

# Thirty Years and Done – Time to Abolish the UK Corporate Governance Code

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Brian R. Cheffins

University of Cambridge and ECGI

Bobby V. Reddy

University of Cambridge

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Corporate Governance Code

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## Abstract

A 1992 Code of Best Practice developed by a committee Sir Adrian Cadbury chaired revolutionised UK corporate governance. The Code, which introduced non-statutory best practice provisions with which listed companies could choose not to comply so long as they explained why, has evolved into the more expansive UK Corporate Governance Code of today. This paper argues that after three decades it is time to do away with the code approach and 'comply-or-explain'. Much of the current Code's content is now irrelevant, and disclosure and compliance expectations have escalated to levels that create substantial net costs for companies. Additionally, the Code is now being used to address 'stakeholder' issues for which the Code's shareholder enforcement dependent comply-or-explain mechanism is poorly suited. The Code correspondingly should be abolished, with some key points it addresses being dealt with instead by new disclosure requirements under the Financial Conduct Authority's Listing Rules.

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Keywords: Corporate governance, UK corporate governance code, Cadbury Code, London Stock Exchange, Listing Rules, Stakeholders

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Brian R. Cheffins\*

S. J. Berwin Professor of Corporate Law  
University of Cambridge, Faculty of Law  
10 West Road  
Cambridge, CB3 9DZ, United Kingdom  
phone: +44 1223 330084  
e-mail: brc21@cam.ac.uk

Bobby V. Reddy

Assistant Professor  
University of Cambridge  
10 West Road  
Cambridge CB3 9DZ, UK  
e-mail: bvr20@cam.ac.uk

\*Corresponding Author

# Thirty Years and Done – Time to Abolish the UK Corporate Governance

## Code

Brian R. Cheffins\*

Bobby V. Reddy\*\*

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### *Abstract*

*A 1992 Code of Best Practice developed by a committee Sir Adrian Cadbury chaired revolutionised UK corporate governance. The Code, which introduced non-statutory best practice provisions with which listed companies could choose not to comply so long as they explained why, has evolved into the more expansive UK Corporate Governance Code of today. This paper argues that after three decades it is time to do away with the code approach and ‘comply-or-explain’. Much of the current Code’s content is now irrelevant, and disclosure and compliance expectations have escalated to levels that create substantial net costs for companies. Additionally, the Code is now being used to address ‘stakeholder’ issues for which the Code’s shareholder enforcement dependent comply-or-explain mechanism is poorly suited. The Code correspondingly should be abolished, with some key points it addresses being dealt with instead by new disclosure requirements under the Financial Conduct Authority’s Listing Rules.*

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\* Faculty of Law, University of Cambridge.

\*\* Faculty of Law, University of Cambridge.

## 1. Introduction

Thirty years ago, the Committee on the Financial Aspects of Corporate Governance, chaired by Sir Adrian Cadbury (Cadbury Committee),<sup>1</sup> promulgated the Cadbury Code of Best Practice (Cadbury Code). The Cadbury Code would prove to be highly influential, serving not only as the forerunner to the current UK Corporate Governance Code (UK CGC or the Code),<sup>2</sup> but also providing a precedent for the adoption of codes in nearly 100 countries around the world.<sup>3</sup> Moreover, a key Cadbury innovation, a ‘comply-or explain’ approach to corporate governance under which listed companies either have to comply with the Code or explain departures,<sup>4</sup> is now thought of as ‘the trademark of corporate governance in the UK.’<sup>5</sup> A proud legacy, then. Nevertheless, the Code should be abolished – thirty years and done.

Early versions of the Code likely fortified governance norms that enhanced managerial accountability. Such norms, however, are now well-accepted, meaning the Code delivers few direct benefits for the ‘premium-listed’ companies that must take the Code into account. In addition, the Code in place has evolved considerably since 1992, and the changes

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<sup>1</sup> *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee Publishing 1992) (Cadbury Report), 10, 14.

<sup>2</sup> Financial Reporting Council, *The UK Corporate Governance Code* (FRC 2018).

<sup>3</sup> Francesca Cuomo, Christine Mallin and Alessandro Zattoni, ‘Corporate Governance Codes: A Review and Research Agenda’ (2016) 24 *Corporate Governance: An International Review* 222, 225-28; Brian R. Cheffins, ‘The Rise of Corporate Governance in the UK: When and Why’ (2015) 68 *Current Legal Problems* 387, 408.

<sup>4</sup> Stock Exchange, *The Listing Rules* (London Stock Exchange 1993) para 12.43(j). Also see Cadbury Report (n 1) para 3.7. The Cadbury Committee did not in fact use the term ‘comply-or explain’: Laura F. Spira and Judy Slinn, *The Cadbury Committee: A History* (OUP 2012) 171.

<sup>5</sup> Financial Reporting Council, *The UK Corporate Governance Code* (FRC 2010) 4.

have been detrimental in large measure for listed companies. The Code has grown in size substantially over the years, thereby increasing the disclosure burden for companies obliged to take the Code into account. Moreover, while the UK CGC is theoretically comply-or-explain in orientation, a bias in favour of full compliance arising from an investor predilection for ‘box-ticking’ has pressured companies to introduce what for them may well be sub-optimal governance arrangements. For companies, the costs to companies arising from the Code likely now markedly outweigh whatever benefits it delivers.

An additional institutional downside with the Code further strengthens the case in favour of abolition. Over the past few years, the Code has increasingly dealt with matters it is poorly suited to address, particularly in relation to non-shareholder corporate constituencies, commonly referred to as stakeholders. Such matters may be of considerable societal importance. Still, with the Code being dependent on shareholder intervention to foster compliance, it is poorly situated institutionally to address stakeholder issues.

After commencing with an overview of the UK CGC, this paper will recount the case in favour of the Code, drawing attention in so doing to innovative aspects of the original Cadbury Code that led to widespread imitation around the world. The paper will then cast doubt on the Code as a continuing corporate governance success story, noting in so doing that the listed company sector has been in decline for much of the period the Code has been in operation. Next, the paper will make the case affirmatively for abolition. One point made here will be that, due partly to the growth of the Code over time, many features of the Code duplicate other regulation or constitute little more than meaningless generalities. Other strikes against the Code are the costs it imposes on publicly traded firms and its use to address stakeholder matters for which it is ill-suited.

One more introductory point needs to be made before we proceed. As we describe in the final substantive section of the paper, we are not advocating in favour of full-scale

deregulation. Instead, we envisage a post-Code world where companies will still be required to discuss under the Listing Rules that apply to listed companies numerous governance topics on which the UK CGC focuses.<sup>6</sup> ‘Comply-or-explain’ and disclosing against best practice recommendations, though, would be consigned to history. This should reduce compliance costs for companies, allow companies more flexibility to innovate in the governance space, and send a message that a more enterprising era is in prospect for premium listed companies.

## 2. Overview of the UK Corporate Governance Code

A brief overview of the development and current nature of the UK CG Code helps to put into context the case for abolition. What began as the Cadbury Code proceeded through several iterations before becoming the Code we know today. Table 1 summarises the evolution of the Code since its genesis in 1992, drawing attention to significant additions made with each version, periodic deregulation initiatives, and the number of principles and provisions.

Two post-Cadbury corporate governance reviews had a significant early impact on the Code’s development. First, a committee chaired by Ronald Hampel (Hampel Committee),<sup>7</sup> charged with reviewing Cadbury and reforms implementing a 1995 report on executive pay,<sup>8</sup> introduced ‘principles’ that would sit alongside Code ‘provisions’ in what became known as the Combined Code. Companies were expected to discuss how they applied the principles

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<sup>6</sup> The rules of the Listing Rules Sourcebook, as published by the Financial Conduct Authority pursuant to Financial Services and Markets Act 2000 (FSMA 2000), chapter 8, s. 73A(1), (2).

<sup>7</sup> See *Committee on Corporate Governance, Final Report* (Gee Publishing 1998) (Hampel Report).

<sup>8</sup> *Directors’ Remuneration: Report of a Study Group Chaired by Sir Richard Greenbury* (Gee Publishing 1995) (Greenbury Report).

Table 1: Code History Chart

Year	Report/Code	Key Code Additions	Deregulation Initiatives	Number of provisions/principles (if applicable)
1992	Cadbury Code of Best Practice, issued by the Committee on the Financial Aspects of Corporate Governance	A pioneer corporate governance code focusing on boards, directors, reporting and financial controls.		19 Provisions
1995	Greenbury Code, promulgated by the Study Group on Directors' Remuneration Sir Richard Greenbury chaired	A pioneer executive pay code, dealing with remuneration committees, disclosure, remuneration policy and severance payments.		39 Provisions
1998	Combined Code, issued by the Hampel Committee in consultation with the London Stock Exchange	Embraced the work of the Cadbury, Greenbury and Hampel Committees.	Introduced a set of broad principles to give companies the opportunity to discuss corporate governance in a flexible fashion and thereby potentially discourage 'box-ticking'.	17 Principles, 48 Provisions
2003	Draft Code in the Higgs Report on non-executives, issued by Derek Higgs	Addressed a wide range of board-related topics, including the structure of the board, board committees, the role of the chair, the selection of directors and the tenure, time commitment and remuneration of directors.		18 Principles, 83 Provisions
2003	Combined Code (revised)	Added supporting principles, which listed companies were obliged to discuss under the Listing Rules.	Considerably reduced the number of provisions as compared with the draft Code in the Higgs Report.	17 Principles, 26 Supporting Principles, 48 Provisions
2006	Combined Code (revised)	Guidance added indicating shareholders voting by proxy should be able to withhold their vote.	Permitted chairs of the board to sit on remuneration committees.	Same as 2003 Code
2008	Combined Code (revised)		Guidance applicable to board chairs was relaxed in certain respects.	Same as 2003 Code



Year	Report/Code	Key Code Additions	Deregulation Initiatives	Number of provisions/principles (if applicable)
2010	UK Corporate Governance Code	Principles/supporting principles were added or reworked dealing with the roles of the chair and non-executive directors, the composition of the board, the commitment level of directors, board resources, the board's responsibility for risk management and gender diversity. Provisions were added dealing with board chairs, external evaluations of the board and the annual election of directors for FTSE 350 companies.		18 Principles, 26 Supporting Principles, 52 Provisions
2012	UK Corporate Governance Code (revised)	Guidance on audit committees and board diversity was expanded.		18 Principles, 26 Supporting Principles, 53 Provisions
2014	UK Corporate Governance Code (revised)	'Viability statement' provision added. Guidance on executive compensation reworked. Companies were expected to indicate their response to sizeable dissenting votes on shareholder resolutions.		18 Principles, 27 Supporting Principles, 55 Provisions
2016	UK Corporate Governance Code (revised)	Revised audit committee provisions on membership qualifications and appointment of external auditors.		Same as 2014 Code.
2018	UK Corporate Governance Code (revised)	There was 'a new focus on stakeholders, integrity and corporate culture' that included implementing a request by the UK Government regarding employee boardroom representation mechanisms.	The FRC was looking 'to shorten and sharpen the revised Code' and removed supporting principles.	18 Principles, 41 Provisions

while disclosing against the provisions on a comply-or-explain basis.<sup>9</sup> Second, in 2003, a review led by Derek Higgs<sup>10</sup> provided the basis for a revised version of the Combined Code that added ‘supporting principles’ to the mix.<sup>11</sup>

Following modest Combined Code revisions in 2006 and 2008, the moniker the ‘UK Corporate Governance Code’ was adopted in 2010, after a review in 2009.<sup>12</sup> This Code was now considerably different from its Cadbury-era forerunner. Corporate law scholar Cally Jordan, has described pithily what had changed:

‘The lineage of the UK Corporate Governance Code 2010 can be traced straight back to the Cadbury Report...but it was a much different creature. Gone was the two-page Code of Best Practice, replaced by a detailed and differentiated approach to corporate governance....’<sup>13</sup>

During the early- and mid-2010s successive minor modifications were made to the 2010 UK CGC (Table 1). A major reworking of the UK CGC took place in 2018, and that

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<sup>9</sup> Committee on Corporate Governance, *The Combined Code: Principles of Good Governance and Code of Best Practice* (Gee Publishing 2000), 1..

<sup>10</sup> Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (DTI 2003) (Higgs Report).

<sup>11</sup> Initially, listed companies were required to disclose how they had applied the supporting principles in the same way as the main principles (FRC, *The Combined Code on Corporate Governance* (FRC July 2003) 1, ‘Preamble’ para 4), but this requirement was quietly dropped in 2008 (FRC, *The Combined Code on Corporate Governance* (FRC June 2008) 1, ‘Preamble’ para 3).

<sup>12</sup> FRC, *2009 Review of the Combined Code: Final Report* (FRC December 2009).

<sup>13</sup> Cally Jordan, ‘Voluntary Codes of Corporate Governance: Evolution and Implications’ in O Fitzgerald (ed), *Corporate Citizen: New Perspectives on the Globalized Rule of Law* (Centre for International Governance Innovation 2020) 209, 223.

version remains in force today.<sup>14</sup> The current UK CGC encompasses 18 principles and 41 provisions, with the supporting principles being deleted as part of the 2018 revision.

The Financial Reporting Council (FRC) issued the current version of the UK CGC.<sup>15</sup> The FRC formally is a private institution rather than a government regulator,<sup>16</sup> currently funded by the accountancy profession and levies imposed on other groups that have regard to or benefit from FRC regulation, including listed companies, insurers, pension funds and actuaries.<sup>17</sup> The FRC is one of the founding fathers of the Code, having inaugurated, along with the London Stock Exchange (LSE) and the accountancy profession, the Cadbury Committee. Pursuant to a Hampel Committee recommendation, the FRC was deputised to oversee the Code.<sup>18</sup> The FRC has promulgated the Code since then.

With respect to the Code, the FRC works in tandem with a government regulator, the Financial Conduct Authority (FCA).<sup>19</sup> The FCA, in its original guise as the Financial Services Authority (FSA), took over from the LSE as the competent authority for UK stock

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<sup>14</sup> FRC, *The UK Corporate Governance Code* (FRC July 2018) (UK CGC 2018).

