Linklaters

English law Outline for a Legal Perspective on an Annual Board "Statement of Significant Audiences and Materiality"[1]

This note was prepared in Autumn 2014 and reflects the law and any proposals for new legislation or policy as it was at 30 November 2014.

Setting the legal landscape

1 Briefly explain the broader legal landscape regarding the obligations that a company has to its stakeholders or with regard to its impact on stakeholders, and in particular whether its primary duty is or is not to shareholders over all other stakeholders.

The Companies Act 2006 ("**Companies Act**") imposes a number of duties on directors, including a requirement that they act in a way that they consider, in good faith, would be most likely to promote the success of the company. In doing so, they must "have regard" to the impact of the company's operations on the community and the environment, amongst other factors, including, for example, the interests of the company's employees and the need to foster the company's business relationships with suppliers, customers and others. The directors must also act with care, skill and diligence. The broader obligation to consider community, reputation and environmental issues is known as the enhanced shareholder value requirement. This is buttressed by equivalent reporting requirements for listed companies in the annual report and accounts.

More generally, company law obligations with regard to stakeholders other than shareholders are relatively limited. There is a slowly evolving consideration of factors within the corporate social responsibility ("CSR"), which is gradually moving CSR topics from the voluntary to the regulated sphere. At board level, risk reporting, remuneration and diversity are current areas of focus. Attention is being paid to the role of auditors and investors in monitoring corporate behaviour. At EU and UK level, companies are operating in a landscape which demands increasing transparency, particularly those in the financial services and extractive sectors. Global trends, and what Eccles' has termed the 'integrated reporting movement' is an ever present concern for the governing minds of our corporate clients.

Regulatory Framework

2 To what legal tradition does the jurisdiction belong, i.e. civil/common law, mixed?

Common Law.

Disclaimer

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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3 Are corporate/securities laws regulated federally/nationally, provincially or both?

Nationally. Some national law derives from EU directives which are then transposed into domestic law and regulation.

4 Who are the government corporate/securities regulators and what are their respective powers (in summary only)?

BIS – Department for Business, Innovation & Skills (the government department responsible for company law and corporate governance).

CMA – Competition & Markets Authority (the body that replaced the Competition Commission and Office of Fair Trading on 1 April 2014).

FCA – Financial Conduct Authority (formerly the Financial Services Authority), the independent body that regulates financial firms providing services to consumers. The FCA is also the regulator under the Disclosure and Transparency Rules (DTR) made for the purposes of Part VI of FSMA and applicable to listed companies. The DTRs relate to periodic reporting, the disclosure of holdings of securities and corporate governance.

PRA – the body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.

UKLA – UK Listing Authority

FRC – Financial Reporting Council and FRC Conduct Committee.

HMRC – HM Revenue & Customs

ICAEW – Institute of Chartered Accountants in England and Wales

SFO – Serious Fraud Office

5 Does the jurisdiction have a stock exchange?

Yes, the London Stock Exchange (the "**LSE**") which is comprised of the Main Market and the Alternative Investment Market ("**AIM**") amongst others.

Incorporation and listing

6 Do the concepts of "limited liability" and "separate legal personality" exist?

The concepts of separate legal personality and limited liability are cornerstones of English law. However, in exceptional situations the court will 'pierce' the 'corporate veil' and impose liability on a parent company.

In very limited circumstances, there is also scope for other persons to incur secondary regulatory liability in respect of an offence where the company has primary liability.

7 Did incorporation or listing historically, or does it today, require any recognition by the company or its directors of a duty to society, an obligation to take account of the company's social or environmental impacts, or to respect its stakeholders?

Continuing obligations in respect of social or environmental issues may exist for companies after incorporation or listing but not on incorporation itself. On listing a company will be required to disclose in listing particulars matters relating to its business and relevant risk factors, which may include matters relating to environmental compliance or social impacts.

The reporting requirements which apply to all companies and in particular to listed companies relevant to this question are addressed at section 17 onwards.

8 Do any stock exchanges have a responsible investment index and is participation voluntary? (See e.g. FTSE4Good, Dow Jones Sustainability Index, the Johannesburg Stock Exchange's Socially Responsible Investment Index).

The FTSE4Good Index series launched in England in July 2001. It assesses the performance of UK companies that meet globally recognised corporate responsibility standards. It is similar to the FTSE All Share index, which lists shares according to market capitalisation but excludes tobacco, nuclear power and arms industries. The FTSE4Good indices have criteria for selecting stock which consider a company's approach to environmental risks and impacts, universal human rights, social issues and stakeholder relations.

The management and evolution of the FTSE4Good Index Series is placed under the direction of the FTSE4Good Policy Committee which is an independent body of experts from the field of corporate responsibility, fund management, academia and the business community. The FTSE4Good Policy Committee acts as an independent judge of whether companies have met the selection criteria for inclusion in the index.

Directors' Duties

9 To whom are directors' duties generally owed?

Section 170(1) of the Companies Act states that general duties are owed by directors to the company itself. This mirrors the common law position that the duties are owed to the company (understood in terms of the members as a whole) and that, with limited exceptions, only the company can enforce them. Case law has also clarified that duties are not owed to other body corporates, such as holding companies, or to subsidiaries (although directors may have regard to the interests of the group as a whole), nor are they owed by directors of a trustee company to the beneficiaries of a trust.

10 What are the duties owed by directors – please state briefly. Please indicate if there are any express or implied duties to avoid damage to the company's reputation.

Under English law directors duties exist in both codified and un-codified form. There are a number of common law and equitable principles that remain relevant. However, the Companies Act codifies a number of duties as follows:

(i) S171 Duty to act within powers

(ii) S172 Duty to promote the success of the company

(iii) S173 Duty to exercise independent judgement

(iv) S174 Duty to exercise reasonable care, skill and diligence

(v) S175 Duty to avoid conflicts of interest

(vi) S176 Duty to not accept benefits from third parties

(vii) S177 Duty to declare interest in proposed transactions or arrangements

One of a number of factors directors must have regard to under S172 is the need to maintain a good reputation for high standards of business conduct. (See below).

11 More generally, are directors required or permitted to consider the company's impacts on non-shareholders, including impacts on the individuals and communities affected by the company's operations? Is the answer the same where the impacts occur outside the jurisdiction? Can or must directors consider such impacts by subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?

Section 172 Companies Act duty on directors[2] requires them to "have regard" to the impact of the company's operations on a range of stakeholders. S172 of the Companies Act includes a non-exhaustive list of factors for directors to consider in relation to their duty to promote the success of the company. The provision provides that a director 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". Where the company has a purpose other than to benefit its members, S172 will be construed in accordance with that purpose.

In order to comply with this duty, directors must have regard to the following non-exhaustive list of factors:

(i) The likely consequences of any decision in the long term;

(ii) The interests of the company's employees;

(iii) The need to foster the company's business relationships with suppliers, customers and others;

(iv) The impact of the company's operations on the community and the environment;

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[2] CA06, sections 171 to 177. The CA06 codifies the common law on directors' duties. Other directors' duties include a duty to act within powers, a duty to exercise independent judgement, a duty to exercise reasonable care and skill, a duty to avoid conflicts of interest, a duty not to accept benefits from third parties and a duty to declare interests in proposed transactions or arrangements. This is covered under section 10.

