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SALEEM SHEIKH and WILLIAM REES
CITY OF LONDON POLYTECHNIC
LAW FACULTY
84 MOORGATE
LONDON EC2

29th JULY 1992

NIGEL PEACE
SECRETARY
COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE
P.O.BOX 433
MOORGATE PLACE
LONDON EC2P 2BJ

Dear Mr Peace

RE: COMMENTS ON THE DRAFT REPORT DATED 27th MAY 1992

Please find enclosed our draft article which we will be submitting to the "Modern Law Review", a legal journal, some time in August for publication. The article will be fully referenced and there may be further additions before our final submission. If we may, and it may also be useful to you, we would like to send you our final version sometime in August with references.

Thank you for giving us the opportunity to comment on the report and we hope some of our comments will be considered by the Committee. If you require our assistance we would be only too happy to assist you in the final report and beyond.

Yours faithfully

SALEEM SHEIKH and WILLIAM REES

CITY OF LONDON POLYTECHNIC

CORPORATE GOVERNANCE AND CORPORATE CONTROL: SELF-REGULATION OR STATUTORY CODIFICATION?

A COMMENT ON THE DRAFT REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE

by William M.Rees and Saleem Sheikh *[1]

INTRODUCTION

> **"Most students of corporation finance dream of a time when corporate administration will be held to a high degree of required responsibility - a responsibility conceived not merely in terms of stockholders' rights, but in terms of economic government satisfying the respective needs of investors, workers, customers, and the aggregate community." A.A.Berle, "For Whom Corporate Managers Are Trustees: A Note"**

The Committee on the Financial Aspects of Corporate Governance under the chairmanship of Sir Adrian Cadbury, was established in May 1991 by the Financial Reporting Council (FRC), the London Stock Exchange and the accountancy profession. These sponsors of the Committee were concerned about the perceived low level of confidence in financial reporting and in the ability of auditors to

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[1]. Department of Law, City of London Polytechnic - the New University of the City of London

provide the safeguards which the users of company reports both sought and expected. They saw the underlying factors as (i) the lack of a clear framework for ensuring that directors kept under review the controls in their business; (ii) the looseness of accounting standards; and (iii) competitive pressures on companies and auditors, which have made it difficult for auditors to stand up to demanding board of directors.

Some unexpected failures of major companies coupled with criticisms of a lack of effective board accountability on issues such as directors' pay had heightened the concerns about the corporate system's working. The need for standards to be raised and for clarification of responsibilities had also clearly emerged from another Working Party set up by The Institute of Chartered Accountants of Scotland in April, 1991, under the chairmanship of Nigel Macdonald, a month before the Cadbury Committee was set up. The Scottish Working Party was concerned with "striking the appropriate balance between the responsibilities of the company directors and those of the auditing profession." Whilst our discussions are confined to the Committee's draft Report proposals, we will however refer, where appropriate, to the Working Party's report by way of comparison.

The Committee's formal terms of reference were to consider the following issues in relation to financial reporting and accountability and to make recommendations on good practice:

(i) the responsibilities of executive and non-executive directors for reviewing and reporting on performance to shareholders and other financially interested parties; and the frequency, clarity

and form in which information should be provided;

(ii) the case for audit committees of the board, including their composition and role;

(iii) the principal responsibilities of auditors and the extent and value of the audit;

(iv) the links between shareholders, boards and auditors; and

(v) any other relevant matters.

In short, these terms of reference were regrettably relatively narrow as they were geared quite simply to seeking to restore confidence in financial reporting and auditing practice.

We shall offer our views in this contribution on the extent to which the Committee has succeeded in meeting those terms of reference in its draft report, which was published on 27th May, 1992.

The frame of reference through which the Committee made its analysis and recommendations was set out in the beginning of the Report; given that the country's economy depends on the drive and efficiency of its companies, the effectiveness with which the boards discharge their responsibilities determines Britain's competitive position; the essence of any system of good corporate governance involves boards having the freedom to drive their companies forward whilst exercising it within a framework of effective accountability. There are two basic assumptions underlying the Committee's recommendations: (a) self-regulation, rather than statutory regulation and enforcement, is the optimum way to improve corporate governance; and (b) financial markets, rather than independent regulators, provide the most appropriate

means of dealing with those companies which fall below the acceptable standards of corporate governance.

