The end of “comply or explain” in UK corporate governance?

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Introduction

I t is a truism to say that recent financial crises have seriously undermined public confidence in the City of London. At the close of the 21st century’s first decade, the Victorian belief that the “gentlemanly capitalists” of EC1 can be relied upon to keep their own proverbial house in order is more tenuous than ever. There is a tendency to view the degeneration of public faith in securities markets as a relatively recent phenomenon triggered by the apparent excesses and irresponsibility of the post-1980s era. However, the City has to varying extents always been perceived as an opaque and murky environment to many outsiders, and the history of corporate and financial regulation in the UK can best be depicted as an ongoing contest between: on the one hand, institutional investors and boards favouring the preservation of operational flexibility and dynamism; and, on the other, a democratic state striving to ensure the public accountability of a sector whose activities have profound (albeit seldom understood) implications for the country’s “real” economy and society.2

The tension between these two regulatory goals has been nowhere more conspicuous than in the field of corporate governance, which is defined here as the problem of holding key executive decision-makers in listed companies accountable for their actions. It is arguably in this controversial area that the above flexibility/accountability trade-off has posed the most intractable difficulties for policy-makers. At the same time, though, this area could also be said to highlight the alleged international comparative advantage of the so-called “London Approach” to financial market regulation most succinctly. Indeed, in a recent document produced by the UK Financial Reporting Council (FRC) as part of the “City of London – City of Learning” initiative, it was recounted that the City of London “has a history of encouraging free trade and good corporate governance, based on the application of simple principles to the individual and distinct circumstances of each

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1 I am grateful for comments received from participants at the ESRC/World Economy and Finance Programme Colloquium “The Globalisation of Corporate Governance? Reform pressures and processes in an era of financial crises” held at Queen’s University Belfast in September 2008. The usual disclaimer applies. An earlier and shorter version of this paper was published in the Journal of Securities Law, Regulation and Compliance (2(1), November 2008) under the title “Averting the overprescription of UK corporate governance norms”.

2 For an argument to this effect in relation to the development of the US system of corporate and financial regulation, see D A Skeel, Icarus in the Boardroom: The fundamental flaws in corporate America and where they came from (Oxford: OUP 2005).
entity”. By strongly resisting the governmental temptation to control for every conceivable contingency, while relying to a significant extent on capital market participants themselves to formulate and police the “rules of the game” in their collective self-interest, the UK is widely regarded to offer a uniquely cost-effective framework of quasi-legal controls in respect of crucial business and financial issues.

At the heart of this innovative financial–regulatory model is the Combined Code on Corporate Governance, which has underlain the UK’s system of corporate governance since its inception (in an earlier form) at the beginning of the 1990s. In contrast to the formal, extensive and detailed catalogue of governance rules imposed on US-listed companies under the 2002 Sarbanes-Oxley Act, the UK has succeeded in preserving a set of corporate governance norms that are non-legally binding in form, relatively broad-based in substance, and readily comprehensible by boards without the need for extensive professional assistance. Arguably the most crucial factor underlying the Combined Code’s comparative advantage in the above regards is the principle of “comply or explain”, by virtue of which UK-listed companies are exempted from the need to adopt a prescriptive “one-size-fits-all” model of internal organisational control. In theory, this novel regulatory technique permits a company to opt out, in effect, from any one or more requirements of the Code that its board considers to be cost-ineffective or otherwise inappropriate for that company’s specific circumstances. At the same time, and as a condition of listing on the London Stock Exchange (LSE), any such deviation from standard governance practice must be explained to investors within the company’s annual accounts and reports. This mandatory disclosure obligation underpins the Code and has the effect of setting Code compliance as the general “default” position for listed companies in the absence of strong countervailing considerations. The Code is consequently vested with sufficient coercive clout to represent a credible managerial “bonding” mechanism in the eyes of institutional investors, thus (theoretically at least) ensuring the preservation of a level of trust conducive to the continuing provision of public equity capital to companies on desirable terms.

In spite of the generally positive reception that the “comply or explain” principle has received within both the investor and directorial communities in the UK over the past decade and a half, however, some serious doubts remain as to whether the central promise of “comply or explain” – namely its purported capacity to ensure an efficient balance between (a) ensuring governance best practice and (b) nurturing board flexibility and diversity – is being effectively achieved in practice. As this article will seek to demonstrate, there has occurred over recent years a progressive growth in detail and rigidity of some of


4 The most recent (June 2008) edition of the Combined Code is available on the website of the UK FRC: www.frc.org.uk/corporate/combinedcode.cfm.


6 The Public Company Accounting Reform and Investor Protection Act of 2002 (otherwise known as the Sarbanes-Oxley Act) was enacted on July 30, 2002. Its shorthand name is a reference to the Democrat and Republican (respectively) Senators Paul Sarbanes and Michael G. Oxley, who sponsored the Bill’s introduction before the US House of Representatives.

7 On this, see FRC, UK Approach, n. 3 above.

the Code’s key Principles and Provisions, which has consequently rendered the Code susceptible to a formulaic and legalistic interpretation both by financial market and corporate actors. This is particularly so in relation to Principle A.2 of the Code, which regulates the controversial issue of the division of leadership responsibilities (DoLR) between the company’s chair and chief executive officer (CEO).9 The problematic application of this Principle today is highlighted by reference to the recent controversy surrounding the British retailer Marks & Spencer plc (M&S), whose decision to promote its current CEO, Sir Stuart Rose, to the dual office of executive chair effective from 2008 onwards was met with widespread investor hostility. It will be submitted that the M&S fallout highlights the potential for intractable “clashes” to occur between seemingly equally ranking Code norms. Such clashes stem ultimately from the formalistic and “closed-ended” nature of Principle A.2 following its reform by the Higgs Committee in 2003,10 and are a source of costly and potentially divisive confusion for investors and boards alike.

The first part of this paper provides a brief historical account of the development of the “comply or explain” principle since its inception in the UK in 1992. The second part documents the recent tendency towards over-prescription of the Code’s key norms as demonstrated by the Marks & Spencer fallout. The third part suggests potential regulatory solutions to the above problems aimed at counteracting the diminishing practical relevance of the “comply or explain” doctrine in UK corporate governance. The fourth part concludes.

A short history of the “comply or explain” doctrine

The principle of “comply or explain” was pioneered in the landmark 1992 report by Sir Adrian Cadbury’s Committee on the Financial Aspects of Corporate Governance.11 As the basis for its inaugural Code of Best Practice on governance, the Cadbury Committee proposed a system of voluntary compliance by corporate boards with certain recommended norms of best practice, backed up by a mandatory disclosure requirement to be contained in UK Listing Rules.

