Reflexive law and section 172 reporting: evolution of social responsibility within company law limits?

Abstract:

This article examines whether the evolution of company narrative reporting based on section 172 UK Companies Act 2006 can be characterised as reflexive law, which preserves the balance between utilitarian company law shareholder value approach and the corporate responsibility demands by society. Thereby mediating between semi-autonomous sub-systems of company law and social responsibility.

It discovers an evolving process in company law, which has some indications of reflexive law and governance within self-imposed limits of non-interference in 'private' spheres of governance. The result is progressive in scope but incapable of delivering radical normative shift in company law towards stakeholder responsibility.

Keywords: company law, company reporting, reflexive law, reflexive governance, social responsibility.

Introduction

The success of the shareholder primacy model has imposed a conceptual stronghold on any reform of company law beyond its traditional limits. The perceived success of the shareholder primacy model has contributed to a strong regulatory allegiance to the core ideal of director accountability to the 'members as a whole', who are seen as contributors of financial capital. It has also led to the externalisation of other stakeholder responsibilities. The argument is often that this model has resulted in great economic success and this has contributed to its spread to different legal systems. Often seen as an offshoot of *Salomon* in the UK[1], protections around limited liability have enabled risk taking and entrepreneurial activity, occasionally at the risk of responsibility.

The current thinking is that the crucial attributes: 'legal personality, limited liability, transferable shares, delegated management under a board structure and investor ownership'[2] are now so beneficial to economic growth that 'corporate law everywhere must, of necessity, provide for them'.[3] Therefore this theoretical model dominates regulatory thinking even in the face of cases of corporate irresponsibility.

However demands for human rights, environmental considerations and employee rights within corporations, continue to surface in the face of evidence of corporate irresponsibility and its detrimental impact which affects wider stakeholders and society. This results in a conceptual struggle for corporate law and regulation. This is an effort which asks for change within a limited scope. This is within a scope which seeks to preserve the perceived gains of the current model but in some way to compel change led by corporations themselves. This struggle can be exemplified by this statement made during the parliamentary debates on corporate governance and social responsibility:

> "I know first-hand the enormous creative potential that a well-functioning company, backed by a strong governance regime, can unleash…I know that the status quo cannot continue. It represents grotesque pay ratios between the top and the bottom, and astronomical executive pay. We have seen the corporate greed of BHS, Sports Direct, Gunstones, ASOS and JD Sports, which treat their low-paid workforce with little more than contempt; the behaviour of energy companies quick to hike prices to maximise profits, but slow to lower them when the market shifts; and the short-termism that has

[1] *Salomon v. Salomon* AC 22 (1897) (HL) (United Kingdom)

[2] John Armour Henry Hansmann Renier Kraakman Mariana Pargendler, *What is Corporate Law?* in *The Anatomy of Corporate Law* 1 (Oxford: Oxford University Press, 2017)

[3] Ibid

> resulted in productivity flat-lining and investment being stifled as directors seek to maximise shareholder value at the cost of everything else.
> …"[4]

This represents a 'utility versus responsibility' challenge which drives experimentation with newer forms of legal regulation for social objective while seeking to preserve status quo. These newer forms of legal regulation could then be seen as an attempt to tackle the wider responsibility challenge while leaving the 'useful' shareholder model of accountability intact. The law is seeking new ways to cope with the questions presented by these social issues without a radical overhaul of the corporate objective or the way in which the company is governed.[5] It is also seeking a compromise position, where it can retain aspects perceived as valuable to the economic organisation and economic prosperity while engendering a change in corporate behaviour and decision-making. This task may be what recommends reflexive law.

Teubner points out that "a reflexive orientation does not ask whether there are social problems to which law must be responsive. Instead it seeks to identify opportunity structures that allow legal regulation to cope with social problems without, *at the same time, irreversibly destroying valued patterns of social life*".[6] Rogowski also suggests that reflexive law can be a manifestation of law's self-imposed limits where the law chooses to engage 'in the balancing of concerns that derive from established legal structures and new legal demands.'[7]

In this vein, the reflexive law frame, may be the adequate lens through which to capture the regulatory compromise forged in section 172 and the attempts to regulate for its effectiveness

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[4] Louise Haigh (Sheffield, Labour) *Corporate Governance and Social Responsibility* Hansard Column 922, Volume 618, 14 December 2016 https://hansard.parliament.uk/commons/2016-12-14/debates/2BF3869A-F4E8-4A20-815F-EC792A63EDA9/CorporateGovernanceAndSocialResponsibility
See also UK Department for Business Energy and Industrial Strategy (BEIS) *Corporate Governance Reform, Green Paper* November 2016
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf

[5] This radical overhaul was suggested during the UK Company Law Review Steering Group, *Modern Company Law For a Competitive Economy: The Strategic Framework* February 1999
https://webarchive.nationalarchives.gov.uk/20121101191957/http://www.bis.gov.uk/files/file23279.pdf
This document on p.37 expressly cites Margaret Blair, *Ownership and Control, Rethinking corporate governance for the twenty-first century* (Washington, D.C.: Brookings Institution, 1995) This document suggests the pluralist approach would involve: 'company law should be modified to include other objectives so that a company is required to serve a wider range of interests not subordinate to, or as a means of achieving shareholder value (as envisaged in the enlightened shareholder view) but as valid in their own rights.' p.37

[6] Gunther Teubner, *Substantive and Reflexive elements in modern law* (17(2) Law and Society Review 239-285 (1983)

[7] Ralf Rogowski *Reflexive Labour Law in the World Society* 114 (Cheltenham: Edward Elgar, 2013)

in the years following.[8] The narrative reporting requirements that have followed on from section 172, may also represent the application of reflexive law to attempt to create change and monitor progress on issues such as directors' duties and social responsibility.

