Notre Dame Law Review

Volume 56 | Issue 5 Article 13

6-1-1981

Corporate Governance in the United Kingdom

P. A. R. Brown

Corporate Governance in the United Kingdom

*P.A.R. Brown**

I. Introduction

Some explanation of the appearance of an unqualified layman—and foreign at that—in this galaxy of professional North American writers may seem desirable; all inquiries should be addressed to the editor. It does seem right, however, that I should warn the reader what not to expect. This is not an expert dissertation on the legal position of those responsible for the governance of corporations in the United Kingdom; still less is it a dissertation about professional liability. Instead, it is a discussion of those aspects of the United Kingdom law concerned with corporate governance which the administrator must understand for the purposes of his work. There will therefore be no illuminating thought or apercu: However, a fairly straight description of the present British situation, and of the reasons for it, may by its implicit assumptions stimulate interesting new perceptions in the North American reader.

The United Kingdom last enacted a comprehensive body of company law in 1948. The 1948 Act[1] was a consolidation measure and therefore a comprehensive statute, requiring no reference to previous legislation. Since then, the process of company law reform has been cumulative; Bagehot said that Sir Robert Peel had "an alluvial mind," and the legislator on company law since 1948 can perhaps lay that flattering unction to his soul. The 1948 Act remains the basis of our company law, embodying all previous statutory experience of company law. Subsequents Acts in 1967,[2] 1976[3] and 1980[4] have added to rather than replaced the earlier one, so that all need to be taken together. There is now a further bill before Parliament; the plutonian rock of the system is still traceable back to Gladstone, but there has been much geological change. Occasionally, commentators—even, in off moments, bureaucrats—have been tempted to speculate on the contents of a completely new Act constructed on 1980 premises. But, at least in the United Kingdom, that is no longer possible, if in the last half-century it ever was: It is too late to be ambitious—the great metamorphoses of the world are ended.

II. The Role of Auditors

The conceptual foundation of company law is, of course, the law of contract. The Articles of a company constitute the contract between the shareholders, and require the directors to account to the shareholders, who appoint them, for their

* Deputy Director, Department of Trade, the United Kingdom.

1 Companies Act, 1948, 11 & 12 Geo. 6, c. 38.
2 Companies Act, 1967, c. 81.
3 Companies Act, 1976, c. 69.
4 Companies Act, 1980, c. 22.

use of the company's resources.[5] There has never in British company law been any question but that the directors bear the ultimate responsibility, and the accountability, for that use. From the directors' responsibility for accounting for their use of company resources arises the function of audit. The audit report to the shareholders by an independent professional is the one normal external check which the shareholders have on the accuracy of the accounts which the directors present to them.[6]

An American reader may find it strange that the directors' annual report to the shareholders, the accounts, and the auditor's report to the shareholders are all filed as a matter of public record with the Companies Registration Office,[7] where they are open to inspection by any member of the public. This obligation applies to every limited liability company in the Kingdom, public or private, large or small.[8] The existence of this massive public record indicates that even though companies are legally the product of a private contract between the shareholders, there has been an historic recognition that there is a public interest in the disclosure of significant information by companies about their affairs.

The fact that the auditor must sign a report on the accounts indicates where his responsibility lies—to the shareholders, not the directors. Indeed, the 1948 Act explicitly provides that the shareholders appoint the auditor, although this usually remains a polite legal fiction.[9] It is an open question whether the auditor may have a responsibility to individual shareholders as well as to the body of shareholders.[10] Although the rule in *Percival v. Wright*[11] clearly absolves directors from responsibility to individual shareholders, that is not necessarily true for the auditor.[12] Of course, when the auditor acts in another capacity as an expert adviser—for instance, in making statements in a prospectus or in a take-over bid—he does owe a professional duty of care to anyone who may rely on those statements. This is a matter of common law[13] as much as of statute law, but section 43 of the 1948 Act gives subscribers a right to seek compensation for loss or damage arising from an untrue statement in a prospectus.

