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COMPANIES BILL: MAKING CORPORATE IRRESPONSIBILITY HISTORY?

This briefing provides a detailed overview of the Corporate Responsibility (CORE) Coalition and the Trade Justice Movement proposed amendments to the Companies Bill and sets out how they might work in practice. Together, the Trade Justice Movement and the CORE coalition represent over 130 organisations with over 9 million individual members. Our member organisations include a diverse group of environment, human rights, development and health organisations, as well as faith-based groups and trade unions.

Further Information

For more information about the campaign or our proposed amendments please contact:

- Sarah-Jayne Clifton, Friends of the Earth: sarahjc@foe.co.uk or 020 7566 4080
- Hannah Ellis, CORE Coalition: hannah.ellis@corporate-responsibility.org or 020 7566 1665
- Julian Oram, Action Aid: julian.oram@actionaid.org or 020 7561 7595

I. Overview: Company Law as a Catalyst for Progressive Business Practice

The Companies Bill (previously known as the Company Law Reform Bill) is the biggest reform of UK company law for 150 years. It will set the basic rules of the road for UK companies in the 21st century and the legal framework within which they operate. The Bill was introduced first in the House of Lords in November 2005 and entered the House of Commons in May 2006. Scrutiny in Standing Committee was concluded in July and the Bill is due to receive its Report Stage and Third Reading on 17, 18 and 19 October 2006.

Member organisations of the Trade Justice Movement and CORE are urging MPs and the Government to seize the opportunity presented by this major reform to create a legal framework which drives UK companies to **combine successful enterprise with ethical and responsible corporate behaviour**. This is a unique opportunity to ensure that British businesses are responsible and accountable, no matter where in the world they operate.

Environmental, health and safety, and labour legislation such as the 'Health and Safety at Work Act' and the 'Environmental Protection Act' are vitally important in setting out what is and is not acceptable corporate practice in the UK. But they are add-ons to the basic incentives and aspirations set by company law and, vitally, they do not address the impacts of UK companies operating in other countries.

Company law has to ensure that the basic framework for the pursuit of business success is in touch with today's societal expectations of business. If it fails to do so, there is a real risk that it will actually undermine the growing number of directors and businesses that take their social

responsibilities seriously and want to do more than the bare minimum, meaning they can be undercut by less scrupulous and less responsible competitors.

The Government has recognised the need to encourage more responsible business practice and has argued that an approach based on Enlightened Shareholder Value (ESV) will deliver the best outcome for both companies and society. But this approach mistakenly assumes that business prosperity will always go hand in hand with responsible behaviour. It fails to recognise that sometimes directors see a short-term business interest in *disregarding* environmental issues or the interests of communities or workers in order to turn a quick profit.

The Companies Bill needs to go further if we are to take advantage of this rare opportunity to create a legal framework for companies that is truly fit for the 21st century and deliver a strengthened legislative commitment to the 'Enlightened Shareholder Value' approach. CORE and the Trade Justice Movement are therefore seeking the following amendments to the Bill to ensure that UK companies take real action to improve their social and environmental impacts around the world. We are also calling on the Government to commit to examining the barriers which prevent UK companies from being liable for abuses committed overseas. See below for an outline of our key demands.

The CORE Coalition and the Trade Justice Movement's proposals for the strengthening of the environmental and social reporting requirements and the directors' duties in the Companies Bill meet five key management tests: they are specific, measurable, attainable, realistic, and timely. They will put the UK on track to demonstrate international leadership in the field of responsible business practice. They will reap benefits to competitiveness through innovation and financial as well as broader societal reward. And they will help to achieve more effectively the goals the Government has set out in relation to the 'Enlightened Shareholder Value' approach, so that company law is truly fit for the 21st century.

It is also essential for the Government to examine the issue of barriers to access to justice for affected communities if we are to help poor countries to overcome the problems of poverty, injustice, and environmental degradation, and to ensure that UK companies do not contribute to, or cause, the problems they face.

II. CORE and the Trade Justice Movement's Key Demands

1. Environmental & Social Reporting

A legal requirement for companies to report on their social and environmental impacts

Corporate transparency is the critical first step towards achieving more ethical and sustainable business performance. The Operating and Financial Review (OFR), which came into force last year and was subsequently withdrawn by the Government earlier this year, would have constituted some progress in this area. While the Government has taken some steps to compensate for the loss of the OFR through new provisions on a Business Review in the Bill, it must go further. *Alongside their annual financial reports, all large and medium-sized public and private companies should be legally required to report on their social and environmental impacts in a way that is proportionate to their size and complexity. There should be clear guidelines on what these reports should include and strengthened responsibilities on auditors to say when they come across conflicting information.*

