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TRIUMPH OR TRAGEDY? THE CURIOUS PATH OF CORPORATE DISCLOSURE REFORM IN THE U.K.

CYNTHIA A. WILLIAMS* AND JOHN M. CONLEY**

INTRODUCTION

It was the best of times, it was the worst of times. . .
It was the spring of hope, it was the winter of despair. . .

—Charles Dickens, *A Tale of Two Cities* (1859)

This quote well characterizes the views of those in London who, in 2005, supported the expanded disclosure of the social and environmental risks posed by companies' business strategies and operational decisions. On March 21, 2005, in a supposed spring of hope, Parliament passed a statute requiring that 1,290 British-based companies listed on the London Stock Exchange, New York Stock Exchange, or NASDAQ publish an annual Operating and Financial Review and Directors Report ("OFR").¹ The OFR statute, the culmination of a decade-long examination of corporate governance, required companies to identify, consider, and disclose a wide range of risks, including material social and environmental risks, as part of providing a comprehensive, forward-looking account of business strategy.² The process of developing the statute was highly-publicized; as one British op-ed writer noted, "[t]he Operating and Financial Review has rarely been out of the headlines since the concept was first mooted in the late 1990s."³ Some version of the OFR has been suggested as best practice for large companies for many years, but this was the first

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¹ The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005, S.I. 2005/1011 (U.K.).

² See generally Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT'L L. J. 493 (2005).

³ David Phillips & Peter Wyman, *Do Not Confuse Good Practice with Red Tape*, FIN. TIMES.COM, Nov. 30, 2005, http://us.ft.com/ftgateway/superpage.ft?news_id=fto113020051345288982 (Peter Wyman is head of regulatory policy for Price Waterhouse-Cooper).

statutory requirement.⁴ But on November 28, 2005, in the “winter of our discontent,” Chancellor of the Exchequer Gordon Brown abruptly reversed course and rescinded the OFR, announcing its demise in a speech to the Confederation of British Industry (“CBI”).⁵

Brown had been advised that “[i]f we wanted [a] deregulatory win with appeal to big business, a radical symbolic stripping-down of the OFR would go down incredibly well.”⁶ In fact, “the government’s efforts ‘backfired spectacularly,’ eliciting a firestorm of criticism ‘from an unlikely alliance of business leaders, City investors, trade unions and green activists,’⁷ and litigation threats from Friends of the Earth.”⁸ As documents produced in advance of that litigation made clear, not only were external parties surprised and appalled by the decision, but the ministers of the Department of Trade and Industry (“DTI”), the departmental author of the legislation, and the Department for Environment, Food and Rural Affairs (“DEFRA”) had only been informed of the decision five days before it was announced.⁹ One may suspect that the OFR “u-turn”¹⁰ also did not “go down incredibly well”¹¹ with Ministers of those Departments, Alan Johnson (DTI) and Margaret Beckett (DEFRA), when seven years of work was scuttled with five days’ notice.¹²

The authors admit to some amount of dismay as well. On November 28, 2005, after publishing and distributing a fifty-eight page law review article that analyzed the OFR in detail just two weeks earlier, we were faced with having written what seemed to be a leading contender

⁴ See Williams & Conley, *supra* note 2, at 493-530.

⁵ Jill Treanor & Mark Milner, *Brown Plan to Cut Red Tape for Business Provokes Chorus of Disapproval*, GUARDIAN (London), Nov. 29, 2005, at 1.

⁶ HM Treasury (U.K.), Meeting Notes Released to FoE as Part of Pre-Action Response (2005), http://hm-treasury.gov.uk/media/02F/9B/EASC_stakeholder_meeting_notes2.pdf [hereinafter HM Treasury Meeting Notes]. As a part of pre-action protocol, Friends of the Earth requested information about the basis for the Chancellor’s decision to rescind the OFR statute. Treasury Solicitors made these meeting notes and other materials public. See *id.*

⁷ John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 3-4 (2005) (quoting Treanor & Milner, *supra* note 5).

⁸ *Id.* at 4.

⁹ Press Release, Friends of the Earth, Brown Kept DTI in Dark Over Corporate Reporting U-Turn (Mar. 8, 2006), http://www.foe.co.uk/resource/press_releases/brown_kept_dti_in_dark_ove_07032006.html [hereinafter FoE Press Release].

¹⁰ *Id.*

¹¹ *Contra* HM Treasury Meeting Notes, *supra* note 6.

¹² FoE Press Release, *supra* note 9.

for the “longest law review article with the shortest half-life” in history.¹³ Two days after Chancellor Brown made his announcement, Professor Jayne Barnard invited one of us to discuss “the origins of [the OFR] proposals, the political dynamics that fostered them, and the political dynamics that ultimately did them in” as part of the *William & Mary Environmental Law and Policy Review* Symposium on “Corporate Governance and Environmental Best Practices.”¹⁴ We accepted with a somewhat heavy heart. For the authors, the Symposium provided a chance to at least think about the apparent denouement of the OFR drama. More importantly, it seemed to be an opportunity to reconsider our thesis on the implications of the OFR developments for our corporate governance theory: that the U.K. was developing a “third way” between the shareholder and stakeholder conceptions of the firm, fueled in significant part by rapidly shifting norms among a substantial number of institutional investors.¹⁵

This Article is the result, although the denouement may have been only apparent, and the drama may have been simply between acts. As it turns out, the Treasury decision was hastily considered and premised on the belief that, after “odd moan[s]” about the expenses of having already begun to prepare annual OFRs, business would welcome the OFR pull-back and investors would generally line up behind business.¹⁶ It was also thought that opposition would primarily come from environmental groups, the corporate social responsibility (“CSR”) lobby, and trade unions.¹⁷ But Treasury did not get the business reaction quite right and it badly misread investor sentiment.¹⁸ In fact, some of the most resounding howls of outrage came from investors, as they collectively acted to express their views about what a revived, albeit stripped-down, OFR would need to include.¹⁹ Moreover, Treasury essentially ignored the accounting profession in rescinding the OFR regulations, even though the original impetus for

¹³ See generally Williams & Conley, *supra* note 2.

¹⁴ E-mail from Jayne W. Barnard, Professor of Law, William & Mary School of Law, to Cynthia A. Williams, Professor of Law, University of Illinois College of Law, and John M. Conley, Professor of Law, University of North Carolina School of Law (Nov. 30, 2005) (on file with authors). See Symposium, *Corporate Governance and Environmental Best Practices*, 31 WM. & MARY ENVTL. L. & POL’Y REV. 1 (2006).

¹⁵ See generally Williams & Conley, *supra* note 2.

¹⁶ Note to Chancellor of HM Treasury (U.K.) on Operating and Financial Review (OFR): Deregulatory Opportunity 5 (October 11, 2005), http://www.hm-treasury.gov.uk/media/BB6/1F/easc_advice10nov020306.pdf [hereinafter Note to Chancellor on OFR Deregulatory Opportunity].

¹⁷ *Id.* at 5.

¹⁸ See *infra* Parts II-III.

¹⁹ See *infra* Part III.

OFRs had come from that quarter.²⁰ The Treasury was correct on one count, though; environmentalists and CSR activists, with which London is awash, quickly added their voices to the din of anger and dismay expressed daily in the press.²¹ Within months, conflicting policy proposals proliferated from Treasury, DTI, DEFRA and Parliament, all trying to fill the regulatory vacuum left by withdrawal of the OFR proposals.²² One public relations executive pithily summarized developments, commenting that "[t]here is a groundswell of opinion telling the Chancellor he has been an idiot."²³ In the middle of this "clumsy policy muddle,"²⁴ Financial Times writer Barney Jopson stated that "it was difficult to know whether to laugh or cry . . . as the government's handling of corporate reporting descended further into farce—or was it tragedy?"²⁵

As this article is being written, this story appears to have entered its final chapter. Barring any other unexpected developments, the nearly twenty-year-old company law reform process, of which the OFR proposal was a part, has apparently entered its final stage, with Parliament recently enacting legislation that fundamentally changes the U.K.'s company law.²⁶ Due in part to the energy unleashed amongst investors, CSR activists, and the accounting community in response to the OFR "u-turn,"²⁷ the new Companies Bill emphasizes the consideration of social and environmental issues within the scope of directors' duties and incorporates social and

²⁰ See *infra* notes 159-63 and accompanying text.

²¹ See *infra* notes 175-78.

²² See *infra* Part IV.

²³ *CIPR Adds Weight to OFR Rescue Lobby*, PRWEEK, Mar. 17, 2006, at 10 (quoting Francis Ingham, Head of Public Affairs, Chartered Institute for Public Relations ("CIPR")). The quote refers to Chancellor Brown as having been an "idiot" in this decision, not generally. *Id.* In fact, Chancellor Brown is very well-regarded, and it is thought uncharacteristic of him to have made such a hasty decision without carefully thinking through the consequences. See generally Andrew Roth, *Gordon Brown Profiled*, GUARDIAN, Mar. 6, 2001, <http://www.guardian.co.uk/budget2001/story/0,,447338,00.html>. Yet, this instance may exemplify a deeply-rooted understanding that, to gain the support of business, one should deregulate higgledy-piggledy, even if it means axing intelligent policies that might promote thoughtful management, market efficiency, and long-term investment. Regrettably, this understanding is probably shared among many leaders with nationwide political aspirations.

²⁴ Barney Jopson, *Directors Need Safe Harbour on Forward-Looking Statements*, FIN. TIMES (London), Feb. 9, 2006, at 10.

²⁵ *Id.*

²⁶ See The Companies Act, 2006, c. 46 (Eng.), available at http://www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en.pdf. This Article was written before the passage of the Companies Act on Nov. 8, 2006. However, the relevant portions of the final, royal assent version of the bill do not differ substantially from the Companies Bill referred to herein.

²⁷ FoE Press Release, *supra* note 9.

environmental reporting into a “business review” that must conform with the European Union’s Accounts Modernization Directive.²⁸ Interestingly, this legislation may accomplish the same substantive ends as the OFR requirements in a more effective way.²⁹

Ultimately, for all of the government’s fumbling, the entire imbroglio may prove to be a cautious advance for corporate accountability. Parliament’s actions on the Companies Bill may strengthen the substantive standards of conduct required of public company directors and make that conduct subject to enhanced disclosure.³⁰ If so, part of the credit will go to the surprising coalition of environmentalists, CSR activists, NGOs, institutional investors, and accountants, all of which reacted strongly to Chancellor Brown’s about-face.³¹ Collectively, their actions leave an impression that London has seen a significant change in the norms concerning the accountability expected of public companies.

To explain the context of the OFR and the debate over it, Part I contrasts the regulation of risk disclosure in the United States to what the U.K.’s original OFR regulations and the EU’s Accounts Modernization Directive reflect. Part II provides some further detail on the U.K. Treasury’s process of deciding to scrap the OFR, focusing particularly on its political analysis. Part III discusses the reactions of various institutional actors to the decision, including companies, accountants, investors, and CSR activists. Part III also traces the subsequent developments that those reactions provoked. Part IV describes the Companies Bill’s new regulation of directors’ duties and disclosure and explores some of the debate concerning its provisions. Part V discusses the implications of these developments for corporate governance theory. Throughout the Article, the authors expand on the previously advanced theory that the corporate governance system in the U.K. is quite distinct from that in the U.S., although both are typically treated as part of a unitary “Anglo-American corporate model.”³²

²⁸ See TRUCOST, PLC, TRUCOST GUIDE—EU ACCOUNTS MODERNISATION DIRECTIVE (2005), available at <http://www.businessandbiodiversity.org/pdf/EU%20Accounts%20and%20Modernization%20Directive.pdf>.

²⁹ See *infra* notes 213-21 and accompanying text.

³⁰ See *infra* notes 213-21 and accompanying text.

³¹ See *infra* Part III.

³² See Williams & Conley, *supra* note 2, at 530-50.

