Regulatory Stakeholder Consideration in UK’s Proposed Company Law Regime---Effects and Expectations

by Shuangge Wen

School of Law
University of Manchester
Yidesheng@yahoo.com
Regulatory Stakeholder Consideration in UK’s Proposed Company Law Regime: Effects and Expectations

Britain is traditionally regarded as a classical representation of the shareholder-value country. Nevertheless, though the long-term, stakeholder-value orientation of corporate social responsibility has often been claimed as incompatible with UK’s “Anglo-Saxon Approach”, during recent years there are signs of growing recognition of corporate social responsibility in UK. In UK’s most recent company law reform, much effort has been put to include stakeholder consideration into its regulatory regime. In this article, the reform effort, i.e., s.158 of the Company Law Reform Bill, is going to be reviewed and possible effects of this provision are going to be impartially evaluated. Conclusion will be drawn that though this proposed CSR statutory approach would have the potential effect of propelling the CSR practice at various levels, due to a number of UK path dependence elements featured with shareholder-centred thought, the implementation of the new provision might be difficult and sluggish and progress towards stakeholder protection is very much likely to be limited.

Key words: Corporate social responsibility, director duty, stakeholders’ interests, UK company law reform, Company Law Reform Bill.

“The world does not fit the Panglossian belief that firms always make optimal choices. This will hold true only in a static optimization framework where information is perfect and profitable opportunities for innovation have already been discovered, so that profit-seeking firms need only choose their approach.”

--- Porter and van der Linde (1995)

After years of planning, in March 2005, the British government published a White Paper Company Law Reform, together with a drafted Company Law Bill, setting out a comprehensive reform proposal of UK’s company law. “A fair, modern, and effective framework of company law” is expected as a result of the reform. Among many recommendations, the most eye-catching one is the explicit recognition and inclusion of other stakeholders’ interests into UK company law regime. While the dominant position of shareholders has again been reinforced by a number of initiatives and provisions, endeavours have been made to integrate corporate social responsibility, a currently fashionable concept, into UK’s traditional shareholder-oriented scheme. It is provided in section 158 of the drafted Bill that, in fulfilling a director’s duty for the benefits of a company’s members as a whole: “A director must have regard to the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, the impact of the company's operations on the community and the environment, and the desirability of the company maintaining a reputation

3 For instance, see of Section 3: Enhancing Shareholder Engagement of Department of Trade and Industry, Company Law Reform, March 2005, Cmd 6456. A number of recommendations such as improving shareholder dialogue, minority shareholder protection and directors’ duty to shareholders, are included in this part, reinforcing the shareholder position within a company.
for high standards of business conduct.\textsuperscript{4} It is a sign that other stakeholders’ interests will be possibly included into the British pro-shareholder regime by way of a regulatory approach, particularly in the area of directors’ duties in which many reviews, reports and draft bills have come to fruition introducing.\textsuperscript{5} However, much debate has arisen with regard to the efficiency and enforceability of this reformed Bill. It has been contended that there is little doubt that this reform fails on all three counts: enforceable, understandable for the public and achieving the balance between risk and reward for a direct right; and really will discourage people from becoming a director.\textsuperscript{6}

UK’s attempt of incorporating stakeholders’ interests into its shareholder regime by virtue of regulations, associated opposition and implementation difficulty are perfect manifestation of the propelling and obstructing elements affecting individual countries reforming their national systems. On the one hand, UK tends to preserve its shareholder-centred corporate tradition; on the other hand, it recognizes the significance of corporate social responsibility in corporations’ long-term development and intends to justify the importance of CSR by virtue of a regulatory approach.

In the light of the above company law reform, this article will examine the effect of newly-prescribed CSR regulatory consideration in the UK shareholder-centred context. It will first clarify the reasons of UK incorporating stakeholder consideration into its legal regime. CSR practice at UK, European and global levels will be respectively presented. The second part is going to provide an impartial evaluation of the effect of UK’s reform in accelerating CSR practice. Both advantages and deficiencies of the proposed statutory approach will be presented objectively. The following part will concentrate on the discussion of UK-based path dependence elements blocking the introduction and implementation of UK’s company law reform Bill. Last but not least, alternative solutions and reforming methods will be presented. Various theories will be applied in support of suggested solutions. It will be recognized that due to the internal deficiency of its composition and shareholder-value characterized contexts it operates in, though s. 158 intends to promote the construction of a CSR regulatory framework and the enhancement of CSR practice in UK, there is little possibility that it could be of any substantial effect in practice.

**Putting CSR on the Britain Map: UK’s Incentive of Reform**

1. **Definition of Corporate Social Responsibility**

Since its first important references appearing in the 1930s and 1940s in America,\textsuperscript{7} there has been a great proliferation of theories, approaches and methodologies with regard to corporate social responsibility. This concept has been used in different contexts and supported by various arguments and conflicting evidence. According to how the interaction phenomena between business and society are focused, Garriga and Mele classified the corporate social

---

\textsuperscript{4} This is the text of the Company Law Reform Bill [HL] to be printed on 24th May 2006, accessed from http://www.publications.parliament.uk/pa/cm200506/cmbills/190/2006190.htm.


responsibility theories into four aspects: economics, politics, social integration and ethics. Alternatively, Lance Moir divided theories which might explain active CSR into three categories: stakeholder theory, social contracts theory and the legitimacy theory. In addition, Brummer further presented three theories in his article to explain to whom corporations might be accountable, respectively, stakeholder theory, social demandingness theory and social activist theory. As noted by Votaw, “corporate social responsibility means something, but not always the same thing to everybody. To some it conveys the idea of legal responsibility or liability; to others, it means socially responsible behaviour in the ethical sense; to still others, the meaning transmitted is that of “responsible for” in a casual mode.”

