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Is the 'Modernisation' of Company Law a Threat to Employee Voice within the Enterprise? A British Perspective

By Simon Deakin

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1. Introduction

In comparative studies of corporate governance, the British model is normally presented as one in which managers act as the agents of shareholders when taking decisions on the structure of the enterprise, leaving employee representatives with a marginal influence, at best, over such decisions. In practice, this 'agency model' is qualified in the British case by principles of company law which provide managers with some autonomy from shareholder pressure, thereby enabling them to adopt a more holistically-orientated 'stakeholder' approach, as well as by employee consultation laws, derived from European Union directives. Yet, the recent fashion in company law and corporate governance reform, in the UK as in the EU more widely, is to strengthen the agency model through measures aimed at empowering shareholders and limiting managerial discretion, in particular in the context of takeover bids. This trend is well represented, at EU level, in the preparatory documents for the Thirteenth Company Law Directive, which justified that measure in terms of the introduction of a market for corporate control (Commission, 2002). In the UK, a similar shareholder orientation lies at the heart of a process of company law reform which began in the late 1990s and which recently culminated in a major company law Bill. What are the implications of this 'modernisation' process for managerial decision-making and employee representation?

To address this question, in the British context, section 2 below sets out relevant aspects of the legal framework for corporate governance in the UK, referring both to company law and labour law, and to associated forms of 'self-regulation' including the City Code on Takeovers and Mergers. Section 3 reviews empirical evidence on the operation of these laws and their impact on managerial decision-making at enterprise level. Section 4 then assesses the prospects for change stemming from the major exercise of company law reform which is currently underway in the UK.

2. The legal framework for corporate governance and managerial decision-making: the interaction of company law and labour law

Company law: directors' duties and the City Code on Takeovers and Mergers

Company law in the UK provides only a loose framework for managerial decision-making, but it is nevertheless one which has a certain impact on managerial priorities, on the prevailing 'enterprise culture', and, in certain situations which give rise to litigation, on concrete outcomes of restructurings. Relevant sources of law include the underlying fiduciary duties which directors owe to the company, and which are the creation of case law; statutory obligations which complement these fiduciary duties; and the regulations and codes which govern takeovers and mergers.

Directors' fiduciary duties are to act *bona fide* in the interests of the *company* and not of the shareholders or any other corporate group. John Kay and Aubrey Silberston (1995: 87) suggest that given the nature of its legal structure, 'perhaps a large corporation is not owned by anybody at all, at least in the normal sense of ownership', meaning ownership as a right to possess and to exclude. However, most company lawyers would not go this far. John Parkinson's work, for example, more clearly recognises the existence of a 'legal model' in which the interests of the company are closely identified with the commercial interests of its members who are, in law, the *shareholders*. Although directors' duties are owed to the company, and may not normally be directly enforced by the shareholders as a consequence of the principle known as the rule in *Foss* v. *Harbottle*,[1] this does not mean that the directors must further the interests of the company *as a legal entity*: As Parkinson (1993: 7) puts it:

> The correct position is thus that the corporate entity is a vehicle for benefiting the interests of a specified group or groups. These interests the law has defined as the interests of the shareholders. The duty of management can accordingly be stated as a duty to promote the success of the business venture, *in order* to benefit the members.

Section 309 of the Companies Act 1985 appears to carve out an exception to this basic principle.[2] The provision emerged from the debate which took place at the end of the 1970s and early 1980s over the role of employees in corporate decision making, and which ended with the rejection of codetermination models similar to those which operate in Germany and other continental European systems. Section 309, a much more modest measure than any model of codetermination, states that 'the matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members', i.e. the shareholders. Even this provision is not as significant as it might appear at first sight. This is because it gives no standing to the employees, as a group, to enforce the obligations to which it refers, any more than the shareholders normally have such standing.[3] Moreover, although the language of section 309 appears to be mandatory, this impression too is misleading. Section 309 does not alter the fundamental nature of directors' fiduciary duties at common law, which is that they are subjectively defined: the directors must act in what *they think* are the company's best interests.[4] Except in an egregious case, directors are protected against litigation by the English-law equivalents of the 'business judgment' rule, which effectively means that the courts will not review judgments made in good faith concerning business matters on which they have limited expertise.[5] Moreover, section 309

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1 (1843) 2 Hare 461. The rule holds that the correct claimant in an action against the directors is nearly always the company, and further holds that, as a result of the principle of majority rule within the shareholder body, minority shareholders can only bring a claim for a breach of fiduciary duties by the directors under exceptional circumstances, such as a 'fraud on the minority' involving the diversion of corporate assets to insiders. As we see in section 4 below, this rule will in future be qualified by a new statutory derivative action, set out in the Companies Bill 2006, providing greater leeway for shareholders to bring actions against directors in the company name.

2 This paragraph contains an account of the law in place at the time of writing (July 2006). Section 309 is due to be replaced by a new provision on directors' duties, contained in the Companies Bill 2006: see section 4, below.

3 Companies Act 1985, s. 309(2).

4 See *Greenhalgh* v. *Arderne Cinemas Ltd.* [1951] Ch. 286, 291.

5 See *Prudential Assurance Co. Ltd.* v. *Newman Industries Ltd. (No. 2)* [1982] Ch. 204. The issue of the liability of directors is another of the questions addressed by the companies Bill 2006. See below, section 4.

simply stipulates that the employees' interests are to be taken into account in the context of this broad discretion to balance conflicting interests; it does not stipulate that at any point employees' interests should take priority over those of other corporate constituencies. The limited significance of section 309 has been reaffirmed in the few cases in which it has been discussed since its first appearance in 1980.[6]

The loosely defined nature of the fiduciary obligation may, at the same time, provide a degree of protection for directors who see the company's long-term interests as closely bound up with those of its 'stakeholders'. Here, the unwillingness of the courts to intervene in business matters, and the various obstacles to litigation associated with the rule in *Foss* v. *Harbottle*, limit the opportunities for direct shareholder pressure. The notion of the shareholders' interests can also be stretched a certain way to incorporate their longer-term interest in the success of the company as an enterprise.[7] The government-sponsored recent review of company law confirmed that boards are permitted to take a view based on 'enlightened shareholder value' – which seeks to strike a balance between the competing interests of the different stakeholders – if their objective is to benefit the shareholders in the long run (Company Law Review, 1999, 2000, 2001). It is possible to argue, then, that the fiduciary principle, as it has developed in English law, would allow the directors to recommend rejection of a hostile takeover bid, for example, if they felt that the incumbent management was better equipped than the bidder to maximise the company's long-term value.

