

## UK

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### The current system of corporate governance

There are some 3.7 million businesses in the UK (defined as a legal unit, person or group of people producing goods or services). Of these some 2.5 million are sole traders or partners without employees. There are around 1.2 million limited companies and the vast majority have fewer than ten employees (see table).

<b>Size of company</b>	<b>Number of companies in category</b>
Less than 10 employees	1,010,000
10 to 49 employees	170,000
50 to 249 employees	26,000
More than 250 employees	7,000
Source: <i>Modern Company Law for a Competitive Economy: Developing the Framework. A consultation document from the Company Law Review Steering Group</i> (DTI March 2000)	

All companies are subject to the same broad framework of company law, which has developed, largely in response to particular scandals, since the nineteenth century. The most important piece of recent legislation on companies is the 1985 Companies Act, which consolidated key legislation up to that time. However, there has been a large amount of subsequent legislation on companies, including the Insolvency Acts of 1985 and 1986, the Financial Services Act in 1986 and the 1989 Companies Act, as well as changes introduced without new primary legislation. The legislation covers among other things the duties of directors, the rights of shareholders and reporting and accounting.

Overall, as a recent consultative document from the Department of Trade and Industry (DTI), the government department responsible for company law, makes clear:

“The present structure of the law reflects three purposes. Companies are formed and managed for the benefit of *shareholders*, but subject to safeguards for the benefit of actual and potential *creditors*. Accounting and disclosure requirements, too, operate for the benefit of actual, and potential, shareholders and creditors (including investors and savers) and, through public disclosure of information, for the benefit of *the community as a whole*.” (*Modern Company Law for a Competitive Economy: The Strategic Framework: A consultation document from the Company Law Review Steering Group*; DTI February 1999)

The law distinguishes between three different types of company. These are

- private limited companies (Ltd);
- public limited companies (plc) and
- listed companies (also public limited companies but listed on the Stock Exchange).

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There are 12,000 public limited companies, of which some 2,400 are listed. All the others are private companies.

The legal differences between private and public companies other than listed companies are relatively minor and technical. For example, public companies must have at least two directors (a private company need only have one) and an issued share capital of at least £50,000 (There are no upper or lower limits on share capital for private companies.). Public companies must file information at Companies House sooner than private companies. Among private companies there are also some distinctions based on size, assessed on turnover, balance sheet and number of employees, in terms of the extent of the information that they must provide and the extent to which their accounts must be audited.

There is a greater distinction between listed companies and other sorts of companies. Listed companies must provide much more information about their operations, primarily to protect current and potential investors. They are also subject to a code of good practice, known as the Combined Code, which deals with the appointment and roles of directors, directors' pay, relations with shareholders and accountability and audit. Listed companies are not obliged to follow the rules of the Combined Code but they are required to state whether and how they apply its principles and, if they do not apply them, explain their actions.

The 1985 Companies Act says very little about the way directors control a company. There is no reference to a board of directors or to a chairman, the roles that specific directors exercise or the difference between executive and non-executive directors.

The Combined Code is more specific. It states that

- “every listed company should be headed by an effective board which should lead and control the company”;
- there should be a separation between the chairman, who runs the board and the chief executive, who runs the business”, with the aim that no-one has “unfettered powers of decision”;
- the board should include a balance of executive and non-executive directors(including independent non-executive directors, with the aim that “no individual or small group of individuals can dominate the board’s decision taking”.

Companies are not legally obliged to follow the recommendations of the Combined Code (see above) but research carried out in 1999 found that most do. In total 87% of companies separated the roles of chief executive and chairman and 93% had boards where at least one third were non-executive directors (*Compliance with the Combined Code*; PIRC September 1999).

There is no requirement, either in legislation or the Combined Code, for a two-tier structure with a supervisory board. However, the DTI believes that it would be legally possible to establish such a two-tier body. In its briefing document on the European Company statute published in May 2003 it states:

“The Department is of the opinion that nothing in law presently prevents PLCs incorporated in the UK from adopting articles under which the powers that are granted are divided between two tiers of directors, one exercising management functions and the other a supervisory role in relation to those functions”.

## The actors involved

The UK legal position is clear. The directors run the company in the interest of the shareholders. In this sense there is no formal position for employee representatives in the running of the company and certainly no requirement for employee participation at board level.

Companies are legally obliged to inform and consult employee representatives on a number of issues (see below) but do not have to involve them in management.

