CORE Coalition Response to Corporate Governance Reform Green Paper: February 2017

About CORE

CORE is the UK civil society coalition on corporate accountability. We work with our partner organisations to advance the protection of human rights and the environment with regard to the global operations of UK companies, by promoting a stronger regulatory framework, higher standards of conduct, compliance with the law, and improved access to remedy for those harmed by the activities of UK companies.[1]

CORE was established in 2001 to advocate for changes to the UK's corporate governance framework, to ensure that UK companies would operate in a way that would not have serious adverse consequences for people and the environment domestically and internationally. We also called for enforcement measures to make sure that company directors could be held to account for serious malpractice. During the passage of what became the Companies Act 2006, CORE and partner organisations pointed out the limitations of the shareholder primacy model and called for companies to be run in the interests of all stakeholders, not only shareholders. Our view remains that this would lead to more sustainable companies, greater public trust in business, and a reduction in harmful practices throughout companies' operations and supply chains.

CORE has continued to work on corporate transparency and governance issues, principally around the review of narrative reporting requirements in 2012, the development of the UK's Business and Human Rights Action Plan, and the recent transposition of the EU non-financial reporting directive. CORE supported the introduction of the supply chain reporting requirement in the Modern Slavery Act 2015.

This submission is endorsed by Amnesty International UK and Oxfam.

Introduction

CORE welcomes the publication of the Green Paper and the opportunity to respond. This response covers sections 2-4 of the paper.

In the decade since the overhaul of company law, it has become apparent that the current framework of enlightened shareholder value, combined with a voluntary Corporate Governance Code and an emphasis on 'culture' has failed to address egregious corporate malpractice and to provide collective and individual accountability for management failures. New corporate scandals continue to come to light almost daily and public trust in business remains historically low.

Only genuine reform, not minor adjustments and more voluntary schemes can address these issues. Framing the discussion as a choice between 'high standards and low burdens' is outmoded and unhelpful. Instead, the emphasis should be on how to create meaningful accountability to drive a change in practices.

[1] For more information, see www.corporate-responsibility.org

At the G20 summit earlier this year the Prime Minister committed to take "bold action" to create an "economy that works for everyone"[2] The government should seize the opportunity of corporate governance reform to make this happen.

Summary of recommendations

- Primary legislation should be enacted to give workers the right to board-level representation in all listed and private companies with 250 or more workers.
- In companies of 100 or more workers, workers should be able to trigger board representation rights through their unions or bodies established under statutory consultation procedures.
- Mandatory workers' board representation could be introduced in stages according to company size, starting with the largest companies (for example, those with 1,000 or more workers).
- All companies operating in the UK with an annual turnover of more than £36 million should be required to conduct human rights due diligence throughout their operations, and to report on how they have done so.
- Non-financial reporting requirements should apply to all businesses with more than 500 employees, regardless of legal form.
- Section 172(1) of the Companies Act 2006 should be reworded to retain the requirement for directors to promote the success of the company while removing the duty to do so solely for the benefit of its members. A positive obligation on directors to mitigate serious adverse impacts on employees, suppliers, customers, the community and the environment should be created.
- The category of people who can apply to initiate derivative proceedings should be broadened, so that 'anyone who appears to the court to be interested in the company' could apply. This would enable stakeholders who suffer harm to be able to enforce directors' duties.
- Directors who cause serious harm to stakeholders should be liable to disqualification.

Section 1: Executive pay

No response.

Section 2: Strengthening the employee, customers and wider stakeholder voice

Q7. How can the way in which the interests of employees, customers and wider stakeholders are taken into account at board level in large UK companies be strengthened? Are there any existing examples of good practice that you would like to draw to our attention? Which, if any, of the options (or combination of options) described in the Green Paper would you support? Please explain your reasons.

[2] 'Theresa May vows 'bold action' to build economy 'that works for everybody'', Business Reporter, 5 September 2016 https://business-reporter.co.uk/2016/09/05/theresa-may-vows-bold-action-build-economy-works-everybody/

We support the TUC's proposals for worker representation on company boards.[3] The concept is backed by a number of business leaders and investors, including the CEOs of Aberdeen Asset Manager, Legal & General and UBS, as well as the Chairmen of Barclays and Nationwide.[4] Worker board representation is in place across most of Europe, with 19 out of 28 EU Member States plus Norway having some provision for workers' representation on company boards. In 13 of these countries, the rights to worker representation apply across much of the private sector. Transport company FirstGroup plc has had an employee director since the company's inception in 1989.