However, this is difficult in practice because of the influence of the City Code on Takeovers and Mergers.[8] The Code, like its broad US equivalent the Williams Act, dates from the late 1960s, but unlike the US measure, it did not until recently have any statutory backing. The Panel on Mergers and Takeovers, a self-regulatory body set up by the financial and legal professions and financial sector trade associations based in the City of London, had no direct legal powers of enforcement. Its provisions were strictly observed, however, since UK-based financial and legal professionals who were found to have breached the Panel's rulings could be barred from practising as a consequence. As a result of the adoption by the European Union of the Thirteenth Company Law Directive,[9] the Panel has recently acquired a statutory underpinning,[10] but the substance of the Code remains essentially the same as it was before, and it continues to be based on the Panel's deliberations and rulings. The expectation of both the UK government and of the Panel is that the implementation of the Directive will not have a major impact on the Panel's mode of operation.[11]

The City Code reflects the strong influence of institutional shareholder interests within the UK financial sector, and their capacity for lobbying to maintain a regulatory regime which operates in their favour (Deakin and Slinger, 1997; Deakin, Hobbs, Nash and

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6 See Parkinson, 1993: 82-87, for a valuable discussion.

7 *Gaiman* v. *National Association for Mental Health* [1971] Ch. 317, 330.

8 See the City Code on Takeovers and Mergers, 8th. ed., May 2006, as reproduced on the website of the Takeover Panel: http://www.thetakeoverpanel.org.uk/new/.

9 Directive 2004/25/EC of the European Parliament and the Council of 21 April 2004 on Takeover Bids, L 142 *Official Journal of the European Union* 30.4.2004).

10 The Takeovers Directive (Interim Implementation) Regulations 2006 (SI 2006/1183), which came into force on 20 May 2006, provide a statutory basis for the Panel's operation, and empower it to issue rules on takeover bids. These Regulations will in due course be superseded by provisions of the Companies Bill 2006.

11 See DTI, 2005, and Takeover Panel, 2005.

Slinger, 2003). Its most fundamental principle is the rule of equal treatment for shareholders: 'all holders of the securities of an offeree company of the same class must be offered equivalent treatment'.[12] This is most clearly manifested in the Code's 'mandatory bid' rule which requires the bidder, once it has acquired 30 per cent or more of the voting rights of the company, to make a 'mandatory offer' granting all shareholders the chance to sell for the highest price it has paid for shares of the relevant kind within the offer period and the preceding twelve month period.[13] Partial bids, involving an offer aimed at achieving control through purchasing less than the total share capital of the company, require the Panel's consent, which is only given in exceptional circumstances.[14] During the bid, information given out by either the bidder or target directors must be made 'equally available to all offeree company shareholders as nearly as possible at the same time and in the same manner'.[15]

The Code also imposes on target directors a series of specific obligations which can be thought of as clarifying their duty to act *bona fide* in the interests of the company, but in some respects extend this duty. The target directors must first of all obtain competent, independent financial advice on the merits of the offer,[16] which they must then circulate to the shareholders with their own recommendation.[17] Any document issued by the board of either the bidder or the target must be accompanied by a statement that the directors accept responsibility for the information contained in it.[18] While the point is not completely clear, the likely effect of this is to create a legal duty of care, owed by the directors to the individual *shareholders* to whom the information is issued (and not to the *company* as is the case with their general fiduciary duties).[19]

All this places the directors of the target in the position of being required to give disinterested advice to the shareholders on the merits of the offer, and makes it more difficult for them to resist a bid simply on the grounds that it would lead to the break-up of the company. In a case where the board considers that a hostile bid would be contrary to a long-term strategy of building up the company's business in a particular way, it can express this opinion, but it must be cautious in doing so, since it still has a duty to provide an objective financial assessment of the bid to the shareholders. In the case of the takeover of Manchester United FC by the US businessman Malcolm Glazer in 2005, the board took the view that Glazer's offer, because it would impose a high debt burden on the company, was not in its long-term interests. However, the board was also aware that the offer could well be regarded as a fair one, since it was by no means clear that the shareholders would not be better off by accepting it. The board issued this statement:

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12 City Code, General Principle 1.1.

13 Ibid., rule 9. See also Companies Act 1985, s. 430A providing a statutory right to sell where the bidder and its associates control 90% in value of the relevant shares; s. 428 grants the bidder a right of compulsory purchase of the last 10% of shares.

14 City Code, rule 36.

15 City Code., rule 20.1.

16 Ibid., rule 3.1.

17 Ibid., rule 25.1(a).

18 Ibid., rule 19.2.

19 A claim in tort might well be made out notwithstanding the restrictive decision of the House of Lords (on auditor liability) in *Caparo Industries plc* v. *Dickman* [1990] 2 AC 6, and it is also possible that directors who provide misleading advice on the sale of shares may commit a breach of statutory duty actionable by the shareholders: *Gething* v. *Kilner* [1972] 1 All ER 1166.

> 'The Board believes that the nature and return requirements of [the proposed] capital structure will put pressure on the business of Manchester United… The proposed offer is at a level which, if made, the Board is likely to regard as fair… If the current proposal were to develop into an offer… the Board considers that it is unlikely to be able to recommend the offer as being in the best interests of Manchester United, notwithstanding the fairness of the price'.

Following this statement, a majority of the shareholders accepted Glazer's bid.

General Principle 9 of the Code used to state that 'it is the shareholders' interests, taken as a whole, together with those of employees and creditors, which should be considered when the directors are giving advice to shareholders'. This provision, like section 309 of the Companies Act 1985, was less significant in practice than in appeared to be on paper, since it provided no basis on which employees or creditors, who had (and have) no standing before the Takeover Panel, can challenge a board's decision. Case-law on fiduciary duties from the 1980s also suggested that, during a *contested* takeover, *only* the interests of the shareholders could be taken into account.[20] As a result it probably matters little that following recent revisions to the Code, the relevant General Principle, which is based on the parallel provisions of the Thirteenth Company Law Directive, now simply states that 'the board of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the bid'.[21]

The Code used to require the bidder to state, in its offer document, 'its intentions regarding the continuation of the business of the offeree company; its intentions regarding any major changes to be introduced in the business, including any redeployment of the fixed assets of the offeree company; the long-term commercial justification for the proposed offer; and its intentions with regard to the continued employment of the employees of the offeree company and its subsidiaries'. This meant little in practice; it simply required the bidder to issue a general statement of its intentions, which generally took the form of a standard-term or 'boilerplate' provision in offer documents. However, as a result of changes made to the Code following the implementation of the Thirteenth Directive, more prescriptive provisions concerning the potential impact of takeovers on employees have been introduced. The bidder must now provide detailed information on its strategic intentions with regard to the target, possible job losses, and changes to terms and conditions of employment,[22] and the target must give its views, in the defence document, on the implications of the bid for employment.[23] Breach of these provisions is a criminal offence. They also have potentially significant implications for employees' consultation rights under labour law.[24] In addition, employee representatives of the target have the right to have their views of the effects of the bid on employment included in relevant defence document issued by the target.[25]

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20 *Heron International Ltd.* v. *Grade* [1983] BCLC 244.