The issues on which consultation takes place and the bodies that must be consulted are set out below. It is important to remember that in the UK no statutory permanent structure of employee representation, like works councils, exists, so in most cases it is trade union representatives who are informed and consulted.

<b>Issues requiring information and/or consultation</b>	<b>Body informed and/or consulted</b>
Collective redundancies (20 or more employees made redundant within 90 days)	Recognised* trade union, where there is one, or other form of employee representatives, either already existing or specially elected for that purpose
Transfer of undertakings	Same as collective redundancies
Information required for collective bargaining without which trade union representatives “would be impeded to a material extent” in carrying out negotiations	Recognised* trade union
Health and safety	Safety representatives appointed by a recognised* trade union if these exist, otherwise the employees directly or their elected representatives
Occupational pension schemes (under certain circumstances)	Recognised* trade union
European works councils	Members of European works councils – precise methods of election depend on the European works council agreement. UK members of the special negotiating body, who negotiate the initial agreement, must be directly elected by the work force
*A recognised union in this sense is one with whom the employer is prepared to negotiate on pay and conditions. Since 1999 it has been possible to compel medium and large employers to recognise a union, even when they are opposed, provided certain conditions, essentially the majority support of the workforce, are met.	

## Practice of employee participation

There is no evidence to suggest that, other than in a few very exceptional cases, the practice in the UK differs from the legal position in terms of their participation at board level. Almost always employee involvement is limited at best to information and consultation and in many cases even this will not take place, particularly if there is no union presence. A major survey of more than 3,000 workplaces in 1998 found that “almost three in five workplaces had no worker representatives of any kind and this was true of nine out of every ten workplaces where there were no union members” (*Britain at Work: as depicted in the 1998 Workplace Employee Relations Survey*; Mark Cully, Stephen Woodland, Andrew O’Reilly, Gill Dix, Routledge 1999).

Consultation is also largely limited to questions linked directly to employment. A survey of 366 workplaces, carried out for the TUC in 2002 found that unions are more likely to be consulted about these issues, including those of redundancies and transfers where law requires consultation, than broader concerns such as the company’s activities or economic situation (see table).

<b>Consultation arrangements with the unions</b>	
	Percentage consulted
Activities of the organisation	26.5%
Economic situation of the organisation	21.6%
Employment issues (including future plans)	52.2%
Substantial changes affecting the workforce (other than redundancies and transfers)	57.7%
Redundancies and transfers	66.4%
Source: <i>Trade union involvement in information and consultation – a survey of current practice</i> (Labour Research Department October 2002)	

The same survey did, however, produce two examples where there was employee participation at board level. Both are in the public sector and both are municipally owned bus companies. They are interesting in indicating that board level participation is not completely unknown in the UK and that mechanisms can be found to choose employee directors. However, they are very much the exception. The details are as follows.

At Nottingham City Transport 82% of shares are owned by Nottingham City Council. There are two employee directors who are elected by the whole workforce every two years. They sit on the company's board and report back to the joint shop stewards meeting. In addition the union has a meeting with senior managers after each company board meeting in the Joint Consultative Committee.

Lothian Buses is wholly owned by the local authorities (91% Edinburgh 9% the adjacent councils). There is one worker director on the board of the company, who is elected every three years by the whole workforce. The Joint Trade Union Committee makes a recommendation but other candidates can and do stand. The worker director receives a normal salary plus non-executive director payments and has one day a week release to visit depots and other sites. It has recently been agreed that the individual can only be a director for two terms. The current worker director is a bus driver and was elected in September 2001.

In addition to this handful of worker directors there have also been a small number of trade union officials who have held company directorships, normally in state-owned companies. A recent

example was Sir Ken Jackson, who was a director of the nuclear waste company Nirex while he was general secretary of the AEEU.

## History

Employee participation in management structures has been the subject of debate in the UK trade union movement in the past. In 1944 in discussion on post-war reconstruction the General Council (executive committee) of the TUC opposed employee participation on the boards of nationalised industries. It argued that “it does not seem by any means certain that it would be in the best interest of the workpeople of a nationalised industry to have, as directly representative of them, members of the controlling board who would be committed to joint decisions”.

However, by the 1960s and 1970s, with trade unions growing in strength, the issue was again being taken up, this time in a more positive way. Industrial Democracy a 1974 report from the General Council of the TUC called for 50% trade union participation on the boards of both state-owned and private companies. However, some within the trade unions remained concerned that they could be committed to decisions they opposed and the 1975 TUC Congress, while backing 50% trade union membership of boards, passed a motion which rejected “any form of participation which would tend to weaken ... essential trade union independence”.