All listed companies registered in the UK were accordingly urged to comply with the Code’s initial nineteen provisions covering the four overarching (and overlapping) issues of the board of directors, non-executive directors, executive directors, and reporting and controls. In respect of each relevant company, the board was required to make a statement about the firm’s compliance with the Code as part of their annual directors’ report, and, in the event of non-compliance with any one or more provisions, to provide supporting reasons for the deviation(s) from the Code. Meanwhile, institutional shareholders and/or their professional advisors were encouraged to use their ownership influence to pressurise companies towards compliance with the Code’s provisions.

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9 See Combined Code, n. 4 above, pp. 6–7.
11 Cadbury Report, n. 5 above.
This novel “soft”\textsuperscript{12} approach was justified on the basis that a mandatory and legalistic set of standards would be likely to encourage a perfunctory form of compliance by companies with the “minimum standard”, whereby boards and their legal advisors would aim to satisfy the strict letter of the law while nevertheless negating the committee’s key policy goals.\textsuperscript{13} The Cadbury Committee members were also very keen to enable a degree of “flexibility in implementation” of the Code,\textsuperscript{14} and emphatically rejected the notion that they should take a uniform, one-size-fits-all approach to prescribing what constitutes an appropriate governance system for any company. Accordingly, the Cadbury Committee recommended that “[t]he Code [should] be followed by individuals and companies in the light of their own specific circumstances . . . and in interpreting it they should give preference to substance over form”.\textsuperscript{15}

When the Cadbury Committee’s recommendations underwent their first comprehensive review in 1998, the over-riding concern of Sir Ronnie Hampel’s review committee was “the need to restrict the regulatory burden on companies, and to substitute principles for detail wherever possible”.\textsuperscript{16} This necessitated a reconfiguration of the balance that had previously been achieved between the dual criteria of compliance and flexibility, with the Hampel Committee recommending an increased emphasis on the latter goal and a correspondingly reduced focus by boards on ensuring “blind” compliance with the Code absent proper regard for the particular circumstances of the relevant company. As the Hampel Committee explained:

Good corporate governance is not just a matter of prescribing particular corporate structures and complying with a number of hard and fast rules. There is a need for broad principles. All concerned should then apply these flexibly and with common sense to the varying circumstances of individual companies.\textsuperscript{17}

The Hampel Committee accordingly recommended a significant change in the process whereby companies report to shareholders and the public on their record of

\textsuperscript{12} The term “soft” denotes that the Code’s substantive provisions are, in practical terms, applicable and enforceable on a purely voluntary basis. However, this does not mean that they are self-regulatory in nature. Rather, the fact that the Code’s application is underpinned by a mandatory disclosure obligation contained in UK Listing Rules demonstrates that, on a formal level, the foundation of the Code’s coerciveness lies in the UK Listing Authority’s delegated statutory powers to enforce the underlying conformance–disclosure obligation, without which the Code’s practical impact would almost certainly be nullified. At the time of the Cadbury Code’s inception in 1992, the UK Listing Authority was the LSE. However, contemporaneously with the inception of the first Combined Code on Corporate Governance in 2000, the LSE was replaced in this role by the then newly formed FSA, whose enforcement powers were considerably stronger than those of its predecessor. In respect of form, therefore, the Combined Code could be said to represent a notably “harder” body of rules than those contained in the earlier Cadbury Code of Best Practice. Adopting Professor Melvin Eisenberg’s terminology, the Combined Code is accordingly best described as a body of “organisational rules” which, although not legal rules in the standard sense of the term, nevertheless “tend to operate in many ways like legal rules” insofar as they are “adopted by private organizations” (in this case, the UK’s FRC) and also are “directly or indirectly backed by formal sanctions”. See M Eisenberg, “Corporate law and social norms” (1999) 99 Columbia Law Review 1253, at 1255–6. On the distinction between the terms “self-regulatory” and “voluntary” in this context, see E Wymeersch, “The enforcement of corporate governance codes” (2006) 6 Journal of Corporate Law Studies 113, at 114.

\textsuperscript{13} Cadbury Report, n. 5 above, at para. 1.10.

\textsuperscript{14} Ibid.

\textsuperscript{15} Ibid., at para. 3.10.


\textsuperscript{17} Ibid., para. 1.11.
conformance\textsuperscript{18} with the Code’s Provisions, together with a complementary alteration to the Code’s underlying structure, both of which were subsequently adopted within the first Combined Code on Corporate Governance in 2000.\textsuperscript{19}

On the basis of Hampel’s suggestions, the Code was divided into two different but adjoining levels of prescription, comprising seventeen relatively open-ended Principles supplemented by a larger number of more detailed explanatory Provisions. Companies were from then onwards required by Listing Rules to produce a two-part corporate governance statement in their annual reports and accounts, explaining: first, in broad and narrative terms, how they \textit{apply} the higher-level Principles of the Code, detailing the particular governance policies that the board has adopted in order to implement those Principles within the specific and current circumstances of the company’s business;\textsuperscript{20} and, secondly, whether the company \textit{complies} with all of the more specific lower-level Provisions of the Code, together with supporting reasons in the event of non-compliance with any one or more of those Provisions.\textsuperscript{21}

In the more recent editions of the Code which followed the publication of the Higgs\textsuperscript{22} and Smith\textsuperscript{23} reports in 2003, the compliance task has been further complicated with the insertion of a third layer of norms into the Code’s basic regulatory structure. As a result, boards are today faced with a three-pronged structure of high-level Main Principles, mid-level Supporting Principles and low-level Provisions. Curiously, the Code contains no express guidance on the precise interaction between these three levels of norm, besides simply reiterating the continuing Listing Requirement for companies to explain how they apply the first category of norms together with their record of conformity with the final category. The rather open-textured wording of the Supporting Principles, however, would suggest that they are of purely illustrative value in relation to each of the Code’s Main Principles.

Since its inception in the Cadbury Committee’s inaugural recommendations sixteen years ago, the “comply or explain” principle has been exported from the UK to provide a basis for numerous other countries’ corporate governance systems, including those of Australia, Canada, Mexico, the Netherlands, Singapore, and, to a very limited extent, even the United States.\textsuperscript{24} More recently, the concept has been adopted as a basis for fledgling

\textsuperscript{18} In this context, “conformance” is not synonymous with “compliance”. Rather, conformance with the Code can be achieved either by complying with all of its constituent provisions, or alternatively by providing an explanation for non-compliance with any provision(s). In this specific sense, the term “conformance” is attributable to a recent report by the Hedge Fund Working Group, in which it promulgated a set of self-regulatory standards of best practice for hedge funds based on the “comply or explain” principle. See \textit{Hedge Fund Standards: Final report} (Hedge Fund Report) (London: Hedge Fund Standards Board January 2008), para. 3.6.

