

Response to the IoD consultation on the Code of Conduct for Directors

Thank you for the opportunity to respond to this consultation. We would like to respond to questions 1, 2, 3 and 4 in your consultation. Being legally trained, our response is relatively cautious regarding the governance effects and the legal risks that entail. We hope that this response, even if viewed as a critical one, is ultimately constructive towards shaping thought leadership for the broader vision, which we support, of improving business culture and restoring public trust.

We are of the view that in order to make a case for government or other influential bodies to encourage adoption of the code and to persuade directors widely to adhere to it, the purpose and governance role of the code must be further clarified.

Purpose of the code

The need for the code seems insufficiently articulated in the consultation paper. The paper broadly mentions business culture and restoring public trust in business. As we consider the corporate failures or scandals of recent years such as the fall of Carillion, or accounting scandals at companies, a pertinent question would be whether the code as is would have made a fundamental difference to business or organizational culture and, if so, how. In this regard the Code's focus is very much on the personal and individual qualities/conduct of the director, and there is vast literature showing that organizational culture can be a different phenomenon to what an individual attempts to uphold personally. There is scope for thinking if the code should provide more wisdom in relation to organizational needs and how individual efforts to act in line with the code's ambitions can be best supported. Indeed, restricting its focus in that way may also mitigate some of the legal risks that we highlight shortly.

Next, we wonder if the purpose of the code is to move towards the professionalisation of directors, setting the code up as a gold standard. Although hardly any would disagree that directors would benefit from having good personal qualities, competence and dedication to the company, having the code as a gold standard for directors may be contrary to certain economic or social objectives. There are no legal requirements, aside from some regulated sectors, for directors to have particular qualities or qualifications. This supports the freedom of both entrepreneurship and to be self-employed in the running of one's business as a company. If the code were perceived to be a gold standard and directors of all manners feel obliged to adopt this, this could act as a barrier to entrepreneurship or become a burden to the self-employed, small company director who does not expect the legal risks we shortly turn to. It is arguable that the subtle professionalisation of directors should be a matter subject to more

social and policy debate. In this respect, although the code purports to apply to all directors, it remains important to consider if the universal scope is workable as drafted. The undertakings in the Code may more naturally fit with executive directors who are externally appointed to the position, than perhaps smaller company directors linked to controlling ownership or non-executive directors.

Role of the code

Whether the code should be promoted, and directors encouraged to adopt it or publicly declare adherence, all depends on what role the code serves in terms of governing directorial conduct. *We perceive some uncertainty in terms of the role of the code as a governance instrument.* First, we are uncertain as to whether the code is a governance instrument that is individual-facing or organisation-facing. Next, we are uncertain as to how the code will be positioned as a soft law instrument within the existing legal and soft law frameworks governing directorial and corporate conduct. Finally, we are uncertain as to how the code can be maintained for its own credibility.

First, we are uncertain as to whether the code creates a governance relationship between the IoD and individual, between the company and individual, or neither. If it is the former, it ostensibly makes no sense, in our view, for an individual not to publicly declare adherence to the code (subject to the potential legal risks below), as there is no way of evaluating change in conduct or the code's effectiveness if it is merely an instrument to encourage personal edification. However, it is unclear how the IoD will ensure that individuals who adhere to the code publicly can be held to credible adherence, and thus, credible signalling of directorial qualities. Without a mechanism for monitoring code compliance, over time it risks losing its behavioural and normative impact.

Alternatively, the code as a governance instrument may create a relationship of the latter type, ie between the company and director. There are matters dealt with in the code that are more in the nature of organisational or the board's collective responsibility. Situating them within the code creates the impression that matters for such organisational and collective responsibility are also matters for the adhering directors' personal ownership, potentially affecting the nature of legal risk they are exposed to, in terms of both contractual and statutory risk. The example in principle one regarding directors personally considering the impact of their decisions upon section 172 stakeholders, and the example in principle two that deals with legal compliance, which is usually the corporation's compliance, may result in the creation of the above impression. We are not arguing that such a form of governance ie that the company holds directors personally to account for the discharge of certain organisational responsibilities, is a policy that cannot be supported. In financial regulation for example, such personal responsibility is expressly instituted. However, such a policy

needs wider regulatory and social support, and it may not be the place for soft law to bring about such implications for directors.