By far the greatest number of commentators that propose active CSR do this by means of stakeholder theory, which can be further divided into three inter-related aspects: descriptive, instrumental and normative. The descriptive model is used to interpret special corporate characteristics and behaviours; the instrumental model identifies the connections between stakeholder management and corporate financial performance; the normative model defends corporate behaviours on moral basis. Notwithstanding the diversity of various arguments and supporting evidence with regard to corporate social responsibility, it is commonly acknowledged that this term incorporates a wide range of issues and stakeholders’ interests: workplace (employees’ interests); market place (customers and suppliers’ interests); environment; community; ethics and human rights.

In the Company Law Reform Bill 2005, the consideration of those stakeholders’ interests has been officially included into the list for directors to take into account.

2. Accelerating CSR Practice in UK

Though UK is widely recognized as a shareholder-centred country, it does not follow that it failed to acknowledge the importance of CSR. In a free market, companies are always competing, not only for capital, but also for sales and customer “brand loyalty”, for the services of the most able employees and favourable supply terms. Corporate groups other than shareholders, as a consequence, are also playing an important role for the success of modern corporations. During recent years, the growing importance of CSR has been fully reflected on the dramatic changes in the attitudes and expectations brought to bear on

---

14 Included in the reporting guidelines of CSR Europe, a membership organization of large companies across Europe. See CSR Europe, Communicating Corporate Social Responsibility, (CSR Europe, Brussels, 2000). Also Ibid., at p 17.
companies. The proportion of the British public saying corporate responsibility is very important in their purchasing decisions has doubled from 1997 to 2001. The public opinion towards corporate profit has also varied a lot. In 1976, the British public agreed by two to one that the profits of large companies are beneficial to customers; by 1999 the balance of opinion was the exact opposite, with two to one disagreeing that companies profits help making things better. Public declining faith in corporate profits, accompanied by a number of scandals occurring in the Anglo-Saxon world, resulted in a vibrant social protest movement which main theme is that corporations are not sufficiently accountable to the societies in which they operate for their environmental and social impacts. This idea is currently undergoing a renaissance of interest under the banner of “corporate social responsibility” in UK.

UK’s intention of boosting up its CSR practice was also largely stimulated by the proliferation of CSR at both European and global levels. During recent years, corporate social responsibility has experienced tremendous blossom. The global acceleration of CSR started from The 1976 OECD Guidelines for Multinational Enterprises and the 1977 ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy. Since then, a number of international codes and Conventions have been produced and ratified in many countries.

At the European level, CSR practice has been fostering since the 2000 Lisbon Summit, during which an EU strategic goal for the next decade was officially established: to become the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion. The European Council made the first appeal on CSR on the basis that it is a positive contribution to this goal. In 2001, the European Commission issued a Green Paper, initiating to promote a “European Framework for Corporate Social Responsibility”. In October 2002, in response to the suggestion of launching a CSR debate in the Green Paper, the European Multi-stakeholder Forum was launched and its final report was produced in July 2004. So far, many European companies have embraced the notion of Corporate Social Responsibility as a rationale to guide their business practices. Along with the changing business reality and

17. Ibid., at p 187.
18. Ibid., at p 185.
21. Ibid.
22. For instance, the UN Draft Code of Conduct on Transnational Corporations, the 1998 ILO (International Labour Organization) Declaration on Fundamental Principles and Rights, the Declaration of World Summit on Sustainable Development 2002, establishing internationally agreed standards on multiple CSR issues.
external pressures from both the global and the European level of promoting social cohesion and business cooperation, the British Government started to feel the need of a comprehensive change of its corporate governance structure.

In the past, UK was gloried in taking the lead in European corporate social responsibility practice. In 1998, the Department for International Development created a Business Partnerships Unit which had a signposting and guidance role to foster partnership with socially responsible firms and to improve the enabling environment for productive investment overseas.\textsuperscript{28} In March 2000, the world’s first minister for corporate social responsibility was appointed by the British Government. From 1999-2000, a Statement of Voluntary Principles on Security and Human Rights was produced by Britain Foreign and Commonwealth Office and the US Department of State. Many extractive industry companies and civil society groups signed up for this voluntary code, agreeing to report credible allegations of human rights abuse by government authorities and press for proper solutions.\textsuperscript{29}

3. The Promotion of a CSR Regulatory Approach

Though stimulated by the proliferation of CSR at both European and global levels, recent UK’s CSR approach went beyond the voluntary European approach\textsuperscript{30} and started to stress the importance of government involvement and regulatory intervention. The attempt of s. 158 of incorporating stakeholders’ interests into its company law structure is consequently expected as strengthened regulatory control on stakeholder consideration. Three specific elements can hereby be distinguished which have the increasing effect of enhancing CSR regulatory framework in UK: failure of previous CSR voluntary approach, regulatory inclination of the Labour Party government and the stimulation of Continental European stakeholder-centred experience.