From the onset the requirements to monitor such changes introduced in the Companies 2006 have undergone a range of changes. The initial decision to have the Operating and Financial Review (OFR) was reversed and then a business review was adopted with the original act.[9] Then this was replaced by the strategic report[10] and then the additional non- financial information statement.[11] This 2018 regulations now requires an additional s.172 statement, which describes how directors have had regard to sections a-f in the strategic report and to publish this statement on the website.[12] The website requirement shows similarities with another recent legislative experiment found in Section 54 of the modern slavery act 2015 (transparency in supply chains provision).The 2018 regulations are part of the corporate governance reforms which the government undertook to encourage corporate responsibility[13] This type of mandated reporting does not indicate the specific outcomes of the process but indirectly shapes semi-autonomous company actions taken to address corporate social responsibility issues captured within the scope of section 172 (1) a-f .

This article examines whether such company narrative reporting on section 172 Companies Act 2006 can be characterised as reflexive law which preserves the utility versus responsibility balance sought in company law. The next section examines reflexive law as a type of regulation, then the following section examines section 172 of the Companies act and its

[8] For more details on the fault lines of the underlying assumptions, especially those adopted as current approach to company law by the *Anatomy of Corporate Law* cited in (n1) 2004 edition, see Paddy Ireland, *Limited liability, Shareholder rights and the problem of corporate irresponsibility* 34 Cambridge Journal of Economics 837-857 (2010)

[9] Nicholas Rowbottom Marek Schroeder *The rise and fall of the UK Operating and Financial Review* Accounting, 27(4) Auditing and Accountability Journal 655-685 (2014); section (S) 417 Companies Act (CA) 2006

[10] The Companies Act 2006 (Strategic Report and Director's Report) Regulations 2013; S. 414C CA 2006

[11] For traded, banking and insurance companies see S. 414CA & 414CB CA 2006 (following the Companies, Partnerships and Groups (Accounting and Non-Financial Regulations) 2016. This was implementing the EU Non-Financial Reporting Directive 2014 for large public interest companies

[12] Companies (Miscellaneous Reporting) Regulations 2018 – S. 426B- applied to unquoted companies as S. 430 Companies Act 2006 already requires quoted companies to publish annual accounts and reports on website.

[13] 'This reform package will complement wider work that the Government and others are undertaking to enhance public trust in business as a force for good and encourage corporate responsibility'. p.7 UK BEIS *Corporate Governance Reform, The Government response to the green paper* August 2017 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/640470/corporate-governance-reform-government-response.pdf This ties in with provision 5 of the corporate governance code 2018: 'The board should understand the views of the company's other key stakeholders and describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making'

relationship to the corporate objective. The third section corporate social responsibility which has given rise to a semi-autonomous social subsystem of regulation. The fourth section looks at the evolution of the narrative reporting requirements under section 172 to discover if the balance required by reflexive law can be deduced. The final section concludes on what this reflexive approach may mean for further legislative attempts to regulate for CSR

Reflexive law

Reflexive law can be seen as law's action through procedural regulation of self-regulation to encourage directed semi-autonomous action. Teubner states that: 'Reflexive law is characterized by a new kind of legal self-restraint. Instead of taking over regulatory responsibility for the outcome of social processes, reflexive law restricts itself to the installation, correction, and redefinition of democratic self-regulatory mechanisms.'[14]The justification for reflexive law can be found in controlling self-regulation through 'coordinating recursively determined forms of social co-operation'[15] Furthermore the external social functions of reflexive law is seen as necessary to structure semi-autonomous social systems through shaping processes of internal discourse and also reflexive law relies on procedural norms that regulate processes.[16]

Reflexive law can be both normative and procedural. Teubner observes that 'social regulation through law is accomplished through the combination of two diverse mechanisms – information and interference'[17] He makes three further observations when discussing social regulation through reflexive law: firstly reflexive law may involve procedural regulation, but it is important to note that, 'every act of procedural regulation has substantive premises and consequences.'[18]Secondly reflexive law should not be merely interpreted in terms of normative social autonomy and hence it does not immediately equate to deregulation rather it could be

[14] Teubner 1983 (n6) p.239
[15]Teubner 1983 (n6) p.254 & 257
[16] Teubner 1983 (n6) p. 255

[17] Gunther Teubner *Law as an autopoietic system* p.65 (Oxford: Blackwell Publishers, 1993)

[18] Teubner 1993 (n17) p.66

used either to safeguard autonomy (for example: strengthen self-regulation) or to impose discipline (for example creating reporting rules where none existed).[19] It should deal with the issue of filling in the gaps in knowledge of the regulators as they will need to understand the object of their regulation.[20] This is what suggests an autopoietic system which is arranged in such a way that the systems to be controlled becomes self-referential and self-regulatory. [21]

Crucially Luhmann suggests that:

"Law –related communications have as operations of the legal systems always a double function as factors of production and as preservers of structure. In this sense, autopoietic systems are always historical systems which start from the state in which they have put themselves"[22]

Finally Teubner emphasizes that 'reflexion in law means both empirical analysis and normative evaluation.[23] In this regard, when he focuses on corporate interest, he also differentiates between three aspects of an enterprise: the function, the performance and the reflection, proposing the formation of corporate interest as a legal term which mediates between these aspects.[24] Therefore 'it aims at creating organizational structure for discursive processes that make possible a balancing of enterprise performance (for consumers, workers and shareholders but also for the political and natural environment) on the one hand and function, (ensuring the satisfaction of future social needs) on the other.[25] This suggested legal device which could provide corrective action describes many of the balancing elements similar to those in section 172. An orientation towards outputs which yield CSR [26] He hints at the probability that this could not be an easy 'concrete legal formulation' hence the need to settle for conveying 'directions & indications'.[27]

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[19] Teubner 1993 (n17) p.68

[20] Ibid

[21] Ibid

[22] N Luhmann *Law as a social system* p.84-85 (Oxford: Oxford University Press, 2004)

[23] Teubner 1993(n17) p.69

[24] Gunther Teubner *Corporate Interest, the public interest of the enterprise in itself* in *Reflexive Labour Law: Studies in Industrial Relations and Employment Regulation* 21-52, 44 (Deventer: Kluwer Law, 1994)

