What effect does the enlightened shareholder value principle in the Companies Act 2006 have on the corporate objective of UK companies?

Reem Kabour

The Organisation for Economic Co-operation and Development defines corporate governance as the system by which companies are directed and controlled, and through which a company's objectives are set.[1] Corporate governance theories are closely linked to those of corporate objectives, as the interests that directors have a duty to promote must be determined in order for one to consider issues of corporate governance.[2] This relationship is demonstrated in the UK Corporate Governance Code's postulation that a company should be managed efficiently to return long-term profits to the shareholders.[3] Corporate objective debates are commonly divided between the shareholder value (SV) theory and the stakeholder theory. This dichotomy remains evident in section 172(1) of the Companies Act (CA) 2006's stipulation that directors have a duty to act in a way which they consider, in good faith, to promote the success of the company for the benefit of its members, or its shareholders, as a whole. This is similar to the fiduciary duty, such as the duty to act *bona fide* in the best interests of the company, owed at common law antecedent to the CA 2006. It continues to require directors, when fulfilling the aforementioned duty, to have regards to the non-exhaustive list of long-term consequences alongside employee interests, fostering business relationships, impact on the community and environment, maintaining an upright reputation, and acting fairly between the company's members.[4] This paper begins by outlining modern discussions on the shareholder-stakeholder paradigm leading up to the codification of directors' duties in the CA 2006, and the underlying political and legal pressures that led to the Company Law Review Steering Group (CLRSG) recommendation to develop the longstanding principle of SV into enlightened shareholder value (ESV) in section 172(1) of the CA 2006. To assess whether section 172(1) of the CA 2006 has modernised the SV model established in the pre-2006 case law, this paper explores the impact of the legislation on subsequent corporate governance practices in the country, specifically in regard to the reporting requirements found in later statutory instruments. Finally, it is concluded that despite legislators omitting to profoundly expand on the case law preceding the ESV provisions, rebranding SV with an 'enlightened' streak creates a margin for more fundamental changes, both legal and normative in nature, in the future of the doctrine, should this be required.

1 Enlightened shareholder value: a revisited approach to the shareholder-stakeholder dichotomy

1.1 Developments leading to the enlightened shareholder value principle

The perennial discussion of corporate objectives gained attention due to a divergence of opinions between Berle and Dodd, wherein Berle defined the currently accepted SV view, that the sole corporate objective is to prioritise shareholder interest by generating shareholder wealth.[5] SV has been popular in Anglo-American corporate governance since the 1970s as a result of the rise of the law and economics movement and prominence of takeover culture.[6] Most notably, Friedman advocated for the

[1] OECD, 'G20/OECD Principles of Corporate Governance' (OECD Publishing, Paris, 2015), <http://dx.doi.org/10.1787/9789264236882-en> accessed 1 August 2018.
[2] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 14.
[3] FRC, 'The UK Corporate Governance Code' (London, April 2016) <https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf> accessed 1 August 2018.
[4] CA 2006, s 172(1).
[5] Adolf Berle, 'Corporate Powers as Powers in Trust' (1931) 44 HLR 1049; Edwin Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 HLR 1145; Adolf Berle, 'For Whom Managers are Trustees: A Note' (1932) 45 HLR 1365. .
[6] Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach' (2007) 29 SLR 577, 596.

traditional model of SV, stating that directors placing non-shareholder interests ahead of shareholders is equivalent to theft on the part of said directors.[7] Such views have gained traction mainly due to the "globalisation of capital markets, the rise of institutional investors, greater shareholder activism and the increasing importance of corporate governance issues."[8] On the other end of the spectrum lies the stakeholder theory, or the idea that directors must run the company for the benefit of all its stakeholders and so are accountable to such stakeholders as they also contribute to the company's success.[9] Mirroring Dodd's original proposal, Dean explains the efficiency of this method, as opposed to SV, to be in "all parties [working] together for a common goal and obtain shared benefit".[10] Academics such as Freeman have pushed for stakeholder control in decision-making,[11] whilst less drastic analyses of the theory have advocated for mere consideration of stakeholder groups. The exact categorisation of 'stakeholder' remains unclear – a study carried out by Fassin recently revealed over one hundred variations of stakeholder groups in legal literature.[12] Stakeholders have been referred to as "those groups without whose support [company] would cease to exist".[13] Freeman categorised stakeholder as "any group…who can affect or is affected by the…[organisation's] objective".[14] This may be attributed to the rapid increase in globalisation, allowing stakeholders to be anyone or anywhere, which contributed to the theory's decline in the 1980s as such an abstract categorisation of the parties served by corporate interest was found to be insufficient.[15] The stakeholder theory was finally rejected by the CLRSG in the making of the CA 2006. Its admirable theoretical foundations are "outweighed by…problems that are caused by endeavouring to strike a balance between [all stakeholder] interests."[16]

