GUIDANCE ON DIRECTORS’ DUTIES
SECTION 172 AND STAKEHOLDER CONSIDERATIONS
## Contents

**Introduction** 3

1. **Executive summary: discharging your duty under section 172** 5
   - Five specific things to help you embed section 172 in decision making in your company 6
   - One over-arching theme 6
   - Section 172 of the Companies Act 2006: the text 7

2. **Practical steps you could take to help discharge your section 172 duty** 8
   - Strategy 8
   - Training 9
   - Information 9
   - Policies and processes 10
   - Engaging with stakeholders 11
   - One over-arching theme: culture 12

3. **Legal context of the section 172 duty** 13
   - Duty to the company, not to shareholders or stakeholders 13
   - Success of the company 13
   - Enforcement 13
   - Good faith 14
   - DTI guidance on the section 172 duty 14
   - Interplay with other duties 14
   - Subjective and objective standards 14
   - Nature of the section 172 duty 15
   - Background to section 172 15
   - Creditors 15
   - Reporting on performance of the duty 15

4. **Example scenario** 16
   - Scaling back a product line 16

**Acknowledgments** 20

**About GC100** 20
Introduction

The decisions and choices made by company directors are key to the success of their companies. In making these decisions and choices, it is good business sense for directors to think not only about shareholders’ interests, but also about other factors which will affect the success of the company. These include, for example, the interests of the company’s employees, the needs of its customers, and relationships with suppliers and other stakeholders.

The Companies Act 2006 supports this good business sense approach. Section 172 imposes a general duty on every company director to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders as a whole. This duty is owed to the company itself.

Section 172 also requires directors, in making their decisions and choices and in setting policies and strategy, 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 success of the company, broader implications of decisions are considered by the directors.

You may find it helpful to see the duty as about creating a culture in the business, so that when you take decisions, their wider impact has been considered.

Section 172 applies across a director’s role, ranging 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 applies to decisions large or small, formal or informal, and taken individually or as a board. In larger companies, many more decisions are taken by management and employees in the context of strategies and policies which have been set by the board. While directors may not be involved in those individual decisions, they should ensure those strategies and policies have been set by the board in accordance with section 172.

There is no one size fits all approach, so this guidance reflects different ways in which different businesses have sought to ensure they achieve their goals responsibly and, at the same time, address their specific company law duties in relation to stakeholder considerations.

When the statutory duties of directors in the Companies Act 2006 came into force in 2007, GC100 issued a guidance note on the duties, focusing in particular on the duty set out in section 172. Ten years after the publication of that initial guidance, we are supplementing it with this additional guidance on the practical interpretation of the duty in section 172.

This guidance aims to provide practical help to directors on their performance of the section 172 duty, rather than formal legal advice. Accordingly:

• First, we provide a short summary of key suggestions of matters for you to consider as a director.

• Second, we set out practical steps you can take as a director. From the training of directors, to taking a thoughtful approach to the information you may need, to the importance of strategy and policies being developed with the section 172 duty and with corporate culture in mind, this guidance is intended to assist directors in the discharge of their duties.

• Third, we have included a summary of the key legal background to and aspects of the section 172 duty.

• Fourth, we have included an example scenario of how directors in a specific business situation could discharge their duties.
It is important to note that, when taking a decision, you must exercise your own judgment. Not all directors will consistently come to the same view. So different boards of directors faced with the same decision can reasonably decide on different outcomes, depending on their own experiences, judgment and views on their respective company’s goals and risk appetite, as well as the circumstances in which the decision is taken.

In short, your duty under section 172 involves both judgment and process: you should aim to have suitable processes in place for your company so that in taking decisions to promote the success of the company, you have considered one way or another the long-term consequences and the wider stakeholder considerations.

Company secretaries and general counsel, as trusted advisers to the board, are primary advisers to boards on directors’ duties and responsibilities and this GC100 guidance reflects the experience and insights of those carrying out those roles in some of our largest publicly listed companies.