21 General Principle 3.

22 City Code, rule 24.1.

23 Ibid, rule 25.1(b).

24 See below, section 3.

25 City Code, rule 30.2(b). This is however subject to the target board receiving the employee representatives' views in good time, which may not always be straightforward. See Takeover Panel 2006: 32-3, for discussion.

The Code contains extensive provisions controlling the use of defences against hostile bids (or 'frustrating measures' in the terms used by the Thirteenth Directive). Once an offer is made or even if the target board has reason to believe that it is about to be made, the target board cannot issue new shares; issue or grant options in respect of any unissued shares; create securities carrying rights of conversion into shares; sell, dispose or acquire assets of a material amount, or contract to do so; or 'enter into contracts otherwise than in the ordinary course of business'.[26] General company law is also relevant here. The 'proper purposes' doctrine prevents the board issuing shares for the purpose of forestalling a hostile takeover, even well in advance of any bid being made.[27] Other advance anti-takeover defences, such as the issue of non-voting stock or the issuing of new stock to friendly insiders, have been discouraged by a combination of the Listing Rules of the London Stock Exchange and institutional shareholder pressure. Protection of pre-emption rights, or the rights of existing shareholders to be granted preference when new stock is issued, is recognised by legislation[28] as well as by guidelines issued by stock exchange and financial industry bodies.[29] The issue of non-voting stock is permissible under general company law, but is vigorously opposed in practice by institutional shareholders.[30]

Thus the Takeover Code, taken in conjunction with related aspects of company law, can be seen to provide strong protection for the interests of the target shareholders; that, after all, has been its main purpose (see Johnstone, 1980). An important side-effect of this protection, however, is to encourage hostile takeover bids by placing limits on the defensive options available to the target management. An incumbent management is not required to be completely passive, and is permitted to put a case in its own defence, but opportunities for defence only arise in the context of an overriding responsibility to see that the shareholders' interests are safeguarded. The effect is not far removed from that of an 'auction rule' which requires the incumbent management to extract the highest possible price for the target shareholders, if necessary by making it possible for rival offers to be made. The entry of second bidders is facilitated by the bid timetable imposed by the Code and by the effective ban on two-tier and partial bids which might otherwise be used to strong-arm the target shareholders into accepting the terms of the first bid.

These regulatory features might be thought to deter bids, by increasing the risk that either the target shareholders or any second bidder will free ride on the efforts of the initial bidder. However, the possibility of free-riding by the shareholders is alleviated by the right of the bidder compulsorily to purchase the last 10% of shares in the event of taking control; in the

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26 City Code, rule 21.

27 See *Howard Smith Ltd.* v. *Ampol Petroleum Ltd.* [1974] AC 821, discussed by Parkinson, 1993: 143.

28 Companies Act 1985, ss. 85-89.

29 These Guidelines were first issued on 21 October 1987 by the International Stock Exchange's Pre-emption Group, consisting of members of the ISE and officers of the principal representatives of institutional shareholders, namely the Association of British Insurers and the National Association of Pension Funds. Under Guideline 1.2, the Investment Committees of the ABI and NAPF agreed to advise their members, under normal circumstances, to approve resolutions for annual disapplication of pre-emption rights, as long as the non pre-emptive issue did not exceed 5% of the issued ordinary share capital as shown in the most recent published accounts of the company.

30 Guidelines published by the Institutional Shareholders Committee (a body representing a number of financial industry interests and trade associations) in December 1991, *The Responsibilities of Institutional Shareholders in the UK*, stated that 'institutional shareholders have for many years been opposed to the creation of equity shares which do not carry full voting rights and have sought the enfranchisement of existing restricted voting or non-voting shares' (para. 3).

language of the European Directive, a 'squeeze-out' rule (on its economic effects, see Yarrow, 1985). Other factors which serve to reduce the risk of an initial bid failing due to free-rider effects are the concentration of voting shares in most UK publicly-quoted companies in the hands of a relatively small number of institutional shareholders (so reducing the number of shareholders who need to be persuaded to sell) and the right of an initial bidder to raise its offer price during the bid period (thereby enabling it to over-bid a second bidder). While there may, then, be a certain screening-out of partial bids which, given their oppressive nature, are arguably not efficiency-enhancing in any event (see Yarrow, 1985), the effect of the Code is to reduce the autonomy enjoyed by the management of the target company in relation to its shareholders and thereby to limit the defensive options it has available to it.

Labour law: information and consultation requirements in the context of takeovers, business transfers and insolvencies

When we turn to labour law, we find that the main influences on managerial decision making in the context of corporate restructuring are derived from the laws which provide employee representatives with rights of information and consultation, coupled with the provisions of employment protection legislation which govern the potential liability of employers for unfair dismissal and/or redundancy. Thanks to the adoption of the EU Directives on European Works Councils[31] and Information and Consultation of Employees,[32] and their transmission into UK law in the TICER and ICER regulations respectively,[33] many UK companies, above a certain size, are subject to the requirement to put in place mechanisms for social dialogue for employee representatives on matters which include mergers and acquisitions. ICER, in particular, may come to have a significant impact on the practice of employee consultation in the UK, by providing a legal framework for the development of a 'second channel' of employee representation which bears some resemblance to continental European models of enterprise-level participation; but as the Regulations have only very recently come into force (6 April 2005), any such effect lies in the future.[34] Of more significance, for present purposes, are rules of long standing which provide for employee consultation in the event of collective redundancies[35] and transfers of undertakings ('TUPE').[36]

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[31] Directive 94/45 of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees, extended to the UK in 1997 following the end of the UK derogation from the Maastricht Agreement on Social Policy.

[32] Directive 2002/14 of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community.

[33] Transnational Information and Consultation of Employees Regulations ('TICER'), SI 1999/3323, and Information and Consultation of Employees Regulations ('ICER'), SI 2004/3426.

[34] Account must also be taken of the significant derogations contained in ICER, which mean that the Regulations may have little impact where pre-existing arrangements for collective bargaining are in place. See generally Deakin and Morris, 2005: 897-909.

[35] Trade Union and Labour Relations (Consolidation) Act 1992 ('TULRCA'), s. 188 et seq., derived originally from Directive 75/129 on the approximation of the laws of the Member States relating to collective redundancies, later consolidated in Directive 1998/59.