<sup>15</sup> UK CGC 2018 (n 14).

<sup>16</sup> John Kingman, *Independent Review of the Financial Reporting Council* (HMSO 2018) 6. However, as discussed below, the FRC could also be described as ‘quasi-governmental’ in nature (see text accompanying nn 148-149).

<sup>17</sup> FRC, ‘About the FRC’ <<https://www.frc.org.uk/about-the-frc/funding>>. Unless otherwise stated, all URLs were last accessed on 24 April 2022.

<sup>18</sup> The Hampel Report stated that the FRC should ‘keep under review the possible need in the future for further studies of corporate governance’ (Hampel Report (n 7) paras. 1.23, 1.26).

<sup>19</sup> The FCA is a statutory regulator under FSMA 2000, Part IA, added by the Financial Service Act 2012, c. 21.

market listings in 2000.<sup>20</sup> The FCA currently promulgates and enforces the Listing Rules, a component of the FCA Handbook which applies to all companies listed on the Main Market of the LSE. Whereas the FRC determines the Code's content, the FCA is responsible for fostering Code-related disclosures under Chapter 9 of the Listing Rules, which only applies to the most prestigious tier of LSE listed companies, the premium tier.<sup>21</sup> Companies listed on the Main Market's standard tier and companies traded on specialist LSE tiers such as the high growth segment and the specialist-fund segment are not obliged to take the UK CGC into account.<sup>22</sup>

Under the Listing Rules, premium-listed companies must disclose in their annual reports to shareholders (i) how they have applied the UK CGC's principles,<sup>23</sup> and (ii) whether they have complied with the provisions. Where there is non-compliance with Code provisions, a company must give reasons for non-compliance.<sup>24</sup> This is the 'comply-or-explain' approach that is a trademark of UK corporate governance.<sup>25</sup>

The UK CGC's 18 principles and 41 provisions span five sections. The first, 'board leadership and company purpose', focuses on what boards should do to generate and preserve value over the long-term, to establish the company's culture and purpose, and to engage with

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<sup>20</sup> Annabel Sykes and Karen Connolly, 'Financial Services and Markets Act: An Overview' (August 2001) Practical Law 1, 21, 22. In 2000, the FSA was designated as the 'UK Listing Authority', a term no longer in use (FCA, *Primary Market Bulletin February 2019 / No. 20* (FCA 2019) 1.

<sup>21</sup> Listing Rules, rule (LR) 9.1.1.

<sup>22</sup> The high-growth and specialist-fund segments are restricted to high-growth companies and investment funds, respectively.

<sup>23</sup> LR 9.8.6(5)R.

<sup>24</sup> LR 9.8.6(6)R.

<sup>25</sup> n 5, and accompanying text.

shareholders and the workforce.<sup>26</sup> Provisions indicate how engagement with shareholders<sup>27</sup> and employees should proceed.<sup>28</sup> Boards are also required to disclose how they have had regard to the non-shareholder stakeholder interests s. 172 of Companies Act 2006 (CA 2006) delineates.<sup>29</sup>

The second section, ‘division of responsibilities’, relates to the structure and operation of the board. Emphasis is placed on delineating the responsibilities of the chair and non-executive directors and identifying how the board should be configured.<sup>30</sup> Most notably, the UK CGC recommends that the roles of chief executive officer and chair not be combined,<sup>31</sup> and that boards have a strong independent cohort.<sup>32</sup>

The third section, ‘composition, succession and evaluation’, deals with who sits on boards, focusing primarily on the appointment process and assessment of the performance of incumbent directors.<sup>33</sup> Boards are instructed to establish nomination committees consisting of a majority of independent non-executive directors,<sup>34</sup> and to promote diversity with respect

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<sup>26</sup> UK CGC 2018 (n 14), principles A, B, C, D and E.

<sup>27</sup> *ibid* provision 4.

<sup>28</sup> *ibid* provision 5.

<sup>29</sup> *ibid* provision 5.

<sup>30</sup> *ibid* principles F, G, H and I.

<sup>31</sup> *ibid* provision 9.

<sup>32</sup> In particular, the UK CGC 2018 (n 14) recommends that at least half the board, excluding the chair, comprise independent non-executive directors (*ibid* provision 11), and that one of those independent directors be anointed as the senior independent director to act as an intermediary for other directors and shareholders outside of the chair (*ibid* provision 12).

<sup>33</sup> *ibid* principles J, K and L.

<sup>34</sup> *ibid* provision 17.

to director appointments.<sup>35</sup> The Code also says directors should be evaluated regularly and should submit themselves to shareholders for annual re-election.<sup>36</sup>

The fourth section, ‘audit, risk and internal control’, is primarily concerned with the company’s audit function. The section is oriented around ensuring that the audit process operates on a transparent and independent basis and encouraging boards to consider emerging risks.<sup>37</sup> Audit committees comprising only independent non-executive directors are recommended.<sup>38</sup> Boards are also urged to assess risks their company faces,<sup>39</sup> to evaluate carefully their company’s going concern status,<sup>40</sup> and to generate a ‘viability statement’ focusing on current operations and future prospects.<sup>41</sup>

The final section, ‘remuneration’, seeks to ensure that executives are not involved in setting their own pay and that independent judgement is exercised with the determination of remuneration outcomes.<sup>42</sup> Remuneration policies are also supposed to be aligned with a company’s purpose, values and long-term strategy.<sup>43</sup> The section recommends that boards form a remuneration committee consisting of independent non-executive directors.<sup>44</sup> Boards

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<sup>35</sup> *ibid* provisions 17 and 19.

<sup>36</sup> *ibid* provision 18.

<sup>37</sup> *ibid* principles M, N and O.

<sup>38</sup> *ibid* provision 24.

<sup>39</sup> *ibid* provisions 28 and 29.

<sup>40</sup> *ibid* provision 30.

<sup>41</sup> *ibid* provision 31.

<sup>42</sup> *ibid* principle Q.

<sup>43</sup> *ibid* principles P and R.

<sup>44</sup> *ibid* provision 32.

should also ensure any advice from remuneration consultants is objective in nature,<sup>45</sup> should formulate remuneration schemes that incentivise the generation of value over the long-term,<sup>46</sup> and should ensure managerial service contracts are no longer than one year in length.<sup>47</sup>

Key Code trends over the past thirty years can be divided conveniently along four main lines: increased redundancy due to other corporate governance developments, enhanced disclosure obligations for listed companies, a compliance orientation, and a greater non-shareholder stakeholder focus. The alterations have led on balance to a detrimental cost-benefit shift. The resulting case in favour of abolition was by no means pre-destined, however. Indeed, the original conceptualisation of the Cadbury Code had many positive facets, and even now the Code has strengths that must be taken into account when considering whether abolition is merited. We consider next the case in favour of the Code.

### **3. The Case in Favour of the UK Corporate Governance Code**

When the Cadbury Committee was established in 1991, the dominant theme in corporate governance was managerial accountability, with academics framing this as a need to reduce ‘agency costs’. An influential paper by Michael Jensen and William Meckling published in 1976 did much to shape agency costs analysis.<sup>48</sup> They framed the relationship between shareholders and company managers as ‘agency’ with shareholders as the principals and the

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<sup>45</sup> *ibid* provision 35.

<sup>46</sup> *ibid* provision 36.

<sup>47</sup> *ibid* provision 39.

<sup>48</sup> Michael C. Jensen and William H. Meckling, ‘Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (1976) 3 *Journal of Financial Economics* 305.

managers their agents. With self-interested managerial agents there was a risk they would fail to act in the best interests of the principals, resulting in ‘agency costs’.<sup>49</sup>

Many have noted that the Cadbury Committee was, in practical terms, focusing on reducing agency costs.<sup>50</sup> The agency cost problem is accentuated in a jurisdiction such as the UK with its dispersed ownership system.<sup>51</sup> Post-World War II British public companies typically lacked dominant shareholders, meaning investors would hold interests that were insufficiently substantial to elicit attentive monitoring of management.<sup>52</sup> Momentum in favour of intervention to foster managerial accountability was reinforced by early 1990s corporate scandals affecting Robert Maxwell’s newspaper group and the conglomerate Polly Peck.<sup>53</sup>

Logical responses, embraced by the Cadbury Committee, were to fortify boards as monitors of executives and to foster communication between boards and shareholders.<sup>54</sup> The Cadbury Committee’s primary initial remit was the financial aspects of corporate

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<sup>49</sup> *ibid* 312–330. Agency costs, according to Jensen and Meckling, are costs expended in aligning the interests of agents and principals, costs of monitoring agents, and any losses incurred through the agents nevertheless pursuing their own interests over those of the principals (*ibid* 308).

<sup>50</sup> See eg John Roberts, ‘The UK Corporate Governance Code Principle of “Comply or Explain”: Understanding Code Compliance as “Subjection”’ (2020) 56 *Abacus* 602, 619–620; Jeroen Veldman and Hugh Willmott, ‘The Cultural Grammar of Governance: The UK Code of Corporate Governance, Reflexivity, and the Limits of “Soft” Regulation’ (2016) 69 *Human Relations* 581, 590, 592; Spira and Slinn (n 4) 34.

<sup>51</sup> Brian R. Cheffins, *Corporate Ownership and Control: British Business Transformed* (OUP 2008) 301–336.

<sup>52</sup> The insight that dispersed ownership could result in a potentially problematic separation between ownership and control was first formalised by Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (Macmillan 1932).

<sup>53</sup> Spira and Slinn (n 4) 33, 37.

<sup>54</sup> *ibid* 199.



governance.<sup>55</sup> Ultimately, though, the Cadbury Report addressed corporate governance in the round, stating ‘Shareholders have delegated many of their responsibilities as owners to the directors who act as their stewards’<sup>56</sup> and indicating ‘The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders.’<sup>57</sup>

The Cadbury Committee was aware that governance was relevant to a ‘wider audience,’<sup>58</sup> not merely shareholders. Nevertheless, the Cadbury Report’s emphasis on shareholders was consistent with a shareholder-oriented approach to corporate governance that tended to prevail in the UK.<sup>59</sup> As the 2009 Walker Review on corporate governance of banks said, explicitly invoking agency cost terminology in so doing ‘The role of corporate governance is to protect and advance the interests of shareholders through...monitoring capable management to achieve this.’<sup>60</sup>

Amelioration of managerial agency costs continues to serve as a potentially cogent justification for the UK CGC. Senior executives of large UK public companies typically own

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<sup>55</sup> The full name of the Cadbury Committee indeed was ‘the Committee on the *Financial Aspects* of Corporate Governance’.

<sup>56</sup> Cadbury Report (n 1) para. 6.6.

<sup>57</sup> Cadbury Report (n 1) para. 6.1.

<sup>58</sup> Although the Cadbury Report affirmed that reports directors issued that formed the basis of UK financial reporting were addressed to shareholders, it also acknowledged that such reports would be ‘important to a wider audience’ (Cadbury Report (n 1) para. 2.7).

<sup>59</sup> Shuangge Wen, *Shareholder Primacy and Corporate Governance: Legal Aspects, Practices and Future Directions* (Routledge, 2013), 12-13.

<sup>60</sup> David Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations* (HM Treasury, 2009) (Walker Review) 23, 68.

only a small percentage of the equity,<sup>61</sup> meaning they are largely seeking to foster corporate success for the benefit of others. Under such circumstances, they may well be tempted to ‘shirk’ their responsibilities or use their control over corporate assets to further their own interests.<sup>62</sup> Shirking and ‘rent extraction’,<sup>63</sup> in the form of self-serving diversion of corporate assets, will adversely affect shareholders and can also have a deleterious impact on other corporate participants, including creditors, employees and customers.<sup>64</sup>

The Cadbury Committee reduced its best practice guidance implicitly intended to reduce agency costs to the form of a Code, saying ‘The accountability of boards to shareholders will, therefore, be strengthened if shareholders require their companies to comply with the Code.’<sup>65</sup> Implementation of recommendations such as splitting the roles of CEO and chair, increasing the number of non-executive directors, and forming board committees comprised of non-executives would, it was supposed, enhance scrutiny of managers in circumstances where shareholders were less than ideally positioned to step forward. When the LSE followed up on the Cadbury Report by requiring listed companies to discuss compliance with the Cadbury Code, boards in turn had to report to shareholders on

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<sup>61</sup> Maria-Teresa Marchica and Roberto Mura, ‘Direct and Ultimate Ownership Structures in the UK: an Intertemporal Perspective over the Last Decade’ (2005) 13 *Corporate Governance: An International Review* 26, 30.

<sup>62</sup> Marc Moore and Martin Petrin, *Corporate Governance: Law, Regulation and Theory* (Palgrave 2017) 36.

<sup>63</sup> David F. Larcker, Gaizka Ormazabal and Daniel J. Taylor, ‘The Market Reaction to Corporate Governance Regulation’ (2011) 101 *Journal of Financial Economics* 431, 446.

<sup>64</sup> Brian R. Cheffins, *Company Law: Theory, Structure and Operation* (OUP 1997), 123.

<sup>65</sup> Cadbury Report (n 1) para. 6.6.

whether their companies had complied with those recommendations or explain deviations.<sup>66</sup> Shareholders, for their part, could intervene if they were not satisfied with explanations for non-compliance.<sup>67</sup>

Assuming, as the Cadbury Committee did, that leaving matters purely to the market was not an option, why tackle agency costs through a ‘code’ rather than by way of legislation? The fact that compliance with provisions was not compulsory came to be seen as a crucial feature of corporate governance in the UK,<sup>68</sup> with the discretion afforded to companies to depart from Code guidance ultimately being hailed as a virtue.<sup>69</sup> The governance needs of publicly traded companies vary widely, the reasoning goes, with some companies needing more independent directors and others fewer, and with some firms benefitting from strong deference to managerial preferences and others by keeping CEO

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<sup>66</sup> LR 1993, para. 12.43(j).