2. Enhanced Directors' Duties

A duty on company directors to take reasonable steps to minimise any significant adverse impacts on workers, local communities and the environment

The current draft of the Bill places a primary duty on company directors to promote the success of the company for the benefit of its shareholders. In fulfilling this duty, directors are required to 'have regard' to other factors. *We do not believe that this weak obligation will lead to any practical improvement in the performance of irresponsible companies. The Government must create a broad incentive for company directors to be proactive in this area through a duty to minimise adverse impacts on workers, the local community and the environment.*

3. Rights of Redress

A commitment by the Government to examine the barriers which prevent UK companies from being liable for abuses committed overseas and to make recommendations

CORE and the Trade Justice Movement believe that there should be greater rights under UK law for affected communities abroad to seek compensation for human rights or environmental abuses committed by UK companies or their overseas subsidiaries and/or affiliates if they are unable to access justice in their own country. *We believe that this issue must be addressed by the Government as a matter of urgency through the establishment of an independent review to examine the barriers which prevent UK companies from being liable for abuses committed overseas, and to make recommendations.*

III. What are we calling for and why?

A. Environmental & Social Reporting

Companies Bill: Part 16, Chapter 5, Clause 423: Contents of directors' report: business review

Background

The CORE Coalition and the Trade Justice Movement support the introduction of mandatory reporting by companies on social and environmental issues. We believe that this is critical to achieving greater transparency about the impacts of company operations, and that it is an essential first step towards achieving a wholesale improvement in corporate social and environmental performance.

If companies are to be held accountable for their wider social and environmental impacts, it is essential that shareholders, employees, communities and pressure groups are able to access reliable, forward-looking information about company activities. This will help drive more responsible business behaviour by making it easier for shareholders to hold directors to account, and also by necessitating improvements in internal corporate reporting and information management systems, making company boards more aware of the social and environmental impacts of their business operations.

Proposed Amendments

CORE and the Trade Justice Movement's proposed amendments to the Business Review reporting requirements set out in the Companies Bill are detailed in Table 1 below.

Table 1

1. Extension of the social and environmental reporting requirements to all large and medium-sized, public and private companies

CORE and the Trade Justice Movement believe that all of the 36,000 large and medium-sized public and private companies that are required to produce a Business Review should be required to report on the full range of environmental, social, employee and other non-financial issues in a manner consistent with the size and complexity of their business operations. This requirement should not be confined to the 1,300 or so publicly listed companies as per the current draft of the Bill. Furthermore, as currently drafted, the Bill excludes large private equity firms as well as foreign-owned private subsidiaries from the requirement to incorporate non-financial analysis in their Business Review. This includes companies such as ASDA or Virgin Airlines. The effect is that larger companies would not be operating on a level playing field across UK business.

The current draft of the Bill also discharges medium-sized companies from including information from non-financial key performance indicators (KPIs) – including on environmental and employee matters - in their Business Reviews. Environmental, social and community, and employee matters are as relevant for the operations of medium-sized companies as they are for large companies. Medium-sized companies should therefore also be required to report on them, including through the use of non-financial key performance indicators where these are available. Making it clear that the level of reporting need only be consistent with the size and complexity of the business will ensure that medium-sized companies are not overburdened.

2. Explicitly requiring all companies to report on supplier issues

CORE and the Trade Justice Movement believe that, as well as information on social, employee and environmental issues, an understanding of the treatment of suppliers is pertinent to the understanding of the company's business, and the principal risks and uncertainties that it faces. Furthermore, suppliers themselves are at risk of businesses not considering the impacts of their buyers' policies on price, standards and performance.

The OFR required the provision of information on a company's suppliers – "information about persons with whom the company has contractual or other arrangements which are essential to the business of the company". This requirement is not included in the Business Review reporting requirements as currently set out in the Bill. We believe that the requirement to report on supplier issues must be made explicit by including it on the face of the Bill alongside the other factors listed in Clause 423.

3. Introduction of Mandatory Reporting Standards through Statutory Guidance

We are extremely concerned that the Government does not intend to produce a statutory reporting standard for the Business Review. Mandatory reporting standards ease compliance with reporting requirements by providing guidance and clarity for companies on what information should be included in narrative reports. They also help to ensure comparability of the reports and facilitate assessment by interested parties – including shareholders and other stakeholders – of a company's relative social and environmental performance vis-à-vis its competitors, and its own progress in these areas year-on-year. Clear statutory guidance on what information should be contained within the Business Review is therefore key to the delivery of 'Enlightened Shareholder Value' – the Government's overarching objective for the narrative reporting provisions and the directors' duties set out in the Bill. This guidance must be developed in consultation with interested parties and regularly updated.

