Part I: The Company in a Modern Economy

Main Proposals

Chapter 1: Guiding Principles, Methods and Output

Chapter 2: A New Regime for Small and Private Companies

Chapter 3: The Modern Company: Internal Governance and External Regulation
1.1 This is the Final Report of the Steering Group formed in 1998 to undertake a fundamental review of company law in Great Britain.

1.2 Part I of the Report is designed to outline for the general reader the main features of our proposals. In it we explain the background to the Review, our approach and working methods and set out the core proposals which have resulted.

1.3 The Review was launched by Margaret Beckett, then Secretary of State for Trade and Industry, in March 1998. Its purpose and terms of reference (reproduced at Annex A) were set out in the DTI consultation paper *Modern Company Law for a Competitive Economy*. The purpose was to create a framework of company law which promoted the competitiveness of British companies, struck the proper balance between the interests of those concerned with companies in the context of straightforward, cost-effective and fair regulation, and promoted consistency, predictability and transparency in the law. Our approach to these objectives is set out below.

1.4 Our remit did not extend to certain closely related areas, particularly insolvency, financial services and charities, though we were expected to take due account of the interface with these areas. Nor did it extend to co-operatives (industrial and provident societies) and building societies.

1.5 The March 1998 paper also emphasised the importance of the widest openness and consultation. We have made this an essential part of our approach. We explain more fully how we have done so in the description of our working method below. We have published nine separate consultation documents, listed at Annex F, and a range of other information generated by or provided to the Review, listed at Annex G.\(^1\)

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\(^1\) All of these documents are available from the Review pages on the DTI website; the address is: www.dti.gov.uk/cld/review.htm.
1.6 The Review has had four phases:

(i) up to publication in February 1999 of our first consultation document, *The Strategic Framework*, which set out our intended overall approach and direction, analysed fundamental issues for consultation and outlined the subsequent programme of work;

(ii) the phase leading to publication in March 2000 of *Developing the Framework*, which analysed and made proposals on the key areas of corporate governance and small and private companies;

(iii) the stage resulting in *Completing the Structure*, published in November 2000, which took forward the *Developing the Framework* proposals, revised them in the light of responses, invited further comments on issues emerging and set out new proposals; and

(iv) the final period to the publication of this Final Report, which includes our consideration of the last major consultation and summarises our conclusions generally.

1.7 During the Review we have examined all the main components of company law and have reached firm views on almost every major question. It is not possible to include in this document a full treatment of all those matters without making the document unmanageably large. We shall therefore refer throughout to our earlier documents where our views are already sufficiently recorded there.

1.8 In the rest of this Chapter we:

- explain the main guiding principles which have underpinned our work, and by reference to which it needs in our view to be judged;

- describe the working method adopted to develop and test our proposals; and
Guiding Principles, Methods and Output

briefly summarise the three sets of core policy proposals which animate our main conclusions.

1.9 These core policy proposals are then outlined in Chapters 2 and 3.

Guiding Principles

1.10 We start with the general principle that company law should be primarily enabling or facilitative – i.e. it should provide the means for those engaged in business and other corporate activity to arrange and manage their affairs in the way which they believe is most likely to lead to mutual success and effective productive activity.

1.11 But this does not eliminate the need for legal and other regulatory intervention. Such intervention may be required for any of four main reasons:

- because the desired legal result cannot be achieved without legal provision to define it and make it effective – a legally defined facility is required with appropriate conditions for access to its advantages; the concept of corporate personality, at the heart of the company as an economic device, is a key example;

- because the result sought is so predictable that it makes sense for the law to provide a ready made, but optional, (“default”) solution – for example by the provision of a model constitution, or standard rules for controlling particular transactions, like share issues; where particular protections should only be abandoned with caution, procedural requirements for doing so may need to be more stringent;

- because there is, or may be, substantial risk of market failure, so that protections for the party unable to protect himself through his own choices, actions and remedies are required – examples include protections for shareholders against abuse by directors with a personal interest in company transactions, and many mandatory transparency provisions designed to enable parties to take the appropriate action if they wish; and

2 For an initial statement of these principles as adopted during the first phase of the Review, see The Strategic Framework, Chapter 2.
because there is a public interest in the activity in question which requires that those involved respond to wider demands – perhaps the leading example is the long established requirement that companies publish information about the way in which their economic powers have been exercised, not just for shareholders and creditors, but for the public at large; a further obvious example is the outlawing of fraud and other dishonesty.

