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Corporate Governance

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Law and Practice

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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.

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1. Introduction

1.1 Forms of Corporate/Business Organisations

Anyone choosing to set up a business in the UK may choose between a broad range of business structures.

The most common type of company in England and Wales is a private company limited by shares. A company limited by shares is one in which, in the event that the company goes into liquidation, the liability of its shareholders is limited to the amount paid or payable when subscribing for those shares (that is, limited liability). Private limited companies are not able to offer shares to the public, meaning they cannot offer shares if they consider those shares might become available to anyone other than those receiving the offer.

Companies that wish to offer securities to the public are most commonly registered as a public company limited by shares. UK legislation also affords limited liability to shareholders in public companies but imposes certain additional restrictions on public companies for the protection of shareholders and creditors. More detail on public companies can be found in **3. Management of the Company**.

Other less frequently used forms of company structure include the following.

- Private unlimited companies, which do not have any limit on the members' liability in the event of the company going into liquidation and being unable to pay its debts.
- Companies limited by guarantee, in which the liability of the subscribers is limited to the amount they have agreed to guarantee. These are commonly used by non-profit making organisations.
- Societas Europaea (SE), which can be used by companies or groups with operations in more than one member state of the European Economic Area (EEA). Following the UK's departure from the EU, all existing SEs registered in the UK will convert into 'United Kingdom Societates' and it will not be possible to form new SEs in the UK.
- Partnerships, whereby persons come together to carry on a business with a view to a profit. It does not have its own legal personality and therefore cannot hold assets other than in the name of the partners. Other forms of partnership include a limited partnership (LP) or a limited liability partnership (LLP). In an LP, one or more partners have limited liability and one or more partners have unlimited liability. An LLP has separate legal personality and all partners have limited liability.

1.2 Sources of Corporate Governance Requirements

The key legislation governing the operation of a company incorporated in England and Wales includes the following.

- *Companies Act 2006 (Companies Act)* – the UK company law regime is set out in the Companies Act 2006, which is the principal body of legislation governing the formation and management of companies in the UK. The Companies Act has been fully in force since 1 October 2009.
- *Insolvency Act 1986* – this act contains provisions relating to the insolvency and winding up of companies.
- *Common law* – this includes the parts of the law relating to English companies that has no statutory basis but has been established by judges through case law. This body of case law is known as the common law.
- *Financial Services and Markets Act 2000 (FSMA)* – this act sets out the UK regime for financial services and securities law. In particular, there are restrictions on offering securities and a requirement for companies to produce a prospectus when they offer their securities to the public (subject to certain exceptions). In addition, partnerships, LPs and LLPs are governed by the Partnerships Act 1890, the Limited Partnerships Act 1907 and the Limited Liability Partnerships Act 2000 respectively.

A key source of a company's corporate governance requirements will be its articles of association. The articles of association govern the internal affairs of the company and regulate a great range of matters (subject to the requirements of the Companies Act). These include the rights attached to the company's shares' (including voting rights), the powers of the directors, the regulation of shareholders' and directors' meetings, the alteration of capital and the transfer of shares.

The key corporate governance codes and principles include the following:

- the UK Corporate Governance Code (the Governance Code), which applies to premium listed companies (see **1.3 Corporate Governance Requirements for Publicly Traded Companies** for further details); and
- the Wates Corporate Governance Principles for Large Private Companies (the Wates Principles), which provide a framework for large privately owned companies to consider and report on their corporate governance arrangements (see **2.2 Current Issues and Developments** for further details).

1.3 Corporate Governance Requirements for Publicly Traded Companies

In addition to the requirements of the sources identified in **1.2 Sources of Corporate Governance Requirements**, companies whose shares are publicly traded need to consider the following.

- The Governance Code, which is produced and overseen by the Financial Reporting Council (FRC). It applies to premium listed companies and is generally adhered to by most companies to which it applies. The Governance Code sets out principles and provisions relating to board