<sup>67</sup> ‘It is for the shareholders to call the directors to book if they appear to be failing in their stewardship and they should use this power.’ (Cadbury Report (n 1) para. 6.6). The notion of shareholder intervention where companies are not in compliance with the UK CGC (or have not provided adequate explanations for non-compliance) resonates with successive versions of the UK’s Stewardship Code, a voluntary code for institutional investors relating to the manner in which they steward their investments. See eg FRC, *The UK Stewardship Code 2020* (FRC 2020) 5 -- ‘signatories should consider... the effective application of the UK Corporate Governance Code.’ See also FRC, *The UK Stewardship Code* (FRC September 2012) principle 3 guidance -- ‘institutional investors should seek to... satisfy themselves that the company’s board and committees adhere to the spirit of the UK Corporate Governance Code’.

<sup>68</sup> nn 24-25, and accompanying text.

<sup>69</sup> See eg Arcot and Bruno, ‘One Size Does Not Fit All, After All: Evidence from Corporate Governance’ (2007) 1, 5, 26 <<http://ssrn.com/abstract=887947>>

power fully in check.<sup>70</sup> This means ‘no one size fits all,’<sup>71</sup> and, according to the Walker Review, ‘[f]ew matters if any in the corporate governance space... warrant hard and fast prescription.’<sup>72</sup>

While the code approach is now a well-established feature of UK corporate governance it initially was controversial. Critics suggested that compliance would be patchy because the Code did not mandate adherence and disclosure was not statutorily based, with the rules being set out in the LSE’s Listing Rules.<sup>73</sup> Mo Mowlam, then Labour’s spokesperson on corporate affairs, warned that the Cadbury approach could be a ‘recipe for inactivity.’<sup>74</sup> The *Financial Times* said the Cadbury Committee’s faith in self-regulation by companies and investors was ‘touchingly naïve.’<sup>75</sup>

The critics’ arguments would have been highly telling if companies had subsequently ignored Cadbury Code guidance. Investors and other interested parties would have quickly lost interest in departures from the Code and whatever disclosure-driven discipline the Code was supposed to impose would have rapidly dissipated.<sup>76</sup> Perhaps because of this, the Cadbury Committee strongly emphasised compliance, saying that institutional shareholders

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<sup>70</sup> David Kershaw, *Company Law in Context: Text and Materials* (OUP, 2012) 254.

<sup>71</sup> Higgs Report (n 10) paras. 1.19 and 16.1.

<sup>72</sup> Walker Review (n 60) 31.

<sup>73</sup> Vanessa Finch, ‘Board Performance and Cadbury on Corporate Governance’ (1992) *Journal of Business Law* 581, 584; Cheffins (n 64) 644.

<sup>74</sup> Alison Smith, ‘Labour Attacks Voluntary Approach’ *Financial Times* (London, 28 May 1992) 12.

<sup>75</sup> ‘Cadbury’s Soft Centre’ *Financial Times* (London, 28 May 1992) 22.

<sup>76</sup> ‘Strike it Right’ *Financial Times* (London, 12 May 2003) 20; Iris H.-Y. Chiu, ‘The Role of a Company’s Constitution in Corporate Governance’ (2007) *Journal of Business Law* 697, 708.

‘should use their influence as owners to ensure that the companies in which they have invested comply with the Code.’<sup>77</sup> When discussing the option not to comply with the Code, the Cadbury Report only did so in relation to smaller companies and urged such firms to adhere to the Code, saying, ‘full compliance will bring benefits to the boards of such companies and it should be their objective to ensure that the benefits are achieved.’<sup>78</sup>

It transpired that the Cadbury Committee had little to fear. Adherence to the Cadbury Code was substantial, especially among larger listed companies.<sup>79</sup> Sir Adrian Cadbury said in 1995 he was heartened by the evidence on compliance.<sup>80</sup> The Hampel Committee, acknowledging the Cadbury Code’s significant impact, noted that the Code had led to higher standards of governance and greater awareness of their importance.<sup>81</sup>

Substantial Code compliance would remain the norm thereafter,<sup>82</sup> and ditching a code-based comply-or-explain model in favour of a more prescriptive arrangement fell off the

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<sup>77</sup> Cadbury Report (n 1) Summary of Recommendations, para. 4.

<sup>78</sup> *ibid* para. 3.15.

<sup>79</sup> Martin J. Conyon, ‘Corporate Governance Changes in UK Companies Between 1988 and 1993’ (1994) 2 *Corporate Governance: An International Review* 87; Ken Peasnell, Peter Pope and Steven Young, ‘A New Model Board’ (July 1998) *Accountancy International*, 91; Helen Short, ‘Corporate Governance: Cadbury, Greenbury and Hampel – A Review’ (1999) 7(1) *Journal of Financial Regulation and Compliance* 57, 60.

<sup>80</sup> *Committee on the Financial Aspects of Corporate Governance, Compliance with the Code of Best Practice* (Gee Publishing 1995).

<sup>81</sup> Hampel Report (n 7) paras. 1.2, 1.8.

<sup>82</sup> Bruce A. Rayton and Suwina Cheng, ‘Corporate Governance in the United Kingdom: Changes to the Regulatory Template and Company Practice from 1998-2002’ (2004), University of Bath School of Management Working Paper Series 2004.13 (indicating substantial changes to corporate governance congruent with Code guidance between 1998 and 2002); FRC, *Developments in Corporate Governance 2011: The Impact*

reform agenda. The FRC, in a discussion paper that set the scene for the 2018 overhaul of the UK CGC, specifically identified comply-or-explain as a strength of the UK approach to corporate governance that had continued to be valuable and had correspondingly been preserved.<sup>83</sup>

#### 4. Has the Code Really Been a Public Company Success Story?

The logic underpinning the code approach to corporate governance appears to be impeccable: the UK CGC moves companies toward ‘better’ corporate governance while offering scope for beneficial bespoke adjustments and better corporate governance will in turn improve corporate performance. To the extent this logic is sound, the UK CGC should be encouraging firms to go public and remain publicly traded. The facts give rise to pause here, though.

According to media reports Britain has an ‘incredible, shrinking stock exchange’<sup>84</sup> that ‘is fading away’<sup>85</sup> and ‘needs life support.’<sup>86</sup> The number of companies listed on the LSE fell from over 4400 in 1963 to just under 2000 in the early 1990s and to 1124 as of

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*and Implementation of the UK Corporate Governance and Stewardship Codes* (FRC 2011), 3 (‘Implementation of the UK Corporate Governance Code by listed companies has generally been good’); Bobby V. Reddy, ‘Thinking Outside the Box – Eliminating the Perniciousness of Box-Ticking in the New Corporate Governance Code’ (2019) 82 MLR 692, 697 (summarising data on Code compliance 2011-17).

<sup>83</sup> FRC, *Proposed Revisions to the UK Corporate Governance Code* (FRC December 2017) 2.

<sup>84</sup> Jeremy Warner, ‘Boardroom Wokery is Driving Companies out of Public Markets’ *Sunday Telegraph* (London, 22 August 2021) Business, 2.

<sup>85</sup> ‘Big Bang to a Whimper’ *Economist* (London, 2 October 2021) 9.

<sup>86</sup> Emma Duncan, ‘The London Stock Market Needs Life-Support’ *Times* (London, 5 November 2021) 30.

2021.<sup>87</sup> The UK government was sufficiently concerned to commission Lord Hill in November 2020 to review the UK listing regime,<sup>88</sup> many of whose recommendations the FCA has implemented.<sup>89</sup>

Perhaps counter-intuitively, given the cogent agency costs-reduction rationale for the original Cadbury Code, the Code could be a factor in the LSE's 'startling decline'. Corporate governance has been cited as a cause of the 'shrinking stock exchange', with executives reputedly spending too much time 'jumping through hoops' as the governance burden 'has become simply too onerous.'<sup>90</sup> For instance, in the mid-2000s, there was a surge in private equity-led buyouts of listed firms which had many wondering about the future of the UK public company.<sup>91</sup> It was suggested that 'the main impact' of code-based governance was 'to

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<sup>87</sup> LSE Reports at <<https://www.londonstockexchange.com/reports?tab=lse-historic>> (for 1963 and early 1990s), and London Stock Exchange Reports at <<https://www.londonstockexchange.com/reports?tab=issuers>> (for more recent years).

<sup>88</sup> HM Treasury, *Call for Evidence – UK Listing Review* (HM Treasury 19 November 2020).

<sup>89</sup> HM Treasury, *UK Listing Review* (HM Treasury 3 March 2021) (Hill Review). For the most notable changes see Listing Rules, paras. 5.6.18A - 5.6.18F (reverse takeovers, involving special purpose acquisition companies – 'SPACs'); 9.2.22A-9.2.22F (voting rights attached to shares); 5.2.2(2)G, 6.14.2(2)R and 14.2.2(3)(R) (reduction in free-float).

<sup>90</sup> Ben Wright, 'City Bureaucracy is Destroying the Stock Market, not Private Equity' *Telegraph* (July 9, 2021). See also Economist (n 85); 'Britain's Sluggish Stockmarket' *Economist* (London, 2 October 2021) 18.

<sup>91</sup> Cheffins (n 51) 398.

tempt companies off the stock market via buyouts’ because ‘(b)oards can then drop the combined code in the shredder and be free.’<sup>92</sup>

Initial public offering (IPO) patterns in the early- and mid-2000s provide additional evidence that ‘better’ corporate governance has contributed to the decline of the listed company in the UK. In 2004, the *Financial Times* referred to ‘corporate governance fatigue’, saying ‘governance is driving out enterprise,’ with one by-product being that companies were ‘opting to join the more lightly regulated AIM’,<sup>93</sup> referring to the Alternative Investment Market the London Stock Exchange operates that caters to smaller, less-developed companies. The *Financial Times* noted the following year that ‘AIM has no rules on corporate governance,’ and suggested the then 83-page Combined Code ‘must look frightening to a small company seeking to raise £5m.’<sup>94</sup>

IPO data lends credence to these conjectures about the impact of ‘over-governance’ on listed companies. In 1998, LSE Main Market IPOs that resulted in listings, and hence Cadbury Code disclosures, substantially outnumbered AIM IPOs. That trend began to reverse itself in 1999, the first year listed companies had to discuss compliance with the much-expanded Combined Code.<sup>95</sup> The shift to AIM accelerated further in 2004, the year

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<sup>92</sup> Graham Searjeant, ‘Boardrooms Should Soak Up the Culture of Private Equity’ *Times* (London, 1 February 2007) 52.

<sup>93</sup> Richard Laphorne, ‘Look Beyond the Details of Higgs’ *Financial Times* (London, 24 November 2004) 21.

<sup>94</sup> David Blackwell, ‘The Risks of Turning Corporate Codes into Rules’ *Financial Times* (London, 15 July 2005) 25.

<sup>95</sup> Jim Kelly, ‘Exchange Moves on Corporate Governance “Supercode”’ *Financial Times* (London, 16 December 1998) 14 (indicating that the Code came into effect for financial years ending after 31 December 1998).



after the Higgs Report (Figure 1). Companies only became obliged to discuss compliance with the post-Higgs version of the Combined Code in November 2004, but companies were adjusting their governance arrangements months beforehand.<sup>96</sup>

In 2010, the LSE split its Main Market into a premium tier and a standard tier,<sup>97</sup> with companies on the standard tier not being required to address the UK CGC.<sup>98</sup> The standard tier has struggled to become a credible home for publicly traded UK businesses, with standard-listed companies being excluded from well-known FTSE-indices and with the standard tier being widely perceived as inferior to the premium tier.<sup>99</sup> Accordingly, the emergence of the standard tier has not fostered a governance-related exodus to the standard tier in the same way as with AIM post-Hampel, meaning that the typical listed UK company will be governed by the UK CGC even though only premium listed companies are obliged to take the Code into account.

The declining number of listed companies suggests there is something amiss with the logic that the Code moves listed companies toward the ‘better’ corporate performance associated with better corporate governance. The seemingly obvious connection between

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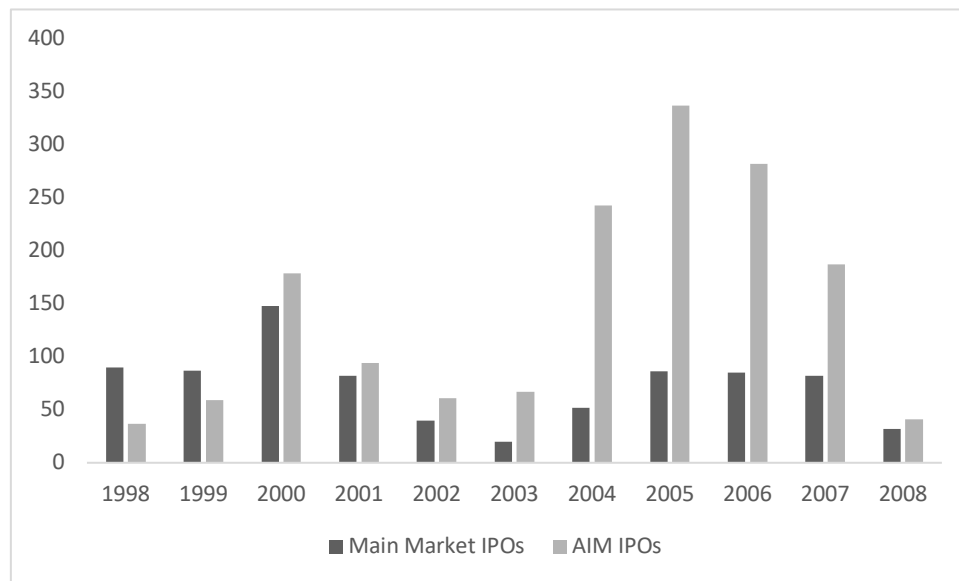
<sup>96</sup> ‘Companies Sorting Out the New Regulatory Changes’ *Birmingham Post* (Birmingham, 4 June 2004) 20.