Competitiveness and Modern Economic Needs

1.12 Thus legal facilities require conditions for their availability, rules to prevent their abuse and rules to protect legitimate public interests in the activities concerned. But the main driver in designing these conditions and rules must be to provide the means for effective collaborative business activity and in particular effective generation of wealth, in the broadest sense. This demands that British companies be competitive, in the sense that they exploit resources in the most efficient way possible to generate such wealth, and that they contribute to an internationally competitive economy. Company law has a significant role to play here, and it needs to be assessed and justified according to its effectiveness in meeting this objective.

1.13 Company law is also a factor in wider international competitiveness. Globalising markets provide real choice as to where to locate economic activity and which jurisdiction to adopt. Our company law needs to be internationally competitive, to ensure that we retain our existing companies and attract new ones. While the economic activity associated with a particular company can increasingly be located anywhere, the place of incorporation still benefits from significant related activities, particularly financial and professional services and activities surrounding top management. However, we need attractive conditions not only for company management and operation, but also for investment. Companies are also both direct users of company law and affected as trading bodies by its application to others. In our work the

3 Favourable conditions are required not only for those who establish here by incorporating or forming local subsidiaries but also for those who prefer to establish branches of an “oversea company” incorporated elsewhere. The need for clear, helpful but fair provisions in this area is addressed in our consultative document Reforming the Law Concerning Oversea Companies, and in our proposed draft clauses in Part III.
generalised call for deregulation has often been opposed by companies themselves, including small companies, which recognise the benefits for them of a disciplined trading environment. International competitiveness and jurisdictional competition do not, therefore, lead inevitably to a “race for the bottom” in standards of regulation. High, good quality, standards of regulation are of value to companies directly and improve their operating environment.

1.14 In the context of international competitiveness we have taken particular account of developments in company law overseas and of the measures adopted, or in prospect, in the European Union. We have learned much from such comparison and there are frequent references to it in our earlier documents\(^4\). The main outstanding considerations in relation to the EU are set out in Annex B.

**Freedom with Transparency**

1.15 We believe that, because effective economic activity is most likely to be brought about by free economic choices based on assessment of the widest possible range of relevant information, the basic framework of our law should provide the maximum possible freedom to the participants, but combined with the necessary supporting transparency to empower the effective exercise of that freedom within an appropriately framed and disciplined decision-making structure.

**Regulation, Deregulation and Abuse**

1.16 Every provision in the Act thus requires examination by reference to its effect on productive activity in modern conditions, and with an initial presumption in favour of freedom for effective decision-making, along with the necessary transparency. We have therefore been

\(^4\) Such references are too many to list here. But see for example, generally, *The Strategic Framework*, Chapter 2 with Annex C and Professor David Milman's report on our website on Europe (community and national aspects), and Chapter 3 (The Comparative Dimension), and ibid. 5.1.31 to 33 (pluralist systems), 5.2 passim with Annex E (small companies), 5.6.14 (incorporation theories in Europe and the US), and 8.12 (review institutions). In *Developing the Framework* see for example paragraph 3.32 and following (directors’ duties) and the extensive work of the Law Commissions on this subject. Overseas systems were examined in detail on several other topics, including capital maintenance, groups, reconstructions and minority remedies. See too the names of numerous experts on various national systems whom we consulted, listed in the Annexes to our documents.
keen to strip out requirements which no longer seem necessary, and – in general – to aim for a framework which is as simplified as possible. The result of this scrutiny has often been deregulation; but we have not regarded our task as simply one of deregulation. In some areas we have proposed additional rules to ensure that markets can work more effectively. In others we have identified patterns of abuse which disrupt and add cost to effective economic activity and have again proposed additional rules which restrict economic freedom to the extent necessary to prevent such abuse. We also recognise that abuse may lead to a more indirect and intangible threat to our economic system – the loss of public confidence in the legitimacy of the exercise of the huge economic powers which are involved. It is right and in the longer term interests of the economy that the law should respond to these concerns, and we have made appropriate recommendations where this need arises. In short, we have sought the right regulatory balance rather than simply to deregulate; nonetheless the net effect of our proposals is one of substantial simplification and deregulation.