Initially, UK adopted the voluntary-based European approach and mainly relied on the business-led agenda in CSR acceleration. Proponents of this approach argue that it is impossible to regulate all CSR behaviour in a legal way as most of them, for instance, charitable giving, are neither required by law nor generally expected of business, and depend on corporations’ voluntary intentions.\textsuperscript{31} Nevertheless, the voluntary CSR approach has been proved inefficient in UK, where most corporations are performing the shareholder wealth maximization at the expense of stakeholders’ interests.\textsuperscript{32} In year 2000, all large UK-listed companies were urged by the Prime Minister, Tony Blair MP to publish an environmental report by the end of 2001.\textsuperscript{33} The Government quickly issued detailed guidelines on corporate

\textsuperscript{29} Ibid., S. A. Aaronson and J. Reeves, at p 24; also see Peter Behr, Companies Sign Pact on Human Rights, Washington Post, 20 December 2000.
\textsuperscript{32} A survey carried out by the Institute of Directors in 1999 revealed that many directors believed that the law required them to maximize short-term shareholder benefit at the expense of long-term profit. See Institute of Directors, Good Boardroom Practice (IOD, London, 1999), also see L. Roach, “The Legal Model of the Company and the Company Law Review” (2005) 26 Company Lawyer 98, at p 102.
\textsuperscript{33} In a speech to the CBI in October 2000, he said: “I am issuing a challenge today, to all of the top 350 companies to be publishing annual environment reports by the end of 2001.” See L. Miles, “Company Stakeholders: Their Position under the New Framework”, (2003) 24 Company Lawyer 56.
environment report as complements to the Prime Minister’s call for reports. Nevertheless, a survey conducted in 2000/2001 showed that of the top 200 FTSE companies, 97 companies did not disclose any information on their social and environmental performance.\(^{34}\) It was further revealed in the 2004 Corporate Social Responsibility Government Update that of the top 250 UK companies, there were still 118 companies did not report on their environmental performance at all as was pressed by the Government.\(^{35}\) Notwithstanding the Government’s efforts of pushing companies to report, businesses reacted indifferently and the figure of voluntary disclosure has not increased much in the past three years.

UK government’s earlier attempt of the 1991 campaign “Making a Corporate Commitment” is another failing example of the voluntary approach.\(^{36}\) During this campaign, the UK’s top 2,000 businesses were required to sign a declaration committing them to set energy saving targets. However, only 30 companies out of 1,400 signatories had publicized their targets by February 1994 as required. It was further disclosed that in fact over a third of signatories had not set any target at all, public or otherwise. Afterwards, the failing reason was bitterly described by the scheme manager as “industries saw no benefit to their businesses”.\(^{37}\)

The implementation of OECD Guidelines in UK also illustrated the difficulty of a pure business-led agenda. Despite the vast amount of documents the Government has published in relation to the Guidelines,\(^{38}\) because no enforceable rewarding or punishing scheme was available in those documents to encourage British firms to adhere to these Guidelines, the British NCP (National Contacting Point) found it was difficult to communicate the Guidelines to companies as well as to establish whether companies are making use of the Guidelines.\(^{39}\) UK business groups have similarly concentrated on resisting regulatory intervention; it is difficult, though, to assert that they have done so by considering the effectiveness of voluntary controls.\(^{40}\)

Consisting of regulations, rules and voluntary codes in disarray, current UK stakeholder protection methods are confusing and centrifugal, and stakeholders’ claims to the good faith fulfillment of their bargains often cannot be accomplished.\(^{41}\) The reluctance of UK firms accepting the regulatory approach by no means indicates its inefficiency. In fact, empirical research has shown that businesses are most active where regulatory pressure is heaviest and when public attention is most intensely focused on them.\(^{42}\)

Given those disappointing experiences under the voluntary approach, the British Government tried to justify the significance of government and regulatory frameworks in

\(^{34}\) Ibid.
\(^{42}\) *Ibid.*, at p 89.
future CSR promotion. In the Corporate Social Responsibility Report 2002, setting up legal frameworks embedding responsible behaviour was clarified as part of the government’s future working scheme and modernising company law was regarded as the primary concern of this expected framework.43

In addition, the ruling Labour Party’s disbelief of self-regulation in financial services factors and attention attached to corporate social responsibility potentially accelerates the company law reform. Compared to the right-wing Conservative Party, Labour Party has displayed more enthusiasm in emphasizing corporations’ social responsibility and promoting their social behaviour. A survey conducted by MORI in 2001 has revealed that while only 12% of the Conservative Party representatives agree that businesses do not pay enough attention to their social responsibilities, over 72% of the Labour Party representatives are in support of this argument.44 In fact, Labour Party often indicated during its election campaign that it would legislate in the area of corporate governance45 and the significance of regulatory frameworks in promoting CSR has been mentioned during several occasions. “The UK benefits from a tried and tested framework of laws and regulations on social and environmental issues. To ensure it remains current, this framework is constantly evolving and can be immensely powerful in making CSR part of normal practice in all types of organizations...Clearly, the company law potentially has an important role to play in relation to CSR objectives.”46 The proposed company law reform, as a consequence, was driven by Labour Party’s inclination to social and employee consideration.

Compared to those of UK, stakeholders of other Continental European countries are offered stronger positions in corporate management. In Member States of Germany, Netherlands and Denmark, representatives of workers are even entitled to have seats in boards of directors and participate into the corporate decision-making process. The influence of those countries can be perceived from many of the previous European harmonization directives. As a member of the European Union, if UK wants to involve more into the European harmonization and make UK-originated companies operate more smoothly in the European single market, some changes to its own regime seems necessary. UK’s introduction of section 158 is therefore envisaged as a movement towards the European attitude, of bridging its traditional Anglo-Saxon style capitalism with the interventionist European approach.

**Effectiveness of the Proposed Reform: an Impartial Evaluation**

Though many promising effects can be expected from the introduction of s. 158, difficulties with regard to its articulation and implementation are easily to be distinguished, which is indicative of the obstacles in the promotion of a CSR regulatory scheme.