leadership and company purpose; division of responsibilities; composition, succession and evaluation; audit, risk and internal control; and remuneration. The Listing Rules require premium listed companies to explain how they have applied the principles set out in the Governance Code and so, to that extent, the principles contained in the Governance Code are compulsory for premium listed companies. In contrast, the provisions of the Governance Code apply on a 'comply or explain' basis that allows for some flexibility in the implementation of the provisions by listed companies.
- The Listing Rules, which are issued by the Financial Conduct Authority (FCA). They set out the requirements for obtaining a listing of securities on the Official List and mandatory continuing obligations that apply once a company is listed. These rules also govern the need for shareholder approval of significant transactions and the disclosure of relevant information to the market. The listing and continuing obligations applicable to any company will depend on whether it has a premium or standard listing. All companies with a premium listing of equity shares, regardless of where they are incorporated, are required under the Listing Rules to make a two-part statement in relation to the Governance Code in their annual report. In the first part of the statement, companies must disclose how they have applied the principles of the Governance Code and in the second part of the statement, companies need to confirm that they have complied with the provisions of the Governance Code, or to the extent that they have not complied, explain what has not been complied with and the company's reasons for non-compliance.
- The Transparency Rules, which are also issued by the FCA. For the most part, the Transparency Rules implement the provision of the EU Transparency Directives. They require companies to include a corporate governance statement in their annual report, setting out certain prescribed information. They also contain requirements in relation to audit committees (or the body responsible for performing similar functions), setting out the minimum functions the body must carry out and requirements as to the composition of that body.
- The EU Market Abuse Regulation (MAR). It sets out requirements relating to the disclosure of inside information by listed companies and governs the related offences of insider dealing and unlawful disclosure of inside information. MAR also restricts when directors may deal in the company's securities and requires directors (and persons closely associated with them) to disclose their share dealings to the relevant company. It is expected that upon a departure of the UK from the EU, the substantive provisions of MAR will apply through domestic UK legislation.
- The AIM Rules, which are published by the London Stock Exchange. These apply to companies with shares admitted to trading on AIM (the market for smaller growing companies in the UK). Additional corporate governance requirements were introduced into the AIM Rules in September 2018 requiring AIM companies to state on their website which recognised corporate governance code they apply and to report, on a 'comply or explain' basis, against that code.

2. Corporate Governance Framework

2.1 Key Rules and Requirements

A number of organisations produce guidance on corporate governance issues in the UK. In particular, the FRC has issued:

- the FRC Guidance on Board Effectiveness, which aims to assist companies implementing the Governance Code and includes guidance on the role of the chair, the executive directors and non-executive directors, as well as on issues including board composition and on board evaluation;
- the FRC Guidance on Audit Committees, which contains best practice guidelines relating to audit committees and the provisions of the Governance Code relating to audit; and
- the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.

A number of institutional investor bodies, including The Investment Association and the Pensions and Lifetime Savings Association, also produce their own corporate governance guidelines that listed companies need to be aware of, and the Institute of Chartered Secretaries and Administrators regularly issues guidance notes on corporate governance issues.

2.2 Current Issues and Developments

There has been considerable focus in the UK on corporate governance in recent years, following a renewed emphasis on the role of business in society. This, coupled with continuing concerns about the rising levels of executive pay, led to a focus on the behaviour and transparency of large UK businesses and how the interests of their wider stakeholders should be taken into account. Prompted by this, the government published a corporate governance consultation paper in November 2016 that discussed a number of potential options for UK corporate governance reform under three broad headings: executive pay; strengthening the employee, customer and wider stakeholder voice; and corporate governance in large privately held businesses. The government published its response paper in August 2017, setting out proposed corporate governance reforms, including new corporate governance reporting requirements, recommendations for provisions in an updated Governance Code and the introduction of a corporate governance code for large privately held companies.

Reporting Requirements
A range of new corporate governance reporting requirements have been introduced for UK-incorporated companies as part of the government's corporate governance reform agenda. They cover areas including performance of the director's Section 172 duty to promote the success of the company, employee and other stakeholder engagement, governance arrangements and chief executive officer (CEO) pay ratios. Each of these reporting requirements applies to a different sub-set of UK-incorporated companies by reference to their size. They apply for financial years beginning on or after 1 January 2019.

UK Corporate Governance Code
A new edition of the Governance Code was published in 2018. It contains a range of new requirements for corporate behaviour and reporting, including:

- an enhanced focus on culture and aligning the company's strategy and values with culture;
- new stakeholder engagement and directors' Section 172 duty disclosure requirements;
- a requirement for the board to have a mechanism for workforce engagement;
- that the chair of the board of directors should not normally remain in post for longer than nine years from the date of their appointment to the board;
- greater focus on gender, social and ethnic diversity in succession planning for the board and senior managers; and
- an enhanced role for the remuneration committee to oversee company-wide remuneration policies and additional executive remuneration reporting requirements, and a focus on board discretion.

The 2018 edition of the Governance Code applies to financial years beginning on or after 1 January 2019.

Corporate Governance Code for Private Companies
The Wates Corporate Governance Principles for Large Private Companies are a set of corporate governance principles for large privately held businesses. Six areas of corporate governance are discussed: purpose and leadership, board composition, director responsibilities, opportunity and risk, remuneration, and stakeholder relationships and engagement. The Wates Principles adopt an 'apply and explain' approach; that is, companies are expected to apply each principle and, for each one, provide a supporting statement that gives an understanding of how their corporate governance processes operate and achieve the desired outcomes.

The Wates Principles provide very large private companies with a framework for complying with the new corporate governance reporting requirement, which applies to accounting periods beginning on or after 1 January 2019, which requires very large UK-incorporated companies to state which corporate governance code, if any, they applied and how that corporate governance code was applied. This is the first attempt to introduce governance conduct provisions for non-listed companies in the UK.