Ordinary shareholders frequently misunderstand the legal duty of the auditor. They are apt to assume that if the audit report is signed without qualifica-

---

5 *See* L. GOWER, J. CRONIN, A. EASSON, & L. WEDDERBURN, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 315-20 (4th ed. 1979) [hereinafter cited as GOWER'S PRINCIPLES]; M. OLIVER, COMPANY LAW 43-46 (7th ed. 1979).

6 *See* GOWER'S PRINCIPLES, *supra* note 5, at 518-24.

7 *See id.* at 499-502.

8 Since there are some 800,000 registered companies, the problems of information storage and retrieval in the Registrar's Office are becoming increasingly severe. The Companies (No. 2) Bill, 1981, would ease this disclosure burden for the smallest companies, but there would remain an obligation to file basic accounting information annually.

In the case of companies listed on the London Stock Exchange, there is a non-statutory Stock Exchange requirement for interim reporting as well. *See* GOWER'S PRINCIPLES, *supra* note 5, at 505-06. For a copy of the Listing Agreement, see P. LOOSE, THE COMPANY DIRECTOR app. E-1 (5th ed. 1975).

9 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 159. Section 14 of the 1976 Companies Act allows the directors to appoint the first auditors. *See* M. OLIVER, COMPANY LAW 162-63 (7th ed. 1979).

10 There is no question that the auditor owes a duty of care to the company. *See, e.g.*, *Re* Thomas Gerrard & Son Ltd., [1968] Ch. 455; Pacific Acceptance Corp. v. Forsyth, [1967] 92 W.N. 29.

11 [1902] 2 Ch. 421.

12 *See, e.g.*, Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465. *See also* GOWER'S PRINCIPLES, *supra* note 5, at 521-24.

13 *See* Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465, for the common law remedy of damages in cases where potential investors have relied upon the special skills of an expert advisor.

tion, there can be nothing wrong—that if the directors or their officers committed a misdemeanor, the auditor would be required to find it. The dictum in *Re Kingston Cotton Mill Co. (No. 2)* [14] has become a legal cliche: The auditor's function is that of a watchdog but not a bloodhound.[15] The first defense against fraud or misuse of the company's resources is the board of directors, and their's is the prime responsibility if it occurs. The distinction between a watchdog and a bloodhound cannot, of course, always be hard and fast. But if, for example, the directors deliberately attempt to deceive the auditor, he may discover traces of the deception, but he is not expected to conduct his audit on the assumption that it may be happening.[16]

However, there is a development in general public expectations which may ultimately find itself reflected in law. Inspectors appointed by the Department of Trade under section 165 of the 1948 Act[17] have not hesitated publicly to criticize auditors who the inspectors believe have not been sufficiently alert to the possibility of fraud or misfeasance. The emergence of a general expectation that at least some of the bloodhound's qualities should be bred into the strain is a matter which a court would doubtless take into consideration.[18]

It may be worthwhile to indulge in a brief digression on the subject of inspections under section 165.[19] That section gives the Secretary of State power to appoint independent inspectors to investigate the affairs of a company and to report to him (the report usually being published afterwards) if (1) a court directs that an inspector be appointed, (2) the company itself decides that an inspector should be appointed, or (3) the Secretary considers that the circumstances suggest fraud, misfeasance, or misconduct towards creditors or company members in the conduct of the company's business, or that the shareholders have not been given the degree of information they might reasonably expect. Inspectors' reports often allege criminal offenses, and even more frequently criticize directors, officers, and auditors of the company for deviousness, lack of backbone, or just second-rate performance. None of this is legally evidence of anything except the opinion of the inspectors; if they allege criminal offenses there will be a proper police investigation and, if justified, a trial.[20] But publication of a report accusing individuals of devious attitudes or shoddy work can obviously be personally painful and professionally damaging, and the accused often complain that the process is itself inherently unfair. Yet the government believes the privilege of operating with limited liability carries certain penalties, one being the liability to be publicly criticized if the individual behaves carelessly or idly in a situation where something is seriously amiss. Whatever the argument about fairness, the

---

14 [1896] 2 Ch. 279.