**1. Potential Positive Effects**

(1) Formation of a CSR-friendly Environment in UK

One possible effect of s.158 is that it would stimulate the creation of CSR-friendly corporate culture and environment. In Britain, the maximization of shareholder wealth is not only a theory, but also a basic feature of corporate ideology and public belief. As has been commented by the Hampel Report 1998 on corporate governance, the single overriding objective shared by all listed companies, whatever their size or type of business, is the preservation and the greatest practicable enhancement over time of their shareholders’ investment. This long-term privileged and deeply-rooted shareholder-centred thought has thrown many directors into the narrow belief that they are obliged under the current legal framework to take a more short-termist and shareholder-centric view at the expense of other corporate groups. The current legal framework, as a consequence, is criticized as “limiting any accountability to stakeholders within a framework of, and to the overall purpose of, profit-maximization for shareholders”. The practical failure of s. 309 of Companies Act 1985 is a typical example of shareholders’ paramount interests overriding other stakeholders’ interests. Given this situation, there would be little impetus for directors to integrate consideration of stakeholders’ interests into their managerial practice of maximizing shareholders’ profits. Though the proposed reform is with no intention of challenging shareholders’ paramount position, the redefinition of the “interests of the company” which emphasizes the significance of coordinating stakeholder relationships over the corporations’ long-term development, aims to render directors aware of the gradual transformation occurring in legal and social frameworks in which corporations exist and operate, and to subsequently adjust their managerial routines. “Legislation can be a blunt instrument, but its use is sometimes essential to bring about change where cultural shifts are unacceptably slow.”

(2) Promotion of UK-originated Multinational Companies’ CSR Practice

Secondly, the introduction of a CSR regulatory approach has prospective effects on the overall arrangement and governance of UK-originated transnational companies’ CSR practice, thus potentially improves the overall CSR performance in a wider playing field, for instance, the European Union, in which those multinational companies operate.

Since the famous Centros case in which the “freedom of establishment” principle has been revived, there seems much prospect of transnational business activities within the European Union range. According to the existing research, although conformance with the

50 This provision is not of significance in legal practice. “In broadening the constituency in this way company law had taken a great leap, even though the technicalities ensured that it would be virtually impossible for employees to get any legal remedies.” B. Pettet, “Duties in Respect of Employee under the Companies Act 1980” (1980) 34 Current Legal Problems 199, at pp. 200-204.
51 Ibid.
host country system is necessarily confirmed, transnational companies operating within a
given country tend to export the cognitive and normative assumptions of managers in the
home country. Those operation methods exported from the home country are often deemed
innovative in the host country and also have potential counter-influence over the host
country business. As a consequence, the promotion of CSR practice in UK would make
UK-originated companies concentrate more on their CSR performance, and subsequently
promote the overall European CSR practice by enhancing other host member states’ CSR
performance.

(3) Effects at the European Level

First of all, the attempt of embedding socially responsible behaviour into UK legal framework
has the likely effect of promoting CSR activities within the European range, especially the
construction of a strategic European CSR framework.

Given increasing transnational companies’ activities, a European strategy would be
meaningful in the overall arrangement and governance of those companies’ CSR practice in
various countries. Moreover, there has been previous practice to govern corporate
socially-responsible behaviour by virtue of Directives, which turned out to be a huge success.
This successful experience is the 1994 European Works Council Directive. Before the
implementation, it received huge opposition and resistance from trade unions and employers,
including those who declare to be stimulated by corporate social responsibility. However,
EWCs have been successful in practice in bringing management and employees together at
the transnational level, where key decisions on the development of large enterprises are
taken. So far more than 650 transnational companies or groups have EWC agreements
covering an estimated 11 million employees, with 10,000 employees’ representatives directly
involved. More than 60% of the European employees were covered by this Directive. “If it
had been left to companies on a voluntary basis, how many European Works Councils
would there be today in the name of good practices?” The CSR regulatory approach has
proved its efficiency in European practice and the EWC Directive is deemed as a strong

59 Ibid.
60 The figure is from the European Trade Union Confederation.
61 This is the argument of the European Trade Union Confederation, calling for a “legislative and contractual framework” for European CSR practice. See Corporate Social Responsibility in a Legislative and Contractual Framework, Resolution adopted by the ETUC Executive Committee, Brussels, October 2001 (151.Ex/10.01/07).
counter-example to the voluntary CSR initiatives advocated by European companies. Nevertheless, despite successful regulatory experience and the initiative to create a “European Framework for Corporate Social Responsibility”, the European dimension remains absent. CSR was described as “concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.” This voluntary feature of CSR activity was further reinforced by a number of soft-worded recommendations in the final part of 2002 European Multi-stakeholder Forum on CSR, such as “increasing knowledge about CSR”, “facilitating the exchange of experience and good practice” as well as “ensuring an enabling environment on CSR”. Moreover, the European CSR approach was clarified by the Green Paper as a voluntary-based strategy. Currently, the European CSR practice mostly relies on a collection of codes of conduct varying from the corporation level to the industry level. In addition, a considerable number of codes designed by international organizations, intending to apply universally to all firms across sectors and countries, trigger further confusion and difficulty in the application process. Most of the codes have no mechanism for accountability or follow-up, which is really frustrating for CSR activists and corporate officials.

As stakeholder consideration consists of an integral part of corporate management and control, the delay of EU CSR regulatory development, consequently, signify the difficulties existing in EU company law harmonization. Since the famous Centros case in which the “freedom of establishment” principle has been revived, there seems much prospect of breaking up the traditional national corporate law barriers within the European Union range. A number of directives spreading various ranges of company law have been drafted and implemented. On the basis of those harmonization achievements, the European Commission further set up a Group of High Level Company Law Experts in September 2001, which produced its final report in 2002, addressing the concerns of forming a modern regulatory European company law framework.

