLIM") project launched by the European Commission.


\(^{15}\) Another obvious example is the European company statute where the process took some 30 years. The draft Fifth Directive was first introduced in 1972 but there is little hope in it being adopted in the near future: see JJ du Plessis and J Dine, ‘The Fate of the Draft Fifth Directive on Company Law: Accommodation Instead of Harmonisation’ [1997] JBL 23.


\(^{17}\) Ibid.


Commission in 1996. That review resulted in helpful proposals to facilitate the use of electronic technology, to enhance disclosure and to simplify the rules relating to such areas as financial assistance, share buybacks, pre-emption rights and non-cash consideration for shares. The European Commission accepted the broad thrust of the proposals from the SLIM Working Group, regarding them as representing ‘an opportunity to bring about significant simplification and modernisation and a reduction in costs and procedures while at the same time safeguarding the interests of shareholders and creditors’. However, at the same time it indicated that further research, analysis and consultation with Member States would be required before the proposals could be taken forward. All this elaborate procedure for proposals that, particularly those relating to legal capital, tinker with the existing rules rather than herald the kind of radical overhaul that many would argue is now required.

EUROPEAN LAW AS A BARRIER TO CHANGE

Commentators differ in their assessment of just how seriously the evolution of European corporate law is held back by the complex legislative procedures and political compromises that can be involved in securing change at that level. However, it is clear that the obligation to comply with EC company law can, in certain significant respects, in particular with regard to legal capital, stultify the drive towards modernisation at the domestic level. The UK is unable to update its company laws in ways that have commended themselves to other common law states that, historically, had company law systems derived from the British model. So, for instance, the UK must continue to insist on par values for shares even though it is widely accepted in common law jurisdictions that this is an outmoded concept and it has been abandoned in many of them including Australia, New Zealand and Canada, though it remains part of Singaporean

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24 The tentative nature of the proposals is well illustrated by the Working Group’s comments on par values - it simply calls for ‘further investigation and research whether the present notions of nominal value and accountable par should be maintained, or whether a simplification would result from the use of shares that merely represent a fraction of the company’.

25 On what is sometimes called the ‘danger of petrification’, compare V Edwards, EC Company Law, Oxford, Clarendon Press, 1999 at p 11 and R Buxbaum and K Hopt, Legal Harmonization and the Business Enterprise 1998 at pp 235-236, 242-234, 265. Several US commentators on the mandatory/enabling character of corporate law make the point that mandatory rules are not really mandatory if they can be easily changed. Black, for example, suggests that a more appropriate designation may be ‘changeable rules’ in BS Black ‘Is Corporate Law Trivial?: A Political and Economic Analysis’ (1990) 84 Northwestern University Law Review 542-559; see also R Romano, The Genius of American Corporate Law, Washington DC, AEI Press, 1993 at p 90. In the context of European company law, however, the process of change is often (but not always - some requirements particularly those relating to accounting are updated relatively frequently) so slow that the conclusion that mandatory really does mean mandatory is difficult to avoid.

26 Section 254C of the Corporations Act (Aus); s 38(1) of the Companies Act 1993 (NZ); s 24(1) of the Canadian Business Corporations Act 1975. The idea of allowing UK private companies (which are not within the scope of the relevant EC directive) to have no par value shares was floated but was eventually dropped after it emerged that this proposal might create more problems than it resolved.
In similar terms to those that apply in Singapore, the UK must continue generally to ban the giving of financial assistance by public companies, even though this may inhibit financial structures that would otherwise be regarded by market participants as legitimate and beneficial and notwithstanding that there is a strong case for saying that the scope for abuse can be adequately regulated through directors’ duties without the need for a specific ban. The UK’s prescriptive approach of a ban subject to certain exceptions and relaxations contrasts sharply with the broadly permissive rules relating to financial assistance now adopted in Australia.

That UK law, under the influence of Europe, may increasingly diverge from that of the common law countries with which its legal system and rules have traditionally been associated in itself is unremarkable. Other countries have had similar experiences as the evolution of Singaporean company law itself demonstrates – historically derived from Australian and, in turn, English law but now increasingly ‘home grown’ so as better to fit the political and social values of the region. But such divergence should result from properly informed and fully deliberated policy choices about the regulatory measures that will best serve the economic, social and political goals of the state or region in question, not from inertia. At a time when may states, including the UK and Singapore, are rethinking their company law and engaging in extensive reform, the EU ought at least to be asking more fundamental questions about whether the legislative policy choices that it made in the past are still appropriate in modern economic conditions. But what one commentator has described as the ‘present crisis atmosphere in European company law’ flowing from the lack of ‘any coherent visions or agenda in the field of company law’ suggests that there is little room for optimism about the likelihood of swift and radical change at the European level.

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27 Section 22 of the Companies Act.
28 Sections 76 and 76A of the Companies Act. But Singapore is ahead of the UK in spelling out on the face of the legislation the civil consequences of an infringement of the ban. One of the guiding principles adopted in the UK’s company law review is that the new companies legislation should state in relation to each rule the consequences of breach, see Modern Company Law for a Competitive Economy: Completing the Structure, London, DTI, 2000, at para 13.9.
29 Modern Company Law for a Competitive Economy: Developing the Framework, London, DTI, 2000, at paras 7.18-7.25. It was, however, the UK that strongly influenced the inclusion of a ban on financial assistance in EC law in the first place. Generally, on how the UK has influenced the development of EC company law see: K Hopt, ‘Company Law in the European Union: Harmonisation and/or Subsidiarity? (1999) 1 International and Comparative Corporate Law Journal 41, 45-47.
30 Sections 260A to 260D of the Corporations Act.
32 The Committee on Company Legislation and Regulatory Framework is undertaking a comprehensive review of company law. Accounting standards are also under review (by the Disclosure and Accounting Standards Committee) and a new Code of Corporate Governance has resulted from the Review on Corporate Governance and Regulation.
34 Ibid.
The Reform Process in the UK

INSTITUTIONAL STRUCTURE, METHODOLOGY AND OUTPUT

The UK government announced the establishment of an independent fundamental review of company law in March 1998. It established a review body – the Company Law Review Steering Group (‘CLRSG’) – to manage the review. In a conscious effort to ensure that the review would not be regarded as a technical exercise of interest only to lawyers, the review process was carefully constructed so as to achieve, in the government’s words ‘maximum openness, and independence and…wide consultation.’ The CLRSG comprised representatives of business, economics and accountancy as well as senior academic and practising lawyers and civil servants. The relatively small CLRSG sat at the apex of a pyramid. Below it sat:

- a broadly-based consultative committee which included wider legal representation – for example from the Law Society, key groups such as the CBI, TUC and the accountancy bodies – as well as other government departments; and
- a series of working groups established to look at detailed aspects of the proposals.

In line with the aim of achieving the widest possible consultation, the various consultation documents published by the CLRSG between 1999 and 2001 were written in a style that sought to keep legal technicalities to a minimum. The final CLRSG Report was published in July 2001. There will now be further consultations before the government decides which parts of the reform package it wishes to incorporate into its legislative programme. For brevity, this article sometimes refers to the CLRSG proposals as being what the UK will do, but it should be understood that such references should be read as being subject to the proviso: ‘if the proposals are adopted in their current form’.

POLITICAL INFLUENCES

There are risks that a process that is built on consultation and consensus building will follow the path of least resistance and produce reform proposals that are undistinguished, fuzzy and unimaginative because they represent the lowest common denominator among all of the interest groups tat have had a say in the process. The Canadian experience with its Business Corporations Act, a widely admired statute which was the brainchild of a three-person committee,
illustrates the success of an alternative model in achieving clear and radical reform. But it was reasonably clear from the outset of the review in the UK that the political will lay behind simplification and rationalisation rather than radical change. The recently elected Labour government evidently did not want to risk alienating business interests by proposing sweeping reform; in its words:

business should not fear large-scale upheaval of familiar requirements. There is rightly a premium on stability, and the government is conscious of the need to avoid gratuitous and unnecessary change and the cost this would impose. There will be no change for its own sake.

This was a strong political steer to the ‘independent’ CLRSG as to how it should conduct the review. Securing and maintaining the support of affected constituencies was a political necessity from the outset if the reform proposals were to have any chance of becoming law. This ‘softly-softly’ approach to company law reform stands in distinct contrast to how the same Labour government tackled securities regulation reform where, effectively, non-negotiable radical change, in the form of the establishment of a single mega-regulator and the dismantling of the last remnants of self-regulation of the financial industry, was simply announced by the government and the consultation process was largely confined to looking at the detailed shape of that reform. The interesting story that is about to unfold is whether to policy of lowering the sights of what the CLRSG could achieve will work in the sense of whether the proposals set out in the July 2001 Final Report will be seen to be uncontroversial and will become law after a straightforward passage through the parliamentary processes. There must be a risk that despite the efforts to make the consultative process inclusive, many affected groups will not begin to take a close interest in the proposals until they really look like becoming law though perhaps by then there will be too much momentum behind the reform process for it to be seriously derailed.

USE OF ECONOMIC ANALYSIS AND EMPIRICAL STUDIES

Being able to draw upon previous work done by the English and Scottish Law Commission in the area of the company law helped the CLRSG in its task. In the period between 1996 and 1999 the English Law Commission conducted detailed technical reviews first of shareholder remedies and then, jointly with the Scottish Law Commission, of directors’ duties. Many of the Law Commissions

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41 Ibid, para 1.4.
42 It is interesting to speculate, though impossible to test precisely, on whether or to what extent individual members of the CLRSG have thought about the poor implementation record of previous company law reform drive in the UK - eg, much of the 1962 Jenkins Report was not implemented in the UK though it was influential elsewhere (eg, C Jordan, *International Survey of Corporate Law in Asia, Europe, North America and the Commonwealth*, Melbourne, Centre for Corporate Law and Securities Regulation, University of Melbourne, 1997 at p87, noting its impact on Singaporean company law) - and have sought to structure the process so as to minimise the risk of this initiative meeting the same sorry fate.
proposals were adopted by the CLRSG whilst others formed the basis for further analysis. One innovative feature of the Law Commissions’ work was the explicit use of economic analysis to provide new insights into reform possibilities. This technique was also employed by the CLRSG. The emphasis on economic analysis supported by empirical studies has not been universally welcomed by commentators; some query why economics has been singled out in preference to other theoretical inputs, others raise fundamental questions about the value that it has added to the process. Whatever else this innovation may have achieved, the decision by the reform bodies to use economic analysis has certainly been a catalyst for a new and enriching debate in the company law literature in the UK.