(v) The desirability of the company maintaining a reputation for high standards of business conduct; and

(vi) The need to act fairly as between members of a company.

The guidance notes to the Companies Act refer to these considerations as the '**principles of enlightened shareholder value'**.

Members of a board will therefore need to be mindful of these factors when making decisions about the company's business. The directors must also act with care, skill and diligence[3].

To "have regard to" means to "give proper consideration to" and the weight to be given to each factor in making any decision is a matter for the good faith judgement of the directors[4]. Practical guidance issued by the Institute of Chartered Secretaries and Administrators ("**ICSA**") acknowledges that at times these factors, and any others that are being considered, may be in conflict. ICSA recommends that the directors should choose the course of action that will promote the overall success of the company for the benefit of members as a whole, even if that may sometimes have a negative impact on one or more of the six factors[5]. It also notes that in the decision-making process there is generally no absolute right or wrong approach. A company's directors must therefore make a judgement in good faith for the success of the company, having regard to all available information and having taken advice when appropriate[6]. The courts will generally look at what the directors believed the company's interests to be at the time they acted and their motive for acting as they did, and have shown a reluctance to substitute their judgement for that of directors[7].

It is a matter of judgment as to the degree to which compliance with this duty should be documented in board papers and minutes. ICSA advises that papers written for the board should refer to those factors which are relevant to the decision being made[8]. The GC100 (an association of general counsel for FTSE100 companies) has pointed out that, despite the importance of briefing papers, their purpose is to assist directors in reaching a decision through exercising their own judgement and so these should not be construed as the decision or a record of the directors' views[9]. The GC100 has taken the view that it is not necessary to minute everything that is said in relation to each factor in board minutes, except to the extent appropriate to reflect the decision taken[10].

ICSA's Duties Guidance points out that traditional considerations such as profitability, the financial effects on shareholders etc. are still of critical importance as they are central to the duty to "promote the success of the company for the benefit of members as a whole".

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3 CA06, section 174. This means the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and the general knowledge, skill and experience that the director has.

4 "Duties of company directors", Ministerial statements, DTI, June 2007

5 ICSA Guidance on Directors' General Duties, January 2008, paragraph 3.2.2

6 *Ibid*, paragraph 3.2.3

7 *Martin Shepherd v Michael Roy Williamson, Phoenix Contracts (Leicester) Limited* [2010] EWHC 2375 (Ch)

8 ICSA Guidance on Directors' General Duties, January 2008, paragraph 3.2.3

9 GS100: Companies Act (2006) – Directors' duties, 7 February 2007, paragraph 6.3

10 *Ibid.*

The Kay Review of UK Equity Markets and Long-Term Decision Making

Other recommendations

The **Kay Report**[#], published in 2012, emphasised that directors were stewards of the assets and operations of their businesses. Their duties were to the company not to the share price. The report recommended that directors should adopt 'good practice statements' to promote stewardship and long-term decision making. The report also highlights the principle that long-term value creation is best served by strategies which focus on investing for sustainable performance rather than treating the business as a portfolio for financial interests. The UK Government response to the report was positive, indicating support for the concept of good practice statements and encouraged business representative groups and investment industry trade associations to review and endorse the statements set out in the report.

In 2010 the EC published a **Financial Institutions Green Paper** on ways to improve corporate governance in financial institutions. It sought comments on, amongst other things, whether a specific duty should be established for a board of directors to take into account the interests of depositors and other stakeholders during the decision-making process. However, most respondents opposed this.

Most recently the FRC has published an updated version of the UK Corporate Governance Code which takes effect for financial years commencing on or after 1 October 2014. Perhaps the most important change is to require companies to publish a viability statement in addition to a going concern statement. There are also changes affecting remuneration policies, encouraging engagement with shareholders and extending the provisions of the Code that relate to AGMs to all general meetings. In particular directors will now be required to:

- state in their annual and half-yearly financial statements whether they considered it appropriate to adopt the going concern basis of accounting and identify any material uncertainties to their ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements;
- make a longer term viability statement in the annual report that they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due, drawing attention to any qualifications or assumptions as necessary. The period which this forward looking assessment should cover is for the directors to select and they should explain the period chosen and why it is appropriate. The FRC expects the period assessed will be "significantly longer" than 12 months;
- confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company's business model, future performance, solvency or liquidity and explain how they are being managed or mitigated; and
- monitor the company's risk management and internal control systems in addition to the existing requirement to review their effectiveness at least annually.

It is not yet clear what impact these amendments will have on corporate governance but they seem likely to formalise the process for determining conclusions of any corporate planning processes.

12 If directors are required or permitted to consider impacts on non-shareholders to what extent do they have discretion in determining how to balance different factors including such impacts? What additional liabilities, if any, do the board or individual directors assume in exercising such discretion?

Within Section 172, as long as directors have regard to any relevant factors and make decisions in 'good faith' as to what they think would promote the best interests of the company, they will not be liable for breach of duty. Under English law it is clear that the test under section 172 Companies Act is subjective. The UK Government confirmed in Parliament that 'good faith' was intended to be a "good faith business judgement" test rather than a "reasonableness" test. The English courts have historically been cautious in their approach to interfering with a directors' business judgement and this seems to continue to be the case under section 172 of the Companies Act. Therefore as far as directors can show that they considered the relevant principles of enlightened shareholder value they are unlikely to incur liability.

13 What are the legal consequences for failing to fulfil any of the duties described above; and who may take action to initiate them? What defences are available?

Directors' duties are owed by the directors to the company, and so, generally, it is the company that is in a position to enforce them. This usually means that the board must resolve to initiate proceedings, which are unlikely to occur in practice.

There is a statutory "exception"[11] to this general rule which takes the form of a derivative claim brought by a shareholder to enforce a right of the company.

There was initially some concern that this mechanism would make it too easy for minority shareholders to exercise disproportionate power over companies, and bring vexatious claims. However, these concerns have been unfounded. There have not been a large number of claims and, of those which have been brought, only a small number have been given leave to proceed.

Practical deterrents include the fact that costs will usually be awarded against unsuccessful claimants and that the relief will be awarded to the company only. There is an additional hurdle, in that court permission must be granted before a derivative claim can be pursued. Taking into account whether the shareholder is acting in good faith, the court must refuse permission if it appears to it that the evidence filed by the applicant does not disclose a case for giving permission, or if is satisfied that: (i) a person acting in accordance with the duty to promote the success of the company would not seek to continue the claim; (ii) where the act or omission complained of has yet to occur, it has been authorised by the company; or (iii) where the act or omission complained of has already occurred, it was either authorised by the company beforehand, or has since been ratified. The bar to a successful claim is therefore set very high.

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[11] CA06, section 260

Can these issues give rise to other causes of action or regulatory routes whereby a stakeholder can exert pressure on a company with regard to its actions?

There are various routes used by stakeholders to exert pressure on a company, but these are currently more a litigation risk than a realistic source of liability. Unless the company itself behaves in such a way that it creates a duty of care to people affected by its or its customers' or suppliers' actions or omissions, tortious liability should not usually arise. There are some instances where the law has become more claimant-friendly (for example, limited circumstances in which parent liability for damage attributable to a subsidiary's operations may arise). These are discussed below.

