The neoliberal manipulation of UK directors' duty of loyalty

by Daniel Attenborough

The law on directors' general duties has recently been displaced from a highly problematic regulatory mixture of common law rules and equitable principles and, instead, moved to a statutory footing in chapter 2 of Part 10 of the Companies Act 2006. The vanguard of this new statutory scheme of obligations is the reformulated duty of loyalty now found in section 172, which determines the propriety of directorial conduct under all the subsequent duties. It follows that it has the potential to provide some guidance for directors in the carrying out of their other functions. For present purposes, section 172(1) requires that: 'a director of a company must act in the way he considers, in good faith, would most likely 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 non-exhaustive list of social and public concerns, such as employees, suppliers, customers, the environment, creditors, and so on]'.

This particular framing of the duty of loyalty is said to endorse and enshrine the animating idea of *enlightened shareholder value*, which was of central importance to the company law reform project. The Company Law Review in a 2000 report entitled *Developing the Framework* defined enlightened shareholder value as an obligation on directors to: 'achieve the success of the company for the benefit of the shareholders by taking proper account of all the relevant considerations for that purpose' and this involves taking 'a proper balanced view of the short and long term; the need to sustain effective ongoing relationships with employees, customers, suppliers and others' as well as to 'consider the impact of its operations on the community and the environment'. Accordingly, this principle is related to corporate governance as it provides for *how* public or private companies are to be managed in the realisation of chosen organisational objectives.

Naturally enough, the effect of introducing a prescribed code of behaviour for directors is to throw the law into a period of uncertainty as to its best reading, based on the difficulties inherent in the nature of language used, of composition and of legislation generally. Many open issues remain about how the courts will apply the reformulated duty of loyalty, the most fundamental of which involve whether this behavioural standard merely replicates the common law position (directors were said to owe their duties to the company and not shareholders individually (*Percival v Wright* [1902] 2 Ch 401)) or represents a more radical departure from the traditional conception of the duty. Additionally, the duty explicitly suggests a highly subjective compliance test that requires a director to act in the way *he or she considers, in good faith*, to be most likely to promote the success of the company for the benefit of the members as a whole. Consequently, there would appear to be no definite standard against which to evaluate the propriety of any given decision. Taken as a whole, it is difficult to anticipate how the operation of the individual components of the duty will work in practice.

A problem in statutory construction can seriously trouble the courts when there is a contest between probabilities of meaning. Legal academics and practitioners have thus enthusiastically spent a considerable portion of time reading, discussing and producing interpretations and evaluations of the best reading of section 172. This dialogue has often in various ways involved reference to the Company Law Review reports and ministerial debates in order to ascertain the purpose of the company. However, there has been up to this point only hidden or half-articulated discussion on how corporate governance operates in the context of major ideological and institutional processes. This unsatisfactory understanding of how these rules function in the context of extraneous bias and distortion, and the profound effect this can have on law-making, can provide a clarifying vantage point from which to approach the particular legislative reform of the duty.

As a preliminary and general matter, it is submitted that the highly subjective nature of the duty is analogous to the originating judicially formulated standard of review that

enabled directors' good faith judgment to render their legal obligations according to situational expectations. However, this purported continuity of the statutory version necessarily operates within the context of all forms of law as social practices. In other words, the subjective nature of the duty and how it is interpreted will be given meaning by the overlaying cultural, ideological and practical context that organisational activity gives rise to. It is thus essential to read the reformulated duty within a broader conceptual framework rather than the more traditional approach of substantive 'black letter' or 'expository' analysis of law.

Central to this understanding is that the canons of statutory interpretation have a place, but it is secondary, after elucidation of more fundamental issues concerning law as a privileged and constitutive way of society-making. The significant explanatory power of this lens draws our attention to the way in which distinct regulatory choices, which are driven by distinct policy preferences, form the law and the application of that law. This essentially means that corporate governance should be understood as a systemic process, which is determined mostly in accordance with prevailing institutional arrangements that lie largely outside the corporate organisation and the parameters of company law. The prevailing context in which these institutional arrangements find expression is that of a globalised, interconnected and interdependent world, the defining characteristics of which are the anti-collectivist, market-based political project of neoliberalism and short-term equity market imperatives of financial capitalism.

Since the 1970s, neoliberalism has not only become hegemonic among mainstream thinkers and political elites in the UK and USA, but has also had a major impact on legal policy and the way we think about law. The ideology inescapably carries with it a very definite and unquestioning cognitive adherence to standard neoclassical economics. Neoliberalism proposes, at least at the rhetorical level, that a necessary condition for human well-being is the maximisation of entrepreneurial freedoms within an institutional framework characterised by private property rights of ownership, individualism, wholly unregulated markets and free trade. An autonomous market that is constrained only by competition, so we are told, ensures that individual rational actors navigating anonymous market signals and making optimal decisions in the allocation of capital and the pursuit of self-interested gain maximises overall social well-being. The role of the state is rendered as rent-seeking, inefficient and restrictive which, in turn, means that wherever possible it should be rolled back in favour of efficient market solutions. Yet the crude dialogue frequently conducted through the prism of simplistic opposites of state versus market does not in fact accurately reflect the presence of an active, often activist, and sometimes violent, regulatory state in most neoliberal varieties of capitalism.