UK Stewardship Code
The UK Stewardship Code (Stewardship Code), which outlines good practice for institutional investors in their engagement with UK listed companies, is currently the subject of a review. Following this review, the Stewardship Code is expected to include a greater focus on investors' values and a need for investors to take account of environmental, social and governance factors in making their decisions. The revised version is expected to be published later in summer 2019.

Implementation of the EU Shareholder Rights Directive
A directive amending the Shareholder Rights Directive was published in the EU Official Journal in May 2017 (SRD II). It was implemented into UK law with effect from 10 June 2019. SRD II seeks to enhance transparency and encourage long-term shareholder engagement in companies whose shares are traded on an EU-regulated market. The key features of SRD II, as implemented in the UK, include the following.

- *Directors' remuneration* – companies are required to publish a report on their directors' remuneration and obtain shareholder approval for the report and the company's remuneration policy. Many of the SRD II requirements are substantially the same as the requirements already imposed on UK-incorporated quoted companies (see **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers** for further details) but there are some detailed differences to the UK regime; in particular, there are some new disclosure requirements and more companies come within the scope of the regime.
- *Related-party transactions* – certain material transactions between a listed company and a related party must be publicly disclosed and approved by the board of directors. The FCA has amended the Transparency Rules to incorporate the related-party aspects of SRD II into UK law. These requirements apply to companies with a premium listing or a standard listing of equity shares (regardless of their country of incorporation) and are in addition to the existing related-party transaction rules for premium-listed companies in Listing Rule 11, which remain unchanged.
- *Regulation of proxy advisors* – proxy advisors are subject to new transparency requirements in relation to their voting recommendations and conflicts of interest, including reporting on a 'comply or explain' basis as to how they have applied a code of conduct. The FCA will maintain a public list of proxy advisors and will be responsible for enforcing these new requirements.
- *Engagement by institutional investors and asset managers* – institutional investors and asset managers must develop

and disclose publicly an engagement policy that describes how they take the long-term interests of their beneficiaries into account in their investment strategies. A number of changes have been made to the FCA Handbook to implement these requirements in relation to asset managers and certain life insurers, and, as noted above, the FRC is reviewing the Stewardship Code, which will reflect the requirements of SRD II.

Reform of the Financial Reporting Council
The government asked Sir John Kingman to lead a review of the FRC in April 2018. The Kingman Review was published in December 2018 and sets out 83 recommendations, including that the FRC be replaced with an independent statutory regulator. The new regulator would have a new mandate, new clarity of mission, new leadership and new powers.

In March 2019, the government published an initial consultation seeking views on the reforms of the FRC proposed in the Kingman Review. It confirmed that it intends to replace the FRC with a new independent statutory regulator that will be called the Audit, Reporting and Governance Authority.

Reform of the Statutory Audit Market
There has been considerable focus in the UK on the purpose and effectiveness of the statutory audit process in recent years.

The Competition and Markets Authority (CMA) launched a detailed study of the audit market in October 2018 and published its final report in April 2019, which concluded that there is a shortfall in the quality of audits in the UK. In light of this, the CMA recommended that the government implement a package of remedies designed to increase the effectiveness of audit committees across FTSE 350 companies, increase market resilience and the choice of statutory audit providers, and address audit quality concerns. The recommended remedies include the following.

- *Audit committee scrutiny* – that audit committees should be more closely regulated by the Audit, Reporting and Governance Authority (the proposed successor body to the Financial Reporting Council).
- *Joint audits and peer reviews* – that FTSE 350 audits should be carried out jointly by two firms, at least one of which should be outside the Big Four.
- *Non-audit services* – an operational split between the audit and non-audit practices of the biggest audit firms in the UK is also recommended by the CMA. The audit practice should have separate management (including a majority of independent non-executive directors), financial statements and remuneration arrangements.
- *Market resilience* – measures to mitigate the risk of the Big Four becoming the big three are also proposed, including the greater monitoring of audit firms by the new regulator.

Separately, the government asked Sir Donald Brydon to lead an independent review into audit standards and the quality and effectiveness of the UK audit market. The Review will primarily focus on the purpose, scope and quality of audit.

The UK Parliament House of Commons Business, Energy and Industrial Strategy Select Committee also published a report on The Future of Audit in March 2019 following an inquiry into the audit sector.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The principal bodies and functions involved in the governance and management of a company in the UK are as follows.

- The board of directors. As discussed in **4.3 Board Composition Requirements/Recommendations**, a company is required to appoint directors. The articles of association of the company will typically delegate management of the company to the directors, enabling them to execute all the powers of the company. The composition and activities of a board of directors will vary depending on the company's circumstances. For companies which are not listed, the board is usually comprised of executive directors who are involved in the day-to-day management of the business. An unlisted company may appoint non-executive directors to the board and the Wates Principles encourage companies to consider this. Publicly listed company boards are likely to include non-executive directors in accordance with the provisions of the Governance Code. The Governance Code states that a chair of the board should be appointed, who should be independent on appointment and should generally serve on the board for not more than nine years. The role of the chair is to lead the board and ensure its effectiveness in directing the company.
- The company secretary. It is a requirement under the Companies Act for a public company to have a company secretary. Private companies are not required to have a company secretary. The role of the company secretary is to support the board and advise the board on corporate governance issues.
- The executive management team. The responsibility of the executive team is to implement the board's decisions and policies, and deal with the day-to-day management of the company. In unlisted companies, the executive team will often comprise the same individuals as the board of directors. In a publicly listed company, the CEO and chief financial officer (CFO) will usually be directors of the company, with the remaining members of the executive team forming sitting on an executive committee or equivalent.