Fostering the Enterprise Culture: Removing Corporate Law Barriers to Entry and Nurturing Businesses

‘THINK SMALL FIRST’

Although an OECD study establishes that the UK already has low barriers to entrepreneurship in comparison to other countries surveyed, as part of its enterprise drive the British government is committed to improving its record of business creation and growth. This drive includes reviewing and reforming regulations that directly or indirectly discourage the creation and expansion of smaller enterprises and innovative start-ups. In the context of the company law reform programme, the emphasis on fostering enterprise was reflected in the identification of reformulation of the rules so as to meet the needs of smaller companies as one of central objectives. The principle here is ‘think small first’, meaning that, in a fundamental reversal of the nineteenth-century Victorian approach that formed the basis of traditional UK company law, and systems derived from it, the basic model for the legislation should be the small and private company with additional provisions applying to larger businesses. But the option of a self-standing statute for smaller companies, along the lines of the South African Close Corporations Act 1984, has

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46 In particular, Completing the Structure at chp 13 entitled ‘Sanctions’.
50 Strategic Framework, chp 5.2; Developing the Framework chp 6; Competing the Structure, chp 2.
been ruled out in favour of an integrated approach. The basic distinction between public and private companies is to remain and the prohibition on private companies accessing the capital markets will be spelt out more clearly.52

In the UK and elsewhere much emphasis has been placed on making the companies legislation user-friendly. It has been explicitly recognised that a guiding principle in reform should be that, so far as possible, rules should be stated in accessible language so as to minimise the legal costs that those who operate incorporated businesses need to incur in order to understand their entitlements and obligations.53 Complex rules that can only be understood with the aid of expensive expert legal advice can indirectly discriminate against smaller businesses because they have less capital and so less capacity to absorb administrative costs.54

PROPOSALS

With regard to the substantive proposals, one of the main themes is simplification of the process of incorporation and of the procedures to be followed by an incorporated business. The package of measures put forward by the CLRSG for this purpose include the following:

(1) There are proposals to reduce the amount and complexity of the incorporation documentation (such as replacing the memorandum and articles with a single constitution and giving companies unlimited capacity thereby obviating the need for an objects clause).55

(2) Measures designed to facilitate more flexible governance and decision-making processes are suggested (such as allowing written resolutions to be passed by a majority instead of the unanimous consent that is currently required56 and turning the requirement to hold an AGM into a rule that small companies can opt into instead of, as at present, one from which they can opt out).57 These measures recognise that the elaborate procedures that have evolved for larger companies may be both unnecessary and inappropriate for smaller companies where there is no significant separation of ownership and control.

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52 Final Report, at paras 4.57-4.62.
53 Completing the Structure, chp 2; Final Report, paras 1.18-1.22. As the then Commonwealth Attorney General said in October 1993 when announcing the establishment of the Australian Corporations Law Simplification Task Force, the central objective was to ‘simplify the Corporations Law and make it capable of being understood so that users can act on their rights and carry out their responsibilities’ – quoted in S Woodward and H Bird, Corporations Law Workbook, Sydney, LBC Information Services 4th edn, 1999 at p 7.
55 Modern Company Law for a Competitive Economy: Company Formulation and Capital Maintenance, October 1999, chp 2; Final Report, chp 9. An instrument of incorporation is required for EC directives purposes thus precluding the option of having no constitution at all which is now allowed under Australian law: s 117 of the Corporations Act (though a constitution is still required for listed companies under ASX r 15.11). Use of electronic communications in the incorporation processes is already provided for in the UK by the Companies Act 1985 (Electronic Communications) Order 2000 (SI 2000/3373). There are now proposals to extend the use of electronic communications by making mandatory for quoted companies website posting and electronic notification of certain information: Final Report, chp 8.
56 Completing the Structure, paras 2.11-2.13; Final Report, para 4.3. This proposal goes further than Australian law where unanimity is still required: ss 248A, 249A of the Corporations Act.
57 Final Report, paras 4.17-4.22.
(3) The appointment of a company secretary is to be made an optional requirement for private companies.\textsuperscript{58}

(4) The costs associated with compliance with disclosure requirements are to be reduced with the removal of the requirement for an independent audit of the accounts of small companies (broadly those with a turnover between £1 million and £4.8 million),\textsuperscript{59} although it remains open for further consideration whether this might be replaced by a lighter and less costly form of assurance known as an independent professional review.\textsuperscript{60} But there will remain an obligation on all limited companies to file annual accounts on single public register so at least some details of the financial affairs of all incorporated businesses with limited liability are open for public inspection.\textsuperscript{61}

(5) Private companies will be allowed to give financial assistance for the acquisition of their own shares\textsuperscript{62} and, with public companies, will benefit from some relaxation of the rules relating to reductions of capital and share buybacks.\textsuperscript{63} The abolition of the concept of authorised share capital\textsuperscript{64} will remove some of the technicalities that bedevil the existing law, as will revision and clarification of the rules relating to distributions.\textsuperscript{65}

At the domestic level, the changes proposed for smaller and private companies do amount, in aggregate, to a ‘very substantial reframing of current requirements’.\textsuperscript{66} However, there is little that is especially innovative about the specific proposals when they are compared to development in other common law jurisdictions like Australia and New Zealand. In enacting these measures, to a large extent the UK will be catching up where it has lagged behind and where reform has been long overdue. But that the UK’s review should not have come up with radically new proposals with regard to use of the corporate form is not particularly surprising given the underlying political and policy goals of the British government and the fact that the existing law is seen to be comparatively business friendly when compared to many other jurisdictions.\textsuperscript{67} Political enthusiasm for enterprise and entrepreneurship effectively meant that questioning of the assumption that limited liability should be freely available and easy to use was never really on the agenda.\textsuperscript{68} So change that would be regarded as

\textsuperscript{58} Ibid, paras 4.6-4.7. Proprietary companies under Australian law are not required to have a company secretary: s 204A of the Corporations Act.

\textsuperscript{59} Companies with an annual turnover of less than £1 million are totally exempt from the independent audit requirement.

\textsuperscript{60} Final Report, paras 4.43-4.53.

\textsuperscript{61} Though simplified disclosure requirements will be available to small and medium sized companies: Developing the Framework, chp 8; Final Report, paras 4.34-4.37. Contrast Australia, where the bulk of companies are relieved of the obligation to prepare and lodge financial statements with a public agency: Butterworths Australian Corporation Law Principles and Practice, Sydney, Butterworths, 1999 at para 3.60025.

\textsuperscript{62} Developing the Framework, paras 7.18-7.25; Final Report, para 4.4.

\textsuperscript{63} Summarised in the Final Report, para 10.6. In particular, reductions of capital without court approval will be allowed.

\textsuperscript{64} Final Report, para 10.6.

\textsuperscript{65} Ibid.

\textsuperscript{66} Developing the Framework, para 7.5.

\textsuperscript{67} The OECD report mentioned above is supported by evidence collected by the CLRSG which indicated that ‘British law is regarded as more business friendly than other European systems, but less so that the law of some North American jurisdictions’: Strategic Framework, para 5.6.3.

\textsuperscript{68} In its Final Report, para 3.13 the CLRSG acknowledged that: ‘By simplifying and clarifying the law and removing unnecessary restrictions we are making such limited liability more accessible for business’. Easy access to limited liability was supported by the clear majority of the relevant responses during the consultation process. There is a large amount of literature considering the advantages of limited liability, with particular emphasis on its economic efficiency. See eg, Halpern, Trebilcock and Turnbull, ‘An Economic Analysis of Limited Liability in Corporation Law’ (1980) 30 University of
radical in a common law jurisdiction such as the UK in the form of erection of barriers to entry – such as minimum capital requirements, minimum qualifications for directors or mandatory insurance – was not seriously considered. A major cultural shift could not be justified without clear empirical evidence to support it. Without such evidence, the task of the review body necessarily became one of identifying possible improvements to a broadly acceptable legal system rather than suggesting fundamental reform.

RELATED INITIATIVES OUTSIDE THE FIELD OF COMPANY LAW

This is not to say that the UK has lacked noteworthy initiatives to foster enterprise and to encourage business growth, but just that the major developments lie outside the field of company law. These include the following:

(1) Over the past four years there have been extensive changes to competition and tax laws designed to encourage enterprise and innovation and still further changes in those areas are in the pipeline.

(2) A government agency, the Small Business Service, has been established to assist small firms.

(3) The UK has recently extended its range of limited liability business structures by establishing the limited liability partnership. Like the US limited liability company, the UK LLP combines the organisation flexibility and tax status of a partnership with limited liability for its members. But it is unclear whether the use of the UK LLP by small businesses will spread in the way that use of the LLC has grown in the US. One of the major factors that drove the UK initiative was pressure not


In a recent study, Freedman re-examines the question whether limited liability is too freely available for small firms and surveys the literature. She concludes that the efficiency arguments for limited liability become much less clear when they are shifted from large companies and applied to smaller companies. Against the current popular trend she argues for signalling devices, such as minimum capital requirements, not as barriers to entry but as preventing incorporations with limited liability that have not been properly considered. J Freedman, ‘Limited Liability: Large Company Theory and Small Firms’ (2000) 63 Modern Law Review 317.