Regrettably, most of the Committee's recommendations were not original and appear to have originated from a combination of the robust and radical proposals made in 1973 in the Conservative Government's White Paper, "Company Law Reform" and in the same year, in the CBI's publication, "The Responsibilities of the British Public Company." Although the CBI's terms of reference nineteen years ago were wider than those of the Cadbury Commmittee, its recommendations were very similar to those now made by the Committee. The CBI was also anxious to "raise the general level of business conduct to that already practised by leading firms large and small." This is very similar to paragraph 2.7 of the Cadbury Report whose stated objective is "to help raise the standards of corporate governance..." The only difference from the work of 1973 is that the term "corporate governance", which hails from the USA, is now a "buzz word" and accordingly has become the centre stage of the discourse.

A central question to the debate is whether a self-regulatory system of corporate governance is preferable to legislation which would have to be obeyed to the letter but not in spirit. The Cadbury Committee appear to have been of the view that this would be the negative outcome of taking the legislative route. This debate on which regulatory system is preferable has never been decisively resolved. The 1973 CBI publication reminds us continually that the voluntary self-regulatory approach is preferable to statutory codification: "Business today operates in a

time of change; it must therefore show itself capable of the degree of evolution and self-reform necessary to cope efficiently with the new circumstances in which it has to operate. The CBI went on to argue that "private enterprise must be capable of its self-reform" and that "the business of private enterprise is capable of working out its own programme of self-reform." The very fragmentation of the British self-regulatory framework has once again renewed demands for a statutory codification of the system of corporate governance.

THE CONCEPT OF CORPORATE GOVERNANCE AND CORPORATE CONTROL

According to the Committee, the term "corporate governance" refers to "the system by which companies are run." The Committee surprisingly devotes only three short paragraphs to this major issue and failed to consider the theoretical aspects underpinning the concept. This may be partly explained by their very narrow terms of reference and partly by their lack of explicit consideration of the American and Canadian experience in this area. Nevertheless, their terms of reference become meaningless without some consideration of the system of corporate governance and its wider implications, which also appear to have been ignored by the Committee. We shall elucidate on the concept of corporate governance with specific reference to the North American contributions to this debate, which , if applied, could usefully have a highly beneficial impact on British law and practice.

e system of corporate governance comprises of board of directors
io are recognised in law as "the directing mind and will" as well
; the controllers of the corporátion vested with wide managerial
ıd trusteeship powers under the company's constitution. Within
his system are located the shareholders who have the task, inter
lia, of ensuring that directors act within the limits and
ooundaries of their duties. A third tier of the system consists of
auditors who provide an objective check on the financial statements
provided by directors. The Committee began with the premise that
the basic system of financial corporate governance in the UK was
sound but then explicitly recognised the low level of openness,
integrity and accountability of directors towards shareholders,
auditors and other potential claimants on the corporation. This
failure is attributed to the weaknesses inherent in the present
corporate mechanisms of disclosure of information and the system of
reporting, with particular reference to financial reporting. The
Committee, therefore, wants to raise the standards of corporate
governance and the level of confidence in financial reporting as
well as "bringing greater clarity to the respective
responsibilities of directors, shareholders and auditors."
Corporate governance is also part of a wider debate on who controls

the corporation since those in control of the company can readily
manipulate, to their advantage, the dissemination of information
and reporting to shareholders and other potential claimants on the
corporation, including employees, suppliers and creditors. Managers
are also in a position to control the social and politica

decisions of the corporation. Corporate control is, therefore, based on the strategic position of the managers within the company. According to Herman, corporate control refers to power: "the capacity to initiate, constrain, circumscribe, or terminate action, either directly or by influence exercised by those with immediate decision-making authority." If the system of corporate governance is to operate efficaciously, the power located within the company needs to be regulated and subjected to greater scrutiny by others. Corporate managers should be made more accountable for their actions. Chayes has contended:

"But to the extent that we are prepared to recognise centres of significant non-governmental power within our society, they too must be subjected to the rule of law. It is implicit in the ideal...that the process and institutions of the society be organised so as to give reasonable assurance that significant power will be exercised not arbitrarily, but in a manner that can be rationally related to the legitimate purposes of the society."