- Shareholders. The shareholders are the owners of the company, and those who hold the board of directors to account. The articles of association and the Companies Act provide that a number of decisions are reserved for shareholders (see **3.2 Types of Decisions Made by Governing Bodies**).

3.2 Types of Decisions Made by Governing Bodies

The decision-making of a company is generally delegated to the board of directors (although there are some decisions that are reserved for the shareholders). The key decisions made at each level of the management of a company are as follows.

- *The board of directors* – most decisions are made by the board of directors and will typically relate to the strategy and general management of the company.
- *The management team* – where the management team is different to the board of directors, it will make decisions on the day-to-day business of the company pursuant to powers delegated by the board of directors.
- *Shareholders* – under the Companies Act, there are a number of decisions that are reserved for shareholders and that can only be passed by shareholder resolution (although some of these decisions can be delegated to the board of directors under a company's articles of association). The decisions include:
  - (a) amending the articles of association;
  - (b) the parameters for certain issues of shares;
  - (c) the buy-back of shares;
  - (d) ratifying a director's conduct (for negligence or breach of duty); and
  - (e) resolving that the company be voluntarily wound up.

3.3 Decision-making Processes

The board of directors, management team and shareholders make decisions in the following ways.

- *The board of directors* – decisions by the board are taken in the form of board resolutions and are taken by the directors at a board meeting. The Companies Act does not stipulate the voting requirements for board resolutions. These requirements are set out in the company's articles of association and resolutions are typically passed by a simple majority. Board resolutions may also take the form of written resolutions, meaning a board meeting does not have to be physically convened. When making decisions, the directors must have regard to their general duties under the Companies Act (see **4.6 Legal Duties of Directors/Officers**), which include that decisions must be in the company's best interest.
- *The management team* – the management team implements decisions made by the board but acts through delegated authorities from the board. As such, decisions must be made within the terms of the delegation.
- *Shareholders* – decisions by shareholders are taken in the form of shareholder resolutions at a general meeting (or for private companies only, by written resolution, in which case a physical meeting will not be required). In order to convene a general meeting to pass a shareholder resolution, a company must provide shareholders with notice of the meeting, including information about the issues that are to be resolved. The Companies Act stipulates the approval threshold for each type of shareholder decision to be passed, which is typically a simple majority (required to pass an ordinary resolution) or not less than 75% of shareholders (required to pass a special resolution). Most shareholder resolutions can be passed by an ordinary resolution while others, such as a disapplication of pre-emption rights on an allotment of shares, require a special resolution. Only a few decisions, including consenting to convene a general meeting on short notice, need 90% or more of shareholders to approve. The company's articles of association may also make the approval thresholds more onerous than as set out in the Companies Act but not less onerous. Public companies are required to hold an annual general meeting of its shareholders (AGM). Standard business for an AGM includes the re-election of directors, appointment of an auditor and authorising certain matters in relation to a company's share capital.

4. Directors and Officers

4.1 Board Structure

Requirements in Law

Under the Companies Act, private companies must have at least one director and public companies at least two directors and a company secretary.

Companies have a single-tier, unitary board. Executive and non-executive directors are both members of the board, in contrast to other jurisdictions where non-executive directors sit on a separate supervisory body.

Requirements under the Governance Code

The Governance Code provides that at least half the board, excluding the chair, should be comprised of independent non-executive directors. The Governance Code also provides that companies should form three committees: a nomination committee, a remuneration committee and an audit committee. The nomination committee should lead the process for making and recommending appointments to the board. The main role of the audit committee is to monitor the integrity of the company's financial statements and review the company's internal controls. The remuneration committee should have responsibility for determining the policy for executive director remuneration and setting remuneration for the chair, executive directors and senior management. The remuneration and audit committees should be comprised entirely of independent non-executive directors and the nomination committee should have a majority of independent non-executive directors.

4.2 Roles of Board Members

Directors can be executive (with a service contract) or non-executive. The board of directors will typically comprise the following.