15 *Id.* at 288.

16 *But see Re* Thomas Gerrard & Son Ltd., [1968] Ch. 455, which held that auditors who came across altered invoices were under a duty to make exhaustive inquiry. Because the auditors failed to do so, and hence failed to find evidence of falsified accounts, they were liable to the company.

17 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 165.

18 For example, *Re* Thomas Gerrard & Son Ltd., [1968] Ch. 455, appears to extend the auditors' liability for negligence in preparing and reporting on company accounts.

19 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 165. *See generally* GOWER'S PRINCIPLES, *supra* note 5, at 671-80.

20 In such a case, publication of the report will almost certainly be held up until after the verdict. For a criticism of the protections afforded to persons under investigation see Sealy, *Companies—Inquisition, Twentieth-Century Style*, 33 CAMBRIDGE L.J. 225 (1974).

appointment of inspectors as a technique has been increasingly used in the past decade, and has undoubtedly helped expose some very unsatisfactory situations, some of which have subsequently been dealt with by legislation.[21]

There exists another inspectorial power of a more limited kind under section 109 of the 1967 Act.[22] This section empowers the Secretary of State to appoint his own officers to examine company records, and to seek explanations of them where possible legal violations appear. The reports of such inspections are not published, but can be used in deciding whether to proceed to a Companies Act prosecution, a police investigation on Companies Act charges, an appointment of inspectors under section 165, or a petition to wind up the company. The section empowers the Department to act wherever it "think[s] there is good reason so to do." This is much less arbitrary and draconian than it sounds, since the requirement to have "good reason" is a real one (which may have to be justified in court).[23]

Returning to the accounting function, it is important to note that the technicalities of accounting are not a government responsibility. The Eighth Schedule to the 1948 Act prescribes certain minimum information which the annual accounts must contain,[24] but does not prescribe either the methods by which the figures are to be calculated or the order and form in which they are to be presented. All these technical matters are left to the profession itself to develop; they are not appropriate to legislation, and the legislative process, slow and spasmodic as it is, would stop desirable technical develpment. The Act's overriding requirement is that the accounts show a "true and fair view of the profit or loss of the company for the financial year."[25] The Act does not prescribe how that view is to be reached, and no doubt, if the matter were to be tested in the courts, the Accounting Standards developed by the accounting profession itself would be accepted as evidence of best practice.

This traditional view of the proper distinction between legislation and technical professional development will be eroded if the Companies (No. 2) Bill 1981, now before Parliament, is enacted in something like its present form. In seeking to implement the Fourth Directive of the European Economic Community[26] on company accounts, that Bill describes in detail the required content and layout of the annual accounts and includes some of the valuation principles necessary as well. Although this imports an element of Continental practice into what has hitherto been the British practice, both the Directive and the Bill still recognize the "true and fair view" principle as overriding should there ever be any con-

21 *See* HANDBOOK OF THE COMPANIES INSPECTION SYSTEM (HMSO 1980).

22 Companies Act, 1967, c. 81, § 109(1). For the procedural rules which apply to such investigations, see Norwest Holst Ltd. v. Secretary of State for Trade, [1978] Ch. 201.

23 This distinction may not be fully appreciated in countries with a more authoritarian tradition of government. An administrator from such a country recently visited the Department and asked the circumstances in which the Department could investigate the affairs of companies. The reply was, when in our opinion we had good reason to do so. He gave a grimly appreciative laugh, which somewhat disturbed his interlocutor.

24 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, sched. 8, paras. 12-14. The accounts must include such information as investment income, rents receivable, interest on loans, depreciation charges, taxes paid, increases of and withdrawals from reserves, dividends paid, and auditors' remuneration.