Before the CA 2006, SV was not statutorily mandated. Directors owed a duty to act in good faith vis-à-vis the way in which the directors, and not the court, consider to be in the best interests of the company, per *Re Smith & Fawcett Ltd*.[17]. *Regentcrest* confirmed the directors' good faith obligation as one that is subjectively determined, relative to the director's state of mind.[18] As the scope of the company's interests was never clearly defined,[19] it was unclear as to whether the interests to be promoted were limited to shareholders or included other stakeholders. Nonetheless, since 1878 SV has been the predominant interpretation of the corporate objective, at which point it was indicated that "directors are trustees for the shareholders".[20] This was confirmed in later cases,[21] but there remained some judicial diffidence on the principle. Some subsequent cases directed that the "interests of the company as a whole" meant "the corporators as a general body."[22] A later exploration of the corporate objective question concluded that "the best interests of the company…are not exclusively those of its shareholders but may include those of its creditors."[23] Cases such as *Fulham Football Club* have similarly raised the notion that "the duties owed by the directors are to the company and the company

[7] Milton Friedman, 'The Social Responsibility of Business Is to Increase Its Profits' *NY Times* (New York, 13 September 1970) 32.
[8] Mohammed Omran, Peter Atrill, and John Pointon, 'Shareholders Verses Stakeholders: Corporate Mission Statements and Investor Returns' (2002) 11 Business Ethics: A European Review 318, 318. .
[9] Kent Greenfield, 'Saving the World With Corporate Law' (2008) 57 Emory Law Journal 947, 975.
[10] Janice Dean, *Directing Public Companies* (Cavendish 2001) 94.
[11] Robert Edward Freeman, 'The Politics of Stakeholder Theory: Some Future Directions' (1994) 4 Business Ethics Quarterly 409. .
[12] Yves Fassin, 'The Stakeholder Model Refined' (2009) 84 JBE 113, 120.
[13] Robert Edward Freeman and David Reed, 'Stockholders and Stakeholders: A New Perspective on Corporate Governance' (1983) 25 California Management Rev 88, 89.
[14] Robert Edward Freeman, *Strategic Management: A Stakeholder Approach* (Pitman/Ballinger 1984) 246.
[15] Andrew Campbell, 'Stakeholders: the Case in Favour' (1997) 30(3) LRP 446, 448.
[16] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 53.
[17] *Re Smith & Fawcett Ltd* [1942] CH 304.
[18] *Regentcrest Pls v Cohen* [2001] 2 BCLC 80.
[19] *Brady v Brady* [1987] 3 BCC 535.
[20] *Re Wincham Shipbuilding, Boiler & Salt Co v Hallmark* (1878) LR 9 Ch D 322, 328.
[21] *Hutton v West Cork Railway Co* (1883) 23 Ch D 654. .
[22] *Greenhalgh v Ardene Cinemas* [1951] Ch 286, 291.
[23] *Lornho Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627, 634.

is more than…its members",[24] and that directors do not in fact owe a fiduciary duty to their shareholders, except in special circumstances.[25]