- *Chair of the board* – the Governance Code recommends that a chair be appointed to the board. The role of the chair is to chair board meetings and take on a leadership role to ensure the effectiveness of the board. The Governance Code recommends that the chair must not be the same person as the chief executive officer, to ensure independence.
- *Non-executive directors* – the Governance Code provides that at least half the board, excluding the chair, be independent as assessed by reference to various criteria set out therein. The Governance Code says that the role of non-executive directors is to challenge and advise the board on the company's strategy and policies. The Wates Principles state that privately held companies should have due regard to the benefits independent non-executive directors can bring.
- *Senior independent director* – the Governance Code provides that the board should appoint one of the independent non-executive directors to be the senior independent director, who should provide a sounding board for the chair and serve as an intermediary for the other directors and shareholders. Led by the senior independent director, the non-executive directors should meet without the chair present at least annually to appraise the chair's performance and on other occasions as necessary.
- *Executive directors* – executive directors may include a chief executive officer, chief financial officer (CFO) and chief operational officer (COO). All or some of these may be board members. There are no specific legal requirements regarding which executive directors a company should appoint and the number or type of executive directors will depend on the business needs of a company. The role of the executive directors is to implement the decisions made by the board of directors and to discharge overall managerial responsibilities. For example, a CEO is typically responsible for the overall management of the company, while a CFO is responsible for the company's accounts and finances, and a COO is responsible for the overall operations and administration of the company.

4.3 Board Composition Requirements/ Recommendations

Subject to the provisions of the Companies Act, the articles of association may prescribe a maximum or minimum number of directors. Corporate directors are currently permitted, but at least one of the directors must be an individual.

The Governance Code recommends that the directors have appropriate skills, experience, independence and knowledge of the business to discharge their responsibilities properly and effectively. The Governance Code recommends that directors are appointed with regards to the benefits of diversity, including diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.

There has been a focus on board diversity for a number of years in the UK. In 2010, Lord Davies was invited by the government to review and identify barriers to women reaching the boardroom and to make recommendations as to how the proportion of women on listed company boards could be increased. Building on this work, the Hampton-Alexander Review was formed in 2016, extending the focus on improving gender balance beyond the boardroom to improving the representation of women in leadership positions of FTSE 350 companies. Its recommendations include that by 2020 a minimum of 33% of a FTSE 350 company's board of directors should be female and a minimum of 33% of a FTSE 100 company's executive committee and direct reports to the executive committee should be female.

In addition, the Parker Review Committee was set up in 2017 to look at ethnic diversity on listed company boards.

4.4 Appointment and Removal of Directors/ Officers

The Companies Act sets out the requirements for appointing directors upon incorporation of a company but is silent on subsequent appointments. Therefore, the process will be set out in the company's articles of association, which usually stipulate that directors can be appointed by a decision of the board of directors or by shareholders, in each case by simple majority.

Upon incorporation, a statement must be delivered to Companies House setting out the proposed directors and a confirmation from each director that he or she is willing to act as a director.

Listed companies typically have a nomination committee that has responsibility for recommending board appointments. The Governance Code recommends that all directors of premium listed companies stand for re-election annually at the company's annual general meeting regardless of the size of the company.

There are a number of ways a director can be removed from office. The Companies Act provides that a director may be removed by ordinary resolution (before the expiration of the director's term). If a director is to be removed before the expiration of his or her term, the Companies Act sets out a number of protections that must be complied with, including that the ordinary resolution cannot be a written resolution and that the director has the right to be heard by the shareholders at the general meeting. In addition, a company's articles of association typically set out grounds for removal.

4.5 Independence of Directors and Conflicts of Interest

Independence

There are no requirements at law regarding independence of directors. However, the Governance Code provides that at least half the members of the board of a premium listed company should comprise independent non-executive directors, determined in accordance with the Governance Code. Independent non-executive directors should not have been an employee of the company or group within the last five years, should not have had a material relationship with the company in the last three years, should not have close family ties with any of the company's advisers, directors or senior employees and should not represent a significant shareholding. However, a company may, notwithstanding the existence of these circumstances, determine a director to be independent. If they do so, this should be explained in the company's annual report.

Conflicts

Under the Companies Act, directors have a duty to avoid situations in which they have, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. The duty is stated to apply, in particular, to the exploitation of any property, information or opportunity. A director will therefore need to consider carefully whether an opportunity rightfully belongs to the company before exploiting it.

There are a number of exceptions to this duty, including where the matter has been authorised by the company's directors, where the company has given authority to the directors for something to be done or where the articles of association contain a provision for dealing with conflicts and the directors are acting in accordance with that provision.

Directors have three related duties, including the duty not to accept benefits from third parties, the duty to declare any interest in a proposed transaction and the duty to declare an interest in an existing transaction (see **4.6 Legal Duties of Directors/Officers**). These interests would typically be declared at the board meeting authorising the transaction.

4.6 Legal Duties of Directors/Officers

The rules governing directors' duties are set out in the Companies Act.

The Companies Act includes a statutory statement of the duties a director owes to the company. The statutory directors' duties are:

- a duty to act within the powers conferred by the company's constitution;
- a duty to promote the success of the company for the benefit of the members as a whole;
- a duty to exercise independent judgment;
- a duty to exercise reasonable care, skill and diligence;
- a duty to avoid conflicts of interest;
- a duty not to accept benefits from third parties; and
- a duty to disclose an interest in a proposed transaction with the company.