25 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 149(1).

26 [1978] J.O. COMM. EUR. (No. L 222/11) (Dir. 78/660).

flict.[27]

Partly in response to a number of inspectors' reports on events occurring in the "boom and bust" years of the early 1970's, the 1976 Act included several provisions concerning auditors. For example, the auditor has a right to make representations to the company[28] and to speak at general meetings.[29] A board must give special notice of any intention to remove an auditor.[30] If an auditor resigns voluntarily he must state any circumstances which in his opinion members or creditors should know about,[31] and he may require the board to call a general meeting at which he may speak.[32] It is made a criminal offense to lie to the auditor.[33] All these provisions are aimed at strengthening the auditor's position in dealing with an overbearing or devious board of directors: One phenomenon of a few spectacular company failures was a pliable and demoralized auditor faced with an effective bully as chief executive. However, it has to be recognized that no amount of legislation can much alter the condition of an invertebrate.

III. The Role of Directors

The concentration of ultimate responsibility on the directors has been steadily developed and refined since 1948. Directors' accountability to shareholders is still in principle governed by the judgment in *Percival v. Wright*;[34] that principle looks increasingly dubious in modern conditions (and has reportedly been dismissed in courts elsewhere)[35] and many would argue that it should be legislatively altered. The case law on the duty of care and skill owed by directors to the body of shareholders was reviewed in the famous judgment in *Re City Equitable Fire Insurance Co.*;[36] many would feel that the standards there prescribed[37] are not very high. Since directors may rely on the opinion and services of those company officers apparently competent to discharge their responsibilities, and since the standard of care and skill imposed on directors is not high, the position of director may not seem an arduous one. The words of the Duke of Plaza-Toro (Limited) may still appear apposite:

27 *See* GOWER'S PRINCIPLES, *supra* note 5, at 525-26.

28 Companies Act, 1976, c. 69, § 15(2).

29 Companies Act, 1967, c. 81, § 14(7).

30 Companies Act, 1976, c. 69, § 15(1). Special notice means that notice of an intent to remove the auditor must be given to the company not less than 28 days before the next general meeting. *See* GOWER'S PRINCIPLES, *supra* note 5, at 520-21, 534-36; M. OLIVER, COMPANY LAW 255-56 (7th ed. 1979).

31 Companies Act, 1976, c. 69, § 16(2).

32 *Id.* § 17.

33 *Id.* § 19.

34 [1902] 2 Ch. 421.

35 *See, e.g.*, Coleman v. Myers, [1977] 2 N.Z.L.R. 225, 268-80, 323-25, in which the Supreme Court of Aukland held that *Percival v. Wright* was wrongly decided; however, the Court of Appeals was content to distinguish that case from the facts at hand. *See also* Alien v. Hyatt, [1914] 30 T.L.R. 444; Oliver v. Oliver, 118 Ga. 362; 45 S.E. 232 (1903).

36 [1925] Ch. 407.

37 The standards of *City Equitable* can be summarized as follows:

(1) A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.

(2) A director is not bound to give continuous attention to the affairs of his company.

(3) In respect of all duties that, having regard to the exigencies of business and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.

Id. at 428-42. *See generally* GOWER'S PRINCIPLES, *supra* note 5, at 602-06.

I sit by selection upon the direction
Of several companies bubble;
As soon as they're floated I'm freely bank-noted,
I'm pretty well paid for my trouble.[38]

An attempt was contemplated in 1978, when a Companies Bill was being prepared, to codify directors' duties. The words chosen were:

> In the exercise of the powers and the discharge of the duties of his office in circumstances of any description, a director of a company owes a duty to the company to exercise such care and diligence as could reasonably be expected of a reasonably prudent person in circumstances of that description and to exercise such skill as may be reasonably expected of a person of his knowledge and experience.[39]

This language seems reasonably clear. The difficulty was that statutory action would virtually preclude further judicial developments—and the opportunity for statutory change comes only occasionally. Some have argued that the 1978 draft in fact merely codified the *City Equitable* judgment, and could hardly be declared a bold advance.[40] In any event, for the reasons just given the attempt was abandoned.