1.17 In The Strategic Framework we expressed a presumption in favour of removing criminal offences where possible and relying on private law or market enforcement. While we propose removal of a number of such offences altogether, and a number more in relation to certain defendants, we have been impressed by the views of expert practitioners about the efficacy of the criminal enforcement process, particularly in the regulatory field. A substantial body of evidence from government and beyond has supported those views and we no longer anticipate root and branch decriminalisation. It is right that there should be a heavy onus on those seeking to justify such offences, but we believe the case has been made.

Accessibility, Coherence and Codification

1.18 It is not only the policy content of the law which should encourage efficient behaviours. It must also be expressed in a form which effectively promotes compliance, and makes such compliance as easy as possible. This requires effective communication, both direct and through various forms of intermediation. Otherwise the law gives rise to significant cost, uncertainty and risk. Simplicity and clarity of language and structure, an awareness of the needs of the users and
an understanding of who they are, are necessary. Such accessibility has been a theme running throughout our deliberations.

1.19 To achieve this we must make use of the full range of types of legal rules, sanctions and mechanisms for enforcement. These range from detailed, precise, substantive rules with specific sanctions, to broader, more imprecise but adaptable principles, to facilitative or “default” rules, and transparency requirements (with or without obligations to justify the matters disclosed). We must also make the most effective use of the different methods of rule-making, from statute, to delegated rule-making, to devolved and co-regulatory structures and codes of practice, contractual or advisory. We have taken careful account of all these aspects and attach particular importance to the choice of the correct mix of these law-making techniques in this complex and fast moving field.

1.20 The growth and effectiveness of non-statutory codes, first in the area of takeover regulation and more recently in the area of company governance, is an important and valuable feature here. We have been particularly concerned to ensure that the strengths of this method of organising corporate affairs, particularly the flexibility, expertise and responsiveness to real needs which it allows, are fully exploited and reflected in the new approach.

1.21 We have also been concerned to examine the whole of the law, and not just the statutory field. Our company law represents the output of a century and a half of continuous statutory development, with the original model overlaid by a series of subsequent reforms which have not always fitted well with the original framework. This statutory structure is itself an overlay on a mass of case law, much of it still in operation, and going back, in some cases, centuries further, deriving from the old common law of agency, contract, property law and trusts. This body of law, much of it devised for quite different purposes but adapted by numerous court decisions over the years for the then current business conditions, remains largely in place. It is inevitable, indeed desirable, that this common law development should generally continue, and the case process has produced great flexibility and depth; but in some key areas it has produced major uncertainties.
and complexity. The case law process is capable of producing robust frameworks of law representing the distilled wisdom of argument over varied factual contexts. But it is not satisfactory that basic rules of business operation and organisation should only be capable of being extracted from a historical examination (often open to costly dispute) of centuries of decisions, often made in widely different and outmoded contexts. In such areas we have judged it right to propose statutory restatements, or codification, often based on significant simplification, or more radical reframing, of the common law rules. One of the results of our open, multi-disciplinary approach has been that many of these areas have been exposed to scrutiny by business people and economists. Their impatience with the complexity and uncertainty of the common law position, often combined with a surprised dissatisfaction with its substantive effect, has encouraged us to propose codification and reform in a range of areas where the common law is of central importance and of less than acceptable accessibility, certainty, simplicity or substantive quality.

1.22 We recognise that there are risks in this approach: statutory language has a perverse life of its own and legislative restatement is less easy to change or override than case law. These risks have led some, but by no means all, of the lawyers commenting on our proposals to oppose such codification in some areas. But we are satisfied that, if the work is done in the appropriate style, and if the substance is fully tested by consultation (which has been done, and which we hope will continue), the benefits, which are perhaps most apparent to those with a practical business or economic perspective, hugely outweigh the risks.

**Modern Asset Mix**

1.23 Effective management and control of resources requires a decision-making process which takes proper account of all the factors relevant to the outcome. In the modern economy these factors have become very wide in scope. While the substantive law is in most cases (for example in the area of directors’ duties) generally well capable of addressing such modern conditions, it is not widely recognised or understood how it does so. Relevant factors include the need to manage relationships with employees, with suppliers of all kinds of resources – physical, intangible and intellectual – and with customers, both direct and indirect. They include the need
Guiding Principles, Methods and Output

to manage wider impacts on consumers, the community and the environment. Reputational assets are also of critical importance in a world where external perceptions can transform business prospects, for better or worse. This is true for all kinds of companies in modern economic and social conditions; but the impact of these factors will of course vary widely from company to company. The law must reflect these changing realities in a flexible way.