This guidance:

- Does not aim to cover the full range of directors’ duties under the Companies Act 2006: it focusses, as explained, on the section 172 duty and stakeholder considerations and putting them in a practical context. There is also a wide array of other laws outside the Act that protect stakeholders and others, from employment legislation to health and safety, environmental to planning and many others. The important issue of compliance with these other laws is not directly addressed here.
- Assumes the company’s purpose does not consist of, or include, purposes other than the benefit of its shareholders, and that the company is not in financial difficulties that require directors to act in creditors’ interests or to consider those interests differently.
- Has been prepared by GC100, whose members have contributed from the perspective of larger publicly listed companies and their UK subsidiaries. While some of the processes and practices used by GC100 members will not be practicable for smaller companies, we hope the guidance will provide useful insights and ideas for all company directors.
1. Executive summary: discharging your duty under section 172

Your duty as a director under section 172 is to act, in good faith, in a way that you believe would be most likely to promote the success of the company for the benefit of its shareholders as a whole. For most commercial companies, success usually means long term value creation from which shareholders will benefit. The duty applies to you as an individual, even if you are collectively taking decisions as a board.

The duty is owed to the company, not directly to shareholders or other stakeholders. It starts with the benefit of shareholders as a whole as its goal. That is because shareholders are the owners, and the company is ultimately run for their benefit. But the law recognises and requires that stakeholder factors need to be part of the assessment. This is about recognising the context in which the company operates: each company affects others as well as its owners and future owners and how it affects those others will impact its success.

Therefore, as you carry out your role as a director, you should have regard to how the company’s activities and your decisions or input will impact:

- Employees.
- Suppliers.
- Customers.
- Others with whom there is a business relationship.
- The community and the environment.
- The company’s reputation for high standards of business conduct.

Note that this list is not exhaustive: you must also consider any other relevant stakeholders or other relevant factors.

You also need to act fairly as between the shareholders of the company.

You should have regard to all these factors in good faith as you carry out your role, using your own skill and judgment, having regard to the likely long-term consequences of your decisions. There is not a simple answer to most of the questions directors face. Every situation will be different:

- A big decision, like shutting a factory and making a significant part of your workforce redundant, buying a substantial new business or closing a major product line will usually require more time and analysis of how the decision will affect stakeholders.
- Less significant or more day-to-day decisions will typically require less time and consideration, or may not come to the board or individual directors at all.

If you are an executive director, you will be involved in many more decisions and issues outside the boardroom, and you are therefore likely to have a different set of circumstances to which your duties apply compared to a non-executive director.

For all directors, your job is not to balance the interests of the company and those of other stakeholders. Instead, after weighing up all the relevant factors, ask yourself which course of action you consider 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 this does not call into question decisions made.
Most of what directors do does not involve decisions. Your role also involves receiving and considering reports or information, debating and sharing views on strategy, policies or on judgments about specific challenges and opportunities. In addition, you and your board colleagues need to delegate to and empower management teams and employees to carry on businesses day to day. You also need to prioritise your time and use judgment in doing so, including as to when to ask questions about subjects which have not been pro-actively raised with you.

So, discharging this duty is not just about how you make decisions as a director yourself. It also means bearing in mind stakeholder factors and other relevant inputs to your decisions or responsibilities in setting strategy, in developing policies, in creating a corporate culture and in guiding and delegating to management and employees.

### Five specific things to help you embed section 172 in decision making in your company

- **Strategy:** reflect the section 172 duty when you set and update your company’s strategy.
- **Training:** establish and attend training courses on induction to the board, with ongoing updates on the section 172 duty in the context of your wider duties and responsibilities.
- **Information:** consider, and arrange to receive, the information you need on appointment and going forward to help you carry out your role and satisfy the duty.
- **Policies and process:** put in place policies and processes appropriate to support your company’s operating strategy and to support its goals in the light of the section 172 duty.
- **Engagement:** consider what should be the company’s approach to engagement with employees and other stakeholders for your company, whether through board engagement or wider corporate engagement.

### One over-arching theme

- **Culture:** as the board seeks to determine or discuss the culture of your company, consider how you propose to embed in the habits and behaviours of 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, whether employees, customers, suppliers, local communities, the environment or others affected by or engaging with the company’s activities.
172 Duty to promote the success of the company

(1) A director of a company 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, and in doing so have regard (amongst other matters) to —

(a) the likely consequences of any decision in the long term,

(b) the interests of the company’s employees,

(c) the need to foster the company’s business relationships with suppliers, customers and others,

(d) the impact of the company’s operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.
2. Practical steps you could take to help discharge your section 172 duty

Set out below are examples of practical steps you could take to support the discharge of your duty under section 172.