One way in which directors' duties may develop further—which would probably have been stopped by the proposed statutory action—resembles that in which auditors' responsibilities have developed: a general public expectation, fed at least partly by the reports of inspectors appointed under section 165. In the past decade, such reports have drawn increasing attention to one aspect of the position of directors—the potential conflict of interest between their public duty and their private concerns. A number of reports have revealed directors, either individually or as a group, treating the company as though it and its assets were their own personal property. Broadly, the policy for many years has been not to address the positive duties of directors (where there is a traditional skepticism about legislation's ability to induce proper behavior) but to tackle instead those situations in which it appears that the motives to proper behavior may be inhibited and muddied by selfish concerns. This approach has followed two courses: a prohibition on certain acts considered in themselves undesirable or wrong, and a requirement to disclose to the company or the other directors situations in which a conflict of interest may be thought to arise which should be judged by others. The starting point is of course the 1948 Act. Section 191 forbids a company from paying a director for loss of office unless the company discloses the particulars to its members and the members approve the proposal.[41] Section 195 requires every company to keep a register of the shareholdings of directors, to be open to inspection by any member before the annual general meeting.[42] Section 199 (as amended by section 60 of the 1980 Act) requires any director who is directly or indirectly interested in a transaction or proposed transaction with the company to declare the nature of his interest at a meeting of the board.[43]

This line of thinking has been fairly consistently developed since 1948. Sec-

38 "The Gondoliers," Act II, in THE COMPLETE PLAYS OF GILBERT AND SULLIVAN 449, 497 (Norton ed. 1976).
39 Companies Bill, 1978, cl. 45(1).
40 *See, e.g.*, GOWER'S PRINCIPLES, *supra* note 5, at 604-06.
41 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 191.
42 *Id.* § 195.
43 *Id.* § 199.

tions 25 through 32 of the 1967 Act prohibit directors and their immediate family (spouse and children) from dealing in options on the company's shares. As an extension of the 1948 provisions, members of the company must be allowed to inspect the service contracts of directors, and directors must give the company notice of any interest or change in interest which he has in the shares or debentures of the company or of any associated company.[44] The 1976 Act (a modest statute) sought to make particularly expeditious directors' notification to the company of any dealing in the company's shares, and obliged the company to notify the Stock Exchange, which is empowered to publish the information in any way that seems suitable to it (a power which the Stock Exchange amply uses).[45] As before, the provisions cover not only the director, but also his immediate family.[46]

In the Companies Bill presented to Parliament in 1973 (which lapsed with the fall of the then Administration in January 1974) there was a bold attempt to deal with what were then believed to be the worst examples of conflicts of interest. Clauses 45 and 46 of that Bill would have made it an offense for anyone to be a director of one company which controlled another company in which he or his family had an equity interest, or for a company to make a loan or guarantee to another company in which any director or group of directors of the first company held one-third or more of the equity.[47] This was perhaps a trifle rash; certainly, the clauses became notoriously unpopular in the business world. But that is not to say the proposal should not have been made—although the proposed penalty would not have been hanging, it did nonetheless concentrate the mind wonderfully, and all subsequent consideration of statutory proposals has been conditioned by that perhaps over-bold and over-simple but nonetheless praiseworthy first attempt.