\textsuperscript{19} \textit{The Combined Code: Principles of best practice and code of best practice} (London: FRC May 2000). This development also coincided with the transfer of responsibility for enforcing the Code’s underlying conformance-disclosure obligation from the formerly self-regulatory LSE to the FSA, so that the Code was in effect transformed from a “private sector initiative” to an institution exhibiting something of a quasi-public character. See E Ferran, “Corporate law, codes and social norms – finding the right regulatory combination and institutional structure” (2001) 1 Journal of Corporate Law Studies 381, at 396.

\textsuperscript{20} Although the Preamble to the most recent (2008) edition of the Code confirms existing common board practice by providing that, where a company is fully compliant with the Code’s Provisions, it need only report the fact of full compliance in its annual corporate governance statement. See Combined Code, n. 4 above, Preamble, at para 4.

\textsuperscript{21} This dual disclosure requirement is today laid down by Listing Rule 9.8.6 (5)–(6), which is contained in the official \textit{Handbook} of the UK Listing Authority, the FSA.

\textsuperscript{22} Higgs Report, n. 10 above.


programmes of self-regulation by financial industry bodies both in the UK and beyond, including the Walker Working Group’s influential guidelines on disclosure and transparency in the UK’s private equity sector,\(^{25}\) and also the newly established Hedge Fund Working Group’s report on standards of best practice for hedge funds.\(^{26}\)

Overall, then, it suffices to say that the Cadbury Committee’s brainchild of “comply or explain” has come a long way within its relatively short existence.

**The problem of over-prescription of code norms**

One of the most common criticisms levelled at the Combined Code over recent years is the charge that it has become too detailed and prescriptive in form. In particular, there is a view that the 2003 revisions to the Code suggested by the Higgs Committee on the role and responsibilities of non-executive directors (NEDs)\(^{27}\) represented an unjustified “knee-jerk” reaction to some well-publicised supervisory failures in US and Continental European companies.\(^{28}\) This arguably has had the effect of increasing the prescriptiveness and rigidity of the Code at the expense of its reputed flexibility. One critic, for instance, has argued that Higgs “introduced so many requirements that it is simply legislation by the back door”,\(^{29}\) while others have described recent developments in UK corporate governance in terms of a process of “regulatory creep” whereby improvements in governance occasioned by codes encourages people to broaden their scope and also increase their level of detail.\(^{30}\)

**The division of leadership responsibilities doctrine**

A notable example of this process of regulatory creep in action can be observed in relation to the controversial Code provision on the separation of the respective offices of the company’s chair and CEO.\(^{31}\) It is a generally accepted principle of British corporate governance today that the dual responsibilities of (a) leading the running of the company’s business and (b) chairing meetings of the company’s board of directors are (within listed companies at least) logically separate tasks that each fall to be performed by different corporate officers. The former task is accordingly the job of the company’s CEO. The latter responsibility meanwhile should normally be vested in a specialist non-executive chair. While the chair is typically expected to set the agenda for and lead the deliberations of the company’s board during formal periodic meetings,\(^{32}\) he or she should not be involved at all in the company’s day-to-day operational management affairs. Vice versa, while the CEO

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\(^{27}\) Higgs Report, n. 10 above.


\(^{31}\) Combined Code, n. 4 above, Code Provision A.2.1.

\(^{32}\) On the general role and functions of the chair, see Combined Code, n. 4 above, Supporting Principle A.2; Higgs Report, n. 10 above, ch. 5; Sir A Cadbury, *Corporate Governance and Chairmanship: A personal view* (Oxford: OUP 2002).
should wield ultimate authority in the normal course of management affairs, he or she must temporarily cede this authority to the chair on entering board meetings.33

Although prima facie counter-intuitive, this arrangement is said to fulfil a crucial dual function. In the first place, the division of leadership responsibilities (DoLR) on the board theoretically "neutralises" the dominance of the CEO during intermittent meetings, thereby providing a temporary "window" through which other less senior corporate officers can (on the invitation of an impartial chair) tender potentially dissenting opinions on key strategic issues unencumbered by the firm's pre-existing authority structure.34 In this way DoLR improves the overall cognitive capacity of the board by ensuring that its deliberations and decisions are reflective of a broad body of opinion as opposed to emanating ultimately from the CEO personally.35 And, secondly, DoLR theoretically enables the board to operate as a robust and credible monitoring mechanism – in other words, a forum for supervising and disciplining underperforming managers – by ensuring that ultimate control over its deliberations is vested in an officer other than one of the senior management team themselves. Accordingly, the board becomes an objective and, to some extent, “external” body which managers submit themselves to for periodic appraisal and sanction.36

The fact that DoLR is a generally accepted corporate governance norm in the UK does not mean, however, that it is universally accepted. For instance, in the United States, which has a markedly similar corporate governance system to Britain characterised (to an even greater extent than the UK) by widely dispersed ownership via a liquid stock market, it is customary for large listed corporations to combine their dual management and board leadership functions under the remit of a unitary executive chair.37 Further, over recent years some commentators have begun to laud the more streamlined board structures exhibited by those formerly listed companies that are taken under private equity ownership, which typically combine the responsibilities of corporate and board leadership in order to achieve a distinct and concentrated strategic focus.38 Finally, even some well-known British listed companies have made the considered decision to refrain from applying the DoLR for

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33 Sir Adrian Cadbury explains that “at the board meeting the chief executive is no longer [the management team’s] executive head, but primus inter pares, first among equals”; Cadbury, Corporate Governance, n. 32 above, p. 112.
35 On the danger of “groupthink” developing within a board which contains a dominant authority figure (e.g. an autocratic CEO), see Morck, “Behavioral finance”, n. 34 above; D C Langevoort, “The human nature of corporate boards: law, norms, and the unintended consequences of independence and accountability” (2001) 89 Georgia Law Journal 797.
37 Cadbury, Corporate Governance, n. 32 above, p. 104.
varying periods of time due to its perceived “ill-fit” with the company’s current strategic circumstances or path-dependent management culture.39

The Cadbury Committee in 1992 recommended that “the chairman’s role . . . should in principle be separate from that of the chief executive”.40 The Cadbury Code therefore stated that “[t]here should be a clearly accepted division of responsibilities at the head of the company, which will ensure that no one individual has unfettered powers of decision”.41 The Cadbury Code further provided that, in those cases “[w]here the chairman is also the chief executive, it is essential there should be a strong and independent element on the board, with a recognised senior member”.42 However, the Cadbury Committee refrained from laying down any definite requirement as to separation of the chair and CEO positions, leaving the decision ultimately up to boards themselves in the light of the company’s specific circumstances and strategic challenges.