At the same time a number of companies, particularly those which were state owned introduced worker directors on their own initiative. The best-known examples, were British Steel, which introduced worker directors on divisional boards in 1967, and the Post Office, which introduced them in 1978.

The CBI (Confederation of British Industry), the main employers’ body, opposed these developments. In 1973 a CBI document stated

“In the British situation, representation on a supervisory board would certainly be union dominated. Taking account the known views of the TUC on this question, the [CBI] has little confidence that union members of the board would acknowledge either a responsibility for the decisions in which they had participated, or the responsibility implicit in board membership to act in the company’s interests as a whole.” (Quoted in *Industrial democracy: a trade unionist’s guide* Labour Research Department 1976)

In 1976 the then Labour government set up the “Committee of Enquiry into Industrial Democracy” chaired by a distinguished academic Lord Bullock. The committee reported in January 1977 proposing an equal number of representatives of both shareholder and employee representatives on the governing board of companies employing more than 2,000 with these two groups appointing a third group of independent directors. It expected that the chairman would generally come from the shareholders, although this would not necessarily be the case. It proposed that the employee directors should be appointed through trade union channels. However, a minority report from the employers’ representatives on the committee opposed these recommendations calling for no more than one-third employee representatives on newly created supervisory boards.

In response the government published a White Paper (*Industrial Democracy* HMSO 1978) in May 1978. This proposed giving employees in companies employing 2,000 or more the right to one third of the seats on the board, either on the existing unitary board or on a newly created policy

board, separate from the board responsible for day-to-day management. The representatives would not come exclusively from the unions as proposed by Bullock, although the details were not spelt out. The proposals would also be a fall-back, employers and unions could reach other agreements if they wished. Finally there would be a delay of three or four years before worker directors would be appointed, as they were to follow the creation of new Joint Representation Committees, with whom management would have to consult about company policy.

The TUC saw these proposals as a “first step” although it was concerned about a number of issues, including the delay and the possible involvement of non-trade union employees. In November 1978 the government promised legislation. However, the government lost the election in May 1979 before it could be introduced.

In June 1979 the newly elected Conservative government announced that it would not be legislating on the issue. The first years of the Conservative government also saw the abandonment of the initiatives in worker participation on the board of state-owned industries. The two-year experiment in the Post Office was ended in December 1980, and in 1983 the practice of appointing British Steel employees as non-executive directors was also terminated.

In the years that followed trade union attention was increasingly directed at more central concerns, such as protecting the right to strike and to organise, while most employers were happy to see the issue disappear from the agenda.

## **Current discussions**

Employee representation at board level is not a major issue for UK trade unionists at present. In the area of employee involvement and participation they are much more concerned with the implementation of the directive on information and consultation at national level (Directive 2002/14/EC establishing a general framework for informing and consulting employees in the European Community). An agreement between the CBI and the TUC was reached in June 2003 and the government published a consultative document and draft regulations on 7 July.

The CBI continues to be hostile to employee participation. It opposed the directive on employee involvement accompanying the European Company Statute arguing that the precedent that it set was “extremely unhelpful”. It considers having employee representatives on management boards not to be “in the culture of UK enterprise” and it therefore believes that very few companies will set themselves up as European Companies.

The UK government has also shown no great enthusiasm for employee participation at board level. It produced a briefing document on the European Company Statute, including employee involvement in May 2003, and it published a consultative document setting out its proposals for the implementation of the directive and the options it proposed to take on the regulation on 6 October 2003 (see next section).

In the press release accompanying the document the DTI minister responsible, Gerry Sutcliffe chose to present it as a technical issue, giving new freedoms to UK companies. His only quote in the press release said:

"The statute potentially offers benefits to British companies by creating a framework by which they will be able to engage in cross-border mergers with companies from other member states. At present, there are no harmonised rules in the EU governing cross-border mergers."

There has been a much more extensive debate on the government's proposals to reform company law. One element of discussion has been on the possibility of extending the directors' duties so that they also have to take act on behalf of other interests not simply those of the shareholders.

