September 29, 2017

Corporate Governance: Stakeholders

In response to the recent Green Paper and the U.K. Government Response, the Institute of Chartered Secretaries and Administrators (ICSA-The Governance Institute) and the Investment Association (IA), with U.K. Government approval, have issued a paper, *The Stakeholder Voice in Board Decision Making*, setting forth core principles for complying with Section 172 of the U.K. Company Law. Section 172 sets forth directors duties and is similar to the constituency statutes in some 30 states, and arguably, based on the 1985 opinion of the Delaware Supreme Court in the Unocal case, Delaware law. Section 172 "states that a director is required to act in the way he or she considers, in good faith, will be most likely to promote the success of the company for the benefit of its members (the shareholders) as a whole," and that in carrying out this duty directors must have regard (amongst other matters) to the following factors:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

The core principles put forth by ICSA-IA are:

1. Boards should identify, and keep under regular review, who they consider their key stakeholders to be and why.
2. Boards should determine which stakeholders they need to engage with directly, as opposed to relying solely on information from management.
3. When evaluating their composition and effectiveness, boards should identify what stakeholder expertise is needed in the boardroom and decide whether

they have, or would benefit from, directors with directly relevant experience or understanding.

4. When recruiting any director, the nomination committee should take the stakeholder perspective into account when deciding on the recruitment process and the selection criteria.

5. The chairman – supported by the company secretary – should keep under review the adequacy of the training received by all directors on stakeholder-related matters, and the induction received by new directors, particularly those without previous board experience.

6. The chairman – supported by the board, management and the company secretary – should determine how best to ensure that the board's decision-making processes give sufficient consideration to key stakeholders.

7. Boards should ensure that appropriate engagement with key stakeholders is taking place and that this is kept under regular review.

8. In designing engagement mechanisms, companies should consider what would be most effective and convenient for the stakeholders, not just the company.

9. The board should report to its shareholders on how it has taken the impact on key stakeholders into account when making decisions.

10. The board should provide feedback to those stakeholders with whom it has engaged, which should be tailored to the different stakeholder groups.

Each of these core principles is explained in detail in the 31-page, *The Stakeholder Voice in Board Decision Making*. The core principles are not intended to be a rigid check-the-box requirement. They are intended "to help company boards think about how to ensure they understand and weigh the interests of the key stakeholders when making strategic decisions." A company is expected to select and modify the core principles to suit its particular circumstances.

Institutional investors, asset managers, organizations like the Investors Stewardship Group, The Business Roundtable and The Council of Institutional Investors that support sustainable long-term investment, ESG and CSR and are opposed to short-termism and activism should give thought to fashioning and endorsing a U.S. version of *The Stakeholder Voice in Board Decision Making*.

Martin Lipton