The particular steps you take will of course depend on the importance to, and impact on, the company of the decision you or the board are taking.

In addition, how you consider the benefit of shareholders as a whole and how you have regard to the factors specified in section 172 will be for you and your board to judge in the context of your company’s own business and circumstances and the environment in which it is operating.

The law is clear: you should have regard to the section 172 factors in exercising your role as a director, and not just in relation to formal board decisions. But that does not require a checklist approach to the factors for everything which you or the board does. Given the breadth of issues you will deal with as a director, a checklist approach to every single thing you do would be unworkable and interfere with good judgment and effective prioritisation.

A particular challenge for directors of large companies, or of parent companies of large groups, is balancing, on the one hand, proportionate oversight and monitoring, without second guessing all management judgments, with, on the other hand, expressing views and taking decisions, consistent with the board’s ultimate responsibilities. It is therefore important to identify and re-assess over time the issues for the board.

Training, thoughtful information flows, sensible policies and processes combined with appropriate consideration of the factors in setting strategy, together with an engagement model for stakeholders, can together help embed directors’ regard to the relevant factors. In that way, the factors are more likely to form a natural and automatic part of your reflections on the issues which you consider in your role as a director. This is at the heart of how many directors address the section 172 duty and stakeholder interests.

<table>
<thead>
<tr>
<th>Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>• In setting strategy, and considering risk issues, think about your overall duties and the stakeholder and other factors which will contribute to the company’s success or will be affected by its activities. Consider how you assess which third parties with whom the company deals are stakeholders and the appropriate engagement with them.</td>
</tr>
<tr>
<td>• Consider the relationship between corporate vision and goals, or your strategy to achieve the vision and goals, and stakeholder interests. For example, most businesses depend on their customers, their own people and their suppliers: should you explicitly recognise your company’s dependencies?</td>
</tr>
<tr>
<td>• Where your corporate vision, goals or strategy reflect stakeholder interests or goals, are you appropriately and proportionately monitoring and reinforcing those elements of the company’s activities?</td>
</tr>
<tr>
<td>• It is easy to find yourself drawn into prioritising immediate and urgent issues, at the expense of the longer term and important issues: consider the extent to which the ongoing and sustained success of your company’s business, its long-term vision and goals and impact (including its impact on the communities and environment in which it operates), as well as its reputation, are important for its success. If they are important, do you think they are given sufficient time and focus by the board and management?</td>
</tr>
</tbody>
</table>
Training

- Provide suitable induction training to all new directors, which should include training on their duties, including those under section 172, and provide refresher courses from time to time. Consider what training on duties is appropriate for subsidiary directors and management.

- Consider what other training or career development is appropriate to extend the skills of the company’s managers and others generally, and which may enhance their effectiveness in achieving the company’s goals in line with the board’s stakeholder and other duties and the requirement to have regard to stakeholder interests.

- Provide guidance for directors including explanations of directors’ roles, duties and responsibilities, including section 172.

Information

- Boards need appropriate and relevant information to make informed judgments, including when deciding which judgments to leave to others in the business who may be better placed to make them. Therefore, you should think about information flows to the board, both those that support achieving success for the benefit of shareholders as a whole and those that support your consideration of stakeholder factors.

- To assess what information is required, ask yourself whether you know enough about the stakeholder interests and factors relevant to your company. You cannot know everything and will have to rely on others for many things, but is the understanding of the board sufficient to discharge your section 172 duty?

- Where you do not know all the relevant facts or have the expertise to make judgments with confidence, are you receiving the right inputs from others?

- Ask yourself whether the metrics and reports you receive are broad enough to address the section 172 duty or whether they are too focussed on, for example, financial reports, current operational issues and market data. Existing information flows may support the right focusses, but you may want to consider whether or not that is the case and not just assume it.

- Consider whether you are receiving too much information, which is obscuring the things that really matter for the success of the company, and whether from time to time the information you need to understand as a priority should be adapted, changed or simplified.