4. Removing the materiality requirement

As currently drafted, the Bill only requires that companies include information on social and

environmental issues in their Business Reviews that is material to the company's business. In our view, companies should be required to report on what is material to society and the environment, not just what is material to business. This is of benefit to companies themselves, as it is the only through full social and environmental reporting that they will be able to understand their full range of risks and opportunities. Wider social and environmental impacts are of interest to the growing number of ethical and socially-responsible investors who base their investment decisions on non-financial factors.

5. Strengthened audit requirements

The auditing requirements for the Business Review as currently drafted are weaker than those for the OFR. Both the OFR and the Business Review provisions required auditors to carry out a 'consistency check', i.e. a check that the information provided corresponds with evidence provided in the company's accounts for that year. However, the OFR went one step further, requiring also that auditors consider whether any other matters had come to their attention during the course of the audit that were inconsistent with the information provided in the OFR.

The Government itself asserted that this second check was necessary to provide adequate assurance for investors and other users in its response to the public consultation on the OFR published in December 2004. However, this second check has been excluded from the audit requirements for the Business Review currently included in the Bill. CORE and the Trade Justice Movement believe that the second audit requirement in the OFR should be added to the audit requirements for the Business Review in order to ensure the accuracy of the information contained within it.

KEY FEATURES OF OUR PROPOSED AMENDMENTS:

- Ensures reporting for a wider range of companies with significant impacts, such as large private equity and international subsidiaries.
- More likely to ensure reporting on sustainable development issues by broadening reporting on, amongst other matters, supply chain relationships.
- Statutory guidance for how directors should report is provided, easing compliance with the regulations.
- Auditors are given a stronger policing role in relation to non-financial reporting and the Business Review.

Evidence in support of our proposed amendments

- 1. Only an expanded Business Review would bring real 'Enlightened Shareholder Value'.**
Enhanced transparency is complementary to, and essential for achieving the Government's aim of Enlightened Shareholder Value. ESV relies on informed shareholders and stakeholders to monitor and enforce company behaviour. This means that the full range of social and environmental factors must be taken into account by company directors and that a complete and transparent reporting process involving stakeholders is undertaken to empower shareholders to fulfil their role.
- 2. The UK is falling behind global standards for social and environmental reporting.**
Mandatory social and environmental reporting already exists in various forms in Australia, Denmark, France, the Netherlands, Norway, South Africa, Sweden, Canada and the US.¹ Developing and emerging economies are already jumping ahead of the UK in seeing the value of companies that are both sustainable and competitive. In South Africa, the JSE Securities Exchange requires companies listed on the Exchange to report to the standards of the widely respected Global Reporting Initiative (GRI). In Malaysia, companies listed on the Kuala Lumpur Stock Exchange are required to disclose all 'material information' for investing.

The Federation of European Accountants, which represents over 500,000 accountants in 32 countries has recently called on there to be standards in this area across the EU. The UK has the expertise and should be leading in this area.

Responding to Critics

1. Won't your proposed reporting requirements mean excessive costs for UK business?

- No. The main reason stated by the Government for scrapping the OFR is that it would lead to excessive cost to UK business. Evidence from leading companies who already undertake full and comprehensive reporting would suggest otherwise.
- Medium-sized Traidcraft plc, with an annual turnover of £10 million, reports that its production of social accounts costs around £25,000 per annum and produces significant savings.
- BOVINCE, a company with an annual turnover of £3.6 million, invested less than £5,000 in its report and produced an estimated saving of £180,000.
- The GRI found that the largest companies with billions of pounds in profit spent on average \$600,000 (approx. £300,000) preparing narrative reports, and that these reports resulted in significant cost savings.
- Statutory guidance on meeting the reporting obligations should offer practical guidance, not a 'gold standard' forcing companies to spend hundreds of thousands of pounds.
- All Business Review reporting should be proportionate to the size and complexity of the company.
- According to UK business leader Sir Mark Moody-Stuart, Chairman of Anglo American Corporation, enhanced trust in companies can lead to "*reduced cost of capital, retention of longer-term investors, distinctive brands and strong reputations*".²

2. Won't your proposal impose yet another major burden on small UK companies?

- The requirement to produce a Business Review only applies to the top 36,000 public and private large and medium-sized companies: this is a tiny proportion of the total number of companies in the UK.
- According to the last available figures from the Department of Trade and Industry, there were 4.3 million business enterprises in the UK at the start of 2004. 99.3% of these were small (0 to 49 employees), 26,000 (0.6 per cent) were medium-sized (50 to 249 employees), and 6,000 (0.1 per cent) were large (250 or more employees)³.
- The Business Review requirements will hence only apply to less than 1% of UK enterprises. Small companies – representing over 99% of the total – will not be affected.