[25] Teubner 1994 (n24) p. 45

[26] Ibid

[27] ibid

Rogowski in a similar vein, addresses reflexive law as analysis of 'processes which 'reflect' within the legal and judicial system, forms of regulation and self-regulation within other social systems and within the legal system in general.[28]

This notion of reflexive law is closely linked to reflexive governance which can be seen as "governance arrangements where either institutions allow for a reflexive adaptation of rules and procedures or where the governed have some capability to affect the construction of the objects of governance".[29]

In a sense, reflexive law has emerged at a cross-roads, 'between a turn to or away from law as a means of social regulation'.[30] The increasing push for the regulation of new aspects of social interaction through publicity via platforms such as social media alongside the wholesale retreat and deregulation of legal aspects across global markets, reflect the challenge posed for law in an increasingly globalised world.[31] For corporate law, this will include the necessity for governance of hitherto 'private' spheres of governance, the progressively complex spheres of corporate action and impact plus the law's own inadequacy in the use of regulatory techniques for dealing with such complexity.

Blankenburg however stresses that there is nothing new in law adopting a procedural guise when entering new fields of regulation[32] but there are indications that law's reflexive response is itself, a conceptual capture resulting from law's limiting and thereby excluding the legal sphere from political debates outside of current economic and market thinking. This may be as a result of 'the hegemony of economic thinking in law'[33], which has left the law, 'caught in polarizing debates over efficiency vs. planning, private vs. public ordering, self-government vs. command/control etc.'[34]

The capture is self-imposed and represents the stronghold that company law has imposed upon itself perhaps for historical reasons linked to the perceived success of the company as a form

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[28] Ralf Rogowski, *Industrial relations, Labour conflict resolution and Reflexive Labour law* in *Reflexive Labour Law: Studies in Industrial Relations and Employment Regulation* 53-94, 53-54 (Deventer: Kluwer Law, 1994)
[29] Peter Feindt, Sabine Weiland *Reflexive governance : exploring the concept and assessing its critical potential for sustainable development* 20(6) Journal of Environmental Policy and Planning 661-674 , 663 (2018)
[30] Peer Zumbansen *Law after the welfare state, Formalism, Functionalism and the ironic turn of reflexive law* 56(3) The American Journal of Comparative Law 769-808,793 (2008)

[31] Ibid
[32] Erhard Blankenburg "The Poverty of Evolutionism: A critique of Teubner' s case for reflexive law: commentary and debate" 18(2) law and Society Review 273-290, 285 (1984)

[33] Zumbansen (n30) , p.803
[34] ibid

of business organisation. This self-imposition is also a result of the corporate law's pursuit of a dual purpose: utility and responsibility. Hurst puts forward the proposition that 'our weakness in the demand for responsibility did not derive from the immediate context of the demand but from other undesirable by-products of our utilitarian emphasis'[35] In corporate law, the corporate objective is caught in a utility versus responsibility debate captured in the compromise that is expressed in section 172 companies Act 2006 with the embodiment of shareholder value as utility and the consideration of stakeholder interests as responsibility.

The inadequacy of the externalising mechanism hitherto adopted by company law when dealing with responsibility issues mentioned in section 172 has been highlighted in historical debates such as the Berle-Dodd debate[36] and the Berle & Means research[37]. Parkinson[38] and McBarnet[39] indicate the role of the law in shaping the objective of the corporate entity in the UK and thus highlights the law's complicity in current model of governance. Hurst points to a point between the 1880s and the 1930s in the US where 'acceptance of the corporation's utility was taken to warrant using law to enlarge manoeuvrability of private power…'[40]This is in line with Luhmann's observation that historical systems such as this, result from an initial self-imposed state.

Therefore the shift to reflexivity could also mask asymmetric power relations.[41] There is a paradox which exists between the handling of 'social' responsibilities such as modern slavery in supply chains or director duties towards environmental responsibilities when compared to the handling of investor protections in international investment agreements.[42] Nevertheless there has been a growth in regulation and regulatory networks of social responsibilities which

[35] James Willard Hurst, *The Legitimacy of the Business Corporation in the law of the United States 1780-1970* 59 (Charlottesville: University of Virginia Press, 1970)

[36] The debate between Berle and Dodd were published in a series of articles between 1931 and 1932. See Adolf AugustusBerle Jr., *Corporate Powers as Powers in Trust* 44 Harvard Law Review 1049-1074 (1931) ; Edwin Merrick Dodd, *For whom are corporate managers trustees?* 45 Harvard Law Review 1145-1163 (1932); Adolf Augustus Berle Jr., *For whom Corporate managers are Trustees: A Note* 45 Harvard Law Review 1365- 1372 (1932).

[37] Adolf Augustus Berle, Gardiner Coit Means, *Modern Corporation and Private Property* (New York: Macmillan Co, 1932)

[38] John Edward Parkinson, *Corporate Power and Responsibility: issues in the theory of company law* (Oxford: Clarendon Press, 1995)

[39] Doreen McBarnet, Aurora Voiculescu, Tom Campbell (eds.), *The New Corporate Accountability- Corporate Social Responsibility and Law* (Cambridge: Cambridge University Press, 2007)

[40] Hurst (n35) p.62

[41] Teubner (n6) p.241

[42] Sol Picciotto *Regulating Global Corporate Capitalism* p.193 (Cambridge: Cambridge University Press, 2011) indicating some of the strong legal rights given to foreign investors under BITs and NAFTA

can create disruptive political effects and expand the landscape of regulation.[43] The challenge is to harness the potential effects and flexibility of the newer reflexive forms of law within this self-imposed limits.[44] However it is also necessary to be aware that the limits are self-imposed and a result of the dominance of the view that companies as presently constituted are essential for desired economic growth.[45]