Tortious liability for negligence

There are instances of UK operating or parent companies being the subject of tort claims asserting negligence for failure to prevent personal injury in the workplace, by contractors or third party security forces.

The cases brought to date have involved defendants who are proximate to the incidents and who are asserted by the plaintiffs to owe a duty of care. Many of these cases settle or are discontinued rather than going to trial.

Parent company liability

English limited liability companies are founded on the principle that they are legal entities distinct from their members, which gives them the ability to benefit from rights and assume obligations and liabilities in their own right. In a group context, such companies therefore also have a legal status separate from each other. A key consequence of this is that, in relation to claims being made against or losses borne by a limited liability subsidiary company, the parent company stands only to lose the fully paid up share capital it had invested in that subsidiary.

However, there is a slow but steady trend under English regulatory and civil law to view corporate groups as more unified organisms rather than a collection of separate legal persons. In particular, there have been a few recent examples of parent companies incurring liability or undertaking to pay compensation in circumstances where unsafe working conditions have resulted in the workers of their subsidiaries suffering industrial disease (specifically, asbestos-related illnesses) in connection with their employment. The relevant claims have been brought in tort, and, they have had the effect of opening a potential route for plaintiffs to seek remedies against parent companies who, while operating on a group basis, have failed to protect their workers from adverse impacts. Claims of this nature have been asserted by plaintiffs but cases rarely come to trial.

Nevertheless, under normal operating conditions, a parent company is very unlikely to face civil or criminal liability under UK law and it is only in a very limited and specific set of circumstances that such liability can arise:

(i) the separate legal personality of two group companies may be ignored if there is impropriety and the corporate structure is a facade – this requires evidence of clear wrongdoing by the controlling members of the company, impropriety in the use of corporate structure to avoid liability or deliberate evasion of responsibility for wrongdoing through interposing a corporate entity;

(ii) where a subsidiary acts as the parent company's agent – although this is rare and will arise only where there is a very high degree of control by the parent over the subsidiary – the subsidiary acts within the scope of the authority granted by the parent company and both parent and subsidiary have consented to this way of doing business;

(iii) where sufficient proximity exists for tortious liability – the state of knowledge or actions/omissions of a parent company of any group company may cause them to incur primary liability in their own right. The risk of such liability increases with the degree of involvement of the parent company in the management or operations of the subsidiary (see below for further details). There must be very significant involvement for this to be a risk;

(iv) unequivocal statutory provision – for example, environmental or safety regulation often contains provisions whereby directors, managers or secretaries of a body corporate can be held liable for offences committed by that body corporate[12] or another body corporate can be held liable as a secondary matter if it caused the offence to be committed by the primary defendant. These provisions are not commonly used; and

(v) vicarious liability for seconded personnel or teams at JV operations[13].

As noted above, a line of case law has recently begun to develop around limb (iii) regarding unsafe working conditions which have resulted in asbestos related disease. In a few instances, respondent parent companies have faced allegations that they had failed to adequately protect workers employed by a subsidiary, notwithstanding the separation of legal corporate personality.

Chandler v Cape[14] concerned a personal injury claim in respect of asbestosis resulting from actions carried out in the course of employment by a subsidiary which was no longer in existence. The Court of Appeal held that in some specific circumstances a parent company may owe a duty of care directly to the employees of a subsidiary as regards their health and safety. Such a duty will arise where (a) the businesses are in all relevant respects the same, (b) the parent has or ought to have superior knowledge of some relevant aspect of health and safety in that industry, (c) the subsidiary's system of work is unsafe and (d) the parent knew or ought to have known this, and the parent knew or ought to have known that the subsidiary or its employees would rely on the parent to use its superior knowledge to protect those employees. It is not necessary to show that the parent was in the practice of intervening in the subsidiary's health and safety policies, but the court will generally look at the relationship, including the parent's intervention in the trading operations of the subsidiary, such as decisions relating to production and funding.

[12] This applies where the relevant acts were (i) committed with the "consent or connivance" of the relevant officer, or where the relevant offence occurred as a result of "neglect" on his/her part or (ii) caused by the act or omission of another person. Such liability also extends to "shadow" directors and shareholders, where such individuals actively manage the company's affairs. A parent company (and/or its shareholders) could therefore be held liable for the acts (or inaction) of a subsidiary where sufficient knowledge of, control over and involvement in the subsidiary's affairs can be attributed to that parent. In practice, criminal liability for a parent company on the basis of such provisions is extremely unlikely.

[13] See the first instance decision of *Colour Quest v Total Downstream UK* [2009] 1 CLC

[14] [2012] EWCA Civ 525

This decision has been affirmed in *Thompson v The Renwick Group plc*[15], although the outcome in that case was quite different. A parent company had appointed a new director to a subsidiary's board to take over health and safety management of a depot where the claimant handled raw asbestos. The claimant subsequently developed pleural thickening and brought a claim in negligence against the parent company, alleging that it owed him a duty of care. The Court of Appeal held that, because that director had not been acting on behalf of the parent company in running the day-to-day operations of the subsidiary, but was instead acting pursuant to his fiduciary duty to the subsidiary, his appointment by the parent company did not give rise to a duty of care to the subsidiary's employees. The court found that the mere co-ordination of operations as between subsidiaries by a parent company did not mean that it had assumed control of the subsidiary and so the test for establishing a duty of care[16] had not been met.

We are aware of a number of instances where negligence claims have been threatened against a UK-incorporated parent company in respect of events which took place outside the UK and which arose out of the operations of a subsidiary company. These claims concerned allegations of safety breaches or human rights abuses occurring in an unsafe working environment in the extractives sector. The Court did not have the opportunity to consider them, as such cases tend not to proceed to trial given difficulties of causation but they were asserted in reliance on the level of awareness and involvement that the parent company had in the operations of its subsidiary.

The key principle that underpins this line of case law is that the trigger for parent company liability is very active influence over or control of a subsidiary's affairs specialist expertise and commonality of businesses.

Liability for JVs

In civil litigation following the UK's Buncefield fuel terminal explosion, the court took an approach towards liability that was highly focused on the actual behaviour of the parties to the JV through which the Buncefield terminal was owned and operated. This is an example of complex contractual arrangements being considered by the courts in the context of the actual behaviour of the parties which may differ as a matter of practice.

The judge found that Total UK was vicariously liable for the negligent tank filling operations of one of its employee who had been seconded to the JV company in which Total held a minority interest, as his actions had resulted in a fire at the company's Buncefield oil storage depot. The factors that were considered by the judge in his judgment included the fact that: (a) the employee was employed by the Total entity; (b) the employee was subject to instruction by its head office staff as to the manner in which he should conduct tank filling operations; (c) the reporting line of the employee was to the terminal operations manager at the head office of Total UK; and (d) the JV company constituted a neutral forum for budgetary purposes without being involved in the day-to-day operations.

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15 [2014] EWCA Civ 635

16 The three limbs of that test are: (i) foreseeability of loss; (ii) proximity; and (iii) it is fair just and reasonable to impose a duty of care on the duty holder. *Caparo v Dickman* [1990] UKHL 2

In a similar vein to the case law on parental tortious duties (see above), the key principle upon which this decision was based is that of *operational control* by one company over another. It is also important to note that the court determined liability on a factual analysis rather than looking only at the relevant JV contracts.