1.24 All these constituencies can impact, positively or negatively, upon a company's success, and this should be reflected not only in the operational rules but also in the basis of accountability for stewardship. Companies, whether consciously or not, are managing as part of their everyday operations a wide range of resources and assets beyond the traditional balance sheet fixed assets cash and investments, in the shape of accumulated human resource and know how, intellectual property, brands, ongoing relationships, plans and strategies and other wider reputational assets. Yet at present, many of these are not reflected fully or at all in the rules for company reporting on which effective discipline of stewardship and wider accountability should be based.

1.25 These factors are of critical and growing importance for all companies in the modern economy. The rules and standards applicable both to management decision-making and to accountability need to reflect and make proper allowance for these criteria for success.

Company Structures

1.26 British law gives greater flexibility to the founders and controllers of companies to design and structure their businesses to suit their needs than any other legal system of which we are aware. We believe this is a great strength, which is likely to prove a major competitive advantage in a period of increasing change in technology, markets and business practice. We have sought to preserve it, whilst ensuring that – mainly through transparency and operation of market forces – means are in place to ensure that such freedom is exploited optimally in the conditions of the time.

1.27 The overwhelming majority of British companies are small, private and largely owner-managed. These businesses are the source of much of our economic growth and employment and
some of them should be the new great public quoted global companies of the future. We all depend heavily on their success. It is crucial that the law provides an optimal framework for the establishment, efficient operation and development and growth of these companies.

Methods of Regulation

1.28 We stressed at the beginning of the Review that a premium attaches to optimising the shape of the law-making function in this area. Issues of politics and principle arise here; but the critical factors in designing a regulatory framework are in our view the quality of the output and the needs of the users. Much of company law is of real economic significance, but highly technical and detailed in character and only fully understood by specialists and professionals. Much of it is not appropriate for primary legislation or is best adopted in a form where primary legislation sets the broad framework but where it can be amended flexibly to respond to developing conditions. Primary legislation alone is not sufficiently fast-moving or flexible to be able to respond to the need for change in the field. If our law is to be competitive and effective we believe that a delegated and “devolved” structure of subordinate regulatory rules and best practice codes is essential, along the lines we propose below. Appropriate systems of institutional governance will be required to ensure that the powers which inevitably go with reliance on expert rule-making and responsiveness to changing economic demands are not abused or misapplied.

Technology

1.29 Electronic communications hold immense potential to speed up and enrich the processes of company governance and regulation. In particular Internet publication provides instantaneous, cheap and non-discriminatory access to company information of all kinds. We recognise that in some cases reliance on the Internet excludes those who do not have access to it; but its virtues are so great that it cannot be neglected as a means of improving company communication. Other methods will still be required to provide the best possible service to the “unwired”, though they are a decreasing proportion of the investing and commercial community.

6 See The Strategic Framework, Chapter 8.
1.30 There are two functions for the law in this connection. The first is to remove the inhibitions which currently limit communication to face to face meetings or written hard copy documents. We made recommendations on this in our first consultation document and Parliament has already passed the Electronic Communications Act 2000 together with an Order enabling electronic company formation and distribution of accounts, annual reports, meeting notices and proxy forms. We make recommendations below to promote the use of electronic communications in other fields.

1.31 But the second area where electronic communications has potential is where the law creates no inhibitions but market practice has not yet moved to adopt the technology, often because to do so requires agreed methods and protocols for inter-communication, as in the case of shareholder vote execution. In this area it will be important to ensure that the appropriate institutions are in place to provide the necessary guidance and stimulus for the adoption of agreed solutions, or, in the event of market failure, to impose them.

Continuity and Radicalism

1.32 Change in company law has very substantial costs and risks. The vast majority of the million or so registered companies are small and rarely take professional advice. When they do so, it will typically be from a local accountant or solicitor who cannot reasonably be expected to be an expert in the implications of complex legal change. Change in company law can therefore be expected to have substantial one-off costs for small business. Major changes may not be adopted at all without disproportionate enforcement effort, or until something goes wrong in a particular company. Change in laws relating to company governance and the relations between shareholders and directors will affect expectations and vested rights in existing companies on which the security and certainty of the wealth creation process depend.

