



Corporate Justice Coalition Response to Restoring trust in audit and corporate governance: July 2021

About Corporate Justice Coalition (CJC)

CJC is the UK's long-standing 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

CJC, previously known as CORE, was established in 2001 to advocate for changes to the UK's corporate governance framework, and to ensure that UK companies operate in a way that does not have serious adverse consequences for people and the environment domestically and internationally. We also call and have called for enforcement measures to ensure that company directors are held to account for serious malpractice.

In 2003, we supported the tabling of a Private Member's Bill, the Corporate Responsibility Bill. During the passage of what became the Companies Act 2006, CJC and its 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.

CJC continues 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. CJC also supported the introduction of the S.54 supply chain reporting requirement in the Modern Slavery Act 2015.

Introduction

CJC welcomes the opportunity to respond to the BEIS department consultation. This response covers chapters 5, 6 and 11 of the report.

The UK Corporate Governance Code was revised in 2018. It now describes the role of the board as being to 'promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society'². This can be seen as a welcome first step towards moving away from shareholder primacy, but one that is unlikely, on its own, to have a significant impact on corporate practice.

The legal framework as it currently stands reinforces the status quo, whereby companies are legally bound to report and deliver maximum financial return to shareholders over and above other wider considerations.

¹ For more information see <https://corporatejusticecoalition.org/>

² <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code>

Genuine reform of corporate governance should reflect changing attitudes in society, wherein most responsible investors and the general public do not want companies to cause significant harm to people and the planet in pursuit of profit³. New corporate scandals continue to come to light almost daily and public trust in business remains historically low.⁴

This year marks the decade anniversary of the United Nations Guiding Principles on Business and Human Rights (UNGPs), the agreed international framework on these issues, supported by the UK Government since its inception. UNGP 3 states that: “States should enforce laws that are aimed at, or have the effect of, requiring business enterprises to respect human rights, and periodically to update the adequacy of such laws to address any gaps.”⁵ It adds that States also should: “... ensure that other laws and policies governing the creation and ongoing operation of business enterprises, such as corporate law, do not constrain but enable business respect for human rights.” Only genuine reform that requires and incentivises responsible corporate conduct can ensure that the UK is upholding this internationally agreed standard.

We propose a number of recommendations for legislative change that should apply to all companies, with a particularly strong emphasis on those whose business activities are linked to significant sustainability risks and impacts. This is critical to ensure that relevant risks and impacts are appropriately addressed, for the long-term sustainability of those companies and the protection of people and planet.

Summary of Recommendations

- All companies operating in the UK should be required to conduct human rights and environmental due diligence throughout their operations, and to report on how they have done so.
- A non-executive committee, composed of independent experts and board members and chaired by a designated nonexecutive director, should be set up and be responsible for monitoring and reviewing the content and implementation of the human right and environmental due diligence process.⁶
- Directors should have a duty of care to monitor the implementation of the human rights and environmental due diligence process.
- Any failure to prevent human rights and environmental harms in a company’s operations and supply chains, or adopting a business model that embeds harmful practices, should be considered a breach of executive directors’ duty of good faith (where deliberate) or duty of care (where accidental⁷), with accompanying civil (based on tortious principles) and criminal liability.
- 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 trade unions or bodies established under statutory consultation procedures.
- Mandatory representation of workers on boards could be introduced in stages according to company size, starting with the largest companies (for example, those with 1,000 or more workers).
- The board should be required to ensure that verifiable targets are included in a human rights and environmental due diligence strategy and that adequate resourcing enables the strategies to be realised.

³ <https://www.socialenterprisemark.org.uk/how-do-companies-actthe-time-for-change-is-now/#footnote>

⁴ <https://www.ukonward.com/generationwhy/>

⁵ https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf

⁶ See the report submitted to the Minister for the Economy and Finance of the French Republic by Patrick de Cambourg, President of the Autorité des Normes Comptables - ‘Ensuring the relevance and reliability of non-financial corporate information: an ambition and a competitive advantage for a sustainable Europe (2019)’, p.205

⁷ Executive directors should have a defence to liability for breach of duty of care where they can show that they reasonably relied on adequate due diligence reports I THINK WE NEED THE RIGHT ADJECTIVE HERE, NO?

- The board should be mandated to discuss and sign-off on an annual progress report on due diligence, which should be included in the company's non-financial report.
- A national regulatory body should be empowered to bring proceedings against the executive directors where non-implementation has failed to prevent serious harm to third parties or harm to the environment.⁸

There must be a right of action for third parties to give evidence to the regulators; trade unions, CSO, environmental organisations.