69 The continental European corporate law tradition places greater emphasis on entry barriers. Minimum capital requirements are imposed on public and private companies by many jurisdictions. This is reflected at the EU level by a requirement in the Second Directive for public companies to have a minimum capital (implemented into English law by ss 117 and 118 of the Companies Act 1985). Nationals of other member states may choose to incorporate private companies in the UK in order to bypass the minimum capital requirements that apply in their home state: Centros Ltd. v. Erhvers-og Selskabstyrelsen Case C-212/97, [1999] ECR 1-1459.


71 For a summary of developments and proposals in competition and tax laws and related policy initiatives in areas such regional development, science investment, support for small businesses and for disadvantaged communities see Productivity in the UK: Enterprise and the Productivity Challenge: The Government’s Strategy for the Next Parliament, London, HM Treasury and DTI, June 2001, paras 1.6, 2.11; A World Class Competition Regime, London, DTI White Paper, July 2001, Cm 5233.

72 Productivity in the UK, supra, paras 1.13, 2.12-2.30.

73 Limited Liability Partnerships Act 2000
to lose major accountancy firms that were threatening to move their business to Jersey in order to take advantage of the attractive LLP legislation being enacted there.74 The final version of the legislation makes the LLP generally available but there are no clear indicators yet whether the structure of the new business form and its tax treatment will make it attractive to the general business community, in particular to small businesses, as well as to traditional partnerships.75

DEVELOPMENTS IN INSOLVENCY LAW

For company lawyers with an eye on developments in cognate fields, reform initiatives relating to UK insolvency law are particularly interesting. There is an unfortunate history in Britain of controversial issues that lies on the boundary between corporate and insolvency law, such as the liability of parent companies of the debts of their insolvent subsidiaries, not receiving full attention in reform programmes because they raise issues that go beyond the scope of an inquiry limited to one or other area of the law. The Cork Committee that reviewed insolvency law in the 1980s held back from making recommendations for the shifting of liability around a corporate group because it recognised that a change to the position on insolvency would have ramifications throughout company law and it did not consider it appropriate to effect radical changes to company law by means of proposals to change insolvency law.76 But the ‘under-capitalisation of subsidiaries and their operation in a way which creates undue risks of insolvency’, are, according to the CLRSG, ‘matters best dealt with by insolvency law’77 and so there are no proposals for reform in this respect. The most significant proposal in this area, which even the CLRSG accepted was ‘not a radical recasting of company law’,78 was for an elective regime for groups in which in return for a guarantee of its debts by its parent an elective subsidiary would be exempt from the obligation to produce individual audited annual accounts. There are similar elective regimes in forces in Ireland and in the Netherlands. There appears to be a proposal to similar effect in Singapore’s recent report on disclosure and accounting standards.79 However, the CLRSG withdrew its proposal for an elective group regime after consultations because of concerns about loss of publicity and the creation of new complexities.80

Separate from the work that is in hand in relation to company law reform, UK insolvency law has also made its way onto the political agenda relating to enterprise and entrepreneurship. Concern that the pro-creditor stance of existing British insolvency law81 may act as a disincentive to potential entrepreneurs and inhibit the growth of a

77 Completing the Structure, para 10.59.
78 Ibid, para 10.57.
rescue culture has resulted in a range of initiatives including recently the idea that administrative receivership – the process whereby a secured creditor holding a floating charge on all of a company’s assets can appoint an insolvency practitioner to take control of the company and realise its assets for the benefit of the appointor - should be abolished, or at least severely restricted, in favour of collective insolvency mechanisms such as a simplified form of administration. The US Chapter 11 procedure is undoubtedly the inspiration behind this idea. It reflects unease about the amount of control that administrative receivership vests in the hands of a single creditor and about the lack of sufficient incentives for that creditor to consider the interests of others. But it is a highly controversial proposal and it seems bound to attract vigorous opposition. Arguments in favour of administrative receivership include:

- that it is a successful rescue mechanism which, although formally for the benefit only of the secured creditor appointor, in fact secures advantages for others affected by the insolvency such as unsecured creditors and employees;
- that glib and under-informed assumptions are made about the benefits of Chapter 11; and
- that the changes to banking practices and terms that would surely be made in order to compensate for the loss of control resulting from the abolition of administrative receivership would probably more than outweigh the advantages secured by taking that step.

A limited empirical study of administrative receivership in the UK suggests that it is relatively efficient and that its availability is likely to reduce the costs of debt finance. There is official support for a systematic programme of research into insolvency processes and practices. It seems likely that the proposal to abolish administrative receivership (except for securitisation structures) will act as a spur to banks and insolvency practitioners to commission such research to support their lobbying efforts regarding claims about the greater efficiency and fairness of collective procedures over administrative receivership.

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82 Generally, *Insolvency – A Second Chance*, London, Insolvency Service, July 2001, Cm 5234 (hereafter ‘Insolvency White Paper’). As well as the proposals relating to administrative receivership, the Insolvency White Paper also indicates that the Enterprise Bill will include a reduction in the period of bankruptcy for ‘honest’ bankrupts (but tougher sanctions for the dishonest), removal of certain restrictions on undischarged bankrupts and removal of Crown preference in the distribution of an insolvent’s assets.


84 The influence of Chapter 11 can also be seen in the new company voluntary arrangements procedure contained in the Insolvency Act 2000.


Achieving an Optimal Balance Between Managerial Freedom and Investor Protection: Governance Requirements Designed to Foster Competitiveness and Economic Growth

ECONOMIC GROWTH, EXTERNAL FINANCE AND DEVELOPMENT OF FINANCIAL SYSTEMS

There is an accumulating body of evidence establishing an inter-relationship between economic growth, access to external finance and development of financial systems. This data indicates that it is important for a state like the UK, that has made placed enterprise, innovation and competitiveness at the centre of its policy agenda, to provide an environment that is conducive to investment. Macro-economic policies designed to promote economic stability play a major role in this respect but the climate for investment can also be affected by legal requirements and, in particular for the purposes of this paper, corporate, securities and insolvency rules and the administrative, regulatory and judicial infrastructure by which they are supported. Empirical studies indicate a link between, on the one hand, cost and availability of capital and investor confidence on the other.

Although exactly how significant strong investor protection laws are to the development of capital markets and to the separation of ownership and control is a hotly-debated subject, the intuitive appeal of the basic assumption supported by the empirical studies — that investors will not make capital readily available in jurisdictions that do not offer them protections against being cheated out of their money — is clear.

THE BRITISH CONTEXT: STRENGTHS AND WEAKNESSES OF THE EXISTING REGULATORY STRUCTURE

The UK already has highly developed capital markets. Like other countries from the common law family, it also comes out well in


international comparisons of investor protection laws. UK investors already have considerable practical power to protect their interests against underperforming management.93 So, in considering how to reform its company law so as better to promote investor confidence, the UK does not need to start from scratch even if that were practically possible or politically desirable.94 But despite its established strengths, existing British company law also has many weaknesses. One indicator of this is that it has long since ceased to be the standard bearer to which other common law states look in reforming their laws.95 In part, this must reflect the profound changes over the past half-century in the economic, political, legislative and social circumstances of many of the Commonwealth countries that might once have naturally looked to the UK,96 as well as the divergence of British company law from its common law roots under the growing influence of Europe. But the UK has also contributed to its own decline by the piecemeal way in which it has, since 1948, amended its company law with new provisions being grafted on to existing requirements or existing provisions being extracted, as happened when securities regulation and insolvency laws were taken out of the companies legislation and put into separate statutes, without proper consideration of the broad framework of company law and its underlying objectives. This process of ad hoc change has produced legislation that is complex, lengthy and often obscure, features that have been rightly criticised in the context of the current review.97

But a curiosity of the British system is that whilst the statutory rules have become increasingly unattractive and inaccessible over the past half-century, the UK has led the way in the development of successful non-statutory voluntary codes and guidance relating to corporate affairs. The Takeover Code and the various corporate governance codes that were developed by committees in the 1990s (Cadbury, Greenbury, Hampel, Turnbull), much of the substance of which has now been consolidated into the Combined Code, are much admired internationally.98 The Singapore Committee on Corporate

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98 BR Cheffins, ‘Corporate Governance Reform: Britain as an Exporter’ in Corporate Governance and the Reform of Company Law, Hume Papers on Public Policy, Vol 8
Governance has expressed support for the UK’s ‘balanced’ approach to corporate governance - ie, an approach that specifies corporate governance best practices but allows companies to depart from these practices subject to appropriate disclosure.

THE OPTIMAL MIX: STRUCTURE, SOURCE AND CONTENT

- What is the optimal mix of statutory and non-statutory regulation?
- Are there rules which are presently set out in statute that could be hived off into a voluntary code?
- Or are there provisions of codes that should be hardened into legally enforceable statutory rules?
- Should voluntary codes be legally underpinned and, if so, how?
- How firm is the line between statutory and voluntary regulation? Should it be (further) blurred?
- Which, if any, non-governmental agencies should have regulatory responsibility?
- Does location of regulatory responsibility need to be reassessed in the light of the conversion of stock exchanges into for-profit commercial companies?

Questions such as these about how to achieve the optimal combination of regulatory instruments and techniques and how to connect governmental and non-governmental requirements within a coherent overall framework are ones that are of particular interest to UK company lawyers because of the particular way in which the regulatory structure in that country has developed. They also appear to be relevant in the Singapore context where, for example, takeovers are regulated in part by means of a non-statutory code, albeit one that differs from its UK equivalent by being promulgated by a government agency and directly supported by legislation.

The proposals concerning the conversion of certain requirements in the SGX Listing Manual into statutory form further demonstrate the relevance in this region of the debate about matching up rules with their most the appropriate source.

These questions are also of broader international interest. Recent literature on the significance of norms in the corporate context provides us with the insight that around the world corporate regulation increasingly depends on a complex network of interacting and mutually reinforcing legal rules, non-enforceable norms and practices.

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No. 1, Edinburgh University Press, 2000 and references cited there to work documenting the influence of UK corporate governance in numerous states including Canada, Australia, Ireland, Hong Kong and South Africa, and also in continental Europe.