14 Are there any other directors' duties which are relevant to the interests of stakeholders?

See above.

15 For all of the above, if these exist in your jurisdiction, does the law provide guidance about the role of supervisory boards in cases of two tier board structures. What obligations are owed by senior management who are not board directors? Is this determined by law if no specific contractual provision applies?

Supervisory boards are not an English structure.

The obligations of senior management are set out in their contracts and terms of reference, which will usually incorporate by reference company policies, including any code of ethics. It would be most unusual for no contract to be in place.

Reporting

16 Are companies required or permitted to disclose the impacts of their operations (including stakeholder impacts) on non-shareholders, as well as any action taken or intended to address those impacts? Is this required as part of financial reporting obligations or pursuant to a separate reporting regime? Please specify for each reporting route whether it is mandatory or voluntary.

The directors of large companies have an obligation to prepare a strategic report for each financial year of the company[17]. The aim of this report is to provide shareholders with information that will enable them to assess how the directors have performed their duty to promote the success of the company (see earlier). It must be approved by the board and signed by a director or the secretary[18].

Contents of the report

The strategic report must contain a fair review of the company's business and a description of the principal risks and uncertainties facing it, and, to the extent necessary for an understanding of the development, performance or position of the business, an analysis using financial and other key performance indicators (including information relating to environmental and employee matters)[19].

[17] CA06, section 414A. This must be a consolidated report for the group where the company is a parent company and the directors prepare group accounts. Small companies may be exempt from the requirement to produce a strategic report if they qualify for the small companies exemption.

[18] CA06, section 414D

[19] CA06, section 414C

Quoted companies (meaning UK-incorporated companies which are listed in the UK, EU or on the NYSE or NASDAQ) must also include a gender diversity breakdown, showing at the end of the financial year the number of persons of each sex who were directors, senior managers and employees of the company.

Such companies must also report, to the extent necessary for an understanding of the development, performance or position of the business, information about environmental matters (including the impact of the company's business on the environment), the company's employees and social, community and human rights issues, as well as information about any related policies of the company, and their effectiveness.

For reports published in respect of periods ending after 30 September 2013, quoted companies have been required to set out in a separate section of the report the aggregate annual greenhouse emissions for their group in respect of Scope 1 and Scope 2 greenhouse gas emissions, or explain to what extent they have been unable to do so and why.

Similarly for reporting periods ending after 30 September 2013, quoted companies are now required to include a disclosure in respect of human rights that would be material to an investor. Principles-based guidance on strategic reports recently published by the FRC[20] (the "**FRC Guidance**")[21] suggests a company could include, where relevant:

(i) a description of its policy in respect of any such matters (and any measures taken to embed it);

(ii) any process of due diligence through which the company assesses actual or potential human rights impacts arising from its activities and through its business relationships;

(iii) any process whereby it integrates findings and takes action to prevent or mitigate human rights impacts and tracks the effectiveness of its efforts and communicates these externally; and

(iv) the company's participation in any relevant remediation processes.

The FRC Guidance notes that directors may refer to a source of relevant guidance in the report, specifically mentioning the UN Guiding Principles on human rights, although it allows for a high degree of flexibility in approach, noting that directors may choose to comply fully or partially with any such guidelines or take a more general regard of their content.

This does not mean that a listed company should include lengthy details of, for example, all environment or human rights-related matters relevant to its business in its strategic report. The FRC Guidance repeatedly notes that only information that is necessary for an understanding of the development, performance, position or future prospects of the company's business (or that is otherwise required by law) should be included. Although the Companies Act does not use the term "material", the concept is implicit in many of its

[20] The FRC is the UK's independent regulator which aims to promote high standards of corporate governance. See section 4 ante.

[21] Guidance on the Strategic Report, FRC, June 2014. The guidance serves as a best practice statement and has persuasive rather than mandatory force.

requirements and the FRC Guidance recommends that only information that is material in the context of the strategic report should be included within it[22].

Information is only to be considered material if its omission or misrepresentation could influence the economic decisions shareholders take on the basis of the annual report as a whole. It is acknowledged that a company's shareholder base may comprise groups with different needs and interests, and so the FRC advises that the needs of all "significant" shareholder groups should be considered when determining if a matter is material. Any quoted company will therefore want to consider carefully who its significant shareholder groups are (which could include, for example, SRI funds holding significant quantities of shares and who have a specific investment mandate), and as regards each significant specified issue relevant to its business, assess whether omission of a description of that issue from its strategic report might influence the economic decisions those shareholders might make based on its annual report. This is clearly a difficult area, where there will often be no one clear right approach, and a significant degree of subjective judgement will inevitably be exercised by companies. Generally though most companies aim for brief disclosures.

European incoming measures

In April 2014 the European Parliament adopted the Directive on Disclosure of Non-financial and Diversity Information by Large Companies and Groups which became effective 20 days after it was published last month in the EU Official Journal. It must be implemented by Member States within two years. The directive, which applies to listed companies and financial institutions employing more than 500 people, requires companies to disclose "relevant and useful information" information concerning their human rights impacts, environmental performance, anti-corruption measures and diversity programmes in their annual reports. Commentators have noted that in implementing the requirements of domestic legislation once passed, companies may wish to follow guidance set out in internationally recognised corporate social responsibility frameworks, such as the UN Guiding Principles and the OECD Guidelines. Companies will need to carefully monitor any draft implementing legislation to obtain as much advance notice as possible of the specific requirements of this expanded reporting regime.

The EU is considering the introduction of a self-certification and reporting regime in respect of conflict minerals. It is currently proposed that (in contrast to the equivalent US regime)[23] this will be voluntary, and so it will be open to affected companies to decide whether or not it opts to comply. It is possible that self-certification could be a brand enabler for companies.

Other UK initiatives

BIS published a "framework for action" (June 2013) on corporate responsibility, seeking feedback on topics including responsible supply chain management and business and human rights.

The Modern Slavery Bill 2014-15 was introduced in June 2014 and is designed to consolidate and simplify existing modern slavery offences into one piece of legislation. The bill focusses on slavery, servitude and forced or compulsory labour and human trafficking and if passed would establish an anti-slavery commissioner and facilitate the imposition of

[22] FRC Guidance, June 2014, section 5.1

[23] US Reporting obligations also existing under the Dodd-Frank.

harsher penalties for offenders. Having received its second reading in July 2014, the Bill has now been committed to a Public Bill Committee for review[24].

Prior to its passage through the House of Commons, NGOs lobbied for inclusion of provisions comparable to those included in equivalent Californian legislation to require UK companies with UK sales of consumer products above a certain volume to report on the measures they had put in place to reduce the risk of human trafficking within their supply chain. These were not originally included in the Modern Slavery Bill but the legislation has since been amended. It currently includes a requirement that all companies supplying good or services in the UK which have a turnover above an amount to be specified will have to prepare a statement each year (not in the annual report) describing the steps the organisation has taken to ensure that slavery and human trafficking are not taking place within its own business or any part of its supply chains. It remains to be seen if this provision remains in the bill when it is passed as an Act.

17 Please describe any mandatory reporting requirement, major voluntary initiative or trend towards voluntary reporting with regard to transparency (for example, payments to government or state-owned entities, reports on government orders to undertake surveillance or interception, reports on tax payments etc.).