Chapter 1

No response

Chapter 2

No response

Chapter 3

No response

Chapter 4

No response

Chapter 5

30. Are there any additional duties that you think should be in scope of the regulator's enforcement powers?

The Government's intention is that the regulator's new enforcement powers will apply to breaches by directors of the existing statutory duties relating to corporate reporting and company audits.⁹ These include:

- the duty to keep adequate accounting records¹⁰
- the duty to approve accounts only if they give a true and fair view¹¹

⁸ The Australian Securities and Investments Commission has the power to bring proceedings in the public interest against directors for breach of disclosure regulations and breach of duty, especially where necessary to restore market confidence and integrity: see M Welsh, 'Raising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' (2014) 42 Federal Law Review 1; in the Netherlands, the Enterprise Chamber has far-reaching powers of intervention in the internal affairs of companies, including nullification of corporate resolutions, suspension, dismissal or appointment of directors, and other remedies including dissolution: see J Van Bekkum, S Hijink, MC Schouten and JW Winter, *Corporate Governance in the Netherlands* (2010) 14 Electronic Journal of Comparative Law 1, 4.

⁹ 120 These duties are contained in the Companies Act 2006, Parts 15 and 16.

¹⁰ Companies Act 2006, section 386

¹¹ Companies Act 2006, section 393

- the duty to approve and sign the annual accounts.¹²
- the duty to approve the directors' report.¹³
- the duty to provide a statement as to disclosure to auditors and to provide information or explanations at the request of the auditor.¹⁴

In order to counteract the pressures imposed on directors by financial markets to maximise short-term shareholder value, and in order to increase director accountability and to ensure a proper consideration of corporate long-term interests and human rights and environmental risks, we recommend that additional duties should be considered:

- Directors should be subject to a **legally-binding obligation to develop, disclose and implement, on behalf of the company, a forward-looking corporate strategy that identifies and addresses human rights and environmental risks and significant impacts connected to the company's business model, operations and supply chain.**
 - Companies should adopt targets relevant for the prevention and mitigation of salient human rights and environmental risks and impacts, as identified by the company's mandatory due diligence process and in line with international standards such as the UNGPs and the OECD guidelines.
 - Targets and the narrative supporting them should be framed in a way that enables an assessment of the company's progress by an auditor with regards to addressing identified sustainability risks and impacts, and should be specific, measurable and time-bound.
- Directors should be required to **oversee the quality of the due diligence processes**, and regularly discuss the results of the sustainability risk and impact assessments delivered through these processes.
- **Directors should be required to monitor the progress** of the implementation of the human rights due diligence process and strategy and ensure that it is addressing all salient risks and impacts.
- Directors should be equipped to provide **meaningful oversight**. This would require that they are informed by:
 - Appropriate expertise in the relevant sector (for example garment sector or environmental sector).
 - The perspective of stakeholders affected by impacts identified through human rights and environmental due diligence processes where the company must meaningfully consult with affected stakeholders as part of its ongoing risk identification, analysis and prevention and mitigation obligations.
 - Where appropriate, non-executives should have access to a budget so they can contribute to responsible decision-making and ensure that due diligence processes are being adhered to.

In order to ensure directors' accountability for this responsibility, we recommend that:

- 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 trade unions or bodies established under statutory consultation procedures.

¹² Companies Act 2006, section 414

¹³ Companies Act 2006, section 419

¹⁴ Companies Act 2006, sections 418 and 499

- Mandatory representation of workers on boards could be introduced in stages according to company size, starting with the largest companies (for example, those with 1,000 or more workers).
- The board should be required to ensure that verifiable targets are included in the human rights and environmental due diligence strategy and that adequate resourcing enable the strategies to be realised.
- The board should be mandated to discuss and sign off on an annual progress report, which should be included in the company's non-financial report.
- A non-executive committee, composed of independent experts and chaired by a designated non-executive director, should be set up and be responsible for monitoring and reviewing the content and implementation of the strategy.¹⁵
- Non-executive directors should have a duty of care to monitor the implementation of the strategy.
- Any failure to prevent human rights and environmental harms, both in the UK and overseas, should be considered a breach of executive directors' duty of good faith (where deliberate) or duty of care (where accidental¹⁶), and could be enforced by the shareholders by derivative action or via a public enforcement mechanism.
- A national regulatory body should be empowered to bring proceedings against the executive directors where non-implementation has failed to prevent serious harm to third parties or unlawful harm to the environment.¹⁷

31. Are there any existing or proposed directors' duties relating to corporate reporting and audit that you think should be specifically included or excluded from further elaboration for the purposes of the directors' enforcement regime?

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.

There are major limitations to this model and there should be other duties that are specifically included in this section. 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.¹⁸
- There is no positive obligation on company directors to take steps to mitigate harmful impacts to stakeholders and the environment.

¹⁵ See the report submitted to the Minister for the Economy and Finance of the French Republic by Patrick de Cambourg, President of the Autorité des Normes Comptables - 'Ensuring the relevance and reliability of non-financial corporate information: an ambition and a competitive advantage for a sustainable Europe (2019)', p. 205

¹⁶ Executive directors should have a defence to liability for breach of duty of care where they can show that they reasonably relied on due diligence reports

¹⁷ The Australian Securities and Investments Commission has power to bring proceedings in the public interest against directors for breach of disclosure regulations and breach of duty, especially where necessary to restore market confidence and integrity: see M Welsh, 'Raising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' (2014) 42 Federal Law Review 1; in the Netherlands, the Enterprise Chamber has far-reaching powers of intervention in the internal affairs of companies, including nullification of corporate resolutions, suspension, dismissal or appointment of directors, and other remedies including dissolution: see J Van Bekkum, S Hijink, MC Schouten and JW Winter, Corporate Governance in the Netherlands (2010) 14 Electronic Journal of Comparative Law 1, 4.