[36] Transfer of Undertakings (Protection of Employment) Regulations, SI 2006/246 ('TUPE'), based on Directive 77/187 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, business or parts of businesses, later consolidated in Directive 2001/23. The 2006 Regulations replaced the earlier 1981 version of TUPE with effect from 6 April 2006. See McMullen, 2006.

Armour and Deakin (2003) argue that these information and consultation laws can be understood as providing employees with voice rights which respect the interests of workers within the enterprise. In so doing, they have the potential to shift the balance of forces at play within corporate governance and alter the outcomes of restructurings. This argument is constructed around three propositions, based on the concepts of 'contingent' voice rights, property-like claims, and monopoly representation.

(1) Employment protection law provides 'contingent' voice rights to employees, that is, rights which are triggered by a significant change in the form of the enterprise threatening their 'firm-specific human capital', such as mass redundancies or the sale of the business undertaking or part of it to a third party

Under UK employment legislation, employees who are made redundant are entitled by statute to receive an award of compensation;[37] they may also obtain compensation for unfair dismissal if the redundancies were carried out on the basis of an unfair selection process (reinstatement, while possible in principle, is very rarely awarded in this context).[38] These rights go some way to recognising the economic significance of redundancy for employees, in particular to the extent that they are augmented for employees with greater seniority, but they do not provide a basis for challenging the decision for redundancy itself. In that sense, they do not touch on the issue of governance. In addition, however, when an employer is contemplating large-scale redundancies or is about to effect a commercial transaction leading to a business transfer within the meaning of TUPE, it must consult the representatives of the employees with a view to reaching agreement on ways of protecting the employment and 'acquired rights' of the employees. Failure to consult can result in a protective award being made against the employer which contains a significantly punitive element: the employer must pay a sum equivalent to the wages or salary of all the employees affected by its breach of the law for the whole of the period during which consultation should have taken place (up to a statutory limit on 'normal' weekly earnings), on top of their existing contractual entitlements.

(2) These claims are in the nature of a property right, which arises when employees' existing or 'acquired' rights automatically bind third parties, such as the purchaser or transferee of the undertaking.

An employer's failure to observe the information and consultation rights of the employees does not have the effect of nullifying the impact of the commercial transaction – the sale or outsourcing of the undertaking, for example – on the employment relationship. The English courts have refused to go this far, holding that a dismissal which is *unfair* in relation to a business transfer is not, for that reason, *void*.[39] Yet the protective award, under UK law, can also have a strong deterrent effect. By in effect doubling (up to a certain limit) the salaries and wages of the workforce for a period of weeks or perhaps months, the sum owed by the employer soon mounts up, eating into the income and assets which would otherwise be available to shareholders or, in some cases, creditors. The viability of a particular managerial strategy for restructuring may thereby be undermined.

[37] Employment Rights Act 1996, Part XI.
[38] Employment Rights Act 1996, Part X.
[39] *Wilson* v. *St. Helens BC/Baxendale* v. *British Fuels* [1998] IRLR 706.

TUPE goes an important step further by ensuring that the employee's claims cannot be overridden merely by virtue of a change in the ownership of the other assets of the firm. This is because of the mechanism contained within TUPE for the novation of contracts of employment in the event of a transfer of all or part of the undertaking. The 'acquired rights' of the employee, both contractual and statutory, are automatically carried over into the employment relationship with the new employer. This is the case not just in relation to terms and conditions of employment and statutory employment rights; the transferee employer also inherits employment-related claims against the transferor, including any liabilities for failure to respect the information and consultation laws and any outstanding claims for redundancy and unfair dismissal compensation.

(3) Information and consultation law operates to collectivise the employees' divergent interests in such a way as to overcome what would otherwise be the considerable governance costs of renegotiating the terms of employment contracts, by vesting these negotiation rights in designated agents who, for this purpose, have monopoly representation rights.

Insolvency law, because of way in which it *collectivises* the rights of creditors, provides a mechanism for resolving divergences of interests between creditors and other stakeholders involved in the process of corporate rescue (see Hart and Moore, 1997, discussed by Armour and Deakin, 2001). In the same way, divergences of interest between different employees can be resolved, to some degree at least, through the employee representatives who are granted monopoly representation rights in relation to information and consultation laws. From an efficiency perspective, a mechanism of this kind is important, in order to reduce the transaction costs which are associated with multi-stakeholder forms of corporate governance.

Under UK law, where an independent trade union is recognised by the employer for the purposes of collective bargaining over the terms and conditions of relevant employees, the employer must enter into consultation over redundancies or a business transfer with *that* union in respect of the workers in question, to the exclusion of all other bodies. Where there is no recognised trade union, the employer must consult employee representatives who are elected or selected under procedures laid down by legislation.

How far the law permits *derogation* from statutory rights – and therefore a full-ranging negotiation – is open to question. The drafters of the 1977 Directive clearly intended there to be scope for bargaining over the acquired rights of employees. The Directive contained a provision permitting a Member State to allow collective agreements to vary the terms and conditions of the transferred employees after a period of one year had elapsed from the transfer (the default being that the transferee was otherwise bound by the terms of the collective agreement in force at the time of the transfer).[40] This provision was not put into effect in the UK. However, a series of recent amendments to the Directive make specific provision for bargaining between the employer and the employee representatives to take place in the context of insolvency.[41]

[40] Directive 77/187, Art. 3(3) (in the original Directive, prior to the amendments made by Directive 98/50, this was Art. 3(2)).

[41] Directive 2001/23 Art 5(2)(b). See Deakin and Morris, 2005: 560-1 on proposals to implement this provision in the UK, which came into force on 6 April 2006; the amendments are discussed by McMullen, 2006.

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How do the rights just described fit together with the rules of company law and those of the Takeover Code? The first and essential point to make is that TUPE has no application to a case in which a restructuring is carried out by means of a share transfer as opposed to the sale of an undertaking. On the other hand, the Takeover Code requires bidders to state their intentions with regard to the future treatment of employees, a provision which, as we have just seen,[42] has been significantly strengthened as a result of the implementation in the UK of the Thirteenth Company Law Directive. Employees have no standing to challenge a particular decision or commercial transaction in the courts on the grounds that there has been a breach of fiduciary duty by the board, nor do they have any standing before the City Panel on Takeovers and Mergers. Nor is there any obligation on the part of either the target board or the board of the bidder to *consult* employee representatives during a bid. However, an obligation of consultation will be triggered as soon as collective redundancies are *in contemplation*, a requirement which has been strengthened by the recent *Junk* decision of the ECJ.[43] There has in the past been some doubt as to how far either the target or bidder may go in providing information to employee representatives without contravening the provisions of the Code and the Listing Rules on the disclosure of price-sensitive information; but the current view of the DTI is that this objection can be overcome if the employee representatives give undertakings of confidentiality, a position also reflected in the Listing Rules (see Deakin and Morris, 2005: 880). Moreover, because of the amendments to the Code which require the bidder to specify its plans for employment in the target in some detail, it is possible that a duty to consult over possible redundancies will be triggered at a much earlier stage than has hitherto been the case, and the involvement of employee representatives in the bid process will be strengthened as a result.

