

EMPLOYEE PARTICIPATION IN CORPORATE GOVERNMENT—A CRITIQUE OF THE BULLOCK REPORT

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I. Introduction.

A central theme of company law reform since Berle and Means wrote their classic study, *The Modern Corporation and Private Property*,¹ has been that of the need to create mechanisms whereby directors will in fact, as well as in theory, be accountable for the way in which they exercise their powers. Under the traditional model of corporate governance directors are accountable to the shareholders who collectively, in theory, exercise ultimate control over the company's affairs. Reality, however, belies this theory and, in the large public company, the shareholders, except perhaps in a crisis situation, do not exercise any meaningful ownership powers. Thus, for example, Midgley in his investigations of shareholder voting behaviour in large, United Kingdom public companies reported:²

Companies were questioned as to whether during the last ten years any shareholders had attempted to exercise control by requisitioning any meetings, proposing or amending resolutions (other than formal votes of thanks, etc.) taking any legal proceedings concerning the company, initiating any enquiry. A negative answer was given in all cases, except that one company recorded an unsuccessful attempt to amend a resolution and another the unsuccessful attempt by a ginger group to defeat the re-election of directors and propose the election of directors of their own choice. . . .

The overall results of his study, Midgley opined, corroborated the widespread belief that "shareholders, as a body, are passive and apathetic about their rights and responsibilities".³ It may be that the growth of the equity holdings of institutional investors will alter this picture of apathy, but as yet there is no evidence of this taking place.⁴ The underlying reasons for this shareholder apathy are, of

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¹ (1932)

² Midgley, *Companies And Their Shareholders—The Uneasy Relationship* (1975), p. 54. On the scope of this investigation, which basically involved fifty-five of the larger United Kingdom public companies: see Midgley, *ibid.*, p. 29.

³ *Op. cit.*, *ibid.*, p. 54.

⁴ The long term trend in shareholdings in the United Kingdom would appear to be in the direction of concentrating equity holdings in the hands of the institutional investors: see Royal Commission on the Distribution of Income and Wealth—Income From Companies And Its Distribution (Report No. 2, 1975, Cmnd 6172) Tables

course, not difficult to unearth: (i) holdings are widely dispersed, something which makes concerted shareholder action difficult; (ii) shareholders are relatively ignorant and on the whole lack the necessary skills and aptitudes to scrutinize management performance; (iii) management enjoys liberal access to corporate proxy machinery⁵ while the access of shareholders is limited and, unless the company decides otherwise, expensive;⁶ (iv) shareholders who are discontented with corporate management will vote with their feet and sell their shares; (v) lastly, a lack of active shareholder involvement in corporate affairs may possibly be explained on the ground that, on the whole, directors manage companies in the economic interests of the shareholders. No doubt an inefficient management performance will depress the market value of a company's shares and eventually this may induce a take-over bid by a bidder who feels that the company's affairs can be operated more profitably.⁷ But this mechanism is uncertain in its operation.⁸ Also, it is open to the objection that the small shareholder is at a disadvantage in relation to other more professional participants in the market and his⁹ "power to sell shares in a badly managed company is cold comfort if the first indication given to him of mismanagement is a sharp drop in the value of his shares". Reliance on the market cannot be a complete answer to the problems caused by inefficiently run companies.

It has also been argued that the traditional model of corporate governance is misconceived in another, fundamental way. Although it is the board of directors that theoretically controls a company's affairs,¹⁰ the reality of the matter is that because of the complexities

9-10, p. 17. As a result of its investigations the commission concluded: "What seems to have been happening is that individuals as a group have been turning away from direct investment in industry and placing their savings with pension funds, life insurance companies, unit trusts, etc., which in turn invest them in industry" (p. 19). This, of course, represents considerable economic power and it has been proposed that members in some of these schemes be given a greater voice in running them: see *Occupational Pension Schemes—The Role of Members in the Running of Schemes Cmnd 6514* (1976).

⁵ See, e.g., *Peel v. London and North Western Rly.*, [1907] 1 Ch.5.

⁶ See e.g., *Companies Act 1948*, 11-12 Geo. 6, c. 38, s. 140(1).

⁷ See Manne, *Mergers and the Market for Corporate Control* (1965), 73 J. of Pol. Econ. 110.

⁸ Kempner, MacMillan and Hawkins, *Business and Society: Tradition and Change* (1974), pp. 149-150.

⁹ *Employee Participation and Company Structure*, Bulletin of the European Communities, Supp. 8/75, at p. 32.

¹⁰ Under the English Companies Acts the jurisdiction of the board is determined by contract among the members, but it is customary to vest in the management extensive management powers: see *Companies Act 1948*, *supra*, footnote 6, Schedule 1, Table A, art. 80.

of modern business, the relative ignorance of non-expert directors, and the relative infrequency of board meetings,¹¹ real management power is in the hands of a company's full time executive employees. This point was made by Batstone as follows:¹²

Managers also achieve considerable influence because of their formal role which provides them with authority, detailed knowledge and information . . . and with large resources in terms of personnel. Furthermore, management originate and formulate proposals. . . . In doing so, they are able to "shape" problems in the manner they desire, taking aspects as given which others might see as crucial features of the issue . . . and promoting what they see as important considerations to the detriment of others.

Much pen and ink has been spent on suggesting reforms to deal with this absence of directors' accountability and with the problem of directors who do not, for whatever reason, exercise anything like a detailed control over corporate business policy making.¹³ As far as reforms of English company law to deal with these issues are concerned they have, at least prior to the publication of the Trades Union Congress, *Interim Report, Industrial Democracy*, in 1973, traditionally taken the form of proposing mechanisms to facilitate the exercise by shareholders of their ownership rights and by requiring greater disclosure by directors of the details, and types of information, relating to a company's affairs. The Cohen Committee on Company Law Amendment reporting in 1945,¹⁴ while recognizing that "[E]xecutive power must inevitably be vested in the directors",¹⁵ considered it desirable to extend shareholder ownership rights to enable shareholders to appoint proxies¹⁶ and to remove directors from office by simple majority vote.¹⁷ These reforms, introduced by the Companies Act 1948,¹⁸ cannot be said to

¹¹ See British Institute of Management, *The Board of Directors*, Management Survey Report No. 10 (1972).

¹² Batstone, *Industrial Democracy: European Experience* (1976), pp. 19-20: this was one of the two reports prepared for the Industrial Democracy Committee (the other was prepared by P. L. Davies). See also Eisenberg, *Legal Models of Management Structure in the Modern Corporation: Officers, Directors and Accountants* (1975), 63 Calif. L. Rev. 375 where this phenomenon is extensively dealt with.

¹³ It is not proposed to deal with these issues in any great detail. See generally Eisenberg, *The Structure of the Corporation* (1976) where this matter is gone into in considerable detail.

¹⁴ Cmnd 6659.

¹⁵ *Ibid.*, p. 77, para. 124.

¹⁶ *Ibid.*, p. 81, para. 132, although it relied heavily on self-regulation to bring about this desired change.

¹⁷ *Ibid.*, pp. 79-80, para. 130.

¹⁸ See Companies Act 1948, *supra*, footnote 6, s. 136 (appointment of proxies); s. 184 (removal of directors). The effectiveness of the latter section was somewhat blunted by the House of Lords' judgment in *Bushell v. Faith*, [1970] A.C. 1099.

have contributed to any great upsurge in shareholder involvement in corporate affairs. The Jenkins Committee,¹⁹ twenty years later, displayed a similar attitude to the enhancing of shareholder ownership rights, and recommended that dispositions of the whole, or substantially the whole, of the assets of a company and certain allotments of shares by directors should require antecedent shareholder approval.²⁰ Neither of these reforms has as yet been implemented.²¹

None of the proposals put forward by the Cohen and Jenkins Committees could be considered to be radical and, given the reasons for shareholder apathy, it is to be doubted if they would make any significant contribution to ensuring management accountability. Much more faith has been placed in the policy of disclosure, both as regards the detail and the range of matters to be disclosed, as a means of guaranteeing management accountability. The *White Paper on Company Law Reform* in 1973 made the not immodest claim that "[O]penness in company affairs is the first principle in securing responsible behaviour".²² In so far as the Companies Acts of 1967²³ and 1976²⁴ have a recognisable, coherent policy it is a commitment to the benign effects of disclosure. Coupled with this, the auditor has been moved very much into centre stage as the officer, directly elected and accountable to shareholders, with primary responsibility for making effective disclosure a reality and not a pious expectation.²⁵ The Achilles heel in the operation of the disclosure philosophy has been a rather lacklustre record on the part of the authorities in ensuring compliance with the disclosure provisions of the Companies Acts.²⁶ However, it may be that the reforms introduced by the Companies Act 1976²⁷ will provide the framework for a more effective enforcement policy.²⁸

The common feature of all the above proposals is to modify corporate constitutional arrangements to enable shareholders to exercise a more effective voice in corporate affairs and more effective supervisory powers over management. Radically alternative measures for ensuring management accountability take the form

¹⁹ Cmnd 1749 (1962).