3. Surely investors won't read all of that information?

- Yes they will, in fact they are demanding it. A report from Investor Relations Magazine, reported in the Financial Times on 26 June 2006, found that 78% of investors and analysts want companies to publish full 'Operating and Financial Reviews' in spite of the Government's last-minute decision to drop the requirement.

How would these proposals work in practice?

1. **Statutory Guidance would provide a clear steer.** Under our proposals, the Secretary of State for Trade and Industry would be required to consult on, issue and regularly update statutory, mandatory guidance on the implementation of the Business Review requirements. This would help companies of different sizes and in different sectors to comply with the reporting requirements by giving a clear steer as to what types of information should be included and how these should be reported on. It would also ensure the comparability of Business Reviews, therefore ensuring they provide meaningful information for shareholders and other company stakeholders.

2. **Implementation of the Business Review would draw on a wealth of existing business-focused guidance.** The Global Reporting Initiative is a widely respected multi-

stakeholder reporting framework which develops and disseminates globally applicable 'sustainability reporting guidelines', including sector-specific supplements.⁴ GRI's 'third generation' guidelines will be launched in October 2006. Both they and the current second edition of the Guidelines contain widely-accepted guidance for reporting on community and environmental policies and impacts as well as key aspects of supply chain relationships.

The AA1000 series of standards also provides clear guidance on the stakeholder engagement and assurance that is an essential tool for responsible business practice and that should underpin the Business Review. ISO 26000 on organisational social responsibility, once concluded, is also likely to provide practical guidance without duplicating existing efforts.

The Accountancy Standards Board has already issued reporting guidance in the form of Reporting Standard 1 on the Operating and Financial Review, linked to Implementation Guidance. RS1 set out principles for directors to apply when preparing an OFR, and provided key elements of a disclosure framework to comply with the OFR Regulations. RS1 could readily be revisited or a successor developed to provide guidance against the new Business Review provisions.

3. Guidance for auditors has already been prepared. Guidance on auditors' reports on directors' reports is contained in guidance from the Auditing Practices Board.⁵ The International Standard on Auditing (ISA) 720 covers auditor's reports on directors' reports. ISA 720 is already written in light of the duty for an auditor to state whether, in the auditor's opinion, the information given in the directors' report is consistent with the financial statements.

Draft Guidance for auditors on the new duty to state whether '*any matters have come to their attention in the performance of their functions which are inconsistent with the information provided in the business review*) had already been prepared in an earlier draft of ISA 720.⁶ That draft was prepared in connection with an equivalent provision under the now-abandoned Operating and Financial Review regime. It would be a simple matter to revisit the Auditing Practices Board's draft guidance in light of the proposed amendment and revised Business Review provisions.

B. Enhanced Directors' Duties

Companies Bill: Part 10, Chapter 2, Clause 173: Duty to promote the success of the company

Background

In deciding on the nature of the directors' duties to be included in the Bill, the Government considered two contrasting approaches: Enlightened Shareholder Value (ESV) and pluralism. The approach finally adopted was ESV, under which the basic goal of a company director is to promote the success of the company in the collective best interests of its shareholders. The Bill will hence embed in Statute for the first time the fiduciary duty (the duty of directors to promote the success of a company for the benefit of its members, i.e. shareholders). This duty has already existed for a long time, but only in case law.

In fulfilling this duty, directors must 'have regard to' a number of factors, including the impact of the company's operations on the community and the environment, in so far as it may have an impact on shareholders. Thus, the duty to consider non-financial factors is secondary to the duty to shareholders. This means that when protecting the environment or the interests of local community conflicts with the delivery of profits, profits must come first.

The key assumption underlying ESV is that business prosperity and responsible business behaviour are two sides of the same coin. The CORE Coalition and the Trade Justice

Movement believe that this assumption is fundamentally flawed. ESV places too much emphasis on the voluntary approach to corporate social responsibility (CSR).

ActionAid, Friends of the Earth, Christian Aid, Amnesty International and other members of CORE and the Trade Justice Movement have numerous case studies which demonstrate that the voluntary approach to CSR cannot be relied upon to prevent corporate abuse and ensure that companies minimise their negative impacts on communities and the environment.

The weaknesses of the voluntary approach have also been highlighted by international institutions. An OECD policy paper on this issue stated: “*There are only a few cases where [voluntary initiatives] have contributed to environmental improvements significantly different from what would have happened anyway*”.⁷ Similarly, policy-makers at the World Bank concluded: “*Voluntary standards are no substitute for a benevolent, well-informed regulator*”.⁸

The Trade Justice Movement and CORE support a pluralist approach to directors’ duties whereby directors are required to balance shareholders’ interests with those of a company’s other stakeholders, including employees, consumers, and the wider community where the company operates. However, we also recognise that the introduction of a pluralist approach to directors’ duties is a significant step, and therefore support, as an interim step, the introduction in the Bill of a *positive* duty on directors to minimise the negative social and environmental impacts of their company operations.