The validity of many of the economic models and theories on corporate governance depend very heavily on concept of corporate control and the legitimacy of power of corporate managers, to support their contention that the main objective of companies is the pursuit of profit maximisation for the benefit of shareholders. This "free market school" has contended that by maximising profits, companies would be fulfilling their economic and social responsibilities towards society. The system of corporate governance, in their view, functions most efficiently when "the motive of business is pecuniary gain." According to Adam Smith in

business to socialise itself." The debate on corporate governance culminated a decade later in the seminal work of Berle and Means in "The Modern Corporation and Private Property." In the Preface to their work, Berle and Means referred to a "corporate revolution" within the company whereby shareholders were "steadily being lost in the creation of a series of huge industrial oligarchies." One of the central aspects of their work concerned their belief in a separation of ownership from control within the company as a result of the wide dispersion of share ownership. Control by shareholders had been "surrendered to a unified direction" with wide discretionary powers vested in corporate managers. Berle and Means were concerned about the degree of concentration of power acquired by corporate managers and concluded that the "professionalism" of management would eventually lead them to pursue other social objectives and to develop a "corporate conscience":

"It is conceivable,- indeed it seems almost essential if the corporate system is to survive - that the control of the great corporations should develop into purely neutral technocracy, balancing a variety of claims by various groups of the income stream, and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity."

However, modern studies on corporate governance and corporate control have disagreed with the vision of separation portrayed Berle and Means. Herman, for example, in 1981, concluded that the separation of ownership from control was far from conclusive. He contended that Berle and Means had "greatly overstated the loss of stockholder's power and the separation and discretion of managers,

.s "Wealth of Nations", the "invisible hand" and the pursuit of elf-interest by corporate managers would motivate companies to perate efficiently. Smith's ardent followers included Professor ilton Friedman and the late Professor Hayek who similarly argued hat the objective of companies is to increase their profits. This traditional company law philosophy is surely based on the false assumption that any deviation from profit maximisation will result in real and uncontrollable power being vested in directors who will, in turn, pursue other undesirable social objectives. This fear was voiced by Mason in the 1950s who remarked:

"What... we are afraid of is that this powerful machine, which so successfully grinds out the goods we want, seems to be running without any discernible controls. The young lad mastering the technique of his bicycle may legitimately shout with pride, "Look ma, no hands" but is this the appropriate motto for a corporate society?"

Advocates of company law reform have challenged the validity of this traditional company law philosophy under the theory of "managerialism." Veblen associated the rise of the modern corporation with the theory of separation of ownership from control. He perceived the shareholders as a group of "absentee owners, wholly and obvious", without any active role in the company. Keynes advanced on the debate in the 1920's and suggested that the conflict between managers and shareholders would eventually lead each to pursue its own objectives and interests. He believed that one of the significant developments of the apparent separation of ownership from control was the "tendency of big

possibly in the interests of yielding more dramatic conclusions." Corporate managers were still pursuing profit maximisation as the main objective of the company.

In our view, one of the main drawbacks of the Committee's discussion in this area has been its failure to challenge the traditional company law philosophy on corporate governence in which the main "dramatis personae" are yet again the directors, shareholders and auditors. The issue of corporate governance is a much wider one than that suggested by the Cadbury Committee and it is hoped that the Committee will consider the interests of other potential claimants on the corporation rather than the traditional interests of the shareholders.

THE BOARD OF DIRECTORS

As part of its aim to achieve an efficient system of corporate governance, the Committee attributed significant importance to the role of the board of directors within the company. If the proposals recommended by the Cadbury Committee are implemented whether by way of self-regulation or statutory codification, directors will be required to undertake internal and external training and attend recognised courses on all aspects of corporate governance. This will apply in particular to newly-appointed board members who may not have any previous experience in corporate affairs.