I. REGULATION OF DISCLOSURE OF RISK

A. *General Approaches: U.S. and U.K.*

The recent business scandals in the United States have led corporate boards, institutional investors, and government officials throughout the world to pay increased attention to issues of corporate governance. Consequently, two issues have gained prominence: (1) the structure of companies' internal financial controls, and (2) companies' openness to addressing a wide range of market, business, strategic and operational risk in their enterprise risk management ("ERM") strategies. In response to the fraud and financial malfeasance of companies such as Enron and WorldCom,³³ the United States Congress and Securities and Exchange Commission ("SEC") worked to enhance internal financial controls and address the fraudulent accounting that misled investors about short-term financial risks. The product was the Sarbanes-Oxley Act,³⁴ which imposes more stringent government oversight of accountants and heightened requirements for corporate officials.³⁵ Although the requirements of Sarbanes-Oxley make sense in light of the Enron debacle, the strategic discussion, disclosure, and management of risk in the United States remains relatively undeveloped, leaving investors exposed to unexplored areas of risk. The Conference Board recently issued a report indicating that only twenty-five percent of directors of non-financial companies consider all major risks, including strategic and business risks, as part of their discussions of risk, and that about two-thirds of the boards of Fortune 500 companies place responsibility for risk analysis entirely in the audit committee.³⁶

In contrast, discussions of internal controls and enterprise risk management were initiated in the U.K. well before the Enron fallout. Since 1998, the Combined Code has provided that listed companies should

³³ See Penelope Patsuris, *The Corporate Scandal Sheet* (Aug. 26, 2002), <http://www.forbes.com/2002/07/25/accountingtracker.html> (describing the facts of several corporate scandals).

³⁴ The Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C. (2007)).

³⁵ See 15 U.S.C. §§ 7241, 7262 (2007) (establishing a bevy of regulations to enhance public company accounting and corporate responsibility, such as making corporate officials certify the state of their internal financial controls and financial reports).

³⁶ See Press Release, The Conference Board, *Corporate Directors May Not Be Providing Sufficiently Robust Enterprise Risk Oversight* (June 6, 2006), http://www.conference-board.org/utilities/pressDetail.cfm?press_ID=2893.

discuss in their Annual Report their systems of internal controls, including “financial, operational and compliance controls and risk management systems.”³⁷ Also, the Turnbull Committee Guidance on Internal Control (“Turnbull Report”), published by the Institute of Chartered Accountants in England and Wales in 1999, gave public companies advice on establishing, evaluating, and publicly reporting on their systems of internal control and risk management.³⁸ The Turnbull Report acknowledged that an effective internal control system might address a wide range of risks, including “legal, health, safety and environmental, reputation, and business probity issues” in addition to financial risk.³⁹ As a result, a cottage industry grew up advising British companies on establishing effective internal controls.⁴⁰ Once the market began to appreciate the importance of risk management and internal control, institutional investors began paying more attention to disclosure about these issues, both to manage investment risk in their own investment portfolios and to evaluate the thinking of boards of listed companies concerning a broad range of potential risks to company strategy, operations or reputation.⁴¹ This is the fertile soil in which the OFR consultation process flourished, trying to instill a longer-term perspective among directors and investors by encouraging directors to identify and discuss social and environmental risks as part of their risk management.⁴²

An example of the interaction of risk management and disclosure may clarify what is at issue in the U.S. versus U.K. and EU approaches to social and environmental risk. Consider risks and opportunities from climate change that, whether from physical changes in the environment, regulatory efforts to mitigate those changes, or technological innovations to address greenhouse gas emissions, are evident across the whole spectrum

³⁷ See FIN. SERVICES AUTH., COMBINED CODE ON CORPORATE GOVERNANCE § 1.C.2.1 (2003). The Combined Code contains principles of corporate governance that are incorporated into the London Stock Exchange’s listing rules, with which listed companies are expected to “comply or explain” their non-compliance. *Id.* pmb1.

³⁸ See INST. OF CHARTERED ACCT. IN ENG. AND WALES, INTERNAL CONTROL: GUIDANCE FOR DIRECTORS ON THE COMBINED CODE 30 (1999). This report is commonly referred to as the “Turnbull Report.”

³⁹ *Id.* app.

⁴⁰ See Institute of Chartered Accountants, Internal Control: The Turnbull Report and Implementing Turnbull, http://www.icaew.com/index.cfm?aub=tb2I_6242 (last visited Mar. 1, 2007).

⁴¹ See generally Williams & Conley, *supra* note 2, at 514-16.

⁴² See *id.*

of economic activity.⁴³ These developments affect myriad industries, including agriculture, energy, transportation, water and waste treatment, oil and gas, forestry, pulp and paper, basic industries (e.g., steel, chemicals, mining), tourism, building construction, real estate, manufacturing, and insurance.⁴⁴ These risks and opportunities have intensified since February 2005, when the Kyoto Protocol took effect.⁴⁵ The parties to the Protocol, including the European Union, Russia, and Japan, have begun to implement mechanisms for limiting greenhouse gas emissions, such as emissions caps and trading systems for excess greenhouse gas capacity.⁴⁶

Even though the United States did not ratify the treaty, American companies face increased financial risks as a result of its coming into force. For instance, European companies from countries participating in the trading system will be able to reap economic benefits from reducing their greenhouse gas emissions by selling credits for their unused emissions.⁴⁷ This seems likely to bring down their costs of production, enhance their competitive economic position, and put U.S. companies at a comparative disadvantage. A related issue is that of insurance costs. Swiss Re, the world's second largest re-insurer, has identified climate risk as "an emerging liability risk."⁴⁸ Accordingly, it is including an analysis of a company's approach to climate risk in its underwriting of liability insurance for directors and officers.⁴⁹ As European companies become motivated by the financial incentives of the Kyoto Protocol and increasingly attend to climate risk, their insurance premiums will presumably become less

⁴³ See INNOVEST STRATEGIC VALUE ADVISORS, INC., CERES SUSTAINABLE GOVERNANCE PROJECT, VALUE AT RISK: CLIMATE CHANGE AND THE FUTURE OF GOVERNANCE 10, 34-44 (2002), available at http://www.ceres.org/pub/docs/Ceres_value_at_risk_0418.pdf.

⁴⁴ *Id.*

⁴⁵ See Kyoto Protocol to the United Nations Framework Convention on Climate Change, Dec. 11, 1997, 37 I.L.M. 22, U.N. Doc. FCCC/CP/1997/L.7/Add.1, available at <http://unfccc.int/resource/docs/convkp/kpeng.pdf>.

⁴⁶ For an overview of the three "flexibility mechanisms" for meeting emission-reduction targets provided for in the Kyoto Protocol, see Secretariat of the U.N. Framework Convention on Climate Change, Kyoto Mechanisms—Background, http://unfccc.int/kyoto_protocol/mechanisms/items/2998.php (last visited Mar. 1, 2007).

⁴⁷ See Secretariat of the U.N. Framework Convention on Climate Change, Emissions Trading, http://unfccc.int/kyoto_protocol/mechanisms/emissions_trading/items/2731.php (last visited Mar. 1, 2007). These benefits go above and beyond the benefits of the reductions themselves, which are often obtained by reducing energy use. See *id.*

⁴⁸ J. Kevin Healy & Jeffery M. Tapick, *Climate Change: It's Not Just a Policy Issue—It's a Legal Problem*, 29 COLUM. J. ENVTL. L. 89, 102 (2004).

⁴⁹ *Id.* at 102.

expensive than those of American companies.⁵⁰ Despite the evidence of the growing financial materiality of the climate change risk, it is still extremely difficult to determine the extent specific industries and individual companies are exposed to that risk by reading their public disclosure documents.⁵¹

We know from analogous studies of the impact of new environmental regulations that companies within an industry are dissimilarly affected by new regulations, depending on where they produce their products, how recently they have upgraded production facilities, what investments they have made in mitigating risks, and so on.⁵² This information—the financial risk posed to sectors and companies by climate change—is unavailable in high-quality form to investors reading American securities filings because of inadequacies in disclosure regulations and how they are interpreted.⁵³ The

⁵⁰ See *id.* at 101-13 (identifying insurance costs, as well as other financial risks to American corporations from climate risk).

⁵¹ See MICHELLE CHAN-FISHEL, FRIENDS OF THE EARTH—U.S., THIRD SURVEY OF CLIMATE CHANGE DISCLOSURE IN SEC FILINGS OF AUTOMOBILE, INSURANCE, OIL & GAS, PETROCHEMICAL, AND UTILITIES COMPANIES 23-29, 38-40 (2004), available at <http://www.foe.org/camps/intl/corpacct/wallstreet/secsurvey2004.pdf>. This survey evaluated climate change disclosure and found continued non-disclosure by some companies in almost every industry with meaningful information about the financial risks of climate change. *Id.* at 23-29. Even in companies where the record is better, such as electrical utilities, where 24 of 26 companies made some disclosure of climate risk, the quality and utility varies widely. *Id.* at 23-29, 38-40. See also DUNCAN AUSTIN ET AL., WORLD RESOURCES INST. & SAM GROUP, CHANGING DRIVERS: THE IMPACT OF CLIMATE CHANGE ON COMPETITIVENESS AND VALUE CREATION IN THE AUTOMOTIVE INDUSTRY 43-55 (2003), available at http://pdf.wri.org/changing_drivers_full_report.pdf (analyzing the competitive challenges and potential financial impact of climate change regulations on individual manufacturers within the global automotive industry and projecting significant, financially material effects that differ between companies); AMANDA SAUER ET AL., WORLD RESOURCES INST. & SAM GROUP, TRANSPARENCY ISSUES WITH THE ACEA AGREEMENT 3-11 (2005), available at http://pdf.wri.org/acea_driving_blindly.pdf (describing the agreement between the European automobile manufacturers' association ("ACEA") and the European Commission, under which the automobile manufacturers agreed to either reduce the carbon intensity of their products by 2008 or face mandatory EU regulation (known as the "ACEA Agreement"), and the lack of information about the financial impact of the ACEA Agreement on individual car manufacturers).

⁵² See DUNCAN AUSTIN & AMANDA SAUER, WORLD RESOURCES INST., CHANGING OIL: EMERGING ENVIRONMENTAL RISKS AND SHAREHOLDER VALUE IN THE OIL AND GAS INDUSTRY 25 (2002) (reporting similar findings for the oil and gas industry); ROBERT REPETTO & DUNCAN AUSTIN, WORLD RESOURCES INST., COMING CLEAN: CORPORATE DISCLOSURE OF FINANCIALLY SIGNIFICANT ENVIRONMENTAL RISKS 27 (2000) (describing differential financial impacts on companies within the paper and pulp mill industries from new environmental regulations, and noting that these differential financial impacts are impossible to ascertain from the companies' securities filings).

⁵³ Although we have argued previously that Item 303 of Regulation S-K, Management

same lack of information is found across a wide range of serious social and environmental risks, all of which may have material, long-term financial consequences. Some examples include: labor abuses in clothing, shoes, and light industry generally;⁵⁴ the effects of oil and gas operations on indigenous peoples' property, culture, and general rights;⁵⁵ HIV/AIDS infection among workers and related individuals;⁵⁶ and human rights policies and security arrangements, especially within extractive industries.⁵⁷ In each of these examples, there exists no requirement that investors routinely be provided with material risk-related information about American companies. In contrast, new disclosure requirements in both the EU and the U.K. should start to bring more of this information to the markets, particularly as institutional investors increasingly demand it. The following sections discuss those disclosure requirements in more detail.⁵⁸

B. *The European Union*

Even before legal developments occurred at the EU level, several individual member states had taken steps in the direction of mandated social and environmental reporting. "For example, France,⁵⁹ Belgium,⁶⁰

Discussion and Analysis ("MD&A"), if broadly interpreted, does require the disclosure of much of this information, many public companies interpret it narrowly. *See Williams & Conley, supra* note 2, at 524-26.

⁵⁴ *See* Clean Clothes Campaign, The Principles of the Clean Clothes Campaign, <http://www.cleanclothes.org/campaign/principles.htm> (last visited Mar. 1, 2007).

⁵⁵ *See* World Rainforest Movement, Bolivia: Indigenous Peoples Concerned by Oil Prospection, <http://www.wrm.org.uy/bulletin/39/Bolivia.html> (last visited Mar. 1, 2007).

⁵⁶ *See, e.g.*, GLOBAL POLICY NETWORK, HIGHLIGHTS OF CURRENT LABOR MARKET CONDITIONS IN LESOTHO 2 (2006), *available at* <http://www.gpn.org/data/lesotho/lesotho-analysis.pdf> (noting that thirty-five percent of the population of Lesotho is HIV positive).

⁵⁷ *See, e.g.*, Amnesty International, Conflict Diamonds, http://www.amnestyusa.org/Our_Issues/Conflict_Diamonds/page.do?id=1011014&n1=3&n2=74 (last visited Mar. 1, 2007).

⁵⁸ The material in the next two subsections draws from our prior work. Its inclusion here, however, is necessary to describe the background of developments with the OFR regulations. *See generally* Williams & Conley, *supra* note 2, at 503-23.

⁵⁹ *See* Law No. 2001-152 of February 19, 2001, Journal Officiel de la République Française [J.O.] [Official Gazette of France], Feb. 20, 2001, p. 2774 (Fr.) (amending C. TRAV. arts. 443-44). This section sets out the "social, environmental and ethical considerations fund management for employee savings should take into account when buying or selling stocks." Williams & Conley, *supra* note 2, at 503 n.44.