In a similar vein, the Hampel Committee in 1998 opined “that, other things being equal, the roles of chairman and chief executive officer are better kept separate”, although the committee acknowledged that “a number of companies have combined the two roles [of chair and CEO] successfully, either permanently or for a time”.43 While the ensuing 2000 version of the Combined Code emphasised that “the running of the board” and “the running of the company’s business” were the “two key tasks at the top of every public company”,44 the Code notably did not recommend that these functions should each be performed by separate officers in all companies. In fact, the only seemingly absolute expectations of boards in this regard established in the 2000 Code were that they: (a) publicly justify any decision to combine the chair and CEO positions in one person; and (b) ensure that they contain a robust independent non-executive element, in particular by appointing a special senior NED to act as the focal point for NEDs’ concerns in respect of the combined chair/CEO office and its consequences for the board.45

In spite of the somewhat ambivalent tone of Cadbury and Hampel’s recommendations on the issue of the chair/CEO split, the committees’ basic affirmative view on the matter nevertheless quickly became recognised as a highly influential tenet of British corporate governance best practice. From a study of 250 randomly selected UK-listed companies, conducted between 1998 and 1993, Franks, Mayer and Renneboog discovered that the chair/CEO roles were combined in 32 per cent of firms.46 But a further study by Conyon

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39 Notable examples from recent years include Wm Morrison Supermarkets plc, ITV plc, and M&S plc (on the last of which, see below).
40 Cadbury Report, n. 5 above, para. 4.9 (my emphasis added).
41 Ibid., para. 1.2.
42 Ibid.
43 Hampel Report, n. 16 above, para. 3.17.
45 Ibid., Code Provision A.2.1. The Hampel Report in fact went further than this and recommended that a senior NED should be identified in a company’s annual report in any event, both for those companies that split the chair/CEO positions and those that did not. See Hampel Report, n. 16 above, para 4.5.
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and Mallin found that, just two years after Cadbury’s initial recommendations (in 1994), this figure had been reduced to 14.2 per cent. Moreover, later data presented by MacNeil and Li showed that, in 2004, only 8 per cent of FTSE All Share companies (excluding investment trusts) were recorded as combining the two offices.

The general success of these early recommendations in engendering near-universal separation of the chair/CEO functions on listed company boards did not, however, discourage the Higgs Committee from asserting a notably more resolute line on the matter in the 2003 version of the Code, the relevant part of which has subsequently been adopted full-scale in the 2006 and (current) 2008 versions. Main Principle A.2 of the current Code, which deals with the issue of the chair and CEO, represents a progression from its post-Hampel predecessor insofar as it now affirmatively recommends “a clear division” between the dual responsibilities of board and executive leadership, as opposed to the Hampel Committee’s requirement that any lack of such division be supported merely by a reasoned justification plus effective “back-up” arrangements. Supporting Principle A.2, meanwhile, re-enforces this basic position by offering a brief description of the chair’s specialist responsibilities in the former of those regards.

The most definite assertion of the DoLR doctrine, though, is Code Provision A.2.1, which states unequivocally that “[t]he roles of chairman and chief executive should not be exercised by the same individual”, and that “[t]he division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board”. Code Provision A.2.2 firmly establishes, moreover, that “[a] chief executive should not go on to be chairman of the same company”. The only slight degree of leeway for boards on this issue is provided by the latter of those Provisions, which stipulates that “[i]f exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of appointment and in the next annual report”.

THE M&S FALLOUT

The Higgs Committee’s decision in 2003 to place the DoLR doctrine on a firmer prescriptive footing within the Code is understandable, given that its review was commissioned in the imminent wake of the Enron and Worldcom catastrophes in the United States when considerations of managerial accountability and NEDs’ supervisory


49 See Combined Code, n. 4 above.

50 Ibid., p. 7 (my emphasis added).

51 Ibid.

52 Ibid.
capabilities were thrust into the public and political eyes. Nevertheless, the specific degree of weight that should be afforded to the DoLR doctrine, relative to other Code norms and also to any extraordinary firm-specific circumstances, has become a topical issue of debate following the recent investor furore surrounding the promotion of M&S’s CEO Sir Stuart Rose to the dual position of the company’s executive chair.

M&S first publicly announced its decision in this regard on Monday 10 March 2008, after which the company’s then-chair, Lord Burns, compiled a five-page letter to the company’s major institutional shareholders outlining the board’s reasons for adopting this unusual governance policy. In his letter, Lord Burns explained that, since no single member of M&S’s current board had been with the company prior to the high profile boardroom “clear out” in 2004, both the nomination committee and general board were of the opinion that there was no viable internal candidate currently equipped to take over the CEO position, and that it was therefore “felt important to be able to create an environment in which internal candidates could develop over a defined period of time”. Lord Burns further explained that, while the possibility of the company recruiting an external candidate for the office had also been considered, the board’s conclusion was that during the present tumultuous trading environment this “was likely to be a damaging and unwelcome distraction at precisely the time that the business needed clear leadership to sustain its recovery and transformation”.

At the same time, aware that this course of action entailed deviation from Principle A.2 of the Combined Code, Lord Burns set out a list of “balancing controls” which he claimed would “mitigate the governance concerns that [a joint chair–CEO] structure might otherwise engender”, including (inter alia): (a) promoting the company’s current senior NED, Sir David Michels, to the position of non-executive deputy chair, in which capacity “he will chair the Nomination Committee, provide leadership for the Independent Directors, be responsible for monitoring Board Effectiveness and lead on Corporate Governance issues”; (b) creating a new senior executive position of group finance and operations director (to be filled by current executive director Ian Dyson) in order to reallocate a significant number of the executive chair’s previous day-to-day CEO responsibilities, thereby enabling Sir Stuart Rose “to concentrate on the strategic growth areas of the business”; (c) rendering Sir Stuart Rose’s three-year tenure as executive chair conditional upon annual shareholder re-appointment by way of a resolution to be passed at each subsequent AGM of the company; and (d) ensuring that the proposed new arrangement is only a “transitional governance structure leading to appointment of a new Chairman and Chief Executive by Summer 2011”.