The law states that the business of the company "shall be managed by directors" and case law articulates particular managerial responsibilities in the form of fiduciary and common law duties. Some attempts were made in the 1970s to codify these duties. In the

1977 Department of Trade's White Paper, "The Conduct of Company Directors", the government thought it was desirable to include a general statement of the duties of directors in statute law. It proposed that a codified statutory definition of "fiduciary duty" would require directors "to observe the utmost goof faith towards his company in all of his actions and to act honestly in the exercise of the powers and in the discharge of the duties of his office." A statute would also provide that directors would be prohibited from making use of any money, property or information belonging to the company in which some benefit could be derived by the directors. These duties were contained in Clauses 44 (1) and (2) of the Companies Bill 1978. However, the Bill was never enacted as a result of a change of government in 1979.

However, it is questionable whether these responsibilities and duties bear much resemblance to reality. According to Mace, directors have a very minor role within the corporation. In his book, "Directors-Myth and Reality", Mace observed that the typical board was largely a "vestigial legal organ which included merely subservient and docile appointees of the owner-manager." The duties and responsibilities ascribed by law to directors bear no resemblance in reality to what directors actually did in practice. He found that in practice, directors provided advice and counsel to the company President/Chairman rather than engage in decision making functions. According to one President, the board of directors served as "a sounding board - a wall to bounce the ball against." Another President thought that "the board rubber-stamps the action of management." Most of the

directors did not devote substantial amounts of time to the boards they which they served. They were reluctant to ask inquisitive questions of their President. In reality, they acted in a crisis situation in only two circumstances: firstly, where the President had died or became incapacitated, the board would appoint a successor; and, secondly, where the President's performance was so unsatisfactory that the board would require the President to resign the directors would then appoint a new successor. Mace, therefore, concluded from his studies that it was a myth to suppose that directors established objectives, strategies and policies for their companies. The board merely resembled a "ritualistic performance." Indeed, it is now becoming fashionable in corporate governance circles to ask whether directors serve any useful function at all. According to Axworthy, modern studies in North America have decisively shown that directors "not only do not do what the law envisages of them but...can not fulfil the law's requirements." He concluded that there was no necessary role for directors to serve on company boards and company law should dispense with their requirements without "any deleterious effect."

COMPANY CHAIRMAN AND CHIEF EXECUTIVE

The Cadbury Committee attaches some importance to the roles of the company chairman and chief executive who are usually one and the same person. It considers that the chairman's role is fundamental within the system of corporate governance. The Chairman has the task of accepting overall responsibility for the board. The CBI came to similar conclusions in 1973 when it stated that "the whole

tone of the company and its public image must be set by the board and in particular, by the positive leadership by the chairman. No company can be successful unless the chairman is of a calibre to provide this leadership and to represent the company properly to the outside world."

The Committee recommends that the chairman's role should be separated from that of the chief executive. Otherwise, a combination of both roles in one person would result in an undesirable concentration of power. Again, this recommendation is not an original one. It was, for example, suggested nineteen years ago by the CBI which was then emphatic that there ought to be a clear distinction between the roles and responsibilities of the chairman and the chief executive. The CBI thought that this was a matter on which some flexibility on the part of companies was essential. It concluded:

"What is necessary in a substantial company is that the chairman has executive functions, he should have with him, on an equal or a near equal level, one or more colleagues who will share with him the executive responsibility and thus avoid too much concentration of power." This is a sensible compromise and the separation of roles would, therefore, be a safeguard against abuse and misuse of power by the chairman.

NON EXECUTIVE DIRECTORS

One of the main recommendations of the Committee is for companies to appoint non-executive directors onto their company boards. The Committee believes that their "independent judgment" and monitoring of corporate performance strategy will raise standards of good corporate governance. The non-executive directors will have equal access to corporate information and will share decision making powers with the other board of directors. This will go some way towards reducing instances of abuse and misuse of power by other directors and will lessen the potential for a conflict of interests, especially in the context of takeovers and mergers.

The Committee, therefore, recommended that a majority of non-executive directors should be independent and free of any business or financial connection with the company apart from their fees or shareholdings in the company over which they preside. The task of selecting executive and non-executive directors would be delegated to a "Nomination Committee" which will be required to report back to the board on its recommendations for appointment. The Nominating Committee will consist of a majority of non-executive directors chaired by either a non-executive director or the company chairman. Non-executive directors would be appointed for specified terms and their reappointment will not be automatic.