⁶⁰ Law of April 28, art. 42(3) Moniteur Belge (2d. ed.) May 15, 2003, p. 26,407 (Belg.) (requiring pension organizations' investment strategies to account for social, ethical and environmental aspects).

Germany,⁶¹ and the U.K.⁶² passed laws that require pension funds to disclose the extent to which they take ethical, social, and environmental information into account in constructing their investment portfolios.”⁶³ As hoped, these laws are starting to have important effects on the investment behavior of large public-sector pension funds.⁶⁴ The thinking is that, as pension fund managers start to ask companies for information on these issues, the companies will respond by making the information more generally available.⁶⁵ “Acting more directly, Denmark,⁶⁶ the Netherlands,⁶⁷ Norway,⁶⁸ and Sweden⁶⁹ have all required companies to provide expanded environmental information in their annual reports, starting with Denmark in 1999.”⁷⁰ France has implemented requirements for comprehensive disclosure of both social and environmental information.⁷¹

⁶¹ See Gesetz zur Reform gesetzlichen Rentenversicherung und zur Förderung eines kapitalgedeckten Altersvorsorgevermögens (Altersvermögensgesetz-AMG), v. 29.6.2001 (BGBl. I S. 1310, 1323) (F.R.G.) (requiring that pension funds state whether and, if so, how, investment decisions are affected by social and environmental factors); SUSAN A. AARONSON & JAMES T. REEVES, CORPORATE RESPONSIBILITY IN THE GLOBAL VILLAGE: THE ROLE OF PUBLIC POLICY 21 (2003).

⁶² Occupational Pension Schemes (Investment and Assignment, Forfeiture, Bankruptcy etc.) Amendment Regulations, SI 1999/1849, § 2(4) (U.K.) (amending SI 1996/3127). This regulation “requires trustees of occupational pension funds to disclose ‘the extent to which social, environmental or ethical considerations are taken into account’ when making investment decisions.” Williams & Conley, *supra* note 2, at 504 n.47 (quoting Occupational Schemes Amendment Regulation § 2(4)).

⁶³ Williams & Conley, *supra* note 2, at 503-04.

⁶⁴ *Id.* at 533-35 (describing the impact of the U.K. pension fund disclosure regulations on the growth of the socially-responsible investment market and on engagement by investment professionals in discussions with portfolio companies concerning social and environmental issues).

⁶⁵ See *id.* “Since these requirements are relatively new, none dating back before 1999, any assessment is necessarily tentative.” *Id.* at 504 n.49.

⁶⁶ See generally The Social Index, <http://www.detsocialeindeks.dk/extweb/dsi/dsi.nsf/DocNo/eng-00-02-01> (last visited Mar. 1, 2007). The Danish Ministry of Social Affairs has developed a mechanism called the “social index” to measure companies’ social responsibility. *Id.*

⁶⁷ Uitvoeringsregeling milieuverslaglegging, Dec. 14, 1998, Staatscourant 1998, 248 pag. 11 (Dec. 24, 1998) This regulation “requires companies to report on any environmental effects of their activities”. Williams & Conley, *supra* note 2, at 504 n.51.

⁶⁸ See AARONSON & REEVES, *supra* note 61, app. 4.

⁶⁹ Lag om allmänna pensionsfonder, National Pension Funds Act, SFS 2000:192, available at <http://www.riksdagen.se/debalt/sfst/index.asp>. This Act “requires companies to draw up an annual business plan that describes how investment decisions take environmental and ethical considerations into account.” Williams & Conley, *supra* note 2, at 504 n.53.

⁷⁰ Williams & Conley, *supra* note 2, at 504. See AARONSON & REEVES, *supra* note 61, app. 4.

⁷¹ See Decree No. 2002-221 of February 20, 2002, Journal Officiel de la République Française [J.O.] [Official Gazette of France], Feb. 21, 2002, p. 3360 (Fr.) (concerning the application of [C.COM.] art. 155-102-1 and modifying Decree No. 67-236 of Mar. 23, 1967, J.O., Mar. 24, 1967, p.2843); Williams & Conley, *supra* note 2, at 504 & n.55.

Since 1968, the EU has been in the process of trying to harmonize the company laws⁷² and accounting standards to accord with the Treaty of Rome, which created the European economic community.⁷³ In the last five years the harmonization process has included "extensive discussion of the social and environmental responsibilities of companies, culminating in the enactment of new social and environmental disclosure obligations."⁷⁴ In its May 15, 2001 Communication on the EU Strategy for Sustainable Development, the European Commission "invited" companies with 500 employees or more to publish annually a "triple bottom line" report evaluating their performance against economic, environmental and social criteria.⁷⁵ The Commission also adopted Recommendation 2001/453/EC,⁷⁶ which calls for requirements that companies:

⁷² In American parlance, the company laws would be known as the "corporate laws."

⁷³ Williams & Conley, *supra* note 2, at 505. See European Union, Company Law: Introduction, <http://europa.eu.int/scadplus/leg/en/lvb/l26002.htm> (last visited Mar. 1, 2007) [hereinafter EU Company Law Introduction]. "Harmonization typically proceeds by means of Directives proposed by the European Commission (the EU executive) and passed by the Council of the European Union (a legislative body composed of member state ministers)" with varying degrees of consultative or co-decision-making power vested in the European Parliament, which is directly elected by the EU citizenry. Williams & Conley, *supra* note 2, at 505 n.61. See also EU Company Law Introduction, *supra*. Member states are required to implement Directives through national legislation. See Europa, Decision-making in the European Union, http://europa.eu/institutions/decision-making/index_en.htm (last visited Mar. 1, 2007).

⁷⁴ Williams & Conley, *supra* note 2, at 506. See, e.g., *Communication from the European Commission Concerning Corporate Social Responsibility: A Business Contribution to Sustainable Development*, COM (2002) 347 final (July 2, 2002); *Promoting a European Framework for Corporate Social Responsibility*, at 3, COM (2001) 366 final (July 18, 2001). The European Commission's

aim[] [was] to launch a wide debate on how the European Union could promote corporate social responsibility at both the European and international level, in particular on how to make the most of existing experiences, to encourage the development of innovative practices, to bring greater transparency and to increase the reliability of evaluation and validation.

Id.

⁷⁵ *Commission's Proposal to the Gothenburg European Council: A Sustainable Europe for a Better World: A European Union Strategy for Sustainable Development*, at 8, COM (2001) 264 final (May 15, 2001).

⁷⁶ *Commission Recommendation of 30 May 2001 on the Recognition, Measurement, and Disclosure of Environmental Issues in the Annual Accounts and Annual Reports of Companies*, 2001 O.J. (L 156) 33 (June 13, 2001).

- disclose and incorporate into their financial accounts thirty-nine highly specific categories of environmental information;⁷⁷ and
- include in their annual reports to shareholders information on environmental issues facing the company,⁷⁸ on its policies and programs for improving environmental protection, and on its environmental performance in such areas as energy use, water use, emissions, and waste disposal.⁷⁹

In 2003, much of this Recommendation was given the force of law with passage of the Modernization Directive, which requires EU companies to include “a fair review of the development and performance of the company’s business and of its position, together with a description of the principal risks and uncertainties that it faces” in their annual reports.⁸⁰ The Modernization Directive requires that:

To the extent necessary for an understanding of the company’s development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters.⁸¹

The EU’s legislative bodies explained that the requirement to provide non-financial information should “lead to an analysis of environmental and social aspects necessary for an understanding of the company’s development, performance or position.”⁸² While states were free to “exempt small and medium enterprises from the nonfinancial disclosure

⁷⁷ The recommendations for environmental accounting include: (1) principles for the recognition of environmental expenditures and liabilities and of site dismantling and restoration costs, (2) principles for adjusting the values of impaired assets, and (3) provisions for site restoration or dismantling and for discounting future costs to present value. *Id.* at 37-38.

⁷⁸ *Id.* at 40.

⁷⁹ *Id.* at 40-41. As the Recommendation states, the purpose of this disclosure is to permit “users of the annual report to be able to ascertain to what extent environmental protection is an integral part of the company’s policies and activities.” *Id.* at 40.

⁸⁰ Council Directive 2003/51/EC, art. 1, § 14(a)(1)(a), 2003 O.J. (L 178) 16, 18 (EU). This is commonly referred to as the “Modernization Directive.”

⁸¹ *Id.*

⁸² *Id.* pmb. § 9, at 17.

obligations,”⁸³ the expectation was that large European companies would disclose “much more social and environmental information annually, and, more specifically, to account formally for environmental costs and potential liabilities.”⁸⁴

C. *The United Kingdom*

In 1998, the U.K. launched a comprehensive review of its company law, which in early 2006 led to the introduction of legislation discussed below.⁸⁵ One of the first steps in that review was a discussion of the corporate purpose, or what we in the U.S. call the shareholder/stakeholder debate. In its Final Report, the Company Law Review (“CLR”) Steering Group recognized that the “primary purpose of the corporation is to create profits for shareholders”⁸⁶ The CLR Steering Group went well beyond the narrow American concept of shareholder value, however. First, it “concluded that the time frame for assessing profit creation must be long-term, not short-term.”⁸⁷ Second, it found that “long-term shareholder value is best achieved by reducing a company’s future social and environmental risk,” and by enhancing its reputation through consideration of “the rights and needs of players other than shareholders.”⁸⁸

“Having settled on this ‘enlightened-shareholder’ view, the CLR Steering Group then proposed a number of mechanisms to reinforce its conclusion that companies need to be managed for the long term.”⁸⁹ The

⁸³ Williams & Conley, *supra* note 2, at 509; Council Directive 2003/51/EC, art. 1, § 14(b), at 18.

⁸⁴ Williams & Conley, *supra* note 2, at 510.

⁸⁵ The Companies Act, 2006, c. 46 (Eng.). See *supra* note 26 and accompanying text.

⁸⁶ Williams & Conley, *supra* note 2, at 515. In British elocution, these individuals would be referred to as “members.”

⁸⁷ *Id.* See CO. L. REV. STEERING GROUP, MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: FINAL REPORT xi (2001) [hereinafter CLR STEERING GROUP FINAL REPORT].

⁸⁸ Williams & Conley, *supra* note 2, at 515 (quoting ROGER COWE, ASS’N OF CHARTERED CERTIFIED ACCOUNTANTS, CORPORATE GOVERNANCE: THE STAKEHOLDER CHALLENGE 20 (2001)). See CLR STEERING GROUP FINAL REPORT, *supra* note 87, at xi. The report reads:

Our law should provide the maximum possible freedom combined with the transparency necessary to ensure the responsible and accountable use of that freedom [C]ompany law should reflect the reality of the modern corporate economy, where those who run successful companies recognise the need to develop positive relationships with a wide range of interests beyond shareholders—such as employees, suppliers and customers.

Id.

⁸⁹ Williams & Conley, *supra* note 2, at 516; CLR STEERING GROUP FINAL REPORT, *supra* note 87, at xvii.

mechanism on which we focus is its recommendation that the previously voluntary OFR be made mandatory.⁹⁰ It suggested that all companies of “significant economic size” be required to prepare an OFR as part of their Annual Report and Accounts, and that the OFR “provide a review of the business, its performance, plans and prospects, and information the directors judge necessary for an understanding of the business, such as relationships with employees, suppliers and customers, environmental and community impact, corporate governance and management of risk.”⁹¹

The British government “reacted favorably to many of the CLR Steering Group’s proposals, including the OFR initiative.”⁹² Ultimately, on March 21, 2005, the statute enacting it was passed.⁹³ In its introduction to a set of draft regulations in 2004, the Government gave a number of examples of the sort of information that corporate directors might determine should be disclosed in the OFR, including:

- an explanation of risk management approaches employed by a company that stores, transports or uses significant volumes of hazardous or toxic substances that risk damaging the health of workers or others, or polluting the environment;⁹⁴
- how a company that is a heavy user of natural resources, which may become scarce or the price of which may change significantly, is intending to reduce its dependency on such resources;⁹⁵
- how a company that may be susceptible to the impacts of climate change plans to mitigate the risks and take advantage of the opportunities presented by a changing climate;⁹⁶

⁹⁰ See CLR STEERING GROUP FINAL REPORT, *supra* note 87, at xix.

⁹¹ *Id.* at xix, 49.

⁹² Williams & Conley, *supra* note 2, at 516-17.