- Ask yourself whether you need to consider what information is available to others in the company, irrespective of whether it comes to the board, and whether it appears to be supporting the achievement of the company’s goals and the board’s responsibilities under section 172 in relation to shareholders and stakeholder factors. Certain judgments are likely to rest with management below the board, but you may want to understand aspects of the approach of management to some of those judgments, including whether people are working from consistent (or different) information to that seen by the board.
Policies and processes

Board level

Consider whether and how you may want to:

• Seek to ensure relevant stakeholder factors, whether specified in section 172 or not, are considered in setting policies at board level.

• Consider the balance of focus and responsibility for the duties as between each director, including the chair, non-executive directors and executive directors. As a director you remain personally responsible for the discharge of your own responsibilities, but each director will often rely, to one extent or another, on other directors, in particular on executive directors with allocated responsibilities, as well as on the wider management and team. The chair will often have a key role in guiding board focus appropriately.

• Refer to directors’ duties in their terms of appointment and the description of the role of each director.

• Recognise the section 172 duty in the terms of reference of the board and, if appropriate, each committee.

• Ensure the company secretary attends all board meetings (and is available generally) to advise directors as necessary on matters relating to their duties and responsibilities under section 172.

• Ensure that remuneration policies and incentives reflect section 172 factors where relevant, for example by including appropriate metrics and performance measures.

• In determining the process for board papers, ask that stakeholder factors are addressed where judged relevant, with appropriate inputs to assess them.

• Have a consistent approach to minute taking, whether brief or detailed and as to when section 172 factors are minuted.

Management level

• Provide training and guidance to managers on writing effective board papers to ensure that the impact of a proposed decision is proportionately, clearly and appropriately explained to directors.

• Implement specific company policies and processes on section 172 topics relevant to your company, allocating responsibility to the appropriate management functions.

• Consider: (a) consistency of approach of policies; (b) their accessibility to those they apply to; and (c) the extent to which they are easy to understand.

• Consider how your policies have been rolled out and then applied in practice to achieve planned outcomes.

• Question the balance of prescription and flexibility for your business in your policies: some issues may need strict rules, others may need to allow judgment.
**Directors of UK subsidiary companies**

- Ensure directors of subsidiary group companies know that they owe their duty under section 172 to their subsidiary company, not to the group parent company.

- In most cases, the interests of the subsidiary and parent companies will be closely aligned. That means subsidiary directors may weigh section 172 considerations in a similar way to parent company directors, but it does depend on the facts.

- Subsidiary directors when acting in that role should focus on the interests of the specific subsidiary and its success, but the views of parent companies, as the owners, are usually important and proper factors that should be taken into account.

**Directors of UK joint venture companies**

- Ensure directors of joint venture companies understand that their section 172 duty is owed, in their capacity as directors of the joint venture company, to that company.

- Encourage directors of joint venture companies appointed by one participant in the joint venture to be clear when they are acting as representative of the shareholder and when they are acting as directors of the joint venture company.

- For joint venture directors assessing the joint venture company’s interests, it will normally be a relevant factor that the shareholders have agreed certain processes or goals for the joint venture company.

- Where a joint venture has been established, for example between two shareholders, and it is envisaged that each shareholder’s appointed directors will bring particular attributes or perspectives to the board, encourage the directors to have regard to those expectations.

**Engaging with stakeholders**

- Large publicly listed companies already have the benefit of a lot of guidance on the important question of engagement between the company and shareholders, which is influenced by what shareholders want, by the company’s ownership structure and make up, as well as by the company’s own judgment. A growing body of guidance is also developing on ideas for engagement with other stakeholders.

- This Guidance does not aim to repeat or replicate all those other examples and guides to good practice. Instead it focusses on a smaller number of themes that you may wish to consider in light of the section 172 duty as it relates to you and your company.

- It is self-evident that, for most companies, consideration of stakeholder interests will be less effective, or at least perceived as less effective, unless combined with appropriate engagement, tailored to the circumstances of each company and its business.

- Engagement is rarely a matter solely for the board of a company: it involves judgment and actions on the part of managers and employees, as companies are almost always judged by stakeholders on their direct business interactions with those they deal with in the company.

- Accordingly, as you consider stakeholder engagement, you may wish to consider how stakeholder groups experience the company, its board and management, through those day to day business interactions, as well as through any specific processes, structures or channels established for engagement.