1.33 On the other hand, applying new rules only to newly formed companies creates in law two classes of company with consequent discrimination, distortion and confusion.

7 See The Strategic Framework, Chapter 5.7.
1.34 These considerations put a premium on change which is devised so as to impose the minimum incremental cost and disruption. This can be done in three ways in particular – through “self-enforcing” disclosure requirements; through provisions which will only operate in circumstances where there are disputes, where the law can be expected to be engaged, and which provide resolutions which are consistent with reasonable expectations; or through development of existing best practice, with which well informed and properly run businesses are familiar. This last approach animates our key proposals on directors’ duties (which largely follow the best view of the current law and the best practice of leading companies), the OFR (which is based on ASB guidance, already widely followed by the best run companies) and the institutional structure for law-making and enforcement in the disclosure field (where we adopt and modify the structures and approach of the present FRC, ASB and FRRP). In all these cases we propose an organic development of practices and behaviours which are already in place.

1.35 It is of course right to have careful regard to the costs associated with change. However, these costs are transitory, and it is reasonable to expect companies to bear them if the changes are appropriately engineered to minimise cost, if the consequent benefits – which will be enjoyed indefinitely – are substantial, and if one can be confident that they will accrue.

Our Method

1.36 It is of value to describe briefly our working methods. They form an important means of assessing the acceptability and validity of our proposals.

1.37 The work we had to cover was of very great scope and complexity, and the time available very limited for such a task. So we sought to devise a working method which brought together early in the process the widest range of expert opinion possible, to identify major problems, deploy expertise and judgement in devising solutions and to test those solutions from all perspectives as part of an integrated process.

1.38 In all the major areas under review we relied on working groups, chaired by a member of the Steering Group, to identify issues and bring forward proposals. There have been 14 working groups in all with a number of subgroups to consider particularly specialised, detailed,
or technical issues. The composition of these groups and their terms of reference are described in Annexes to *The Strategic Framework, Developing the Framework, Completing the Structure* and in Annex E to this Report\(^8\). Overlaps and interactions between their work were inevitable. Coordination and overall management of the work programme was provided by the project director. The Steering Group reviewed all minutes and received regular progress reports from chairmen.

1.39 Participation in working groups was invited from individuals identified as having important expertise, perspectives or opinions on the issues under discussion, with a view to achieving effective reflection of a wide range of points of view. Members were normally chosen who had access to organisations or networks on which they could draw for support and criticism of their group's views as they developed. Members were asked not to adopt representative positions but to express openly their personal and expert views on the issues under examination. Members agreed to act on the basis that discussions and possible conclusions were unattributable, but that the issues raised could, and indeed often should, be openly discussed beyond the group.

1.40 In some groups agreement was not reached on some issues, but in all there was very valuable generation of possible solutions and the effect of multi-disciplinary discussion was to generate significant movement in opinion and towards consensus. (This kind of solution and consensus building also took place within the Steering Group itself; it is a discipline we would wish to perpetuate in the *Company Law and Reporting Commission* – see below.)

1.41 In all cases the Steering Group was very strongly influenced by the reports from these groups; but in some there were unresolved issues which we resolved within the Steering Group; and in a few we found arguments persuasive other than those which achieved a consensus within the working group. Thus we have not always simply adopted working groups’ conclusions. But all our major conclusions have been thoroughly tested in such groups or, in the few cases where proposals have not withstood wider exposure, in subsequent consultation.

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8 Our programme of empirical research is also described in those documents. The major further project in the final phase of the Review has been *The Industrial Society* project on the OFR – see Chapter 8. An invaluable review of the literature was prepared for us by the ESRC Centre for Business Research, University of Cambridge. This is published on our website.
1.42 Key issues and emerging proposals, including drafts of major consultation documents, were also debated in the Consultative Committee. This was a very broadly-based group which included representatives from a wide range of perspectives and interests. Throughout the Review it has provided a forum for debate in which to test proposals before publishing them for wider consultation. We are very grateful for the work of this group, which has been extremely valuable.