⁹³ See The Companies Act 1985 (Operating and Financial Review and Directors’ Report etc.) Regulations 2005, S.I. 2005/1011 (U.K.), available at <http://www.opsi.gov.uk/SI/si2005/20051011.htm>. For further discussion of the interim steps in this process, and in particular the quite important redefinition of “materiality” that was part of the OFR process, see Williams & Conley, *supra* note 2, at 515-23.

⁹⁴ U.K. Dep’t of Trade & Indus., Draft Regulations on the Operating and Financial Review and Directors’ Report: A Consultative Document, para. 3.33 (2004) (on file with author).

⁹⁵ *Id.*

⁹⁶ *Id.*

- current and likely future compliance record for companies that are operationally dependent upon legal consents for discharges to air, land or water;⁹⁷ and
- an explanation of the risk management approaches employed by a company to assess the operational impact on biodiversity where failure to avoid or mitigate damage would put development consents at risk.⁹⁸

These examples illustrate the impressive breadth of social and environmental risk disclosure expected pursuant to the OFR requirements. In conjunction with the "detailed financial statements in a company's annual report," OFRs were intended "to explain to the outside world clearly and concisely just how the directors were running the business and to provide an understanding of its operating environment, particularly the opportunities and threats it faces."⁹⁹ Consequently, OFRs would combine expanded risk disclosure with financial information and the directors' views, thereby mirroring, and expanding upon, management discussion and analysis ("MD&A") of financial results in the U.S.. Thus, it was clear that social reporting had come of age via the OFR regulations.

The implementing legislation required the directors of a quoted company to prepare an OFR for financial years beginning on or after April 1, 2005, and so the first OFRs pursuant to the statutory requirement would have been issued beginning in April of 2006.¹⁰⁰ In May of 2005, the Accounting Standards Board issued a Reporting Standard concerning OFRs ("Standard"), which "requires directors to prepare an OFR addressed to members, setting out their analysis of the business, with a forward-looking orientation in order to assist members to assess the strategies adopted by the entity"¹⁰¹ It set out the essential principles to which OFRs must adhere; according to the standard, they must "complement and supplement . . . [company's] financial statements[,] be comprehensive and understandable[,] be balanced and neutral[,] and be comparable over time."¹⁰²

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ Phillips & Wyman, *supra* note 3.

¹⁰⁰ See The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005, S.I. 2005/1011 (U.K.), available at <http://www.opsi.gov.uk/SI/si2005/20051011.htm>.

¹⁰¹ See ACCT. STANDARDS BOARD, REPORTING STANDARD 1: OPERATING AND FINANCIAL REVIEW 3 (2005), available at <http://www.frc.org.uk/images/uploaded/documents/ACF345.pdf>.

¹⁰² *Id.* at 3.

The core of the Standard was contained in paragraphs twenty-eight through thirty, which state:

28. The OFR shall provide information to assist members to assess the strategies adopted by the entity and the potential for those strategies to succeed. The key elements of the disclosure framework necessary to achieve this are:
 - a. the nature of the business, including a description of the market, competitive and regulatory environment in which the entity operates, and the entity's objectives and strategies;
 - b. the development and performance of the business, both in the financial year under review and in the future;
 - c. the resources, principal risks and uncertainties and relationships that may affect the entity's long-term value; and
 - d. position of the business including a description of the capital structure, treasury policies and objectives and liquidity of the entity, both in the financial year under review and the future.

Details of particular matters

29. To the extent necessary to meet the requirements set out in paragraph 28 above, the OFR shall include information about:
 - a. environmental matters (including the impact of the business of the entity on the environment);
 - b. the entity's employees;
 - c. social and community issues;
 - d. persons with whom the entity has contractual or other arrangements which are essential to the business of the entity;

- e. receipts from, and returns to, members of the entity in respect of shares held by them; and
- f. all other matters the directors consider to be relevant.

30. For items (a) to (c) in paragraph 29, the OFR shall, in particular, include:

- a. The policies of the entity in each area mentioned; and
- b. the extent to which those policies have been successfully implemented.¹⁰³

The Standard also stated that “to the extent necessary to meet the requirements set out in paragraph 28 . . . , the OFR shall include the key performance indicators, both financial and, where appropriate, non-financial, used by the directors to assess progress against their stated objectives.”¹⁰⁴ Given the OFR requirement’s derivation from risk management and reporting standards, it is not surprising that the Standard included elements of these disciplines. For example, one paragraph in the Standard required company OFRs to “include a description of the principal risks and uncertainties facing the entity, together with a commentary on the directors’ approach to them.”¹⁰⁵ It also required discussion of stakeholder relationships and an analysis of specific aspects of a company’s financial position, including capital structure, treasury policies, cash flows, current and prospective liquidity, and key performance indicators.¹⁰⁶ The Standard emphasized, though, that nothing in it required the disclosure of matters in negotiation if such disclosure, in the eyes of the directors, could be prejudicial to the company.¹⁰⁷

Altogether, the Standard provided a comprehensive and intelligent framework for forward-looking disclosure of a company’s strategy, goals, risks, opportunities, financial performance, and expectations for the future. The framework also gave companies the opportunity to discuss the social and environmental factors that might have an impact on future

¹⁰³ *Id.* at 11-12 (citation omitted). Paragraphs twenty-nine and thirty “reflect the wording in the OFR Regulations.” *Id.* at 12.

¹⁰⁴ *Id.* at 14.

¹⁰⁵ *Id.* at 16-17.

¹⁰⁶ *See id.* at 18-22.

¹⁰⁷ *See id.* at 22.

financial performance. Given problems with financial reporting in the recent past, particularly in the United States, the OFR regulations and Operating Standard seem to have advanced an intelligent policy that would elicit exactly the sorts of information investors ought to have when judging a company's prospects. Its demise as a statutory requirement was, therefore, unfortunate.

II. THE OFR U-TURN

Confidential memos on the Treasury Department's website, posted as a result of litigation threatened by Friends of the Earth, give a unique view into the decision-making process preceding the u-turn. The very posting of the memos seems itself to be an indication of the value of transparency in promoting accountability. Although, in this instance, the documents do not show the Treasury Department's decision-making in a particularly favorable light, the episode provides an excellent example of the direct relationship between transparency and accountability in a democracy. The U.K. Government ought to be commended for its disclosure.

In a 2005 letter to Friends of the Earth, Adam Chapman, writing for the Treasury Solicitor, described the process that led to the decision as having started in July 2005 when "officials at HM Treasury were asked to identify deregulatory opportunities."¹⁰⁸ Yet, one might infer from meeting notes released to Friends of the Earth that the actual idea to scrap the OFR was suggested earlier, specifically in a June 8, 2005 meeting between someone from Hermes, an institutional fund manager, and unidentified HM Treasury officials.¹⁰⁹ The meeting note reads, in its entirety:

Hermes note (08/06):

He thinks the OFR is colossally over-engineered and says this is also what the accountants are saying. If we wanted deregulatory win with appeal to big business, a radical symbolic stripping-down of the OFR would go down incredibly well. I see his point. Is it feasible?¹¹⁰

¹⁰⁸ Letter from Adam Chapman for the Treasury Solicitor to Phil Michaels, Friends of the Earth 8 (Dec. 22, 2005), available at <http://www.hm-treasury.gov.uk/media/BB6/B1/eascpreactionresponse020306.pdf>.

¹⁰⁹ HM Treasury Meeting Notes, *supra* note 6.

¹¹⁰ *Id.*

It seems ironic that Hermes was the apparent author of this suggestion. Hermes is independent of any other financial services group,¹¹¹ avoiding many conflicts of interest faced by other fund managers here in the U.S., like Magellan or Vanguard.¹¹² It describes itself as follows:

We invest funds on behalf of around 240 clients including pension funds, insurance companies, government entities[,] and financial institutions, as well as charities and endowments. However, Hermes' largest client is the BT Pension Scheme (BTPS) who, as owner of Hermes, gives its investment management perspective a unique insight and close alignment to the needs of other long-term investors and especially pension funds.¹¹³

Hermes invests in underperforming companies that are fundamentally sound and works with them to turn things around.¹¹⁴ Moreover, scholars have credited Hermes for being explicit about the need for investors to establish long-term relationships with companies and for companies to "manage effectively relationships with their employees, suppliers[,] and customers" as well as to provide high ethical standards and "environmentally and socially responsible behaviour. . . ."¹¹⁵ The kind of thoughtful management and long-term perspective that the OFR sought to encourage would seem to be precisely what a firm like Hermes would favor. It is possible that Hermes perceived a potential competitive disadvantage if the kind of knowledge it developed in its "long-term relationships with companies" became more freely available. That explanation is supported by a published quote of Hermes' Associate Director for Governance and Engagement, Paul Lee, who broke ranks with most institutional investors and supported the OFR u-turn, asserting that information should be available based on "[d]iscussions [that] should be between two parties:

¹¹¹ See Hermes Pensions Management Limited, About Hermes: Introduction, <http://www.hermes.co.uk/about/introduction.htm> (last visited Mar. 1, 2007).

¹¹² See, e.g., Stephen J. Choi & Jill E. Fisch, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 YALE L. J. 269 (2003) (discussing conflicts of interest on Wall Street).

¹¹³ See About Hermes: Introduction, *supra* note 111.

¹¹⁴ See John Armour, Simon Deakin & Suzanne J. Konzelmann, *Shareholder Primacy and the Trajectory of UK Corporate Governance*, 41 BRIT. J. OF INDUS. REL. 531, 548 (2003).

¹¹⁵ *Id.* at 548.

companies and their owners who should be able to develop practical guidance and best practice between them.”¹¹⁶

Once the suggestion to scrap the OFR requirements was planted, it took root quickly. Soon after the meeting with Hermes, HM Treasury completed a policy and political analysis of the potential effects of dropping the OFR requirements. Treasury concluded that, after an “odd moan” about the wasted expense of having begun to prepare annual OFRs,¹¹⁷ the main challenge would be dealing with possible “handling issues.”¹¹⁸ Treasury predicted that “[c]hanging the requirement so soon would be perceived in some quarters as a U-turn”¹¹⁹ and “muddled Government policy in this area.”¹²⁰ But it also divined that businesses would welcome the OFR pull-back,¹²¹ which ended up being largely correct. An editorial writer for the Times of London, a publication that which represents the most conservative strand of British business opinion, praised the decision, writing “[t]he Government’s decision to repent on this nonsense is to be welcomed.”¹²² The Confederation of British Industry also pronounced itself “delighted” by the decision.¹²³

On balance, however, the response from business appeared tepid. Treasury’s own analysis recognized that the OFR requirements were “intended to increase transparency in reporting and ha[d] been welcomed, or at least accepted, by most stakeholders, including directly affected businesses.”¹²⁴ Indeed, Miles Templeman, the director-general of the Institute of Directors, “concede[d] the scrapping of the OFRs has had a mixed reaction among his members.”¹²⁵ Also, Peter Montagnon of the

¹¹⁶ Clare Bettelley, *Investors Lobby Government to Promote OFR*, FIN. WEEK, Mar. 24, 2006, <http://www.financeweek.co.uk/cgi-bin/item.cgi?id=3421&d=pnd&h=pndh&f=pndf>.

¹¹⁷ Note to Chancellor on OFR Deregulatory Opportunity, *supra* note 16, at 5.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ See HM Treasury, Operating and Financial Review: Internal Discussion Note 6 (Sept. 29, 2005), http://hm-treasury.gov.uk/media/BB5/CF/eascadvice29sept_020306.pdf [hereinafter OFR Internal Discussion Note].

¹²¹ See generally *id.*

¹²² See Patience Wheatcroft, Editorial, *Putting an End to the Numbers Game*, TIMES (London), Nov. 29, 2005, at 41.

¹²³ See Larry Elliott & Ashley Seager, *Brown Pledges to Cut Red Tape in Drive to Woo Industry*, GUARDIAN, Nov. 28, 2005, at 1, available at <http://business.guardian.co.uk/story/0,,1652097,00.html> (describing CBI’s sentiment that the OFR requirements were “three times as tough as required by Brussels and would put British firms at a disadvantage against European rivals”).

¹²⁴ See OFR Internal Discussion Note, *supra* note 120, at 1.

¹²⁵ See James Blitz, *Red Tape Removal Proves Controversial*, FIN. TIMES, Nov. 30, 2005, at 3, available at <http://search.ft.com/searchArticle?javascriptEnabled=true&id=051130000917>.

Association of British Insurers wrote that he supported proposals to ensure "the kind of high-quality narrative reporting that investors and companies wanted to see out of [OFRs] but without imposing unacceptable burdens of cost or potential liability."¹²⁶

In the end, few business interests publicly criticized the decision, with the exceptions of insurers,¹²⁷ human resources directors,¹²⁸ and public relations specialists.¹²⁹ Although executives in companies that are CSR leaders often say in private interviews that they would welcome regulation to produce a level playing field, they rarely express that view publicly. In general, companies are loath to get too far in front of their respective industries on CSR issues.¹³⁰

¹²⁶ Miles Templeman & Peter Montagnon, Letter to the Editor, *Companies Should Be Encouraged to Continue with OFR*, FIN. TIMES, Dec. 2, 2005, at 18.

