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Corporate Governance

Introduction

James Palmer
Herbert Smith Freehills LLP

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INTRODUCTION

Herbert Smith Freehills LLP operates from 27 offices across Asia Pacific, Europe, the Middle East, Africa and North America. The firm is at the heart of the new global business landscape, providing premium quality, full-service legal advice. Herbert Smith Freehills provides many of the world's most important organisations with access to market-leading dispute resolution, projects and transactional legal advice, combined with expertise in a number of global industry sectors, including banks, consumer products, energy, financial buyers, infrastructure and transport, mining, pharmaceuticals and healthcare, real estate, TMT, and manufacturing and industrials. The dedicated corporate governance advisory team comprises governance specialists with technical expertise who provide practical advice to clients on the full spectrum of governance issues. The team advises listed and private companies on the regulatory, reporting and governance standards applicable to them. The firm draws on its wide-ranging experience to advise on legal and regulatory requirements, emerging trends and market best practice.

Contributing Editor

James Palmer is chair and senior partner at Herbert Smith Freehills. He specialises in corporate law, governance and financial regulation. James has been with the firm for more than 30 years and advises clients on transactions, governance, strategic and reputational challenges and negotiations. He has had extensive involvement in the significant developments in UK and EU law and regulation across takeovers, capital markets, company law and corporate governance, including in particular the UK law on directors' duties and liabilities and shareholder derivative actions. James contributed both to the 2007 and to the 2018 GC100 guidance on directors' duties.

Co-authors

Caroline Rae advises leading corporates and financial institutions on private acquisitions and disposals, public company takeovers, joint ventures and equity capital raisings, with a particular focus in the financial services sector. Caroline is a member of the Corporate Governance Advisory Team and advises a number of the firm's listed company clients on the UK Corporate Governance Code, corporate reporting, listed company regulation and compliance and board advisory matters.

Gareth Sykes helps companies navigate the increasingly challenging corporate law and governance framework. He is a member of the firm's Corporate Governance Advisory team, advising a range of listed and privately held companies on a variety of governance issues. Gareth's expertise includes advising on corporate reporting requirements, the UK Corporate Governance Code, continuing obligations pursuant to the UK listing regime, company meetings and directors' duties. A key part of his role is horizon-scanning, analysing new law and regulation to ensure that the firm's clients anticipate and remain at the forefront of corporate governance developments and practice. Gareth writes widely on corporate governance matters.

The Changing World of Governance

The traditional role of governance

For many years, in most countries, corporate governance has been seen principally as the framework by which boards of companies, as managers of businesses, are controlled by and engage with the shareholders who ultimately own the business.

In the case of a private or public company 20 or 30 years ago, this involved setting the rules in a given jurisdiction for disclosure and reporting to shareholders, shareholder voting, board management of its and the company's affairs, and setting the framework for the relevant rights, duties and liabilities of those who had come together to own or run the relevant business. In large part, jurisdictions such as the UK and Delaware, USA, have sought to provide flexibility to the parties, allowing them to set rules according to what works best for them, but within an overall framework. Regulators of public securities markets have added extra layers in order to reflect the particular dynamics of those markets. Over and above the legal and regulatory requirements, practices have developed which are not mandated but are expected to apply, absent good reason to the contrary; in effect, a level of flexibility in the private law relationships between boards and investors has continued.

That is not to say that governance has always been exclusively a matter of private law rights under the constitution of the relevant company or under the laws governing companies, save where public securities market regulation applies. There is also a long tradition under most corporate law of certain matters being required – for example, for information to be filed publicly at national or state corporate registries, and of obligations being imposed on those who lead companies which are subject to criminal enforcement. This is to ensure a level of governance protection for creditors and investors dealing with companies in the relevant markets: the accountability is required to take the benefits of limited liability through incorporation.

In most major jurisdictions for incorporation or public trading of securities, over the last two decades there has been a dramatic increase in focus on corporate governance and disclosure. This has included responding to actual or perceived scandals or failures, reflecting the more complex nature of corporate structures and activities, and reflecting the ever-more complex intermediation and ownership structures behind shareholders on the corporate register.

However, we are also seeing proposals for more and more governance regulation to further wider social and stakeholder goals, reflecting the important role of businesses within countries and internationally, and ever-increasing levels of short-term political interest in governance, as a way of signalling political positions.

Stakeholder and social roles of governance

As an example, the UK in recent years has introduced extensive changes to the reporting requirements for public companies. These cover not only issues such as better reporting of risks, but also reporting on social factors and aspects of businesses, from climate change to gender pay ratios. Other countries will have different views, but many of these have been largely welcomed in the UK as elements of responsible business governance and transparency. It seems highly likely that this trend will continue and be picked up in other markets.

There is no doubt that reporting of societal aspects of businesses can lead to check-box responses, but it can also positively influence how companies engage with those issues. In the UK, changes to date have largely been managed through increasing transparency rather than absolute requirements being imposed as to the conduct of businesses. The expansion of non-binding guidance by industry groups seeking to shift behaviours has also helped in that regard – for instance, the guidance issued last year by the GC100 (the organisation for UK FTSE 100 general counsel and company secretaries) in relation to the stakeholder duties applicable under Section 172 Companies Act 2006.

Short-term political intervention in governance

Short-term political interest and intervention in governance is not completely new: 'foreign' ownership and other public interest issues have always been subjects ripe for political intervention, both with and without a cogent policy agenda, but the increased extent of such interest is striking. Politicians across the political spectrum have increasingly sought 'quick-fix' solutions to real and perceived issues in the governance of companies, inevitably on occasions without the time, inputs and understanding required to see the way in which existing laws and rules work. Even when the policy issues are real, it remains important to ensure that overly simplistic policy responses do not undermine good governance structures, or otherwise fail to achieve their stated purposes. This is not about resisting all change, some of which will enhance corporate effectiveness and outcomes, but about challenging the soundbite initiatives that can sometimes be put forward. Effective corporate law and governance structures facilitate responsible business, investment and trade and ill-considered changes can easily cause them to lose effectiveness.

Often the solution is not through changes to governance law, but through improvement to requirements and duties in relation to a particular underlying social concern – for example, using employment law, not corporate law, to address employee rights.

Engagement by business and governance lawyers in development of governance rules

It is easy to blame politicians for the challenges brought about by poorly thought-through proposals, and in part this may be justified. However, in many jurisdictions it seems inevitable that focus on how businesses are governed, and their wider social impact, will only expand in the foreseeable future. This requires governance lawyers to seek to understand the underlying pressures on politicians to intervene, to seek to anticipate justified concerns, and to build trust with policy-makers in order to be listened to when the legally complex implications of policies need to be explained to them.

Ultimately, if we do not engage in supporting good governance outcomes – which balance the value of the historic flexibility of governance frameworks with the social outcomes which are increasingly matters of valid social concern – we will have only ourselves to blame. The evidence to date suggests thoughtful engagement in this jurisdiction has worked well at managing the less well-considered proposals for change.

Herbert Smith Freehills LLP

Exchange House
Primrose Street
London EC2A 2EG

HERBERT SMITH FREEHILLS

Tel: +44 20 7374 8000
Fax: +44 20 7374 0888
Email: gareth.sykes@hsf.com
Web: www.herbertsmithfreehills.com