55 Ibid., p. 3.
56 Ibid., p. 2.
57 Ibid., p. 4.
58 Ibid.
59 Ibid.
60 Ibid.
61 Ibid., p. 5.
Although a small number of M&S’s institutional shareholders such as Invesco Perpetual and Standard Life publicly supported the board’s unorthodox policy in this regard, the overall air of investor opinion in the press was one of hostility. In some instances this negative reaction was understandable, such as where Legal & General claimed to have been given only one hour’s notice of the company’s decision prior to its official public announcement, thus rendering impossible any effective process of consultation between the two parties prior to finalisation of the company’s policy in this regard. This is despite Combined Code Provision A.2 clearly requiring that the board consult (and not just inform) the company’s major shareholders in advance of any definite decision to amalgamate the CEO and chair positions. In other instances, however, the basis for investors’ antagonism towards M&S’s board was not so clearly comprehensible, and arguably suggested a fundamental misunderstanding from some quarters as to the precise normative status of the Code. For example, Peter Chambers, chief executive of Legal & General Investment Management, was recorded in The Times newspaper as saying:

We believe we have a moral responsibility to uphold corporate ethics in the UK and believe bellwether companies share this responsibility. We don’t believe M&S should be explaining why they are not complying. They should be complying.

In a similar tone, Schroder’s head of UK equities Richard Buxton reportedly accused the company of setting “an appalling example” on corporate governance by promoting its CEO in this way, despite M&S’s board having undertaken to provide a detailed written account to shareholders of its reasons for adopting this unorthodox policy.

“CLASH” OF CODE PRINCIPLES

While the basic proprietary entitlement of shareholders to form their own conclusions in respect of controversial governance matters should ultimately be respected, there is the risk that an overly conservative approach by investors towards policing compliance with the Code might pressurise boards to forego potentially value-adding “alternative” governance structures in favour of an inappropriate one-size-fits-all model. Indeed, the Preface to the 2006 edition of the Combined Code emphasises that, “whilst shareholders have every right to challenge companies’ explanations if they are unconvincing, they should not be evaluated in a mechanistic way and departures from the

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62 Invesco Perpetual’s Head of Equities Neil Woodford claimed that “[i]t is entirely appropriate for the M&S board to have taken the decision they have reached with regard to Stuart Rose”, in that “[i]t is especially important to create an executive structure that maintains Stuart’s leadership of the business but that also enables him to bring on successor talent such that at the appropriate time he can step down”. See M Donati, “M&S makes concession to appease shareholders”, Drapers Record, 3 April 2008.
63 See Z Wood, “This isn’t just any shareholder revolt . . . “, The Observer, 6 April 2008.
64 S Hawkes and P Hosking, “L&G given one hour’s notice of M&S decision to promote Rose”, The Times, 12 March 2008.
65 Although the board afterwards justified this deviation from proper Code procedure in its annual Corporate Governance Statement for 2008 on grounds of the risk of potential press leaks resulting from such private consultations. The statement is available to consult on the company’s website: www.marksandspencer.com.
67 S Hawkes, “M&S says it had to raise Rose to executive chairman role”, The Times, 4 April 2008.
69 This was the relevant edition of the Code in operation for most of the period of the M&S affair.
Code should not automatically be treated as breaches”. 70 Rather, “institutional shareholders should carefully consider explanations given for departure from the Code and make reasoned judgements in each case”. 71

Even on the assumption, though, that shareholders are prepared to evaluate carefully a company’s explanation for deviating from any Code provision and make reasoned judgments thereon, 72 there remains doubt as to the precise “high-level” considerations that should guide shareholders’ deliberations in this regard. In the M&S case, for instance, Lord Burns amplified in his letter to shareholders that “the Board has taken what it believes is the best decision for shareholders, cogniscent of its prime objective to ensure the Company’s ongoing commercial success.” 73 This point is expanded on by M&S’s board in its annual Corporate Governance Statement for 2008, where it explains in further detail how the new management structure will be conducive to stable and effective leadership for the ultimate benefit of the company and its shareholders. 74 The difficulty, though, is that, while the board is correct to recognise that promoting the long-term success of the company for the benefit of its shareholders is the board members’ over-riding positive legal duty as directors, 75 the criterion of “corporate success” is not expressly stated at any point in the relevant Code Principle (A.2) pertaining to the issue of division of leadership responsibilities.

The only reference in the Code to the “corporate success” criterion appears in Principle A.1, which deals with the separate (albeit not unrelated) issue of board leadership. Main Principle A.1 states that “[e]very company should be headed by an effective board, which is collectively responsible for the success of the company”. 76 Supporting Principle A.1 meanwhile expands on this by explaining that the board’s overall role “is to provide entrepreneurial leadership of the company”. 77 In explaining how this Principle had been applied in the context of their proposed restructuring plan, M&S’s board stated that “[t]he new structure will ensure continuity of leadership, strengthen the Board and streamline the organisation”, thereby “focus[ing] everyone on business performance during a period of significant trading uncertainty” while also “address[ing] investor concerns over succession”. 78

In contrast to Principle A.1’s dynamic “leadership” doctrine and its annex to the projected commercial benefit of the company, however, Principle A.2 is markedly more “static” in form. Under Main Principle A.2, the division of leadership responsibilities at the top of the company arguably appears to represent a worthy goal of the Code in its own right, regardless of any wider strategic factors that may justify temporarily sacrificing separate board vis-à-vis business leadership in favour of achieving concentrated entrepreneurial direction of the company. In other words, rather than being viewed merely as a procedural means towards the ultimate substantive end of ensuring effective board leadership and resultant corporate success, the DoLR doctrine is potentially construable as an independent policy goal of British corporate governance in itself. On this basis, investors might legitimately query the extent to which M&S board’s reasoned reference to “the Company’s ongoing

71 FRC, Combined Code, n. 70 above. This important statement is almost wholly reproduced in the revised Preface to the current 2008 edition of the Code, on which see nn. 94–6 below and accompanying text.
72 This assumption is, admittedly, somewhat tenuous: see FRC, 2007 Review, n. 68.
73 Burns, “Letter”, n. 54 above, p. 5 (my emphasis added).
74 M&S, Statement, n. 65 above.
75 By virtue of the directors’ statutory duty of loyalty under s. 172 of the Companies Act 2006.
76 Combined Code, n. 4 above, p. 5.
77 Ibid.
78 M&S Statement, n. 65 above.
commercial success”79 provided a truly valid justification for eliding separation of its chair and CEO functions, as according to the literal wording of the Code this ultimately entailed the board deploying one independent policy goal of the Code (effective leadership) to defend its non-fulfilment of another, apparently equally high-ranking goal (DoLR).