Section 286 of the draft Securities and Futures Act 2001 conferring the power to make codes etc on the Monetary Authority of Singapore. Section 286(5) provides that failure to comply with the Code can be taken into account in legal proceedings. There is no directly equivalent provision in the UK Financial Services and Markets Act 2000 but, as in the predecessor legislation, the FSA can endorse the Takeover Code so as to facilitate the imposition of FSA disciplinary sanctions on regulated firms and individuals who fail to comply with it.

‘The Securities and Futures Act 2001’, Consultation Document, Singapore, MAS, 2001 at pt 5 discussing proposals to strengthen corporate disclosure, in particular converting the continuous disclosure of material information by listed corporations, currently a non-statutory requirement in the SGX Listing Manual, into a legal obligation. As from May 2000 responsibility for the UK Listing Rules passed from the London Stock Exchange to the UK Listing Authority which is part of the FSA. The Listing Rules are part of the regulatory regime imposed by or under the Financial Services and Markets Act 2000.

Fitting the pieces of the jigsaw into a conceptually coherent overall picture is a complex task. The first step is to consider how to remedy deficiencies in the existing rules. After that thinking can then turn to how best to combine the revised rules within an overall framework. The following sections of this paper adopt this approach, looking first at proposed changes to the substance of company law and then at the suggested new regulatory and institutional framework. The account of the proposed substantive changes is necessarily selective and brief. The emphasis is on directors’ duties, shareholder enforcement and transparency because of their central role in underpinning corporate governance structures and process. The data relating to the significance that international investors attach to corporate governance when making their investment decisions is a powerful argument for placing reform in these areas in the forefront of this discussion about adjustments to the legal climate in order to improve the environment for the growth of investor confidence.

Reforming Directors’ Duties – Current Proposals

GENERAL DUTIES: CODIFICATION

(1) The general case law duties of directors relating to loyalty, propriety, independence, avoidance of conflict of interests, fairness and care and skill will be recast in statutory form. This proposal evolved from one that was initially presented as essentially an exercise in clarification rather than substantive change to one where it was expressly acknowledged as an opportunity to correct defects in existing law and to adjust it so as to fit modern business needs and expectations. The statutory statement is intended to be an exhaustive statement of the general duties owed by directors but it will be drafted at a sufficiently high level of generality to facilitate judicial development within its terms.

(2) Consideration is also being given to setting out civil remedies for breach of directors’ general duties on the face of the legislation.

(3) General provisions exempting directors from liability will continue to be void.

(4) The circumstances in which shareholders can ratify individual breaches of duty by directors will be confirmed and clarified by being set out in legislation.

(5) Provision for companies to purchase insurance for their directors will continue.


102 ‘Corporate governance’ is a term that has no fixed meaning, see BR Cheffins, ‘Corporate Governance Reform: Britain as an Exporter’ in Corporate Governance and the Reform of Company Law, Hume Papers on Public Policy, Vol 8 No. 1, Edinburgh University Press, 2000 but its use to denote processes and structures is consistent with the ‘Final Report’, Singapore Committee of Corporate Governance at para 1.

103 This section is based on proposals set out mainly in Developing the Framework. It also reflects further refinement of the proposals in Completing the Structure and the Final Report.

104 For a summary of the codification proposals, see the Final Report at chp 3.

105 Final Report, para 3.7.

(6) There will be no statutory business judgment rule because it is considered that the statement of directors’ duties will be drafted in sufficiently flexible terms to allow the British courts to continue to show their traditional reluctance to examine the merits of business decisions.107

(7) Existing powers conferred on the court to relieve directors from liability will be preserved and slightly extended.

In the past there has been a reluctance in the UK to codify directors’ duties because of the risk of loss of flexibility and adaptability traditionally associated with fiduciary duties developed by case law.108 But codification now appears to be an idea whose time has finally arrived in the UK, albeit some time after its adoption, though to variable extents, in several Commonwealth countries including Singapore.109 However, the level of detail and the exhaustive nature of the proposed UK codification are features that take it beyond the type of codification that is currently contained in Australian, New Zealand and Singaporean companies legislation. Codification is supported, principally on grounds of certainty and accessibility, by the British business community and also by prominent organisations such as the London Stock Exchange.110 What distinguishes the UK in this respect from the US, where the vagueness inherent in fiduciary standards derived from case law is often held up for praise rather than being a target for criticism on grounds of uncertainty?111 Part of the answer to this question may lie in the fact that the UK does not have nor, despite proposed reforms to the derivative action, is it likely in future to have a large number of suits producing a rich seam of modern judicial precedent on which to draw in order to remove uncertainty about precisely what is required of directors in particular circumstances.112 But focusing on derivative suits alone gives an inaccurate picture of judicial activism in the corporate field in the UK since the large number of unfair prejudice and disqualification cases provides plenty of examples of the judges fashioning and developing the law to fit


109 Section 157 of the Companies Act.


contemporary conditions.113 In any case, possible differences in levels of corporate litigation do not explain why the statement needs to be exhaustive when, as some have argued,114 partial codification, as adopted in Australia, Canada and, indeed, Singapore,115 can achieve a good balance between certainty and flexibility. The argument that the UK CLRSG has put forward on this issue is that a broadly drafted statutory statement will still leave room for some judicial creativity and that if, in future, there arises a case for some wholly new basis of liability then this should be debated through the democratically elected parliamentary channels instead of being imposed by the courts.116

THE ‘SCOPE’ QUESTION: SHAREHOLDERS OR STAKEHOLDERS?

So far, the issue that has attracted the most attention in the discussion of reforming directors’ duties in the UK has been the ‘scope’ question, that is, the question of the interests that company law and, in particular, directors’ duties, should be designed to serve.117 Should directors be required to manage their company for the benefit of its shareholders or should they serve the wider range of constituencies who make commitments to it, such as employees and suppliers and perhaps even customers and local communities in the locations in which they operate? It is especially fitting to look at this issue in Singapore since it was Tony Blair’s speech here in January 1996 in which he unveiled his vision of a ‘stakeholding society’ that catapulted the concept onto the political agenda in the UK.

Much of the heat has now gone out of the British debate about whether or in what way it is appropriate to use company law to achieve stakeholder-type objectives. A broad consensus has now formed around the view that directors should be required to operate their companies for the benefit of their shareholders and this is what the proposed statutory statement of duties provides. At first glance then, it looks as if the debate was largely fruitless since the UK appears to have ended up with a reaffirmation of the status quo. But closer examination establishes that this is not the case for two reasons.

Growing General Awareness of the Importance of Corporate Social Responsibility

First, the debate about the wider responsibilities of corporate management that has taken place within the company law reform context has to be put into a wider setting. Internationally there is increasing public antagonism about corporate power as events such as the demonstrations against the WTO meeting in Seattle and the

113 Eg, Re Barings plc (No 5) [1999] 1 BCLC 433, a disqualification case, is widely acknowledged as the leading modern authority on the duty of care of directors. See further, LS Sealy, ‘Directors’ Duties Revisited’ (2001) 22 Company Lawyer 79, 83.
115 Section 157 of the Companies Act.
116 Developing the Framework, para 3.82. According to Completing the Structure, para 3.31 almost all responses to Developing the Framework supported these views.
Gothenburg and Genoa summit meetings, and campaigns to force the major players in the pharmaceutical industry to allow the supply of cheap anti-AIDS drugs to Africa serve to demonstrate. Regardless of strict legal technicalities, there is now a growing awareness that companies that do not pay attention to their reputation in social and environmental affairs will suffer real damage to their competitive position, whether it be in the search for customers, employees or capital. Initiatives like the establishment of socially responsible investment funds and ethical share indices and the enactment of rules relating to disclosure of socially responsible investment policies by pension funds reinforce this trend. Social responsibility has been specifically built into the European Union’s drive to become the world’s most competitive economy by 2010 and a corporate social responsibility campaign leading up to the specially designated European Year on Corporate Social Responsibility in 2005 has been launched.

‘Enlightened Shareholder Value’

The second reason is more technical though it links in with the first. The UK proposes to amplify the duty of directors to operate their companies for the benefit of their shareholders by stating that the circumstances to which they should have regard for that purpose include:

1. the need to foster business relationships with employees, suppliers, customers and others;
2. the impact of their operations on affected communities and on the environment;
3. the need to maintain a reputation for high standards of business conduct; and
4. the need to achieve fair outcomes as between members.

Directors will also be required to have regard to the interests of creditors in relation to threatened insolvency. Whilst this ‘inclusive’, ‘enlightened shareholder value’ approach technically amounts only to a requirement to ‘have regard’ to these circumstances and it is qualified by a statement that directors need only consider them as their duties of care and skill may require, the better social and environmental performance that the international community now increasingly expects of companies should provide incentives for companies to manage in the way that shareholders would wish them to.

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121 http://www.csreurope.org/campaign.
122 The duty is owed to shareholders collectively. One of the main factors driving rejection of more radical stakeholder approaches was that duties owed to a range of constituencies were felt to be a recipe for complete managerial discretion and lack of accountability.
123 Final Report, para 3.8.
124 This requirement was added only at a late stage in the review process: Final Report, para 3.13. How best to include reference to creditors’ interests in the statement clearly divided the CLRSG and it is an issue on which it recommended still further consultation: ibid, paras 3.12-3.20.
directors to engage genuinely with these issues and not just pay lip service to them.

The Operating and Financial Review (‘OFR’)

Related to the ‘inclusive’ formulation of directors’ duty, is a proposed new disclosure obligation which is the most pluralist, enterprise-orientated measure in the UK company reform package.125 There will be an obligation on companies of significant economic size to publish and Operating and Financial Review (‘OFR’) as part of their annual report. As presently suggested,126 the threshold criteria are that companies must satisfy at least two of the following:

- for public companies
  turnover exceeding £5 million,
  balance sheet total exceeding £25 million
  number of employees exceeding 500
- for private companies
  equivalent thresholds of £500 million, £250 million and 5,000.