The duties apply to all the directors of a company. However, the statutory statement of duties does not cover all the obligations of a director. Other obligations are contained throughout the Companies Act, such as the duty to deliver accounts and the obligation to disclose an interest in an existing transaction with the company. There are also obligations contained in other statutes; for example, the Insolvency Act 1986. In addition, directors have a general fiduciary duty to their shareholders that arises from the relationship of trust and confidence between them and their shareholders.

4.7 Responsibility/Accountability of Directors

The directors' statutory duties as set out in the Companies Act are owed directly to the company (not to any individual shareholder(s) or to any stakeholder(s)). However, embedded within them is a requirement to have regard to the interests of a number of stakeholders. The duty to promote the success of the company requires directors to have regard to the interests of its employees, community and the environment, and to foster the company's relationships with suppliers, customers and others when considering this duty.

In addition, the directors owe a fiduciary duty under the common law to shareholders to provide them with information that is sufficient, clear and not misleading, to enable them to make an informed decision as to how to vote at a shareholder meeting.

4.8 Breach of Directors' Duties

As a general rule, a company is the only person able to bring a claim against one of its directors for breach of duty, since the duty is owed by the directors to the company itself. This means that a shareholder (acting on their own behalf) cannot bring an action against a director for breach of duty, which results in practical difficulties, in so far as the board is unlikely to approve the company bringing an action against one of their own for breach of duty. To mitigate this, the Companies Act contains a statutory procedure pursuant to which a shareholder may, in certain circumstances, bring a derivative claim on behalf of the company. Further detail on such actions is set out in **5.4 Shareholder Claims**.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

In addition to liability relating to breaches of duty, directors may also be liable for breaches of statutory provisions within the Companies Act, such as those relating to unlawful distributions or unlawful directors' remuneration payments. In certain circumstances, directors may also be subject to criminal penalties, particularly in relation to health, safety and environmental matters; competition and anti-competitive behaviour; and bribery, corruption and fraud.

Directors can to an extent protect themselves from the liabilities arising from their role; however, there are some limitations on public policy grounds. A company may generally indemnify directors against liability incurred towards a third party in the performance of their role. However, companies may not indemnify their directors for breaches of duties or negligence. Similarly, there are limitations to the extent to which a company can indemnify directors in circumstances where criminal proceedings are being brought against them.

A company may also purchase D&O insurance for directors.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

At law, approval by shareholders is required for any director's service contract for which the guaranteed term is longer than two years. Failure to obtain approval makes the relevant contractual provision void and allows the company to terminate the service contract at any time by giving reasonable notice.

A quoted company (that is, a company whose equity share capital is listed on the Official List in the UK, a company officially listed in an EEA state or admitted to dealing on NASDAQ or the NYSE) may not make any remuneration payment to a director or former director unless that payment is in accordance with its latest remuneration policy approved by shareholders (or the payment has been separately approved by shareholders). The directors' remuneration policy is a binding policy and must be approved by an ordinary resolution of shareholders at least once every three years. In addition, shareholders are required to vote on a statement disclosing the directors' remuneration and loss of office payments for the previous year. This vote is indicative and does not have the effect of clawing back any payment that has already been made; however, if the directors' remuneration report is not approved by shareholders, the company is required to table a new remuneration policy the following year. These requirements have recently been extended to non-quoted traded companies to comply with the requirements of SRD II (see **2.2 Current Issues and Developments**). Traded companies are companies with voting share admitted to trading on a regulated market in an EEA state.

The Governance Code also places additional reporting requirements on a company's remuneration committee in relation to the pay of directors and senior managers. The remuneration committee is required to provide a full description of its strategic rationale in making remuneration decisions, including explaining why the remuneration is appropriate; how the committee addressed issues such as clarity, risk and proportionality; and whether any shareholder engagement or workforce engagement has been sought. A quoted company must also publish the pay difference between its CEO and its average UK employee.

4.11 Disclosure of Payments to Directors/Officers

Certain details of a director's remuneration are required to be disclosed in the directors' remuneration report contained in a quoted company's annual report and accounts.

A directors' remuneration report must contain a statement from the chair of the remuneration committee that summarises major decisions on directors' remuneration, any substantial changes relating to directors' remuneration made during the year and the context in which those changes and decisions occurred or were taken. There are then a number of detailed disclosures that must be included on topics, including a single total figure of remuneration of each director; any variable pay awards made under bonus or incentive schemes; pensions entitlements; and directors' shareholdings. If a directors' remuneration policy is included in the report, it must cover pay and benefits for current directors and potential new recruits, and exit payments for directors who leave. These requirements have recently been extended to non-quoted traded companies to comply with the requirements of SRD II (see **2.2 Current Issues and Developments**).