- You may wish to consider the extent to which engagement feedback both from stakeholders to the company and vice versa is or needs to be fed back to the management, board or into the wider business.
Consider the balance between data collation, such as employee or customer survey responses and complaints or other feedback, on the one hand, and specific board or senior management interactions with smaller groups of stakeholders, on the other hand.

Consider asking yourself and management whether your company does what it says it does to and for stakeholders, or whether it is perceived as doing so.

One over-arching theme: culture

All the guidance set out above is intended to provide ideas as to how different boards can address their duties to the company in relation to stakeholders. In practice the processes, rules and decisions your company makes will create a culture or cultures within the company or within its different business segments. A clear tone from the top will support developing the culture you wish to have throughout the organisation and inform business decisions at all levels. It is clearly good business practice for directors, management and employees to think about how customer service, staff experience and the other elements of stakeholder factors support the success of the business, in focussing on managing what are, indirectly, shareholders’ assets, for the benefit of those shareholders. Your company’s culture can develop so it is automatic that relevant stakeholder factors are built into the conduct of the company’s business.

You may wish to bear in mind the importance of board and senior management actions and leadership in setting culture, as well as the importance for most businesses of embedding appropriate culture at all levels. In most organisations culture is set not only by what the board and senior management do and say, but also by what is said and done by managers or role models (good or bad) at every level of the organisation: new employees will often worry most about what their direct manager or supervisor does or says they should do, rather than the provisions of a remote policy. You should consider what culture or cultures are right for different parts of your company’s activities.

There is a temptation to assume that all corporate cultures can always easily balance the pursuit of success for the benefit of shareholders with the interests of employees and the demands of other stakeholders. The section 172 duty does not require balancing of the varied interests, but having regard to them, in pursuing the success of the company for shareholders as a whole.

It is not so simple in reality, and difficult judgments need to be made. It is often easier to make these difficult judgments and to recognise the trade-offs if your company is clear and transparent about how it approaches them, mitigating to some extent inevitable disappointments. So considerations such as approach to risk, policies on career progression and communication about market opportunities and challenges can, in many companies, support effective engagement with stakeholders, at the same time forming part of your discharge of your section 172 duties.

While there is no prescribed corporate culture that all companies need to abide by, most companies and their directors aspire to be successful for their shareholders and at the same time to satisfy their customers, to be valued as customers themselves by their own suppliers and to have motivated workforces who in turn attract further people to come and work for the company. Many of the most admired companies also have a strong sense of social purpose and/or a stewardship approach to their business, their stakeholders and the environment.

Markets and events can also intervene to cut across these goals, but reputational risk and damage, whether with specific stakeholders or more widely, often relate to failure by a company to meet standards of behaviour or performance set by law, regulation or commitments formally or informally made to those stakeholders. All companies will have failings, as no system can avoid human impact and miscommunication (or worse), but how your company deals with and responds to such failings may be a matter for your board to consider in contemplating your approach to stakeholder interests and culture.
3. Legal context of the section 172 duty

Duty to the company, not to shareholders or stakeholders

Section 170 of the Companies Act 2006 is explicit that the section 172 duty, together with the other general duties set out in that part of the Act, are owed by a director to the company, not direct to shareholders or stakeholders. This is a key element of limited liability, which is itself a cornerstone of UK company law and the use of UK incorporated companies.

Success of the company

Section 172 is carefully drafted to be clear that the over-arching duty is to promote the success of the company for the benefit of its members as a whole, acting in good faith. The stakeholder factors in sub-section 172(1)(a) to (f) impose an additional duty to have regard (among other matters) to those factors. So directors carrying out their duties are not faced with a conflict between the duty to the company, for the benefit of the shareholders as a whole, and stakeholder interests. But they must have regard to those stakeholder factors. How they address both the interests of the members as a whole and the stakeholder considerations, is a matter for them, in good faith.

As explained above, for most commercial companies long term value creation is their strategic goal, but value creation and the success of the company needs to be considered in each company’s particular context. For some companies, short term measures or goals may either at times or consistently be their priority. For others, for example in declining markets or facing stronger competition, successfully managing as best they can that declining market or those challenges might be the key goal.