The 1980 Act is—for the moment at least—the culmination of these attempts. For instance, under sections 47 through 67 a director may have no contract of employment more than five years in duration unless the contract is approved by a resolution in general meeting. A director may have no contract with the company involving substantial[48] non-cash assets (whether for purchase or sale) without a similar resolution in general meeting. The 1980 Act repeats the prohibition of the 1948 Act on loans (and guarantees and securities on loans) by any company to its directors or to those of its holding company, and extends that prohibition to persons connected with directors of public companies and to "quasi-loans"[49] made by public companies to directors or connected persons.[50] Certain loans are excepted from the extended prohibition—for example, loans between group companies even if one of them is connected with the other's director and (in certain circumstances) loans to enable the company's business to be

44 Companies Act, 1967, c. 81, § 26.
45 *Id.* § 25.
46 Companies Act, 1967, c. 81, § 31.
47 Companies Bill, 1973, cls. 45, 46.
48 "Substantial" is defined by reference to the net assets of the company. *See* Companies Act, 1980, c. 22, § 48(2).
49 A "quasi-loan" represents yet another extension of the legislative jungle. It is in substance a loan, but consists of the payment or promise of payment to a third party on behalf of a director, rendering the director liable to reimburse the company. For the statutory definition of quasi-loan, see Companies Act, 1980, c. 22, § 65(2).
50 *Id.* § 49.

properly carried out.[51] Breach of these provisions is made a criminal offense.[52] In the event of a breach, the transaction is made civilly voidable if that is a practical possibility, and restitution and indemnification may also be required.[53] The Act's purpose is obvious: to preclude directors from using their authority in the company, or the resources of the company, to further their personal interests (or those of their immediate family). Except in the most obvious cases of unavoidable conflicts of interest, the shareholders must be notified and given the opportunity to decide whether they approve or disapprove.

All this is in a sense negative and prohibitive. But there is in the 1980 Act one positive addition to the duties of directors—section 46, which states that directors in executing their duties must consider the interests of the employees taken as a whole.[54] Section 46(2) states that this duty, like all other duties of directors, is owed to the company and enforceable by the company alone. The provision thus implies no alteration in the basic duty which directors owe to the company, and gives employees no enforceable rights. As a practical matter it is obvious that directors must take employees' interests into account in making policy decisions if they are to foster the long-term interests of the company—a board which consistently ignored those interests would soon have no company to run. The legislation is therefore intended simply to give legislative recognition (and sanction, to the extent it is necessary) to existing best practice. At the very least, these new provisions will provide a defense for directors charged by shareholders with a failure of duty; the directors may claim that they attempted to take account of employees' interests where those interests did not coincide with shareholders' immediate interests (as they often will not).

It may surprise the North American reader to learn that insider dealing makes its first statutory appearance in the 1980 Act; insider dealing is now a crime.[55] The relevant sections of the Act[56] culminate a series of attempts beginning with the 1973 Bill to deal with the problem of insider trading. There is virtually no separate legislative body of securities law in the United Kingdom. Such securities laws as there are appear in scattered parts of the various Companies Acts[57] and in the Prevention of Fraud (Investments) Act.[58] There is a long history of argument about the definition of "insider" and of the offense which it is intended to stop, and indeed about whether to impose criminal or civil sanctions.[59] In any case, the current provisions are confessedly experimental. The

51 For the exemptions from § 49, see *id.* § 50.

Money-lending companies are recognized as presenting a special problem in that their normal business is lending money, their directors may well own businesses which can properly borrow money from the company, and their lending decisions are made by individual branch managers and not at all governed by the head office, still less by the board of directors. Therefore, there are some exceptions which enable money-lending companies to continue to treat directors and their families as normal customers for finance. The accounts of money-lending companies must disclose loans to these parties; recognized banks may disclose by means of an annual statement available for shareholder inspection.

52 Companies Act, 1980, c. 22, § 53.

53 *Id.* § 52.

54 *Id.* § 46.

55 Companies Act, 1980, c. 22, § 72 makes an inside dealer liable on conviction to a maximum of two years' imprisonment and a fine.

56 *Id.* §§ 68-73.

57 *See, e.g.*, Companies Act, 1948, 11 & 12 Geo. 6, c. 38, §§ 193-95; Companies Act, 1967, c. 81, §§ 25-32; Companies Act, 1976, c. 69, §§ 24, 25; Companies Act, 1980, c. 22, §§ 68-73.