¹²⁷ See, e.g., Jean Eagleshamand & Kate Burgess, *Reporting Rule U-Turn Comes Under Fire*, FIN. TIMES, Nov. 29, 2005, at 2, available at <http://www.ft.com/cms/s/27ab4da4-607c-11da-a3a6-0000779e2340.html> (quoting Peter Montagnon as saying, "[w]e're baffled, bewildered and rather disappointed" by the OFR u-turn). The Association of British Insurers' members hold approximately one-quarter of the U.K. equity market. See Williams & Conley, *supra* note 2, at 536-38 (citing statistic on share ownership in the U.K.). These comments would seem to indicate the commitment of the British insurance interest to their role as investors.

¹²⁸ Such directors saw the value of developing better metrics for the value of a company's human capital. See Richard Donkin, *For Once, Bureaucracy that is Good for Business*, FIN. TIMES, Dec. 8, 2005, at 9. Donkin asserts that the case for OFR reporting and human capital measurement is strong: "The vital signs of a healthy company are the attitudes, skill, knowledge and approaches of its employees." *Id.* He also reported speaking with members of the HR Society in London, where "there seemed to be general dismay at the chancellor's decision but a determination, also, that companies should continue to develop their use and application of employee metrics." *Id.*

¹²⁹ Such specialists had an obvious economic interest in expanded communications requirements. See, e.g., Tom Williams, *CIPR Attacks DTI over OFR U-Turn*, PR WEEK, Jan. 27, 2006, at 3 ("CIPR head of . . . [Public Affairs] Francis Ingham this week described the Government's decision to rescind the OFR . . . as 'surprising and unhelpful.'") CIPR is an acronym for the Chartered Institute for Public Relations. See About the CIPR, <http://www.ipr.org.uk/About/aboutframeset.htm> (last visited Mar. 1, 2007).

¹³⁰ See, e.g., Ruth V. Aquilera et al., *Putting the "S" Back in CSR: A Multi-level Theory of Corporate Social Responsibility*, 32 ACAD. OF MGMT. REV. (forthcoming July 2007) (developing a theoretical model for understanding companies' motivations to initiate CSR programs and asserting that, because companies' relational motivations within their industries can be stronger than their competitive, self-interested motivations, companies do not compete on CSR grounds to the extent otherwise expected); Pratima Bansal & Kendall Roth, *Why Companies Go Green: A Model of Ecological Responsiveness*, 43 ACAD. OF MGMT. J. 717, 727-28 (2000) (discussing the results of interviews with executives in 53 firms in five industries and reporting that there exists tremendous field cohesion, that industries have strong social norms that are imposed within the industry, and that companies express the view that they do not want to lead or be out front on environmental issues).

Treasury's political analysis further assumed that investors would be "neutral to broadly supportive" of the pull-back,¹³¹ beliefs that subsequent events proved to be widely off the mark.¹³² The political analysis did predict opposition,¹³³ which it assumed would be from "environmental groups[,] trade unions,"¹³⁴ and from the "significant lobby" of CSR groups.¹³⁵ The main task Treasury perceived was to "balance the concerns of CSR groups, environmental groups, and unions, with those of investors and businesses."¹³⁶ Treating the concerns of those interests as in simple opposition to each other, however, ignored the trends in London over the past ten years, where many institutional investors and some businesses had incorporated the concerns of CSR activists into their strategies.¹³⁷

At the time this policy change was being considered by Treasury, the U.K., like the rest of Europe, was under a directive from the EU to improve narrative reporting and forward-looking information.¹³⁸ The decision within Treasury was framed as a choice between the OFR as it had developed versus a roll-back to the impliedly less-demanding Directive.¹³⁹ The Directive and the OFR were in fact very similar in several important respects. They used parallel language, with the OFR regulations drawing substantially from the Directive's language, even though the OFR process had begun earlier. Both required the discussion of "environmental, social, and employee matters 'to the extent necessary' to provide an informed understanding of [a] company's strategic development, performance, current position, and future risks and uncertainties."¹⁴⁰ Both required the use of "key performance indicators" for financial matters, and for non-financial matters such as the environment or employee issues "where appropriate" to provide a balanced and comprehensive analysis.¹⁴¹ Significantly, how

¹³¹ Note to Chancellor on OFR Deregulatory Opportunity, *supra* note 16, at 5.

¹³² See *infra* Part III.

¹³³ See OFR Internal Discussion Note, *supra* note 120, at 6.

¹³⁴ See *id.* at 1.

¹³⁵ *Id.* at 5.

¹³⁶ *Id.*

¹³⁷ See, e.g., *The Case for Corporate Social Responsibility*, MAD.CO.UK, Apr. 2, 2007, <http://www.mad.co.uk/Main/News/Disciplines/Marketing/Articles/c1137acb5ff144108bf0f68c213ba4f1/The-case-for-corporate-social-responsibility.html> (reporting that "[i]n 1998, 28% of UK consumers considered good corporate social responsibility to be an important purchasing decision factor. By 2002, this figure had risen to 44%").

¹³⁸ See Williams & Conley, *supra* note 2, at 505-09 (discussing harmonization of company law in the EU, and its Accounts Modernization Directive ("Directive")).

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 522.

¹⁴¹ Compare Directive 2003/51/EC, *supra* note 80, with The Companies Act 1985 (Operating

ever, the reporting requirements of the OFR were much more specific than those of the Directive, particularly as the OFR requirements had been defined by the Accounting Standards Board's Standard.¹⁴² Consequently, the OFR pull-back has left companies and their accountants with less guidance on how to conform their reporting to law, although they can certainly continue to use the Standard on a voluntary basis.

HM Treasury's analysis assumed that the primary cost savings to companies from scaling back the OFR would come from adopting the less onerous auditing standard of the Directive. The Directive requires an audit opinion that the expanded narrative report is consistent with the accounts, while the OFR would have required an opinion that nothing came to the auditor's attention that was inconsistent with the OFR.¹⁴³ According to a Treasury memo, "[t]he argument is that information about the fuller picture is not verifiable against accounts and so other sources need to be considered. OFRs capture more of this sort of information than the expanded directors' report, which is why only OFRs would be subjected to the higher assurance standard."¹⁴⁴ Using DTI figures for the additional costs of this audit requirement—an extra £29.3 million in total, or £22,713 per company¹⁴⁵—Treasury determined the extra value of the OFR was not worth the additional cost:

There is no question that a statutory, and more comprehensively audited, OFR has clear benefits but we are not persuaded that the cost to quoted companies justifies this level of regulation. Rolling back to the requirements of the EU Accounts Modernisation Directive minima would reduce business costs . . . [but] would nonetheless still result in an appreciable improvement in narrative reporting (compared to the pre-statutory OFR situation). A substantial

and Financial Review and Directors' Report etc.) Regulations 2005, S.I. 2005/1011 § 234ZZB(3) (U.K.), available at <http://www.opsi.gov.uk/SI/si2005/20051011.htm>.

¹⁴² Compare Directive 2003/51/EC, *supra* note 80, with The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005, S.I. 2005/1011 (U.K.), available at <http://www.opsi.gov.uk/SI/si2005/20051011.htm>.

¹⁴³ Compare Directive 2003/51/EC, *supra* note 80, with The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005, S.I. 2005/1011 § 235 (U.K.), available at <http://www.opsi.gov.uk/SI/si2005/20051011.htm>.

¹⁴⁴ OFR Internal Discussion Note, *supra* note 120, at 4.

¹⁴⁵ *Id.* at 5.

part of the benefits identified by the DTI (including enhanced credibility and improved investor relations, lower average cost of capital and more liquid capital markets) should still be realised.¹⁴⁶

Treasury's analysis seems suspect on several grounds. First, its assessment of the relative burdens of the two standards seems backwards. The OFR standard appeared not to trigger any duty unless the auditor had actually seen something that was inconsistent with the company's representations in its OFR.¹⁴⁷ In other words, it did not appear to create any affirmative duty to investigate. By comparison, the Directive's standard appears much more open-ended, with its requirement that the company's narrative report be adjudged consistent with accounts.¹⁴⁸ Second, the cost estimates, which are curiously specific to the last pound, strike us as speculative at best. The internal Treasury memos mention a need to confirm these figures with DTI,¹⁴⁹ but there is no evidence that this actually happened.

Even if the Treasury's analysis of burden were correct, one might be forgiven for thinking that £22,713 per company is a fairly modest price to pay for the benefits DTI had identified from the OFR—enhanced credibility, improved investor relations, lower average cost of capital, and more liquid capital markets.¹⁵⁰ As one member of the Company Law Reform Steering Group wrote:

The worst kind of dumbing down of company law was how one eminent lawyer described to me the chancellor's decision last week to scrap the operating and financial review. The worst of it is that this policymaking on the hoof will do little to simplify regulation or reduce costs for UK business—the supposed [pound sterling] 30m of savings

¹⁴⁶ Note to Chancellor of HM Treasury on Operating and Financial Review (OFR) Regulations: Proposal to Roll-Back to EU Minima 7 (Nov. 11, 2005) [hereinafter Note to Chancellor on OFR Proposal to Roll-Back], *available at* <http://www.hm-treasury.gov.uk/media/BB5/C2/eascadvice11nov020306.pdf>.

¹⁴⁷ See *supra* note 143 and accompanying text.

¹⁴⁸ See *supra* notes 143 and accompanying text.

¹⁴⁹ OFR Internal Discussion Note, *supra* note 120, at 5 (“[T]his increment seems unusually large. We need to confirm that the DTI RIA [regulatory impact analysis] did not make an error.”); Note to Chancellor on OFR Deregulatory Opportunity, *supra* note 16, at 1 n.1 (“Note—all costs taken from DTI RIA, dated 8 October 2004. These costs should be verified with DTI.”)

¹⁵⁰ See OFR Internal Discussion Note, *supra* note 120, at 1.

has a very plucked from the air look about it—because listed companies will still have to produce a similar document to comply with the European Union's accounts modernisation directive.

This calls for more social and environmental reporting. Yet it will not contain the forward looking information required by the OFR on business prospects. Nor will it encourage a proper discussion of those business drivers and risks that are not captured by historic cost accounting, which was a vital part of the OFR's purpose.¹⁵¹

III. REACTIONS TO THE OFR U-TURN

If this were simply an example of a government policy choice that miscalculated the politics of a situation, it might not be very interesting, and it certainly would not be unique. Yet, the *way* that the Treasury department miscalculated the politics of the situation makes this worth exploring, as are the implications for corporate governance. First, the interests of the accountancy profession were not mentioned in the October 11, 2005 analysis of whether to scrap the OFR.¹⁵² By November 11, 2005, when the decision was final and Treasury was working out "handling issues," Treasury had recognized that the "audit profession may have concerns about reducing the scope of corporate reporting and loss of an anticipated workflow."¹⁵³ This, however, understated the affected interests quite substantially.

While the accounting profession certainly had financial interests in the OFR regulations, its commitment to them cannot be fairly described as purely mercenary. Part of the commitment was historical; the requirements had originated in the accountancy profession, and its members had been influential in shaping it. For example, the Turnbull Committee's guidance report on internal control, a project of the Institute of Chartered Accountants in England and Wales, had first argued that businesses should identify and manage a wide range of business risks and also evaluate internal controls with respect to those risks.¹⁵⁴ A report on the

¹⁵¹ John Plender, *Out of the OFR Mess*, FIN. TIMES, Dec 5, 2005, at 26.

¹⁵² See Note to Chancellor on OFR Deregulatory Opportunity, *supra* note 16.

¹⁵³ *Id.* at 3.