Some companies are now faced with mandatory requirements to make detailed country-by-country disclosures on profits and amounts paid to government whether as tax or otherwise.

These apply to financial institutions under the Capital Requirements Regulations 2013 and to companies active in the extractive and logging industries under the Accounting Directive.

17.1 Financial institutions requirements

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into force on 1 January 2014. As a one-off obligation, on or before 1 July 2014:

- all institutions within the scope of CRD IV (broadly banks and financial institutions) must have published basic information on their name, nature of activities and geographical location, number of employees and turnover on a consolidated country-by-country basis for each country in which the institution has a subsidiary or branch or both; and
- global systemically important institutions or "GSIIs" must have notified the EC and HMRC of additional information on their profit or loss before tax, corporation tax paid and public subsidies received, again on a consolidated country-by-country basis for each country in which the institution has a subsidiary or branch or both.

Under the Capital Requirements Regulations 2013, global systemically important institutions ("GSIIs") were required to provide the EC and HMRC with additional information on profits, taxes paid and subsidies received by the same date. Such requirements were primarily aimed at increasing transparency and combatting corruption in the countries in which the companies operate.

[24] http://services.parliament.uk/bills/2014-15/modernslavery.html

As an ongoing obligation, on or before 31 December 2015 and annually thereafter, all affected institutions (not just GSIIs) must publish the basic information and, subject to an assessment by the EC, the additional information on a country-by-country basis. Unlike the information to be disclosed on or before 1 July 2014, the information to be disclosed as an ongoing obligation must be audited.

17.2 Extractive Sector requirements

Large companies incorporated in an EU member state or listed on an EU regulated market will be obliged to comply in future with new reporting requirements relating to payments to Government or government owned entities in respect of extractive activities (mining, oil and gas exploration, and logging of primary forests), following amendments to the EU Transparency Directive and Accounting Directive.

EU Member States are now in the process of implementing laws which will require such companies to report publicly each year on certain types of payment made to government or local government or to state owned entities in connection with projects where the payment exceeds €100,000 and it relates to extractive activities.

The purpose of the regime is to raise standards of transparency and to enable the better management of the investment made in developing countries by these companies.

The UK is introducing these requirements one year early and they will now apply to affected companies with respect to reporting periods commencing after 1 January 2015.

17.3 Voluntary Reporting

It is market practice for large companies to publish extensive sustainability reports, outlining the actions they are undertaking to ensure that they operate a sustainable business, including identifying and mitigating environmental impacts. Increasingly, these reports also cover social impacts. NGOs often focus on statements of action or intention made in such reports and attempt to bring pressure to bear on companies to evidence the steps they are taking in connection with them. That said, under current law it is unlikely that liability would attach special circumstances. It is prudent, however, to engage in a process of verification prior to publication to ensure that all statements made in any such report can be supported by appropriate evidence should this be required.

Also of increasing prevalence in the ICT sector are law enforcement relationship reports, in which ICT companies publish details of the volume and type of interception or other data requests they have received from government agencies over the course of a specific period. These are an attempt to use transparency to illustrate the difficult position of ICT companies trying to balance compliance with laws and regulatory orders relating to interception, surveillance and communications data retention, with respect for privacy, freedom of expression and other human rights.

18 Do legal reporting obligations extend to such impacts outside the jurisdiction; to the impacts of subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?

This is indicated in the discussions of individual reporting obligations set out above. Generally reporting relates to the activities of the company or group of companies (including those joint ventures that are consolidated for financial reporting purposes). It will therefore usually extend to impacts outside the jurisdiction and to impacts of subsidiaries and some joint ventures.

Currently reporting does not extend to the supply chain, but this is in the process of change pursuant to the EU Directive on Disclosure of Non-financial and Diversity Information by Large Companies and Groups and in the UK the current proposed reporting requirements under the Modern Slavery Bill.

19 Who must verify these reports; who can access reports; and what are the legal or regulatory consequences of failing to report or misrepresentation? Is there a regulator tasked with investigating complaints of misreporting?

19.1 Companies Act reporting

The strategic review and annual report of a Companies Act company are not required to be subject to external third party verification, although the company's auditor must state in his report on the annual accounts whether in his opinion the information given in the strategic report and directors' report is consistent with those accounts, s.496 CA 2006. Under section 498A CA 2006 the auditor must also check that a corporate governance statement has been prepared. In any event, companies take care to verify the statements in them for both commercial and legal risk management reasons.

If no strategic report is prepared, each director who failed to take all reasonable steps to secure compliance with the requirement to prepare a report will be guilty of an offence[25]. Similarly, if a strategic report is approved which does not comply with the requirements of the CA06, each director who knew that it did not comply (or was reckless as to whether it complied) and failed to take all reasonable steps for securing compliance or to prevent the report from being approved will be guilty of an offence. In each case, a potentially unlimited fine can be imposed on offending directors.

Regulatory liability

The FRC adopts a risk-based approach in selecting entities for review, taking account of industry sectors which are considered to present the greatest risks. For 2014, it is focusing on the support services and information technology (including software) sectors. Beyond this there is currently no formal regulatory monitoring of the quality of the explanations companies provide when explaining departures from the UK Corporate Governance Code and the FRC believes that it is for shareholders to judge whether corporate governance in a particular company is satisfactory.

If it appears to the FRC that there is, or may be, a question as to whether a strategic report is compliant, then it may require the directors to give an explanation or prepare a revised version of the report (giving them not less than one month to do so). As a practical matter, the FRC usually writes informally to a company to discuss any issue of concern and to seek its response before writing formally under this procedure. If no explanation is received, or it is unsatisfactory, or if the revised report still falls short, then the FRC is empowered to apply to court[26] for a declaration that the report is non-compliant and an order requiring the preparation of a new report. To date, no such applications have been made as matters have always been resolved by negotiation or formal process. The FRC does appear to respond to well-informed complaints made by NGOs and pressure groups.

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[25] CA06, section 414A(5)

[26] CA06, sections 455 to 457 and the Supervision of Accounts and Reports (Prescribed Body) and Companies (Defective Accounts and Directors' Reports) (Authorised Person) Order 2012

Claims by shareholders

Defects in information in a listed company's report should not result in a shareholder having a direct right of action against the company's directors. However, a shareholder could claim against the company if they can show that they have suffered loss, and that there was knowledge or recklessness, or dishonest concealment, on the part of one or more directors regarding these defects, or dishonest delay in the release of information. The company might then be able to claim its own loss (i.e. any compensation paid to a shareholder) against directors whose knowledge, recklessness or dishonest concealment gave rise to it.

This represents the combined effect of the following liability regimes:

(i) issuers (broadly, issuers of all securities which are admitted to trading on a UK securities market or where the UK is the issuer's home state) are liable to pay compensation to a person who acquires, continues to hold or disposes of such securities in reasonable reliance on information disclosed by recognised means (i.e. by way of a regulatory information service or other means of disclosure used to communicate information to the relevant market) and who suffers loss as a result of:

   (a) an untrue or misleading statement in relation to which a person discharging managerial responsibilities (a "**PDMR**", which includes, amongst others, a director or senior executive with responsibility for the information in question or its publication) knew the statement to be untrue or misleading and was reckless as to the fact;

   (b) an omission of any matter required to be included in published information in relation to which a PDMR knew the omission to be a dishonest concealment of a material fact; or

   (c) delay in publishing the information in relation to which a PDMR acted dishonestly in delaying publication of the information. Dishonesty means conduct that would be regarded as dishonest by persons who regularly trade in the relevant securities markets and the PDMR was aware (or must be taken to be aware) would be regarded as dishonest (The Financial Services and Markets Act 2000 ("**FSMA**"), section 90A and schedule 10A); and

(ii) a director will be liable to compensate the company for any loss it suffers as a result of any untrue or misleading statement in, or omission from, such a report, but only if he knew (or was reckless as to whether) the statement was untrue or misleading, or knew the omission to be dishonest concealment of a material fact (CA06, section 463).