The 1973 Conservative Government's White Paper was convinced with the desirability of appointing non-executive directors onto company boards. It suggested that the non-executive director could play a powerful and useful role on the board "partly by his concern for the interests of the shareholders and partly by obliging executive members to look beyond their immediate concerns to the longer

future and to the wider stage upon which the individual company must operate." The White Paper recommended that every company over a certain size would benefit from their presence and concluded that shareholders might reasonably rely on the non-executive director to be particularly sensitive to their interests, since he would be "less committed to the managerial view and hence better able to discharge the "stewardship" function."

Later in the same year the CBI agreed with the appointment of non-executive directors as "highly desirable." They would exercise an independent and objective approach to corporate policies and would bring to the company the benefit of their knowledge and experience in wider areas. However, the non-executive director would need to be familiar with the company's management and financial dealings and although not expected to be an expert in all areas, he would need to ensure that the company was operating efficiently. Another recommendation by the CBI was that non-executive directors should have access to all corporate information. Further, as a means of expressing their dissatisfaction with the board, non-executive directors would be required to prepare a memorandum for circulation and discussion by the board. If no change was effected by the board as a result of the recommendations in the memorandum, the ultimate resort would be to resign from the company. Non-executive directors would be under a duty to provide a statement in connection with their resignation taking into account the "best interests of the company and the shareholders." It is suggested that this statement should be registered at Companies House on resignation which would be similar to the procedure for auditors in connection with their

cessation from office under section—=—— Companies Act 1985.

PRO-NED, an organisation established in 1982, has recommended that companies should appoint independent non-executive directors onto their boards. It has formulated a "Code of Recommended Practice on Non-Executive Directors." The Code defines an "independent non-executive director" as one who has integrity, independence, personality and experience to fulfil the role of a non-executive director effectively. As a guideline, the Code suggests the duties and responsibilities of a non-executive director should include the contribution to an independent view of the board's deliberation; to help the board provide the company with effective leadership; to ensure the continuing effectiveness of the executive directors and management; and to ensure high standards of financial probity on the part of the company. They would be appointed for a specific term and would be subject to reelection by rotation.

In our view, the role of non-executive director's ought to go further than that suggested by the Committee and Pro-Ned. In light of the American experience, consideration should be given to the appointment of public directors. Stone has, for example, proposed two types of public directors who could usefully serve on company boards: "General Public Directors" ("GPD's") would operate with a board mandate and would devote at least half of their time to the company boards on which they have been appointed to serve. The GPD's would have a "superego function", whereby they would be expected to enhance the company's image in society and to consider the interests of the community. "Special Public Directors" ("SPD's"), however, would only be appointed in exceptional

circumstances, as where expert assistance was required in specialist areas of technological innovation, product safety and environmental pollution. Their appointment could be triggered in two situations: In a "demonstrated delinquency situation", they would be appointed if a company had been in frequent violation of the law and where it was apparent that the traditional legal mechanisms would be inadequate to ensure compliance by the company. In a "generic industry problem", SPD's would be appointed if an event of serious social concern had arisen and where the company had not been involved in a repeated violation of the law. The appointment of SPD's would be by the court or an agency/Commission before which the company would have to appear through its directors.

We suggest that specific duties should be assigned to these public directors to reflect their importance in society.

THE CODE OF BEST PRACTICE

At the very heart of the Committee's recommendations is the proposal for a Code of Best Practice ("the Code"). This is specifically designed to achieve the necessary high standards of corporate behaviour. The key question which we wish to address is: how likely is it that this Code will achieve this admirable objective?

The Committee has enlisted the support in this enterprise of the London Stock Exchange and unsurprisingly its other sponsors, convened by the FRC, who will in two years' time take the initiative to appoint a group to examine the progress and

establish an ongoing review of the Code. More immediately, the Stock Exchange intend to require all listed companies registered in the UK, as a continuing obligation of listing, to state whether they are complying with the Code and if not, why. This new listing requirement beginning with companies' 1992 accounts is a rare exception to the predominantly voluntary nature of the proposed reforms. The threat that the Stock Exchange would delist companies which chose not to disclose their degree of compliance with the Code is unlikely to cause considerable fear amongst such deviant directors on the basis of the Stock Exchange's track record given that it has rarely used such a sanction. Such delisting for non-disclosure would also have the knock-on effect of making it more difficult for investors to get rid of their shares in the offending company by selling them. The Stock Exchange proposes to draw public attention to cases of inadequate disclosure; a programme of disclosure will also be undertaken to assist future monitoring of the Code.

