



The Law Society

**Law Society response to the Financial Reporting
Council Consultation on the Revised UK Corporate
Governance Code (“The Code”)**

March 2010

SUPPORTING
solicitors

Law Society response to the Financial Reporting Council Consultation on the Revised UK Corporate Governance Code ("The Code")

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This response has been prepared on behalf of the Company Law Committee of the Law Society of England and Wales and the City of London Law Society Company Law Committee.

The Law Society of England and Wales is the representative body of over 120,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This response has been prepared on behalf of the Law Society by members of the Company Law Committee. The committee is made up of senior and specialist corporate lawyers

The City of London Law Society (CLLS) represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees and in this case the response has been prepared by the CLLS Company Law Committee.

The joint committee is broadly supportive of the approach of the proposed changes. We do not propose to comment on questions of policy but confine our comments to legal and practical implementation of the proposed changes.

1. **Long term success**

Main Principle A1 has been amended to state that:

"Every company should be headed by an effective board which is collectively responsible for the **long-term** success of the company."

In legal terms the duty of a director to promote the success of a company is not so circumscribed. Is it correct that a board must always be responsible for long-term success? How should they consider bid proposals or administration/ insolvency events? Can a company not be formed to undertake a particular venture? We query whether it is appropriate to include the qualifying reference to the long-term, when the board is also responsible for success in the short and medium term.

2. **Role of directors**

A revised supporting principle has been added to A1 as follows:

"All directors are fiduciaries who must act objectively in the best interests of the company and in accordance with their statutory duties."

The note to the draft states that this revision takes account of the duties in the Companies Act 2006 and as the footnote in the draft states those duties relate only to UK companies.

In our view those of the duties of directors which have been set out in the Companies Act 2006 are set out clearly there. It is not helpful to layer a different description of a particular duty on to a board by means of the Code. For example, section 172 (the duty to promote the success of the company) requires a director to act in the way *he considers in good faith would be most likely to* promote the success of the company. That is quite substantially different from stating that he **must** act **objectively** in the best interests of the company.

The use of the word 'and' linking the two parts of this supporting principle emphasise the fact that the first sub-sentence is an additional requirement. As well as being unhelpful to add a further layer to the statutory duties we do not understand why the statutory duties are referred to - since by definition they will apply. Are overseas companies to be asked to comply or explain against UK statutory duties?

3. **Board re-election**

We have some concerns with the proposal to require annual re-election of the whole board. In our view it is contrary to the long-term nature of the role the director should be fulfilling and would surely encourage a short term approach. We would presumably need to ensure that the business could be managed coherently should none be re-elected?

We are not attracted to the idea that the Chairman would be re-elected annually. We do not think it is appropriate to make the Chairman the "scapegoat" for the whole board. We think making him vulnerable to removal on an annual basis would weaken his role in the board room (which is contrary to the approach which we believe should be taken). Finally, we consider that inviting the Chairman to be re-elected annually is an attack on the collective responsibility approach, which we believe to be an important feature of UK corporate law.

We would prefer to see no prescriptive measure included in the Code on this issue and for a period to be left in order that market practice develop. We believe that active stewardship, perhaps collectively, by key shareholders may lead to an appropriate solution, though that may be different for different companies.

4. **Business review requirements**

The Code includes a new provision C.1.2., as follows:

"The directors should include in the annual report an explanation of the basis on which the company generates revenues and makes a profit from its operations (the business model) and its overall financial strategy."

We are concerned about this requirement being introduced through the Code rather than through legislation or regulation.

The OFR experience proved costly for many corporates and we would like to be clear what is required by this disclosure and how it differs from the current business review requirements.

5. **Overseas companies**

Whilst the Code is expressed as applying to overseas companies we are not sure that overseas companies have been considered in sufficient detail in the individual provisions. An example is given above in relation to directors' duties. We wonder if a solution would be to include an introductory provision and explanation of how overseas companies should comply - for example, with the spirit rather than the letter.