<sup>97</sup> FSA, *Listing Regime Review: Feedback on CP09/24 and CP09/28 with Final Rules* (FRC February 2010). Prior to the split into premium and standard tiers, the Main Market was divided into primary and secondary tiers, with UK companies restricted to the primary tier.

<sup>98</sup> n 21, and accompanying text. Standard-listed companies must, however, disclose the corporate governance code to which they are subject or which they have voluntarily chosen to apply (FCA Handbook’s Disclosure Guidance and Transparency Rules Sourcebook (DTR), rule 7.2.2).

<sup>99</sup> FCA, *Discussion Paper DP17/2: Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape* (FCA February 2017) 19. The Hill Review also noted that the standard tier suffers from an ‘identity and branding crisis’ (n 89) 22.

Figure 1: Main Market/AIM IPOs, 1998-2008



Source: London Stock Exchange Reports at <<https://www.londonstockexchange.com/reports?tab=lse-historic>>

governance and performance indeed may be illusory. The assumption that sound governance is a beneficial corrective to risks potentially wayward executives pose can be framed as a testable hypothesis: ‘good governance translates into good returns.’<sup>100</sup> This proposition allegedly has achieved ‘slogan status’ in the corporate governance literature and qualifies as corporate governance ‘folk wisdom.’<sup>101</sup> There is, however, a problem: the data does not tally with the consensus view.

The 2009 Walker Review drew attention to the fact that assumptions that better corporate governance will improve corporate performance lacked strong empirical support, saying ‘Advice to this Review on available economic and business school research on the

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<sup>100</sup> Jens Frankenreiter and others, ‘Cleaning Corporate Governance’ (2021) 170 *University of Pennsylvania Law Review* 1, 61.

<sup>101</sup> *ibid.*

impact of NEDs on the decision-taking of boards (and the resulting added value to the entity) is that such research gives little evidence-based guidance.<sup>102</sup> Nothing material has changed in the interim. A 2018 study of adherence to UK CGC board-related recommendations acknowledged prior ‘evidence on the association between various separate dimensions of board governance arrangements and corporate performance is somewhat mixed’,<sup>103</sup> and reported that while ‘strong’ corporate governance, measured by a board governance index drawing upon key Code propositions, was positively associated with some measures of corporate performance the stock market was indifferent to such governance arrangements.<sup>104</sup>

A tension between innovation and control in the corporate realm may help to explain the mixed results.<sup>105</sup> The need for control arises in the corporate context because of potentially wayward management. Innovation is essential because in a quickly changing market environment the firms most likely to succeed will be those with the capacity to develop new ideas, to take risks and to alter existing strategies quickly and boldly.

The UK CGC says a listed company’s non-executive directors ‘should scrutinise and hold to account the performance of management.’<sup>106</sup> In companies where this sentiment is

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<sup>102</sup> Walker Review (n 60) 37. For a summary of the pre-Walker Review literature, see Saeed Akbar and others, ‘More on the Relationship Between Corporate Governance and Firm Performance in the UK: Evidence From the Application of Generalized Method of Moments Estimation’ (2016) 38 *Research in International Business and Finance* 417, 418.

<sup>103</sup> Amama Shaukat and Grzegorz Trojanowski, ‘Board Governance and Corporate Performance’ (2018) 45 *Journal of Business, Finance and Accounting* 184, 187.

<sup>104</sup> *ibid* 204.

<sup>105</sup> Cheffins (n 64) 624.

<sup>106</sup> UK CGC 2018 (n 14) provision 13.

truly taken to heart, the balance could tip too far away from innovation in favour of control. A management team seeking to make necessary bold changes could well encounter red tape and criticism rather than receiving the advice, support and encouragement that would provide the platform for greater corporate success.<sup>107</sup> There is awareness of the potential downsides in the corporate sector. Tim Martin, the founder and chair of the listed pub group JD Wetherspoon, told investors in 2019 that by ‘vesting so much power in non-executive directors’ the UK CGC was ‘disenfranchising executives.’<sup>108</sup> He struck a similar chord in 2020, saying, ‘Since the introduction of the current corporate governance regime I don’t think there’s a single example of PLC that over the last 30 years gone from strength to strength.’<sup>109</sup>

The lack of empirical evidence confirming the hypothesis that ‘better’ corporate governance’ fosters better corporate performance lends credence to the proposition that ‘over-governance’ could be helping to foster the decline of the listed company in the UK. Caution is in order, though. With empirical studies of the impact of ‘better’ corporate governance methodological challenges may well be contributing to the mixed results. These include difficulties associated with isolating the impact of governance with regression analysis and endogeneity (strong corporate performance may be a driver of ‘better’ governance arrangements as much as the other way around).<sup>110</sup> Additionally, the decline of

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<sup>107</sup> Cheffins (n 64) 624.

<sup>108</sup> ‘Q1 Trading Update, 13 November 2019’ Wetherspoon, Investors: Reports, Results, Presentations <<https://www.jdwetherspoon.com/investors-home/reports-results-presentations>>

<sup>109</sup> Hannah Uttley, ‘Wetherspoons Toasts a Year of “Absolute Hell”’, *Sunday Telegraph* (London, 13 December 2020) Business 1.

<sup>110</sup> Reddy (n 82) 702. Even the deployment of highly sophisticated econometrics to resolve the endogeneity issue fails to indicate that corporate governance is a determinant of corporate performance. See eg M. Babajide

the UK stock market is a multi-causal phenomenon; ‘over-governance’ is at best one of a number of contributory factors.<sup>111</sup> However, even accepting that the decline of the listed company does not provide in isolation a convincing rationale for abolishing the UK CGC, there are other reasons why the Code likely is no longer fit-for-purpose. One of these, discussed next, is that over time much of the Code has become inconsequential from a governance perspective.

### **5. Code Irrelevance as a Reason for Abolishing the Code**

To the extent that the ‘folk wisdom’ linking better corporate governance with better corporate performance is correct, the aspiration of the Cadbury Committee to identify and prescribe corporate governance best practice was sound enough in principle. Disclosure against codes of best practice can potentially help to foster beneficial governance practices.<sup>112</sup> Whatever theoretical benefits Code-driven ‘better’ corporate governance might offer, however, a strong case can be made for abolition of the UK CGC on the grounds of irrelevance. The present-day Code is inconsequential in part because publicly traded companies would likely adopt key Code features in the absence of the Code. In addition, various facets of the Code are superfluous on their own terms. With the Code being redundant in many respects, costs associated with its operation make it a detrimental enterprise on a net-basis.

Instances where publicly traded firms have got ‘out in front’ of the Code in significant ways provide evidence that companies would frequently adopt beneficial features of the UK

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Wintoki and others, ‘Endogeneity and the Dynamics of Internal Corporate Governance’ (2012) 105 *Journal of Financial Economics* 581.

<sup>111</sup> Brian R. Cheffins and Bobby V. Reddy, ‘Will Listing Rule Reform Deliver Strong Public Markets for the UK?’ (2022) 1, 37-47 <<https://ssrn.com/abstract=4028930>>

<sup>112</sup> Björn FASTERLING, ‘Development of Norms Through Compliance Disclosure’ (2012) 106 *J. Bus. Ethics* 73.

CGC in its absence. The pioneering 1992 Cadbury Report acknowledged, for instance, that the pre-Code governance environment was satisfactory in many ways. The report said, ‘The basic system of corporate governance in Britain is sound. The principles are well known and widely followed. Indeed, the Code closely reflects existing best practice.’<sup>113</sup>

Corporate governance codes did prompt various meaningful changes to corporate governance arrangements in the UK in the 1990s.<sup>114</sup> Nevertheless, listed companies would continue to get out in front of Code guidance. For instance, as of 2000, the typical larger publicly quoted company had a majority of non-executives on the board,<sup>115</sup> substantially anticipating a 2003 change to the Code stipulating that one-half of a company’s board should be independent.<sup>116</sup>

AIM and standard tier companies – none of which are obliged to take the UK CGC into account<sup>117</sup> -- also illustrate that firms can adopt what are assumed to be beneficial corporate governance arrangements in the absence of a Code. Prior to 2018, AIM companies only had to consider whether their corporate governance regime was appropriate and disclose

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<sup>113</sup> Cadbury Report (n 1) para. 1.7. See, though, Ian Jones and Michael G. Pollitt, ‘Who Influences Debates in Corporate Ethics? An Investigation into the Development of Corporate Governance in the UK Since 1990’ (2001) ESRC Centre for Business Research, University of Cambridge Working Paper No. 221, 1, 15 (indicating that pre-Cadbury only a small percentage of FTSE 100 companies complied with all of the key points of the Cadbury Code).

<sup>114</sup> Jones and Pollitt (ibid) 16; Conyon (n 79). The proliferation of board committees was particularly marked.

<sup>115</sup> Rayton and Cheng (n 82) 1.

<sup>116</sup> ibid 7; Combined Code (2003) (n 11) Code Provision A.3.2.

<sup>117</sup> See text accompanying nn 93-94 and 98.

the regime's key features.<sup>118</sup> Nevertheless, there were features of AIM corporate governance that closely resembled those provided for by the Code. For instance, in the mid-2000s, shortly after the Combined Code was amended to say that listed companies should have a board where at least half of the directors were independent, on average forty-five per cent of AIM company board members were independent NEDs.<sup>119</sup> In the late 2000s, while many AIM company boards did not have a nomination committee, consistent with Combined Code guidance, the vast majority of AIM companies did have audit and remuneration committees and most split the roles of CEO and chair of the board.<sup>120</sup> As for standard-listed companies, which only have to disclose the corporate governance code to which they are subject or which they have voluntarily chosen to apply, they often voluntarily adopt key UK CGC recommendations, such as those pertaining to the splitting of the CEO/chair roles, independent director representation on boards and the use of board committees.<sup>121</sup>

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<sup>118</sup> Paul Arathoon, 'Key Changes to the AIM Rules' (*CharlesRussellSpeechlys*, 10 May 2018)

<<https://www.charlesrussellspeechlys.com/en/news-and-insights/insights/corporate/2018/key-changes-to-the-aim-rules/>> Since 2018, AIM companies have been required to identify on their websites a corporate governance code which they have decided to apply and divulge variations from it (LSE, *AIM Rules* (LSE 1 January 2021) Rule 26).

<sup>119</sup> Chris Mallin & Kean Ow-Yong, 'Factors Influencing Corporate Governance Disclosures: Evidence from Alternative Investment Market (AIM) Companies in the UK' (2012) 18 *European Journal of Finance* 515, 526.

<sup>120</sup> Combined Code (2008) (n 11) Provisions A.2.1 (CEO/chair), A.4.1 (nomination committee), B.2.1 (remuneration committee), C.3.1 (audit committee). Neeta Shah, 'Corporate Governance in the Alternative Investment Market of the London Stock Exchange' (2014) PhD thesis, Royal Holloway, University of London, 211-12.

<sup>121</sup> As of the end of 2015, the last year when published LSE issuer data included premium/standard-listed designations, for the nine companies from then that are still standard-listed as of February 2022, six complied

In addition to it being likely that premium-listed companies would implement many Code recommendations in the absence of the Code, numerous aspects of the Code are superfluous on their own terms. This is because what is said either largely duplicates other regulatory schemes or constitutes little more than uncontentious corporate governance generalities. Consider, for instance, executive pay. Detailed treatment of managerial remuneration in the UK CGC is a vestige of guidance the 1995 Greenbury Report issued.<sup>122</sup> This guidance, which was incorporated into the Combined Code in 1998,<sup>123</sup> was subsequently retained in large measure despite companies becoming subject to substantial statutory disclosure requirements in 2002, subsequently fortified in 2013.<sup>124</sup> Currently, provisions 35 and 41 of the UK CGC substantially replicate disclosure requirements set out in regulations governing the contents of directors' remuneration reports which quoted companies must file publicly and distribute to shareholders.<sup>125</sup>

UK CG Code Principle P, and provisions 34 and 36 to 40, provide guidance on suitable executive pay arrangements. What is said, however, is superficial compared with institutional investor and proxy advisor policies that canvass executive pay in considerable

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with the independent director guidance in the UK CGC, eight had not combined the roles of CEO and chair, all had audit committees, all had remuneration committees, and seven had nomination committees.

<sup>122</sup> Greenbury Report (n 8).

<sup>123</sup> See Table 1.

<sup>124</sup> Moore and Petrin (n 62), 250-51.

<sup>125</sup> CA 2006, ss. 420-23, 430, 441; schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, SI 2008/No. 410, as amended by the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 (SI 2013/No. 1981), ss. 22(1), (b), (c), 26, 29, 36, 38-40; the Companies (Miscellaneous Reporting) Regulations 2018 and the Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019.



depth.<sup>126</sup> Listed companies in their turn are likely to pay close attention to such privately generated policies. Statutory changes in 2002 and 2013 mean shareholders have binding voting rights regarding the remuneration policy of companies<sup>127</sup> and advisory annual voting rights over payments actually made to directors.<sup>128</sup> This arrangement discourages listed companies from introducing remuneration arrangements that depart substantially from declared policies of investor groups and their advisors, and thus likely does considerably more to shape executive pay than UK CGC guidance.

The duplication pattern affecting the UK CGC is not restricted to executive pay. Table 2 identifies additional examples of the Code replicating other regulatory arrangements. Table 3 does likewise with Code measures restating basic corporate governance received wisdom.

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<sup>126</sup> See eg The Investment Association, *Principles of Remuneration* (Investment Association 18 November 2021) <<https://www.theia.org/industry-policy/guidelines/guidelines-listed-companies>>; Glass Lewis, *2022 Policy Guidelines: United Kingdom* (2022) 32-42 <<https://www.glasslewis.com/voting-policies-current/>>

<sup>127</sup> CA 2006, s. 439A.

<sup>128</sup> CA 2006, s. 439. On the changes made in 2013, see Moore and Petrin (n 62), 251-52.