²⁰ *Ibid.*, pp. 41-43, paras 117-121.

²¹ See, however, Companies Bill 1973, cls 54-55.

²² Cmnd 5391, p. 7, para. 10.

²³ C. 81.

²⁴ C. 69.

²⁵ See Companies Act 1976, *ibid.*, ss 13-19; Prentice, Companies Act 1976 (1977), 40 Mod. L. Rev. 314, at pp. 316-318.

²⁶ See Prentice, *op. cit.*, *ibid.*, at pp. 314-315.

²⁷ *Supra*, footnote 24.

²⁸ Prentice, *op. cit.*, footnote 25.

of allowing other "client-groups of the corporation, such as employees, suppliers and customers"²⁹ to play a formal role in the governance of a company. In the past this policy has taken the form of strengthening the position of these groups vis à vis the company, but has stopped short of giving any formal right to participate in the institutions of corporate government.³⁰ Recently suggestions have been made for giving corporate client groups a more formal role in the corporate decision making structure. One such proposal is that of the Committee of Inquiry on Industrial Democracy.³¹ Its report is an important contribution to the literature of company law reform and is of interest to all who feel that company law should in some way be reformed so as to recognize specifically the interests of a company's client groups. It is proposed here to examine this report and, in particular, to assess the impact its implementation would have on English company law. As a backdrop, some preliminary observations on the present role of the employee in English company law need to be made.

II. *Company Law and The Employee.*

English company law does not, with one or two minor exceptions,³² directly recognise the interests of corporate employees, although as we have seen other mechanisms have been introduced to strengthen the position of employees vis à vis corporate employers. On the whole the employee, as far as English company law is concerned, might as well not exist: directors cannot, in exercising their powers, "take direct account of the interests of the employees".³³ There is general agreement that this state of affairs is undesirable and that reform is long overdue.³⁴ As the law now stands employee interests

²⁹ Eisenberg, *op. cit.*, footnote 13, pp. 19-20.

³⁰ A recent example of this type of legislation in the United Kingdom has been that relating to the provision of information to trade unions for collective bargaining purposes: see Gospel, *Disclosure of Information to Trade Unions* (1976), 5 *Ind. L. J.* 223.

³¹ Cmnd 6706 (1977). Hereafter referred to as the Bullock Committee or simply Bullock after its chairman Lord Bullock, Master of St. Catherine's College, Oxford. For more limited proposals on the rights of employees in a take-over situation see Hepple, *Workers' Rights in Mergers and Takeovers: The EEC Proposals* (1976), 5 *Ind. L. J.* 197.

³² See, e.g., Companies Act 1948, *supra*, footnote 6, s. 319 (as amended by the Employment Protection Act 1975, c. 71, ss 63-69) dealing with unpaid wages and other employment benefits in a winding-up; Companies Act 1967, c. 81, s. 18, dealing with disclosure of details relating to work force. See, *The Future of Company Reports*, Cmnd 6888 (1977), pp. 9-10.

³³ Wedderburn, *Company Law Reform*, Fabian Tract 363 (1965), p. 14.

³⁴ See, e.g., *The Responsibilities of the British Public Company* (Confederation of British Industry, 1973), pp. 19-22; White Paper, *op. cit.*, footnote 22, p. 20, para. 59; Companies Bill 1973, cl. 53.

can be taken into consideration only in so far as this is designed to contribute to the maximization of the economic interests of the shareholders. This view was pungently expressed in the much quoted dictum of Bowen L.J., that "the law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company".³⁵ An enlightened board of directors will not be unduly constricted by this doctrine, as it is plausibly arguable that anything contributing to the welfare of the labor force will redound to the benefit of the shareholders.³⁶ As the Biedenkopf Commission³⁷ observed,

. . . in every company there are structural and objectively necessary conflicts of interests. In the first place there is the conflict concerning wages, in the second place the necessary conflict between measures taken by the company and the interests of workers in the maintenance of jobs. . . .³⁸

These conflicts are endemic features of modern corporate life and there is no evidence that management's ability to solve them is unduly constrained by a failure on the part of English company law to recognize explicitly the interests of employees. The only situation where the present rule has caused acute difficulty has been with respect to the making of gratuitous payments on the dissolution of a company or on the termination of a substantial part of its business. Such payments have been held to be *ultra vires* in that, at this juncture, the interests of the company can hardly be considered to be furthered by policies designed to improve employer-employee relations.³⁹ But this is a relatively atypical situation, and the matter has now been dealt with by legislation.⁴⁰ A more controversial question is whether directors can use their powers in order to resist a take-over bid because it would be detrimental to the interests of the employees. As the law now stands it would appear that they cannot,⁴¹ although there is the possibility that judicial attitudes on

³⁵ *Hutton v. West Cork Rly Co.* (1883), 23 Ch.D. 654, at p. 673. See also *Hampson v. Price's Patent Candle Co.* (1876), 45 L.J. (Ch.) 437. The position in Canada could well be different: *Teck Corporation Ltd v. Millar* (1972), 33 D.L.R. (3d) 288, at pp. 314-315 (B.C.S.C.).

³⁶ See, e.g., the acceptance of this type of reasoning with respect to charitable donations: *Evans v. Brunner Mond & Co.*, [1921] 1 Ch. 359.

³⁷ Co-Determination In The Company (1976), translated by D. O'Neill, Queen's University, Belfast, p. 15. This report examined the system of co-determination in Western Germany.

³⁸ *Ibid.*, p. 15.

³⁹ *Parke v. Daily News Ltd.*, [1962] Ch. 927.

⁴⁰ See generally Rideout, *Principles of Labour Law* (2nd ed., 1976), Ch. 7. In fact in *Parke v. Daily News Ltd.*, *ibid.*, the severance payments would have been quite valid if the employees had negotiated in their contracts of employment for their payment.

⁴¹ *Hogg v. Cramphorn Ltd.*, [1967] Ch. 254.

this issue may alter.⁴² What directors cannot do under the present law is consider the interests of employees to the complete exclusion of those of the shareholders. However, it is to be doubted whether, as a matter of policy, it would be desirable to permit directors to adopt such a policy of partiality towards employees.

III. *The Bullock Proposals.*

Even should company law be modified to allow directors to treat the interests of employees as forming an integral part of the interests of the company, such a reform will not afford employees any direct institutional involvement in corporate governance.⁴³ Until recently proposals for employee participation in the running of companies did not enjoy wide support in England. This was due mainly to trade union hostility; such schemes were viewed as being merely one variant of the "aristocratic embrace" and as being incompatible with trade union autonomy.⁴⁴ However, over the last decade there has been a change of attitude by the trade union movement to employee participation in corporate management and in 1973 the Trades Union Congress published a report favouring parity co-determination, that is, that employees should have equal representation with shareholder representatives on company boards.⁴⁵ The reasons for this change were probably (i) a feeling that certain corporate decisions of critical importance to employees were not, and probably could not, be

⁴² *Teck Corporation Ltd v. Millar*, *supra*, footnote 35. In none of the cases dealing with the collateral purposes doctrine has the court squarely dealt with the issue of whether or not directors can entrench their own policy preferences. The spirit of the reasoning in *Smith (Howard) Ltd v. Ampol Petroleum Ltd*, [1974] A.C. 821 (P.C.) is against giving much power to the directors.

⁴³ On the theoretical justifications for employee participation in corporate governance see Dahl, *After the Revolution?* (1970), pp. 121-140. Dahl states that the dilemma of the legitimacy of the power of directors succinctly: "Thus the traditional private property view of authority in the corporation denies the right of citizenship in corporate government to all the affected parties except the one group that does not, will not, and probably cannot exercise that right (*i.e.* the shareholders). If property ownership is necessarily attached to the right of internal control, then the modern corporation must be owned *de facto* not by the stockholders but by the managers. But if property ownership does *not* carry with it the right of internal control, then the stockholders have no special claim to citizenship, and very likely no reasonable claim at all" (pp. 125-126).