The OFR is intended to cover all that the directors view as material for users to achieve a proper assessment of the performance and future plans and prospects of the business, including, where relevant, its relationships with employees and others and its impact on the community and the environment. It is envisaged that all companies preparing an OFR should be required to report on three mandatory items:

1. the company’s business, strategy and principal drivers of performance;
2. a review of the development of the company’s business over the year; and
3. the dynamics of the business, including events, trends and other factors which may subsequently affect future performance.

The OFR is presented by the CLRSG as a competitiveness-enhancing measure because it will equip interested parties with more information on which to assess corporate performance. The OFR is not an entirely new concept in British corporate practice since it is already recommended in guidance published by the Accounting Standards Board and adopted on a voluntary basis by some companies. International interest in corporate social and environmental reporting is also gaining momentum.127

125 But some consider that it does not go far enough, eg because it is subject to a materiality threshold which it is for the directors to determine: Completing the Structure, para 3.7. It is suggested by the CLRSG that, as a way of addressing this concern, the process by which an ORF is prepared, though not value judgments about materiality, should be subject to audit review. This proposal should also be seen against a broader background that embraces labour law too. The UK has now implemented the European Works Council Directive (94/95, OJ 254/64) which obliges larger undertakings to establish works councils or other procedures for informing and consulting employees: The Transnational Information and Consultation of Employees Regulations (1999/3323). See further, on the impact of European employment law initiatives on corporate operations, J Dine, ‘Implementation of European Initiatives in the UK: The Role of Fiduciary Duties’ [1999] Company Financial and Insolvency Law Review 218.

126 But the CLRSG indicates that further empirical research is required: Final Report, para 3.44.

127 Eg, the Global Reporting Initiative which describes itself as ‘an international multi-stakeholder effort to create a common framework for voluntary reporting of the economic, environmental and social impact of organisation-level activity’: http://www.globalreporting.org. The GRI was established in 1997 by the Coalition for
EMPHASIS ON DISCLOSURE

One of the guiding principles adopted by the CLRSG in the early stages of its review was to favour the facilitation of transactions combined with a presumption against intervention by the state. Although the imposition of new mandatory disclosure requirements is a form of state intervention, it is consistent with this transaction-facilitative approach since, according to the conventional rationale, mandatory disclosure requirements correct a market failure in the provision of socially optimal levels of information. Generally the UK is moving towards more disclosure-based regimes in both company law and securities regulation. Singapore corporate and securities law reform is also moving in the same direction.

BUT ALSO RETENTION OF PRESCRIPTIVE RULES RELATING TO DIRECTORS’ TRANSACTIONS

The articulation in the early stages of the review of a guiding principle involving a presumption against prescriptive legislation suggested that the detailed statutory rules relating to directors’ dealings with their companies might be significantly relaxed. However, it is now clear that significant deregulation in relation to directors’ substantial property transactions, loans etc, will not occur as part of the current reform initiative. Various detailed prescriptive rules relating to self-interested transactions by directors and their associates will be retained in addition to the broadly worded statement of general duties. There is some lightening of the regulatory burden. For example:

1. a new opt-out permitting loans to directors where these have been authorised by the general meeting will be provided; and
2. it will be made clear that, subject to certain safeguards, independent board authorisation may suffice for directors to exploit corporate opportunities personally.


129 Eg, ‘Proposed Changes to the Listing Rules at N2’, London, FSA, June 2001, FSA Consultation Paper No. 100, para 5.4. But note C Mayer, ‘Regulatory Principles and the Financial Services and Markets Act 2000’ in E Ferran and C Goodhart, Regulating Financial Services and Markets in the Twenty-first Century 131 The Law Commissions had also previously raised the issue of repeal of the detailed prescriptive rules in their directors’ duties project: ‘Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties’, LC Rep No. 262, Scot LC Paper No. 173 (1999) pt 6 (but their recommendation was for retention of the rules and this was supported by the majority of respondents to the consultation exercise).


131 Disclosure and, in the case of public companies, permission to rely on board approval must first be granted by the company’s constitution.

132 This relaxation was added at a late stage: Final Report, paras 3.21-3.27. Under present law, board authorisation can suffice where this is provided for in the articles but
Also certain procedural inconsistencies will be tidied up.
But in some respects the direction of the reform in this area is
towards more rather than less state intervention. For example:

(1) the restriction on the giving of loans to directors will be
extended generally to private companies; and

(2) directors service contracts will be limited to three years on first
appointment (presently five) and one year thereafter unless the
shareholders authorise in advance a longer period below the
three-year ceiling.\(^{135}\)

The second example hardens into legislative rules matters which are
presented addressed through the Combined Code.\(^{136}\)

Tough sanctions, including criminal penalties, will continue to be
attached to the detailed rules. This is a little surprising since a
presumption against creating criminal offences was also adopted by
the CLRSG at the outset of its review as one of guiding principles for
reform. This preference for continued use of criminal sanctions
appears to reflect concerns about the efficiency and effectiveness of
civil and administrative sanctions and civil enforcement
mechanisms.\(^{137}\)

Civil Enforcement – Reforming the Derivative Action

The English Law Commission conducted an extensive inquiry into
shareholder remedies in the period between 1995 and 1997.\(^{138}\) This
resulted in recommendations for a new statutory derivative action and
for certain changes to the unfair prejudice remedy. The major problem
identified by the Law Commission in relation to the unfair prejudice
remedy, which in the UK is a remedy used mainly in the context of
smaller private company disputes,\(^{139}\) was the excessive length and cost
of many proceedings. The more active case management powers that
have become available to the courts as a consequence of sweeping
changes to civil procedure rules\(^{140}\) and also a House of Lords decision
clarifying and, arguably, restricting the scope of remedy\(^{141}\) have

the scope for relaxation of the authorisation requirements via the articles is constrained
by s 310 of the Companies Act 1985.

\(^{135}\) Final Report, paras 6.10-6.14 clarify the proposals regarding duration of service
contracts.

\(^{136}\) Combined Code, B.1.7, though this only requires boards to set notice/contract
periods of one year as an objective and recognises that it may not be possible to achieve
this immediately. The reduction from five to three years in the duration of service
contracts not requiring shareholder approval was dealt with in the Cadbury Committee
(‘Cadbury Committee Report’), at para 4.41.

\(^{137}\) ‘Completing the Structure’, paras 13.23-13.29; Final Report at chp 15. Note criticism
by S Worthington, ‘Reforming Directors’ Duties’ (2001) 64 Modern Law Review 439,
457-458, a member of the Company Law Review Working Group on Sanctions.

\(^{138}\) ‘Shareholder Remedies’, Law Com Con Paper No. 142 (1995); ‘Shareholder

\(^{139}\) The minority oppression remedy appears to be more actively used in larger company
disputes in Malaysia/Singapore: PTH Koh, ‘Principles, Practice and Prospects of

\(^{140}\) See North Holdings Ltd v. Southern Tropics Ltd [1992] 2 BCLC 625 on the
application of the active case management powers in the context of unfair prejudice
petitions. See further Practice Direction (Applications under the Companies Act 1985

\(^{141}\) O’Neill v. Phillips [1999] 1 WLR 1092 (HL). The Law Commission’s work on
shareholder remedies attracted considerable attention and was the subject of extensive
academic commentary and analysis, including a special issue of the Company Financial
and Insolvency Law Journal ([1997](2) Company Financial and Insolvency Law
reduced these problems without the need for substantive changes to company law. Although some further largely clarificatory changes to that remedy are suggested, it is only the derivative action that now remains the subject of sweeping reform proposals.

Broadly speaking, the CLRSG has endorsed the recommendations of the Law Commission for a new statutory derivative action to replace the old common law derivative action entirely. Features of the proposed new derivative action include:

- it will cover breach of duty by directors including breach of the duty of care and skill;
- it will only be available to existing registered shareholders, not to directors, former shareholders or beneficial owners of shares.

This reform is long overdue. Existing case law on the derivative action is confused, complex and often obscure. Statutory derivative actions are now common elsewhere in the Commonwealth, including in Singapore, and as the Law Commission noted:

In an age of increasing globalisation of investment and growing interest in corporate governance, greater transparency in the requirements for a derivative action is in our view highly desirable.

However whilst reform will bring much needed clarity and will make the remedy more accessible, it is unlikely to result in a significant increase in the number of derivative suits. This prediction is derived from a number of considerations:

(1) The statutory derivative action will be subject to tough judicial control and a shareholder will have to obtain leave to proceed beyond the preliminary stages;
(2) Unlike the position in Singapore, a lawful ratification or decision not to sue will bar a derivative action completely.
(3) Whether a disinterested majority of the shareholders support the action is a factor that the court will take into account in deciding whether to grant leave.
(4) Although a shareholder will be entitled to apply to court for an indemnity out of company funds covering its own costs and those that it may be ordered to pay to the defendant, the circumstances in which this indemnity is granted are open to restrictive interpretation. So the shareholder must take the risk of having to meet its own costs and those of the defendant under the 'loser pays' principle but will not be compensated for taking this risk by the possibility of receiving a direct personal benefit.

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142 The CLRSG also exhorts the government to take steps to encourage the use of alternative dispute resolution (‘ADR’) schemes for shareholder disputes in small companies: Final Report, paras 4.10-4.12.
143 Reversing Pavlides v. Jensen [1956] Ch 565 which excluded ‘simple’ negligence from the scope of the common law derivative action.
144 Section 216A, derived from the Canada Business Corporations Act, ss 238-240. This selection does not preclude a common law derivative action. Also it does not apply to listed companies, an odd limitation from the perspective of an observer from the UK. However the range of persons who can bring an action is broader than the proposed UK provision – eg beneficial owners of shares can apply.
146 But for an against-the-tide view on the difficulties faced by minority shareholders under existing law see R Reed, ‘Derivative Claims: the Application for Permission to Continue’ (2000) 21 Company Lawyer 156 who argues that the uncertainty inherent in the remedy can work to the claimant’s advantage at least in the preliminary stages of proceedings.
147 Section 216B of the Companies Act.
148 Wallersteiner v. Moir (No. 2) [1975] QB 373.
if the claim succeeds since the option of allowing the court to make such awards has been ruled out. Some doubt has been expressed with regard to whether a shareholder could reduce this risk through a conditional fee arrangement in respect of its own costs and insurance in respect of the defendant’s costs should the claim fail.