In justifying non-compliance with Code Provision A.2.1 in its annual Corporate Governance Statement, M&S’s board cited the proposed “back-up” arrangement that had previously been detailed in Lord Burns’ letter,80 most notably including the creation of a new non-executive deputy chairship position to provide an effective check on the executive chair’s power.81 However, investors might reasonably question whether even in this respect the board referenced a criterion of relevance to Principle A.2’s DoLR doctrine, since strictly speaking the deputy chair constitutes a senior independent director and therefore falls to be covered under the rubric of the separate Code Principle A.3 on the issue of board balance and independence. Main Principle A.3 provides that “[t]he board should include a balance of executive and non-executive directors (and in particular non-executive directors) such that no individual or small group of individuals can dominate the board’s decision taking”.

Code Provision A.3.3 further recommends that the board should nominate one of the independent NEDs to act as a senior independent director, echoing the previous recommendations in this regard which followed the Cadbury and Hampel Reports.83

In view of the fact that M&S’s creation of the Deputy Chairship position was achieved by promoting the company’s existing senior independent director (Sir David Michels) to this functionally more senior position, while retaining (and, moreover, strengthening) his status as the premier non-executive member of the board (outside the chair), it may be argued that for the purposes of the Code he should continue to be formally treated as the company’s de facto senior NED. According to this logic, the strengthening of Sir David Michels’ boardroom influence under the reorganisation should be treated primarily as a factor relevant to the achievement of boardroom balance and independence for the purposes of Principle A.3. On the other hand, this criterion is arguably of no direct relevance to the attainment of an effective division of leadership responsibilities for the purposes of Principle A.2, given that the role of deputy chair is not a leadership position in the strict sense of the term.

Therefore, even though the issue of board balance and independence is by no means far removed from that of DoLR, there is once again an apparent collision of equal-ranking Code Principles. In this instance, the achievement of a balance of executive and non-executive influence on the board (as required by Principle A.3) is effectively cited as a “defence” to the “charge” of failing to comply with Principle A.2’s DoLR norm. Further, since M&S’s board felt the need to explain Sir David Michels’ appointment at three separate points in the company’s annual Corporate Governance Statement84 in view of the perceived relevance of this criterion to each of the Code’s first three Principles (A.1–A.3), there resulted an inevitable degree of repetition of material which arguably diminished the intended narrative flow of the document.

79 See M&S Statement, n. 65 above.
80 See Burns, “Letter”, n. 54 above.
81 On this, see ibid. and text accompanying n. 58 above.
82 Combined Code, n. 4 above, p. 7.
83 On which, see, respectively, Cadbury Report, n. 5 above, and text accompanying n. 42 above; and Hampel Report, n. 16 above, and text accompanying n. 45 above.
84 See M&S, Statement, n. 65 above.
Potentially differing conceptions of an efficient board structure

Of course, the fact that non-compliance with any provision or even Main Principle of the Code (including the DoLR doctrine) is formally permissible when accompanied by a satisfactory explanation from the board theoretically means that, regardless of the precise wording or relative grading of different Code Principles, the criterion of corporate success (at least where effectively articulated by the board) will always “trump” any other considerations expressed within the Code. However, translating this theoretical position into the actual practice of compliance monitoring by shareholders is problematic on account of the absence of any common agreement amongst the investment community as to what actually signifies “corporate success”.

On one view, the success of a company may be equated with its entrepreneurial dynamism and resultant capacity for product market innovation. Such qualities would appear to be consistent with a board structure that facilitates concentrated strategic leadership unencumbered by onerous extraneous constraints such as a divided leadership structure. It is also likely, however, that investors will perceive a company’s propensity for success as being reflected in the extent to which its senior managers are willing to “bond” the stock market’s expectations by voluntarily submitting to an onerous board monitoring regime. In other words a company’s managers may choose to “tie their own hands”, metaphorically, in order to project a credible signal to investors that the latter’s wealth will not be expropriated or otherwise diminished through mismanagement of the business. Such a governance strategy may prove to be particularly valuable in companies where there exists either a significant informational deficit or serious absence of trust between managerial “insiders” and stock market “outsiders”, with the likely effect that investors will be unable or unwilling to accept with confidence the specific strategic reasons proffered by managers in support of a non-compliance decision as a credible justification for deviation from the Code.

Adopting this latter course of logic, the criterion of DoLRs becomes of paramount importance not only as a factor that is generally conducive to a successful corporate governance system, but also as an a priori determinant of managerial (and consequent corporate) efficiency in its own right. Therefore, insofar as Principle A.2 presents the DoLR doctrine as being an independent goal of the Code which, moreover, is on an apparent par with the Principle A.1 goal of effective leadership, one could reasonably be led to the conclusion that both Principles represent alternative (and potentially conflicting) conceptions of what constitutes an efficient board governance structure. It follows from this that to the extent a relatively uninformed or untrusting investor regards managerial accountability as being a more credible determinant of likely corporate success than entrepreneurial flexibility, they are entitled to regard Principle A.2 in effect as a mandatory managerial constraint regardless of any reasons that a board may offer in an attempt to justify temporary deviation from this norm.

86 On this, see n. 38 above and accompanying text.
87 On this concept generally, see n. 8 above and accompanying text.
89 The original exponents of the idea of the board of directors as a managerial “bonding” device were the financial economists Michael Jensen and Bill Meckling, who first advanced the notion in their pathbreaking 1976 article “Theory of the firm”, n. 36 above.
Re-affirming the practical relevance of “comply or explain”

The need for a “Macro-Principle” in the Combined Code

Although the recent approval by M&S’s shareholders of its controversial board reorganisation plans90 at the company’s 2008 AGM has put an (at least temporary) end to the recent controversy surrounding the company’s governance structure,91 this episode is by no means of academic interest only. On the contrary, the M&S debacle highlights continuing problems with the drafting of the Combined Code and, in particular, the Code’s arguably excessive level of prescription in certain key respects.92 As the M&S case vividly illustrates, this is a source of uncertainty not only for boards themselves in compiling effective and relevant explanations for non-compliance with any Code provision(s), but also for investors and their corporate governance advisors. The latter group is increasingly faced with the need to make difficult and uncertain judgments on the basis of necessarily limited information, equipped with a collection of confusing and, at times, contradictory yardsticks in the Code as to what constitutes a good governance structure.