AUDITING AND THE DISCLOSURE PHILOSOPHY

The Committee is principally concerned with the financial aspects of good corporate governance and to raise the standards of the present financial reporting and accountability procedures. This is in accordance with the recommendations previously proposed by the Cohen and the Jenkins Committees.

One of the main weakness in the present system of financial reporting is the existence of various sets of accounting principles and procedures and inconsistent results derived from the same set

of facts in arriving at a true and fair view. The Committee is concerned that this results in a distortion in the financial reports presented to shareholders and recommends that the company's reports and accounts should be presented with greater clarity than at present, to the shareholders. The financial reports should be supported by statistics indicating the company's performance and future prospects. This will entail directors displaying a high level of disclosure of their financial dealings to the auditors as well as the shareholders.

The Committee also recommended that any interim statements on the company's position should be drawn to the shareholder' attention. Further, the Chairman's report should refer to the company's financial position and there should be a shortened version of the company's corporate accounts.

In order to regulate the company's financial position, the Cadbury Committee recommends that all listed companies should have Audit Committees on the board of directors. The Audit Committee would act to safeguard the interests of both the shareholders and creditors against unlawful depletion of corporate funds by directors. They would be formally constituted and their relationship with the board of directors would need to be clarified. They would have specific terms of reference stating their membership, authority, rules and duties and they would be required to meet at least three times a year to assess the company's financial position. They would be comprised exclusively of non-executive directors of the company and a majority of these non-executive directors would be independent of the company. Their role would be to consider areas of corporate

concerns and to exercise their independent judgment as committee members. The Cadbury Committee believed that an Audit Committee should be given full access to corporate information with full authority to seek external professional advice at their discretion. Their duties would include making recommendations to the board on the appointment of external auditors; reviewing the half-year and annual financial statements before submission to the board; discussing with the external auditors the nature and scope of the audit with a view to resolving any problems; a reviewing the internal audit programme and findings of internal investigation. However,the Chairman of the Audit Committee would only be accountable to the shareholders at the annual general meeting. This is unsatisfactory and we recommend that a good system of corporate governence entails regular accountability of the Chairman of the Audit Committee to the shareholders.

The Cadbury Committee's recommendations for the establishment of audit committees are not original. These proposals were put forward by the Labour Government in its 1977 White Paper which referred to the developments and experience of audit committees in North American companies. The White Paper recommended that audit committees should comprise of non-executive directors and their main duties would include reviewing the financial statements and monitoring the company's internal governance controls. The experience in North America revealed that Audit Committees were useful in strengthening the influence of non-executive directors and auditors within the company. Although the Labour Government in its White Papper favoured the setting up of Audit Committees, it

did not go so far as to suggest legislation in this area: "The time may come when it will be appropriate to legislate in this field, but the Government believes initially at least it will be better for companies, investors and their representative bodies to work out schemes which can benefit from a degree of flexibility which the law could not provide."

A notable omission by the Committee is its lack of consideration of corporate social audits. At present, company law does not make any provision for the reporting of non-financial information on the social activities of companies. The social audit is an American concept. It measures a company's social performance in areas such as environmental pollution, waste, misleading advertisements, unsafe consumer products, and product quality. This ought to be put onto the statutory agenda. In our view, as part of good corporate practice, companies should be required to identify areas of their social activities and then to measure them. In this way, companies can compare the current results with their past performance with a view to raising the standards of corporate performance. This task could ideally be allocated tp public directors.