¹⁵⁴ See INST. OF CHARTERED ACCT. IN ENG. AND WALES, IMPLEMENTING TURNBULL: A BOARDROOM BRIEFING 4 (1999), available at <http://www.icaew.co.uk/index.cfm?route=>

implementation of Turnbull concluded that “the [Turnbull] guidance has contributed to a marked improvement in the overall standard of risk management and internal control since 1999,”¹⁵⁵ and, considering the October, 2005 date, ironically concluded that “[t]aken together with the Operating and Financial Review, the internal control statement [in the annual report] provides an opportunity for the board to help shareholders understand the risk and control issues facing the company”¹⁵⁶

As these statements suggest, accountants had embraced the importance of enhanced reporting as a technique for improving company management and producing better information for investors. Literally days before the OFR pull-back, the Association of Chartered Certified Accountants (“ACCA”), an international association of 105,000 accountants, published a report on how expanded reporting could “drive the business forward.”¹⁵⁷ Letters written by accountants or officials in accountancy organizations in response to Treasury’s decision emphasized the *business* benefits of the OFR, not the social or environmental aspects of the enhanced reporting.¹⁵⁸ A letter from Seamus Gillen of Glenfen, the reputation

120612. The Combined Code on Corporate Governance is a synthesis of influential corporate governance analyses and recommendations of Cadbury, Greenbury, Hampel, and Higgs, and includes the London Stock Exchange’s requirements that listed companies comply or explain their non-compliance with the Code. *See* FIN. REP. COUNCIL, COMBINED CODE ON CORPORATE GOVERNANCE pmb1. para. 4 (2003) [hereinafter FRC, COMBINED CODE], available at http://www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf.

¹⁵⁵ FIN. REP. COUNCIL, INTERNAL CONTROL: REVISED GUIDANCE FOR DIRECTORS ON THE COMBINED CODE 1 (2005) [hereinafter FRC, INTERNAL CONTROL], available at <http://www.frc.org.uk/documents/pagemanager/frc/Revised%20Turnbull%20Guidance%20October%202005.pdf>.

¹⁵⁶ *Id.* at 2.

¹⁵⁷ ASS’N OF CHARTERED CERTIFIED ACCT., OPINION PAPER: OFR, STRATEGY AND REPUTATION 3 (2005), available at <http://www.accaglobal.com/pdfs/tech-sar-002.pdf>.

¹⁵⁸ *See, e.g.,* Tony Good & John Rogers, Letter to the Editor, *Chancellor has Given Succour to Businesses That Do Not Wish to Explain or to be Held Accountable*, FIN. TIMES, Nov. 30, 2005, at 18. According to Good:

The OFR is not inherently prescriptive; it is not focused solely on social and environmental strategies and is not an example of the European gold plating that so concerns the chancellor.

The OFR was a carefully evaluated proposal arising from the Company Law Review, and has commanded a broad measure of support, especially from investors.

Id. *See also* David Phillips & Peter Wyman, Letter to the Editor, *Do Not Confuse Good Practice with Red Tape*, FIN. EXPRESS, Dec. 6, 2005, http://www.financialexpress-bd.com/index3.asp?cnd=12/6/2005§ion_id=4&newsid=9002&spcl=no (“The OFR was never designed to replace the detailed financial statements in a company’s annual report, but rather to give a complementary and user-friendly overview of business-critical issues to

and risk management consultancy which collaborated with ACCA in its study, represents the typical perspective:

The reason the chancellor's decision has been met with such dismay, including a challenge from the floor of the CBI conference itself, is because many companies perceived the advantages OFR-style reporting would bring. Apart from the increased transparency generated by stronger levels of disclosure, our work with companies confirmed that they saw the opportunity for using the exercise to drive improvements in performance, and to produce tangible benefits that exceeded the costs.¹⁵⁹

The Financial Reporting Council ("FRC"), the "unified, independent regulator" for corporate reporting and governance in the U.K., comprised of "the Accounting Standards Board, the Auditing Practices Board, the Financial Reporting Review Panel, the Accountancy Investigation and Discipline Board, and the Professional Oversight Board for Accountancy" put out a frosty press release on November 29, 2005.¹⁶⁰ In it, the FRC "noted the announcement made . . . by the Chancellor of the Exchequer" and, in a model of understatement, stated that "[t]he announcement has implications for a number of the FRC's operating bodies."¹⁶¹ After promising to make further announcements "[a]s the Government's detailed plans for removing the statutory requirement for the OFR (while retaining the requirement for an enhanced business review in the director's report) become clearer,"¹⁶² the FRC provided a cogent summary of the profession's views:

enable readers to reach a better informed view of the company's performance."); Charles Tilley, Opinion, *A Lost Opportunity on Reporting Rules*, FIN. TIMES, Nov. 30, 2005, at 19.

Without a form of narrative reporting such as the OFR, business reporting remains essentially backward looking and focused on historical financial statements. The financial statements do not—and cannot—cover strategy, intangible assets, prospects, opportunities[,] and risks. One of the key objectives of the OFR is to assist members [investors] "to assess the strategies adopted by the entity and the potential for those strategies to succeed."

Id.

¹⁵⁹ See Seamus Gillen, Letter to the Editor, *A Setback in Search for Growing Trust*, FIN. TIMES, Dec. 1, 2005, at 22.

¹⁶⁰ Press Release, Fin. Rep. Council, The Operating and Financial Review (Nov. 29, 2005), available at <http://www.icaew.co.uk/index.cfm?route=124411>.

¹⁶¹ See *id.*

¹⁶² *Id.*

The FRC has long believed that the publication of a narrative explanation of a company's development, performance, position and prospects should be encouraged as an important element of best practice in corporate reporting. The ASB first produced a statement of best practice in 1993 (updated in 2003). A significant number of FTSE 100 companies already publish an OFR. Regardless of whether or not an OFR is a statutory requirement, the FRC's view of best practice remains unchanged. . . . [The ASB's Reporting Standard] is the most up-to-date and authoritative good source of best practice guidance for companies to follow.¹⁶³

HM Treasury entirely missed the accountancy profession's intellectual commitment to risk management and internal control, an action that is particularly frustrating in a post-Sarbanes-Oxley world where many U.S.-listed British companies need to discuss their internal financial controls anyway. Indeed, Treasury was stunningly obtuse in ignoring the accountants' embrace of the OFR as part of a process to force boards of listed companies to think carefully about a broad range of potential risks to company strategy, operations, and reputation.

Treasury, in addition, badly misread investor sentiment on the OFR regulations, thinking that investors would be "neutral to broadly supportive."¹⁶⁴ Some investors clearly were sympathetic, or at least not particularly opposed, to the roll-back. As noted above, Hermes was cited in Treasury documents as a source supporting the idea of the roll-back.¹⁶⁵ Treasury said that its analysis was based on a poll in which 34% of investors had opposed the original proposals.¹⁶⁶ However, that same poll showed that 41% of fund managers said that they supported the proposal.¹⁶⁷ From a qualitative perspective, the intensity of support of those investors who saw value in the OFR requirements has been higher than the intensity of opposition of those who did not. As the Financial Times put the point:

¹⁶³ *Id.*

¹⁶⁴ Note to Chancellor on OFR Deregulatory Opportunity, *supra* note 16, at 5.

¹⁶⁵ See Letter from Adam Chapman, *supra* note 108.

¹⁶⁶ Note to Chancellor on OFR Deregulatory Opportunity, *supra* note 16, at 5.

¹⁶⁷ See *id.*

[T]he [OFR] concept is popular with investors and many leading companies already include an OFR in their annual reports.

Mr. Brown's decision to scrap the OFR at this late stage shows a poor grasp of the difference between necessary government regulation and superfluous red tape.¹⁶⁸

Consequently, investors and investor organizations, as the accountants had, immediately burst into print with criticism of the decision. For example, the lead sentence of one November 29, 2005 article read: "Gordon Brown was lambasted by investors, accountants and environmentalists yesterday for abandoning plans to force listed companies to disclose more about their operations."¹⁶⁹ Investors were quoted in the article as being "surprised and disappointed,"¹⁷⁰ and in a later article were described as being "aghast."¹⁷¹ The November 30th letter to the editor by Tony Good, Chairman of the Accounting Advocacy Committee, and John Rogers, Chief Executive of the U.K. Society of Investment Professionals, is illustrative of the tenor of many such comments:

At a time when the introduction of international financial reporting standards has concerned many that financial reports are becoming less coherent, it seems very strange to play down a measure that provides a coherent framework for explaining the results and management's strategies for the business. . . .

. . . To conclude—at this very late stage and in the face of the needs of the investor community—that such an initiative is burdensome "red tape," is frankly absurd.¹⁷²

¹⁶⁸ Editorial, *One Step Forward, Two Steps Back*, FIN. TIMES, Nov. 29, 2005, at 18 ("Worse [than the news that the Chancellor was going to study 'why Britain gold-plates so much European regulation'] was his unexpected decision to abolish what he surprisingly described as an example of goldplating—the operating and financial review.").

¹⁶⁹ Patrick Hosking, *Chancellor's U-turn Over Reviews Sparks Fury*, TIMES ONLINE, Nov. 29, 2005, <http://business.timesonline.co.uk/article/0,,9063-1895293,00.html>.

¹⁷⁰ *Id.* (quoting Anita Skipper, head of governance at Morley, "which invests £148 billion on behalf of Norwich Union policyholders").

¹⁷¹ Robert Bruce, *Who Thrived and Suffered Through 2005*, FIN. TIMES, Dec. 22, 2005, at 14 (describing analysts, companies, and investors as being "aghast" with the OFR pull-back).

¹⁷² Good & Rogers, *supra* note 158, at 18.

The Treasury's analysis missed an important shift among many investors in the U.K.. These investors increasingly understand that companies must manage a wide range of potential risks, including social, environmental, and business probity risks.¹⁷³ As investors, they want information that shows them that their companies have an intelligent risk management system in place. Management's improper handling of social and environmental issues would seem to be one reason for institutional investors to *intervene* with management to fulfill institutions' fiduciary duties to their shareholders. But by perceiving social and environmental concerns to be inevitably in opposition to financial and business concerns, Treasury failed to comprehend the extent to which sophisticated investors in London now understand the direct connections between the two.¹⁷⁴

Treasury was correct in one aspect of its political analysis: that environmentalists, trade unions, and other groups would oppose its decision.¹⁷⁵ As expected, those groups also burst into print with astonishment and outrage.¹⁷⁶ That outrage reached its apogee with Friends of the

¹⁷³ See, e.g., INT'L LIBRARY OF ENVTL. ECON. AND POLICY, CORPORATE STRATEGIES FOR MANAGING ENVIRONMENTAL RISKS 1 (2004), available at <https://depot.erudit.org/retrieve/904/2004s-43.pdf>.

¹⁷⁴ See, e.g., ASS'N OF BRITISH INSURERS, DISCLOSURE GUIDELINES ON SOCIALLY-RESPONSIBLE INVESTMENT 1-4 (2003), available at http://www.ivis.co.uk/pages/gdsc7_1.PDF (discussing the disclosure expected of public companies on social, environmental, ethical, and economic issues); INSTITUTIONAL SHAREHOLDERS COMM., THE RESPONSIBILITIES OF INSTITUTIONAL SHAREHOLDERS AND AGENTS—STATEMENT OF PRINCIPLES 1 (2005), available at http://www.manifest.co.uk/links_search/StatementofPrinciplesRevisedFinalSeptember200511.pdf. The Institutional Shareholders' Committee is comprised of the Association of British Insurers, the National Association of Pension Funds, and the Investment Management Association, representing an overwhelming majority of institutional funds under management. See generally Williams & Conley, *supra* note 2, at 536-47 (discussing this shift in thinking amongst many institutional investors in London).

¹⁷⁵ Note to Chancellor on OFR Deregulatory Opportunity, *supra* note 16, at 1.

¹⁷⁶ See, e.g., Deborah Doane & Brendan Barber, Letter to the Editor, *Government Has a Lot to Explain on OFR Abolition*, FIN. TIMES, Dec. 1, 2005, at 22 ("Gordon Brown's announcement that the government is to abolish the newly introduced operating and financial review is a slap in the face for those trying to ensure that business is more accountable for its wider impacts on society and the environment . . ."); Jill Treanor & Mark Milner, *Brown Plan to Cut Red Tape for Business Provokes Chorus of Disapproval*, GUARDIAN, Nov. 29, 2005, <http://business.guardian.co.uk/story/0,1653143,00.html> ("Gordon Brown's efforts to mend the Labour government's relationship with big business backfired spectacularly yesterday when the centrepiece of his proposals to cut red tape ran into a chorus of criticism from an unlikely alliance of business leaders, City investors, trade unions and green activists.").