In the final analysis, the responsibility for promoting neoliberalism as a political project remains with individual sovereign states; that is to say, any given state is not typically a neutral policymaker in relation to aspects of the company and the limits of company law. The central insight is that the state is not, as neoliberal advocates may suggest, external or involuntarily relinquishing sovereignty, but is a qualitatively different state that purposefully establishes and preserves through constant action an artificial institutional framework appropriate to such competitive, market-centric practices. If markets do not exist, then they must be created or reconfigured, by state action if necessary.

What is uniquely characteristic of the current period of neoliberalism is the extraordinary extent to which the specific embedding of finance has been both deepened and broadened. Such developments have within the literature been best captured by the notion of *financialisation*. It is, directly or otherwise, the subject of all the literature on neoliberalism, globalisation and stabilisation. Although a recent, still ill-defined term, financialisation essentially means the ongoing and increasing role of financial motives and the extension and growth of 'liberalised' financial markets, financial actors and financial institutions in the operation of the domestic and international economies. Within this framework, capital is raised for the purpose of creating, selling and trading securities and derivative securities that do not finance industry but, instead, trade within markets that exist as an economy unto themselves. To be sure, the shift in gravity of organisational activity from an increasingly underinvested or obsolete productive base to the dysfunctional nature of finance-driven growth and financial interests denotes a new form of competition, which has worked to re-orientate the equity holder to the front and centre of economic activity.

Indeed, for several decades a recurrent dimension to UK and US academic writing has been focused on the homogenising force of global finance, the neoliberal logic of which has assisted the reassertion of the shareholder-centred conception of the company being constitutionalised and entrenched around the world by legal and extra-legal drivers. What this means in company law terms is a corporate managerial standard of generating an optimal (or at least relatively high) dividend or capital return from a company's business for the main benefit of its shareholders. The various other corporate constituent groups receive no inevitable primacy.

If we look inside the new statutory reformulation of the duty, we see very clearly that it enshrines and endorses a strongly oriented shareholder prerogative. Section 172 challenges the classic doctrinal logic of the common law to the extent that it qualitatively reinvents the 'interests of the company' (terminology which is omitted from the statutory formulation), by defining such interests explicitly in terms of

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the success of the company *for the benefit of its shareholders as a whole.* The genesis of this avowedly narrow duty of loyalty has its origins in the Company Law Review's expressed ideological presumption against interventionist legislation and in favour of facilitating markets (*Strategic Framework*, para 2.1-2.34). It is these ideological pressures and the globalisation of product and financial markets, it is submitted, which mandate a consensus on the shareholder-oriented model of the company. Crucially, this is despite the fact that English legal doctrine has hitherto never provided unequivocal support for this position, because directors' general duties were owed to the company itself rather than to any specific corporate constituent group. Neoliberal thinking as a discipline-shaping phenomenon influences not only the role and expectations of most shareholders, but also the corporate organisation and the architecture of company law. Although there is an expectation in the UK and in Europe generally that shareholders should behave responsibly, neoliberalism provides shareholders the freedom to necessarily possess short- term, profit-maximising goals that lead them to seek out the highest returns in a global economy. This legal myopia precludes the moral choice of harmonising the interests of shareholders with the interests of a host of other corporate participants.

Viewed this way, the introduction of non-shareholder interests into the second part of section 172(1) appears to be less of a balancing act and, instead, a particular ordering of the hitherto various unranked interests of the company. It will be recalled that this second strand of the duty was purported to engender the 'enlightened' aspect of the enlightened shareholder value approach preferred by the Company Law Review and the government. In fact, the inclusion of social and public values was heralded as having the potential to offset notions of corporate performance being measured solely and simplistically through maximising shareholder wealth maximization. This is, of course, bound up with the enduring and fundamental argument in corporate governance that the shareholders are not the only group whose wellbeing is affected by corporate decisions. However, because corporate directors and officers are required only to have regard to non-shareholder interests, and this is limited to the extent that it will promote the success of the company for the benefit of the shareholders, it is fair to suggest that the current wording of the provision is best read as a precatory aspect of the duty that attempts to obfuscate notions of distributional unfairness. Indeed, is not unreasonable to conclude that the formalised 'regard list' of various socio-economic factors, as a practical matter, is expressly unequal to the primacy of the informal alliance between managers and equity holders, and non- shareholder interests are valued only instrumentally to achieving this economic-individualistic objective rather than as a substantive programme of action to address real concerns based on any ethical or intrinsic value.

This line of thinking is further buttressed through the fact that it is only the board of directors, a majority of shareholders, or a minority of shareholders via derivative proceedings under part 11 of the legislation that have legal standing to enforce any possible breach of directors' general duties. From this perspective, the 'enlightened' rhetoric of the duty simply obscures the powerful economic incentives driving business activity, as well as the economic pressures to which companies and decision-makers are subjected.

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