Parker highlights this import of the compromise position that company law has placed itself in. She suggests that: "for example, in company law this would mean that 'fiduciary duties should be transformed into duties of disclosure, audit, justification, consultation and organisation of internal control processes'"[46] but then drives for three further limitations[47]:

a. That the law should set out substantive value, principles and outcomes for CSR
b. Companies should engage in deliberative democracy with identified stakeholders
c. Informal regulation to cover gaps or areas of new corporate responsibility which need to be addressed

These echo principles which can also be derived from broad reflexive governance principles. Feindt and Weiland suggest that reflexive governance occurs under the following circumstances:

> "Where institutional and procedural arrangement involve actors across varied levels of governance and/or various epistemic backgrounds and practical contexts, in an effort to reflect on and possibly adapt their cognitive and normative beliefs, in ways that take into account and acknowledge alternative understandings of the problems, in an attempt to integrate multiple approaches to problem solution."[48]

This endorses a stakeholder approach, goal setting in deliberative and communicative manner, engagement form within companies, government and other stakeholders and shared platforms where understandings from CSR could reinforce other areas of company law accountability while integrating diverse legal and extra-legal approaches to problem solving to ensure the collective success of company in the societal interest.

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[43] Abraham Newman and Elliot Posner Voluntary Disruptions: International Soft Law, Finance and Power p.30 (Oxford: Oxford University Press, 2018)
[44] Picciotto (n42), p. 202: 'The challenge for creative lawyering is to find ways to combine the strength of corporate codes and formal laws'.
[45] See Hurst (n35)p.62
[46] Christine Parker, *The open corporation* p.297 (Cambridge: Cambridge University Press 2002)
[47] Ibid at p. 297-299
[48] Feindt & Weiland (n29) p.665

Feindt and Weiland find some tensions which may be created in the process and they include the question of flexibility and openness in the regulations versus the need for defined outcomes in the affected areas, the question of evolutionary change versus counter-hegemonic approaches which challenge and change the status quo, genuine learning through processes versus further entrenchment of strategic interests and finally the potential for such reflexion to cause changes in internal governance priorities and structures. [49]

Nevertheless within this current regulatory frame, there is evidence of experimentation and evolution. The next section begins the examination of such experimentation by considering section 172 and the self-imposition of the limited sphere of regulation

[49] ibid. This adapts the five inherent conceptual tensions which they found in their work

Section 172 and the corporate objective

This statement made in the debates in the white paper on modernising company law, pre- the 2006 Act, indicates some evidence of the utility versus responsibility bargaining and the self-imposition of restricted legal spheres:

> In early Review documents the debate about how to approach defining directors' duties produced two distinct positions. They were labelled 'Enlightened Shareholder Value' (ESV) and 'Pluralist'. The ESV approach towards defining directors' duties maintained that the primary duty of a company director was to maximise value for the company's shareholders. However, it added that other relationships were significant in this and therefore needed to be taken into account when judging how to carry out this duty. The interests of employees, customers, suppliers, and local residents, as well as the environmental impact of the company's activities and its good standing in the eyes of the public, all had to be considered when judging what was in the interests of shareholders. ***Such an approach would require no fundamental change to existing company law, which obliges directors to act in the interests of members of the company; and therefore any revision of the law along ESV lines would consist of codification rather than significant reform. The pluralist approach to defining directors' duties would require a more fundamental change in company law.*** Where the ESV approach would have directors ***consider the impact on other stakeholders of their attempts to produce shareholder value***, the pluralist approach would ***force directors to consider the interests of stakeholders in their own right***. Shareholders would become merely one of a number of parties whose interests the directors would weigh against each other when making decisions.[50]

This codification of director's or managers fiduciary duties is contained in s.170-177 but the relevant section which adopted this ESV approach is s.172 Companies Act 2006. This section was heralded as innovative and novel because it incorporated elements of the stakeholder approach[51] however on closer scrutiny it represents a mediated position quite similar to the position advocated by 'enlightened self-interest' models. This is an attempt to integrate wider considerations within a shareholder wealth maximisation focused model. It does not alter the basic focus of the corporation from a private contractual one. It is still preserves semi-autonomous spheres of private decision-making in the interests of the company.

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[50] House of Commons Trade and Industry Committee *The White Paper on Modernising Company Law Sixth Report of Session 2002–03 Report, together with minutes of evidence and appendices* paras: 12-15 https://publications.parliament.uk/pa/cm200203/cmselect/cmtrdind/439/43906.htm

[51] Bryan Horrigan *Corporate Social Responsibility in the 21st Century* (Cheltenham: Edward Elgar, 2010)

Earlier suggestions of this potential mediated position can be seen in the work of Parkinson who suggested:

> ...broadening directors' discretion to permit them to depart from the requirements of profit maximisation' would be a necessary adjustment to create an appropriate legal setting for changes in management behaviour that are the intended consequence of other methods of inducing responsibility. A reformed fiduciary duty might accordingly stipulate that the directors are under an obligation to conduct the business for profit, but that in so doing they must take account of affected interests (which might be specified).'[52]

The 2006 Act endorsed this limited approach which it termed the ESV approach. This approach adopts a shareholder focused model that allows for consideration of other factors which may affect that shareholder value in the long term. It permits the consideration of other 'stakeholders' interests but only as it affects shareholder value and 'the success of the company' (profit). Nevertheless it is evident from the ministerial statements about the bill that this could have multiple interpretations:

> 'There are two ways of looking at the statutory statement of directors' duties: on the one the hand it simply codifies the existing common law obligations of company directors; on the other – especially in section 172: the duty to act in the interests of the company – it marks a radical departure in articulating the connection between what is good for a company and what is good for society at large.'[53]

One perspective of section 172, views this sections as the law's self-imposed limitation and acknowledgment of the semi-autonomous system of corporate management decision-making on social issues. Thereby giving directions to exercise director discretion in balancing competing objectives in company interest, without specifying how it needs to be done. Arden LJ in *Rolls-Royce Plc v Unite the Union* indicates how this guidance may be viewed judicially, by stating thus:

> the reasonable employer for the purposes of reg. 32(2) might well be expected to be motivated not simply by its narrow financial self-interest but also by enlightened self-interest, and thus take into account the interests of the employees generally as

[52] Parkinson (n38) p.371

[53] Margaret Hodge *Ministerial statements on Duties of company directors – Company 2006* (UK: DTI, July 2007) p.1 https://webarchive.nationalarchives.gov.uk/20070628230000/http://www.dti.gov.uk/files/file40139.pdf

> one of the factors to which it should have regard in determining the business need of the undertaking (compare Companies Act 2006, s 172). [54]

Villiers points out that 'such provisions tend to increase the discretion of the directors and managers, thus giving them a potential defence against challenges from shareholders rather than protecting the non-shareholders.'[55] Others remark that corporate law's approach to corporate power and responsibility, privileges shareholder interests and its fundamental structures may permit irresponsibility.[56]The necessity for shareholder focus is not integral to corporate law but has emerged due to political interests which demonstrate its utility through influential contractarian theories.[57] Hurst also indicates that historically, it is an emphasis which privileges a utilitarian perspective.[58] This balancing within self-limitation can be seen as a manifestation of reflexive law, because it also involves the decision to preserve share-holder primacy private spheres of decision-making while directing 'voluntary' forms of self-regulation[59]

An examination of this approach in the light of reflexive law suggests that the use of newer forms of regulation was necessitated by the complexity of the dialectical sub-systems and power spheres at play. One of such sub-systems can be seen as CSR. The exact reasons from law's refrain from direct regulation of such sub-systems include: Firstly, a self-imposed restraint by law in order to focus on structuring directed self-regulation within a sphere where control has been ceded to private governance. Secondly, there is an acceptance of the law's limitations including gaps in knowledge for the regulators and new areas, where the imposition

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[54] EWCA Civ. 387 Para. 169 (2009). Reg 32(2) referred to the then Employment Equality (age) Regulations 2006/1031 now superseded by the Equality Act 2010.

[55] Charlotte Villiers *Corporate law, corporate power and corporate social responsibility* in *Perspectives on Corporate Social Responsibility* 85-112,94 (Cheltenham: Edward Elgar, 2008)

[56] Ireland (n8) p. 848 notes that 'the rigid application of the Salomon principle, coupled with de facto, no-liability shareholding, has thus greatly extended the scope for opportunistic behaviour, further institutionalising corporate irresponsibility. It is not, perhaps, surprising that the leading legal academic Otto Kahn-Freund, writing in 1944 when group structures were beginning to proliferate, described Salomon and its rigid application by the courts as 'calamitous''.

[57] For example see: Michael Jensen, William Meckling *Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure* 3(4) Journal of Financial Economics 305-360, 357 (1976) 'The publicly held business corporation is an awesome social invention…Both the law and the sophistication of contracts relevant to the modern corporation are the products of a historical process in which there were strong incentives for individuals to minimize agency costs. Moreover, there were alternative organizational forms available, and opportunities to invent new ones. Whatever its shortcomings, the corporation has thus far survived the market test against potential alternatives'.

[58] Hurst (n5) p.59

[59] Ireland (n8) p.853

of discipline while needed may be difficult and finally, it could allow for evaluation and evolution of legal regulation on the basis of evidence yielded through indirect processes such reporting on company self-regulation.

The next section examines the emergence of CSR and its semi-autonomous sub-system as a result of law's limitation.

CSR and the emergence of a semi-autonomous social subsystem

CSR developed as an umbrella concept which covers various issues that fall within the relationship between business and society. The EU commission defines to CSR as "the responsibility of enterprises for their impacts on society".[60] It can refer to the concern with social, environmental and labour issues affecting the company. CSR as a concept somewhat developed as a result of the externalising effect on the part of company law.[61] The aspect which delimited the scope of certain decision-making as within the 'private' sphere of influence, hence the phrase: 'beyond the law'. Therefore large parts of CSR developed as an attempt to modify the corporate objective through corporate self-referential action or legislative 'add-ons'.[62] This can be viewed partly as part of the corporate desire to self-direct their own action and limit government intervention but also the law's deliberate imposition of limitations in its intervention within spheres of private decision-making following the domination liberalisation ideology which shrunk the role of the state.[63] Company law and the company purpose established very limited scope of reference for CSR.

[60] EU, *A renewed EU strategy 2011-14 for Corporate Social Responsibility* /* COM/2011/0681 final */ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52011DC0681

[61] Donham pushed for this self-regulatory action as early as 1927 for reasons which include the lack of direction from law see: "when the lawyer ceased to be advisory leader and sound counsellor and …went to work as a servant of the businessman, mainly doing his will, he lost something and the community lost a great deal…these conditions exist in the law because the men of real imagination and ability in the legal profession have not, on the whole, retained their social point of view or used their talents to solve the increasingly complex problems of our organised community." Wallace Brett Donham "The social significance of the businessman" 5(4) Harvard Business Review 406-419, 410 (1927)

[62] See Ward's argument : "The argument here would be that sustainable development (and/or other values associated with CSR) should be integrated within the basic legal framework, governing the formation and functioning of business enterprises – not exclusively as an 'add-on' in the form of environmental, labour or anti-corruption legislation- to name a few examples" Halina Ward, *Corporate Social Responsibility in Law and Policy* in *Perspectives on Corporate Social Responsibility* 8-38, 21 (Cheltenham: Edward Elgar, 2008)

[63] Picciotto (n42)

This dilemma on the corporate objective is best captured by the US Berle –Dodd debate.[64] Berle in 1931 in his essay 'Corporate Powers as Powers in Trust' which proposed that corporate managers exercised powers held in trust on behalf of the shareholders. This assertion adopts a traditional legal position which endorsed accountability and governance within the corporation of managers and directors to shareholders. [65] Dodd responded with the argument that 'business is permitted and encouraged by law because it is of service to the community rather than because it is a source of profit to its owners.'[66] He pointed to the early assumption of voluntary responsibilities by businessmen as support for his argument.[67] This echoes aspects which can be seen in the present s 172, which preserves director discretion for stakeholder issues.