Different companies will choose to address these differently, whether by exploring new approaches or markets or opportunities, changing business models, considering greater efficiency measures, optimising available value creation opportunities, considering combination with others, or winding down of some or all of their business, as a few examples.

Enforcement

Enforcement of the duties is a matter for the company alone. There are limited exceptions, including, for example, statutory and regulatory powers which have regard to compliance with duties, as well as the right of shareholders to bring derivative actions in the company’s name against a director under sections 260-269 of the Companies Act 2006. The specific requirements for such a claim include both substantive and procedural thresholds to bringing a successful derivative claim against a director for breach of duty.
Good faith

Section 172 requires directors to act in good faith in deciding how to promote the success of the company. As set out in the Explanatory Notes on the Companies Act 2006 published by the Department of Trade and Industry (DTI) (the predecessor to the present Department for Business, Enterprise & Industrial Strategy) at the time of introduction into law of the Act, “[t]he decision as to what will promote the success of the company, and what constitutes such success, is one for the director’s good faith judgment. This ensures that business decisions on, for example, strategy and tactics are for the directors, and not subject to decision by the courts, subject to good faith”.

DTI guidance on the section 172 duty

Directors may find the DTI’s guidance at the time section 172 was introduced helpful. The DTI said, in the Explanatory Notes: “In having regard to the factors listed [in section 172], the duty to exercise reasonable care, skill and diligence (section 174) will apply. It will not be sufficient to pay lip service to the factors, and, in many cases the directors will need to take action to comply with this aspect of the duty. At the same time, the duty does not require a director to do more than good faith and the duty to exercise reasonable care, skill and diligence would require, nor would it be possible for a director acting in good faith to be held liable for a process failure which would not have affected his decision as to which course of action would best promote the success of the company”.

Interplay with other duties

The section 172 duty needs to be applied along with the other duties of a director, including:

- Other general duties, such as the duty to exercise reasonable skill, care and diligence, (section 174) duty to exercise independent judgment (section 173), the duty to act within powers (section 171) and the various conflict avoidance duties (sections 175-177).
- Other company law duties, such as the duties to file accounts.
- The numerous other duties imposed by criminal and civil laws on directors and companies.

So a breach of the criminal law or other laws or regulations is not excused by section 172.

Subjective and objective standards

The section 172 duty must be fulfilled by a director in accordance with the duty of care, skill and diligence imposed by section 174. That imposes two standards:

- An objective standard of 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.
- A subjective standard, based on the director’s own abilities, of the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that the director has.
Nature of the section 172 duty

The section 172 duty is, like the other duties set out in that part of the Companies Act 2006 (except for the duty of care, skill and diligence), a fiduciary duty. This is not addressed in detail here, but in essence recognises the position of trust that a director holds, and the need for good faith on the part of directors, as well as avoiding self-serving behaviour in carrying out the duties.

Background to section 172

It is helpful, in understanding section 172, to understand some of its history and context. The Companies Act 2006 codified the pre-existing common law (non-statutory) duties of directors. In doing so the legislation made a small number of intentional changes to the duties, such as extending the list of stakeholder and other factors to which a director has to have regard, but in the main, as the Attorney General said in the debates leading up to passing of the Act into law “…the main purpose in codifying the general duties of directors is to make what is expected of directors clearer and to make the law more accessible to them and to others”.

The common law duty which was codified by section 172 was usually described as the duty to act in good faith in the best interests of the company itself.

The degree of continuity in approach from the old common law is expressly set out in section 170 which provides that:

“(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.

(4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.”

So the history of looking to the interests of the company is in effect a matter to which the courts and directors should have regard in considering the discharge by a director of the section 172 duty.

Creditors

The interests of creditors are not addressed in detail here, but section 172 is clear that it is subject to both statutory and common law rules requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company. It is therefore clear that in certain circumstances the interests of creditors are a more important consideration for directors than the interests of shareholders.

Reporting on performance of the duty

For companies that are required to prepare a strategic report in their annual report, a new duty to report, in a section 172 statement, on how directors have regard to the stakeholder factors set out in section 172 has been introduced by the government in section 414CZA, and a new requirement for website disclosure of the section 172 statement has been introduced in section 426B. These do not apply to a company that qualifies as medium-sized in relation to that financial year (under sections 465 to 467, Companies Act 2006). It is clear that the direct connection between these reporting and disclosure obligations and how boards address stakeholder considerations will need consideration and that boards should bear in mind those obligations in assessing their approach.
4. Example scenario

We set out below an example to guide you on how the section 172 duty can be discharged in particular circumstances.