1.43 All the major issues we have addressed have been analysed, and our proposed solutions to them explained and argued, in at least one published consultative document. Respondents have thus had at least one opportunity, and in the most important cases two or three, to give us their views. In some cases consultation has led us to change our views and revised proposals have been presented for further consultation. In a very few cases such revised views are included in this Final Report for public consideration for the first time. We would expect the DTI to seek further views on these. But in all but a very small minority of cases our views have been thoroughly tested and consulted upon, and we are confident that no further consultation is needed (except on the draft legislation).

1.44 Some hundreds of responses were received on each major consultation. The Review Team produced a digest of these responses by reference to each question, as asked in the consultation document, thus enabling us to review the evidence on each of our proposals in a systematic and accessible form. These digests, excluding confidential responses, are published on our website.

1.45 We assessed responses according to the weight and expertise of the body responding and according to the force of the arguments deployed. In the overwhelming majority of cases we found the great majority and weight of responses either supported our views, or deployed such compelling arguments that we were led to change our views in their direction. On a few occasions we found the views of a smaller majority compelling. We have been conscious of the need for a legislative project of this scale and significance to command the support of a substantial consensus of qualified opinion on the overwhelming majority of its proposals. But we have not felt constrained to change our views of the substantial merits in order to mobilise such a consensus on any major issue.
1.46 The result is that practically all our proposals are supported by a substantial majority of respondents\(^9\). In the rare cases where this majority support is not overwhelming there are typically as many who criticise our proposals on the ground that they do not go far enough as criticise them for going too far. In only one area (company charges) is opinion so divided that we have not been able to proceed on the basis of a consensus of opinion and reasoning in which we have confidence.

Output

1.47 We have sought to achieve a complete set of viable proposals on major policy issues for replacing the whole of the Act and those parts of the common law which we believe should be codified and/or reformed. We have gone into sufficient detail on these on the basis of the open working method described above to have a high degree of confidence that they will work.

1.48 However, in this field absolute confidence can only be achieved when the full range of detail is worked out. In some key areas where such technical viability is likely to be of real concern we have asked the Review Team to prepare instructions for drafting. We have been very fortunate to have had seconded to us for the last year of the Review a member of the Office of Parliamentary Counsel who has carried this drafting work forward in recent months.

1.49 Full detailed policies and some illustrative draft clauses have thus been worked out on company formation, capital maintenance, oversea companies, directors’ duties and some key elements of the “think small first” regime. This has led to some minor changes in policy and the resolution of a significant number of new lower order policy issues in these areas, but no major difficulties with our proposals. This work has enabled us to test the effectiveness of our method, to expose the style of our proposals in some important areas in the form of final legislative output (though of course these clauses are not Government proposals) and enabled us, and the DTI, to assess the scale of resources which will be needed to complete the project. That scale is substantial.

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\(^9\) The very few and relatively minor exceptions have been identified in our consultation documents. The main exception in this document is the recommendation in favour of codification of the unanimous consent rule – see paragraph 2.14.
1.50 There are just a few areas where we have failed to achieve this level and quality of output. The most important is that of company charges, where the Working Group reached provisional views in the light of one consultation (itself showing no consensus on a wide range of critical issues) which are so radically different from earlier proposals that further confirmation of their viability is necessary (see Chapter 12). Work will also be necessary on detailed areas of the Act not covered so far by the line by line scrutiny which is required in the preparation of instructions to the draftsman. In these areas we may expect some change to our proposals and the raising of new issues of a low order, as has happened on the preparation of clauses so far.

1.51 But, with these minor exceptions, we regard the work of developing reasonably detailed and viable policy proposals on the whole of core company law as essentially complete.

Three Core Policies

1.52 The results of this approach and working method can be seen in the three core policy proposals which form the basis of our recommendations:

- the “think small first” approach to private company regulation and legislative structure;
- an inclusive, open and flexible regime for company governance; and
- a flexible and responsive institutional structure for rule-making and enforcement, with an emphasis on transparency and market enforcement.