Earth's almost immediate turn to litigation,¹⁷⁷ filing a press release on December 7, 2005 stating its belief that the decision was "procedurally unfair, irrational/perverse, a breach of legitimate expectation . . . based upon material errors of fact," and thus "unlawful."¹⁷⁸

IV. THE LEGISLATIVE STATUS IN 2006

The withdrawal of the OFR left a "policy vacuum."¹⁷⁹ Given the need to pass legislation to conform with the EU Accounts Modernization Directive, the Government could not just lie low and wait out the bad press.¹⁸⁰ Rather, it had to do something to develop the requirements for the Business Review. Moreover, because the Companies Bill¹⁸¹ contained references to the OFR requirements, the Government needed to bring forward amendments to that Bill, which had been introduced in the House of Lords on November 1, 2005.¹⁸² Thus, on December 15, 2005, DTI Minister Alan Michael "invit[ed] views from interested parties by 15th February" about the Companies Bill amendments, and requirements for the Business Review, even as he clarified the reporting requirements for businesses in light of the OFR withdrawal.¹⁸³

The "clarification" was a model of trying to appease all factions, starting with its commitment to business "not to impose regulatory requirements on U.K. businesses over and above relevant EU Directive requirements,"¹⁸⁴ or in the current British jargon, not to "gold-plate" such Directives. The U.K. government then extended a tentative olive branch to civil society by recognizing the importance of companies reporting on "non-financial

¹⁷⁷ See Jean Eaglesham, *Legal Challenge on Brown's U-Turn*, FIN. TIMES, Dec. 8, 2005, at 3 ("The legal action is likely to fuel the controversy about the last-minute abolition of the rules, which was welcomed by business groups as a deregulatory step but has been attacked by investors, trade unions and green lobbyists.").

¹⁷⁸ Press Release, Friends of the Earth, *Brown Faces Legal Challenge After Scrapping OFR* (Dec. 8, 2005), available at http://www.foe.co.uk/resource/press_releases/brown_faces_legal_challenge_07122005.html.

¹⁷⁹ Barney Jopson, *Brown's U-Turn on Reporting Defended as a Recalibration*, FIN. TIMES, Dec. 16, 2005, at 2.

¹⁸⁰ See Council Directive 2003/51/EC, *supra* note 80.

¹⁸¹ This became The Companies Act, 2006. See *supra* note 26 and accompanying text.

¹⁸² See U.K. Department of Trade and Industry, *Company Law Reform: Small Business Summary*, <http://www.dti.gov.uk/files/file23007.pdf> (last visited Mar. 1, 2007).

¹⁸³ Alun Michael, Minister for Industry and the Regions, Written Ministerial Statement, 440 COMMONS HANSARD 176ws-77ws (Dec. 15, 2005), available at <http://www.publications.parliament.uk/pa/cm200506/cmhansrd/cm051215/wmstext/51215m05.htm>.

¹⁸⁴ *Id.*

issues relevant to the development and performance of the business, including, for example, environmental matters and human capital management, and they will need to do so under the Business Review requirements.”¹⁸⁵ It also tried to mollify the large proportion of companies that had been in the process of preparing their first mandatory OFRs:

Companies that have been preparing to produce an OFR will be able to use that work to produce their Business Review. In addition, many companies have been producing a voluntary OFR from some years, and may wish to continue doing so using work that they have done toward the mandatory OFR. Or they may use that work to improve the quality and depth of their Business Review.¹⁸⁶

This statement went down about as well as the original Treasury decision. In his comments accompanying the above so-called clarification, DTI Minister Michael said that “[g]iven the nature of the proposed change, which is a recalibration of existing policy rather than a fundamental change, and given the extensive evidence collected in the recent consultation process on this issue, it was not considered necessary to carry out further public consultation [on the legislation repealing the OFR].”¹⁸⁷ Calling this policy reversal a “recalibration” is “rather like Napoleon presenting the retreat from Moscow as a ‘slight change of plan,’” quipped Mark Goyder of Tomorrow’s Company.¹⁸⁸ He explained his view thusly:

Over the next five years forward-looking statements will become universal around the world. We need rigour in measuring and reporting on the values and behaviours that are essential to the creation of enduring shareholder value. Investors need to have their finger on the pulse of relationships with customers, employees and suppliers. The OFR standard offers a clear, understandable framework for moving into this new generation of reporting. Companies that have already put in the work have told us that the OFR is

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

¹⁸⁷ Barney Jopson, *Brown’s U-Turn on Reporting Rule Defended as a ‘Recalibration’*, FIN. TIMES (London), Dec. 16, 2005, at 2.

¹⁸⁸ Mark Goyder, Letter to the Editor, *Irony of ‘Slight Change of Plan’ Over OFR*, FIN. TIMES, Dec. 19, 2005, at 18.

strengthening their focus on strategy and their selection of the right performance indicators.

The irony of the "recalibration" is that companies are left with most of the work to comply with a European Union directive, but with added uncertainty and fewer of the benefits that come from focusing on the future. Investors are deprived of a clear and consistent framework which they may use in question companies on the intangibles. This is a costly regulatory blight to impose on business.¹⁸⁹

Indeed, after a brief holiday pause, the uncertainty over what to report, and how, grew as different approaches proliferated. In January, DEFRA, the environmental agency, sent a letter to thousands of businesses reminding them of their obligation to report on significant environmental issues in preparing the Business Review.¹⁹⁰ Yet, months later, fewer than ten percent of businesses knew that they had an obligation to discuss environmental and social aspects of their business in their Business Review.¹⁹¹ The *Financial Times* reported that the DEFRA letter "points to a degree of confusion within government over post-OFR company reporting," even as "the Financial Reporting Council, the corporate reporting regulator, is turning its own OFR reporting standard—now stripped of its statutory backing—into a statement of best practice."¹⁹² Several institutional investors and corporate governance groups who found the reporting requirements confusing wrote to DTI on January 20, 2006, asking it to act to "fill a dangerous policy vacuum created by the sudden abolition of a new corporate reporting rule."¹⁹³ Within days, Parliament was piling on, with "[t]he head of the Commons Treasury Committee . . . rais[ing] doubts over the wisdom of scrapping mandatory OFRs" and a House of Lords committee stating that "the House may wish to ask whether there is adequate co-ordination within government in developing the

¹⁸⁹ *Id.*

¹⁹⁰ See Fiona Harvey & Barney Jopson, *Warning Over Green Reporting Rules Red Tape*, FIN. TIMES, Jan. 24, 2006, at 2.

¹⁹¹ See Kit Bingham, *Companies Reveal Lack of Awareness*, PENROSE FIN., Apr. 3, 2006.

¹⁹² Harvey & Jopson, *supra* note 190, at 2.

¹⁹³ Barney Jopson, *Action Urged to Cut Risk Caused by Abolition of Reporting Rule*, FIN. TIMES, Jan. 23, 2006, at 3. See generally Letter from Francis Ingham, Head of Public Affairs, Chartered Institute of Public Relations, et al., to Alan Johnson, Secretary of State for Trade and Industry (Jan. 20, 2006), available at http://www.usshq.co.uk/downloads/pdf/all_sections/corporate_disclosure_letter_dti.pdf.

underlying policy, given that the OFR requirement was introduced by the secretary of state for trade and industry and its removal was announced by the chancellor.”¹⁹⁴ Then, on February 1, 2006, the potential litigation with Friends of the Earth was settled. As part of the settlement, the government announced that it would re-examine its decision on the OFR requirements as part of its consultation on the Business Review.¹⁹⁵ At this point, Gerald Russell, senior partner at Ernst & Young, probably spoke for many in London when he called the situation a “farce,” explaining, “There was extensive consultation before the OFR was adopted—what on earth is the point of going through it all again? It would be much better to admit the error and reinstate the original position.”¹⁹⁶

Throughout the Spring of 2006, institutional investor activists took the lead in trying to identify an intelligent way forward. The original effort, reflected in the January 20 letter referred to above, was to encourage the government to clarify reporting responsibilities in the short term; this encouragement did not produce a satisfactory result.¹⁹⁷ With the expanded consultation, investors stepped up their efforts, first with a thoughtful letter from Neil Dwane of Allianz Global Investors and Peter Moon of Universities Superannuation Scheme, the chief investment officers of two large institutional investors. They called for a move beyond an “overly ideological debate” to a recognition of the need for “rigorous reporting” to allow investors to “adopt a longer-term investment horizon, take into account the factors that define corporate profitability in the medium and longer term, [and] allocate capital more efficiently.”¹⁹⁸ Then, on March 23, 2006, a letter signed by twenty-seven institutional investors, pension funds, and corporate governance activists was delivered to the DTI.¹⁹⁹ Apparently recognizing that reinstating the OFR was not likely,

¹⁹⁴ Barney Jopson, *Chancellor's Abolition of Reporting Rules Fuels Discontent*, FIN. TIMES, Jan. 28, 2006, at 2 (quoting Lord's Committee).

¹⁹⁵ DEP'T OF TRADE AND INDUS., NARRATIVE BUSINESS REPORTING: A CONSULTATION ON NARRATIVE REPORTING REQUIREMENTS FOR COMPANIES (2006), available at <http://www.dti.gov.uk/files/file23928.pdf?pubpdfdownload=06%2F886>.

¹⁹⁶ Paul Grant, *OFR Back on the Agenda After Government U-Turn*, ACCT. AGE, Feb. 2, 2006, <http://www.accountancyage.com/articles/print/2149618>.

¹⁹⁷ See Letter from Francis Ingham et al., *supra* note 193.

¹⁹⁸ Neil Dwane & Peter Moon, *Time to Speak up on Reporting Standards: Clarity on Performance is Essential if Government Expectations of Long-Term Investment are to be Realised*, FIN. TIMES, Feb. 27, 2006, at 6.

¹⁹⁹ See generally Letter from Anne Richards, Chief Investment Officer, Aberdeen Asset Management, et al., to Alan Johnson, Secretary of State for Trade and Industry (Mar. 23, 2006), available at <http://www.usshq.co.uk/File/pdf/others/CLR%20Letter.pdf>.

and that the debate had become polarized, the letter urged the government to do four things: (1) use the Accounting Standards Board's Reporting Statement as voluntary best practice for compliance with the Business Review;²⁰⁰ (2) address directors' concerns about personal liability by clarifying the policy on good-faith "forward looking" statements and not penalizing directors if events turned out differently than predicted;²⁰¹ (3) align British developments with work being undertaken by the International Accounting Standards Board on comprehensive business reporting;²⁰² and (4) assume a leadership role in "moving to an 'enlightened shareholder value' approach which is focused on the long term."²⁰³ The letter concluded that:

The type of information that companies produce, and in what form they produce it, has a profound impact on the way in which shareholders use that information—and a knock-on effect on the way in which capital markets play their role in i) the efficient allocation of capital and ii) discouraging the externalization of costs on to other companies, society, the environment and future generations. Whilst the above proposals are clearly focused on the needs of long-term responsible investors, the changes that would result would go a long way towards meeting the legitimate expectations of wider stakeholders. These proposals, therefore, represent a workable solution in the short term, and address the Government's medium and long-term objectives.²⁰⁴

The authors of the March 23 letter also articulated ten principles for comprehensive business reporting, reproduced as Appendix A to this Article.²⁰⁵ These principles assumed that international convergence would ultimately require more comprehensive business reporting and that, by including "the totality of variables that influence corporate performance (including extra-financial factors)," improved quality and range of the information reported would enhance both a company's decision-making and

²⁰⁰ *Id.* at 1.

²⁰¹ *Id.* at 1-2.

²⁰² *Id.* at 2.

²⁰³ *Id.* at 2.

²⁰⁴ *Id.*

²⁰⁵ *See infra* app. A.

the judgments made in the capital markets.²⁰⁶ The writers also pointed to “extra-financial factors,” such as

fundamentals that have the potential to impact companies’ financial performance or reputation in a material way, yet are generally not part of traditional fundamental analysis. Some examples are future political or regulatory risks, the alignment of management and board with long-term company value, R&D/innovation, the quality of human resources management, risks associated with governance structure, the environment, branding, corporate ethics, and stakeholder relations.²⁰⁷

Governments, like most people, seem loath to admit error. Thus, the process came to a regrettable, if predictable, conclusion. On May 3, 2006, the Government announced a package of reforms that did not reinstate the OFR requirements and seemingly took up only one of the March 23rd letter-writers’ suggestions: that of providing protection from liability to directors for good-faith statements in their Business Review.²⁰⁸ The Government’s announcement appeared far from apologetic. Indeed, the statements in its press release have an aggressive tone, emphasizing that its “aim has always been to encourage meaningful strategic, forward-looking information to assist shareholder engagement while avoiding disproportionate burdens on business, in line with our better regulation agenda.”²⁰⁹ Thus, it determined that “the additional burden imposed by the statutory OFR requirement is not justified in light of the competitiveness of UK businesses.”²¹⁰ Then, in an unexpected twist, the Government brought attention to what it had long ago decided to do on directors’ duties:

On directors’ duties, the Government amendments seek to put beyond doubt that the need to have regard to certain factors (including the interest of the employees and impact on the environment) is subject to the overriding duty to

²⁰⁶ See Letter from Anne Richards et al., *supra* note 199, app. 1.