To this end, the FRC has very recently implemented a moderate change to the Combined Code as an outcome of its 2007 review of the Code’s operation.93 The latest 2008 edition of the Code accordingly contains a revised and more detailed Preamble, which begins by amplifying the following two key considerations:

(i) Good corporate governance should contribute to better company performance by helping a board discharge its duties in the best interests of shareholders

(ii) Good governance should facilitate efficient, effective and entrepreneurial management that can deliver shareholder value over the longer term94

The new Preamble further makes clear that “[t]he Code is not a rigid set of rules”, but rather is “a guide to the components of good board practice distilled from consultation and widespread experience over many years”.95 It is therefore “recognised that non-compliance may be justified in particular circumstances if good governance can be achieved by other means”.96 This addition to the Code was prompted by concerns voiced as to the general level of detail in the Code today, and the consequent bureaucratic burden that the conformance process has come to entail for investors and boards alike.97 In particular, the

90 On these plans, see nn. 54–61 above and accompanying text.
91 On the other hand, the fact that 22% of M&S’s voting shareholder base either abstained from voting on, or else actively opposed, the resolution to appoint Sir Stuart Rose to the office of executive chair demonstrates the continuing high level of investor hostility in relation to this issue. See T Braithwaite, E Rigby and K Burgess, “M&S shareholders give Sir Stuart dressing down in promotion vote”, Financial Times, 10 July 2008. Indeed, in January 2009, Sir Stuart Rose was again asked to justify publicly his dual executive chair position in light of the company’s announcement of twenty-seven planned store closures following disappointing quarterly sales figures. In response, Sir Stuart reportedly advanced the colourful defence that “[i]f this was an aeroplane flying through a storm, I don’t think the best thing to do is shoot the pilot”. See M Leroux, “Rose spurns a pay rise as M&S cuts costs by £200m”, The Times, 8 January 2009.
92 On this, see nn. 72–84 above and accompanying text.
93 For the review itself and subsequent responses to the FRC consultation, see FRC, Summary of Responses, n. 68 above.
94 Preamble, Combined Code, n. 4 above, para. 1.
95 Ibid., para. 2.
96 Ibid. (my emphasis added).
97 As the Institute of Directors opined in its response to the review, for instance: “[m]any directors . . . consider that a disproportionate amount of their effort is directed towards compliance and conformance, rather than the strategic direction of the company”. See FRC, Summary of Responses, n. 68 above, para. 5.
FRC acknowledged in its review a number of requests from respondents for it to “emphasise that the primary objective of the Code is to support the board in providing entrepreneurial leadership of the company”.98

The above statements together represent a constructive addition to the Code, and should go at least some way towards improving the quality and commonality of dialogue between boards and investors in cases of strategic non-compliance. There is, nevertheless, some cause for scepticism as to how effective this change will prove on its own, absent any more thoroughgoing alteration of the relative weighting of the Code’s intrinsic Principles. Indeed, it is notably also stated in the revised Preamble to the 2008 edition of the Code that, where a board chooses not to comply with any of the Code’s provisions, it “should aim to illustrate how [the company’s] actual practices are consistent with the principle to which the particular provision relates and contribute to good governance”.99 The use of the word “and” (as opposed to “or”) here is significant in that it suggests boards should not attempt to justify an alternative governance practice (for example, a combined executive chair appointment) by reference to any determinant of “good governance” other than the relevant Code Principle itself (for example, the DoLR doctrine in Principle A.2).100 If followed literally by boards and their governance advisors, this particular statement would therefore appear to contradict (and hence undermine) the FRC’s expressed objective in revising the Preamble to the Code, which is to encourage a less rigid and more dynamic approach by boards and investors towards their respective tasks of compiling and evaluating companies’ annual governance statements.

Of course, it remains open to boards to attempt to justify non-compliance with any Code provision via reasoned reference to a term of the Preface itself. For example, M&S’s temporary executive/deputy-chair leadership structure is arguably a means of securing “efficient, effective and entrepreneurial management”,101 and this in itself is therefore a potentially acceptable justification for adopting such an unorthodox arrangement. However, an explanation phrased in these terms, regardless of its genuineness or quality, will be a highly risky strategy for boards given the absence of any express guidance in the Code as to the relative weighting to be afforded to the Preface vis-à-vis the Code’s intrinsic Principles and Provisions.

It is therefore submitted that there is a need for the FRC to give serious thought to the feasibility of implementing a more fundamental alteration of the Combined Code along the above lines during its next planned Review process in 2010. In particular, the FRC should consider the feasibility of establishing a unifying “Macro-Principle” of the Code, which might provide an objective basis upon which both boards and investors can evaluate and “grade” conflicting Code norms in the event that a proposed governance policy appears to put one or more Main Principles into conflict with one another. This could be achieved by elevating the normative status in the Code of Principle A.1 (board leadership) relative to Principles A.2 and A.3 (DoLR and board independence and balance). By reforming the lexical order of these three key Principles in this way, the FRC will vest boards with greater freedom to produce a comprehensive economic case for temporarily deviating from a standard (divided) leadership structure.

Rather than merely adding a further unwanted layer of prescription to the Code, such a reform will in fact provide a much-needed common criterion around which to structure

98 FRC, Summary of Responses, n. 68 above, para. 7.
99 Combined Code, n. 4 above, para. 5 (my emphasis added).
100 On this, see nn. 31–52 above and accompanying text.
101 Preamble, Combined Code, n. 4 above, para. 1., and text accompanying n. 94 above.
productive dialogue between boards and investors as to innovative strategies for application of the Code’s various Principles and Provisions. In this way, it promises to reduce the risk of costly misunderstandings occurring between both sides, which often have the effect of encouraging “blanket” compliance by boards with the Code’s provisions aimed at preempting potential public dispute and/or shareholder reprisal.\(^{102}\)

**Simplification of Corporate Governance Statements**

In its recent Review, the FRC acknowledged further comments from some respondents as to the arguably excessive reporting demands entailed by the dual “appliance” and “compliance” dimensions of the corporate governance statement. In particular, submissions were received to the effect that:

> the requirement in the Listing Rules for boards to state how they have applied the Code’s principles (as well as how they have complied with or explained its provisions) was adding unnecessarily to the “boilerplate” disclosures because it “is often interpreted as a requirement to explain how all 60+ elements of the Main and Supporting principles are applied”.\(^{103}\)

It was observed that, partly as a result of this, many companies were copying the same material in their corporate governance statements on a year-on-year basis with little regard to whether the discussion therein referenced factors of relevance to the company’s current situation.\(^{104}\)