⁴⁴ See Clegg, *Trade Unionism under Collective Bargaining* (1976), p. 89; Clarke, Fatchett, Roberts, *Workers' Participation in Management in Britain* (1972), pp. 134-151.

⁴⁵ *Industrial Democracy (Interim Report)*, p. 37. A final report was published in 1974. The TUC recommended a two-tier structure (a management board and a supervisory board), the employee representatives to be appointed to the supervisory board. Not all unions support employee participation in corporate management: see (1976), No. 127 *Ind. Rel. Rev. & Rep.* 10.

covered by collective bargaining;⁴⁶ (ii) British entry into the European Economic Community, where co-determination is widespread and accepted by the trade union movements of the relevant member states;⁴⁷ (iii) the relatively uninspiring British economic performance which has led to a search for more radical, and hopefully more effective, means of improving economic efficiency; (iv) lastly, and more speculatively, the so-called "democratic imperative that those who will be substantially affected by decisions made by social and political institutions must be involved in the making of those decisions".⁴⁸ Coupled with this, and of a similar nature, it has been argued that with the extension of democratic political values "it will be increasingly difficult to maintain autocracy or even paternalism in industry".⁴⁹

The Committee of Enquiry on Industrial Democracy was appointed in 1975 and it reported in 1977. The terms of reference of the committee obliged it to accept the merits of a "radical extension of industrial democracy in the control of companies" and therefore its report was primarily concerned with the form that any proposed scheme of industrial democracy⁵⁰ should take and how it should be implemented. Although the committee interpreted its terms of reference in the widest possible sense, it in no way could be considered to have evaluated the question of whether industrial participation is in itself desirable. It is planned to examine its proposals from one point of view and, that is, their impact on the nature of shareholder rights in company law. As will be seen, the effect of implementing the Bullock Committee's proposals, or for that matter any proposals designed to give employees an effective

⁴⁶ See, e.g., *Industrial Democracy, op. cit., ibid.*, p. 34: "Major decisions on investment, location, closures, take-overs and mergers, and product specialisation of the organisation are generally taken at levels where collective bargaining does not take place, and indeed are subject matter not readily covered by collective bargaining."

⁴⁷ Vagts, *Reforming the "Modern" Corporation: Perspectives From The German* (1968), 80 Harv. L. Rev. 23; *Employee Participation and Company Structure, op. cit.*, footnote 9.

⁴⁸ *Employee Participation and Company Structure, op. cit., ibid.*, at p. 9.

⁴⁹ Kerr, Dunlop, Harbison, Myers, *Industrialism and Industrial Man* (1973), p. 159.

⁵⁰ The phrases industrial democracy and industrial participation are both vague and emotive, a combination that hardly makes for clarity of thought. Participation can range all the way from consultation designed to make a decision already arrived at more palatable, to effective control over the making and content of any given decision: See generally Pateman, *Participation And Democratic Theory* (1970), pp. 67-74. Where the phrases industrial democracy, industrial participation or co-determination are used in this article they will be used in the sense, as defined by Pateman, that "involves a modification, to a greater or lesser degree, of the orthodox authority structure; namely one where decision making is the 'prerogative' of management, in which workers play no part" (*ibid.*, p. 68).

voice in corporate management, will radically alter these rights and will transform the prevailing legal relationship between shareholders and the board, and between the board and corporate management.

The Bullock Committee recommended the introduction by law of a system of industrial democracy in all companies employing more than 2,000 employees. Employees and shareholders should be given equal representation on the board and there should also be an independent co-opted third element on the board. This proposal gave rise to the $2X + Y$ formula, "where X represents the number of employee representatives and also represents the number of shareholder representatives, and Y is the number of co-opted directors".⁵¹ The Y element is to be co-opted with the agreement of the employee and shareholder representatives, be an uneven number greater than one, and not constitute more than one third of the board.⁵² Provision is made for the situation where the employee and shareholder representatives cannot agree on the size of the reconstituted board when employee representation is first introduced.⁵³ Where there is no agreement on the identity of the co-opted element a new purpose built government body, to be called the Industrial Democracy Commission,⁵⁴ will "be empowered to make a binding nomination of people to sit as members of the third group".⁵⁵

As was stated above, the only companies affected by the proposals are those employing 2,000 or more persons, or where a group of companies *in toto* employs more than 2,000 employees.⁵⁶ The proposed scheme would not be mandatory in the sense that it would apply irrespective of the wishes of the employees. It could, however, be foisted on an unwilling company. Trade unions "recognised on behalf of grades which constitute at least twenty per cent of a company's employees" are to be given the right to demand a ballot of all employees on whether or not they wish to have employee representation on the company's board.⁵⁷ If there is a

⁵¹ Bullock, p. 98, para. 21. The Bullock Committee was not unanimous. A minority report proposed that: (i) employee representation at board level should be on a Supervisory Board; (ii) all employees should have a right to vote in the elections of the employee-directors and (iii) adequate participatory sub-structures should be created before employees are represented on the board.

⁵² *Ibid.*, p. 96, para. 13.

⁵³ A formula for determining the size of the respective X elements is laid down in para. 38, p. 103, with the Y element being roughly a third of this figure.

⁵⁴ Bullock, pp. 152-154.

⁵⁵ *Ibid.*, p. 104, para. 43.

⁵⁶ This would affect about 738 enterprises employing between them six to seven million employees: Bullock, pp. 6-7.

⁵⁷ Bullock, p. 116, para. 20. Provision is made for re-testing employee opinion in subsequent years (*ibid.*, para. 21).

request for a ballot then all employees⁵⁸ should be allowed to take part and the scheme considered approved if a majority, representing at least one third of the eligible employees, vote in its favour.⁵⁹ It is recommended that the ballot be kept simple and a suitable question is stated to be:⁶⁰ "do you want employee representation on the company board through the trade unions recognised by your employer?" Once the scheme is "triggered" (that is approved) then it will be implemented by the trade unions and the company, with the onus on the unions to devise⁶¹ "a satisfactory method of selecting employee representatives". As regards the qualifications of employee representatives, the Bullock Committee considered that these⁶² "can best be left to the trade unions themselves". Such representatives, it was thought, would normally be chosen from among the company's employees but, where it was considered desirable, full-time union officials could be elected as employee representatives.⁶³

IV. *The Bullock Proposals and Shareholder Rights.*

The introduction of a scheme of employee board representation is not merely a matter of conferring on employees the right to elect directors—if that were all that was involved it could be achieved under the present law as there is nothing to prevent employees from being given the right to elect directors by a company's articles of association.⁶⁴ An effective sharing of power by the employee

⁵⁸ Part-time employees are to be excluded and industries with a high labour turnover can impose special conditions as to voting eligibility: Bullock, p. 114, para. 16.

⁵⁹ Bullock, p. 114, para. 17.

⁶⁰ *Ibid.*, p. 115, para. 18.

⁶¹ *Ibid.*, p. 117, para. 27. This aspect of the Bullock proposals has generated considerable controversy as being undemocratic and a blatant attempt to extend trade union power: see In place of Bullock (Confederation of British Industry, 1977), p. 18. The Bullock Committee recommended this scheme so that employee directors would have access to resources necessary to enable them to carry out their responsibilities effectively: Bullock, pp. 109-112. It is of significance that "in enterprises employing 2,000 or more people in the private sector, average trade union membership is of the order of 70 per cent". Bullock, p. 15, para. 14. This high figure, however, would argue for allowing all employees to vote as there is every likelihood that the trade union slate would be elected. As one Labour M.P., sympathetic to the Bullock Committee proposals and to the role of the trade unions envisaged by these proposals, has stated: "The most difficult case to refute is the libertarian one. Why should democratic rights be confined to trade unionists alone?" (New Statesman, 4th March, 1977, p. 280.)

⁶² Bullock, p. 120, para. 36.

⁶³ *Ibid.*, p. 121, para. 39. For the subsequent views of one of the members of the Bullock Committee see Wedderburn, New Statesman, 29th July 1977, p. 137.