---

64 Ibid., at p 6.
66 The European Approach was defined as “complementing and adding value to existing activities by: (1) providing an overall European framework, aiming at promoting quality and coherence of corporate social responsibility practices, through developing broad principles, approaches and tools, and promoting best practice and innovative ideas; (2) supporting best practice approaches to cost-effective evaluation and independent verification of corporate social responsibility practices, ensuring thereby their effectiveness and credibility.” Followed by the recommendation of “launching a wide debate and seeking views on corporate social responsibility at national, European and international level”, it is of no doubt that the suggested European approach is voluntary based. See Commission Green Paper on Promoting a European Framework for Corporate Social Responsibility, COM (2001) 366 final (July 18, 2001), available at http://europa.eu.int/comm/employment_social/so-dial/CSR/greenpaper_en.pdf, at p 5.
68 Ibid., at p 7.
Nevertheless, compared to the rate of adoption of single market measures and achievements in other areas, progress on EU company law harmonization so far is limited. Currently, the European corporate law systems are of a high degree of diversity. Key harmonization proposals concerning the legal structure of corporations (5th company law directive), cross-border mergers (10th company law directive), takeover bid procedures (13th company law directive) and regulation on a European company statute (Societas Europea) have been blocked before the EU Council of Ministers for many years. Areas covered by harmonization directives mainly concern corporate capital and finance, while core company law issues such as corporate management and corporate structure are still diversely regulated and inadequately enforced in individual Member States.

The inadequacy of EU regulatory development, including both the CSR framework and company law harmonization, was mainly attributable to the insurmountable path dependence divergence among Member States. The path dependence theory was initiated by Roe and Bebchuk and further developed by Schmidt and Spindler. Basically it argues that elements affecting the efficiency of corporate performance and arrangements vary from time to time. What used to promote efficient corporate performance may turn out to obstructing the way of corporate development after a certain period of time. However, if the cost of switching to efficient corporate systems outweighs the cost of inefficiency of current system, then the nation may tend to maintain current inefficient systems rather than transferring to a new and efficient system. Therefore, the corporate structures that an economy has at any later point in time depend in part on those that it had at earlier point. Currently, there are two main path dependence factors blocking the way of European regulatory development, respectively, various economic structures and related legal traditions.

Distinct from those of Continental European countries in which stakeholders are of a highly-favoured position, UK’s economic structure more closely associates with the Anglo-Saxon style which is characteristic of a large number of quoted companies, a liquid capital market where ownership and control rights are frequently traded, and little concentration of shareholdings. UK corporate law structure is consequently categorized as the outsider system which largely relies on various market mechanisms and investor exit choice for its corporate control. Most Continental European countries, on the contrary, depend on large stakeholder internal control due to their relatively undeveloped markets. Those, accordingly, affect the forms of legal traditions further categorized into German Civil Law, Code Civil, Scandinavian law and Common law.

The diversity and lock-in effects of national path dependence factors are important

---

73 Ibid.
elements leading to the European company law deadlock. In recent years, with the increasing market integration and shifts in pension financing and privatization, a greater role for the market is expected in corporate control. Some major European and Japanese companies for the first time attempt under pressure to focus upon shareholder value and a move towards UK market-driven corporate governance model can be perceived in European initiatives. Nevertheless, those changes are still on a business-led agenda and no mandatory order or legal requirement was involved.

By integrating stakeholders’ interests into the list of relevant factors for directors to consider, s. 158 of the drafted Bill is to be praised for potentially accelerating the establishment of European CSR regulatory framework. On the one hand, the promotion of CSR practice in UK would make UK-originated companies concentrate more on their CSR performance, thus promoting the overall European CSR practice; on the other hand, it is indicative of individual member states’ positive attitude of introducing and supporting CSR regulatory regime. While UK’s attempts are not radical departures from its current legal model, it is a brave step of tackling the central conflicting issues and will certainly make EU more confident in the efficiency and practicality of a CSR regulatory approach.

Furthermore, the attempt of incorporating CSR into UK statutory scheme has the likely impact of stimulating the Europeanisation of national company law regimes. The amendment of directors’ duty is the legal acknowledgment of the stakeholder thought within a shareholder regime, and could help minimize the gap between UK corporate governance model and those of other continental European countries. Though there is no enforcement method contained in this drafted bill, it is a brave movement towards an inclusive approach in which characteristics of both the outside system and inside system are embedded. In line with the single market mechanism gradually achieving its effect in Europe, the UK company law reform, together with Continental European companies’ attempts, motivate other European countries to make compromising modifications to their corporate law frameworks in expectation of a gradual convergence of corporate governance.

2. The Dark-side of the Drafted Bill: Potential Problems and Inefficiency

By no means is the proposed UK company law reform flawless. Despite long-time investigation work and mildest reform measures, the drafted Bill has been subject to strong criticism since its naissance. The first difficulty with regard to its implementation is the creation of multiple directorship. It is commented that by giving directors additional and conflicting duties to stakeholders, people would be discouraged from being directors. The parliamentary brief published by the Law Society on January 11, 2006 addressed that the new requirement of directors “promoting the success of the company for its members” will make

---

78 Ibid.
80 “The bill turns that assumption on its head, by giving directors additional and conflicting duties, towards the environment, the community, suppliers, staff and other stakeholders. This is a litigants’ charter and will allow any unpleasant lobby group - just look how nasty the animal rights mob have turned - to sue directors personally for anything they do not like.” See G. Trefgarne, “Same Again, Your Lordship, Kill the Bill”, Sunday Telegraph, 29 January 2006, accessed on http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2006/01/29/ccom29.xml
multiple directorships much more difficult to manage than at present, and any conflicts of interests that may arise will “be much less flexibly dealt with by the code than by the common law.”

Most of the criticism has arisen with regard to the drafted Bill’s enforceability. Firstly, the Bill fails to specify the situations under which directors are accountable to stakeholders’ interests. The issue of whether directors are required to consider stakeholders’ interests under all circumstances or just under certain circumstances when stakeholders’ interests not conflicting with shareholders’ is not specified in any part of the Bill. Secondly, s. 158 is still under the banner of shareholder primacy and it by no means challenges the paramount position of shareholders. Initially, the enlightened shareholder model which is now incorporated into the Company Law Bill in the form of section 158, and the more radical stakeholder model were both presented in the Law Commission’s recommendations.