Q8. Which type of company do you think should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee number or other size threshold?

Workers should have the right to board-level representation in all listed and private companies with 250 or more workers. In companies of 100 or more workers, workers should be able to trigger board representation rights through their unions or bodies established under statutory consultation procedures. Mandatory workers' board representation could be introduced in stages according to company size, starting with the largest companies (for example, those with 1,000 or more workers). Workers' representation rights should apply to a unitary or two-tier board structure.

Q9. How should reform be taken forward? Should a legislative, code-based or voluntary approach be used to drive change? Please explain your reasons, including any evidence on likely costs and benefits.

While there is a role for voluntary initiatives and code-based approaches, legislation creates a level-playing field for all companies within the scope of the law. This avoids a situation where a handful of leading companies take action in response to a voluntary scheme, while others continue with business as usual. A stark example of this was the corporate response to the 'Think, Act, Report' scheme, a voluntary reporting initiative on gender pay inequality in large companies introduced in 2011. While 270 firms including HSBC, Tesco and Vodafone signed up to the scheme, only five companies had published their gender pay gap statistics by March 2015, prompting MPs to vote in favour of introducing mandatory measures.[5]

Section 3: Corporate governance in large, privately-held businesses

Q10. What is your view of the case for strengthening the corporate governance framework for the UK's largest, privately-held businesses? What do you see as the benefits for doing so? What are the risks to be considered? Are there any existing examples of good practice in privately-held businesses that you would like to draw to our attention?

In our response to the government's consultation on the transposition of the EU Non-Financial Reporting (NFR) Directive, we noted that companies' activities may pose risks to people and the environment regardless of the companies' legal form.[6] We therefore support measures that would create a level playing for due diligence, transparency and accountability in all large companies.

Q11. If you think that the corporate governance framework should be strengthened for the largest privately-held businesses, which businesses should be in scope? Where should any size threshold be set?

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[3] 'All Aboard': Making Worker Representation on Company Boards a Reality', TUC, October 2016
[4] 'City figures back May's plan for workers on the board', Financial Times, 19 October 2016 https://www.ft.com/content/009ebf92-9550-11e6-a1dc-bdf38d484582
[5] 'Lib Dems push through mandatory reporting of gender pay gaps', The Guardian, 6 March 2015, https://www.theguardian.com/money/2015/mar/06/lib-dems-push-mandatory-reporting-of-gender-pay-gaps
[6] Response to the EU Non-Financial Reporting Directive: a call for views, CORE Coalition, 15 April 2016, http://corporate-responsibility.org/wp-content/uploads/2016/04/160415_BIS-NFR-consultation_CORE-response.pdf

See response to Q12.

Q12. If you think that strengthening is needed how should this be achieved? Should legislation be used or would a voluntary approach be preferable? How could compliance be monitored?

Legislation should be introduced to require all companies operating in the UK with an annual turnover of more than £36 million (the same scope as the Modern Slavery Act supply chain reporting requirement) to be required to conduct human rights due diligence (HRDD) throughout their operations as described in the UN Guiding Principles on Business and Human Rights (UNGPs),[7] and to report on how they have done so. This would be consistent with the UK Government's commitment to implement the UNGPs. The introduction of such a requirement would have significant potential to prevent human rights abuses occurring in the first instance. A reporting obligation would also ensure that the least transparent "laggard" companies would be required to publish information regarding their assessments of potential adverse impacts on people and the steps taken to mitigate these.

Proposals for mandatory HRDD provisions are currently under discussion in France, Germany and Switzerland.[8]

Q13. Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business?

Yes. We recommend that the reporting requirements introduced into the Companies Act 2006 via the transposition of the EU NFR Directive should apply to all businesses with more than 500 employees, not only quoted companies.

Section 4: Other issues

Q14. Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Apart from the issues addressed specifically in this Green Paper can you suggest any other improvements to the framework?

Section 172 of the Companies Act 2006 describes the Directors' Duties to promote the success of the company for the benefits of its members as a whole, while having regard to the interests of the company's employees and other matters. The major limitations to this model are as follows:

- It requires directors to put the interests of the members of a solvent company ahead of the interests of other stakeholders.[9]

- There is no positive obligation on company directors to take steps to mitigate harmful impacts to stakeholders and the environment.