⁶⁴ See Pennington, Company Law (3rd ed., 1973), p. 471.

representatives will necessitate the severe curtailment of the ownership rights of shareholders and the existing perception of the shareholder as the theoretical owner of the company will have to be radically modified. Failure to do this would enable shareholders to overrule unilaterally matters which had been decided upon by a board partly composed of employee representatives⁶⁵ and thus undermine the effectiveness of any transfer of management power to the employees. To prevent this, the Bullock Committee proposed that with respect to certain "attributed functions" the board should have the "exclusive right to submit a resolution for consideration at the shareholders' meeting".⁶⁶ These "attributed functions" are:⁶⁷

- (a) winding-up of the company;
- (b) changes in the memorandum and articles of association;
- (c) recommendations to shareholders on the payment of dividends;
- (d) changes in the capital structure of a company (e.g. as regards the relationship between the board and the shareholders, a reduction or increase in the authorized share capital; as regards the relationship between the board and senior management, the issue of securities on a take-over or merger);
- (e) disposal of a substantial part of the undertaking.

Although the board would have the exclusive right to convene a meeting of shareholders to discuss the above issues, "the shareholders' meeting should retain the right to decide whether to pass the resolutions or not".⁶⁸ A number of observations need to be made on these proposals.

(a) These alterations probably do no more than reflect the present reality of the relationship between shareholders and directors. As Midgley's study indicated, the shareholders' meeting is not an initiating organ, its function is normally to rubber stamp what has been put before it by the board. Bullock considered that its "proposals will have the effect of bringing the law into line with reality, rather than reducing any real power or valuable rights that shareholders possess".⁶⁹ It is difficult to accept unreservedly the latter part of this statement, as there is a material difference between possessing rights which, for whatever reason, one does not exercise

⁶⁵ Bullock, p. 80, para. 26. See generally Davies, *Employee Representation On Company Boards And Participation In Corporate Planning* (1975), 38 Mod. L. Rev. 254.

⁶⁶ Bullock, p. 77, para. 18.

⁶⁷ *Ibid.* These were the attributed functions which it was proposed to vest in the board vis à vis the shareholders. Additional functions were recommended with respect to the relationship between the board and corporate management. These will be dealt with at a later point.

⁶⁸ Bullock, p. 81, para. 28.

⁶⁹ *Ibid.*, para. 29.

and being deprived of those rights.⁷⁰ Also, there may be one important area where shareholder passivity cannot be taken for granted and that is with respect to corporate constitutional alterations.⁷¹ Although shareholders are to retain certain other powers,⁷² the implementation of the Bullock proposals would further attenuate the already minimal control exercised by shareholders over the board. However, in the context of the policy argued for by Bullock—that there should be a substantial sharing of corporate power by the legal owners (the shareholders) with the employees—then these proposals are inevitable. Failure to make such reforms would enable management to use the shareholders' meeting as a forum to continue a dispute already lost at board level.

(b) The second observation to be made about the Bullock proposals is, paradoxically, they do not go far enough. Shareholders still retain a veto and, in light of Bullock's commitment to a strong version of parity co-determination, this looks anomalous. The logic of the Bullock position would have argued for a removal of even this residual element of shareholder ownership control. One can envision a number of situations where shareholders would be most reluctant to endorse a board proposal. This may be particularly so where a proposal has been passed over the objections of the shareholder representatives on the board; thus, in this situation, these representatives could do what the scheme of "attributed functions" was designed to prevent them from doing, continue at the shareholders' meeting a dispute lost at board level. For a similar reason, it is odd that Bullock also recommended that the shareholders should have a right to impose borrowing limits on the board, particularly as this power was not subject to the attributed functions machinery and, accordingly, if the articles were appropriately drafted such a limitation could be imposed by shareholder initiative.

(c) The "attributed functions" mechanism has nothing to say on externally generated corporate changes (other than take-overs) such as, for example, a creditor initiated winding up because of insolvency. It is manifestly obvious that in this situation the interests

⁷⁰ This is important in the context of company law as arguably a reason for shareholder acquiescence is that, rightly or wrongly, shareholders perceive the board as on the whole acting in their interests.

⁷¹ See Eisenberg, *op. cit.*, footnote 12, pp. 30-68.

⁷² "In other respects we see no need to make changes in the shareholders' legal rights. In particular, we think that the power to impose borrowing limits on the board, to appoint auditors and to require a Department of Trade investigation of a company's affairs [under s. 165 of the Companies Act 1948, *supra*, footnote 6] all of which are important means by which shareholders can check on the activities of the board, should remain vested in the shareholders": Bullock, p. 82, para. 31.

of the employees in having some say in the matter will be most pressing.⁷³ It would be difficult, however, to devise a scheme for effective employee participation at this stage (which would of necessity circumscribe the powers of the creditors) that would not dry up the sources of long term and short term debt capital, or at least make them considerably more expensive.⁷⁴ The *Bullock Report* recognized that the "lender wishes to ensure that the company is able to service its debt and ultimately repay it", and anything that impairs this sense of assurance will directly effect the cost, and perhaps the availability, of external debt financing. If any protection is to be provided to employees in this situation it will have to be outside the institutional machinery of the winding up and also quantifiable in advance as a risk at the time a loan is made.⁷⁵

As far as shareholders are concerned the overall effect of the Bullock proposals is to diminish significantly their legal powers vis à vis the board. Shareholders would still possess some powers (for instance the right to remove their representatives from office) but these would be marginal. Although these changes would probably do no more than bring legal theory into line with commercial practice, they would make it impossible, or at least very difficult, to develop the shareholders' meeting as an instrument of control over directors. The important question is whether the employees and their representatives will perform this role, and on that it is impossible to give a dogmatic answer.

V. *The Problem of Groups of Companies* (Including Multinationals).

As the Bullock Committee pointed out large industry in the United Kingdom⁷⁶ "is organised in pyramids of holding and subsidiary companies" and it estimated that the ⁷⁷ "738 enterprises employing 2,000 or more people in the United Kingdom will therefore translate into a larger number of separate companies employing 2,000 or more. No precise figure can be given, but the number is likely to be

⁷³ They will play a role in so far as the board is a decision making organ in a winding up. The general principle, however, is for the board to cease to have any executive power in this situation: Companies Act 1948, *ibid.*, ss 285 (2), 296 (2); *Measures Bros. Ltd v. Measures*, [1910] 2 Ch. 248; *Re Oriental Inland Steam Co.* (1874), 9 Ch. App. 557, at p. 560; *Re Oriental Bank Corporation, ex p. Guillemin* (1884), 28 Ch.D. 634.

⁷⁴ Between 1970-74 debt financing constituted, on average, somewhere in the region of 25% of the provision of new funds of companies in manufacturing, distribution and other services; see Bullock, p. 9, Table 3.

⁷⁵ E.g., the statutory guarantee of redundancy payments or the preferential treatment of wages on a winding up: see *supra*, footnote 32.

⁷⁶ Bullock, p. 130, para. 10.

⁷⁷ *Ibid.*

of the order of 1,800'. Both at statutory level,⁷⁸ and in judicial decisions,⁷⁹ the courts have recognized the economic reality of group enterprises where the component parts are composed of separate legal entities. Bullock considered that there should be a more explicit legal recognition of the economic interdependence of associated companies by providing that⁸⁰ "directors of a holding company should be enabled to consider the interests of shareholders in and employees of a subsidiary company . . .", a reform which would probably constitute no great change as a matter of commercial practice.⁸¹ Bullock also considered that⁸² "it is for serious consideration whether directors of a subsidiary should be enabled to consider the interests of employees of and shareholders in the holding company, and indeed, in all companies in the group". This is a more debatable change, as it would further facilitate parent exploitation of a subsidiary to the prejudice of any minority shareholders in the subsidiary.⁸³ Should such a reform be adopted, it would be essential to provide minority shareholders in a subsidiary with an appraisal remedy and also make the parent directly liable for the debts of the subsidiary so as to protect the latter's creditors.⁸⁴

Of more significance are Bullock's proposals for employee representation with respect to groups of companies, which will have far reaching effects on parent-subsidiary relationships, especially where non-United Kingdom multinationals are concerned. Many parent companies will employ less than 2,000 employees, while their individual subsidiaries each employ more than that number. This will be the case where the parent merely co-ordinates group activity and provides financial, administrative or management services for the various component parts of the group. In this type of corporate set up "board level representation would be incomplete if it applied

⁷⁸ See, e.g., Companies Act 1948, *supra*, footnote 6, s. 150, as amended by Companies Act 1976, *supra*, footnote 24, s. 8, (obligation to prepare group accounts); Companies Act 1976, s. 18 (power of auditors of parent to obtain information relating to subsidiary).