“Think Small First”

1.53 Simplification and accessibility lie at the heart of our proposals for small companies. Most small private company managers never consider the law except for the annual reporting cycle and in major crises of governance. The law should correspond to the reasonable

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10 Similarly, the area of company seals raises far-reaching issues of property law included in a recent examination by the Law Commission; these go beyond our terms of reference and the expertise accessible to our working method. However, we hope that it may be possible for the DTI to carry forward the Law Commission work as it applies to corporations in the context of this Review.
expectations of honest business people, so that they do not unwittingly fall foul of the rules, and to ensure that where a crisis does occur, the outcome provided by the law is acceptable, not unexpected, and not disruptive.

1.54 We propose to simplify the law for all private companies, removing unnecessary detail and excessive regulation. In particular, we propose easier decision-making processes, with a more flexible written resolution procedure and a codification, clarification and extension of the unanimous consent rule, which enables members by agreement to do or decide anything which the company has power to do. Codification will provide greater certainty and clarity, particularly for small companies, providing statutory recognition for common law procedures frequently used by small companies (although, we suspect, often in ignorance of the common law rules or the limits to them).

1.55 We also propose that the law for private companies should be redesigned to suit the needs of the overwhelming majority which are small and owner-managed, while leaving it workable for larger ones, but readily adaptable for their more sophisticated needs, and through their greater resources.

An Inclusive, Open and Flexible Scheme of Company Governance

1.56 Basic principles on the operation and control of companies should, so far as internal governance is concerned, be common to all companies. Our general principles lead us to propose three main components:

- an accessible codified statement of the general duties which directors owe to their company as managers and monitors, embodying a modern, inclusive view of the range of decision-making and objective standards of professional care and skill, tailored to the role of the individual director;

- fuller, faster disclosure for all companies and, for large companies with significant economic power, a regime reflecting stewardship of assets and relationships which are of real importance in the modern economy, with public accountability for these; and
• a sharper focus on the shareholder, with first, increased facilities for direct recognition,
in companies with a complex ownership structure, of the “real” shareholder with rights
to control and influence decision-making, and second, more flexible mechanisms for
company meetings and better provision of information.

1.57 This will enhance shareholder powers, which are already exceptionally wide and
effective in Britain. But it will be accompanied by an increased scrutiny of the responsible
exercise of these powers, together with transparency and accountability for fiduciary institutional
investors managing funds on behalf of, and at the risk of, ultimate savers and pensioners. Such
investors and their associates are major providers of services to company managers, while now
substantially controlling almost all major quoted companies. Our prosperity depends heavily on
the active and responsible exercise of their powers.

A Flexible, Responsive Institutional Structure

1.58 Our terms of reference and our principles stress the need for appropriate law-making
and enforcement structures, with the right forms of law and law-making and the right institutions
to promulgate and enforce the resulting rules.

1.59 These apparently technical matters are at the centre of our proposals for ensuring that
the law properly reflects the current needs of business and continues to do so. This requires the
right mix of sources of law:

• primary legislation from Parliament;

• secondary legislation by Ministers, under Parliamentary scrutiny and control;

• devolved rule-making by bodies recognised through primary legislation as appropriate;
  and

• self regulation and best practice adopted by agreement or recognised custom.

1.60 It also requires the right mix of forms of law: substantive law, with criminal or civil
sanctions; or transparency rules, which leave the market to exercise its disciplinary role in
response to disclosure, whether pure disclosure as in company accounting, or the more challenging “comply or disclose” form of the Combined Code.

1.61 Our proposals demonstrate a general presumption in favour of devolved rule-making and transparency combined with market forces wherever the subject matter allows. Primary legislation should set the broad framework and general principles. For reasons of accessibility it should also include the essential narrative which provides coherence. But where flexibility is important – for example to respond to changing markets, business practices, or technology – devolved rule-making is essential to ensure responsiveness and to adapt the structure to developing needs.

1.62 These three core policy proposals are outlined in more detail below: “think small first” in the next Chapter and our proposals on governance and the institutional structure in Chapter 311.

11 The main components of our proposals for small companies and on governance have already been set out in detail: on small companies see The Strategic Framework Chapter 5.2, Developing the Framework Chapters 6 and 7, and Completing the Structure Chapter 2; and on governance, see The Strategic Framework Chapters 5.1, 6 and 7, Developing the Framework Chapters 2 to 5, and Completing the Structure Chapters 3 to 6. Possible approaches to institutional issues were first exposed last November: see Completing the Structure Chapter 12; see too The Strategic Framework Chapter 8. Detailed final proposals are covered in Part II, see Chapter 5 below.