(5) State financial assistance towards the costs of legal proceedings is not available to a shareholder bringing a derivative action.

These various continuing legal and practical disincentives, combined with the long-established cultural disinclination of investors in the UK to resort to intra-corporate litigation, suggest that the enactment of a statutory derivative action may well make no more than a modest difference in the number of shareholder suits.

Piecing Everything together: the Regulatory and Institutional Framework

Certain aspects of the CLRSG’s proposals regarding the regulatory and institutional framework for company law are distinctive and command attention. The institutional structure for company law has a role to play in promoting the international competitiveness of the UK as a place to do business and in which to invest. There is an obvious overlap in this respect with the institutional structure for securities and financial regulation. An issue that the CLRSG’s proposals put directly into the spotlight is the optimal overall institutional framework for corporate and securities regulation in a physically small, but economically significant, state such as the UK: given the degree of inter-relationship between the two and the indistinct boundaries between them, should there be a single, fused administrative framework for company law and securities regulation or should there be distinct institutional arrangements for each area? A related issue, and one that is particularly sensitive in the UK context, is where the balance should lie between the respective roles of public and private institutions in the formation and development of corporate regulation. The solution proposed by the CLRSG appears to shift the balance towards greater public institutionalisation of corporate regulation, a result that sits uneasily with the presumption against state intervention which was adopted as one of the guiding principles at the outset of the reform initiative.

150 The possibility of making such an order is open under Canadian law but in practice the courts have been reluctant to use this power: BR Cheffins, ‘Reforming the Derivative Action: The Canadian Experience and British Prospects’ [1997] Company Financial and Insolvency Law Review 227, 257.

151 J O’Hare, K Browne and R Hill, O’Hare & Hill Civil Litigation, London, Sweet & Maxwell, 9th edn, 2000 at chp 2. Conditional fee arrangements are permitted under ss 58 and 58A, Courts and Legal Services Act 1990. But note A Boyle, R Sykes and LS Sealy, Gore-Browne on Companies para 28.9.2 where it is suggested that a CFA may be open to challenge in the case of a derivative action since is detracts from the right of the company to receive all of the proceeds of a successful action.

152 Wallersteiner v. Moir (No. 2) [1975] QB 373.


154 This section is based on proposals set out in Completing the Structure, chp 12. This chapter provides a helpful account of mechanisms in the UK for passing and amending primary and secondary legislation.

155 Ibid, para 12.6.
One key decision by the CLRSG is to recommend that basic principles of company law should be in the primary legislation but that more detailed requirements should be put into secondary legislation or into rules made by a specialist body. The main considerations underlying this decision are democratic legitimacy, accessibility and flexibility. Some matters, such as general directors’ duties, are thought to be so fundamental or to embody such significant elements of public policy that they should be for Parliament to determine through primary legislation. The primary legislation is also regarded as the appropriate location for structural provisions (the ‘architecture of the new framework’) and for requirements that need to be in the main body of the legislation if it is to be readily comprehensible. But more detailed rules are thought to be best located in delegated legislation because requirements in that form can be changed more easily than primary legislation and because this avoids cluttering up the primary source with technicalities that may only be of interest to specialists and/or which only need to be consulted on an irregular basis.

The decision to reserve the primary legislation for fundamental rules has not attracted much comment in the UK but appears to be generally welcomed. How well the plan is actually executed can only be a matter for speculation until detailed drafts of the proposed new primary legislation begin to emerge. Despite the CLRSG’s admirable rhetoric, it would seem over-optimistic to assume that the UK will end up with primary legislation that is significantly shorter than its current, lengthy Companies Act 1985. If the remarkably long-winded set of provisions regulating political donations that have recently been inserted into the Act is anything to go by, it would be more reasonable to work on the assumption that the new legislation will end up being even longer than its predecessor. But, even so, the decision to use delegated legislation to a significant extent combined with the facts that insolvency law and financial regulation have separate statutes, should mean that the UK legislation is unlikely to approach anything like the huge and, to an outsider’s eyes, unwieldy size of the Australian Corporations Act.

I use the term ‘delegated legislation’ here to embrace secondary legislation made by government departments and also rules made by other agencies in the exercise of powers that have been delegated to them by statute. The UK already devolves rule-making powers to

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156 Ibid, para 12.20.
157 Ibid, para 12.36.
158 Ibid, para 12.20
159 LS Sealy, Company Law and Commercial Reality, London, Sweet & Maxwell, 1984, at pp 6-14 commenting on the quantity and complexity of English company law and noting how the reform committees (Cohen Committee (1945) and Jenkins Committee (1962)) failed to match words about deregulation to deeds since their recommendations increased the burden on business as, in the author’s words (at p 7) ‘every new Companies Act in English history has done’.
160 As Companies Act 1985, pt XA. This part was inserted by the Political Parties, Elections and Referendums Act 2000, sch 19. It requires shareholder approval of donations. It is a breach of duty for directors to make unauthorised donations. Pt XA ss 347K provides a statutory derivative action (including provision for costs and information access) for this specific situation.
specialist agencies, for example in relation to listing and in respect of accounting standards. What is now proposed by the CLRSG is an extension of this method of rulemaking in the corporate field (under the structure established by the Financial Services and Markets Act 2000 it is also to be extensively employed in relation to financial regulation).

The CLRSG proposes the establishment of a new institutional framework based on the existing arrangements relating to accounting and financial reporting. These present arrangements involve the Financial Reporting Council (‘FRC’) and its subsidiaries, the Accounting Standards Board (‘ASB’) and the Financial Reporting Review Panel (‘FRRP’). The whole of this existing organisational structure is supported and funded jointly by the accountancy profession, the City of London and the government. Government funding amounts to around one-third of the FRC’s finances. The FRC maintains that whilst the structure has the strong support of government, it is not government-controlled but rather is part of the private sector process of self-regulation. The CLRSG current proposals do not recommend a change in the formal status or funding of the regulatory bodies. But there are clear political sensitivities here – both about ensuring the acceptability of the proposals to the powerful business, professional and investment constituencies that could be expected to resist encroachment by the state into areas of self-regulation, and about not adding to the state’s funding obligations. Awareness of such sensitivities means that the CLRSG’s claims simply to be building upon the existing structural arrangements should not necessarily be taken at face value. Under the proposals as they currently stand (though this is an area where much more discussion about legislative engineering is likely to take place before change is enacted), the public character of the bodies performing regulatory functions will increase significantly. It is proposed that legislation should specify boundaries of their powers, factors to which they should have regard in performing their functions, consultation requirements, some requirements as to their membership and possibly also the basic principles to be followed in setting standards. Given the extended range of powers and responsibilities that will be devolved to these bodies there would undoubtedly be concerns about representation and accountability if state controls of this type on their composition and operations were not imposed. But the overall effect of the proposals would seem to shift institutional structures that already sit in the rather fuzzy public/private middle ground somewhat closer to directly state-controlled territory.

It is intended that the Company Law and Reporting Commission (‘CLRC’) will assume the position of the FRC. The CLRC will be the parent organisation for a number of bodies including a Standards Board. The Standards Board will assume the role of the ASB. The Standards Board will also be given power to write legally enforceable rules in other areas of company law. Whilst the range of rule-making powers outside the accounting field that is currently envisaged for the Standards Board is fairly modest, a significant feature is that it

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162 Part VI, Financial Services and Markets Act 2000, in force with effect from 1 December 2001 - delegation to the FSA acting as the UK Listing Authority.

163 This section draws upon Completing the Structure, chp 12 and Final Report, chp 5.

164 Section 256 of the Companies Act 1985 - delegation to the Accounting Standards Board.


166 Ibid.

167 Final Report, paras 5.47-5.50 (disclosure requirements) and paras 5.51-5.58 (substantive rules on company general meetings (eg use of electronic voting and web sites) and communication between companies, shareholders and beneficial owners in the absence of an industry standard).
covers areas that, at present, are regulated by means of ‘best practice’
– type guidance. It seems reasonable to assume that, over time, the
rule-making powers delegated to the Standards Board are more likely
to expand than to contract. So, we may be at start of a process of
increasing encroachment by the state, though the writing of legally
enforceable rules by an agency with strong statutory backing, into
areas of corporate activity where previously industry has regulated
itself.

It is also envisaged that the Standards Board will assume
responsibility for the Combined Code, as well as for guidance in
other areas. Technically, this will not result in the Combined Code
itself becoming legally enforceable though there will continue to be a
legally enforceable obligation imposed by the Standards Board (rather
than in the Listing Rules where this rule is presently found) to disclose
compliance with the Code and to explain non-compliance. However,
even though it remains formally voluntary, there is a risk that locating
responsibility with the Standards Board will amount to de facto
hardening of the Combined Code because companies may hesitate not
to comply with it in case this is seen by the Standards Board as a
‘failure’ that needs to be corrected by state intervention in the form of
more prescriptive requirements. The Standards Board will be well-
placed to secure the intervention that it considers desirable since it can
itself make legally enforceable rules within the scope of its devolved
powers or can look to government either to supply the legal rules or to
extend the agency’s rule-making powers for that purpose. As a
constituent part of an organisational structure to which significant
regulatory responsibilities have been devolved by statute, the
Standards Board will presumably enjoy good channels of
communication with relevant government departments.