It is not sufficient for directors simply to “have regard to” the interests of company employees, the business relationship with suppliers, and the impact of the company’s operations on the community and the environment.

Whilst still within the framework of Enlightened Shareholder Value and hence still secondary to the duty to promote the success of the company, a stronger, positive duty to minimise negative impacts would constitute an important step in the right direction in terms of bringing about more responsible business behaviour.

Proposed Amendments

CORE and the Trade Justice Movement’s proposed amendments to the directors’ duties set out in the Companies Bill are detailed in Table 2 below.

Table 2

Introduction of positive duty to minimise negative impacts

- In fulfilling their primary duty to promote the success of the company for the benefit of its members as a whole, directors should also be required to *endeavour* to:
 - (a) have regard to the likely consequences of any decision in the long term,
 - (b) promote the interests of the company’s employees,
 - (c) foster the company’s business relationships with suppliers, customers and others,
 - (d) minimise any adverse impact of the company’s operations on the community and the environment,
 - (e) maintain a reputation for high standards of business conduct, and
 - (f) act fairly as between members of the company.
- The primary purpose of this amendment is twofold:
 1. To **incentivise** directors to be proactive as opposed to passive in their consideration of the impacts of their business operations on employees, communities, suppliers, and the environment; and
 2. To **protect** those directors who do act responsibly from being sued by shareholders who are only concerned with the short-term success of the company and are therefore happy for the company to externalise its costs by harming people and the environment in pursuit

of this end⁹.

- Company directors will need detailed guidance about what, in practical terms, the enhanced duties will mean for them. Such guidance will also need to be regularly updated as the way the directors' duties should be translated into practice is likely to change through time.

KEY FEATURES OF OUR PROPOSED AMENDMENTS:

- ☑ Rather than a weak requirement to 'have regard to' other factors such as business relationships or environmental or community impacts through them, directors should *endeavour* to achieve a range of positive outcomes including minimising any adverse impact of the company's operations on the community and the environment.
- ☑ Explicitly pointing directors in the direction of considering the business case for responsible behaviour has the potential to foster unprecedented social and environmental innovation on the part of UK companies – to the benefit both of the UK and the wider world.

Evidence in support of our proposed amendments

- 1. Strengthened directors' duties will provide a real boost for the board level leadership that is widely accepted as a prerequisite for corporate social responsibility.**
UN Secretary General Kofi Annan¹⁰, as well as opinion-leaders from UK business-membership associations Business in the Community, the Prince of Wales International Business Leadership Forum¹¹ and the Work Foundation agree that leadership from the top is crucially important in putting corporate social responsibility at the heart of business.¹² That is why directors' duties to take account of – and act on – the key issues in responsible business need to be strengthened.
- 2. Private partnerships already place responsibility in the hands of their owners: PLCs should have the same level of responsibility to their employees and others.**
Company directors should have a personal duty because of the enormous privilege which companies hold through limited liability. Private partnerships have no such directors' duties because they do not have limited liability and are therefore personally subject to general legal requirements on environment or health and safety.
- 3. Directors whose leadership is essential are prone to complacency over implementation of organisational values.**
The 2006 edition of the Roffey Park Institute's annual survey of managers, *Management Agenda*¹³ notes a growing trend towards employee scepticism about the practice of organisational values, with 60% of respondents in the survey, especially in the private sector, responding that "*the espoused values of their organisation do not reflect values in practice*"... They add that "*Board Directors are most likely to believe that the espoused values are the same as those practised*". This is why directors need a clear steer from the heart of company law in the form of their basic duties.
- 4. Legislation on strengthened directors' duties will be a key motivator of change for the better.**
A 1999 review of literature on CEO and supervisor drivers of activities associated with good health and safety results concludes that *regulation is the single most important motivator of behavioural change*.¹⁴ The Work and Pensions Select Committee argued in its July 2004 report *The work of the Health and Safety Commission and Executive*, that "[t]he imposition of legally binding duties on directors would increase the likelihood of directors taking ownership of health and safety problems, positively impact on the current levels of preventable work-place death and injury and create more of a level playing field between those directors who take their health and safety responsibilities seriously and those who do

not." We agree. The same argument applies to the key issues associated with responsible business practices across the range of factors of concern to stakeholders.