CSR can be seen in the light of this voluntary assumption of responsibilities of the corporate manager or director beyond the sphere of shareholders' interests and strict profit-making. Parkinson also identifies that these arguments shared a common task which is to identify how company law regulates corporate power in the public interest.[68] Berle (&Means)[69], later analysed the internal position of the large corporations and found the managers/ directors devoid of control from the owners (shareholders). They proposed that this may then form the basis, for corporations could be called to account by society.[70]

The question of whether the director is adequately held to account internally and how this affects his external responsibilities has come to dominate company law and places corporate theories, corporate governance and regulation at the heart of the CSR debate. Dean Donham in 1927 blamed an abdication of this responsibility by the law for the lacuna left for the businessman.[71] In a sense the vacuum created by hard law allowed for the development of soft law and self –regulation. However there is a question of whether this was a deliberate vacuum influenced by dominant political ideology to give room for corporate power.[72]Nevertheless the assumption of self-regulation prevented hard legal regulation but was also used to achieve objectives not provided in hard law. Reflexive law argues that this may be deliberate action by

[64] See: Berle, Dodd (n36)
[65] Berle (n36)
[66] Dodd (n36)
[67] Ibid
[68] Parkinson (n38)
[69] Berle & Means (n37)
[70] Berle & Means Ibid. This position would only result from the failure of the contractarian control mechanism.
[71] Donham (n61)
[72] Allison Marchildon *Corporate responsibility or corporate power? CSR and the shaping of the definitions and solutions to our public problems* 9(1) Journal of Political Power 45-64 (2016) see also *Chapter 3- Legitimacy of power as core to CSR* in Adaeze Okoye *Legal Approaches and CSR* (Abingdon: Routledge, 2017)

company law may also be a result of law's realisation of its own self-referential nature and limited ability to deal adequately with issues arising within other semi-autonomous systems.

As a semi-autonomous sub- system, CSR then developed as a complex field of management-led action, often defined as 'the obligations of businessmen to pursue those policies, to make those decisions or to follow those lines of action which are desirable in terms of the objectives and values of our society.'[73]This self –direction in this area gave rise to different management conceptions of CSR. Some include Corporate Social Performance (CSP)[74], corporate citizenship[75] and stakeholder management principles[76].

Wood defines CSP as 'the business organisation's configuration of principles of social responsibility, processes of social responsiveness, and policies , programs and observable outcomes as they relate to the firm's societal relationship'.[77] Abrams suggested the management balancing claims of various interested groups by the corporate citizen.[78] Evan and Freeman identify, 'stakeholder management principles' as:

> The corporation ought to be managed for the benefit of its stakeholders: its customers, suppliers, owners, employees and local communities....Management bears a fiduciary relationship to stakeholders and to the corporation as an abstract entity. It must act in the interest of stakeholders as their agent, and it must act in the interest of the corporation to ensure the survival of the firm, safeguarding the long-term stakes of these groups.[79]

This aspect of balancing of interests of various interested groups is then captured in section 172 as it attempts to encapsulate directors' duties by capturing existing semi-autonomous practices. However this did not involve a deviation from the legal starting point of corporate

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[73] Howard Rothmann Bowen, *Social responsibilities of the Businessman* 44 (New York: Harper & Row, 1953)

[74] Archie Carroll *A three-dimensional conceptual model of corporate social performance* 4(4) Academy of Management Review 497- 505 (1979); Steven Wartick and Philip Cochran *The evolution of the Corporate Social Performance Model* 10(4) Academy of Management Review 758-769 (1985); Donna Wood *Corporate Social Performance Re-visited* 16(4) Academy of Management Review 691-718 (1991); Diane Swanson *Addressing a Theoretical problem by re-orienting the corporate social performance model* 20(1) Academy of Management Review 43-64 (1995); Diane Swanson *Towards an Integrative Theory of Business and Society: A research strategy for Corporate Social Performance* 24(3) Academy of Management Review 596-621(1999).

[75] Frank Abrams, *Management's Responsibilities in a Complex World* 29(3) Harvard Business Review 29-34,30 (1951)

[76] William Evan, Edward Freeman *A Stakeholder Theory of the Corporation: Kantian Capitalism* in *Ethical Theory and Business* 97-106, 103 (New Jersey: Prentice-Hall, 1988)

[77] Wood (n74) p.693

[78] Abrams (n75)

[79] Evan & Freeman (n76)

accountability which privileges 'members as a whole', i.e. private sphere of decision-making in the company between the directors and the shareholders in general meetings. S.172 then only permitted the consideration of other stakeholder interests on a deliberative and communicative basis. The consideration of these other interests within section 172 the companies act, is validated through a reporting mechanism with meta-regulatory consequences. That is the legal requirement is placed on the company to report but the content is left to the scope of the company and although legal consequences will arise, they do not pertain to benchmarks about content even where desirable content indicators are given. The next section examines the requirements for reporting which has followed section 172.

The evolution of company reporting following s. 172

S. 172 in its text, calls for a balancing of interests and directs directors' private decision-making in the outlined spheres which includes: long term likely consequences, employee interests, business relationships, community and environmental issues, company reputation and fairness.[80] The Companies Act presents reporting as a method of evaluating the compliance with s.172. Company reporting under s. 172 would need to indicate the following conditions in order to be characterised as reflexive governance process as identified by Feindt & Weiland:[81]

1. Provision of institutional and procedural arrangements which involve actors across varied levels of governance within and outside the company and across different business contexts.
2. Reflection on and the potential adoption, change or adaptation of cognitive and normative beliefs.
3. Action in ways which into take into account and/or acknowledge stakeholder viewpoints and multiple approaches to issues faced.
4. Integrate diverse approaches to solving issues identified from this process or arrangement.