Table 2: UK Corporate Governance Code Measures Replicating Other Regulation (Excluding Remuneration Topics)

UK Corporate Governance Code Measure	Guidance to Companies	Similar Regulatory Measure
Principles A, K, provision 1 (first sentence), provision 7.	The board's role is promote the long-term success of the company. The board should manage conflict of interests, exercise independence of judgment and ensure members have a suitable combination of skills, experience and knowledge.	CA 2006, ss. 172-77 -- Directors owe duties to their company to promote its success, to exercise independent judgment, to exercise care, skill and diligence and to avoid conflicts of interest, including by disclosing interests in transactions in which there is a personal interest.
Provisions 1, 28, 29	Directors should monitor risk management, assess principal risks and describe risks to the future success of the business in the annual report they must prepare and file publicly.	CA 2006, ss. 414A, 414C, 447 -- The directors must, in a strategic report they are obliged to generate and file annually, describe for shareholders the principal risks facing the company and trends likely to affect the future development of the company.
Provision 5, para. 1	The board should understand the views of stakeholders and describe in the annual report how their interests and matters set out in CA 2006 s. 172 have featured in board decision-making.	CA 2006 ss. 172, 414CZA – Directors must have regard for prescribed stakeholders and must describe in the strategic report they prepare what has been done in this respect.
Provisions 14, 23, 26, 41	The responsibilities of the board should be set out in writing and should be publicly available. A company's annual report should describe the work of the audit, nomination and remuneration committees.	Disclosure and Transparency Rules, para. 7.2.7 – A corporate governance statement that must either be in the directors' annual report or be a standalone document must describe the composition and operation of the company's administrative body (board) and its committees.
Principle M, provisions 24, 25	The board should ensure the effectiveness of the company's internal audit function and should create an audit committee comprised of independent directors that takes on responsibilities provision 25 specifies.	Disclosure and Transparency Rules, paras. 1B.1.2, 7.1.1, 7.1.1A, 7.1.3 -- A listed company must have a body with a majority of members independent of the company that is responsible for monitoring the company's financial reporting process, its system of internal financial controls and its external auditing procedures.
Provision 27	Directors should state that the annual report and accounts they are responsible for preparing are fair, balanced and understandable.	CA 2006, ss. 393-94, 447 – The board can only approve the annual accounts the company must prepare and file if they provide a true and fair view of the company's financial position.
Principle N, provisions 30, 31	The board should present a fair statement of the company's prospects, state whether the company's accounts have been prepared on the basis the company is a going concern and indicate a period for which it is reasonable to expect the	Listing Rules, para. 9.8.6(3) requires companies to make disclosures on matters UK CG Code Provisions 30 and 31 canvass. National and international accounting standards require a company's board to indicate whether the company is capable of continuing as a going concern. <sup>129</sup> The FCA

<sup>129</sup> Paul Davies, Sarah Worthington and Christopher Hare, *Gower: Principles of Modern Company Law*,

Eleventh Edition (Sweet & Maxwell, 2021), 781.

UK Corporate Governance Code Measure	Guidance to Companies	Similar Regulatory Measure
	company will be able to continue in operation ('viability statement').	acknowledged in 2014, that the 'going concern statement' under the Code (provision 30) broadly mimicked required disclosures under other regulatory rules and accounting standards. <sup>130</sup>

Table 3: UK Corporate Governance Code Measures Addressing Uncontentious Governance Generalities (Excluding Remuneration Topics)

UK Corporate Governance Code Measure	Topic	Corporate Governance Received Wisdom
Provision 8	Directors expressing concern about the operation of the board, including when resigning.	There is extensive Association of Chartered Certified Accountants (ACCA) guidance for dissenting directors contemplating resigning. <sup>131</sup>
Principle F	The role of the chair of the board.	The FRC offers detailed guidance on point. <sup>132</sup>
Principle H, Provision 13	The role of non-executive directors.	The FRC offers detailed guidance on point, <sup>133</sup> as does the Institute of Directors. <sup>134</sup>
Provision 16	The role of the company secretary, particularly with respect to corporate governance.	The FRC offers detailed guidance on point. <sup>135</sup>

<sup>130</sup> FRC, *Consultation Document, Proposed Revisions to the Corporate Governance Code* (FRC, 2014) 11.

<sup>131</sup> ACCA, *Resigning from a Board: Guidance for Directors* (ACCA, 2008)

<<https://www.accaglobal.com/ca/en/technical-activities/technical-resources-search/2008/december/resigning-from-a-board-guidance-for-directors.html>>

<sup>132</sup> FRC, *Guidance on Board Effectiveness* (London, 2018) 18-19.

<sup>133</sup> *ibid* 22.

<sup>134</sup> Institute of Directors, *What is the Role of the Non-Executive Director?*, 21 November 2018,

<<https://www.iod.com/services/information-and-advice/resources-and-factsheets/details/What-is-the-role-of-the-NonExecutive-Director>>

<sup>135</sup> FRC (2018) (n 132) 23.

In 2011, the FRC said of code-based corporate governance, '[the] dynamic interaction between codesetting and response demonstrates the advantages this has over slower-changing law-based systems.'<sup>136</sup> How then has the UK CGC ended up mimicking arrangements companies likely would put in place in any case, replicating other regulation, or putting forward uncontentious generalities? Part of the reason is that finding novel points to address has become more challenging with corporate governance having grown substantially as a field in the thirty years since the Cadbury Committee issued its pioneering report. 'Corporate governance' barely featured in discussions of public companies in Britain until the early 1990s.<sup>137</sup> Matters have changed dramatically since then. For instance, among just over ninety sources with the phrase 'corporate governance' in the title listed in the Institute of Advanced Legal Studies online catalogue, only seven have a publication date from before 1995.<sup>138</sup>

Changes to the allocation of Code-drafting responsibilities likely also help to explain why substantial elements of the current UK CGC are redundant or superfluous. The Cadbury and Hampel Committees were both well-positioned to identify corporate governance guidance that anticipated best business practice. The Cadbury Committee was comprised of a

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<sup>136</sup> FRC (2011) (n 82) 1.

<sup>137</sup> Cheffins (n 3) 391-94.

<sup>138</sup> Institute of Advanced Legal Studies Library <<https://catalogue.libraries.london.ac.uk/search~S6>> (search conducted 26 March 2022).

mix of current or former company directors,<sup>139</sup> senior members of the accountancy and legal professions, and representatives of the institutional shareholder community and the LSE.<sup>140</sup> While the Department of Trade and Industry provided staff, including the Committee's secretary,<sup>141</sup> there were no government officials on the Committee. As for the Hampel Committee, public company executives predominated, with institutional shareholders and the accountancy and legal professions also being represented.<sup>142</sup> Again, there were no government officials on the Committee.

The direct proximity to the public company sector that left the Cadbury and Hampel Committees well-positioned to identify emerging best practice trends would be largely absent following 2000. With the 2003 Higgs Report, there was no committee akin to that associated with the Cadbury and Hampel initiatives. Instead, Derek Higgs, who was serving as a non-executive director for a number of publicly traded companies after a distinguished career in financial services, led the government commissioned review.<sup>143</sup> Civil servants provided logistical support<sup>144</sup> and took the lead role in formulating the proposed new Code included in

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<sup>139</sup> eg Jonathan Charkham, who was identified by the Cadbury Report as an adviser to the Bank of England, was a director of a bedding manufacturer in the 1950s and 1960s – 'Jonathan Charkham' *Times* (London, 12 June 2006) 47.

<sup>140</sup> Cadbury Report (n 1) 61-62; Jones and Pollitt (n 113) 17-18, 75. See also Stephen Wilks, *The Political Power of the Business Corporation* (Edward Elgar 2013), 228 (describing the Cadbury Committee as 'four accountants, four financial market specialists, three industrialists and one lawyer.')

<sup>141</sup> Cheffins (n 64) 374.

<sup>142</sup> Hampel Report (n 7) 65; Jones and Pollitt (n 113) 28, 75.

<sup>143</sup> Christopher Adams and Tony Tassell, 'Heavyweight Riding to the Rescue of Boardroom Review' *Financial Times* (London, April 16, 2002) 22.

<sup>144</sup> Jones and Pollitt (n 113) 165.

the report Higgs issued,<sup>145</sup> a draft that was criticised as cumbersome and excessively detailed.<sup>146</sup> The FRC stepped in to rework the post-Higgs version of the Combined Code ‘to present it in a way that doesn’t look as prescriptive.’<sup>147</sup>

The FRC continues to have responsibility for promulgating and periodically updating the Code. Although the FRC is formally a private entity -- a company limited by guarantee -- and is situated closer to corporate and market actors than standard public law-making bodies,<sup>148</sup> it can still be described as ‘quasi-governmental’ in character. With the FRC’s directors being appointed by the government and with the government having classified the FRC officially as a public body, the FRC is tied substantially to the government machinery.<sup>149</sup> Tim Martin of JD Wetherspoon caustically referred in 2019 in relation to the UK CGC to ‘(t)he vast gap between the technocrats who make the rules and commercial reality.’<sup>150</sup> While this assessment may be overly harsh,<sup>151</sup> the FRC’s governmental features

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<sup>145</sup> ‘Hating Higgs’ *Economist* (London, March 15, 2003) 79.

<sup>146</sup> Martin Dickson, ‘Higgs in the Pillory Facing Hail of Rotten Eggs’ *Financial Times* (London, March 5, 2003) 25; Bryan Nicholson, ‘The Role of the Regulator’ in Ken Rushton (ed), *The Business Case for Corporate Governance* (CUP, 2008) 100, 110-11.

<sup>147</sup> Antonia Senior, ‘Final Higgs Code Will Be “Unrecognisable”’ *Times* (London, 9 July 2003) 27.

<sup>148</sup> Moore and Petrin (n 62) 22.

<sup>149</sup> Paul Davies, Sarah Worthington and Christopher Hare, *Gower: Principles of Modern Company Law, Eleventh Edition* (Sweet & Maxwell 2021) 62; Kingman (n 16) 18.

<sup>150</sup> Wetherspoon (n 108).

<sup>151</sup> Indeed, in 2009, the *Times* characterised the FRC staff as ‘market-friendly’: David Wighton, ‘If it Ain’t Broke, Just a Tidy Up’ *Times* (London, 22 July 2009) 35.

likely do compromise its familiarity with emerging governance trends suitable to memorialise in the UK CGC.

A by-product of the links between the FRC and government is that government policy has started to bleed into the Code. A speech Theresa May gave as part of her successful 2016 Conservative leadership campaign expressing a desire to mandate employees on company boards stands out.<sup>152</sup> After May became Prime Minister, the FRC's chief executive told the Business, Energy and Industrial Strategy Committee that primary legislation would be required to implement worker representation on boards.<sup>153</sup> The Government, however, was not prepared to take this step, despite May's 2016 pledge. Instead, the Department for Business, Energy and Industrial Strategy (DBEIS) invited the FRC to consult on revising the UK CGC to include a comply-or-explain provision advising boards to implement one of three employee engagement mechanisms – a non-executive director designated to foster engagement with the workforce, an employee advisory panel or a workforce representative on the board.<sup>154</sup> The FRC duly complied.<sup>155</sup>

To the extent a lack of familiarity with cutting edge corporate governance developments afflicts the UK CGC and strengthens the case in favour of abolition, the logic likely will become more compelling soon. John Kingman, in a 2018 government

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<sup>152</sup> Theresa May, '2016 Speech to Launch Leadership Campaign', <https://www.ukpol.co.uk/theresa-may-2016-speech-to-launch-leadership-campaign/> ('...if I'm Prime Minister, we're going to change that system and we're going to have not just consumers represented on company boards, but employees as well.').

<sup>153</sup> *House of Commons' Business Energy Industrial Strategy Committee, Corporate Governance: Fourth Report of Session 2016-17* (House of Commons 2017) 56.

<sup>154</sup> DBEIS, *Corporate Governance Reform: The Government Response to the Green Paper Consultation* (DBEIS August 2017) para. 2.43.

<sup>155</sup> UK CGC 2018 (n 14) Provision 5.

commissioned review of the FRC, recommended that the FRC be replaced by a new independent regulator, the Audit, Reporting and Governance Authority (ARGA), ‘with clear statutory powers and objectives’.<sup>156</sup> His recommendations have not yet been adopted, but the government is still planning to fold the FRC into ARGA, with new staff added in tandem with new powers.<sup>157</sup> The direction of travel thus likely will be even more toward the ‘technocrats’ bemoaned by Martin<sup>158</sup> and further away from the business and practitioner-led committees of yore.

## 6. Disclosure and Compliance Costs as Reasons for Abolishing the Code

Despite the tenuous link between better corporate governance and better corporate performance, despite it being reasonably likely that publicly traded companies will adopt beneficial corporate governance arrangements in the absence of the Code and despite the Code not being at the cutting edge of corporate governance thinking, it is still conceivable that the UK CGC has beneficial governance effects. Nevertheless, the case for abolition of the Code remains strong, because the costs associated with the operation of the Code may well exceed those benefits. Companies incur Code-related costs (A) by engaging in disclosure to satisfy Listing Rule requirements to describe the extent to which they adhere to UK CGC guidance, and (B) by adopting sub-optimal governance structures due to pressures companies face to comply with the Code.

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<sup>156</sup> Kingman (n 16) 9.

<sup>157</sup> Harriett Russell, ‘New Boss Insists Audit Watchdog Will Bare Teeth Following Reform’ *Telegraph* (London, 24 October 2019) 3; FRC, *Financial Reporting Council: 3-Year Plan 2022-25* (FRC 2022) 4, 6, 13-14, 16.

<sup>158</sup> n 150, and accompanying text.



### A. *Disclosure Costs*

Companies, in order to comply with disclosure requirements applicable to them, have to hire staff and pay professional advisors to ensure proper preparation and timely filing of the relevant documentation.<sup>159</sup> The early 1990s amending of the Listing Rules to require companies to disclose whether they had complied with the Cadbury Code or explain non-compliance added to these costs. With only nineteen provisions, however, the additional burden should have been modest.