The government decided essentially to leave matters as they are, with directors acting for the shareholders, although enlightened self-interest might also mean taking other groups into account. It stated in its white paper *Modernising Company Law* (HMSO July 2002) that:

“the basic goal for directors should be the success of the company in the collective best interests of shareholders, but that that directors should also recognise, as the circumstances require, the company's need to foster relationships with its employees, customers and suppliers, its need to maintain its business reputation, and its need to consider the company's impact on the community and the working environment.”

This was a disappointment for the TUC, which had called for a more pluralist approach. However, it is interesting that the possibility of having employees as directors played no significant role in the debate.

### **Implementing the legislation in the UK**

As already noted the UK government produced a consultative document setting out its proposals on how the European Company Statute legislation should apply to the UK on 6 October 2003 (*Implementation of the European Company Statute - the European Public Limited Liability Company Regulations 2004 – A Consultative Document*). The consultation was set to close on 9 January 2004 and as elsewhere the regulation will come into force on 8 October 2004 and the directive should be incorporated into national law by the same date.

The bulk of the consultative document sets out the requirements of the regulation and the directive. However, it also indicates how the British government proposes to introduce them into UK law.

On the issues covered by the regulation, essentially dealing with company law, the general approach is to interfere as little as possible in company decisions. As the consultation document states, the legislative framework should “provide for maximum flexibility in the way in which SEs are structured”.

Three examples make this clear.

The first deals with authorisation. In a two-tier SE structure the regulation provides that an SE's statutes should list the categories of transactions which require authorisation by the supervisory board. But it allows member states to influence how this works, either by permitting the supervisory board to decide which issues must be referred to it, or by the government itself listing the categories to be included in the statutes. However, in SEs based in the UK there this will not occur. As the consultative document states: “It is not proposed that either of these options be adopted, as it is appropriate that the competence of the two organs to take decisions should be a matter for the company's constitution as set out in its statutes”.

The second example deals with information, where the consultative document rejects the option that allows member states to give rights to each individual member of the supervisory board to require information necessary to carry out his or her duties. The document argues that this option

is not necessary, that the supervisory board should take this decision collectively and that “provision could be made where appropriate, in the statutes”.

Finally on the size of the boards, supervisory, management or single-tier, the British government does not intend to move away from the current situation which gives almost a free rein to companies. (The exception is an SE with employee participation on a single-tier board, where the document accepts that the regulation requires that, the board must have at least three members.) Otherwise the current rules apply as the consultative document states:

“Section 282 of the Companies Act 1985 requires PLCs to have at least two directors and it is proposed that like provision should be made for SEs. In the case of an SE with a two-tier board it is proposed, therefore, that both the management organ and the supervisory organ should each have a minimum of one member. There is no limit on the maximum number of directors a PLC may have and it is not considered appropriate to impose any such limit on SEs.”

In other words the only requirement in terms of size in a two-tier board structure will be that each board must have at least one member.

On the more general issue of setting up two-tier boards, the British government believes that is no need to change the law to achieve this in the UK, because, as already stated, it considers that there is currently no legal bar to companies setting a two-tier structure. They only need to change their articles of association, the rules that they themselves agree, to do so.

The decision to allow changes to be introduced through changes to a company’s articles of association is in line with the UK government’s general approach of leaving as much as possible to companies themselves to determine.

On the directive, much of the consultative document is taken up with setting out the measures already agreed at EU level. However, the UK government has to decide on a number of practical issues to take account of the specifics of the UK’s industrial relations system.

Its proposals on these are included in the consultation document.

The directive gives member states some discretion in deciding how the members of the Special Negotiating Body (SNB) will be chosen. The British government favours election by employees or, where such a body exists, appointment by a representative body, described as a “consultative committee”. To be able to choose the SNB members the consultative committee must, in the words of the draft regulations be a body,

- “whose normal functions include or comprise the carrying out of an information and consultation function;
- which is able to carry out its information and consultation function without interference from the management of the participating company;
- which, in carrying out its information and consultation function, represents all the employees of the participating company; and
- which consists wholly of persons who are employees of the participating company, its concerned subsidiaries or establishments.”

This consultative committee will in most cases be a trade union body, although there will also be some cases where other bodies have this role.

On membership of the SNB, the draft regulations specifically propose that, as well as employees, full-time trade union officials will be entitled to be members, although this is subject to management agreement.

On complaints, they are to go to the Central Arbitration Committee (CAC), the government appointed body that currently deals with issues like union recognition and information disclosure. The maximum penalty that can be imposed on companies which fail to comply with the rulings of the CAC is £75,000, imposed by the Employment Appeals Tribunal.