The scenario is a suggestion as to how the directors in question could discharge their duties.

For the avoidance of doubt, the example is illustrative of ways directors can discharge their duties and is not intended to reflect the approach which will need to be taken to reporting on the exercise of the section 172(1) duty when subject to that obligation.

Scaling back a product line

Facts

- A is a large supermarket retailer with stores based in the UK, elsewhere in Europe and in Asia. It has operating subsidiaries in multiple jurisdictions. It is incorporated in England and Wales as a public limited company and its shares are listed on the main market of the London Stock Exchange.

- A’s market share and margins are under pressure from new low-cost entrants to its markets and from online sales. Clothing sales are particularly challenging. They represent approximately 10 per cent of the group revenues and they currently break even but with a trend of declining margins and of possible losses ahead. The share price has been adversely affected by this trend.

- A’s CEO and board agree to pursue cost saving initiatives with a view to sustaining profitability levels and restoring investor confidence.

- A’s CEO asks its relevant operating division leadership team to consider options for the clothing business.

- The executive management team develop preliminary proposals to assess options which include:
  - Closure or cut back of the clothing business, ceasing or scaling back clothing sales globally, or in particular markets.
  - Sourcing new suppliers at lower cost and with better products.

- The management team and CEO recommend:
  - Scaling back of the clothing product range, using a smaller proportion of store space for clothing sales in all stores and in certain stores ceasing to sell clothing.
  - Switching product sourcing for over one third of clothing product lines, to lower cost suppliers.
  - Recruiting a small number of new buyers into the division with a strong track record at a competitor.
  - Implementing the changes over an 18-month period with a view to improving margins within 12 months.
Approval process

1. Prior processes and considerations:

- Strategy discussions and planning, as part of five-year strategy setting for the group as a whole and regular review of decisions against strategic goals. These included:
  - Consideration of sustainable business success including consideration of employee, customer, supplier, shareholder and other stakeholder considerations.
  - Annual board review of community engagement programme and impact, in particular on staff, customers and reputation.
  - Development of policies for remuneration, benefits, incentives, redundancy and other terms for staff in different geographic markets.
  - Development of delegated authorities, express and implied, setting out matters for the plc board, for the CEO and for authorities at subsidiary level, including from relevant group companies to specific management team members.
  - Regular board and management reviews and consideration of trading, operational and financial reporting, which had identified the clothing business as under particular challenge and had considered market and other factors.
  - Development of group and national internal policies across a range of issues including pricing, suppliers and sourcing, bribery and corruption and human rights.
  - Board training on directors’ duties provided at appointment and through updates.

2. Management recommendations included:

- Operational choices within the delegated authority of the CEO and relevant regional management teams.

- Specific terms to be proposed for redundancies, implementation of which required approval by the plc board.

- Contract changes, cost outlays and redundancies, which required approval by the board or managing director (as applicable) of six relevant subsidiaries.

3. Board papers for plc board consideration of the proposal:

- The board was already aware from regular financial and management reports of the pressures on performance in the clothing business.

- A paper prepared by the COO which had received inputs from various internal management teams including finance, HR, communications, government relations and operational and regional management, as well as legal and tax:
  - The paper set out the financial position and planned impact in terms of cost savings and margin effect over time.
  - It identified the key market context, implementation and revenue risks and proposed communications plan timetable.
- It also set out high level summaries of alternative options including closure or disposal of the business line concerned with summaries of the rationale for proceeding as recommended and key financial and other pros and cons of the options.

- The paper also included input from the review by the supplier/purchasing team on product quality, stability and speed of supply and testing in relation to the proposed major changes of suppliers for the clothing business.

- It also confirmed that the work had been done to ensure new supplies would be sourced in accordance with relevant internal standards and policies, which include community and environment considerations.

- It did not specifically address community impacts of redundancies since the stores were all in urban areas and any redundancy impacts in the areas would be minimal.