[80] Companies Act 2006
[81] Feindt & Weiland (n49)

The first method advocated at the onset was the Operating and Financial Review (OFR).[82] This OFR was to be a detailed report within the annual report. This was supposed to be a mandatory endorsed means of social and environmental reporting.[83] However the government reversed the decision to make the OFR mandatory. Rather it adopted the business review approach which was then stipulated in the original s.417 and passed with the act. This approach is based on the EU Accounts Directive[84] for the adoption of a member-wide business review.

This approach is recommended for large corporations. This initial requirement was found in:

> **Old s.417: Companies Act 2006:** Contents of directors' report: business review
>
> (2)The purpose of the business review is to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company).
> The business review must contain—fair review of the company's business, and a description of the principal risks and uncertainties facing the company.
> A balanced and comprehensive analysis of—the development and performance of the company's business during the financial year, and the position of the company's business at the end of that year, consistent with the size and complexity of the business.
> Quoted companies were also to include: the main trends and factors likely to affect the future development, performance and position of the company's business; and information about— environment, employees and social and community issues

The primary audience outlined in s. 417 was the 'members of the company'. Therefore the review was therefore focused on the perceptions of the shareholder and what projects the success of the company to that category. The inclusions of social and environmental issues are only in so far as it affects 'the success of the company'. Therefore the review would focus on how the decisions were taken by directors for their members' audience.

s. 417 was then amended by the s.414A-D the Companies Act 2006 (Strategic Report and Directors Report) 2013. The UK government cited this as part of the state implementation of the 2011 UN Guiding Principles on Business and Human rights.[85] Section 414C below

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[82] The Companies Act 1985 (Operating and Financial Review and Directors report etc…) Regulations 2005. This followed prior voluntary OFR disclosure (1993 OFR guidance UK Accounting Standards Board) - see Rowbottom & Schroeder (n9)

[83] Ibid

[84] Directive 2003/51/EC

[85] HM Government *Good Business: Implementing the UN Guidelines on Business and Human Rights* May 2016 p.7 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/522805/Good_Business_Implementing_the_UN_Guiding_Principles_on_Business_and_Human_Rights_updated_May_2016.pdf .This may

indicates the key changes and this includes: increased external regulatory focus with a separate strategic report focused on similar area to the business review but more clearly outlined. The objectives were similar: "The purpose of the strategic report is to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company)."

> Listed companies were also directed to report on addition human rights issues, thus environment, employees, social, community and human rights issues, "including information about any policies of the company in relation to those matters and the effectiveness of those policies."
> There was also the potential to explain omissions.[86]

Finally quoted companies were asked to report on company strategy, business model and a breakdown on sex of directors, senior managers and employees[87]

The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016 then amended the Companies act 2006 (for public interest entities (PIES), that is, a traded banking or insurance company with more than 500 employees) to include a non-financial information statement as part of its strategic report.[88] This implemented the EU Non-Financial Reporting Directive.[89] Following a UK corporate governance green paper in 2016/17 on corporate governance reform, where one of the identified problems included the effectiveness of the section 172 approach[90], the companies (miscellaneous reporting) regulations 2018 inserted a further requirement for a section 172(1) statement. The new section 414CZA(1) requires that "a strategic report for a financial year of a company must include a statement (a "section 172(1) statement") which describes how the directors have regard to the matters set out in section 172(1)(a) to (f) when performing their duty under section 172"

The potential overlaps for quoted companies are noted in section 414CB (7).[91]

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also have been influenced by the Directive 2014/95/ EU 22 October 2014 amending Directive 2013/34/EU with regards to disclosure of non-financial and diversity information by certain large undertakings and groups.

[86] 'If the report does not contain information of each kind mentioned in paragraphs (b) (i), (ii) and (iii), it must state which of those kinds of information it does not contain'.

[87] S. 414(c) (8) CA 2006

[88] S. 414CA & S.414CB CA 2006

[89] Directive 2014/95/EU

[90] 'UK company law already enshrines the importance of wider interested groups in corporate governance. Section 172 of the Companies Act 2006 gives directors a responsibility to create successful businesses for the benefit of shareholders, whilst having regard to a range of other interests. The challenge is to ensure that all companies are taking the steps needed to understand and take account of wider interests and different social perspectives'. p.34 see UK BEIS Green paper (n4)

[91] [91] Financial Reporting Council UK (FRC) *Guidance on Strategic Report* July 2018 points out that: 'Section 414CB

Section 426B(1) also extends the requirement for publication to unquoted large companies falling within the scope of section 414 CZA, who must now also publish the section 172 statement on the website Section 430 of the companies act already requires annual accounts and reports of quoted companies to be published on the website.

Additional requirements have also been added to the director's report[92], these were introduced in the form of amendments to the large and medium sized companies and groups (accounts and reports) regulations 2008 schedule 7, part 4 , 11 which now requires details in the report on engagement with employees and how the directors had regard to employee interests . While 11B now requires the directors to make a statement summarising how regard was paid to companies' business relationship with suppliers, customers and others.[93] This is in addition to the corporate governance code 2018 for listed companies still based on the 'comply or explain' principles but clearly requires the board to consider 'views of the company's other key stakeholders and describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making'.[94] The 2018 Wates corporate governance principles for large private companies also explicitly refers to section 172.[95]

From the lens of reflexive governance, the reporting process on the face of it, involves actors from across various levels of governance as well as varied stakeholders but many of these actors remain at a passive level. The report addressed to shareholders is now publicised allowing for publicity as a form of censure but without direct recourse of action for employees and other stakeholders on the basis of report content.

