UK company legislation has traditionally had a paradox at its heart. While it has been highly prescriptive in terms of laying out the residual rights of shareholders, it is silent on the role of the board of directors. This gap has been filled in recent years by the introduction of the combined code on corporate governance. The implications of the code, with its emphasis on the monitoring role of non-executive directors, are to push the UK towards a de facto two-tier board system. Similarly, many European countries are introducing choice, between one- and two-tier boards, as to the optimal board structure.

Under UK corporate legislation, there is limited prescription for the structure, composition and functioning of the board of directors of a public company, other than the fact that it has to have a minimum of two directors (under the Companies Act 1985). There is a statutory requirement that the board produces annual financial reports for shareholders. The law in this respect is currently being changed, subsequent to the Company Law Review, to add forward-looking and soft data to the mandatory reporting requirements. However, even with these reforms, there is very little guidance on how the board should discharge and balance the managerial and monitoring functions upon which it must report annually. Absence of statutory guidance and regulations on these issues contrasts both with the presence in the UK statutes of powerful mandatory regulations on the removal of directors by an ordinary majority of shareholders, and with the highly prescriptive nature of Continental European legislation.
Shareholders in the UK have the legal power to tell the board what to do at any point in the financial year, not just at the AGM, if a large enough group can coordinate their actions. Therefore, they are guaranteed the ultimate residual control of the board, but the board itself has no statutory guidance as to how it should operate. Again, this contrasts with many Continental European jurisdictions. For example, in Germany there are over 40 sections in the company law legislation dealing with the duties and functioning of the supervisory board.¹⁸

Moreover, in the UK this perspective is not altered if one examines the evolution of case law. Take, for example, the law of negligence. The courts have traditionally formulated the standard of care of directors in highly subjective terms, while there are indications that the law is evolving towards an objective standard of care. For example, in recent litigation, the directors of Barings Bank were disqualified essentially on a theory of negligence. The Court found that the directors were negligent in not putting in place adequate reporting systems in relation to the bank’s Singapore activities.

The rise of the code: from managing to monitoring

Therefore, this black hole relating to the board’s composition and structure still exists in the UK in relation to the legislation, but has been filled by the combined codes on corporate governance which started with Cadbury in 1992. Overall, this is a positive development as the code is relatively flexible with its ‘comply or explain’ provisions, and firms can opt out entirely by delisting. However, the introduction of the Combined Code emphasised the board’s monitoring function for the first time, complementing the traditional role of setting corporate strategy. On a functional level at least, this moved the UK towards the traditional European two-tier board.¹⁹

The Code was a response to a number of Enron-style corporate collapses that had taken place in the UK in the late 1980s such as Polly Peck and Maxwell. These cases had occurred because there had been insufficient board-level scrutiny over powerful CEOs. The perception that lack of effective monitoring is at the heart of the corporate governance problem has survived subsequent reviews. For example, Hampel in 1996 was sceptical as to the Cadbury approach, and questioned whether monitoring was getting in the way of the