[7] *UN Guiding Principles on Business and Human Rights*, UN OHCHR, HR/PUB/11/04, 2011, pp. 17-24
[8] 'State regulatory approaches: the trend toward mandatory human rights due diligence and reporting across sectors', Session at the 2016 Forum on Business & Human Rights-November, http://www.ohchr.org/Documents/Issues/Business/ForumSession5/Nov16/StateRegulatoryApproaches.pdf
[9] Written evidence from David Chivers QC to the BEIS Select Committee Corporate Governance Inquiry (CGV0103), http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-energy-and-industrial-strategy-committee/corporate-governance/written/41945.html

- The private enforcement mechanism has not worked and there is no public enforcement mechanism.[10]

- It does not provide meaningful individual or collective accountability for serious malpractice in large companies, creating a sense that people at the top of big business are playing by a dramatically different set of rules to the rest of society, and experience few lasting consequences when employees, customers and consumers suffer as a consequence of management failures. As Prof. John Kay argued in a recent article, corporate wrongdoing arises from individual wrongdoing which should be identified and punished.[11]

To address these issues, we recommend that Section 172 of the Companies Act 2006 should be reworded as follows:

(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, and in doing so—

(a) have regard to the likely consequences of any decision in the long term,

(b) act to mitigate serious adverse impacts on employees, suppliers, customers, the community and the environment,

(c) maintain a reputation for high standards of business conduct

The effect of main clause (1) would be to make the interests of members just one of the factors to which the directors have regard. The effect of (b) and (c) would be to create a positive obligation on directors to take reasonable steps to prevent serious adverse impacts and to maintain a good corporate reputation, rather than merely 'having regard' to these factors in the promotion of the success of the company.

Enforcement mechanism

As PIRC pointed out in its evidence to the BEIS Committee inquiry into corporate governance, enforcement under the Companies Act is generally predicated on legal interpretation by Courts setting case law precedent. There are clearly problems if cases are not taken to test, or if cases are settled prior to judgments to avoid a precedent being set.[12]

In his submission to the same inquiry, Professor Andrew Keay noted that no actions have been brought in the UK for breach of general duties contained in the Companies Act against either directors of any of the financial institutions that collapsed or were bailed out as a result of the global financial crisis, or any other companies that failed as a direct or indirect result of the crisis. This is notwithstanding that several reports have questioned the actions of the boards of directors involved in these companies. For instance, in relation to the bank HBOS, even though it was concluded by the Parliamentary Commission on Banking Standards that the Bank's board 'had abrogated and remitted to the executive management the

[10] Written evidence from Professor Andrew Keay (CGV0010) to the BEIS Select Committee Corporate Governance Inquiry, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-energy-and-industrial-strategy-committee/corporate-governance/written/41581.html

[11] 'Justice has settled for second best in the Rolls-Royce scandal' John Kay, FT, 20 January 2017 https://www.ft.com/content/2c2ffb2e-df08-11e6-86ac-f253db7791c6

[12] Written evidence from PIRC Limited(CGV0154) to the BEIS Select Committee Corporate Governance Inquiry, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-energy-and-industrial-strategy-committee/corporate-governance/written/42451.pdf

formulation of strategy, a matter for which the Board should properly have been responsible,' no director was subject to action. A way to improve the present situation would be to broaden the category of people who can apply to initiate derivative proceedings, so that 'anyone who appears to the court to be interested in the company' could apply.[13] In theory, this would enable stakeholders who suffer harm to be able to enforce directors' duties.

Creating individual director accountability through public sanction

The existing disqualification regime should be reformed to deal with misconduct in relation to solvent companies, beyond breaches of competition law. Other serious misconduct should also be a trigger to disqualification. Individual accountability of this kind would deter directors from breaching their duties and prevent them from exploiting their positions and failing to exert sufficient care and diligence, as well as refraining from overlooking the improper actions or lack of care on the part of colleagues and managers.[14] The government should consider how criminal law could be revised to penalise and deter the most serious misconduct in the UK and through corporate international operations. We recommend this is addressed in the government's response to the Ministry of Justice Call for Evidence on corporate liability for economic crime.

[13] Op cit, n. 10
[14] Ibid.