- The paper (as is customary) did not list specifically the section 172 factors for board consideration or regard. It did however identify key employee, supplier and investor and government relations impacts, as well as focussing on financial and strategic implications. It noted likely redundancies and also potential new roles as other business lines could expand to use retail space available as a consequence of the reduction in the clothing range. It noted the process for maximising the extent of voluntary redundancies and for potential transfer of staff to other roles as new opportunities arise.

4. Consideration and approval by the plc board:

- The board members were sent the board papers and read and considered the papers in advance of the board meeting.

- The COO gave a brief introductory presentation and summary of the recommendations at the start of the board consideration of the proposals.

- The board discussion included questions on timetable, potential for restored financial performance in the business, risks, and discussion on competitive dynamics, opportunities to use the proceeds of the planned improved performance to invest in other higher margin business lines, supplier and sourcing policy appropriateness and compliance.

- The impact on employees was discussed and in particular the redundancy plan, which required separate approval, was approved. No objection was received to the management’s communication plan and other aspects of the plan. A specific comment on comparability and fairness as between redundancy terms in the UK and another European market, reflecting different benefit structures and employee rights in the two markets, was identified for the management team to re-consider and report back on but ultimately to decide on without the need for further board approval.

- The board discussed the impact of the decision on the remuneration of the executive directors, in particular whether the outcome was, or could be perceived, as out of step with the impact of employees and the redundancy plan.
Exercise of the section 172 duties in this example

- The duty under section 172 was complied with by each director bringing his or her individual judgment and considerable experience of business decisions to weigh up the course of action they considered most likely to promote the success of the company.
- The proposed measures were not short term, but medium to long term.
- Using their experience and the information in the papers, including the description by the COO and, in discussion, the CEO of the well prepared and organised processes, the board members did consider the statutory factors.
- The recommendation reflected their good faith and considered views on the approach most likely to be successful.
- Customer, employee, supplier and other relevant stakeholder factors, including wider factors such as remuneration outcomes and any reputational impact, were either addressed specifically in the papers or were within the reflections and considerations weighed by directors.
- The duty was also discharged by the board’s assurance through the papers and the discussion, that the issues relevant to the decision had been addressed by the management team in developing and weighing up the proposed and alternative options.
Acknowledgments

Many thanks to James Palmer and Carol Shutkever, Herbert Smith Freehills LLP, for their significant support in developing the guidance.

GC100 is also grateful to all those who provided assistance, in particular:

- Adam Atashzai, The Finsbury Group Ltd.
- Vanessa Knapp OBE, Visiting Professor, Queen Mary University of London.
- William Underhill and Nilufar von Bismarck, Slaughter and May.
- Lucy Fergusson, Linklaters LLP.
- Martin Moore QC.
- Mary Cox, Practical Law Corporate, Thomson Reuters Professional (UK) Limited.

About GC100

GC100 is the voice of general counsel and company secretaries working in FTSE 100 companies and was first formed in March 2005 in response to the increasing volume and complexity of domestic and international law and regulation which impacts on UK listed companies. Our aim is to engage with government, regulators and policy makers to provide practical and business-focused input on law and regulation which affects the largest UK listed companies.

GC100 is an independent unincorporated membership association which is run through its Executive Committee. The team at Practical Law, a product of the Legal UK & Ireland business of Thomson Reuters, resources the secretariat support to GC100.

There are currently over 125 individual members of the group with representation from around 85 companies in the FTSE 100.
DISCLAIMER
This Guidance, which does not necessarily reflect the views of all individual members of GC100 or their employing companies, has been produced for guidance only.

It is the responsibility of individual directors to ensure that they understand and meet the requirements of the Companies Act 2006 and to take specific external advice (legal or otherwise) if they deem it necessary.

Nothing in this Guidance represents advice by GC100 or any of its members, Practical Law or Thomson Reuters Professional (UK) Limited, and none of GC100, Practical Law or Thomson Reuters Professional (UK) Limited accepts any responsibility or liability to any person for or in respect of the Guidance.
The Association of General Counsel and Company Secretaries Working in FTSE 100 Companies

GC100 is an independent unincorporated membership association which is run through its Executive Committee.

If you have any queries on this guidance please contact the GC100 Secretary, Mary Mullally: Mary.Mullally@thomsonreuters.com and/or Camelia.Thomas@thomsonreuters.com.