The new directors' duties will offer a primary incentive for good practice and a pointer for innovation. They will complement legislation that already provides for personal liability and criminal penalties for directors, for example under environmental or health and safety law. Where there is no tailor-made personal liability legislation for directors, especially related to impacts on communities and impacts outside the UK, our proposals will add a regulatory driver of good practice to complement existing motivators.

5. Directors must have a duty to take account of the interests of certain 'unsecured creditors' throughout a company's life, consistent with the duty to promote the success of the company as a whole.

Limited liability is a privilege. Directors stand to gain great rewards from that privilege. It is important, therefore, that they are not allowed to abuse the privilege by discounting the interests of other stakeholders. In the event of impending insolvency, directors' duties place greater emphasis on the interests of the company's creditors (as reflected in, for example, provisions on directors' liability for wrongful trading).

Insolvency law (recently revised in the Enterprise Act 2002) then provides a balance between the interests of secured and unsecured creditors. When companies have negative environmental and social impacts, it is all too often workers, suppliers, the environment and community members who are, *de facto*, the unsecured creditors. A requirement on directors to take these factors into account throughout the life of the company and minimise negative impacts has the effect of encouraging an enterprise culture that factors concern for the interests of potential unsecured creditors into the corporate governance and risk management equation from the start.

Responding to Critics

1. Won't a positive duty open the floodgates to litigation and put people off becoming directors?

- No. This is linked to the nature of how litigation arises in the first place. Before a director is at any personal financial risk:
 - (i) The director must be in breach of duty;
 - (ii) That breach of duty must cause financial loss to the company;
 - (iii) The company (either by its board of directors or, if a court so permits, by a derivative claim brought by a shareholder) must choose to sue that director.
- Neither the duties presently set out in the Bill, nor the more positive duties suggested by CORE and the Trade Justice Movement, lead to any increased chance of a director being in breach of duty. Provided that the director's obligations are clearly understood there is little likelihood that directors will more frequently breach those duties than is presently the case.
- Furthermore, under the Enlightened Shareholder Value framework a director is not personally liable to any stakeholder (even a shareholder). A director can only be liable to a company for financial loss caused to the company by a breach of duty. If the company has suffered no loss, no claim can be brought against a director. While CORE and the Trade Justice Movement regard this as an inherent limitation (and flaw) in the Enlightened Shareholder Value model, it does mean that directors will remain invulnerable to wider stakeholder claims provided that they have, in fact, benefited the company.
- In addition, the referees for whether our proposed duty had been met or not would be no different from those elsewhere in the Companies Bill, other existing legislation or common law. Actions against directors for a breach of duty can only be brought by the company itself,

either through the board of directors, or a minority group of shareholders through derivative claims. The derivative action provisions in the Bill are aimed only at shareholders and do not open the door for other stakeholders to bring forward additional claims against companies and/or their directors. These provisions should not be confused with provisions in the United States which allow for Class Action suits. Such actions are not currently allowed under British Law.

- To provide further barriers against frivolous legal actions the Government brought forward amendments at the Report Stage Reading of the Bill in the House of Lords to strengthen the procedure for derivative claims (actions brought by minority shareholders against a director for a breach of duty). Shareholders who bring a derivative claim will not be able to claim damages for themselves, only for the company, and the courts will have stronger powers to dismiss non-meritorious claims at an earlier stage.
 - It is extremely time-consuming and expensive to bring any form of legal action in the UK and the loser pays principle continues to be a barrier to frivolous actions and even some legitimate legal cases. Furthermore, the courts always have the power to kick out frivolous litigation, and lawyers can be professionally disciplined for bringing such cases.
- 2. Won't the introduction of a positive duty confuse directors / make them face two different directions by requiring them to promote the interests of shareholders AND other stakeholders?**
- No. The primary duty of directors will still be to promote the success of the company for the benefit of its members. Our positive duty will only come secondary to this. Hence when there is a conflict, the interests of shareholders will continue to take precedence. There will be no confusion for directors in this regard, and the production by the Government of guidance on the interpretation of the directors' duties set out in the Bill will help to ensure that this is the case. However, we are confident that, while shareholders concerns remain primary, a positive duty on directors will strengthen their commitment and ability to manage and mitigate their negative social and environmental impacts while fulfilling their duty to shareholders.
- 3. Won't a positive duty on directors mean that companies leave the UK and incorporate overseas?**
- No. The central determinants of choice of location for incorporation are many and varied with factors such as rule of law, transparency, regulatory environment for the relevant business area, competency of potential employees, and location of the customer base being relevant, as well as tax and transparency. The main reasons why companies will move offshore are either to seek a lower tax regime (e.g. in the Cayman Islands or Bermuda), or to seek to avoid scrutiny of their operations (e.g. Panama, Liberia etc.).
 - Directors' duties are not a major influence on locational decision-making, and as the minor changes proposed through the introduction of our positive duty will not lead to any significant increase in directors' liability, then this amendment in itself will have almost no impact on a decision to move overseas. Other factors will be of more relevance.
- 4. Won't a positive duty on directors lead to box-ticking and legalistic implementation?**
- No. We are not calling for the Bill to codify precisely what actions directors should take to minimise negative impacts on communities and the environment or promote the interests of their employees, etc..
 - Our positive duty would simply create a broad incentive for directors to be proactive in their consideration of the environmental and social impacts of their business, and take reasonable steps to improve these impacts.
 - Box-ticking and legalistically driven avoidance strategies are no more likely to result from this proposal than any other duty placed on directors because our proposals go with the grain of existing company law and enshrine these duties at the level of principle rather than prescription.

