

GC100 guidance on section 172: focus on directors' duties

GC100, the association of general counsel and company secretaries working in UK FTSE 100 companies, has published guidance on directors' duties under section 172 of the Companies Act 2006 (section 172) (2006 Act) and stakeholder considerations (the guidance).

The government invited the GC100 to publish the guidance as part of the package of measures to improve the UK's corporate governance framework which was announced in August 2017 (see box "Background").

The nature of section 172

Section 172(1) requires directors to act in the way that they consider, in their good faith judgment, would be most likely to promote the success of the company for the benefit of its shareholders as a whole. In making decisions, directors are also required to have regard to a non-exhaustive list of factors, including the interests of employees and how the actions and behaviours of the company affect customers, suppliers, the community and the environment, as well as the company's reputation. The factors are designed to ensure that, in promoting the company's success, directors consider the broader implications of decisions. The duty is owed to the company itself and not directly to the company's shareholders or stakeholders.

The duty should be considered together with and alongside a director's other statutory duties under the 2006 Act, in particular, the duty to exercise reasonable skill, care and diligence (section 174), and the duty to exercise independent judgment (section 173). It should also be considered in accordance with section 170, which recognises the need to consider the duty with regard to the common law rules on the duty to act in the best interests of the company.

GC100 guidance

The guidance seeks to provide practical help to directors on the performance of their duty under section 172, with a particular focus on wider stakeholder considerations. It contains:

- Suggestions for directors on matters they could consider.
- Examples of practical steps that directors can take in order to comply with their section 172 duty.

Background

When the government published its corporate governance reform green paper in November 2016, it noted that some stakeholders believed that companies needed to do more to reassure the public that they are being run with an understanding and recognition of their responsibilities to employees, customers, suppliers and wider society (see *News brief "Corporate governance green paper: restoring trust and confidence?"*, www.practicallaw.com/0-638-0471). Although views were not formally sought on the subject, the green paper stimulated a debate on the wording of the duty of directors in section 172 of the Companies Act 2006 (section 172) (2006 Act).

In its August 2017 response, the government set out its corporate governance reform package (see *News brief "Corporate governance reforms: government proposals published"*, www.practicallaw.com/w-010-4890 and feature article "Corporate governance reforms: widening responsibilities", www.practicallaw.com/w-016-1385). The government confirmed that it did not intend to amend the 2006 Act, but said that further guidance for UK-incorporated companies of all sizes on how the "enlightened shareholder value" model enshrined in section 172 should work in practice would be valuable, and asked the GC100 to produce that guidance.

- A summary of the key legal background to the section 172 duty.
- An example scenario of how directors could discharge their duties in a specific business situation, demonstrating the complexity of the considerations in practice.

Discharging the section 172 duty

The guidance explains that the section 172 duty applies across the full spectrum of a director's role, from setting their company's strategy and defining its culture, to agreeing governance structures, settling business plans and budgets, setting policies and procedures, and making business decisions. It clarifies that the role of the director is not to balance the interests of the company and stakeholders. Instead, after weighing up all of the relevant factors, a director should consider which course of action best leads to the success of the company, having regard to the long term. This can sometimes mean that certain stakeholders are adversely affected, but that fact alone does not make the decision invalid.

The guidance emphasises that every situation that a director is faced with will be different, and that the individual circumstances of a company and its directors mean that different boards of

directors, when faced with the same decision, can reasonably decide to pursue different outcomes, depending on their own experiences, judgments and views.

The guidance also notes that there is no one-size-fits-all approach to compliance with section 172. As such, it reflects the different ways in which a variety of businesses seek to ensure that they achieve their goals responsibly and, at the same time, address their specific company law duties in relation to stakeholder considerations. It also notes that it is intended to be read alongside the guidance on directors' duties that the GC100 published in 2007 when the statutory statement of directors' duties in the 2006 Act came into force.

Practical suggestions to assist directors

The guidance emphasises the importance of company culture. It suggests that, when the board seeks to determine or discuss the culture of the company, it considers how to embed in the behaviours of the board, management and employees a culture which, in its pursuit of success for the benefit of shareholders as a whole, is consistent with the company's goals in relation to stakeholders.

In addition, in order to embed section 172 decision making in their company, it suggests that directors:

- Reflect the section 172 duty when setting and updating company strategy, for example, assessing which third parties the company deals with are considered to be its stakeholders, looking at how best to engage with stakeholders and considering the relationship between the company's vision and stakeholder interests.
- Provide directors' duties training to new directors when they join a board and on an ongoing basis, and consider what training may be appropriate for directors of subsidiary company boards, company management and others.
- Consider the quantity and quality of information required by directors to enable them to carry out their role and satisfy the duty, including information flows to the board, ensuring that input from others is received as and when appropriate and how those below board level consider stakeholder factors.

- Put in place policies and processes appropriate to support the company's operating strategy and to support its goals in the light of the section 172 duty at board level, management level and subsidiary company level.
- Consider the company's approach to engagement with employees and other stakeholders, whether through board engagement or wider corporate engagement, noting that consideration of stakeholder interests may be less effective, or perceived as such, unless it is combined with appropriate, tailored engagement.

The guidance goes on to discuss these practical suggestions in the context of an example scenario setting out how the section 172 duty could be discharged.

Practical implications

The duty contained in section 172 has been in force for over a decade. The increasing focus

on stakeholder interests and responsible business practices, in particular in light of a number of well-publicised corporate insolvencies, has now brought to the fore questions around whether and how directors are discharging their statutory duties.

This focus will likely intensify as companies start to comply with the new requirement introduced by The Companies (Miscellaneous Reporting) Regulations 2018 (*SI 2018/860*) to produce a section 172(1) statement setting out details of how the directors have regard to the stakeholder factors set out in section 172 (www.practicallaw.com/w-015-4017). As such, the guidance provides a timely overview of the key issues that directors should bear in mind when considering their section 172 duty.

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