⁷⁹ See, e.g., Gower, *Company Law* (3rd. ed., 1969), pp. 213-216; *DHN Food Distributors Ltd v. Borough of Tower Hamlets*, [1976] 3 All E.R. 462 (C.A.).

⁸⁰ P. 130, para. 11.

⁸¹ See, e.g., *Charterbridge Corporation Ltd v. Lloyds Bank Ltd*, [1970] Ch. 62.

⁸² P. 130, para. 11.

⁸³ See, e.g., *Scottish Co-operative Wholesale Society v. Meyer*, [1959] A.C. 324 (H.L.).

⁸⁴ See Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy* (1975), 42 U. Chi. L. Rev. 589; Posner, *The Rights of Creditors of Affiliated Corporations* (1976), 43 U. Chi. L. Rev. 499; Landers, *Another Word on Parents, Subsidiaries and Affiliates in Bankruptcy* (1976), 43 U. Chi. L. Rev. 527.

only to large operating subsidiaries and not to the board at the apex of the pyramid of decision making".⁸⁵ For this reason, the *Bullock Report* proposed that its recommendations should apply to the board of a holding company where the aggregate work-force of the group was 2,000 or more employees, and also to each individual subsidiary company which has a work-force of 2,000 or more employees.⁸⁶ This will insert employee representatives at the appropriate points in the group structure where the major decisions are taken.

A requirement for the efficient operation of groups of companies is that the ultimate power to dictate policy to subsidiaries should be vested in the parent company, otherwise the economic cohesiveness of the group cannot be ensured. However, if the Bullock proposals on groups were introduced without modification this would greatly threaten the economic viability of the group as the parent could no longer dictate the composition of the employee representatives on its subsidiary's board, it could merely elect one of X elements of the board. In addition, the "attributed functions" mechanism would deprive the parent company as shareholder of the initiative with respect to the important business functions mandatorily attributed to the board. Bullock was sensitive to this issue and proposed that where there is no agreement on the co-option of the members of the Y element on the board of the subsidiary then "the holding company should in the last resort have the power to appoint them", a power which should also be exercisable with respect to sub-subsidiaries.⁸⁷ These proposals are far reaching. For all intents and purposes they would eliminate the entity doctrine as far as groups are concerned. It is difficult to imagine how the courts could do anything but recognize the group as a single legal entity where the law was so fashioned as to recognize expressly the overriding interests of the parent in having the legal power to control the policies of the subsidiary.⁸⁸ Nowhere in the *Bullock Report* are these likely consequences clearly dealt with. However, were the Bullock proposals on groups to be introduced then attention would have to be paid to them.

The fusion of the separate legal entities of companies in a group situation is made manifest by the Bullock proposals on the definition

⁸⁵ Bullock, p. 132, para. 16.

⁸⁶ *Ibid.*, para. 18.

⁸⁷ *Ibid.*, p. 135, para. 26; pp. 136-137, para. 29. For example, if Co. A is the parent of Co. B and Co. B is the parent of Co. C, then Co. A should have the power to appoint the Y element to both the Co. C and Co. B boards.

⁸⁸ It might be argued that this is the present position under English law and this has not led the courts to ignore completely the entity doctrine as applied to groups. But the explicit recognition of special parental rights would be a much more compelling recognition of the interests of the parent.

of subsidiary company. As presently defined by section 154 of the Companies Act 1948, a parent-subsidiary relationship exists (i) where one company is a member of another company and controls the composition of its board, or (ii) where one company "holds more than half in nominal value of [the] equity share capital" of another company. Bullock proposes the addition of a third element to this definition, namely, that the subsidiary has "executed and registered an instrument of acknowledgement of control by that other company".⁸⁹ The implications of this change for the entity doctrine are not particularly clearly spelt out in the report.⁹⁰ Also, the problem with this definition is it assumes, absent any instrument of control, that there will be an absence of the close economic ties characteristic of the parent-subsidiary relationship and which, for example, presently require the preparation of group accounts. Because the parent-subsidiary relationship will be dependent as a result of the Bullock proposals, in part, on an explicit agreement, and will not be automatically triggered off when certain conditions have been satisfied, there is every possibility that a parent will ensure that the subsidiary does not execute the "instrument of control" to avoid the aspects of company law which apply to parent-subsidiary relationships. As the *Bullock Report* recommends that its parent-subsidiary definition should apply to all companies, regardless of the fact that they do not possess reconstituted boards, the potential for manipulative abuse is very much present.

The primary justification for the proposed re-definition of the parent-subsidiary relationship was to deal with a successful take-over bid, where the offeree company had a reconstituted board but the offeror did not. It was felt that this would frustrate the enlightened labour policy of the offeree company.⁹¹ This is not particularly convincing. Even if the offeror does not possess a reconstituted board it would still have to operate within the context of the reconstituted board of the offeree company. Admittedly, it would control ultimately the Y element, but the answer to this would be for the employees to seek representation on the parent board. This is a much preferable solution to the instrument of control proposal of Bullock, a proposal which among its defects will only operate to

⁸⁹ P. 140, para. 41. Bullock proposed that these instruments of control be registered with the Registrar of Companies. Bullock also proposed that this new definition should apply whether or not the boards of the respective companies had been re-constituted.

⁹⁰ *Ibid.*, p. 142, paras 45-46, where the only area of difficulty foreseen by Bullock are with respect to the disclosure of directors' shareholdings and insider trading.

⁹¹ *Ibid.*, p. 140, paras 39-40; p. 141, para. 43: "Company take-overs cannot expect to be unaffected by these new developments."

protect incompetent managements of offeree companies which refuse to execute such agreements.⁹² Also, where an instrument of control is executed, consideration will have to be given to the question of conferring on minority shareholders in the subsidiary an automatic appraisal right, or some similar right to protect their interests, as the subsidiary is manifestly going to be operated in the interests of the parent. In recommending that the parent-subsidiary relationship should require the execution of an instrument of control, Bullock sought support from the German rules relating to a *Konzern*. Under these rules a formal "contract of control" can be entered into, in certain circumstances, by two companies whereby one company can exercise control over another for the former's benefit.⁹³ It is a feature of these rules, however, that special protection is afforded to the minority shareholders in the dominated company.⁹⁴

There is one special area where the Bullock proposals on groups will cause problems and that is with respect to multinationals, particularly foreign multinationals carrying on business in the United Kingdom.⁹⁵ As it is proposed to vest in the parent the ultimate right to appoint the Y element on the subsidiary's board, a foreign parent could always appoint a majority of the subsidiary's board without the likelihood of employee representatives being appointed to its board according to the $2X + Y$ formula. It was the ultimate possibility of such a re-constitution of the parent board that formed the underpinning for the Bullock proposals on groups. As this would not be feasible in the case of a foreign parent, the *Bullock Report* recommended that special provisions be made with respect to United Kingdom subsidiaries of foreign parents, although it appreciated that this could be considered discriminatory against foreign capital.⁹⁶ Bullock proposed that the ultimate right to appoint the Y element to the board of the English subsidiary of a foreign parent be vested in the Industrial Democracy Commission, if conciliation failed to

⁹² *Ibid.*, p. 141, para. 44 rather complacently states: "... the managers in an offeree company would, we believe, welcome the opportunity for their board to be able to negotiate terms with the new corporate dominant shareholder before their company became its subsidiary and before it acquired the extended legal powers of a holding company."

⁹³ See Lutter, *The Konzern in Germany Company Law*, [1973] J.B.L. 278.

⁹⁴ *Ibid.*, at p. 282.

⁹⁵ British based multinationals which have large work-forces overseas (see Bullock, p. 7, Table 2) do not give rise to any acute regulatory problems. Employees can be represented on the parent board. This will leave the employees of overseas subsidiaries unrepresented on the boards of those companies, but this is hardly the fault of English domestic law which is powerless to remedy this state of affairs. The only way in which this situation could be dealt with is by international agreement: see Bullock, pp. 142-144.