3. Case study evidence on the impact of the law on corporate restructurings

Two empirical research projects in which the author took part have looked specifically at the role of the law in shaping the outcomes of restructurings: these are studies by Deakin and Slinger (1997) and Deakin, Hobbs, Nash and Slinger (2002) on the impact of directors' duties and the City Code, and studies by Armour and Deakin (2000, 2001) on the impact of employee information and consultation laws in the context of insolvencies and business transfers. The essential findings, for the present discussion, are summarized below.

The takeover studies

For the study on takeovers, the objective was to construct a sample of bids which contained examples of both hostile and agreed bids, and cross-border bids by UK companies and for UK companies mounted during the period 1993-1996. In interviews we put this question to company directors, lawyers, merchant bankers, institutional shareholders and employee representatives:

> Did directors' duties to consider interests of creditors and employees as well as those of shareholders affect the preparations for, the conduct of and the aftermath of the bid?

[42] In section 2, above.
[43] Case C-188/03 *Junk* v. *Kuhnel* [2005] IRLR 310.

On the central question of directors' duties, the response was almost invariably that while directors might consider employees' and creditors' interests, the outcome of a bid was determined by shareholder value. Shareholder value took precedence over all other considerations. The responses to the question are separated out below by group, with advisers first, followed by directors, employee representatives, and institutional investors.
A typical comment from an adviser was as follows:

> Directors *do* consider employees' interests, but no-one really knows what that means. At the margin the touchy-feely things matter, but the board of directors, faced with 2 people offering £1 and £1.10 must go for the higher. The decision, of course, is not usually put like that, but I don't know of any cases where employees' interests have come first.

Employees were only mentioned out of lip service to the obligation of the offeror company to state its intentions with regard to employment:

> Directors' duties to consider other interests are rarely an issue unless the company is near to insolvency. These clauses together are a bit of a sop. Rule 24 of the Code requires a statement of intentions towards employees, which always gets reduced to the standard phrase: 'the bidder will ensure that all rights of the target employees will be met in full.' Sometimes people do say more - sometimes a target will screw a stronger statement out of the bidder. And where companies intend not to make redundancies, they will tend to say it.

More pithily, we were told: 'much is spoken about directors' duties to employees, but it is rarely relevant'; and, 'the Takeover Code and Companies Acts just muddle these issues up: directors have to recommend 'the deal' when they are really just recommending the price.'

Directors told us that their focus was on the financial aspects of a bid:

> The one thing that [our merchant bankers] kept saying was that 'you have to be sure that when you say that a price is inadequate, you mean it and can back it up.' Were we advised that we could take into account the interests of the company as a whole? No - the primary advice was that 'there is a price at which you have to say yes.'

In particular, non-executive directors were identified as advocates for the shareholder interest, even where this meant dismembering the corporate enterprise:

> Were we advised of our legal obligations to our shareholders? Yes - there was lots of advice. One of the non-executive directors did push us hard to consider closure and selling up as an option to get maximum shareholder value (about 5 years before the bid).

Institutional investors likewise thought that directors should focus on shareholder concerns. One was 'happy with the idea that directors owe duties to "the company" but was of the view that 'during a bid, especially, the directors understand this as being a duty to shareholders.' Another considered that for directors to perform according to their fiduciary duties, 'they had to show that it was in the interests of shareholders to sell'.

The pursuit of stakeholder interests was not seen as a viable alternative to shareholder value:

> It is hard to make a case that [the duty further the interests of the company as a whole] affected the bid greatly. In principle a defending company might put employees' interests before those of shareholders but they are basically serving shareholders' interests first. If directors have a duty, it is to ensure that employees have marketable skills. I see directors' duties to employees as being more like pension rights protection than long-term employment safeguards.

Employee representatives were less clearly opposed to bids than might have been thought. Hostile bids were sometimes seen as shaking up incumbent managerial teams with which the employees had little by way of common interest. Hence employee representatives commented unfavourably on the tendency of target directors to be excessively well-rewarded even before bids, in pay and share options, and on the negative effect this had on the workforce. Particular criticism was reserved for the practice of linking managerial remuneration to the number of workers dismissed:

> The other thing that caused trouble was the directors' incentives schemes. They had a bonus system which had work completed according to certain targets divided by the number of staff that they employed to do it. So what they did was to sack a lot of staff, and employed outside contractors, to fulfil their conditions and increase their bonuses.

None of the employee representatives were convinced that a higher commitment from management to consultation would have materially affected the bids in which they were involved. In part this was out of a frank recognition that the decision was in the hands of shareholders and hence was 'purely a commercial thing'. The priority was to keep lines of communication open after the bid in an attempt to avoid compulsory redundancies and smooth the way of the new owners. This was a typical comment:

> We take the view now that we're not going to be able to prevent [the takeover] - so we try to get the best deal we can. Given the current industrial relations climate, I don't think that even a 'requirement to consult' would make much difference.

Assessment

For target directors, the nature of the advice received was of paramount importance. During bids, they saw their duty in terms of maximizing the potential value of the company *as a financial asset of the shareholders*. This obligation stood before any requirement to consult employees, to consider their interests, or to further the interests of the company as a whole. Even outside the bid period, the perceived 'duty' to focus on shareholder value could lead a non-executive director to see it as his role to force management to consider closing down the enterprise. Correspondingly, institutional investors applauded directors who saw their responsibilities in these terms.

The attitudes of employee representatives are best described as pragmatic. They expected little from target managers whose interests were seen to be tied up with share options and remuneration packages which would leave them better off whatever the outcome of the bid. There was no expectation of consultation with the target

management, and no prospect of it making a difference to the outcome of the bid if it did take place. By contrast, the intervention of bidders could be seen in a positive light, particularly where there had already been a breakdown of trust with incumbent management. Informal links could be established with the bidder at an early stage, and a relationship constructed with a view to the future, even it was recognised on both sides that the most immediate issue was likely to be the management of redundancies.