After consideration, the company law reform steering group agreed on the mild and compromising “Enlightened Shareholder Value” approach --- encouraging the consideration of other stakeholders’ interests whilst maintaining shareholders’ ultimate position within the company. Furthermore, in the Company Law Reform Bill Regulatory Impact Assessment published by DTI in June 2006, the consideration of stakeholders’ interests was clarified as one of the measures in achieving the objective of “enhancing a long-term investment culture”. When assessing the potential benefits the company law reform bill could yield, shareholders’ benefits were highlighted rather than stakeholders’ interests. It is illustrative that UK is not ready for a radical change of its current system: the state is not as aggressive as we might expect when defending investor interests. It would be of less opportunity for directors to act in the interests of stakeholders when they are bound to pursue the ultimate shareholders’ interests.

Thirdly, s. 158 failed to clarify the priorities among various stakeholders. There is only one vague provision that “(directors must) act fairly as between members of the company”. Yet this stipulation does not specify which interests should prevail when two or more stakeholders’ interests are in conflict. In addition, if this provision is to be implemented, the possible standard of assessing directors’ behaviour of balancing various interests would have to be subjective as an objective standard would make the court intrude too much into the business decision-makings, which will be followed by excessive legal costs and a huge amount of court inquiry work. Nevertheless, a subjective duty would in practice amount to

---


82 The stakeholder theory proposes a number of ways of enforcing stakeholders’ interests. One method is to permit various corporate groups’ direct involvement into corporate decision-making process. Another one is to set up corresponding representation forces governing directors’ managerial behaviour, making them have full regard to stakeholder’ interests when making their decisions. See J. Dean, “Stakeholding and Company Law”, (2001) 22 Company Lawyer 66, at p 69.


85 “Company law reform has the potential to improve performance across the economy as a whole, in particular by reducing the potential for conflicts of interest to develop between directors and shareholders. Mitigating this type of conflict helps to reduce the costs associated with the contractual arrangement between investors and companies (agency costs).” DTI, Company Law Reform Bill Regulatory Impact Assessment, London: DTI (2006), at p 5.


little more than directors’ discretion, which would be largely unpoliced.\textsuperscript{88}

The principle contained in s. 158 is soft-worded with no indication of to what extent stakeholders’ interests being considered by directors, or the remedy or relief available to stakeholders when their interests being prejudiced. Given the lack of enforcement methods, this provision is little more than a dead letter and it is doubtful that the drafted Bill could be of any substantial effect in enhancing stakeholder protection.

In UK law, there has been previous frustrated experience of promulgating stakeholders’ interests owing to the lack of enforcement method, i.e., s. 309 of the Companies Act 1985, which required directors to consider employees’ interests as well as the interests of its members. Before s. 309 was implemented, there was high expectation that it would substantially increase the protection of employees. It was regarded as a statutory provision representing a tentative step towards recognising the employees’ role in the enterprise.\textsuperscript{89} Nevertheless, as it did not specify the priority when employees’ interests conflict with members’, nor did it provide employees with any means of enforcing this duty, s. 309 failed to provide any substantial protection to employees in practice. Its practical effect turned out as diluting directors’ accountability to shareholders, rather than strengthening their accountability to employees.\textsuperscript{90} With no enforcement method, there is quite a possibility that s. 158 would end up with the same practical result as s. 309 of the Companies Act 1985.

Taking more than 8 years to produce and expected to be enforced in the spring of 2006,\textsuperscript{91} this Bill is still retained with the House of Lords and there is no sign of its approval in the near future, let alone its actual implementation.\textsuperscript{92} Given all those difficulties, the drafted Bill is not favoured with either businesses or legal practitioners.

\textbf{Causes of Difficulty: Path Dependence Elements}

The difficulties in relation to implementation of s. 158 were mainly attributable to insurmountable path dependence factors. The path dependence theory was initiated by Roe and Bebchuk\textsuperscript{93} and further developed by Schmidt & Spindler\textsuperscript{94}. Basically it argues that elements affecting the efficiency of corporate performance and arrangements vary from time to time. What used to promote efficient corporate performance may turn out to obstructing the


\textsuperscript{92} Running up to 780 pages and comprising 885 clauses, it is irony that the DTI is actually expecting a “simple and efficient company law framework” from this reform. Access on http://www.dti.gov.uk/bbl/co-law-reform-bill/clr-review/page22794.html


way of corporate development after a certain period of time. However, if the cost of switching to efficient corporate systems outweighs the cost of inefficiency of current system, then the nation may tend to maintain current inefficient systems rather than transferring to a new and efficient system. Therefore, the corporate structures that an economy has at any later point in time depend in part on those that it had at earlier point. Currently, there are three main path dependence factors blocking the way of UK CSR regulatory development, respectively, UK existing economic structure, political concerns and legal traditions.