The shift from private to public regulation that I have suggested
may be present in the CLRSG’s proposals regarding the establishment
of the CLRC and its subsidiaries should not be exaggerated. To a large
extent, these proposals are based on the existing UK framework of
regulation in relation to accounting and the immediate impact of the
proposed extension of that framework to cover corporate regulation
more generally will be modest. Outside the area of accounting, it is
not envisaged that the CLRC or its subsidiaries will have any
enforcement powers or responsibilities. Its position differs from that
of, say, the Australian Securities and Investment Commission in that
(and other) respects. But, once established, agencies tend to grow and
their existence can set in train a series of events that turn out to be
much more significant than was ever envisaged at the outset. For this
reason, the proposals regarding the new institutional framework
dererve careful scrutiny. One area where speculation as to future
developments is particularly pertinent is in relation to the regulation of
takeovers. If the CLRC is successfully established, regulatory
responsibilities for corporate affairs and securities regulation in the

168 The Institute of Chartered Securities and Administrators’ guidance on organisation of
company meeting, ‘The Electric Communications Order 2000 - ICSA’s Guide to
Recommended Best Practice’ (ICSA, London, 2000), covers at least some of the same
ground as that which is to be delegated to the Standards Board.
169 We propose also that, at least until the new bodies have established confidence
enough to justify an extended jurisdiction, the Standards Board’s powers should extend
only to...: Final Report, para 3.6. An area of possible future expansion of rule-making
powers is in relation to rights of beneficial owners of shares, although at present
mainly a guidance issuance role is envisaged for the Standards Board: Final Report,
para 3.51.
170 This is presently the responsibility of the FRC.
171 The CLRC will also perform guidance issuance functions.
172 But the CLRSG does not agree: Final Report, para 5.46. Note also ibid, para 5.60
which expressly recommends against the Standards Board having power to make
substantive rules in the ‘sensitive’ area of governance.
UK will then be dominated by two agencies that are either established by statute (the FSA) or strongly supported by statute (the CLRC). In that environment, the position of the Takeover Panel may seem increasingly anomalous. That the Takeover Panel may eventually become a subsidiary of the CLRC is an entirely plausible projection.

The unfolding of the relationship between the CLRC and its subsidiaries (particularly the Standards Board) and the FSA (particularly in its role as UK Listing Authority) will also merit close observation. Presumably, the agencies will draw up informal and formal understandings regarding their respective regulatory responsibilities in areas of overlap. Is that likely to prove to be a better solution to the problems that may stem from the indistinct boundaries between the two areas of law or would it make more sense to combine responsibilities within a single unitary authority? Much has been made of the advantages of a unitary authority in relation to financial regulation173 so why not extend the remit of the FSA to cover company law as well?

One of the strongest arguments for separation of functions relates back to the general theme of this paper: competitiveness. Whilst some commentators make the case for the potentially beneficial social welfare implications of greater regulatory competition in securities law,174 international co-operation and co-ordination of effort by regulatory authorities in standard-setting, surveillance and compliance are widely regarded by policymakers as the most effective way of responding to the systemic risk and opportunities for financial fraud and market manipulation that are present within the international financial system.175 Whilst financial regulators should not be immune from having to consider the competitive impact of their regulatory requirements, promotion of its home state’s international competitiveness should not be an overriding objective of a national financial regulator since this could impede efforts to secure international co-operation with other regulatory authorities and could inappropriately draw the regulator into essentially commercial issues.176 On the other hand, constraints regarding enthusiastic pursuit

176 These were the grounds on which the government and the FSA successfully resisted calls for the promotion of competitiveness to be included in the statutory statement of regulatory objectives in section 2 of the Financial Services and Markets Act 2000; Joint Committee on Financial Services and Markets, Draft Financial Services and Markets Bill First Report, Vol II (HL Paper 50-II, HC 328-II, 1999) Q34 (reply by Davies, Chairman FSA). The desirability of facilitating innovation in financial services, the international character of financial services and markets and the desirability of maintaining the UK’s competitive position, the need to minimise the adverse effects on competition that may arise from exercise of the FSA’s general functions and the desirability of facilitating competition between those who are subject to FSA regulation are included in the list of regulatory principles to which the FSA must ‘have regard’:...
of international competitive advantages do not apply to corporate regulation where the systemic risks that affect financial systems are not present. There is no reason why a corporate regulatory authority should not be free, or even required, to put promotion of competitiveness at the heart of its regulatory objectives.

Another argument for keeping responsibilities for financial and corporate regulation separate is that amalgamation could result in the needs of smaller, privately owned business not receiving adequate attention. A financial regulator concentrates on maintaining confidence in the financial system and ensuring investor protection. Much of what concerns smaller businesses is likely to fall outside these areas.177 Under the CLRSG proposals the institutional framework would include an advisory Private Companies Committee as a subsidiary of the CLRC.

Assessment: will the UK reform initiative produce ‘modern company law for a competitive economy’?

Economically advances states like the UK do not start from scratch when they reform their corporate laws. They have existing corporate laws that are historically contingent supported by institutions and practices that have evolved to meet the needs of their particular markets.178 Residual memories of the scandals that triggered certain rules can persist and make people hesitate to abandon them.179 Sophisticated legal and financial advisers, who know the quirks of the system and work round them, may resist change unless the projected long-term advantages of reform clearly outweigh the costs that will be involved in adapting to the new requirements. Political considerations may make governments proceed cautiously so as not to disrupt relationships with constituencies on which they depend for support.

It was fairly clear from the outset of the company law reform initiative that the UK government did not want to be seen to be indulging in change for change’s sake and that what is sought from the CLRSG were proposals that would simplify the law rather than alter it radically. In overall terms, the package of reform measures that the CLRSG has delivered is not particularly radical in substance. Nor is it especially original: apart from the mandatory obligation on larger companies to make an Operating and Financial Review, an idea that does not appear to have an immediately obvious counterpart in comparable jurisdictions, the significant changes tend to follow developments that have already occurred elsewhere in the Commonwealth. It is, however, fair to suggest that the proposed statement of directors’ duties is more comprehensive than those in comparable jurisdictions and that codification of remedies, if adopted, will be an important step forward in the evolution of corporate law. The collaborative and consensus-building approach adopted for the review meant that it was never likely to come up with major innovations. Also, in view of the clear ‘steer’ given by its political

179 The ban on companies making loans to their directors (s 330 of the Companies Act 1985) illustrates this point. This ban was introduced into the UK legislation in 1980 in response to a number of scandals: ‘Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties’ Law Com Report No. 262, Scot Law Com Paper No. 173, 1999, para 12.2. Under current proposals this ban will be extended.
masters at the outset, perhaps the CLRSG’s avoidance of fundamental substantive reform should be applauded rather than criticised. There is little practical point in recommending sweeping change if the political will to implement it is lacking.

At the outset of its review the CLRSG adopted four guiding principles (or presumptions). Although the principles are reformulated to some extent in the Final Report, the original principles remain useful in assessing whether the reform package will be ‘modern’ and ‘competitive’. It is also interesting to identify where and why, in the light of experience and extensive consultation, the CLRSG has departed from the principles as originally articulated.

PRESUMPTION IN FAVOUR OF MINIMISING COMPLEXITY AND MAXIMISING ACCESSIBILITY (INCLUDING, ‘THINK SMALL FIRST’ PRINCIPLES)

Existing UK companies legislation is notoriously and indefensibly complex. It is still based on foundations that were laid down in the 19th century but the structure is now close to collapse under the weight of additional regulation that has built up over many years. Some of the underlying conceptual considerations that influenced the development of company law in the Victorian era no longer apply. A full assessment of whether deeds match up to words cannot be attempted until the regulatory framework is established and we can see how well the drafters have dealt with the major challenge of structural re-organisation that is involved in ‘thinking small first’. But it seems a fair prediction that one of the greatest achievements of the current reform programme will be that company law is made clearer and more comprehensible. The idea of putting fundamental principles (including directors’ duties) into primary legislation is appealing. So too is the proposal first made by the Law Commissions’ in their directors’ duties project for the publication of government-backed guidance pamphlets amplifying what is expected of directors in particular circumstances, although the issue of the legal significance that may be attached to such guidance needs careful handling.

There are competitive advantages in clarity. An outdated, obscure legal structure can create costs for business and impede efforts to attract inward investment. Although it is unrealistic to suppose that a decision whether or not to start a business in the UK will turn solely on how easily the company law rules can be understood without recourse to specialist legal advice, in some cases this factor may make a marginal difference. Effective performance of directors’ duties can only be helped by directors first having a clear idea of what is expected of them, and the way in which their legal obligations are expressed can play an important educational role. The strong link between effective performance of directors’ responsibilities and competitiveness was expressly recognised by the Cadbury Committee: ‘The country’s economy depends on the drive and efficiency of its companies. Thus the effectiveness with which their boards discharge their responsibilities determines Britain’s competitive position’.

181 Final Report, chp 1.
That Committee also acknowledged that greater clarity with regard to responsibilities would help to foster investor confidence.\(^{185}\) As well as improving the clarity of the legislation, the CLRSG’s proposals will certainly simplify certain corporate processes, such as company formation and decision making within smaller companies. Relieving smaller companies from the independent audit requirement and simplifying the disclosure requirements to which they are subject will lighten the regulatory burden and reduce the costs involved in operating a business in corporate form. Another proposal which has not been discussed in this paper for reasons of space but which will reduce complexity if it is adopted is for the establishment of a statutory merger procedure to facilitate mergers within wholly owned groups.\(^{186}\) Inspiration for this proposal appears to have come from the successful New Zealand amalgamations provisions which have proved popular as a simplified way of effecting group reconstructions.\(^{187}\)

**PRESUMPTION AGAINST INTERVENTIONIST LEGISLATION AND IN FAVOUR OF FACILITATING MARKETS, INCLUDING PROVISION FOR TRANSPARENCY OF INFORMATION**

Broadly speaking,\(^ {188}\) company law can be characterised as enabling, meaning that the rules operate by way of default in circumstances where the parties have not specifically negotiated other arrangements. The rationale for state provision of company law default rules is that they reduce transaction costs and so are attractive to businesses and investors. Or company laws can be characterised as mandatory, where the state requires those who operate within the corporate form to do, or refrain from doing, certain things in order to achieve desirable social welfare results. But this distinction is a fairly crude one. One obvious necessary refinement is that the classification of default rules needs to distinguish rules by reference to the process for opting out of them: the more elaborate and costly the opt-out procedure, the closer the rule is to being, in effect, mandatory.\(^ {189}\) A similar refinement needs to be made in relation to mandatory rules since these can range from rules that can be altered easily (a British example would be a rule that is contained in delegated legislation) to rules that are firmly entrenched (eg a rule that is derived from European company law).