58 *See, e.g.*, Prevention of Fraud (Investments) Act, 1958, 6 & 7 Eliz. 2, c. 45, §§ 13, 14.

59 *See generally* GOWER'S PRINCIPLES, *supra* note 5, at 630-40.

matter is mentioned here because of the position of directors and their professional advisers. Directors are inevitably insiders, and professional and other advisers are made so by the definition chosen in the Act: One is an insider if the position he occupies in relation to the company is such as might be expected normally to give him access to inside information and, in a particular case, actually does so.[60] There is therefore a definitional question in each case: Does the suspected person occupy the position of an insider, and does he actually have, and act upon, inside information which he knows to be such? Opponents of the legislation point out that a shareholding by a director in his own company is desirable in principle, and that this circumstance "locks in" a director and precludes his dealing safely. The argument can also be advanced, though with considerably less cogency, regarding professional and other advisers. In order to meet the point, the legislation includes what has become known as the "general defense"—an accused person may show that despite the circumstantial evidence he had some pressing reason for doing what he did other than making a profit or avoiding a loss.[61]

The main direction of the provisions discussed above has been to stop people in responsible positions from doing irresponsible or wicked things. As already remarked, most administrators (and some legislators) are skeptical about the law's ability to make people do responsible and right things; such law may produce occasional conformity, but can have no significant effect on attitudes or on general patterns of behavior (a fact evident at least since the Reformation). Nonetheless, serious consideration has from time to time been given to the possibility of amending the law on the structure of companies in order to improve corporate performance—using "improvement" in its economic and competitive sense, and ignoring various efforts of a "social accountability" kind to define companies' performance in noneconomic terms. Some of the ideas considered have been general in nature, others specific. One general proposal suggests that companies be required to include information in the directors' annual report over and above the reporting of basic financial facts. This is partly an expression of the general public interest in the way a company behaves, and is advanced as a way of shaming the back-sliders into propriety. It has occasionally extended to proposals covering such matters as labor relations, pollution, sex discrimination, employment practices, and (more simply measurable) future prospects, flow of funds, and export performance. A few of these obligations have existed in the legislation for some time (for example, the 1967 Act requires companies to report on export performance).[62] Most, however, are open to the objection that they may not be relevant to particular companies (and almost certainly not on any properly comparable basis), that they may not be measurable (and therefore may lead to mere bromide), and that they all cost the company time and money. There is also the purist's objection that however worthy these goals may be, they are not matters of company law—they relate to all businesses, whether companies or not. So although decent principles can undoubtedly be quoted in support

60 The statutory definition of an insider is contained in the Companies Act, 1980, c. 22, § 68.

61 *Id.* § 68(8). There is the additional safeguard that a prosecution may only be brought by the Secretary of State or the Director of Public Prosecutions, *i.e.*, no casual or malicious or speculative prosecution can take place. *Id.* § 72(2).

62 Companies Act, 1967, c. 81, § 20.

of most of these items, and although openness of corporate performance is desirable, legislation does not require much of this potential range of disclosure. More specific attempts to improve corporate performance by prescribed structural change have referred to the two-tier board, nonexecutive directors, and audit committees. The two-tier board is of course employed in some European countries to accommodate employee directors, but it has also been advanced as a recipe for improved corporate performance, by making those responsible for the company's management separate from, and responsible to, a policy board appointed by the shareholders.[63] No British government, however, has thought it right to prescribe any particular form of board structure. Subject to the overriding duties and responsibilities of directors (which all board members share equally), the large flexibility in management allowed by the law's present structure permits a company to choose whatever system best suits its operations, and the judgment of whether the company's performance is satisfactory is made by reference not to statutory stipulations but to the market place.