¹⁸ 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 (access to judicial remedy).¹⁹
- 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.²⁰

Legislation should be introduced to require all companies operating in the UK to conduct human rights and environmental due diligence throughout their operations - as outlined in the UN Guiding Principles on Business and Human Rights (UNGPs)²¹ - to report on how they have done so (explained above), and to hold companies liable when they fail to prevent human rights abuses and environmental harms.. 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.

Section 6

35. Do you agree that a new statutory requirement on auditors to consider wider information, amplified by detailed standards set out and enforced by the regulator, would help deliver the Government's aims to see audit become more trusted, more informative and hence more valuable to the UK?

Yes, but only if companies are held to account where they have failed to prevent serious harms to people and the planet as a result of breaching their duties (as set out earlier). Auditors and monitoring initiatives need to involve workers in a meaningful way. They must be transparent and accountable by adhering to enforceable regulations that provide legal and commercial consequences for auditors and auditing firms that fail to identify essential and foreseeable, and thus avoidable, human rights risks. There must be legal and commercial consequences for the sourcing companies who fail to stop, prevent, or mitigate identified human rights risks and remedy actual human rights violations.

In addition to new corporate governance reforms, we propose that a new human rights and environmental due diligence law be introduced in the UK to ensure greater corporate accountability and provide remedy to victims of abuse by holding companies liable when they fail to prevent human rights abuses and environmental harms. A new UK law that mandates due diligence on this vital issue would align with ongoing legislative developments in other countries. It would expand and deepen the transparency in supply chains provision in the Modern Slavery Act - to go beyond reporting measures, and to expand coverage across all human rights abuses and environmental harms. It would also build on, and go beyond, the Government's recent, welcome proposal for due diligence on products associated with deforestation, while ensuring the

¹⁹ 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>

²⁰ '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>

²¹ 7 UN Guiding Principles on Business and Human Rights, UN OHCHR, HR/PUB/11/04, 2011, pp. 17-24

UK meets its commitment to implement the UNGPs, and that resilient business is responsible business. A new law would hold companies to account when they fail to prevent human rights abuses and environmental harms, modelled on the 2010 Bribery Act section 7²²– as recommended in 2017 by Parliament’s Joint Committee on Human Rights²³, and confirmed as legally feasible in 2020 by the British Institute of International and Comparative Law²⁴. This law should mandate companies to undertake ‘human rights and environmental due diligence’ across their supply chains.

Section 11

98. Are there any additional powers that you think the regulator should have available where an expert review identifies significant non-compliance by a company in relation to its corporate reporting and audits?

A national regulatory body should be empowered to bring proceedings against the executive directors where non-implementation has led to a failure to prevent serious harm to third parties or unlawful harm to the environment. A regulatory body should also have the power to act when it has reasonable suspicion that directors duties have been breached. The dedicated regulator needs to be equipped with an effective investigation function and have adequate funding. There should also be a public enforcement mechanism. A failure to prevent human rights harms should be a strict liability offence, accompanied by a due diligence defence; in other words, there should be liability for damages which automatically accrues unless the company can prove it had in place procedures reasonable in all the circumstances to prevent a harm from occurring.²⁵

A company which breaches its duty to prevent such harms occurring should be punishable in both civil and criminal courts. Sanctions could include depending on the severity of the offence and the impacts caused²⁶:

- a) imprisonment or a fine, or both;
- b) a person being prohibited from being a director of a company for a specified period of years;
- c) a person being required to make redress to any other person who suffered as a result of any offence;
- d) a company being suspended from trading on the Stock Exchange;
- e) a company being wound-up.

Other Recommendations

Our final recommendation is to change ‘employee’ to ‘workforce’ throughout the Companies Act.

This amendment would have the effect of broadening the scope of the reporting requirements in the Companies Act to require companies to report on and have regard to their whole workforce, rather than just

²² <https://www.legislation.gov.uk/ukpga/2010/23/section/7>

²³ https://publications.parliament.uk/pa/jt201617/jtselect/jtrights/443/44311.htm#_idTextAnchor094

²⁴ <https://www.biicl.org/publications/a-uk-failure-to-prevent-mechanism-for-corporate-human-rights-harms>

²⁵ https://corporatejusticecoalition.org/wp-content/uploads/2020/10/CJC-F2P-General-Parliamentary-Briefing_FINAL.pdf

²⁶ <https://bills.parliament.uk/publications/41860/documents/390>

their directly employed employees, as at present. This would close a loophole, as when the most recent revisions to the Companies Act were being drafted prior to 2006, indirect employment was much less prevalent than now and the word 'employee' was clearly not intended to differentiate between different part of a company's workforce.