Matters have changed. Due to periods of substantial expansion, the UK CGC is a considerably larger document than the Cadbury Code, comprised of principles as well as provisions and canvassing a considerably wider array of governance concerns (Table 1).<sup>160</sup> While with the 2018 version of the Code the FRC succeeded to some degree in fulfilling a pledge “to shorten and sharpen the revised Code”<sup>161</sup> the Telegraph said in 2019 ‘The dispiriting consensus seems to be that reporting on governance has got out of control.’<sup>162</sup> Figure 2 identifies Code word count changes over time and demonstrates that each post-Hampel version has been much more expansive than the original Cadbury Code, including the present UK CGC.

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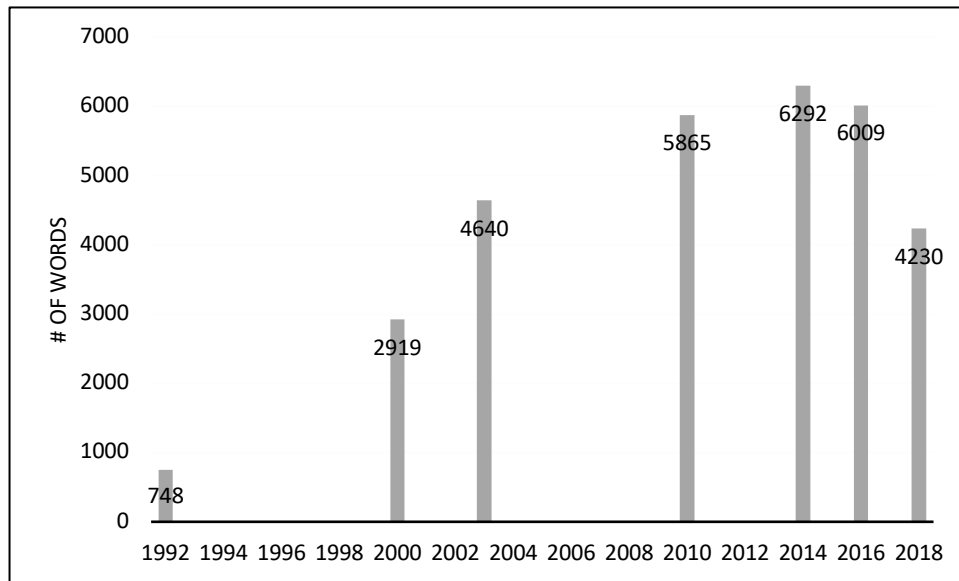
<sup>159</sup> Cheffins (n 64) 204.

<sup>160</sup> For a summary of the current Code see nn 26-47, and accompanying text.

<sup>161</sup> FRC, Proposed Revisions to the UK Corporate Governance Code (FRC, 2017), 2.

<sup>162</sup> Richard Buxton, ‘A Radical Break for Boards from “Loadsamoney” Values’ *Telegraph* (London, 22 November 2019) Business, 2. See also Reddy (n 82) 701 (‘The levels of disclosure required can overwhelm governance teams’).

Figure 2 -- Corporate Governance Code Word Count, 1992-2018



Sources: The dates listed in Figure 1 are the issuance of the Cadbury Code of Best Practice (1992), the initial version of the Combined Code in place when the FSA (now FCA) took responsibility for mandating Code disclosures (2000), a substantially revised version of the Combined Code (2003), the first UK Corporate Governance Code (2010), revised versions of that Code (2014, 2016) and the current version of the Code (2018). Word counts exclude introductory sections, footnotes, schedules and guidance.

Disclosure-related costs have increased not merely because the Code has become larger but also because of greater expectations regarding what is supposed to be disclosed. The original Cadbury Report indicated companies need not report on ‘every item in which they are in compliance’.<sup>163</sup> Consequently, the relatively small number of provisions aside, the disclosure burden for a company that adhered fully to the Cadbury Code’s guidance would have been modest.

Matters changed substantially with the introduction of principles under the Combined Code in 1998.<sup>164</sup> At this point in time, companies became obliged to disclose affirmatively how they had applied Code principles regardless of the extent to which they adhered to Code

<sup>163</sup> Cadbury Report (n 1) para. 3.8.

<sup>164</sup> See Table 3.

provisions.<sup>165</sup> The FRC in turn subsequently encouraged companies to offer greater detail when discussing principles.<sup>166</sup> The nature of provisions also changed, with the FRC increasingly introducing measures that were de facto disclosure obligations rather than generally framed corporate governance standards where companies could simply affirm compliance.<sup>167</sup>

2022 could represent a further increase in Code-related disclosure costs. The FRC, in a 2021 review of corporate governance, indicated that it expects companies to report on ‘outcomes and actions’ rather than merely offering ‘declarations or statements of intent without detail’.<sup>168</sup> The FRC thus appears to be prodding companies to engage in meaningful disclosure not only when they have failed to comply but also when they adhere to Code provisions.<sup>169</sup> Code-related disclosure thus seems destined to become increasingly burdensome.

### B. *Compliance Inefficiency Costs*

Mandatory legal rules can impose costs by precluding parties from customising their operating environments to meet their own distinctive requirements, thereby inhibiting the

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<sup>165</sup> Combined Code (2000) (n 9) 1.

<sup>166</sup> See eg FRC, *Review of Corporate Governance Reporting* (FRC 2020) 7, 13, 15, 24, 26 and 39.

<sup>167</sup> eg companies must make relevant disclosures in order to comply with UK CGC 2018 (n 14) provisions 1, 2, 4, 5, 14, 23, 26, 28, 30, 31 and 41. Previous versions of the code included a schedule of disclosures required by the code to maintain compliance. See eg FRC, *The UK Corporate Governance Code* (FRC April 2016) 28-30.

<sup>168</sup> FRC, *Review of Corporate Governance Reporting* (FRC November 2021) 1, 5.

<sup>169</sup> The focus on ‘activities and outcomes’ in the context of the 2018 version of the UK CGC resembles the approach taken by the FRC’s latterly published 2020 Stewardship Code which details reporting expectations of institutional investors in the stewardship of their investment assets (FRC (2020) (n 166)).

achievement of efficient outcomes.<sup>170</sup> The UK CGC seemingly addresses this difficulty neatly<sup>171</sup> by enabling companies to ignore provisions that are a poor fit so long as the step taken is divulged.<sup>172</sup> The resulting avoidance of a ‘one-size-fits-all’ framework is a much-vaunted positive feature of the Code.<sup>173</sup> As a previous version of the UK CGC stated, ‘It is recognised that an alternative to following a provision may be justified in particular circumstances if good governance can be achieved by other means.’<sup>174</sup>

However, all is not quite what it seems. In practice, the flexibility for which comply-or-explain is renowned is somewhat illusory, with provisions tending to operate as the functional equivalent to a mandatory checklist of governance requirements. A 2019 report found that seventy-three per cent of surveyed FTSE 350<sup>175</sup> companies complied with every provision of the previous version of the UK CGC, and ninety-five per cent complied with all but one or two provisions.<sup>176</sup> Compliance rates, while still substantial, did drop appreciably

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<sup>170</sup> Cheffins (n 64) 228.

<sup>171</sup> *ibid* 646.

<sup>172</sup> nn 24-25, and accompanying text. UK CGC 2018 (n 14) 2 – ‘An alternative to complying with a Provision may be justified in particular circumstances based on a range of factors, including the size, complexity, history and ownership structure of a company.’

<sup>173</sup> nn 69-71, and accompanying text.

<sup>174</sup> FRC (2016) (n 167) 4.

<sup>175</sup> An index of the largest 350 premium-listed companies based upon market capitalisation.

<sup>176</sup> Grant Thornton, *Corporate Governance Review 2019* (Grant Thornton 2019) 43.

in 2020 and 2021.<sup>177</sup> This was because the current version of the UK CGC had just come into force, necessitating adjustments on the part of listed companies.<sup>178</sup>

The route by which substantial compliance has been achieved implies companies have been incurring costs by adhering to provisions that suit them poorly. For many years regulators have bemoaned widespread ‘box-ticking’ by investors that leaves little room for Code departures supported by explanations.<sup>179</sup> Executives have therefore found themselves under pressure to implement governance arrangements that were ill-suited to their company’s circumstances. Management also may have been spending substantial time ensuring compliance that could have been devoted to running the company effectively. Both patterns will have created costs for companies.

It is not necessary to rehearse fully why listed company boards succumb to box-ticking behaviour.<sup>180</sup> The principal reason, however, is that shareholders expect compliance<sup>181</sup> regardless of circumstance and correspondingly give explanations

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<sup>177</sup> Grant Thornton, *Corporate Governance Review 2020* (Grant Thornton 2020), 10; FRC (2021) (n 168) 6.

<sup>178</sup> eg contractual limitations will hinder the capacity of companies to comply immediately with the recommendation that pension contributions for executive directors be aligned with pension contributions for the workforce as a whole (UK CGC 2018 (n 14) provision 38), and companies will take time to implement the employee engagement mechanisms recommended by the UK CGC (ibid provision 5) and to usher out chairs who have served for more than nine years (ibid provision 19). Also see Linklaters, ‘Corporate governance: A Brave New World for “Comply or Explain”’

<<https://www.linklaters.com/en/insights/blogs/employmentlinks/corporate-governance-a-brave-new-world-for-comply-or-explain>>

<sup>179</sup> See eg Hampel Report (n 7) para. 1.12; FRC (2009) (n 12) 33; FRC, *Developments in Corporate Governance and Stewardship 2016* (FRC 2017) 7; FRC (2020) (n 166) 1.

<sup>180</sup> For a detailed synopsis of box-ticking, see Reddy (n 82) 698-703.

<sup>181</sup> Andrew Chambers, *Chambers’ Corporate Governance Handbook, 7th ed.* (Bloomsbury 2017) 770.

accompanying non-compliance disclosures short shrift.<sup>182</sup> The obligation to account for non-compliance further reinforces incentives for companies to adhere to what may be for a company sub-optimal Code provisions. For companies already struggling to cope with substantial governance-related disclosure obligations, acting in accordance with ill-fitting provisions may well become the path of least resistance.<sup>183</sup>

Pressure in favour of Code compliance comes from other sources. Numerous UK CGC provisions in effect instruct companies to make relevant disclosures rather than offering corporate governance guidance.<sup>184</sup> In such instances, characterising adherence to the Code as voluntary is something of a misnomer. While with a provision recommending a specific governance arrangement opting out and explaining should be feasible, when a provision imposes a de facto disclosure obligation it will be impracticable for companies to explain why they have not followed through.<sup>185</sup>

The FRC is also increasingly emphasising the need for compliance. In a 2020 review of corporate governance, the FRC noted in relation to a newly added UK CGC provision indicating executive remuneration pension contributions should be aligned with workforce pension contributions<sup>186</sup> that it expected companies to move to full compliance ‘as soon as

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<sup>182</sup> Reddy (n 82) 698-700; Paul Coombes and Simon Wong, ‘Why Codes of Governance Work: Corporate-Governance Codes are Definitely Effective – Within Limits’ (2004) 2 *The McKinsey Quarterly* 48, 53; Sridhar Arcot and Valentina Bruno, ‘In Letter but not in Spirit: An Analysis of Corporate Governance in the UK’ (2005) 32 [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=819784](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=819784) .

<sup>183</sup> Reddy (n 82) 701.

<sup>184</sup> See n 167.

<sup>185</sup> See eg Reddy (n 82) 708.

<sup>186</sup> UK CGC 2018 (n 14) provision 38.

possible'.<sup>187</sup> The following year the FRC acknowledged examples of justifiable explanations for deviations from provisions but placed considerable emphasis on their temporary nature.<sup>188</sup>

The multi-faceted momentum in favour of compliance means that companies may well opt to implement ill-suited Code provisions despite the theoretical choice available to opt out. The downsides with mandatory rules correspondingly come into play with the UK CGC to a greater extent than would have been anticipated.

## **7. Mismatch between the Code and Stakeholder Issues as a Reason for Abolishing the Code**

While the Cadbury Code was promulgated in an era when addressing managerial agency was the top governance priority,<sup>189</sup> governance discourse has increasingly been shaped recently by the revival of a long-running, somewhat cyclical debate<sup>190</sup> as to whether those running companies should treat shareholder interests as paramount or prioritise other stakeholder interests equally.<sup>191</sup> Consistent with the zeitgeist, the UK CGC has been taking on an

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<sup>187</sup> FRC (2020) (n 166) 20.

<sup>188</sup> FRC (2021) (n 168) 8, 14, 34 and 39.

<sup>189</sup> nn 48-57, and accompanying text.

<sup>190</sup> Brian R. Cheffins, 'The Trajectory of (Corporate Law) Scholarship' (2004) 63 CLJ 456, 498.

<sup>191</sup> See eg Business Roundtable, 'Statement on the Purpose of a Corporation' (August 2019)

<<https://opportunity.businessroundtable.org/ourcommitment/>>; Jonathan M. Karpoff, 'On a Stakeholder Model of Corporate Governance' (2021) 50 Financial Management 321; Jill E. Fisch and Steven D. Solomon, 'Should Corporations have a Purpose' (2021) 99 Texas Law Review 1309; Dorothy Lund, 'Corporate Finance for Social Good' (2021) 121 Columbia Law Review 1617; DBEIS, *Restoring Trust in Audit and Corporate Governance: Consultation on the Government's Proposals* (HMSO 2021), 74 ('Additionally, and increasingly, directors are required to have regard to the interests of other stakeholders and to make disclosures on matters of interest to society as a whole.')

increasingly stakeholder tilt. This trend strengthens still further the case in favour of abolition of the Code because it is poorly suited for addressing stakeholder-related issues.