Additionally, directors' service contracts must be open to inspection by members and members may request copies.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

A shareholder's relationship with the company in which he holds shares is a contractual one. Under the Companies Act, the articles of association bind the company and its members to the same extent as if they were covenants on the part of the company and each member to observe the provisions. The articles of association therefore constitute a form of contract between the company and its shareholders, and between the shareholders themselves. The shares held by the members give a right of participation in the company on the terms of the articles of association.

A shareholder does not have a proprietary interest in the underlying assets of a company. Shareholders are entitled in proportion to their respective shareholdings to a share of the distributed profits of the company and, on a winding-up, to the surplus assets of the company after the company's creditors have been repaid in full. Shareholders are not liable for the acts of the company, except in very limited circumstances when the corporate veil can be pierced, where a company's limited liability status is set aside and a shareholder is liable for the company's acts.

5.2 Role of Shareholders in Company Management

Articles of association usually delegate to the directors the exercise of the powers of the company, save for those powers that are required by the articles or the Companies Act to be exercised by the shareholders in a general meeting or by shareholder resolution. Therefore, it is rare for shareholders in their capacity as such to have involvement in the day-to-day running of the company. Shareholders in joint venture companies may agree contractually that certain actions will not be taken by the company unless agreed by a particular number or majority of shareholders.

If desired, shareholders can direct the management of a company to take, or refrain from taking, certain actions in the business by directing the directors to call a general meeting. The shareholders must hold more that 5% of the voting rights to make this request and must explain the general nature of the issues they wish to raise at the meeting. Directors will not be required to table a resolution if it is defamatory, frivolous or vexatious, or if it would not be effective if passed.

5.3 Shareholder Meetings

A public company is required to hold an AGM every year within six months of its financial year-end. There is no statutory requirement for a private company to hold an AGM but there may be an express requirement to hold one in the company's articles of association. For public companies, 21 clear days' notice of the AGM is required, unless all who are entitled to attend and vote consent to shorter notice being given.

Any shareholder meeting other than an AGM is a general meeting. The minimum statutory notice period required for a general meeting of a private company (which is not a traded company) is 14 clear days. For public companies, the minimum statutory notice period for general meetings other than AGMs is 14 clear days; however, it is 21 clear days for public companies which are traded companies. Traded companies can reduce the minimum notice period for these meetings to 14 clear days if (i) shareholders have passed an annual resolution to shorten the notice period to 14 clear days and (ii) the company allows shareholders to appoint a proxy by electronic means via a website.

Shareholders holding 90% (in the case of private companies) or 95% (in the case of public companies) of the nominal value of shares giving a right to attend and vote may agree to shorter notice of general meetings. The articles of association may specify a longer notice period (but the articles of association cannot specify a shorter period).

Shareholder meetings are almost exclusively physical meetings. There are very few examples of virtual, or electronic, shareholder meetings (that is, a shareholder meeting held exclusively through the use of online technology, with no physical meeting). Increasingly articles of association permit companies to hold virtual shareholder meetings, that is, a physical meeting where shareholders can also participate online as an alternative to attending the physical location in person, although these are rare in practice.

5.4 Shareholder Claims

As a general rule, a company is the right person to bring a claim against one of its directors for breach of duty, since the duty is owed to the company. However, the Companies Act contains a statutory procedure under which a shareholder may bring a derivative claim – that is, proceedings on behalf of a company – against a director, for negligence, default, breach of duty or breach of trust.

The factors that the court will look at when deciding whether to allow a derivative claim include whether a director who is acting to promote the success of the company would proceed with it, whether the relevant act or omission was previously authorised by the company, whether the breach has been ratified and the views of independent shareholders.

In addition, shareholders can apply to the court for protection against unfair prejudice if they believe the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of its members or a group of its members.

Claims against the company may also arise if a publicly traded company does not behave properly in relation to the treatment of the release of information to the market. In particular, under Section 90A of the Financial Services and Markets Act 2000, a company is liable to pay compensation to a person who acquires, continues to hold or disposes of the securities in reliance on information disclosed by the company using recognised means and who suffers loss in respect of the securities as a result of either any untrue or misleading statement in that published information, or the omission from that published information of any information required to be included in it. The company is then only liable if a person discharging managerial responsibilities knew that the statement was untrue or misleading, or was reckless as to whether it was, or knew the omission was a dishonest concealment of a material fact.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Any shareholder whose interest in the voting rights of a publicly traded company reaches, exceeds or falls below 3%, 4%, 5% and each 1% threshold thereafter must disclose this to the company, which must notify the market.

The Takeover Code requires that for any public listed companies, if any person, or group of persons acting in concert, acquires 30% or more of the company's voting rights, they will trigger an obligation to make a general takeover bid to acquire the remainder of the shares.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Companies are required to publish an annual report and accounts for each financial year, unless an exemption applies. A public company must do so within six months of the end of its financial year, whereas a private company must do so within nine months. The Companies Act sets out the contents requirements of the annual report and accounts, which is supplemented by various regulations, including, for example, The Large and Medium-sized Companies and Groups (Accounts & Reports) Regulations 2008 (as amended). Generally, the Companies Act requires the annual report and accounts to comprise a directors' report, a strategic report and financial statements. Quoted companies and traded companies are also required to include a directors' remuneration report. Listed companies also include a corporate governance statement discussing their corporate governance arrangements.