Regarding nonexecutive directors and audit committees, there is no serious dispute that they can be of great benefit if seriously employed; but there is no point in legislating for the form if the serious intent is missing. Those companies which can see the potential benefits are likely to already employ the system or some modification of it. Other companies would obey any legal requirement in form and not in practice—it is all too easy to envisage a set of nonexecutive directors consisting of a powerful chairman's sisters, cousins and aunts. Scepticism increases when it is suggested that the nonexecutive directors, or a group of them constituting an audit committee, should have a separate reporting function to the shareholders. It has always been a prime consideration of the law that all directors should have the same legal responsibilities. There are practical as well as legal reasons for this, in the desire not to introduce divided management into the councils of a company. The idea, therefore, of requiring one group of directors to report separately on the performance of the rest has always been scouted. As already indicated, the only persons reporting on the board's performance are the auditors.[64]

There are certain general powers in reserve for dealing with director misfeasance (quite apart from separate statutes, such as the Theft Act,[65] which may occasionally apply). For example, section 210 of the 1948 Act allowed an "oppressed minority" of shareholders to appeal to the court which, if it finds that a compulsory winding-up is justified but that that would be unfair to the petitioners, could "make such order as it thinks fit."[66] The courts interpreted "oppressed" with such strictness as to make the section of very limited use,[67] and

63 The two-tier board is compulsory for certain types and sizes of corporations in Austria, Denmark, West Germany, and the Netherlands. It is optional in France. The two-tier board is unavailable in Italy, Liechenstein, Sweden, and Switzerland. *See generally* P. MEINHARDT, COMPANY LAW IN EUROPE (2d ed. 1978).

64 *See* text accompanying notes 9-16 *supra*.

65 *See* Theft Act, 1968, c. 60.

66 Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 210(2).

67 The most commonly accepted definition of "oppressive" is "burdensome, harsh and wrongful." Scottish Coop. Wholesale Soc'y v. Meyer, [1959] A.C. 324, 342. Courts have refused to apply § 210 to conduct which is merely careless, *see, e.g.*, *Re* Five Minute Car Wash Serv. Ltd. [1966] 1 All E.R. 242, and to conduct which is not continuous, *see, e.g.*, *Re* Westbourne Galleries Ltd., [1970] 2 All E.R. 374. *See generally* GOWER'S PRINCIPLES, *supra* note 5, at 665-70.

section 75 of the 1980 Act (replacing section 210) now permits a shareholder's petition whenever "the affairs of the company are being or have been conducted in a manner which is unfairly prejudicial to the interests of some part of the members (including at least himself) or . . . any actual or proposed act or omission of the company . . . is or would be so prejudicial."[68] Section 332 of the 1948 Act enables the court to make anyone who is knowingly party to the affair personally liable for the company's debts if in a winding-up it appears that the creditors have been defrauded. Further, sections 187 and 188 of the 1948 Act prohibit undischarged bankrupts from acting as directors and empower the court to disqualify anyone from taking part in the management of a company who has been found guilty of offenses in connection with the promotion, formation or management of a company. Section 9 of the Insolvency Act 1976 enables a director to be disqualified for involvement in two liquidations within five years.[69] Clause 48 of the 1981 Bill is designed to make the disqualification provisions more effective by, for example, extending the maximum period of disqualification on indictment from five to fifteen years and empowering courts of summary jurisdiction (the magistrates) to disqualify on summary conviction for up to five years.

Because responsibility is so concentrated on directors and statutory requirements and possible penalties increasingly impinge on them, it may appear to the reader that "company director" is likely to become an endangered species. Hypothetically this must be a risk, but the number of company registrations quoted earlier[70] indicates that the rewards remain tempting. It may also appear that fraud, especially by directors, is chronic and rampant. Such an impression is a consequence of the scope of this article, rather than an objective reality: Those concerned with this area of administration know that the dishonest director makes the headlines but is nevertheless a rarety.

68 Companies Act, 1980, c. 22, § 75(1).
69 Insolvency Act, 1976, c. 60, § 9.
70 *See* note 8 *supra*.