The trigger for liability in each case is therefore very high[27].

Other similar liability regimes exist in the context of statements made when selling shares[28]. Companies should take note of these if they are engaged in any equities

[27] CA06, section 463 should provide directors with some protection from common law liability arising in negligence (see *Hedley Byrne v Heller* [1964] AC 465) or the tort of deceit (see *Derry v Peek* (1889) 14 App Cas 337) for statements made in the strategic report. However, section 463 specifically states that it does not affect any criminal offence or civil penalty (penalties specified under statute in relation to a failure to comply with a statutory duty, regulatory code or some other kind of culpable behaviour e.g. market abuse).

transactions (such as a rights issue). Custom and practice has been to avoid general disclosure of sustainability risks and this approach is likely to continue in the near term, although we have observed a trend towards increased transparency and reporting in the longer term. Work is being undertaken by a group of commercial banks to consider moving away from this approach in relation to the extractive sectors.

19.2 Liability for statements made outside the strategic report

There is a very limited risk under English law currently that a company could incur liability at common law for misstatements negligently made outside the strategic report. This liability would be tortious and a claimant would have to establish a duty of care, breach and show causation in the normal way.

Many cases on negligent misstatement have based a duty of care on the principle of "assumption of responsibility"[29] which considers whether the representor assumed responsibility towards the claimant and whether the claimant relied on the statement to its detriment[30]. For companies dealing directly and on an exclusive basis with specific groups (for example, a small group of shareholders with a common and specific interest), it is conceivable that such a special relationship could arise. Generally the probability of such a relationship arising from public reports and other public communications appears low.

We are not aware of any high profile examples of claims brought against companies for negligent misstatement in the context described above. However, such claims have been brought in the US, although they do not appear to have resulted in court decisions. For example, a claim was brought against FIJI Water for negligent misstatement in California. FIJI Water had marked itself as an environmentally sensible and carbon-negative company when in practice it had been using a system of forward crediting to achieve carbon-negative status. Carbon offsets necessary to render FIJI Water carbon-neutral would not actually occur until 2037. The plaintiff alleged that she was induced into buying the bottled water on the basis of this misstatement[31]. It is unclear whether this litigation has settled or remains ongoing.

It is possible for a company to limit its exposure to liability and litigation risk for negligent misstatements by incorporating disclaimers into relevant documentation and on websites[32] (or into terms and conditions governing their use) where this is appropriate and by ensuring that all statements it makes can be supported and are up to date.

Liability may also be incurred in the context of contractual relationships for negligent misrepresentations made by the company[33]. These are statements made by one contracting party to another that induce the other party to contract and cause them loss.

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[28] For example, see section 90 FSMA which governs statements made in listing particulars or a prospectus, and section 89 of the Financial Services Act 2012 which governs statements made (or facts concealed) in connection with inducing another person to enter into certain agreements or exercising or refraining from exercising any rights attached to a relevant investment.

[29] *Henderson v Merrett Syndicates* [1994] UKHL 5

[30] It has also been established that it may be possible for a shareholder to bring a claim in negligence against a listed company for losses suffered by it as a result of failing to disclose information: *Hall and others v Cable and Wireless Plc* [2009] EWHC 1793 (Comm). This had previously been discounted based on the decision in *Caparo Industries v Dickman* [1990] 2 WLR 358, a House of Lords decision that auditors owed no duty of care for their audit work either to individual shareholders or to members of the public who might be potential investors.

[31] http://www.triplepundit.com/2012/12/sustainability-reporting-law-practical-considerations-avoiding-liability/

[32] *Gary Patchett and Karen Patchett v Swimming Pool & Allied Trades Association Ltd* [2009] EWCA Civ 717

[33] Misrepresentation Act 1967

Misrepresentations can be made fraudulently, negligently or innocently and can entitle the injured party to damages and rescission in some cases[34].

20 What is the external assurance regime for reporting on a company's impacts on stakeholders? Please specify any mandatory requirements and also where reporting is voluntary what the current market practice is as regards third party assurance.

Listed companies commonly obtain external assurance and less commonly more detailed external verification of their corporate responsibility or sustainability reports. This is undertaken on a voluntary basis. There is no mandatory verification required currently.

Please summarise any regulatory guidance on reporting that relates to impacts on non-shareholder stake-holders.

Guidance on reporting is published by a range of bodies including the FRC in respect of annual reports. Other bodies provide guidance on more specific forms of reporting – for example the Department of Environment, Fisheries, the Rural Economy and Agriculture publishes guidance on mandatory corporate greenhouse gas reporting and also produce guidance on non-mandatory environmental reporting.

Transparency requirements are or will be the subject of EU and domestic guidance.

Stakeholder engagement

21 Are there any restrictions on circulating shareholder proposals which deal with impacts on non-shareholders, including stakeholder impacts?

No.

22 Are institutional investors, including pension funds, required or permitted to consider such impacts in their investment decisions? What is the legal duty that pension funds owe with regard to investment decisions in this regard?

The Law Commission of England and Wales published guidance in July 2014 on pension trustees duties in setting investment strategy.

This guidance stemmed from a conclusion reached by Professor Kay in his 2012 review on the UK capital market, in which he noted that some pension fund trustees equated their fiduciary responsibility with an obligation to maximise short term returns and believed it excluded consideration of factors that could impact on the longer term performance of a company such as environmental and social impacts. He recommended that the Law Commission review this issue to address uncertainties and misunderstandings.

The Law Commission was asked in particular to consider how far trustees may or must consider interests beyond the maximization of financial return, such as environmental or social impacts or the ethical beliefs of their beneficiaries.

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[34] Misrepresentation claims are typically made under the Misrepresentation Act 1967, though fraudulent misrepresentation claims can be made under the common law.

22.1 Duties of pension fund trustees

The Law Commission notes that the duties of pension fund trustees derive from three sources:

(a) **the trust deed** – the trustees should first ask themselves what the purpose is of the investment power they have been granted under the deed and how they can use that power for the purpose of the trust.

(b) **pensions legislation** –the Occupational Pension Schemes (Investment) Regulations 2005 set out general principles applicable to large schemes, including that investment powers should be exercised in a way calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole. The Law Commission considers these duties apply as a matter of trust law to all trust based schemes.

(c) duties arising under case law – the case law requires that trustees should:

(i) act for the proper purpose

(ii) take into account all relevant considerations and ignore irrelevant ones

(iii) take advice; and

(iv) not fetter their discretion by applying a pre-existing judgment

(v) act with such care and skill as is reasonable in the circumstances, taking account of any special or professional knowledge or skill they have.