The Code first took on an explicitly stakeholder orientation in 2010. At that point in time, supporting principles were added that urged those carrying out searches for directors to have due regard to the benefits of diversity, including gender,<sup>192</sup> and encouraged remuneration committees to be sensitive to employee pay and conditions when determining executive remuneration.<sup>193</sup> Board diversity considerations featured more prominently in the 2012 version of the UK CGC.<sup>194</sup> The FRC, however, really began running with the stakeholder ball with the current version of the UK CGC.

When consulting on the 2018 version of the Code the FRC said ‘Relationships with stakeholders are central to the new Code.’<sup>195</sup> Correspondingly, unlike with previous versions of the Code, references are made to successful companies contributing to wider society,<sup>196</sup> company purpose, values and culture,<sup>197</sup> workforce policies and practices,<sup>198</sup> and the need for managers to engage with and fulfil responsibilities to stakeholders in addition to

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<sup>192</sup> FRC 2010 (n 5) supporting principle B.2.

<sup>193</sup> *ibid* supporting principle D.1.

<sup>194</sup> FRC, *The UK Corporate Governance Code (FRC 2012)*, Supporting Principle, B.2, Code Provision B.2.4, Supporting Principle, B.6.

<sup>195</sup> FRC, *Feedback Statement: Consulting on a Revised UK Corporate Governance Code (FRC 2018)*, 1.

<sup>196</sup> UK CGC 2018 (*ibid*) principle A.

<sup>197</sup> *ibid* principle B, principle E, principle P and provision 40.

<sup>198</sup> *ibid* principle E, provision 2 and provisions 6, 33, 41.



shareholders.<sup>199</sup> The UK CGC now refers to ‘workforce’ thirteen times and ‘stakeholders’ six times as compared to zero and one reference respectively in the 2016 Code.<sup>200</sup>

The FRC’s 2021 review of corporate governance reporting<sup>201</sup> has taken UK CGC disclosure priorities still further in a stakeholder-oriented direction. Fifteen pages of the review’s ‘main findings’ (out of a total of forty-nine pages) cover stakeholder engagement.<sup>202</sup> The review also dedicates four pages to bemoaning the dearth of corporate reporting on modern slavery issues<sup>203</sup> and climate change.<sup>204</sup> While both issues plausibly fall within the orbit of the UK CGC due to provisions urging disclosure of company risk factors, neither topic is expressly referenced in the UK CGC.<sup>205</sup>

Two caveats apply to this apparent change of tack. First, as the FRC recognises, the UK CGC cannot supplant directors’ duties as codified in UK companies legislation.<sup>206</sup> While

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<sup>199</sup> *ibid* principle D, provision 5 and provision 41.

<sup>200</sup> FRC (2016) (n 167); UK CGC 2018 (n 14).

<sup>201</sup> FRC (2021) (n 168).

<sup>202</sup> *ibid* 15-29.

<sup>203</sup> *ibid* 27.

<sup>204</sup> *ibid* 30-32. Also see Louise Clarence-Smith, ‘Regulator Rebukes Firms Over Governance’, *Times* (London, 25 November 2021) 51.

<sup>205</sup> UK CGC 2018 (n 14) provisions 28, 29 and 31.

<sup>206</sup> *ibid* 3 – ‘Nothing in this Code overrides or is intended as an interpretation of the statutory statement of directors’ duties in the [Companies] Act [2006].’

directors' duties have a stakeholder dimension, directors are obliged to promote company success primarily for the benefit of shareholders.<sup>207</sup>

Second, the UK CGC's comply-or-explain structure is strongly shareholder-oriented. Companies legislation stipulates that the annual reports where companies describe their approach to the Code must be circulated to shareholders.<sup>208</sup> Shareholders, moreover, are exclusively vested with key powers that can be deployed to encourage Code compliance, such as removal of directors,<sup>209</sup> voting on directors standing for annual re-election,<sup>210</sup> and votes on executive pay.<sup>211</sup> Therefore, the extent to which UK CGC-dictated stakeholder governance norms will be observed will necessarily be dependent upon the extent to which shareholders are inclined to enforce them. When Code measures have been designed to reduce managerial agency costs likely to erode investors' risk-adjusted returns, it is plausible that shareholders will be motivated to encourage Code compliance. The logic is considerably shakier with stakeholder-related aspects of the UK CGC.

Some are optimistic that due to a recent re-direction of the world economy toward greater sustainability, shareholders are currently ready, willing and able to push companies in

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<sup>207</sup> Paraphrasing Companies Act 2006 (CA 2006), s. 172. Although s. 172 requires directors to have regard to non-shareholder stakeholder interests, the underlying duty is to still act in good faith to promote the success of the company for the benefit of its members as a whole.

<sup>208</sup> CA 2006, s. 423(1)(a).

<sup>209</sup> CA 2006, s. 168.

<sup>210</sup> The UK CGC recommends that all directors put themselves up for annual re-election at the annual general meeting of shareholders (UK CGC 2018 (n 14) provision 18).

<sup>211</sup> CA 2006, ss. 439, 439A.

an environmental, social and governance (ESG)-friendly direction.<sup>212</sup> The jury, however, remains out on the appetite investors have to pursue an ESG agenda. Shareholders can conceivably be counted-on to support initiatives where treating the environment, employees, suppliers and customers better improves the bottom line. The extent to which investors will do the same, however, when profits have to be sacrificed remains unclear.<sup>213</sup> Even the CEO of asset management giant BlackRock, who has been praised for the firm's focus on ESG and stakeholder matters,<sup>214</sup> has acknowledged that the firm's focus on sustainability is related to investor returns.<sup>215</sup> Assuming there is only so far institutional investors will go in supporting an ESG agenda,<sup>216</sup> with the shareholder-oriented feedback loop that underpins UK CGC

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<sup>212</sup> Wolf-Georg Ringe, 'Investor-led Sustainability in Corporate Governance' (2021) ECGI Working Paper N° 615/2021; Alan R. Palmiter, 'Capitalism, Heal Thyself' (2021), unpublished working paper, <<https://ssrn.com/abstract=3940395>> (emphasising, however, share price effects rather than shareholder engagement).

<sup>213</sup> Jill Treanor, 'Do Bosses Really Want to be Good?' *Sunday Times* (London, 19 January 2020) Business, 5; James Mackintosh, 'Why the Sustainable Craze Is Flawed' *Wall Street Journal* (New York, 24 January 2022) B9; Kim Phillips-Fein, 'Big Business Will Not Save Us' *New York Times* (New York, 6 February 2022) Sunday Review, 3.

<sup>214</sup> Michael Pergrine, 'Larry Fink Goes on the Offensive for Stakeholder Capitalism' *Fortune* (New York, 18 January 2022), <https://www.forbes.com/sites/michaelperegrine/2022/01/18/larry-fink-goes-on-the-offense-for-stakeholder-capitalism/?sh=7edebb4ec842> (indicating that a letter Fink sends out annually to US CEOs contributes to broader and necessary leadership dialogue on the role of the purpose of the corporation).

<sup>215</sup> BlackRock, 'Larry Fink's 2022 Letter to CEOs: The Power of Capitalism' (18 January 2022).

<sup>216</sup> See eg Tariq Fancy, 'The Secret Diary of a 'Sustainable Investor' (August 2021) <<https://medium.com/@sosofancy/the-secret-diary-of-a-sustainable-investor-part-1-70b6987fa139>>; William Power, 'Does Sustainable Investing Really Help the Environment?' *The Wall Street Journal* (New York, 11 August 2021) <<https://www.wsj.com/articles/sustainable-investing-good-for-environment-11636056370>>; Bobby V. Reddy,

enforcement there is a serious risk that the Code's stakeholder-friendly shift in direction will 'lead to fluffy prose about values, culture and purpose and not much else.'<sup>217</sup>

The way in which policymakers are likely to respond when the Code has been invoked to deal with stakeholder issues reinforces concerns to which the emerging Code enforcement mismatch gives rise. For civil servants saddled with Theresa May's 2016 commitment to put workers on boards, the FRC's acceptance of the Government's invitation to amend the Code served as a helpful policy 'get out of jail free' card.<sup>218</sup> This is not an isolated example. It will be sorely tempting for policymakers to duck hard policy choices when they know UK CGC reforms can be cited to say 'something is being done'. As Cally Jordan has said:

'the voluntary code provides a tempting alternative to grappling with and resolving the more contentious issues of corporate governance....The aspirational nature of the Code on long-debated issues...continues to thwart resolution and momentum. There is smoke but little fire.'<sup>219</sup>

The temptation the Code creates for policymakers to procrastinate with tough governance-related calls strengthens the case in favour of abolition of the Code. Forcing choices on regulators by taking away their get out of jail free Code card, is, as a matter of institutional integrity, salutary public policy. This is particularly the case in the stakeholder

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'The Emperor's New Code? Time to Re-Evaluate the Nature of Stewardship Engagement Under the UK's Stewardship Code' (2021) 84 MLR 842, 865-871.

<sup>217</sup> Buxton (n 162). See also Clarence-Smith, Regulator (n 204) (summarising expressions of disappointment by the FRC regarding stakeholder-related disclosures).

<sup>218</sup> nn 152-155, and accompanying text.

<sup>219</sup> Jordan (n 13) 224.

context where there are doubts about the efficacy of the shareholder-oriented feedback loop that underpins Code compliance.

## 8. The Post-Code World

Although the original Cadbury Code was a trailblazer in ‘regulatory’ corporate governance, as matters have evolved, the Code at best currently generates marginal benefits while being functionally irrelevant in many contexts and at worst imposes meaningful costs for companies while offering an ‘easy-out’ for policymakers confronted with challenging corporate governance issues. The Code therefore should be abolished. We envisage in so proposing that beneficial aspects can be retained, partly by the operation of corporate governance norms. We are also not advocating full-scale deregulation. Instead, various facets of the Code can be translated into disclosure obligations for listed companies.

### A. *The Continued Operation of Corporate Governance Norms*

Abolition of the UK CGC should not disrupt on any sort of wholesale basis governance arrangements in listed companies. Far from it. Corporate governance norms typically consistent with Code guidance would do much to shape governance arrangements without a best practice Code in place. The corporate governance arrangements of pre-Code listed companies and AIM and standard-listed companies illustrate this.<sup>220</sup> The American experience is also instructive. The US, which has enjoyed considerably greater stock market growth than the UK over the last twenty years,<sup>221</sup> does not employ a regulator-backed

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<sup>220</sup> nn 113-121, and accompanying text.

<sup>221</sup> Cheffins and Reddy (n 111) 6.

corporate governance code, and comply-or-explain governance rules are rare.<sup>222</sup>

Nevertheless, influential best practice norms are well developed.<sup>223</sup>

With listed companies, what the Code currently says likely would do much to shape post-Code governance in the wake of abolition.<sup>224</sup> Since compliance with the Code has been substantial over time,<sup>225</sup> radical post-abolition departures could rattle the confidence of investors, hitting share prices of the companies involved. Moreover, proxy advisors likely would bear what had been key Code arrangements in mind when assessing companies and advising shareholders on voting decisions.<sup>226</sup> Hence, while abolition of the Code should make it simpler for companies to deviate from governance norms believed to have substantial detrimental effects, ‘institutional memory’ should simultaneously sustain practices such as

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<sup>222</sup> The closest to a comply-or-explain requirement in the US is that issuers must explain why either the same individual is CEO and chair, or why separate individuals have been chosen for the role. See The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111–203 (July 21, 2010), §972.

<sup>223</sup> eg US proxy advisors have formed a corporate governance expectation that at least two-thirds of the board be independent directors (Glass Lewis, *2022 Policy Guidelines: United States* (2022) 1, 15

<https://www.glasslewis.com/wp-content/uploads/2021/11/US-Voting-Guidelines-US-GL-2022.pdf?hsCtaTracking=257fcf1c-f11e-4835-81a3-d13fbc7b1f4c%7C1dad2378-213f-45f6-8509-788274627609>). Additionally, corporate governance principles have been established by representative

organisations (eg National Association of Corporate Directors, ‘Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies’ (2011), Business Roundtable, ‘Principles of Corporate Governance’ (2016), and CII, ‘Corporate Governance Policies’ (7 March 2022)).

<sup>224</sup> Reddy (n 82) 725.

<sup>225</sup> nn 79-82 and 175-178, and accompanying text.

<sup>226</sup> Reddy (n 82) 723.

splitting the chair and CEO roles and substantial independent director representation on boards and board committees.<sup>227</sup>

### B. *Disclosure*

While premium listed companies likely would adhere to well-known governance norms in the absence of a Code, this process would be facilitated if interested parties could identify readily key governance arrangements companies have in place. Correspondingly, post-abolition translating various aspects of the UK CGC into disclosure obligations for premium listed companies would be a sensible move. Statutory reform is one possibility, but delays associated with the law-making process likely would negate a key advantage of the Code, namely nimble revisions that are unrealistic when the protracted process of Parliamentary scrutiny is involved.<sup>228</sup> Deploying the Listing Rules section of the FCA's Handbook,<sup>229</sup> which the FCA can amend quite readily on its own initiative,<sup>230</sup> is an attractive compromise.

It is beyond the scope of this paper to canvass in detail potential post-Code disclosure arrangements but a helpful benchmark for the FCA to follow would be to focus on Code topics shareholders should be strongly motivated to evaluate. Plausible candidates would be: (i) the background and prior commitments of directors, including any relationships that could impair their independence (ii) the structure and division of responsibilities of the board, including disclosing whether the roles of chief executive officer and chair of the board have

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<sup>227</sup> *ibid* 724.

<sup>228</sup> Cheffins (n 64) 178-187.

<sup>229</sup> See <<https://www.handbook.fca.org.uk/handbook>>

<sup>230</sup> On the authority the FCA has to make the Listing Rules, see n 6. Amendments to the Listing Rules are presaged by consultations. Nevertheless, the rules are revised regularly.

been split, (iii) the use, composition and level of independence of board committees, (iv) the number of board meetings and board committee meetings, together with director attendance data, (v) the processes employed to evaluate the effectiveness of the board, (vi) formal policies and procedures governing shareholder engagement, and (vii) a company's risk management arrangements.