The existing UK corporate legal system has been said to fit broadly within enabling model\(^ {190}\) but there are plenty of mandatory rules and the procedures involved in opting out of default rules are often quite elaborate or, as one scholar has described them: ‘prolonged

\(^{185}\) Ibid, para 1.6.
\(^{186}\) Completing the Structure, chp 11 and Final Report, chp 13. There are also new proposed mechanisms to allow jurisdical migration of companies: Completing the Structure, chp 11 and Final Report, chp 14.
ritual’. Will the enabling/mandatory balance shift significantly if the CLRSG proposals are implemented? The presumption suggests that the balance should shift more in favour of enabling rules (although the presumption, as originally formulated, can be regarded as inherently contradictory in that it eschews state intervention but at the same time advocates it since ‘provision for transparency of information’ essentially means mandatory disclosure obligations). A move away from prescriptive rules would be consistent with the policy of promoting competition through the removal of regulatory burdens.

Certainly some mandatory and strong default rules will be relaxed, particularly those relating to corporate capital. It is clear that the CLRSG would have gone further in reducing state intervention in matters of corporate finance had it not been for the constraining effect of European community law. But a substantial portion of the detailed prescriptive rules regulating directors’ dealings with their company will remain, and some of them will even be strengthened. There will also be new prescriptive rules written by the Standards Board, although these will be weak mandatory rules in the sense that there will be a fairly straightforward procedure for changing them if they become inappropriate in changing market conditions. And there is always the threat of more state intervention waiting in the wings: when announcing new disclosure requirements on boardroom pay in March 2001, the Secretary of State made it clear that disclosure might only be an interim step and that the government would be monitoring compliance with best practice requirements before deciding whether tougher legal regulation, in the form of a compulsory shareholder vote on boardroom pay, was required.

The initial apparent zeal for a ‘hand-off’ approach is not, then, translating into specific proposals to dismantle the panoply of specific rules regulating directors’ activities. Overall, it is difficult to find a coherent theme running through the UK’s evolving approach to the responsibilities of directors but, despite the initial rhetoric, it does seem that government and policymakers are sceptical about the market’s ability to put in place effective corporate governance without state intervention. Further, the continuing preference for specific rules indicates that the judiciary is not (yet) regarded as being able to play a strong role in disciplining management through the application of broadly worded general duties. The reformulated statement of

192 The statement of guiding principles in Final Report, chp 1 avoids this difficulty.
guiding principles in the Final Report published in July 2001 reflects this shift in approach: although the idea that company law should be broadly enabling or facilitative is repeated, the need for state intervention on market failure, public interest and other grounds, is strongly stated. 198

PRESUMPTION AGAINST CREATING CRIMINAL OFFENCES UNLESS THE SUBJECT MATTER DEMANDS IT

Here, too, there is a gap between the impression created by the initial presumption and the specific proposals that have emerged. Although some refinement in the scope of those who can be held liable for certain criminal offences is proposed, 199 it appears that ‘the subject matter demands’ the use of criminal sanctions rather more frequently than many observers might have predicted at the start of the reform process. The CLRSG’s conclusion is that ‘criminal sanctions should not to any material extent be replaced by a system of civil ones’. 200 Criminal sanctions for regulatory offences are regarded as highly efficient in that they generate high compliance levels before recourse to enforcement proceedings. In relation to the specific duties imposed on directors, criminal sanctions are seen to have a powerful deterrent effect.

But there is one crumb for non-interventionists in that the enthusiasm for criminal sanctions does not go quite so far as in Australia and Singapore: 201 as now, criminal sanctions will not be attached to breaches of general duties because this is viewed as allowing for unwarranted interference by public authorities in the private affairs of companies. The CLRSG has also declined to adopt a civil penalties regime for breaches of the companies legislation. However, under the Financial Services and Markets Act 2000, directors of listed companies will be liable to civil penalties if they contravene the Listing Rules, 202 as will directors (and others) who engage in conduct that amounts to market abuse. 203 In addition, there are proposals to set out in statute the range of civil sanctions against directors who act in breach of their general duties as well as to clarify the sanctions for breach of specific duties. 204 The CLRSG also recommends that companies should be required to include in annual reports disclosure of convictions for criminal breaches of the companies legislation by them or by their key employees. 205

So the UK remains wedded to tough sanctions. 206 Tough sanctions, accompanied by credible enforcement, can promote investor confidence. But tough sanctions can also over-deter if they make those who are subject to them overly defensive and unwilling to take risks. Whether the UK has got the balance right is a story that has yet to unfold. What seems fairly clear at this stage is that when discussion shifts from articulation of broad principle to analysis of specific

198 Paras 1.10-1.11, 1.15 (freedom with transparency).
200 Completing the Structure, para 13.29. This is confirmed in Final Report, para 1.17 and chp 15 which also confirms proposals for new dishonesty offences relating to directors’ transactions and to accounts and audit.
201 Section 184 of the Corporations Act (Aus); s 157 of the Companies Act (Sing).
203 Ibid, pt VIII.
205 Final Report, paras 15.31-15.34.
206 Also relevant here is the Company Director Disqualification Act 1986 which allows for the disqualification of directors on a variety of grounds including unfitness and public interest.
measures that might be adopted, UK policymakers have no real appetite for deregulation in relation to sanctions.

PRESUMPTION IN FAVOUR OF ALLOCATING JURISDICTION TO THE MOST SUITABLE REGULATORY BODIES

One of the most interesting features of the discussions that have taken place in the UK about the allocation of regulatory responsibilities is how clearly they have exposed the role of government in managing ‘self-regulation’. There is nothing novel in the observation that the government can influence the development of market-based regulation. One well-known technique is for it to invite the market to regulate itself with the implicit threat of an escalation in direct intervention should the invitation be declined - the Takeover Code and the corporate governance code were, at least in part, driven by pressure to stave off legislative intervention.207 But the government and CLRSG have been more explicit in this review: the relationship between law and non-statutory codes was part of the terms of reference set by the government; and the private sector origins of the Combined Code did not prevent the CLRSG from treating questions about what it should contain and about its status as falling squarely within the scope of the review. This approach leaves no doubt about the very fuzzy line that in reality divides state and market-based regulation.

The establishment of the CLRC and its subsidiary bodies represents an opportunity to streamline and rationalise the sources of regulation and guidance on best practice. Rationalisation of this sort may be helpful in attracting inward investment since those who are unfamiliar with UK markets may find the range of bodies currently involved in the formulation of regulatory policy, practices and guidance off-putting. There may also be some savings for business. But the potential merits of this development do need to be set against the risk that the CLRC will be a vehicle for sub-optimal regulatory intervention by the state, that it will inhibit the development of innovative market-based regulatory solutions and that it will be dominated by special-interest groups and/or out of touch with the needs of the markets that it regulates. Closer cost-benefit analysis of the proposal is needed but for now, a note of caution about the implications of the proposed institutional changes in the UK is warranted.

Finally: Looking Ahead

The paper has presented a rather downbeat assessment of UK company law reform. The UK will have a much better corporate legal framework if the reforms are implemented but its strengths are likely to lie rather more in clarity and accessibility than in substantive innovation. But another benefit resulting from the review that the UK has undertaken should not be overlooked. The efforts of the CLRSG and the elaborate consultation exercises which it has conducted have provided the UK with up-to-date information and analysis on which to form a clear policy agenda with regard to corporate regulation. For example, the extensive debate about stakeholding has helped to clarify ways in which company law can, and cannot, be used to achieve desirable social welfare goals. A positive use of that accumulated knowledge and experience would be to channel it into the

development of European company law since there is a pressing need for further change at that level. However, whilst European policymakers have grasped the principle that rules that are ill-adapted to modern market conditions can have negative effects on competitiveness, the complex process of translating European policy initiatives into legislative action continues to present formidable challenges.

Within the UK issues that seem bound to attract particular attention in the next round of consultations leading up to new companies legislation are the role and responsibilities of institutional investors.208 The CLRSG has raised two major questions: whether fiduciary investors (such as fund managers) are inhibited from exercising their powers by conflicts of interest; and whether they are so inhibited by an absence of due diligence. It also raises concerns about the efficiency of the vote execution process. Evidence considered by the CLRSG leads it to suggest that intervention on public interest grounds is necessary and it makes a number of recommendations for new disclosure requirements, including: companies should disclose significant commercial relationships with investors controlling more than 3 percent of their shares; companies should disclose the number of votes cast on resolutions on polls; and institutional investors should disclose how they have voted on resolutions and their decisions on takeovers. The last of these proposals is particularly controversial as the tentative nature of the CLRSG’s proposal recognises: its proposal is that the new legislation should give the government a reserve power to impose such an obligation if it ‘proves necessary in the light of experience’. This exhortation (or thinly-veiled threat) to the institutions to regulate themselves by means of best practice hints at the political compromises and trade-offs that will surely be involved in securing reform that is sensitive to the internationally competitive nature of capital markets and to the ease with which investors can avoid regulatory burdens by moving their capital to more receptive jurisdictions and, at the same time, is properly reflective of the public interest concerns that flow from the central role that institutional investors occupy within the corporate governance system.

208 This section is based on discussion and proposals contained in Final Report paras 6.19-6.40.