- 5. Won't a positive duty on directors be a disincentive from taking up board level positions?**
- No. As stated above, the duty will lead to almost no significant increase in directors' liability and will therefore be unlikely to discourage people from taking up directorships.
 - Boards of directors are already responsible for the legal and ethical frameworks within which companies operate, and they already operate in a complex environment within which they must make judgements against a whole host of competing factors.
 - Shareholders turn to directors for answers when companies behave unethically or their reputations are damaged. And it is to directors that aggrieved community members turn for a response in the event of irresponsible behaviour or disastrous mistakes.
 - Providing directors with a duty to take account of and act on such matters is a pointer to do what they should already be doing. It is law catching up with the social reality and therefore clarifying what is already expected under common law.
- 6. Won't a positive duty on directors increase the regulatory burden on British business?**
- No. The strengthened directors' duty would only be an additional burden for those businesses that were poor performers from an environmental or social perspective. These are businesses that the UK's company law framework should not support.
 - Implementing management frameworks on social and environmental issues actually results in risk mitigation and cost reduction in practice (see below).
 - Furthermore, this amendment would be of benefit to businesses that are already seeking to operate responsibly by creating a fairer regulatory framework and therefore a more level playing field.
- 7. Won't a positive duty on directors stimulate a move away from limited companies towards 'Limited Liability Partnership' (LLP) status, making such entities even less accountable?**
- No. LLPs cannot in practice be used to "replace" companies in corporate or equity structures. The LLP is a corporate vehicle designed to afford limited liability status to persons previously working in partnership. It has severe limitations when used for other purposes.
 - The LLP structure is not equivalent to that of a company. In particular, an LLP has no directors, nor do members hold "shares" equivalent to those held in a company. Furthermore, the LLP structure is unsuited to access to equity markets (although it can raise loan capital) and could not be listed on a stock exchange.

How would these proposals work in practice?

1. Good practice is already well established. In all of the areas proposed for directors' consideration in Clause 173 there is a broad body of experience and practice across all sizes of UK company to provide a strong basis both for providing clear guidance and for implementing the substantive duty. Indeed, the UK's position as a global leader in the field of voluntary corporate social responsibility, and its home to world class expertise in the field, position UK business as a whole extremely well to adapt quickly and derive the potential commercial benefits of the new duties.

2. Courts will be reluctant to second-guess directors' judgment save in extreme cases. A great deal is left to directors' discretion and judgment. Courts are generally reluctant to interfere in business decision-making, substituting their views for the business judgement of directors. The list of factors explicitly mentioned in the clause would quickly become part of individual directors' commercial mindset. They would on occasion be explicitly on the agenda for boardroom meetings. They would lead to enhanced efforts to engage with external stakeholders; to carry out advance impact assessment exercises of various kinds; and to foster positive, non-exploitative working relationships with employees.

3. There is flexibility for different sizes and types of businesses. The outcomes required under the Bill for the board of a FTSE-100-listed multinationals would not be the same as those appropriate or required of directors of a small company. The key to compliance with the new duties will be for directors to demonstrate that the factors mentioned in the clause were considered and given some weight; had a real impact on the decision-making process, and that the process of taking them into account had led to action. There is no evidence that these proposals would be burdensome for smaller companies either. Smaller companies have consistently demonstrated that they can act in a responsible manner vis-à-vis factors affecting their supply chain.