UK’s existing economic structure, including various market mechanisms, prevailing shareholding structure and corporate control mechanisms, play a major role in the persistence of its traditional company law scheme. Distinct from Continental European countries featuring a small number of listed companies and illiquid capital markets, UK is acknowledged for its vivid market mechanisms and flexible investor exit control. “Britain had one of the most unconstrained market economies in the world. She was the first European nation to develop a self-regulating market system, and her markets have been free from state intervention to a degree that has no continental parallel. From the repeal of the Corn Laws in 1846 to the tariff measures of 1930s, Britain remained the principal defender of free trade in the international system.” The priorities of corporate governance issues constantly vary in various countries in line with national-specific economic contexts. For instance, UK company law emphasizes the dominant position of shareholders who control the management by exit-decisions on the external capital market and its previous reform attempts such as Cadbury Report were mainly concerning the adequacy of financial control and directors’ accountability. While for most Continental European countries, the main issue of corporate governance is the influence of large stakeholders, such as bank-creditors over the corporation and the efficiency of management control. As the enhancement of stakeholders’ interests is inconsistent with UK economic characteristics, it is difficult to introduce and further enforce stakeholder protection methods in UK. Recently, the Financial Reporting Council issued a notice, calling to protect the UK’s governance model from European pressures, in which the Chief Executive of the FRC clearly stated: “we do not want the EU to pursue governance harmonization to the point that the UK approach is outlawed. We have a huge market where the system works.”

UK’s political forces and legal traditions also play a significant role in blocking the effective introduction of new directors’ duty. Politics, as a strong force, “shapes particular outcomes and is often responsible for the widely divergent features of corporate organization found in different national jurisdictions.” In countries featuring social democracy policy, the national strategy would generally be more sympathetic to employees and other

---

98 Ibid.
stakeholders. As a consequence, directors are generally required in those countries to consider stakeholders’ interests and subject to their supervision in the corporate management process. Nevertheless, Britain is deemed as a “right-wing” country featuring liberal market democracy rather than a “left-wing” social democracy.101 This is especially the case after the victory of Margaret Thatcher’s election. Lots of national-owned firms, including BT, were privatized. Previous social friendly policies were dismantled and shareholders’ position was reinforced.102 The regulatory state has not substantially changed after the Labour Party came into power. Compared to other Continental European countries, the main business policy remains cautious to its stakeholders.103 Unless the political policy has made corresponding adjustments, it would be difficult to implement the stakeholder-friendly company law in an environment where the national policy is committed to the shareholder-centred direction.

UK’s current company law regime designed in favour of investors’ interests, and other legal complementarities to the British company law such as voluntary codes and self-regulation traditions, also have the potential effect of slowing down the proposed company law reform. UK has a long-standing self-regulation tradition and previous company law reforms were mainly on a private code-based approach. The past three committees, i.e., the Cadbury, Greenbury and Hampel, all operated under the assumption that “legislation was likely if business did not put its own house in order”104. The Cadbury code was most admired for its principle-based regulatory style extolling the virtues of flexibility and avoiding “one-size-fits-all” rules.105 The closer the interrelation between the national corporate law and the other components of the national legal system is, the more problematic it is to exchange the corporate law without changing the entire legal environment simultaneously.106 Furthermore, as the human capital of lawyers and managers who are familiar with a certain corporate law system would be devalued if firms switch to a different corporate law,107 those legal practitioners are of strong insistence in respect of current legal regime. It is therefore difficult to see how the drafted Bill, which is committed to promote voluntary-based CSR behaviour under the regulatory approach by virtue of a thorough codification of directors’ duty, would be efficiently integrated with other voluntary codes and successfully implemented by those opposing legal practitioners.

Possible Solutions

Given those impeding elements discussed above, it is unlikely that s. 158 could be of any substantial effect in improving stakeholders’ consideration in the English law regime. In a business world where firms are increasingly competitive, CSR needs to be more heavily

104 Ibid.
105 Ibid.
107 Ibid.
regulated than what this vague, generous provision could offer. Nevertheless, as was discussed in the last section, the difficulty of implementing stakeholders’ interests is mainly attributable to a number of UK-based elements and it would be impossible to make a thorough transformation within a short period of time. Though being criticized as soft-worded and confusing, s. 158 accords with the UK self-regulatory and shareholder-centred tradition. Whilst maintaining shareholders’ paramount position and directors’ discretion powers as untouched, it is effective in making directors and the public aware of the growing importance of stakeholders’ interests and mainstreaming CSR concept in the business society. The ideal solution, therefore, is to complement it with detailed standards in certain fields, rather than to replace it with radical stakeholder enforcement thoughts.

Interests of various stakeholders differ and conflict with each other. With regard to the relationship between their interests and the company, stakeholders can be divided into primary stakeholders and secondary stakeholders. The primary stakeholders, including shareholders, employees, creditors and managers of the company, have a real, direct and tangible interest in the company. Clarkson define a primary stakeholder group as “one without whose continuing participation the corporation cannot survive as a going concern.” Secondary stakeholders, involving suppliers, customers, government and local community, are defined as “those who influence or affect, or are influenced or affected by the corporation, but they are not engaged in transactions with the corporation and are not essential for its survival.” According to the research of A. J. Hillman and G. D. Keim, companies’ relations with different stakeholder groups can yield distinct effects on the corporate business development. “Building better relations with primary stakeholders like employees, customers, suppliers, and communities could lead to increased shareholder wealth by helping firms develop intangible, valuable assets which can be sources of competitive advantage. On the other hand, using corporate resources for social issues not related to primary stakeholders may not create value for shareholders.” More specific regulations should be introduced into current legal regime to ensure minimum legal protection standards to contractual stakeholders’ interests whose relations will, in turn, generate value for shareholders. For instance, employee protection, consumer and creditors’ rights can be specifically underpinned by regulatory control. The instrumental model could hereby be adopted in justifying the adoption of specific regulations: it is necessary to protect the interests of “those groups without whose support the organization would cease to exist.” Alternatively, the normative model which interprets the business behaviour on the basis of morality, could defend the general principles such as s. 158 which are designed to create a CSR-friendly atmosphere: stakeholders are defined by their legitimate interest in the