⁹⁶ Pp. 146-147, paras 57-58.

produce agreement between the employee and shareholder representatives on the composition of the subsidiary board. Such an appointment could only be made after the "wishes of the foreign parent" and the views of the Secretary of State for Industry had been ascertained.⁹⁷

While the *Bullock Report* formulates machinery for dealing with the appointment of the Y element to British based subsidiaries of foreign parents, it does not deal with the criteria to be invoked in determining whether or not the views of the foreign parent should prevail. The examples given in the *Bullock Report* are of little help. It posits the hypothetical of a foreign parent which⁹⁸ "decides deliberately to veto all nominations for the third group of directors, except their own . . .". Here the answer seems obvious, the position of the foreign parent has nothing to commend it. The other hypothetical involved a reconstituted subsidiary board where the foreign parent wishes to remove the co-opted members who, along with the employee representatives, are unreasonably blocking "a modernisation scheme involving redundancies".⁹⁹ Again, the outcome of this dispute seems foredoomed. Not only are these hypotheticals extreme, but they are not typical of the types of dispute which will cause the most acute difficulties with respect to foreign multinationals. Take the following problems. The representatives of a foreign parent on the reconstituted board of its United Kingdom subsidiary wish to adopt the following policies to which the other members of the board (that is the employee representatives and the co-opted members) object: (i) increase cash payments in the form of dividends to the foreign parent for expansion of the group's activities in some other part of the world, (ii) adopt a rationalization scheme involving the transfer of part of its business from the United Kingdom to Europe with a consequential loss of jobs in the United Kingdom, (iii) transfer part of its business to Europe because of poor industrial relations in the United Kingdom. These, it is submitted, are more representative of the types of difficult decisions on which the Industrial Democracy Commission may have to adjudicate, and the criteria to be applied in their solution are nowhere spelt out in the *Bullock Report*, although perhaps they can only be evolved on a case by case basis. One suspects that where there is a conflict between group economic viability and the more immediate economic and social interests of United Kingdom employees the former will almost invariably be deferred to the latter. This will make the United Kingdom relatively unattractive for international firms to set up

⁹⁷ P. 147, para. 59. The Industrial Democracy Commission would be obliged to take these views into consideration before reaching a decision.

⁹⁸ P. 149, para. 63.

⁹⁹ *Ibid.*

business, particularly if the hypothesis is correct that multinational firms pursue, and will pursue to an increasing extent, policies of centralized control in order to bring about an integrated global economic unit.¹⁰⁰ The *Bullock Report* contains a rather desultory and inconclusive discussion on this issue and eventually is satisfied with the unhelpful observation that "any attempt to predict, let alone to quantify the implications for investors of employee representation on the board of large British enterprises is difficult".¹⁰¹ Difficult it may be, but a more intensive effort at least to delineate the issues involving foreign investor confidence could have been made.¹⁰²

There is one last point to be dealt with concerning multinationals. To evade the requirement of having to reconstitute the board of its British subsidiary it would be possible for a foreign parent to carry on its business in the United Kingdom as an unincorporated branch. It would appear that a small number of foreign concerns already conduct their business in this form.¹⁰³ To combat this, Bullock proposed that if employees of an unincorporated branch of a foreign enterprise vote for employee representation then it "should be incorporated" or some alternative arrangements made giving satisfactory representation to employees.¹⁰⁴ Compelling foreign companies to carry on business in a form they find unacceptable, and perhaps extremely inconvenient, could operate as a deterrent to foreign business. Also, it is difficult to see what alternatives to incorporation could be made to work if it is considered desirable to duplicate for the employees of the unincorporated concern something similar to the "attributed functions" mechanism recommend with respect to the company. There is no reason to assume that the shareholders of the foreign parent will be disposed towards the aspirations of English work people to have substantial control over their working lives. Accordingly, it is difficult to see how their rights could be effectively curtailed where the business carried on in the United Kingdom is conducted by means of an unincorporated firm.

VI. *Employee Representation and Directors' Duties.*

An aspect of company law which will be materially affected by the implementation of any proposals on co-determination is that relating to directors' duties. Not surprisingly the Bullock Committee

¹⁰⁰ See *The Impact of Foreign Direct Investment on the United Kingdom*, Department of Trade and Industry (H.M.S.O., 1973), pp. 126-127.

¹⁰¹ P. 54, para. 41.

¹⁰² See Department of Trade report, *op. cit.*, footnote 100.

¹⁰³ Bullock, pp. 144-145, para. 52.

¹⁰⁴ *Ibid.*

recommended that directors, in carrying out their duties, "should take into account the interests of the company's employees as well as its shareholders".¹⁰⁵ Bullock considered that this obligation should be made mandatory, and proposed the adoption of clause 1 of the Industrial Democracy Bill introduced unsuccessfully in Parliament in 1975.¹⁰⁶ This provided:

The matters to which the directors . . . of a company shall have regard in exercising their powers shall include the interests of the company's workers generally as well as the interests of its shareholders.

This reform is relatively uncontroversial, it has the support of the employers' federation,¹⁰⁷ the Confederation of British Industry, and the Conservative government in its ill fated Companies Bill in 1973¹⁰⁸ introduced a provision along these lines. It has been perceptively pointed out, however, that these reforms may have more far reaching effects than their proponents appreciate¹⁰⁹ in that the imposition of new, employee-oriented duties on directors requires, as a corollary, that appropriate channels of accountability be established. It is, of course, possible to have a non-correlational duty,¹¹⁰ but it would be odd to do this in the context of introducing obligations on directors to have regard to the interests of corporate employees. However, even should this duty be imposed on directors, it does not necessarily follow that the machinery of accountability must take the form of employee participation at board level. An alternative solution, and one in keeping with the present provisions of English company law, would be to require the directors to make a report, in the directors' annual report,¹¹¹ on the state of industrial relations, and other employee related matters. This report could be made available to employee representatives for use in collective bargaining negotiations. All in all, it is to be doubted if the proposals of Bullock with respect to directors' duties to consider the interests

¹⁰⁵ Bullock, p. 84, para. 38.

¹⁰⁶ Reproduced in Bullock, *ibid.*

¹⁰⁷ A New Look at the Responsibilities of the British Public Company (Confederation of British Industry, 1973).

¹⁰⁸ Cl. 53, reproduced in Bullock, p. 84, para. 38.

¹⁰⁹ *Industrial Democracy*. (A Conference on the Report of The Bullock Committee), Leicester University, 4th-5th April 1977, by Professor Wedderburn. See also, Davies and Lord Wedderburn of Charlton, *The Land of Industrial Democracy* (1977), 6 Ind. L.J. 197, at p. 199.

¹¹⁰ See, e.g., Harris, *Trust, Power and Duty* (1971), 87 L.Q. Rev. 31, at pp. 48-51.

¹¹¹ See, *Companies Act 1948*, *supra*, footnote 6, s. 157(1); *Companies Act 1967*, *supra*, footnote 32, ss 15-24. Bullock, p. 87, para. 46 recommends that the directors' report should be made available to employees and also that "documents which are available for inspection to shareholders to be made available to employees also".

of employees will make a great deal of difference. As was stated earlier, directors already, because of the realities of commercial life, have to take them into consideration. The change proposed by Bullock would, of course, in no way justify the board in ignoring the interests of shareholders and, if the directors were to act in this way, then presumably the shareholders could impugn this action as being an improper use by the board of their powers.

As regards directors' duties in general, Bullock proposed that all directors "should have the same legal duties and liabilities"¹¹² and basically that directors should "act in the best interests of the company".¹¹³ As regards the employee directors on the board, this requirement will cause considerable difficulties. Even if one concedes that directors presently perform a balancing function, the requirement that all directors act "in the best interests of the company" will impose on the employee representatives obligations which might bring them into direct conflict with their constituents. As has been said of such a duty:

The integrational function of the concept [is] . . . evident. Participation is tolerated but not as an instrument exclusively designed to safeguard the expectations of workers. The link between participation and the plant's benefit dissociates the representatives from the workers and transforms them into a special kind of manager.¹¹⁴

Bullock was aware of this difficulty, but did not indicate how the dilemma should be resolved. The *Report* did state that an employee-director should not act as a trade union representative and vote according to instructions,¹¹⁵ yet it recognized that it would "be unreasonable and unrealistic not to expect the employee representatives, the representatives of the workforce, to argue strongly at board level for the interests of their constituents".¹¹⁶ What this all adds up

¹¹² P. 83, para. 37.

¹¹³ *Ibid.*, p. 85, para. 39.