The purpose of the strategic report is to inform members of the company and help them assess how the directors have performed their duty under Section 172 (duty to promote the success of the company). It must contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company. It must also contain an analysis of the development and performance of the company's business during the financial year and the position of the company's business at the end of the year, consistent with the size and complexity of the business. Certain companies must also include information on their greenhouse gas emission and workforce gender diversity statistics. The strategic report may also contain key performance indicators on various financial and non-financial matters. Following implementation of the EU Non-Financial Reporting Directive in the UK, "public interest entities" (that is, companies whose transferable securities are admitted to trading on an EU-regulated market, insurers and credit institutions) with more than 500 employees are required to include prescribed non-financial information in their strategic report. The required information includes disclosures in relation to anti-corruption and anti-bribery matters, environmental matters, employees, social matters and respect for human rights; a description of the company's policies in relation to the non-financial matters; and the principal risks relating to the non-financial matters arising in connection with the company's operations.

The directors' report is now effectively a repository for a number of miscellaneous statutory disclosures, including in relation to the directors, company constitution, share capital and political donations.

See **4.11 Disclosure of Payments to Directors/Officers** for discussion of the contents requirements of the directors' remuneration report and see **6.2 Disclosure of Corporate Governance Arrangements** for discussion of the contents requirements of the corporate governance statement.

For listed companies, the contents requirements set out above are supplemented by the provisions contained in the Transparency Rules. In particular, these provide that the annual report must include consolidated audited accounts, a management report and a responsibility statement. The Transparency Rules require a company to publish an annual report as soon as possible and in any event within four months after the end of each financial year. The Transparency Rules also require listed companies to produce a half-yearly report within three months of the half-year end comprising a condensed set of financial statements, an interim management report and responsibility statements.

A company must also file certain information with the UK companies registry, Companies House, on an annual basis. This includes the annual report and accounts. The annual filing requirements also include a confirmation statement confirming information in respect of its shareholders, directors and persons who have significant control over the company.

6.2 Disclosure of Corporate Governance Arrangements

Pursuant to the Listing Rules, companies are required to state how they have applied the principles of the Governance Code in a manner that would enable shareholders to evaluate how the principles have been applied and state whether they have complied with the provisions of the Governance Code, and if not, explain why.

The Governance Code also sets out certain information that should be included in the corporate governance statement contained in the annual report. This includes discussion of matters including board composition, the remuneration of directors and the relationship between a company and its auditor. The Governance Code does not have the force of law but premium listed companies are required to report annually on their compliance and explain any extent to which they have not complied, providing reasons for that non-compliance.

Private companies over a certain size are required to include in their annual report a statement on the company's governance arrangements.

6.3 Companies Registry Filings

A company must notify Companies House as and when there are any changes to its particulars, such as the registered office, directors or changes in share capital. In addition, all special resolutions must be filed at Companies House within 15 days of being passed and the Companies Act specifies certain ordinary resolutions that are required to be filed at Companies House (eg, an ordinary resolution authorising directors to allot shares). All documents filed with Companies House will be publicly available for free online.

7. Audit, Risk and Internal Controls

7.1 External Auditors

A company is required to appoint an external auditor when preparing its annual accounts unless it is subject to an exemption. Small and dormant companies are exempt from audit unless a sufficient number of members require an audit. A company will be classed as small if it is not exempt and meets two of the following three thresholds:

- it must have an annual turnover of not more than £10.2 million;
- it must have a balance sheet total of not more than £5.1 million; and
- its average number of employees must be not more than 50.

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Directors are responsible for the preparation of the company accounts in accordance with all relevant law and regulations. Auditors report on whether the accounts meet the requirements as asserted by the directors, but this does not relieve the directors of their responsibilities.

The EU Audit Regulation also governs the relationship between public listed companies and their auditors, and applies additional requirements to the relationship between auditors and the companies, such as the mandatory rotation of auditors after a maximum of 20 years and the requirement to run a tender process of audit services.

7.2 Management Risk and Internal Controls

The Governance Code places new requirements on premium listed companies to confirm within their annual report that they have carried out a robust assessment of the company's risks. In particular, directors must include a statement explaining how they have had regard to the need to foster the company's business relationships with suppliers, customers and others, and a statement explaining how the directors have engaged with employees and have regard to employee interests. Directors are also required to confirm that they have assessed the company's 'emerging risks' in addition to its principal risks and that they have assessed the prospects of the company, and have a reasonable expectation that it will continue in operation and meet its liabilities as they fall due over the period of its assessment.

In addition, to assess the company's financial risks and controls functionally, premium listed companies are required to appoint an audit committee of non-executive directors, whose role is to ensure that shareholder interests are properly protected in relation to financial reporting.