The insolvency studies

Armour and Deakin (2000, 2003; see also Deakin and Armour, 2004) studied a number of corporate restructurings involving insolvencies and business transfers, the most important and illustrative of which involved the sale of the Rover vehicle manufacturing company from BMW to the Phoenix consortium in 2000. BMW initially planned to sell Rover to a venture capital company, Alchemy Partners. As the deal was nearing completion, Alchemy withdrew, leaving the way clear for Rover to be 'rescued' by the Phoenix consortium. Phoenix brought together a number of stakeholder groups: former Rover executives, many of whom had left the company when BWM took it over; employees and their representatives including several trade unions; suppliers and customers, including an extensive network of car dealers; and local government authorities in the west midlands area of England, where most of Rover's plants were based.

When the sale to Alchemy was pending, six new business units were formed as subsidiary companies of the Rover Group. The shares in these companies were then purchased by BMW's UK holding company. The purpose was to separate out those parts of the group which would stay with BMW (such as the engine plant and the Cowley works which was to be retained to produce the new Mini model for BMW), those which would be sold to Ford (Land Rover), and those parts which would be left for Alchemy. The effect was to create seven subsidiaries in all, including the original Rover Group company from which the other six had been spun off. The intention was to effect the sale of the Longbridge assets to Alchemy in the form of a transfer of shares in the residual Rover Group company.

BMW structured the proposed sale of Rover to Alchemy in such a way that it could be argued that it involved a transfer of shares and not a formal change of employer; on that basis, TUPE would not apply. If this was the case, the employees would retain whatever statutory and contractual rights they had when Alchemy took over, but there would no duty upon either employer to consult or inform employee representatives. Nor would Alchemy be rigidly bound to preserve terms and conditions after the transfer.

However, it was arguable that transfers had taken place in the case of the creation of the six new subsidiary companies, to which employees within the relevant business units had been allocated. This was because it was akin to a process of 'hiving down' of the type which, under case law, could be regarded as a single transaction, in which BMW's UK holding company was substituted for Rover as the employer. The unwillingness of the courts to accept that TUPE could be avoided by complex transactions of this type was reasserted in a decision of the High Court *In the Matter of Maxwell Fleet and Facilities Management Ltd*. around the time of the proposed sale.[44] Lawyers acting for a group of managerial employees advanced the argument that the creation of the 'residual'

[44] [2000] IRLR 368, 372-373.

Rover company, in anticipation of the sale of shares to Alchemy, was also akin to a hiving down and, as such, would in due course be caught by TUPE. This point was less clearly in the employees' favour, but it could not be said to have been beyond doubt.

Neither Rover Group nor any of BMW's other UK subsidiaries had entered into consultation with employee representatives over the transfers. The relevant employee representatives were the recognised unions, which thereby had the opportunity to initiate litigation directly. It was also argued by the employees that since both BMW and Alchemy had indicated that there would be redundancies arising from the sale of Rover Group and the other subsidiary companies, a breach of the redundancy consultation laws had occurred. In *Kerry Foods Ltd.* v. *Creber*,[45] the EAT had held, a few months previously, that an employer's liability under a protective award could be transferred over under regulation 5 of TUPE, overruling earlier case law. This meant that any failure by BMW or its subsidiaries to comply with the information and consultation requirements would be transmitted to buyers of its businesses. Then the ECJ's decision in *Allen* v. *Amalgamated Construction Co. Ltd.*[46] confirmed that there was no reason why transfers of undertakings between companies in the same corporate group could not come under the Acquired Rights Directive, thereby further strengthening the employees' claims. On these various bases, the unions lodged applications for protective awards covering all 28,000 employees of the former Rover Group before employment tribunals at the end of April. In addition, steps were taken to prepare individual claims in respect of breach of contract for dismissals carried out in contravention of 'no compulsory redundancy' agreements entered into between Rover and the unions, which, it was claimed, had been incorporated into employees' contracts of employment. Altogether, the potential value of these claims exceeded £300 million.

It was against this background that Alchemy withdrew from negotiations with BMW on 27 April, only a day or so from the deadline set for finalising the deal. It is unclear what precisely triggered the collapse of the Alchemy deal. Reports written after the event suggest that the prospect of taking on open-ended pension commitments, together with liabilities to Rover's network of dealers which were also unclear in their extent, deterred Alchemy from proceeding.[47] At the time of the failed deal, press reports suggested that the catalyst was BMW's insistence that Alchemy should offer it an indemnity against potential claims for (among other things) breach of the information and consultation laws, and contractual claims for wrongful dismissal. It was reported that Alchemy had been ready to pay £50 million for the company, with BMW meeting certain liabilities arising from restructuring, but that it was not prepared to agree to an indemnity extending to 'hundred and hundreds of millions of pounds.'[48]

The sale to the Phoenix consortium was completed on 10 May. Rover was sold for a nominal £10, with BMW putting in £575 million to help certain running costs. The Phoenix management pressed the unions to agree to a waiver of claims arising out of the failure of BMW (through Rover) to begin consultation at the time the prospective sale to Alchemy was announced. Although the claim was not waived, agreement was reached on its withdrawal on the basis that consultation between Phoenix and the unions had begun at an earlier date. The effect was to save £100 million. In return,

[45] [2000] IRLR 10.
[46] [2000] IRLR 119.
[47] Brady and Lorenz, 2002*:* 186-8.
[48] Financial Times, 'How the Alchemy deal fell apart', 1 May 2000.

Phoenix agreed to insert enhanced redundancy terms in the contracts of employment of Longbridge employees. A further £200 million was saved by Phoenix's decision to dismiss fewer than 1,000 workers at Longbridge, thereby avoiding large-scale redundancy compensation claims.

Lawyers acting for the unions involved commented at the time: '[i]t was the unions' intention to put as many [legal] obstacles in Alchemy's way as possible, but at the same time not to roll over . . . and give a blank cheque to John Towers [head of the Phoenix consortium]'.[49] According to lawyers acting for the Rover managers, 'the same employment issues that bedevilled the Alchemy bid arose again but were resolved by discussion, negotiation and agreement'.[50] Without formally waiving their claims, the employees and their representatives had found themselves in a position where their involvement in the rescue process had led to the success of the one bid which was consistent with maintaining Rover as a volume car producer.

As one of the unions' lawyers said, '[w]e threw a lot of things in the air in the hope [that the bid] could go wrong for Alchemy'.[51] The issue, for example, of whether a TUPE transfer would have occurred when Alchemy purchased the shares in the residual Rover company was never tested; it was unclear how far, if at all, the corporate veil could be lifted to attach various liabilities incurred by BMW's subsidiaries on to its UK holding company; and the issue of the contractual status of the original no-compulsory-redundancy clauses remained unsettled. It was possible that had these issues come to court, they would have been resolved in favour of the employer. However, during complex and difficult negotiations, these legal issues posed enormous potential risks for any buyer of Rover which intended to carry out large-scale restructurings. Phoenix's advantage, in this respect, was the limited degree of restructuring which it intended to carry out.