¹¹⁴ Simitis, *Workers' Participation In The Enterprise—Transcending Company Law?* (1975), 38 Mod. L. Rev. 1, at p. 12. See also Daubler, *Co-Determination: The German Experience* (1975), 4 Ind. L. J. 218, at p. 225. The phrase "bona fide in the interests of the company" has been used in other areas of company law, particularly with respect to alterations to the articles of association, as a means of papering over factional disputes: see e.g., *Peters' American Delicacy Co. Ltd v. Heath* (1939), 61 C.L.R. 457, at pp. 481-482. As one judge has stated "This formula, 'bona fide in the interests of the company' is one that [may] . . . become little more than an alibi for a refusal to consider the merits of the case . . ." per Lord Wilberforce in *Ebrahimi v. Westbourne Galleries Ltd*, [1973] A.C. 360, at p. 381 (H.L.).

¹¹⁵ Where an employee representative does find himself so mandated, he must disclose this to the board and refrain from voting: Bullock, pp. 125-126, para. 57. Bullock considered it to be "quite clear that an employee representative would be in breach of his duty if he voted in a particular way solely because of the instructions of his trade union": p. 85, para. 40.

¹¹⁶ Pp. 84-85, para. 40.

to is the proposition that provided he is not mandated the employee-director may legitimately pursue the interests of the employees. As regards matters of critical and immediate concern to employees such as strikes, lock-outs and collective bargaining, Bullock considered that, if these issues were discussed at board level, it would probably be valuable to have representatives of the employees present. With this it is hard to disagree. Bullock, however, also considered that there was no need to have any detailed provisions prohibiting, for example, employee representatives from taking part in deliberations involving these matters:¹¹⁷

For employee representatives are most unlikely to demand that senior management reveal their bargaining position and strategy and, if they did make such a demand, they would almost certainly not be supported by the shareholder representatives and co-opted directors.

This is unconvincing. The real problem is, as has been pointed out by others, that on occasions there is a divergence of interest between management and labour and the law, if it is to reflect social reality, cannot ignore this, although it may try to channel, and attempt to regulate, the consequences of this divergence.¹¹⁸ By formulating directors' duties as if both employees and management shared a unitary frame of reference this element of conflict is merely ignored, but it is in no way resolved. It would have been preferable if Bullock had explicitly recognized that directors elected by a special class should be able to act in the furtherance of the interest of that class.¹¹⁹ Whether, of course, this would be a desirable change is a completely different matter. What is clear is that the institutional representation of employees on the board will not eliminate, although it may possibly curtail, employee-management conflict.¹²⁰

An area of directors' duties which caused much anxiety to

¹¹⁷ P. 125, para. 56.

¹¹⁸ Otto Kahn-Freund, *Labour and the Law* (1972), pp. 18-20; Fox, *Industrial Sociology and Industrial Relations*, Royal Commission on Trade Unions and Employers' Associations, Research Paper No. 3 (1966).

¹¹⁹ Cf., Final Report of the Commission of Enquiry into the Working and Administration of the Present Company Law of Ghana (1961, Accra), cl. 203(3) which also verbally papers over the conflict. Somewhat similar problems arise, although the conflict is less acute, where nominees are appointed to a board to look after special capital interests.

¹²⁰ That there will be a certain level of conflict is recognized by the Bullock recommendation that employee representatives on the board should not be precluded from taking part in discussions because of their contracts of employment by the rule proscribing directors from voting on matters in which they have an interest: Bullock, p. 126, para. 58. The Bullock minority made much of this issue and considered that the majority proposals would "create considerable conflict of interest for the employee representative when the issue under discussion was one which was negotiable with the very Trade Union to which the representative himself belonged": Bullock, p. 177, para. 33.

Bullock was the obligation of directors not to disclose prematurely confidential information which could cause damage to the company. This is a particularly acute problem in light of the paramount importance which Bullock attached to the obligation of the employee representatives to report back to their constituents. It was, in the opinion of Bullock, "essential to the success of board level representation that employee representatives should be in close touch with their constituents. They must make it their regular job to report on what the board is doing or proposing to do and why".¹²¹ The ability of the representatives to report back will be a direct function of the confidentiality doctrine. It is not easy to evaluate how significant this confidentiality issue will be as a matter of practice. Over a wide range of issues it will cause no great difficulty, as there will be a harmony of interest between the employees and the company. As Bullock asserts, with some plausibility, the "[I]ndividual employee representatives are no more likely than existing directors deliberately to leak confidential information to competitors or price-sensitive information to speculators".¹²² Where, however, the confidential information involves plans which will have a direct impact on the interests of employees, particularly ones which are potentially detrimental such as a plant re-location, then the employee representatives may not necessarily share the views of the other board members as to the overriding corporate interest in keeping the information secret. Also, the credibility of the employee representatives would be severely impaired if they were to keep silent when in possession of information of critical importance to their constituents.

The *Bullock Report* recognized these difficulties, but beyond asserting that they should not be exaggerated and observing that European experience had indicated that "breaches of confidentiality as a result of board level representation were extremely rare",¹²³ it made few recommendations. The only positive recommendation was that it should be a board matter as to what to categorize as confidential. Although not a dramatic proposal, this may go a considerable way in solving the problem: if the board establishes its own categories of confidentiality there is a greater likelihood that the employee representatives will comply with this classification. Such a reform would require legislation to enable the board to decide by majority vote what information is to be treated as confidential. It may be anomalous to allow directors, in this limited way, to set their

¹²¹ P. 87, para. 49. See also, p. 123, para. 46, on proposals relating to a company's responsibilities to provide facilities to enable employee representatives to communicate with their constituents.

¹²² P. 89, para. 53.

¹²³ P. 90, para. 57.

own duties, but a failure to do so would permit a disgruntled shareholder to commence a derivative action¹²⁴ to complain of a breach of duty by an employee-director in releasing confidential information. It is to be doubted if an action should be allowed where the board has agreed on the disclosure of such information.

The confidentiality issue illustrates that with employee representatives on corporate boards there would be, in all likelihood, a considerable asymmetry between the power of the shareholder representatives and that of the employee representatives. When dealing with the mechanism of the "attributed functions" of the board it was stated that one of its consequences, if not its primary purpose, was the preventing of management from bringing before the shareholders' meeting a dispute already lost at board level. It can be seen that no similar restraint will be imposed on employee representatives vis à vis their constituents. All board decisions, to be effectively implemented, have to be accepted, or at least acquiesced in, by the employees. This, of course, is the position without co-determination, but the co-determination system will greatly enhance the leverage of employee power at a time when that of the shareholders has been reduced. As the employee representatives will have access to corporate plans at their formative stage, they are thus able to report back to their constituents who will have an opportunity from this point onwards to take whatever action they consider appropriate. This, of course, can have beneficial results, but it does further expand the power of the employees with no equivalent or counteracting power being vested in the shareholders.

Bullock is silent on the relationship between the enforcement of directors' duties and the shareholders. As was pointed out above,¹²⁵ the derivative action is so surrounded with procedural hurdles under English law, that it is not easily available to shareholders. Were access to it to be liberalized, this would provide disgruntled shareholders with an opportunity to harass the board. The availability of the derivative action as an instrument of harassment depends also on the nature of the substantive duties imposed on directors. Although the fiduciary duties of directors are strict,¹²⁶ outside the problem of confidential information and perhaps that relating to conflicts of interest, these duties will not impose on the

¹²⁴ The derivative action under English law is hedged in with restrictions: see Wedderburn, [1957] Camb. L.J. 194; [1958] Camb. L.J. 93. Recently there has been some relaxation in the rule allowing a shareholder to bring a derivative action (see Prentice, *Wallersteiner v. Moir*: The Demise of The Rule In Foss v. Harbottle? (1975), 40 Conv. (N.S.) 51; *Daniels v. Daniels*, [1978] 2 W.L.R. 73), but there has been no attempt to introduce an overall legislative solution.