22.2 Purpose of Investment Powers

The purpose of the investment powers is to provide a pension with contributions made to provide a return some years in the future. The aim is therefore to secure the best realistic return over the long term.

In this regard the Law Commission makes clear that trustees can always take account of financial factors in considering how to exercise their investment powers. A **financial factor** is any matter which relevant to the primary duty of balancing risks against returns. **A non financial factor** is a consideration motivated by other concerns such as improving members quality of life, or disapproving of certain industrial sectors.

Pension fund trustees may consider factors going to the long term sustainability of a company as a financial factor when investing in equities over the long term. These could include a wide range of factors including poor governance, poor safety or environmental management or risks to a company's reputation where these have the potential to give rise to financial impacts.

The Law Commission's guidance therefore concludes that there is no impediment to trustees considering environmental, social or governance factors where they are or may be financially material. Indeed trustees should take account of risks that **are** financially material. It is for trustees, exercising their discretion and taking advice as appropriate from advisers and investment managers, to decide what risks are material and how to take them into account. This includes risks going to the long term sustainability of a company.

Conversely non-financial factors may only be taken into account if two tests are met:

(a) trustees should have good reason to think that scheme members would share the concern; and

(b) the decision should not involve a risk of significant financial detriment to the fund.

22.3 Stewardship Code for Institutional Investors

The UK led the way in creating the voluntary Stewardship Code to delineate the responsibilities of institutional investors concerning voting, shareholder engagement and monitoring of the companies they invest in.

Although the Stewardship Code applies on a comply or explain basis, UK-authorised asset managers are required to disclose the nature of their commitments to the Code or alternative investment strategy [FCA's COB 2.2.3].

The Occupational Pension Schemes (Investment) Regulations 2005 require trustees of pension schemes to disclose in their Statement of Investment Principles the extent to which they take social, ethical or environmental issues into account in their investment decisions.

The NAPF's Responsible Investment Guide (2013) is designed to assist investors, especially pension funds, in developing policies[35]. It explains:

- why pension fund investors should be seeking to incorporate non-financial risks, including governance and material environmental and social risks, within their investment decisions and
- how pension funds can, in keeping with their fiduciary duty, move the market towards one where responsible investment is considered the norm.

Some companies listed in the UK have noted a trend recently towards increased engagement on ethical sustainability and governance issues ("ESG") by institutional investors who may be taking ESG performance as one of a number of hygiene factors indicative of good corporate governance.

Levels of shareholder activism seem to have risen in general on both sides of the Atlantic, not just from 'traditional' activist funds, but also from institutional investors who are increasing their dialogue with companies. Institutional investors have acted on the suggestion in the Stewardship Code that they should be willing to take collective action by forming groupings for collective engagement.

22.4 EU proposals

EU proposals in the draft amendment to the Shareholder Rights Directive would impose new obligations on asset managers and institutional investors. These would include disclosure of investment strategies and the terms of management contracts that incentivise managers to focus on long-term performance. Engagement policies and the exercise of voting rights would also have to be publicly disclosed, albeit on a comply or explain basis. As its name implies, the Shareholder Rights Directive is intended to enhance shareholder voting powers, and the draft amendment is also intended to do this by introducing provisions on related party transactions.

[35] The NAPF are institutional investor advisers, and compliance with their guide is voluntary, though it is an informally influential document.

22.5 NGO Campaign relating to stranded assets

A number of NGOs or think tanks such as Carbon Tracker have been campaigning over the past couple of years to assert that some assets and interests held by fossil fuel companies may be "stranded assets" because climate science and policy would preclude their exploitation. They argue that investment values should be adjusted to reflect this. A stranded assets programme was instituted in 2012 at the Smith School at Oxford University and campaigners have argued that this is an area that the Bank of England should consider.

On 30 November 2014 it was reported in the Financial Times that the Bank of England is to examine formally for the first time whether fossil fuel companies pose risks to financial stability on the basis that some of the world's proven coal, oil and gas reserves may be un-burnable if global warming is to be kept to safe limits. The Governor of the Bank of England wrote to advise the Parliamentary Environment Committee of this intention on 30 October and indicated that he expected the Financial Policy Committee of the Bank of England also to consider the issue as part of its horizon scanning work on financial stability risks. The Bank of England has also been reported to be considering the risk that climate change poses to the solvency of insurers

The parliamentary Environmental Audit Committee has also been investigating the issue of stranded assets.

How does the legal duty of the fund align with term and contractual performance criteria of fund managers – does this facilitate or deter consideration of such impacts?

See above. The NAPF's Responsible Investment Guide (2013) addresses how investors can incorporate non-financial risk into their decision-making process without violating their financial duty.

23 Can non-shareholders address companies' annual general meetings?

Non-shareholders have no right to attend or speak at a company meeting. It is usual, however, for some non-shareholders to be invited to attend such meetings and the default model articles for UK companies expressly allow the chairman to permit non-shareholders to attend and speak at a meeting. Even if not provided for in a company's articles, the Chairman has the power to allow non-shareholders to attend and speak, although in this case the power is subject to the will of the meeting.

What is the minimum shareholding required for a shareholder to raise a question at a company's AGM?

The Shareholder Rights Directive was implemented by The Companies (Shareholders' Rights) Regulations 2009. The regulations amended the Companies Act to give shareholders a number of additional rights to be heard:

- 5% (reduced from 10%) of members can requisition a general meeting (Section 303)
- every member has the right to have questions answered at a general meeting, unless an exception applies (Section 319A)

- 5% of members can require "other matters of business" which are not resolutions to be included in the annual general meeting agenda (Section 338A).
- companies are also required to provide additional information in notices of meetings and on company websites.

In addition, members of a public company can requisition a resolution to put before shareholders at an annual general meeting (5% of members or at least 100 members – s.338 CA 2006) and can require the company to circulate a statement to members about a resolution or meeting business (s.314).

Section E of the UK Corporate Governance Code deals with relations between companies and shareholders. Among other things:

- the chairman should discuss governance and strategy with major shareholders (Provision E1.1);
- the senior independent director should attend sufficient meetings with a range of major shareholders to help develop a balanced understanding of their concerns (Provision E1.1);
- the chairman should ensure the views of shareholders are communicated to the board as a whole (Provision E1.1);
- the board should state in the annual report the steps taken to ensure that members of the board, especially NEDs, develop an understanding of the views of major shareholders, e.g. through face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion (Provision E1.2); and
- new directors should avail themselves of opportunities to meet major shareholders as part of their induction (Provision B4.1).

Section E also recommends that company boards should use general meetings to communicate with investors and to encourage their participation. In particular, directors should:

- propose a separate resolution on each substantially separate issue (E.2.1);
- give shareholders the option to withhold their vote if they do not wish to vote for or against a resolution (E.2.1);
- properly record and count all votes given by proxy (E.2.2);
- publish information about how votes have been cast or withheld and explain how the board intends to deal with situations where a significant proportion of votes have been cast against a resolution (E.2.2);
- arrange for all directors to attend the AGM and for key directors to be available to answer questions (E.2.3); and
- make sure that information about the meeting is circulated well in advance of the meeting taking place (and to give more time than is required by law) so that shareholders can properly consider the issues (E.2.4).