Director selection mechanics is another area of potential importance to shareholders where disclosure could be deployed. In particular, companies could be required to state whether they provide for annual re-election of directors, which provision 18 of the UK CGC endorses and for which nearly all FTSE-350 premium-listed companies provide.<sup>231</sup> A case could be made, however, for going further and translating annual election of directors into a legislative requirement. Having a say annually on the selection of directors is conceptually an important power for shareholders to have. Such rights would also beneficially supplement a long-standing right of shareholders to remove directors at any time by way of majority vote,<sup>232</sup> since if board turnover was contemplated there would be no need for shareholders to ensure the relevant dismissal resolutions were included on the agenda of the annual general meeting.<sup>233</sup> Moreover, a controversial provision in the UK CGC indicating that the chair should not remain in post beyond nine years<sup>234</sup> could be safely cast aside, given that

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<sup>231</sup> The most recent report on corporate governance published by Grant Thornton (Grant Thornton (n 177) 10) found that annual re-election was not one of the top-16 most commonly breached Provisions of the UK CGC, meaning that less than 1.4 per cent of FTSE-350 companies did not comply with the Provision (ibid 12).

<sup>232</sup> CA 2006, s. 168. The power to remove directors was introduced by Companies Act 1948, 11 & 12 Geo. 6, c. 38, s. 184

<sup>233</sup> For companies incorporated in England and Wales, members can propose resolutions at the annual general meeting if they hold at least five per cent of the voting rights, or comprise 100 members with a right to vote with an average sum paid-up per member of at least £100 (CA 2006, s. 338).

<sup>234</sup> See eg FRC (2018) (n 195) paras. 1.9, 2.48-2.52.



shareholders would have the opportunity to vote each year against the chair's re-election as a director if they believed a long tenure was prejudicing the chair's effectiveness.

There are also stakeholder-related matters the UK CGC addresses where shareholder-related justifications of disclosure regulation could be advanced. For instance, the manner in which companies engage with stakeholders, currently addressed in provision 5 of the Code, can impact shareholder wealth. There have also been instances where stakeholder-oriented disclosure has been mandated quite recently with respect to gender pay gaps,<sup>235</sup> diversity<sup>236</sup> and climate-related issues.<sup>237</sup> A plausible argument correspondingly could be made in favour of requiring disclosure of various stakeholder engagement practices in tandem with abolition of the UK CGC.

The case in favour of mandating stakeholder-oriented governance disclosure is hardly open-and-shut, however. Again, the Code is poorly suited for addressing stakeholder issues where shareholder interests are not in play.<sup>238</sup> The same dynamics seem likely to affect compulsory disclosure of such matters under the Listing Rules, assuming that disclosure is not occurring in tandem with a related non-disclosure oriented intervention. It is beyond the scope of this article to offer a definitive analysis of the best regulatory strategy with respect to

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<sup>235</sup> Large employers must publish detailed gender pay gap information under the Equality Act 2010 (Gender Pay Gap Information) Regulations 2017.

<sup>236</sup> Detailed information on diversity policy must be published by listed companies under DTR 7.2.8AR. The FCA is planning to add diversity disclosure requirements to the Listing Rules – FCA, Diversity and Inclusion on Company Boards and Executive Management, PS 22/3 (FCA, 2022).

<sup>237</sup> See LRs 9.8.6(8)R and 14.3.27R-14.3.32G (requiring for premium- and standard-listed companies significant comply-or-explain reporting against the Task Force on Climate-Related Financial Disclosures framework).

<sup>238</sup> nn 213-218, and accompanying text.

governance-related stakeholder issues, but our analysis indicates a Code-based approach can be safely forsaken.

### *C. UK CGC Measures to be Displaced*

While under the proposal advanced here substantial elements of the UK CGC would be translated into disclosure obligations, in many cases Code measures would fall by the wayside. This might prompt concerns about substantial erosion of corporate governance standards. Such an outcome is unlikely.

Several Code principles and provisions can be described as ‘generalities’ (Table 3). In such instances, substituting in mandatory disclosure obligations following abolition of the UK CGC does not seem justified, given the attendant costs for companies. Privately issued guidance statements already issued should suffice as informal corporate governance benchmarks.

With the numerous facets of the Code that replicate other regulation (Table 2), such measures could be safely abolished without any disclosure-related follow up. Remuneration-related aspects of the UK CGC fall into this category, given extensive statutorily-backed disclosure requirements unrelated to the Code<sup>239</sup> and given the substantial scope shareholders have to reject remuneration schemes of which they disapprove.<sup>240</sup> Similar reasoning applies to the UK CGC’s audit-related content, much of which is superfluous due to what is mandatorily required for listed companies under the FCA’s Disclosure and Transparency Rules.<sup>241</sup> The UK CGC recommendations for audit committee membership<sup>242</sup> are more

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<sup>239</sup> n 125, and accompanying text.

<sup>240</sup> n 127, and accompanying text.

<sup>241</sup> DTR 7.1.1AR and 7.1.2AR.

<sup>242</sup> UK CGC 2018 (n 14) provision 24.

stringent than current regulatory requirements but these are ingrained as market practice and seem unlikely to be dislodged absent a substantial post-Code relaxation of audit committee norms.

Legislative reform could reinforce the superfluous nature of audit-related elements of the Code soon. The Government appears intent on displacing current audit ‘best practice’ guidelines with a more prescriptive regime<sup>243</sup> under the auspices of ARGAs akin to the US’s Sarbanes-Oxley Act.<sup>244</sup> Mandatory rules governing internal controls and company viability statements thus may soon cover much the same ground as Code measures on point.<sup>245</sup>

#### D. *Revisiting the Policy Arguments*

To what extent would the post-Code World described above ‘solve’ the UK CGC’s problems? A key policy argument in favour of abolishing the UK CGC is that it imposes an onerous disclosure burden on premium-listed companies. Shutting down the Code would necessarily reduce Code-related disclosure to zero. On the other hand, the proposal outlined here contemplates amending the Listing Rules to require disclosure in relation to various issues the UK GCC currently addresses.<sup>246</sup> Moreover, unlike with UK CGC provisions currently, a company would have to engage in disclosure of prescribed corporate governance

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<sup>243</sup> eg see Searchlight Consulting, ‘Controls and the move to the UK Sarbanes-Oxley Act (SOX)’ (26 November 2021) <<https://www.searchlightconsulting.co.uk/2021/11/26/controls-and-the-move-to-sox/>>

<sup>244</sup> The Sarbanes-Oxley Act of 2002 (Pub.L. 107–204 (July 30, 2002)).

<sup>245</sup> See DBEIS (n 191). According to the White Paper, directors of listed companies (and also potentially other large companies) could be required to report annually on, and take responsibility for, the effectiveness of the company’s internal control structures (ibid chapter 2). Additionally, listed companies could be required to make an annual ‘resilience statement’ (ibid chapter 3) which would mirror, in many respects, the viability statement recommended under provision 31 of the UK CGC 2018 (n 14).

<sup>246</sup> See ‘Disclosure’ above.

arrangements rather than simply stating there has been compliance with the UK CGC. On the other hand, the FRC's approach with the Code governance has begun to favour similar disclosure notwithstanding best practice compliance.<sup>247</sup> More generally, the range of matters where disclosure would be required under our Code abolition proposal would be markedly narrower, which should reduce attendant costs considerably. Premium-listed companies would still face greater governance-related disclosure requirements than standard-listed companies, AIM companies and large private companies<sup>248</sup> but the differences would narrow markedly under our proposed regime.

Under our proposal, much-maligned box-ticking would disappear in its traditional form because there would no longer be any Code-related boxes to tick. This does not mean listed companies would have a completely free hand. Governance norms would remain intact, and boards would still feel under pressure from shareholders and proxy advisors to adhere to market 'best practice'. It should be easier for boards to justify deviations from conventional governance wisdom, however, given that departures would no longer be stamped with a formal, officially endorsed 'non-compliance' tag.<sup>249</sup> The American experience, where no formal regulatory code subsists, illustrates the point. Large US-listed companies habitually conform to widely-known governance norms, yet the governance

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<sup>247</sup> nn 168-169, and accompanying text.

<sup>248</sup> Although private companies are not subject to the UK CGC, private companies that qualify as 'large' are required to state which governance code they follow or explain why they do not follow a code (Companies (Miscellaneous Reporting) Regulations 2018, s. 26). FRC 'The Wates Principles Corporate Governance Principles for Large Private Companies' (FRC, 2018) is one such code for private companies, and the 'apply-and-explain' requirements thereunder will elicit substantial levels of disclosure.

<sup>249</sup> Reddy (n 82) 722.

arrangements of smaller publicly traded companies, where deviations from norms are arguably more warranted,<sup>250</sup> are less uniform.<sup>251</sup>

Abolishing the UK CGC would by definition bring a halt to the Code being used for addressing stakeholder issues, a problematic practice with Code enforcement hinging on shareholder responses.<sup>252</sup> The regulatory burden companies face may not be reduced markedly because policymakers could still impose -- as they have in fact done<sup>253</sup> -- separate disclosure requirements addressing stakeholder issues. Regardless, abolition of stakeholder-related Code measures would be beneficial from an institutional perspective. Policymakers would no longer be able to rely on the Code as a 'get out of jail free' card to 'pass the buck' with stakeholder related issues. Instead, they would have to address such issues directly and be fully accountable regarding effectiveness.

An additional possible plus with abolishing the UK CGC merits emphasis. Moving away from a 'compliance' focus and eliminating comply-or-explain as a bucket into which a variety of disparate concepts can be tossed could usher in a new era where corporate innovation and flexibility<sup>254</sup> are promoted without a drastic drop in corporate governance standards. This perhaps could help to reverse the decline of the UK stock market that has become sufficiently serious recently to merit changes to the Listing Rules designed to encourage more companies to list their shares.<sup>255</sup>

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<sup>250</sup> D. Lund, 'In Search of Good Corporate Governance' (2022) *The Yale Law Journal Forum* 854, 867-70.

<sup>251</sup> *ibid* 858.

<sup>252</sup> See nn 208-211, and accompanying text.

<sup>253</sup> See eg nn 235-237.

<sup>254</sup> In relation to the benefits of flexibility in a US context, see Lund (2022) (n 250) 867-71.

<sup>255</sup> nn 88-89 and accompanying text.

## 9. Conclusion

The Cadbury Committee's trailblazing 1992 Code of Best Practice has had a profound impact on corporate governance over the past three decades. Governance codes have proliferated throughout the world and a code has remained a centrepiece of UK corporate governance, albeit oriented around a considerably larger and more intricate document than the original two-page set of provisions. A self-regulatory dimension has featured prominently, with companies being given scope to comply-or-explain rather than simply adhere to Code principles.

While UK corporate governance has had a strong Code orientation over the past three decades, it is time for a change. For reasons this paper has advanced, the UK CGC should be abolished.

The UK CGC suffers from various shortcomings that justify abolition. First, the Code is irrelevant in material respects. Many UK CGC measures duplicate requirements regulatorily mandated elsewhere, or constitute meaningless platitudes that affirm widely-accepted ideas. Even the pioneering Cadbury Code was hardly a revolutionary document, with its recommendations often reflecting existing best practice. The duplicative nature of the UK CGC is now sufficiently pronounced to fortify the case in favour of abolition.

Second, the costs to companies of being subject to the Code have increased, making it much more likely that these exceed benefits the Code theoretically offers. With the Code having grown substantially in size, for companies being subject to the Code has become considerably more burdensome. Furthermore, although the scope offered to opt out of provisions has been a Code hallmark, expectations of compliance have become substantial. Companies have long faced investor box-ticking, which has pushed them toward adherence to the Code. Recently, the FRC has been expressly prioritising compliance over flexibility.

Costs for those companies for which the Code's recommendations are ill-suited have correspondingly increased. Abolition of the Code would do much to correct matters.

Third, and finally, the UK CGC has increasingly taken on a misguided stakeholder focus. This verdict stands regardless of the merits in the abstract of factoring in stakeholder considerations as part of corporate governance. The Code, by its very nature, is an unsatisfactory stakeholder protection mechanism. The Code operates by virtue of a feedback loop whereunder shareholders can intervene if they deem justifications for Code deviations to be unsatisfactory. There is only so far that shareholders will go in promoting non-shareholder stakeholder interests, with investors naturally treating the maximization of risk-adjusted shareholder returns as their main priority. The problem is compounded because the Code provides policymakers with a tempting opportunity to pass the buck with potentially contentious stakeholder issues.

Mindful of these Code shortcomings, this article advocates turning the page after three decades. More precisely, the position staked out here is that the UK CGC should be abolished. This would not mean full deregulation. Instead, companies would be required to disclose under the Listing Rules corporate governance arrangements of a particularly high priority to shareholders. Governance-related disclosure costs would correspondingly still subsist. Still, such costs should be considerably lower than they are at present. Moreover, while the UK CGC theoretically operates on a comply-or-explain basis, the termination of provision-related box-ticking should give companies considerably more scope to adopt individually tailored governance arrangements than they have at present. Code abolition would additionally mean policymakers would no longer be able to use the UK CGC to pass the buck with contentious corporate governance issues, most obviously those relating to stakeholders. To the extent that protecting stakeholders should be a corporate governance

priority, withdrawing the get out of jail free card the Code provides should precipitate more meaningful action.

The abolition of the Code also could have significant market-wide benefits. The UK stock market has been lagging for some time, with the pattern having been sufficiently acute recently to foster Listing Rule changes designed to foster initial public offerings of shares. Over-governance has been cited as a key reason why companies would prefer not to be publicly traded. Abolition of the Code would attack this pattern head on, and thus might help to restore the publicly traded company to the status it held three decades ago. The Cadbury Committee's introduction of the code concept to UK corporate governance was an innovative step that may well have been right for that time. After three decades, however, it is time to say thank-you and goodnight to code-based governance in the United Kingdom.



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