The post-sale corporate governance structure of the company, now newly independent and named MG Rover, was intended to reflect the interests of the various stakeholder groups which had participated in the Phoenix rescue, in particular the workforce and the local suppliers and dealers who relied on Rover for the maintenance of their businesses. The new management team decided to set aside 35% of the shares in the company for the workforce and 25% for the dealers. The dealers' shares were held via a trust company, and the holdings of individual dealers were revalued periodically according to a sliding scale formula based on annual sales of Rover cars. In the short term, at least, the decision to spread ownership in this way was well received, and helped to reinforce a perception that the company would be run along stakeholder-orientated lines.[52] However, the structure put in place by Rover's new managers later became the subject of concern.

The central issue was the corporate structure set up by the new team to manage the 'dowry' conferred upon Rover by BMW. As part of the deal for taking Rover off its hands, BMW agreed to make available to the new company over £500 million, essentially in the form of a loan, but under terms so generous that it was unlikely ever to be repaid in full: it had to be returned if Rover was sold within three years of the sale

[49] Financial Times, 'Claims that hurt Alchemy bid to be waived', 9 May 2000.
[50] Ibid.
[51] Ibid.
[52] Brady and Lorenz, 2002: 213 and 221-3.

(something which did not happen) and phased repayments would also come into effect once Rover returned to profit (something which has yet to happen), but in any event was not repayable for fifty years.[53] Rover's new management team arranged initially for the 'dowry' to be paid into the corporate vehicle which they had set up to handle the Rover deal, a company named Techtronic. In 2000 a new holding company was set up, MG Rover Holdings, and in 2002 this company was renamed Phoenix Venture Holdings (PVH).

PVH became the holding company for MG Rover and for a number of other subsidiaries. The so-called stakeholder groups, the employees and dealers, held their equity interests in Rover the form of non-voting stock in PVH; the four founders of Phoenix, led by John Towers, held between them 40% of the shares but 100% of the voting stock of PVH. Under the articles of association of PVH, the 'stakeholder' groups were only entitled to receive a dividend on income paid over to PVH from MG Rover, the car production arm of the group.

MG Rover never made a profit, and by 2004 its liabilities exceeded its assets by over £200 million. However, other parts of the PVH group were profitable, largely as a result of sales of property carried out by PVH, including a sale and leaseback of the main Longbridge site.[54] Although this structure was defended by Rover's new managers as a mechanism for channeling investment into the core vehicle manufacturing business, others described it as a device for protecting their interests against the possibility that MG Rover would fail: '[i]f Rover were to be closed, about 5,000 workers at its Longbridge plant in Birmingham would be out of work, Britain would have lost its last independent volume car company and the Phoenix Four would sit in control of a surviving business worth about £70 million'.[55]

This disquiet spread to the trade unions which had been most closely involved in the rescue and rehabilitation of the company. The unions' negotiating team was led at the time of the rescue by Tony Woodley, then a national official of the Transport and General Workers' Union, and elected as the TGWU's General Secretary in 2003. In March 2004 Woodley issued an open letter to Rover's management, calling for the integration of the different companies of the Rover group into a single corporate structure, and for the appointment of independent directors to the group board. According to his letter, reintegration was needed to 'make it abundantly clear that no one could gain from the end of car-making and no-one could be contemplating such a disastrous eventuality'.[56]

The background to these concerns was the continuing failure of the core vehicle manufacturing business to return to profit. There were a number of significant obstacles in the way of long-term sustainability. One was the Longbridge plant itself, a 'brownfield' site first constructed in the 1930s, which had enjoyed only limited investment since the early 1980s, and which in the view of vehicle industry experts suffered from excess capacity caused by a continuing failure to streamline and modernize its infrastructure.[57]

[53] Brady and Lorenz 2002: 209.
[54] The information contained in this paragraph is based on 'Rover's financial rebuild' *The Guardian*, 2 March 2004.
[55] Ibid.
[56] 'Union ally calls for independent Rover directors' *The Guardian*, 10 March 2004.
[57] Professor Kumar Bhattacharya of the Warwick Manufacturing Group, cited in Brady and Lorenz, 2002*:* 111-112.

The second difficulty stemmed from the widespread perception that Rover was a 'dying brand', no longer associated with quality or innovation.[58] Both of these problems were exacerbated by the way in which BMW exited the company: it retained (and then done much to restore) the Mini brand and the relatively efficient Cowley production line, while also selling on the profitable Land Rover division to Ford. Thus the new Rover company was left with the least valuable parts of the business which BMW had bought in 1994.

In 2005, these issues came to a head, and after the failure of merger talks with one Chinese corporation, SAIC (based in Shanghai), the company was declared insolvent and the remaining workers dismissed. The administrators arranged a trade sale of business assets to another Chinese company, Nanjing Automobile, which has stated its intention to re-start production at Longbridge, but has not yet done so.

Assessment

Rover's rescue owed much to the influence of the continental European model of employee consultation embodied in the Acquired Rights Directive and implemented in the UK through TUPE. For the reasons explained earlier, in the absence of this law, it is more likely that the sale of Rover to Alchemy would have gone ahead, and that the stakeholder-orientated Phoenix bid would have failed. The subsequent failure of Phoenix has however cast doubt on the argument that TUPE operated, in 2000, to preserve employment in Rover; such success was short-lived. It may be that the gradual run-down of employment under Phoenix was preferable to the sudden loss of nearly 30,000 jobs, with further job losses in the network of suppliers and dealers, which was a possibility in 2000. The wider lessons of the post-rescue period are still hard to discern, pending the completion of a DTI inquiry into the structure and organization of the Phoenix group of companies. However, a striking feature of the governance structure adopted by Phoenix is already clear, namely that it did not provide an effective mechanism for the exercise of employee voice: the shares held on behalf of the employees did not carry any voting rights, and no employee representatives were nominated as directors of the company (although an offer of a directorship was apparently made to Tony Woodley, as representative of the TGWU; he turned it down). Thus in contrast to the models of employee participation which operate on the continent, under UK labour law the 'contingent' nature of the voice rights provided by the law means that they can only be exercised for limited periods, when a restructuring is in contemplation or taking place, and not on a continuing basis. After the sale to Phoenix was completed, the opportunity for the employees to bring collective voice to bear on issues of governance and work organization was more or less at an end. Rover was managed in the same way as any other company, and the opportunity for extended cooperation between management and labour, which could perhaps have sustained the enterprise over the longer term, was lost.

4. The potential impact of recently proposed changes to company law

A major review of company law in the UK has been going on since the late 1990s; this resulted in several reports of a Company Law Review Steering Group set up under the auspices of the DTI, which have now resulted in draft legislation, the Company Law Reform Bill, is due to become law in 2006. Among other things, the new law codifies the law relating to directors' duties, a potentially sensitive area with implications for the role of employees within corporate governance.