²⁰⁷ *Id.* app. 1 n.1.

²⁰⁸ See Press Release, Dep’t of Trade and Indus., New Clauses to Keep Company Law Reform ‘Light Touch’ (May 3, 2006), available at <http://www.gnn.gov.uk/content/detail.asp?NavigatedFromSearch=True&NewsAreaID=2&ReleaseID=199124>; Letter from Anne Richards et al, *supra* note 199, app. 1, para. 8.

²⁰⁹ Press Release, Dep’t of Trade and Indus., *supra* note 208.

²¹⁰ *Id.*

act in the way the director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members [shareholders] as a whole.²¹¹

From a distance, it is not clear why the Government thought it necessary to emphasize this issue in the press release. Having rejected the pluralist, stakeholder model of the corporation early in the Company Law Reform process, it is puzzling that the Government thought it necessary to "put beyond doubt" that directors' duties are focused on the success of the company for the benefit of shareholders.²¹²

Still, as the Companies Bill currently stands, what has been put beyond doubt comes surprisingly close to a stakeholder model of directors' duties, even though the government describes it as "enlightened shareholder value".²¹³ The relevant section reads as follows:

Section 173: Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company's employees,
- (c) the need to foster the company's business relationships with suppliers, customers[,] and others,
- (d) the impact of the company's operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members of the company.²¹⁴

²¹¹ *Id.*

²¹² *Id.*

²¹³ U.K. DEP'T OF TRADE AND INDUS., COMPANIES BILL: PAPER SEEKING VIEWS ON THE APPLICATION OF THE COMPANIES BILL TO EXISTING COMPANIES 29 (2006), *available at* <http://www.dti.gov.uk/files/file33125.doc>.

²¹⁴ Companies Bill, 2006, c. 2, §173 (U.K.)

According to the remarks of DTI Minister for Industry and the Regions Margaret Hodge made during Parliamentary debate, “the elements[—] (1)(a) to (f)—are crucial to any understanding of a corporate responsibility agenda.”²¹⁵ When this provision was being debated in the House of Commons on July 11, 2006, Minister Hodge emphasized the extent to which the provision on directors’ duties is a departure from narrow conceptions of shareholders’ interests:

The clause does codify and bring into law for the first time duties around corporate social responsibility. I do not run away from that; it is a deliberate act by the Government. That is at the heart of the Bill. For me, one of the key issues is how we marry the commercial success of individual companies and the resulting benefits to, and growth and prosperity of, the economy, with sustainability and social justice. Again, for me, that is a good example of what lies at the core of what this Labour Government [is] about: trying to see those two issues as part of a single whole and, despite uncomfortable tensions, trying to integrate them as consistent principles, rather than allow them to be competing ambitions with no commonality.²¹⁶

The Business Review requirement articulates this statement of duties, with its purpose being “to inform members of the company and help them assess how the directors have performed their duty under Section 173 (duty to promote the success of the company).”²¹⁷ More specifically, the provision requires,

to the extent necessary for an understanding of the development, performance[,] or position of the company’s business, . . . information about

- (i) environmental matters (including the impact of the company’s business on the environment);
- (ii) the company’s employees; and
- (iii) social and community issues²¹⁸

²¹⁵ 326 PARL. DEB., H.C. (6th ser.) (2006) 559 (emphasis omitted).

²¹⁶ *Id.* at 582.

²¹⁷ Companies Bill § 423.

²¹⁸ *Id.*

If the review does not contain all of this information, it must provide an affirmative statement of what has been omitted.²¹⁹ In addition, a Review must include, "where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters."²²⁰ Significantly, provisions (I) through (iii) and the "key performance indicators" language are nearly identical to the Accounting Standards Board proposed reporting standard *for the OFR*.²²¹

V. ANALYSIS AND CONCLUSION

Even by the standards of British political melodrama, the OFR saga has been extraordinary. The original proposal, though aggressive, evoked reactions that ranged from enthusiasm to grudging acceptance with surprisingly little outright hostility. On the eve of the OFR's implementation, even those corporate interests that opposed it had invested substantial resources in preparing to comply. At the last minute, however, the Blair Government apparently had an attack of political tone-deafness, overreacting to what was in fact muted criticism, overestimating the opportunity to pander to business interests, and underestimating the broad support that the requirements had engendered. In any event, the pull-back infuriated the OFR's ideological supporters, disappointed many in the investment community, and left the corporate community probably more confused than relieved. It would seem that no one knows just what happens next.

The first question is simple to state, but almost impossible to answer: What is the law of non-financial reporting in the U.K.? As characterized by a writer to the *Financial Times*, the OFR and the related accounting standards "offer[ed] a clear, understandable framework for moving into this new generation of reporting."²²² However, according to the expert commentary reviewed in the preceding section, the new duties imposed by the Business Review seem anything but "clear" and "understandable."²²³

²¹⁹ *Id.*

²²⁰ *Id.*

²²¹ Compare *id.*, with The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005, S.I. 2005/1011 § 234ZZB(3) (U.K.), available at <http://www.opsi.gov.uk/SI/si2005/20051011.htm>.

²²² Goyder, *supra* note 188, at 18.

²²³ *Id.*

What exactly prompted these divergent assessments is unclear. It might be argued that the amended Companies Bill is substantively the same as what the OFR would have imposed. Indeed, the language of the Business Review requirement closely tracks the OFR-implementing Standard promulgated by the Accounting Standards Board.²²⁴ Both approaches call for consideration of and reporting on the environmental, labor, and social aspects of a company's position, performance, and prospects using non-financial "key performance indicators."²²⁵ The Business Review provision is explicit in applying a materiality standard—the repeated "to the extent necessary for an understanding of the development, performance or position of the company's business"²²⁶—but the OFR scheme also makes reference to materiality;²²⁷ in any event, the concept is universal in accounting and auditing. Moreover, the Business Review requires a direct acknowledgment if the directors have judged environmental, labor, or social information to be immaterial.

So perhaps the infamous u-turn was in reality a 360-degree turn, as least as judged in broad outlines. The British ship of state may now be heading in about the same direction as it was in the OFR-driven "spring of hope." The Government certainly invited suspicion when it pulled the OFR in an apparent, if not transparent, effort to pander to short-term business interests. The devious-sounding Treasury memos that quickly surfaced did not help the Government's credibility. Prompted by the ironically progressive House of Lords, however, the U.K. in the end appears to have taken a significant step in the direction of promoting enlightened, long-term shareholder value as the goal of corporate management and reporting. Our early judgment is that the Business Review procedure, working in synergy with the best practices codes and expressions of institutional investor sentiment that came out during the OFR process, could have essentially the same information-forcing power as the OFR. Much of the detailed disclosure required by the Reporting Standard in implementing the OFR will now be voluntary, risking loss of the inclusion of

²²⁴ Compare Companies Bill § 423, with The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005, S.I. 2005/1011 § 234ZZB(3) (U.K.), available at <http://www.opsi.gov.uk/SI/si2005/20051011.htm>.

²²⁵ See Companies Bill § 423; The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005, S.I. 2005/1011 § 234ZZB(3) (U.K.), available at <http://www.opsi.gov.uk/SI/si2005/20051011.htm>.

²²⁶ Companies Bill § 423.

²²⁷ See U.K. DEP'T OF TRADE & INDUS., MODERNIZING COMPANY LAW FOR A COMPETITIVE ECONOMY (2002); see also Williams & Conley, *supra* note 2, at 512-23.

information about areas of a business important to investors that would have occurred under the Reporting Standard as a mandatory standard.²²⁸ Still, investor pressures could mean that the Reporting Standard, now recommended as best practice, becomes the norm.

The potential for "information-forcing" is worthy of emphasis. The OFR was not, and the Companies Bill is not, a specific behavioral code. The Companies Bill requires that directors act with "regard" for social, labor, environmental, and ethical issues, but "in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole."²²⁹ Significantly, the exercise of good faith will protect against director liability. So ultimately, the primary effect of the Companies Act is, and the primary effect of the OFR would have been, to compel an enhanced level of reporting. It will be up to investors, especially institutional investors, to pay attention to and make use of the information they will get, forcefully consulting with their portfolio companies, and, in egregious cases, disinvesting. In terms of corporate theory, the ultimate question is whether shareholders will accept the invitation to become "enlightened."

This prompts two final comments about comparative law, politics, and finance in the U.S. and the U.K. The first concerns the rationality and openness of the entire OFR process, up to and including the u-turn. The OFR process was one of extraordinary consultation among all interested constituencies. When each was given a voice, it turned out that a number of them said surprising things. The process thus produced a relative consensus that seemed surprising, even astonishing, to those of us made cynical by the interest-group wars on this side of the Atlantic. When the Government repudiated the results of the process, Friends of the Earth's deft use of pre-litigation discovery exposed all of the repudiation's ill-informed irrationality. If, as we cautiously predict, the Business Review outcome proves to be the substantial equivalent of the OFR, this exposure will have proved critical. We wonder if the same could have happened here.

Second, the whole episode reveals an aspect of British investment culture that might put its American counterpart to shame. The U.K.'s institutional investors have repeatedly made the case that, as rational, self-interested investors, CSR issues matter to them. These sentiments have been seconded by these investors' accountants. With occasional exceptions

²²⁸ ASS'N OF CHARTERED CERTIFIED ACCT., *THE OPERATING AND FINANCIAL REVIEW: A CATALYST FOR IMPROVED CORPORATE SOCIAL AND ENVIRONMENTAL DISCLOSURE* 4-7 (2005).

²²⁹ Companies Bill §158(1).

usually among high visibility public funds, that clear statement of purpose has been absent in this country. In our judgment, the institutions' leadership has been essential in the U.K. Unless such leadership emerges among American institutions, we would be surprised to see the United States move in the direction of the OFR and Business Review at all.

APPENDIX A

PRINCIPLES FOR BETTER REPORTING AND IMPROVED ACCOUNTABILITY²³⁴

Underpinning our support for enhanced (or comprehensive) business reporting is our belief that it is important to:

1. *Improve company decision-making and risk management:* experience shows that the process of reporting on the drivers of long-term value and risk which are most relevant to their particular company focuses the minds of senior management, and thus helps them actively manage these factors and so improves their decision-making.
2. *Improve investor decision making and so foster long term value creation:* by enabling investors to compare the prospects and performance of companies more accurately, this improves the financial system's focus on long-term value creation and the allocation of capital with benefits for the entire economy and those who have a diversified exposure to it.
3. *Improve stakeholder communication and trust:* without compromising the accountability of companies to shareholders, enhanced business reporting is fully aligned with the "enlightened shareholder value" approach and goes a long way to enabling employees, the community, regulators and all stakeholders to assess better the performance of companies on critical environmental, social and governance issues and to understand their "values in action."
4. *Encourage a shift from compliance to judgement:* recognising that every company is different, there is a clear need for an overall framework which offers companies the flexibility to exercise their judgement and think less in terms of an external standard for reporting but rather to be aware of and focus in a practical way on the real health of their business.

²³⁴ This appendix is reprinted from Letter from Anne Richards, Chief Investment Officer, Aberdeen Asset Management, et al., to Alan Johnson, Secretary of State for Trade and Industry, at app. 1 (Mar. 23, 2006) (footnote omitted), available at <http://www.usshq.co.uk/File/pdf/others/CLR%20Letter.pdf>.

5. *Improve the quality and range of information reported on:* encouraging corporate managers to consider the totality of variables that influence corporate performance (including extra-financial factors) encourages greater use of judgement by capital markets in evaluating and comparing the prospects and performance of companies beyond traditional financial analyses.
6. *Encourage simplicity, brevity and reduce duplication of effort:* by freeing companies to convey information with the minimum of repetition—allowing them to cross-refer readers to other available information outside of the core narrative—companies can create a core narrative which captures, in one place, all the key information and context that is needed for interested parties to form an overall assessment of the company.
7. *Encourage smarter regulation and greater market freedom:* by maintaining a regime that achieves the optimum balance between minimal burden on companies and maximum market transparency and which takes into account of company size and ownership structure.
8. *Protect companies, and in particular individual directors, against inappropriate legal risks:* the risk that evolution in the reporting framework may be used in opportunistic derivative suits and other unwarranted litigation is real and needs joint action.
9. *Accept the right of executives to decline to disclose information where it is in their competitive interest to do so:* investors should respect this rationale and companies should not use it as an easy excuse.
10. *Prepare for international convergence:* by shaping UK reporting regimes so that they are ready for the emerging model of international standards and to play a leadership role in encouraging such convergence, so that any short-term threat of competitive disadvantage to “UK plc” is quickly removed and indeed converted into a first-mover advantage.