Next, we are conscious that the code will be a piece of soft law that is layered upon laws and soft laws already applicable to many companies, such as the Corporate Governance Code, the Wates Principles, on top of directors' duties. How it interacts with these layers of law and soft law would be important, as contradictions and conflicts would result in undue legal risk for the individuals who declare adherence to the code. For instance, does the code intend to goldplate existing laws, and is there a need to recount conflict of interest management, rejection of bribery, and matters that are already provided in law? Could this change the expectation regarding standard of compliance with law? There is a question of whether the code needs to provide that which is already addressed by other pieces of law or soft law. We understand that the code might want to pinpoint and centralise these existing instruments and/or obligations to directors, but the general nature of the principles in the code provides insufficient guidance in that case.

Finally, the IoD would presumably not wish for the code to become a means for reputation washing for adhering directors. It is unclear what mechanisms would be put in place to allow adhering directors to signal adoption in a credible manner, and whether signatory auditing and approval, such as carried out by the FRC for the Stewardship Code, is a model that you have in mind.

Specific issues of Legal risk

We highlight the specific issues below as likely to result in enhanced but unclear legal risk for directors. It is uncertain whether the judiciary, in deciding cases on breaches of directors' duties, would give weight to directors' declaration of adherence to the code and the implications of such adherence. We perceive the following instances of potentially enhanced legal risk for directors:

1. Principle 1 on the devotion of sufficient time can raise issues regarding the standard of care for non-executive directors in particular, and what is expected in terms of 'sufficient time', should a question of their alleged negligence arise in litigation. Regarding the exhibition of 'high standards of personal conduct,' is it expected that the code extends to behaviour outside of the organisation? If not, this should be made clear. If so, this furthers the challenge of legal risk mentioned above.
2. Principle 2 on compliance with the letter and spirit of the law raise issues for the standard of care and good faith for directors, as, to what extent can they rely on legal and accounting advice, and how does 'spirit of the law' interact with directors' subjective good faith in business judgment or obligation to promote the success of the company? It would be helpful for the code to clarify how

directors should navigate potentially conflicting undertakings. For example, the obligation to ‘deal honestly with all parties’ whilst also ‘safeguard[ing] confidential information.’

3. Principle 4 provides that directors should ask for legal advice at early stages of ‘matters for concern’ and matters of creditor protection. It is uncertain if these steps would be expected for directors’ standard of care, and whether this is consistent with the jurisprudence in *Sequana*. We wonder if there is a corresponding need to make available sufficient corporate resources to facilitate this undertaking e.g. to enable directors to take independent advice? Further, we are mindful that the undertaking to ‘take personal responsibility for my actions’ may risk additional (actual or perceived) legal risk that will present a potential barrier to adoption or contribute to the legal uncertainty mentioned above.
4. Principle 5 on making decisions on an objective basis and based on evidence raises questions regarding its compatibility with the subjective good faith standard for business judgment. This standard may protect directors under circumstances of time pressure and information limitation that may be hard to avoid. It would be uncertain if Principle 5 would be more demanding than this. It is unclear what the scope of the undertaking to ‘respect’ the legitimate interests of relevant stakeholders is and whether this goes beyond the obligation to have regard to such stakeholders under s 172, Companies Act 2006.
5. Principle 6 on responsible business raises liability questions as it mixes themes where there are clear existing legal obligations (e.g., rejecting corrupt practices) with areas marked by soft law instruments and/or limited legal obligations (e.g. supply chain expectations regarding environmental impacts). Particularly in relation to the latter, this brings questions on gold-plating as explored above.
6. Consideration may be needed over the use of the word ‘undertake’ for directors who are also members of the legal profession. Should the code undertakings be perceived as presenting a risk of giving a professional undertaking, this could create a barrier to adoption.

Finally, in the broader scheme of promoting good business culture and restoring public trust, the IoD is well placed for thought leadership without necessarily mobilising a code of conduct for directors. Perhaps a campaign targeted at directorial training for putting business and organisational culture in order could be appropriate, or training in relation to initiatives to improve Board quality such as having a shadow board in place. A more limited code for directorial management of organisational culture may also work, entailing perhaps less legal risk than an all-encompassing code that attracts governance questions and legal risk in the manner argued above. We applaud the IoD’s thought leadership towards promoting good business culture and restoring public trust in business, and will be happy to engage further in conversations if you would like to.

Sincerely

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