[58] Brady and Lorenz, 2002*:* pp. 37-38.

In principle, as we have seen, UK company law observes the legal principle that directors must act in good faith in the interests of the *company*, rather than those of the shareholders alone. In this context it is significant that the Company Law Review criticized the priority given to shareholder interests by the City Code, arguing that there was potential for conflict between general company law and the Code's strong endorsement of shareholder primacy (see Company Law Review Steering Group, 1999: 39). The Review also recommended the introduction of a concept of 'enlightened shareholder value' to express the idea that the board's task was to strike a balance between the competing interests of the different stakeholders in order to benefit the shareholders in the long run (Company Law Review Steering Group, 1999: 37). It accordingly proposed a restatement of duties in which there would be '[a]n obligation on directors to achieve the success of the company for the benefit of the shareholders by taking proper account of all the relevant considerations for that purpose' including 'a proper balanced view of the short and long term, the need to sustain effective ongoing relationships with employees, customers, suppliers and others; and the need to maintain the company's reputation and to consider the impact of its operations on the community and the environment' (Company Law Review Steering Group, 2000: 12; see also Company Law Review Steering Group, 2001: 41). The Steering Group coupled this with a proposal for a new statutory requirement for listed companies (and certain other 'very large companies with real economic power') to publish an operating and financial review (OFR) as part of the annual report. This would 'cover all that is material in the directors' view for users to achieve a proper assessment of the performance and future plans and prospects of the business' including 'where relevant its relationships with employees and others and its impact on the community and environment' (Company Law Review Steering Group, 2000: 13). This OFR was to be based on an existing, non-statutory model for company reporting which is recommended by the UK Accounting Standards Board and is already in widespread use by listed companies.

The Steering Group's regarded its proposal was as compromise between the 'enlightened shareholder value' and 'pluralist' points of view. The proposal's objective, it argued, was 'pluralist', in the sense that 'companies should be run in such a way which maximizes overall competitiveness and wealth and welfare for all'. The means chosen to achieve this end were the 'inclusive duty' and 'broader accountability':

> The proposed statement of directors' duties requires directors to act in the collective best interests of shareholders, but recognises that this can only be achieved by taking due account of wider interests. The transparency element provides the information needed to underpin this approach to governance. Just as importantly, we believe that this wider reporting requirement – particularly for large companies – will be an important contribution to competitiveness. Companies are increasingly reliant on qualitative and intangible, or 'soft' assets such as the skills and knowledge of their employees and their corporate reputation. The reporting framework must recognize this and ensure that companies provide the market and other interests with the information they need to understand their companies' business and assess performance. (Company Law Review Steering Group, 2000: 14-15).

Clause 173 of the Companies Bill 2006, which is headed 'Duty to promote the interests of the company', now provides that:

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole…

(3) In fulfilling the duty imposed by this section a director must (so far as reasonably practicable) have regard to –

(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment
(e) the desirability of the company maintaining a reputation for high standards of business conduct ,and
(f) the need to act fairly as between the members of the company.

The new provision replaces section 309 of the Companies Act 1985, on the grounds that it incorporates a reference to employees' interests (in paragraph (b)). This could be regarded as signalling a weakening of the employee interest, which is now simply one of a number of considerations which directors must take into account. Section 309 was in any case a weak provision, so there is an argument for saying that its repeal does not matter. But in other respects the new Bill tilts the law in the direction of a clearer assertion of the agency model. In particular by easing the restraints previously imposed on derivative actions by shareholders,[59] it makes it even more likely in future that boards will act with a view to ensuring that the financial interests of shareholders are prioritised. When the options for shareholders to bring actions against directors were highly limited, it did not greatly matter that employees lacked standing to do the same; but now that shareholders have new powers to use litigation to bring directors to account, the absence of a parallel mechanism for bringing employee influence to bear becomes a significant omission. While it is perhaps conceivable that the new derivative action could be used by employees representatives or NGOs in their capacity as shareholders to challenge decisions of boards which impact negatively on their interests, the court has the power to prevent such a claim being brought at all if it can be shown that a person acting with regard to the duty to promote the company's interests would not pursue it. Thus the basic test remains whether the board's decision is taken with a view to ensuring the company's commercial success. The government's evident reluctance to bring the OFR into force[60] is a further sign that it does not intend to use the Bill to promote a 'stakeholder' model of corporate governance.

5. Conclusion

The UK has long had a corporate governance system strongly orientated towards the agency model, in which company directors are understood as acting as the agents of

[59] See Part 11 of the Bill.
[60] Shortly before Christmas 2005, the Chancellor of the Exchequer and likely future Prime Minister, Gordon Brown, announced that the OFR would remain voluntary, on the grounds that it was unnecessary 'red tape'. Then in February 2006 the government announced that it was reconsidering its position in the light of litigation initiated by the NGO Friends of the Earth, on the grounds that there had been a legal failure to consult relevant parties on the proposed scrapping of the law. Then in May 2006 the DTI announced that a watered-down version of the OFR would be reintroduced into the Companies Bill 2006.

shareholders. Although core company law is slightly ambivalent on this point, stressing that directors' duties are owed to the company as a whole and not just to shareholders, the priority of shareholders' interests is clearly articulated in the City Code on Takeovers and Mergers, which has a considerable influence on how listed companies are managed. There is empirical evidence that directors of listed companies in the UK see their role in terms which are compatible with the agency model, particularly in the context of restructurings, with the regulatory framework for takeover bids playing a major role in perpetuating this view. On the other hand, laws providing for information and consultation with employee representatives are relatively strong in the context of redundancies and business transfers, and are not viewed, officially at least, as contradicting the City Code and stock exchange Listing Rules. Consultation laws can make a difference to outcomes, as the Rover case shows, and they may come to have a greater impact on takeover bids in future, thanks to the measures taken to implement the Thirteenth Company Law Directive in the UK. Nevertheless, the recently proposed changes to UK company law are arguably a step backwards for the exercise of employee voice at firm level. Although the Company Law Review used the inclusive language of 'enlightened' shareholder value, it also rejected a 'pluralist' position which would have moved the focus of company law away from a focus on shareholder returns. The Companies Bill 2006 takes a significant step towards further entrenching the agency model, and removes some of the ambivalence of the pre-existing law on the issue of shareholder priority, not least by easing the rules on shareholder-led litigation. Thus while the impact of company law 'modernisation' will be less keenly felt in the UK than, perhaps, in some continental European jurisdictions, because the UK already has a strong, shareholder-orientated enterprise culture, company law reforms are likely to push the UK further still in the direction of the agency model.

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