Other issues of corporate governance

24 Are there any other laws, policies, codes or guidelines or standards applied in the context of particular contractual relationships (for example project finance) or through adherence to particular sustainability principles (for example the UN Global Compact, the OECD Guidelines for Multinational Enterprises ("OECD Guidelines") etc.), related to corporate governance that might encourage companies to consider in a structured way their impacts upon and the interests of their wider stakeholders including through a stakeholder engagement process?

24.1 International Guidelines, principles and standards

The UN Guiding Principles on Business and Human Rights (UN Guiding Principles) and OECD Guidelines, while not legally binding, also set expectations that companies will communicate publicly the actions they are undertaking to address their adverse human rights impacts.

The OECD Common Approach and the Equator Principles both require the financial institutions that have committed to apply these standards to report publicly on the projects to which they have provided credit (usually resulting in corresponding reporting obligations on borrowers to enable them to meet these requirements).

24.2 National Guidelines and standards

Politicians have recently called for measures to regulate the way in which gas, electricity and water utilities companies operating in the UK report their finances[36] to promote greater transparency and help consumers to understand how rates are calculated. This has largely been driven by the reported differences between the fluctuating wholesale price of energy and the (increasing) rates which utilities companies are charging customers, which has attracted widespread public and political scrutiny over recent years. The proposed measures aim to reassure customers that high energy prices are not fuelling excessive profits, and enhance public confidence in the sector.

24.3 Increasing relevance of sustainability issues in access to finance and business

A poor environmental or social track record may on occasion be a barrier to access to finance (including equity investment) and customer relationships. Those procuring goods and services (including government authorities) have begun to engage in "ethical" due diligence processes. In some instances they may require suppliers to evidence compliance with their sustainability policies which now often include a human rights component. These are occasionally supported by contractual commitments, although these generally tend to be relatively weak.

Export credit agencies ("**ECAs**") from OECD member states (which include the UK) adhere to a "common approach" on environmental and social due diligence (the "**Common Approach**")[37]. This requires ECAs to screen projects they are contemplating granting credit to (provided it will have a repayment term of more than two years). They must classify them according to their potential environmental and social impacts, which include

[36] http://www.parliament.uk/business/committees/committees-a-z/commons-select/energy-and-climate-change-committee/news/eppp-substantive/

[37] http://www.oecd.org/officialdocuments/displaydocument/?cote=TAD/ECG%282012%295&doclanguage=en

"relevant adverse project-related human rights impacts". An environmental and social review must be undertaken, during which the ECA must consider any statements or reports made publicly available by the NCPs in its jurisdiction. The UK Government has stated that UK Export Finance (which also goes by the name of Export Credit Guarantee Department (the "**ECGD**")) will consider any negative final NCP statements a company has received in respect of its human rights record when considering a project for export credit[38].

The environmental and social review must be benchmarked against the IFC Performance Standards, save in respect of low-impact projects. ECAs are required to decide whether the support they are intending to provide should involve conditions that must be fulfilled prior to, or after, that support is committed (for example, measures to prevent, minimise, mitigate or remedy potential adverse social impacts, covenants and monitoring requirements). In relation to human rights, the UK Government has stated that it intends to ensure that agreements facilitating investment overseas by UK or EU companies incorporate the business responsibility to respect human rights and do not undermine the host country's ability to either meet its international human rights obligations or to impose the same environmental social regulation on foreign investors as it does on domestic firms[39].

In the UK NGOs have launched campaigns against ECGD support for projects with adverse environmental, social and/or human rights impacts. In some cases judicial review applications in respect of ECGD decisions to finance projects have been brought by such NGOs. For example, in 2007 WWF and The Corner House sought review of support granted to the Sakhalin oil and gas development in part on the basis that the ECGD had decided to support the project without carrying out an environmental and social impact assessment in accordance with its own policies. Ultimately, the project withdrew its application for ECGD support prior to any consideration of the application, citing delays in obtaining financing approval caused by, amongst other factors, the judicial review application. This scrutiny of Government agencies, such as ECGD increases pressure on them to assess the environmental and social implications of candidate projects with greater stringency

A large number of commercial lenders have adopted the Equator Principles[40] which include similar requirements to the OECD Common Approach. They apply to certain types of financing specifically for the purpose of a particular project, require project screening and environmental and social impact assessments, as well as the inclusion of certain mandatory compliance covenants as a minimum in financing agreements. The third iteration of these principles, which were adopted in 2013, make reference to environmental, social and human rights issues. Individual commercial lenders often seek to impose their own policies on borrowers where these impose more extensive requirements and these are gaining in importance in a financing context. In addition, a subset of these banks have discussed standalone principles on human rights.

24.4 Contractual developments

A number of companies have included or are contemplating inclusion of environmental and human rights provisions into their standard terms and conditions of supply and standard JV agreements amongst other contracts.

[38] *"Good Business: Implementing the UN Guiding Principles on Business and Human Rights"*, HM Government (presented to Parliament by the Secretary of State for Foreign and Commonwealth Affairs), September 2013

[39] *Ibid.*

[40] http://www.equator-principles.com/index.php/ep3/ep3

It is now well established that lenders will require covenants as to borrower compliance with environmental and social laws and, where appropriate, draw up and implement action plans to mitigate or eliminate social impacts of a particular project in financing agreements where these are within the scope of the Equator Principles or OECD Common Approach discussed above. Failure to comply with covenants of this type is likely, subject to the expiry of any applicable grace periods, to constitute an event of default which could result in acceleration of the relevant loan causing potential financial and reputational damage to the borrower particularly if this triggers cross-default provisions in other financing arrangements it has entered into.

25 Are there any laws requiring representation of particular stakeholder constituencies (i.e. employees, representatives of affected communities) on company boards?

No.

26 Are there any laws requiring gender, racial/ethnic, religious or other stakeholder constituencies (i.e. employees, representatives of affected communities) on company boards?

The March 2014 progress report by Lord Davies on women on boards showed that the proportion of women on the boards of FTSE 100 companies had risen to 20.7%, bringing the UK's 25% target set for September 2015 within reach.

In respect of reporting periods ending after 30 September 2013, listed companies must report on gender diversity issues under the UK Corporate Governance Code and must now include senior executive and general employee gender statistics as part of the strategic report.

In addition, the EU directive on non-financial reporting will require EU-listed companies to publish their diversity policy and details on its effectiveness. This is similar to the UK Corporate Governance Code requirement but the definition of diversity is broader and covers age and geographical diversity and educational and professional background.

A further draft EU directive on gender balance proposes a target 40% representation for the underrepresented sex among non-executive directors by 2020, with sanctions for failing to comply with director selection procedures, was not agreed ahead of the European elections. Some member states have argued that EU legislation is not required in this area. Italy, which took over the Presidency in July 2014, is said to be treating this initiative as a priority to achieve a compromise solution.

27 In your jurisdiction is there any legal route whereby a parent company can incur liability with regard to the impacts that one of its subsidiaries has had on stakeholder groups? Are there any serious proposals to impose such responsibility?

See the discussion in response to question 13 for a discussion on these issues.

28 Are you aware of any incoming law proposals that are relevant to the issues raised in this questionnaire? If so please describe, providing an indication of the anticipated date the legislation will come into force or be adopted.

Any such proposals have been discussed in the body of the document.

Linklaters (VHW)
3rd December 2014