



Explanation of the Companies Act 2006 (Amendment) (Company Purpose) Bill

4 December 2019

The attached proposed legislation incorporates into U.K. law the understanding of corporate purpose that has been developing across the U.K. economy. The legislation represents an evolution – not a revolution – in our understanding of capitalism that reflects both the problems faced by our global society and the resources capitalism can bring to the solution of those problems.

I. The New Definition of Corporate Purpose.

Section 172 of the Companies Act 2006 currently requires the directors of a company to promote the success of the company for the benefit of the members as a whole. Section 172, as revised, continues to require that a company be managed for the benefit of the members, but it makes clear that a company's business must also be operated in a manner that—

- benefits wider society and the environment in a manner commensurate with the size of the company and the nature of its operations; and
- reduces harms the company creates or costs it imposes on wider society or the environment with the goal of eliminating any such harm or cost.

Effectively, the purpose of every UK company will be to produce benefit for the members in a way that also benefits wider society and the environment. Underlying the new understanding of corporate purpose is a recognition that the law provides the owners of corporations with limited liability, and it is not unreasonable to expect in return appropriate behaviour and recognition by business of the responsibility that limited liability entails.

Revised Section 172 recognizes that business has been the source of enormous material prosperity, and the intent of revised Section 172 is for that engine of progress to continue unabated. What is different in revised Section 172 is its recognition that the manner in which business has been conducted has sometimes sacrificed the broader interests of society and the environment for the sake of maximizing shareholder value. Business needs to continue to be the engine of material prosperity – revised Section 172 simply requires that business operates in a way that also recognizes its obligations to society and the environment.

II. Application of the New Definition.

Under revised Section 172(2)(a), the benefits to wider society and the environment created by a company must be commensurate with the size of the company and the nature of its operations. A large company should produce greater benefits than a smaller company. Similarly, the benefits produced by a company with largely passive operations will be very different from the benefits produced by a company with significant manufacturing operations. Section 172(2)(b) is similarly focused on the situation of each specific company because Section 172(2)(b) is tied to the external costs imposed by the company.

The other rules on corporate governance in the Companies Act 2006 are not changed. Members will continue to elect directors and monitor their performance. To assist the members in understanding how the purpose of their company is being pursued by the directors, Section 172(5) gives the Secretary of State the authority to adopt regulations on accounting for benefits to wider society and the environment. Section 172(6) anticipates that the Secretary of State will adjust the scope, detail, and application of those regulations as appropriate to recognize the wide variety in size and operations of UK businesses.

COMPANIES ACT 2006 (AMENDMENT) COMPANY PURPOSE BILL

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Amend the Companies Act 2006 to provide that the duty of a director of a company is to promote the purpose of the company, and operate the company in a manner that benefits the members, wider society, and the environment.

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

1 Amendment to s172 of the Companies Act 2006

Section 172 of the Companies Act 2006 shall be amended and replaced in its entirety as follows:

172 Duty to advance the purpose of the company

- (1) A director of a company must act in the way the director considers, in good faith, would be most likely to advance the purpose of the company, and in doing so must have regard (amongst other matters) to the following considerations—
 - (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 well-deserved reputation for trustworthiness and high standards of business conduct, and (f) the success of the company for the benefit of its members as a whole and the need to act fairly as between members of the company.
- (2) The purpose of a company shall be to benefit its members as a whole, whilst operating in a manner that also—
 - (a) benefits wider society and the environment in a manner commensurate with the size of the company and the nature of its operations; and
 - (b) reduces harms the company creates or costs it imposes on wider society or the environment, with the goal of eliminating any such harm or cost.
- (3) Where different interested parties view the considerations set out in subsection (1) differently, a director must seek to act fairly as between those interested parties.
- (4) A company may specify in its articles a purpose that is more beneficial to wider society and the environment than the purpose set out in subsection (2).

(5) The Secretary of State shall make provision by regulations as to the form and content of the accounts and reports that a company must prepare to account for—

- (a) how it benefits wider society and the environment, and
- (b) the harms it creates or costs it imposes on wider society and the environment and, separately, the actions it is taking to reduce or eliminate those harms and costs.

(6) The Secretary of State may prescribe by regulations that certain accounting and reporting requirements provided for by regulations under sub-section (5) shall apply—

- (a) only to companies which have a total turnover of not less than a prescribed amount, or
- (b) otherwise in a manner that is commensurate with the size and complexity of the company.

(7) The duty imposed upon directors by this section—

- (a) 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; and
- (b) is owed solely to the company and not to any other interested parties.

2 Amendment to s414CZA of the Companies Act 2006

Section 414CZA of the Companies Act 2006 shall be amended and replaced in its entirety as follows:

414CZA Section 172(1) statement

- (1) A strategic report for a financial year of a company must include a statement (a “section 172(1) statement”) which describes how the directors when performing their duty under section 172 —
 - (a) have advanced the purpose of the company, and
 - (b) have had regard to the matters set out in section 172(1)(a) to (f).
- (2) Subsection (1) does not apply if the company qualifies as medium-sized in relation to that financial year (see sections 465 to 467).

3. Extent, commencement and short title

- (1) This Act extends to the whole of the United Kingdom.
- (2) This Act comes into force on the day on which it is passed.
- (3) This Act may be cited as the Companies Act 2006 (Amendment) (Company Purpose) Act 2019.