Another major omission by the Committee has been its lack of consideration of the effect of the Companies Act 1989 on the disclosure philosophy. Some of the provisions under the 1989 Act effectively limit the amount of information which is now required to be disclosed by companies in their financial reports coupled with the impact of the elective regime which applies to private companies. The Committee appears to have ignored the views of vociferous opponents of greater disclosure of information. Sealy

has questioned the value and necessity of corporate disclosure. In his view, disclosure in some cases has ceased to fulfil its original purpose and he suggests that there are other valid mechanisms whereby disclosure can be effected.

In our view, the Committee should consider implementing the recommendations made by the Boothman Committee in 1977, which was set up to "re-examine the scope and aims of published financial information in light of the modern needs and conditions." The Report recommended, inter alia, that financial reports should seek to satisfy the information needs of various users and should not be limited to shareholders. Those claimants with a right to wider financial information would include employees. The Cadbury Committee should also consider the desirability for an Employment Report which would be incorporated in the financial report. It would be concerned primarily with information about the number of employees employed; the age distribution and sex of employees; the main functions of employees; the geographical location of major employment centres; major plant and site closures; disposals and acquisitions by the company during the past year; and the identity of trade unions recognised by the company for the purposes of collective bargaining.

TOWARDS COMPANY LAW REFORM: CONCLUSIONS AND RECOMMENDATIONS

In 1965, Lord Wedderburn wrote:

> " Company law stands in need of reform. But reform of what kind?"

This question is equally applicable today to the debate on

corporate governance as it was in 1965. His comments were in response to the apparent neglect of company law to take account of wider considerations including greater disclosure of information, directors' duties towards shareholders and other potential claimants on the corporation. These are issues which ought long ago to have been placed on the agenda of company law reform. This plea for a more radical re-examination of company law was set against the failure and timidity of the Cohen and the Jenkins Committees to challenge the traditional legal philosophy of company law, which had not addressed the wider issues associated with the concept of corporate governance and control.

The present system of corporate governance, self-regulation and the monitoring and control of corporate affairs is inadequate and unsatisfactory to protect the interests of shareholders, creditors and other potential claimants on the corporation. We, therefore, suggest that the following matters should be considered by the Cadbury Committee in formulating its final report.

1. A Companies Commission should be established which would act as a supervisory body in accordance wit the proposals put forward by a report of a working group of the Labour Party's Industrial Policy Sub-Committee. It recommended that the Commission should have a continuing role in the control and regulation of corporate activities "particularly with reference to the form and frequency of disclosure of information."

The Sub-Committee did not favour a purely advisory role for the Commission and thought that the Commission could best act "effectively and independently on its own account." New legislation

would be required to give substantive powers to the Commission in their exercise of regulation and monitoring of corporate activities and its independence from any interference. The composition and organisation of the Commission and its commissioners should be left to the judgment and experience of a Chairman appointed by the government minister. It would have a continuing role in the control and regulation of corporate activities. The proposed Company Commission's relationship with the present self-regulatory authorities would vary according to circumstances but the Sub-Committee envisaged that the overall responsibility and final say in matters of dispute would be arbitrated by the Commission.

The Commission would have the sanctions of criminal law available to it in some cases and would take measures to enforce and bring proceedings for a violation of the law. Civil penalities on the present failure to file returns would need to be revised. In particular, the Commission would be required to consider breaches of the Code by companies and to impose fines and penalties for non-compliance.

The Commission would be required to update the proposed Code of Best Practice and to circulate amendments to companies.

2. Every company should be required to incorporate the Code of Best Practice as part of its constitution which would have contractual effect under section 14 Companies Act 1985, breach of which would entitle a shareholder to bring proceedings against the company to ensure compliance. Consideration should be given to the amendment of section 14 CA 1985 to include any other interested person to enable proceedings to be brought if aggrieved by breaches

of the Code or this enforcement mechanism could be left to the Company Commission.

3. The duties of directors should be codified in a form similar to the provisions of clauses 44 (1) and (2) of the Companies Bill 1978.

4. The Audit Committees should be required to produce social audits measuring the social performance of companies.

5. Greater disclosure of information and system of reporting to wider groups is required but consideration should be given to the effect of

elective resolutions under the Companies Act 1985 as amended by the Companies Act 1989.

6. That all the above matters be codified in a Corporate Democracy Act which should also take account of wider considerations in the form of industrial democracy and worker representation.