---

109 Ibid.
111 Ibid.
113 Ibid., at p 125.
corporation, rather than simply by the corporation’s interest in them.\textsuperscript{115} Because all stakeholders have intrinsic value within the company, corporate managers are obliged to consider those interests on the basis of ethical consideration, even when doing so would not enhance corporate profit or shareholder gain.\textsuperscript{116} It is necessary to create a CSR-friendly environment even in a shareholder-centred country so that managers can be more aware of stakeholders’ interests in their managerial process. A combined method is therefore envisaged: on the one hand, general principles such as s. 158 of the company law reform bill will emphasize the overall importance of stakeholders’ interests and create a stakeholder-friendly environment; on the other hand, specific regulations in certain fields can ensure minimum protection available to certain stakeholder groups whose interests will yield competitive value for companies.\textsuperscript{117} Such a method also accords with the legitimacy theory that as business tend to use its power to legitimate its activities, firms would pay most attention to those legitimate stakeholder groups who have power and urgency.\textsuperscript{118} It would also be more easily accepted by corporate investors as their interests would be largely enhanced through long-term co-operative relationship with other stakeholders.

Though detailed regulations are generally not preferred by businesses, the following figure has shown that social improvements may be more readily achieved through direct regulation than via the market alone\textsuperscript{119} and further asserted the practicality of the combined approach.

\begin{table}[h]
\centering
\begin{tabular}{|l|l|l|}
\hline
Regulation & Prediction by Business & Reality \\
\hline
National Minimum Wage & Would result in over 1 million UK job losses within two years & Unemployment fell by 200,000 \\
\hline
EEC Introduction of Catalytic Converters & The cost of technology would be £400 to £600 per vehicle, with a fuel consumption penalty on top & Real costs of around £30 to £50 per converter; technological innovation led to smaller, cheaper cars \\
\hline
US Clean Air Act & Would cost the America $51 to $91 billion per year and result in anywhere from 20,000 to 4 million & Yearly cost of $22 billion to business, but employment in areas affected up by 22 percent; the benefits arising are between \\
\hline
\end{tabular}
\caption{Regulation or Burden?\textsuperscript{120}}
\end{table}

\textsuperscript{117} “Organizational advantages derive from developing relationships with key stakeholders: customers, employees, suppliers and communities where business operate cannot be easily or quickly duplicated by other companies. Participating in social issues, on the other hand, may be seen at best as a transactional investment easily copied by competitors.” See A. J. Hillman and G. D. Keim, “Shareholder Value, Stakeholder Management, and Social Issues: What’s the Bottom Line?” (2001) 22 Strategic Management Journal 125-139.
\textsuperscript{118} L. Moir, “What Do We Mean by Corporate Social Responsibility?” (2001) 1 Corporate Governance 16-22, at p 19.
\textsuperscript{120} Available from D. Doane, From Red Tape to Road Signs: Redefining Regulation and Its Purpose, (London: CORE Coalition, 2004).
Considering the voluntary nature of corporations’ socially responsible behaviour, in addition to the current practice, more awarding schemes can be introduced into the new framework. One successful example of awarding schemes is the current UK payroll giving method, which is a tax-effective way for employees to donate to charity by authorizing a deduction from their gross pay before tax.\textsuperscript{121} From April 2000 to 2001, payroll giving donations have increased from £37 million to £55 million. Half a million people are now taking advantage of the scheme.\textsuperscript{122} It is suggested that more awarding schemes such as fiscal instruments could be put into practice to embrace new models of social engagement, and to assist the take-up of practices.\textsuperscript{123}

CSR is not only a matter for UK’s local businesses, but is of importance to the European Union and the whole world. UK’s future approach of promoting CSR, therefore, should involve the partnership of business and social communities, national governments and international organizations, which would involve the enhancing cooperation of the UK Government and businesses with European Commission, United Nations, OECD and other NGOs.

Conclusion

Based on UK’s proposed company law reform and current company law context, this article aims to deliver a thorough examination of s. 158 and the potential effects of this CSR regulatory attempt.

Even though the UK company law reform approach does not depart much from its traditional shareholder-centred scheme, it would be wrong to conclude it as an affirmation of the legal model in its strictest form.\textsuperscript{124} The amendment of directors’ duty to the company is a brave attempt of increasing shareholder profit by developing long-term cooperative relationships with other stakeholders. The inclusion of the stakeholders’ interests for directors to take into account has the potential effect of promoting CSR performance at both UK and European levels. It even goes so far as to encourage the establishment of a CSR regulatory framework in EU. Nevertheless, owing to a number of national-characterized elements in favour of investor interests, it is unlikely that an isolated principle regarding stakeholder consideration could be of any substantial effect in practice. Due to the vagueness of its wording and lack of enforcement method, it is highly possible that s. 156 will turn into another failing s. 309 of the Companies Act 1985.

Additional policies and enforcement methods therefore are called for if stakeholders’

\textsuperscript{121} For detailed information see Department of Trade and Industry, \textit{Business and Society: Corporate Social Responsibility Report 2002}, (May 2002), at p 15.
\textsuperscript{122} Ibid.
\textsuperscript{123} Ibid.
interests are to be effectively promoted. Considering the self-regulation tradition in UK, it is not preferable to impose all the mandatory rules requiring corporations to act in a socially responsible manner in the form of company law. Rather, a combination of methods, i.e., voluntary codes in conjunction with minimum legal standards, punishments in association with awarding schemes, could be favoured. It is hoped that through a combined approach integrated with various regulatory methods and coordinated relationships with other regulatory bodies, the proposed Enlightened Shareholder Value approach will eventually lead to a realization of CSR performance and corporate control standards in UK, and the Anglo-Saxon shareholder model and the Continental European stakeholder model could be effectively bridged just as we envisaged.

Shuangge Wen
School of Law
University of Manchester
Yidesheng@yahoo.com