Insofar as the corporate governance reporting obligation stems not from any provision of the Code itself but rather from the Listing Rules of the LSE, it falls outside of the FRC’s jurisdiction and instead within the remit of the Financial Services Authority (FSA) as the UK’s Listing Authority. The FSA has, however, recently taken it upon itself to tackle this issue within the purview of its implementation of EU Directive 2006/46/EC on company reporting. In essence, the directive inserts a new Art. 46a into the existing EU Fourth Company Law Directive, requiring all companies whose securities are admitted to trading on a regulated market in the EU to (inter alia) publish an annual corporate governance statement similar in key respects to that which listed UK companies are currently expected to produce by virtue of Listing Rule 9.8.6 (5)—(6).\(^{105}\)

Since, in relation to listed UK companies at least, the new European rule effectively gold-plates the existing domestic requirement for a company to publish an explanatory statement in respect of its compliance (or otherwise) with the Combined Code, the FSA has provided that a British company which complies with its current listing obligation in this

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\(^{102}\) Indeed, one notable factor conducive to a perfunctory box-ticking approach by investors and companies towards Code compliance is the potential for differing estimations by these two groups of the likely costs of compliance with any particular Code provision. As MacNeil and Li explain, “[a] high cost of compliance may well create an expectation within a company that investors would regard non-compliance as justified, but there remains the risk that the company’s assessment of this issue would not be the same as investors, not least because assessment of the cost of compliance is largely subjective”. See MacNeil and Li, “Comply or explain”, n. 48 above, p. 487.

\(^{103}\) FRC, *Summary of Responses*, n. 68 above, para. 47, citing a quote from the corporate governance lobby group Quoted Companies Alliance.

\(^{104}\) In response to the FRC’s recent review of the Combined Code’s impact, one company chair admitted that “the majority of the information contained in the corporate governance section is copied from year to year or plagiarised from somewhere else. There is neither time nor the appetite for discussion or debate about the quality of the content.” See FRC, *Summary of Responses*, n. 68 above, para. 43, citing a quote from Ian Paterson.

regard will be treated as immediately satisfying the corresponding EU requirement.106 But the EU-wide “comply or explain” principle is on a procedural level not as demanding as its UK counterpart insofar as the European rule requires only that a company discloses: (a) the particular corporate governance code to which it is subject; (b) the extent to which it complies with the provisions of that code; and (c) any reasons for non-compliance with those provisions. Unlike the UK requirement, though, the EU rule does not demand the publication of a further narrative “appliance” statement detailing the company’s policy in relation to application of the relevant code’s provisions as a whole.

Accordingly the FSA, in formulating its policy for implementation of the directive’s requirement in respect of the corporate governance statement, expressly considered removing the much-criticised “appliance” aspect of the domestic governance disclosure rule. This was for the dual purpose of bringing the UK regime into line with the basic standard applicable across the EC as a whole, while at the same time responding to the concerns raised by respondents to the recent FRC review about the tendency for boiler-plating of companies’ appliance statements.107

The FSA's final view on the matter was that it should retain the dual appliance and compliance components to the disclosure obligation, but that Listing Rule 9.8.6(5) should be slightly altered so as to provide expressly that the “appliance” aspect of the statement need only reference how the company has applied the Main Principles set out in s. 1 of the Combined Code, as opposed to the provisions of this part in general, as was the previously understood position under the rule.108 Listing Rule 9.8.6(5) has since been altered accordingly.109

The FSA's simplification of the corporate governance disclosure requirement will not resolve the difficulties faced by investors in evaluating the relative importance of seemingly conflicting Code Principles. However, it will give boards greater freedom to explain how their governance arrangements achieve the general outcomes expected by the Principles, unencumbered (at least in the first part of the statement) by the need to link the company’s policies in respect of each Principle to the more detailed Code Provisions underlying that general norm. As such, it should be welcomed as a constructive, albeit incomplete, move in the direction of enhancing the characteristic flexibility of the Code’s application, which should in turn help to mitigate the effect of the increased prescriptiveness of its key governance Principles.110

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106 This is by virtue of the new Rule 7.2.4G of the FSA's Disclosure and Transparency Rules (DTR), which expressly provides that “[a] listed company which complies with LR 9.8.6R(6) (the comply or explain rule in relation to the Combined Code) will satisfy the requirements of DTR 7.2.2R and 7.2.3R [i.e. the obligation to include a comply or explain statement in its annual corporate governance statement as required by the EU Fourth Company Law Directive]”.


109 Listing Rule 9.8.6(5) now states that, “[i]n the case of a listed company incorporated in the United Kingdom . . . its annual financial report [must contain] a statement of how the listed company has applied the Main Principles set out in section 1 of the Combined Code, in a manner that would enable shareholders to evaluate how the principles have been applied” (my emphasis added). In the previous (pre-2008) version of the rule, the highlighted term “Main Principles” read merely “Principles”, which was deemed to give an insufficiently clear indication of in relation to which specific level(s) of the Code’s norms a company’s board was required to explain its appliance strategy.

110 For an example of this last trend, see nn. 49–52 above and accompanying text.
Conclusion

It is hoped that this article will contribute towards the continuing policy debate in relation to the future development of the UK’s corporate governance regulatory regime and, in particular, to the FRC’s next-planned review of the Combined Code in 2010. In any event, it should be emphasised that, however regulators choose to proceed in this area in future, they must resist the temptation to respond in a knee-jerk manner to the recent turmoil in international financial markets by proposing either increased prescriptiveness of the Code’s substantive provisions, or else further formalisation of the method for its enforcement.111

As the experience of the controversial Sarbanes-Oxley legislation in the United States has illustrated, there are no guarantees that such a step will be conducive in the long run either to a more attractive investment environment, or to more accountable or responsible corporate management.112

In the context of these concerns, it is therefore reassuring to note a comment by the FRC’s chief executive Paul Boyle that, in the council’s belief, “the recent difficulties in the financial sector do not require a general tightening of governance standards across the UK corporate sector”.113 It is submitted that, for the reasons set out above, such a cautious approach towards reform of the current regulatory environment should be strongly encouraged. Moreover, any future suggestions for reform of the Code should be focused towards the goal of enhancing, rather than encumbering, the capacity of the Code to engender effective, performance-enhancing board structures on an individual company level. This is because a truly dynamic and company-specific system of compliance monitoring, far from undermining managerial accountability, will on the contrary provide boards with a greater incentive to take their company’s annual corporate governance statement seriously, instead of viewing it as a mere bureaucratic inconvenience bearing little relevance to the company’s “real” business affairs.

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111 Ferran argues that “[a] system of corporate regulation tailored to the needs of modern business should, ideally, combine elements of both [command and control, and responsive or reflexive regulation], but with a preference for responsive regulation wherever there exist effective incentives to generate a culture of compliance amongst market participants”. Ferran, “Corporate law”, n. 19 above, p. 385 (my emphasis added).