4. There is plenty of business-facing practical guidance already that can be adapted to statutory guidance. While there is no universally agreed 'best practice' approach to establishing a management structure for ensuring responsible business practices across the board, a number of tools have been developed that directors could make use of to help them discharge their duties:

- Established thinking on environmental impact assessment, or stakeholder consultation – such as the AA1000 Stakeholder Engagement Standard.
- Existing European level guidance for smaller enterprises on how to go about designing and implementing an environmental management system.¹⁵
- The International Organisation for Standardisation is currently developing an international guidance standard for organisational social responsibility (ISO 26000) for publication during 2008.
- Further practical guidance for the future could readily come from the activities of the UK's CSR Academy¹⁶, established during 2004 with the support of the Department of Trade and Industry. The Academy provides guidance and training based on a 'corporate social responsibility competency framework' that could easily be adapted to meet the competency needs of UK company directors under the new duty.¹⁷

C. Rights of Redress for Affected Communities

Background

At present, a minority of UK registered companies abuse the protection afforded by separate limited liability for each company by taking the profit, while walking away when there are liabilities - sometimes avoiding UK legislation altogether. At its worst, this behaviour can be seen in the activities of organised crime, arms brokers, money-laundering and tax evasion, but there has also been a problem where subsidiaries of UK companies have made handsome profits out of hazardous activities overseas, repatriated the profits, and left the country before the victims have a chance to seek redress in their own countries.

The OECD report *Behind the corporate veil: using corporate entities for illicit purposes* (May 2001)¹⁸ prepared by the OECD Steering Group on Corporate Governance, states, "Almost every economic crime involves the misuse of corporate entities", and goes on to detail how subsidiaries are misused. Currently in the UK, the Government is permitted to look behind the corporate veil when it comes to tax and financial reporting by companies. However, the victims of corporate subsidiaries are rarely permitted to claim against the recipient of the profits, namely the UK parent, even where the subsidiary is wholly or substantially owned.

CORE and the Trade Justice Movement believe that there should be greater rights under UK law for affected communities abroad to seek compensation for human rights or environmental abuses committed by UK companies or their overseas subsidiaries or affiliates if they are unable to access justice in their own country. The Government has argued that the Companies Bill is not the right place to advance this objective, but has not yet indicated an alternative means through which the possibilities for better access to justice could be advanced.

Our Proposals

CORE and the Trade Justice Movement are calling on the Government to examine this issue as a matter of urgency, including whether stronger rights of redress for significant adverse impacts can be achieved through changes to company law, or through what other means they can be achieved. We recommend that the Government establish an independent review to examine the barriers which prevent UK companies from being liable for abuses committed overseas, and to make recommendations. Amongst other things, the review should address the following questions:

1. Whether there is a problem in relation to a lack of accountability of UK business overseas.
2. In what circumstances should the parent company be responsible for subsidiary operations?
3. If there are problems in accountability, what options are there in addressing these?

¹ For an overview, see the sustainability reporting page of the website of DG Employment and Social Affairs, at http://ec.europa.eu/employment_social/soc-dial/csr/abc13.htm#_Toc85625637. See also *Canadian Securities Regulators Introduce Mandatory Corporate Environmental and Social Disclosure*, CISDL Legal Brief, April 2005

² Sir Mark Moody Stuart, "A Task for Davos: The Measure of a Good Company", *International Herald Tribune*, January 25, 2003

³ DTI Statistical Press Release of 25 August 2005, based on information held by the Office of National Statistics

⁴ See www.globalreporting.org

⁵ Revised ISA (UK and Ireland) 720 (Revised) April 2006, at

<http://www.frc.org.uk/images/uploaded/documents/ISA%20720%20web%20optimized1.pdf>.

⁶ Exposure Draft, October 2005, available online at <http://www.treasurers.org/technical/papers/resources/apbexposedraftoct05.pdf>

⁷ Organisation for Economic Co-operation and Development (OECD)(2003), *Voluntary Approaches for Environmental Policy: Effectiveness, Efficiency and Usage in Policy Mixes*, Paris: OECD

⁸ Klein, Michael & Tim Harford (2004), *Corporate Responsibility: When will voluntary reputation building improve standards?*, World Bank Group – Public Policy Journal, Issue 271

⁹ In 2005, an Australian Parliamentary enquiry was raised because shareholders were concerned that companies were donating funds to the South Asian Tsunami, against their fiduciary duty.

¹⁰ See <http://www.unis.unvienna.org/unis/pressrels/2001/sgsm7936.html>

¹¹ http://www.iblf.org/media_room/general.jsp?id=148, 18th July 2002

¹² <http://www.theworkfoundation.com/newsroom/pressreleases.jsp?ref=128>

¹³ Summary at <http://www.roffeypark.com/docs/ExecSummaryAgenda06.pdf>

¹⁴ See <http://www.nohsc.gov.au/Pdf/OHSSolutions/GEOSupervisorDrivers.pdf>

¹⁵ See e.g. the EMAS toolkit for small enterprises at http://www.inem.org/new_toolkit/

¹⁶ See www.csracademy.org.uk

¹⁷ <http://www.bitc.org.uk/document.rm?id=1489>, at page 3

¹⁸ <http://www1.oecd.org/publications/e-book/2101131e.pdf>,