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sets out the content of the non-financial information statement which effectively requires entities within its scope to include additional non-financial information. As many of the disclosures in 414CB are similar to those required in section 414C for quoted companies, section 414CB(7) of the Act provides exemptions from overlapping disclosure requirements'. p.9 https://www.frc.org.uk/getattachment/fb05dd7b-c76c-424e-9daf-4293c9fa2d6a/Guidance-on-the-Strategic-Report-31-7-18.pdf

[92] S. 415 CA 2006 requires directors to prepare a report for each financial year although S. 415A exempts small companies

[93] See amendments made by the Companies (Miscellaneous Reporting) Regulations 2018 https://www.legislation.gov.uk/ukdsi/2018/9780111170298

[94] FRC *UK Corporate Governance Code* July 2018 Provision 5 https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf

[95] FRC *The Wates Corporate Governance Principles for large private companies* December 2018 p.6. (The new report was in response to the corporate governance green paper and report - see also: p.1-5) https://www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf

The link to management strategy and policy is capable of causing normative effects because it could drive companies who do not have such policies, to adopt one. On a wider scale, the adoption of CSR policies post section 172 is now validated through reporting but the effective audience remains shareholders and capital markets. Johnstone observes this development, when he remarks that 'as a result of the changes during the course of the twentieth century, which culminated in Section 172, CSR is now confined to practices that are acceptable to the shareholders and the capital markets.'[96] There is a subjectivity in such reporting that may result in anomalies and partial disclosures as it rests with the directors to decide what amounts to 'an understanding of the development, performance or position of the company's business'. [97] The use of disclosure as a monitoring mechanism can shape corporate behaviour but there are other critical issues which may deter from its value. The directed users of these reports, the shareholders may not use these reports in the intended fashion. There is evidence that the corporate annual reports are not effectively utilized by shareholders.[98] In addition, the large shareholders, institutional investors have mainly chosen inaction on the issues of CSR. They have largely opted to remain guided by the economic incentive.[99] The drive for socially responsible investment (SRI) is still in its infancy.[100]

Section 172 therefore effectively utilises information and interference to shape social regulation through procedural law. However this is itself effected by choosing to limit and modify its scope of interference in a reactionary way and for a specific audience.

Secondly the progression from business review to strategic report and now with the section 172 statement does show modification adaptation of a procedural reporting with substantive consequences especially in the scope of coverage, the format and outline of content. It is predicated on the notion of secondary effects. There is some sense in which there is an

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[96] Andrew Johnston, *The Shrinking Scope of CSR in UK Corporate Law* 74 Wash. & Lee L. Rev. 1001 – 1042, 1035 (2017) https://scholarlycommons.law.wlu.edu/wlulr/vol74/iss2/16

[97] S. 417(6) CA 2006

[98] Charlotte Villiers *Corporate reporting and Company Law* (Cambridge: Cambridge University Press, 2006)

[99] Lloyd Kurtz *Socially responsible Investment and Shareholder Activism* in in *Oxford Handbook on CSR* 249-280 (Oxford: Oxford University Press 2008)

[100] Ibid. For the dominance of Financial logic in SRIs see: Shipeng Yan, Fabrizio Ferraro, Juan Almandoz *The Rise of Socially responsible investment funds: The paradoxical role of financial logic* 69(2) Administrative Science Quarterly 466-501 (2019)

experimental evolution towards specificity of categories on concern but not towards level or standard of content.

This may be for the two fold reasons: on the one hand, the nature of responsibility captured by section 172 is itself evolving and not static but on the other hand, and more fundamentally the law struggles with social regulation of what it terms company law's 'private spheres'.

The manner in which these reports are collated or prepared will also determine the effect of reflexive governance. The drivers for taking into account multiple stakeholder perspectives are few. It is still a focus on how the corporation and its financial position is affected by social or community issues, environmental matters or employees. Horrigan highlights the subtle difference between reporting how the company's internal and external affairs affect the company and its prospects for the future as distinct from reporting on how the company and its affairs affect and otherwise relate to the societal landscape around them.[101]

The FRC guidance on the strategic report 2018 gives the following example: "A company could disclose a stakeholder map that identifies its key stakeholder relationships showing the dependencies of each part of the business on different groups of stakeholders and the impacts that the business has on each of those groups. This could include the environmental and community resources that the company is dependent on how those resources generate and preserve value.'[102]

The perspective is still firmly that of self-interest and added value. The FRC guidance section 7b for PIES identities that 'A description of the strategy for achieving an entity's objectives provides insight into its future development, performance, position and future prospects. The disclosure of the entity's objectives places the strategy in context and allows shareholders to make an assessment of its appropriateness.'[103]Finally there is potential for diverse approaches to be used but within a limited scope which privileges long term shareholder value. The emphasis is still on the preservation of the existing model of company law and directed autonomous action within that scope

[101] Horrigan (n51) p.260

[102] FRC (n91) p.59

[103] ibid p.41

Conclusion

The reflexive nature of governance emerging from s. 172 regulation occurs within the self-imposition of shareholder value primacy model. It exemplifies a restraint from direct involvement in regulating stakeholder issues within 'private' company regulatory space. However it resorts to guidance on reporting about issues which it recommends should fall within defined director private decision-making spheres but it refrains from setting pre-determined goals and stating how such balancing or consideration should be done. It defines a procedural process which attempts to shape company normative beliefs but this occurs within company's law self-imposed limitation based on the historical utility of private governance, in the interest of a single privileged group, 'members as a whole'.

The success of reflexive law lies in evolutionary change and the creation for shared spaces of co-governance and newer forms of regulation, some of which may be disruptive. From a review of the changes to the UK Company reporting regulations, one can see this nature of reflexive law emerging. Fiduciary duties are being transformed into duties of disclosure, audit, justification[104] but the notion of consultation with stakeholders or the re-organisation of internal control processes is less apparent and may warrant further sociologically inquiry.

Nevertheless it is important to identify that this is not a radical tool which confronts limitations in the chosen model used in company law rather it is a new type of governance which operates within the status quo. The gap between company law and external regulatory law of issues within CSR (such as the environment, human rights and employment rights) which affect each of the stakeholder issues is not narrowing.

[104] See elements specified by Parker (n46)