¹²⁵ *Ibid.*

¹²⁶ See generally Gower, *op. cit.*, footnote 79, pp. 524-545.

employee representatives any unmanageable obligations. With respect to the duties of care and skill, the situation is more problematic. As the law now stands, the duties of care and skill imposed on directors are minimal, if not derisory:¹²⁷ a director is not obliged to give continuous attention to the company's affairs and, in fact, there is no modern English case in which a director has been found guilty of negligence by absenting himself from board meetings.¹²⁸ Reform of these rules is long overdue, but if they were made more stringent this might cause difficulty and eventual embarrassment to employee directors.¹²⁹ To deal with this problem the employee representatives' duties of care and skill could be limited to employee related matters, but this would violate the Bullock principle "that all directors should have the same legal duties and liabilities"¹³⁰ and would be unacceptable from a policy point of view: an argument can be made for holding a director to a higher standard of skill because of his special expertise,¹³¹ but there is little to recommend lowering, or removing, a particular duty because of a lack of expertise.¹³² If, however, the standard of care and skill of directors is raised, this will provide the shareholders with an opportunity to harass directors, unless their right to commence a derivative action is circumscribed.

¹²⁷ See *Re City Equitable Fire Insurance Co., Ltd.* [1925] Ch. 407, at pp. 426-430.

¹²⁸ Gower, *op. cit.*, footnote 79, p. 551: "The director who stays away runs the risk of not being reappointed when he next comes up for re-election, but little risk of liability for what is done in his absence." See *Re Denham & Co.* (1883), 25 Ch. D. 752; *Marquis of Bute's Case*, [1892] 2 Ch. 100; *Huckerby v. Elliott*, [1970] 1 All E.R. 189.

¹²⁹ This would only be so if shareholders were given the right to commence a derivative action respecting a director's negligence. *Pavlides v. Jensen*, [1956] Ch. 565 would indicate that a shareholder does not have standing in such a situation, although there may now be an exception to this rule where the negligence takes the form of some self-serving action on the part of the directors: *Daniels v. Daniels*, *supra*, footnote 124. It was not within the remit of Bullock to discuss directors' duties in general. It did, however, direct its attention to the question of directors' liability for fraudulent trading under Companies Act 1948, *supra*, footnote 6, s. 332, which renders directors liable to creditors where they conduct the affairs of a company so as, *inter alia*, to defraud creditors. The section has been emasculated by the courts (see *Re Patrick & Lyon Ltd.*, [1933] Ch. 786; *Re William C. Leitch Bros. Ltd.*, [1932] 2 Ch. 71) and Bullock was at pains to emphasise that any reform designed to make it more menacing should restrict its scope to reckless or fraudulent conduct.

¹³⁰ P. 83, para. 37.

¹³¹ See Schaeftler, *The Liabilities of Office: Indemnification and Insurance of Corporate Officers and Directors* (1976), pp. 67-70.

¹³² This problem is premised not on the assumption that the employee representatives on the board will be particularly incompetent, but merely that they will have their proportionate share of inadequates. The portion of Bullock dealing with the training needs of employee representatives seems to underestimate the magnitude of the task: pp. 156-159.

Bullock proposes that many of the traditional shareholders' powers should remain intact. Thus shareholders should retain the right to appoint auditors,¹³³ to require the appointment of Department of Trade inspectors to investigate a company's affairs,¹³⁴ and to remove directors from office, but only those directors they have elected.¹³⁵ However, other aspects of shareholders' powers would also have to be dealt with. There is the question of the derivative action already alluded to. It would also be necessary to deal with the vexed question as to whether or not shareholders can use the corporate name in litigation, at least where directors' wrongs are in question,¹³⁶ otherwise this could be used as an instrument for harassing the employee directors. There is also a rule of English company law, designed to ensure that at all times a company possesses an effective management organ, that if the board is deadlocked, or unable to act, then the power of management reverts to the shareholders in general meeting.¹³⁷ Normally this rule does not play much of a role in the large company as acute board room dissension is rare and, where it occurs, the size of the board, coupled with the casting vote of the chairman, makes the possibility of deadlock unlikely. This will be all changed on the reconstituted board. Harmony will be less assured, the chairman's casting vote can be removed by the board,¹³⁸ and, although the fixing of the Y element as an uneven number is designed to minimize the chances of deadlock, absences or abstentions could frustrate this policy. In a situation of impasse, it would undermine the Bullock scheme if the matter automatically reverted to the shareholders. Accordingly, it will be necessary to provide that the board itself will have to solve its acute disagreements.

VII. *Bullock Proposals: The Directors and Corporate Management.*

To guarantee that the board is the effective locus of management power, Bullock had to deal with the board's relationship with corporate management. While recognizing that a company's management structure will develop in a way appropriate to its

¹³³ Companies Act 1976, *supra*, footnote 24, s. 14. See, *supra*, footnote 72.

¹³⁴ Companies Act 1948, *supra*, footnote 6, s. 165.

¹³⁵ P. 82, para. 32.

¹³⁶ See Wedderburn, (1976), 39 Mod. L. Rev. 327. Bullock did recommend that "the right of shareholders to ratify or validate an act done, for example, by one or more directors who exceeds the power delegated to them, or which needs approval by the company (*e.g.* payment of compensation for loss of office) should be modified" (p. 82, para. 31). Approval would now have to be also given by the board (*ibid.*). What is to happen in a case of conflict is not made clear.

¹³⁷ *Barron v. Potter*, [1914] 1 Ch. 895; *Foster v. Foster*, [1916] 1 Ch. 532.

¹³⁸ Bullock, pp. 105-106.

characteristics and individual needs,¹³⁹ Bullock accepted that the board "cannot exercise detailed influence over every aspect of the company's affairs and it is largely reliant on the proposals and policies put to it by management".¹⁴⁰ Although English companies make use of outside directors,¹⁴¹ there is no evidence to suggest that they exercise effective supervisory power over management and, considering the dominance of the chairman and full-time executives in making such appointments, this is not surprising. There is, of course, no clear-cut distinction between "the functions of a board of directors and those of senior executives",¹⁴² a blurring of functions which is attributable in part to the fact that the prevailing legal norm makes the directors responsible for the management of the company, something which as a matter of fact they are unable to do. However, if the employee representatives are to be given an effective voice in corporate affairs it will be necessary to ensure that major corporate policy decisions are a direct responsibility of the board. To guarantee this, Bullock proposes that the board should vis à vis management exercise the "attributed functions" which it recommends with respect to the shareholders and, in addition, have responsibility for the¹⁴³ (i) "allocation or disposition of resources" (to the extent not covered by the other attributed functions) and (ii) the "appointment, removal, control and remuneration of management, whether members of the board or not, in their capacity as executives or employees".

The impact of such an alteration is impossible to predict. In many ways it would constitute an improvement. Under the present model of corporate governance the board is treated as a decision making organ which assumes, contrary to the facts, that "the board is an integral part of the corporation's management structure".¹⁴⁴ In the case of the proposed Bullock reconstituted board, the board in its dealings with management will be responsible for major financial decisions (for instance the issue of securities on a merger or take-over, declaration of dividends), substantial asset sales and the appointment and removal of corporate management, the latter function obviously involving the responsibility for monitoring management's performance. This, if nothing else, brings into sharp relief the minimum responsibilities of the board and, at this level, it

¹³⁹ P. 69, para. 28.

¹⁴⁰ P. 67, para. 23.

¹⁴¹ P. 63, Table 11. Bullock analyzed the boards of The Times 1,000 companies and found that the "overwhelming proportion of the companies had between one and five non-executive directors" (p. 64, para. 16).

¹⁴² Bullock, pp. 76-77, para. 14.

¹⁴³ Pp. 77-78, para. 18.

¹⁴⁴ Eisenberg, *op. cit.*, footnote 13, p. 165.

distinguishes between day to day corporate management and the responsibilities of the board to supervise corporate management and set general policy guidelines. Although this somewhat minimizes the formal role of the board from what it is presently, it confers on it a brief which it should be capable of carrying out and which could not be performed satisfactorily by any other corporate organ.¹⁴⁵

Conclusion

The *Bullock Report* constitutes by far one of the most thorough and thoughtful examinations of the impact of employee participation on the customary rules of company law.¹⁴⁶ Effective employee representation on the board will bring in its train a host of significant changes in the ownership rights of shareholders. Company law, as Bullock points out, is presently "largely based on the concept of ownership",¹⁴⁷ a state of affairs which would be radically modified should the proposals be implemented to give an effective voice to employees in corporate management.

¹⁴⁵ Eisenberg, *op. cit.*, *ibid.*, p. 170.

¹⁴⁶ This was due in no small part to the research paper prepared by Mr. P.L. Davies for the Committee: European Experience with Worker Representation on the Board (H.M.S.O., 1976).

¹⁴⁷ P. 59, para. 2