Most of the substantive rules defining the corporate objectives contained in the CA 1862 and surrounding case law remained true to their original form. Accordingly, the Department of Trade and Industry commissioned a review for company law reform in 1998, to be overseen by a new body of specialists, the CLRSG. The review aimed to spark further discussion on corporate objectives in UK companies. The first wave of consultations targeted the scope of interest that should be promoted and noted that the corporate objective is fundamentally rooted in companies being formed and managed for the benefit of shareholders.[26] In response to criticism of SV prevalent in common law principles, the CLRSG characterised SV's flaws as those of implementation, as company law can achieve its goal of "overall prosperity and welfare" if the ideologies of SV are efficiently applied.[27] The second wave of the review addressed the clear support for a shareholder-oriented model but within a more 'inclusive' model embracing long-termism.[28] That is, a director must "exercise his powers…in good faith…taking account of both the short and the long term consequences…to promote the success of the company for the benefit of its members as a whole."[29] The third step of the review denied any support for pluralism, a variant of stakeholderism, due to its abstract scope of interests.[30] The CLRSG's Final Report drafted general principles introducing ESV: directors must act in good faith to promote the success of the company for the benefit of its members as a whole and must take into account, in good faith, all material factors in deciding what is most likely to promote the success of the company.[31] Following the CLRSG's reform review, three White Papers were published by the government which confirmed the CLRSG's approach and additionally proposed an annual report be published by directors detailing their ESV duty compliance.[32] From there, the Government introduced the Company Law Reform Bill 2005, which eventually brought ESV into the legislative sphere in sections 172 and 417 in the CA 2006. This review and the subsequent Act "[preserved] the substance of the existing law where it worked as well as to incorporate improvements in the light of the review process".[33]

1.2 The continuity of shareholder value in the new law: is enlightened shareholder value rooted in outdated notions for a 21st century corporate governance model?

Academics commonly explain the dominance hitherto of SV in UK corporate governance as being founded in shareholders' sole claim to the residual returns of the company. Since SV enhances overall economic performance, neoclassical economists find that residual returns act as rewards for shareholders' critical economic functions and as a cushion for bearing risk without any contractual guarantee.[34] Critics argue that this is outmoded as shareholders do not take any risk, but merely estimate the chance of shares increasing in value without actually contributing to managerial efforts.[35] Keynes regards shareholders as 'functionless investors' distinct from risk-taking corporate owners,[36] and similar to this argument's is Berle's social ethics perspective that shareholders toil not to earn reward, but are simply beneficiaries by position.[37] Other academics contend that shareholders cannot

[24] *Fulham Football Club Ltd v Cabra* [1994] 1 BCLC 363, 379.
[25] *Dawson International plc v Coats Paton plc* [1989] BCLC 1247.
[26] DTI, *Modern Company Law for a Competitive Economy: Strategic Framework* (CLR, 1999).
[27] ibid para 5.
[28] DTI, *Modern Company Law for a Competitive Economy: Developing the Framework* (CLR, 2000) para 2.
[29] ibid para 3.
[30] DTI, *Modern Company Law for a Competitive Economy: Completing the Structure* (CLR, 2000) para 3.
[31] DTI, *Modern Company Law for a Competitive Economy: Final Report* (CLR, 2001).
[32] DTI, *Modernising Company Law* (White Paper, Cm 5553, 2002) para 3.
[33] Philip Bovey, 'A Damn Close Run Thing – The Companies Act 2006' (2008) 29(1) Statute L Rev 11, 25.
[34] Mary O'Sullivan, *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany* (OUP 2000) 43.
[35] ibid 48.
[36] John Maynard Keynes, 'The General Theory of Employment, Interest, and Money' in *Collected Writings* (vol 7, Macmillans 1973) 376. .
[37] Mary O'Sullivan, *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany* (OUP 2000) 48.

be the sole residual claimants as other constituent interests are affected by company managers' decisions *ex post facto*.[38] Contractarianism, whereby a company is visualised as a 'nexus of contracts',[39] may be employed to debunk this claim. In this model, shareholders cannot be considered the sole residual claimants, as all corporate participants contribute to the nexus of contracts that constitutes the corporation itself, and thus all stakeholders fall under the scope of residual claimants. Instead, shareholders' ownership only pertains to their input and not to the corporation. Bainbridge has opposed this view on the grounds that shareholders enjoy a special protective status due to their sole negotiating power being to withhold capital, as juxtaposed by the representation afforded to others within a company by politically powerful interest groups such as unions.[40] While other stakeholder groups can also withhold their input, some firms can go years without equity investment, making stakeholders more relied upon for continuous value generation and ultimately furnishing them with a stronger negotiating position to influence management decisions. This is especially the case as voluntary stakeholders are additionally protected by contract and involuntary stakeholders are protected by tort. Consequently, shareholders' exit voice is arguably one way they retain power in the company.[41] Nonetheless, with increased popularity of institutional investors and shareholder activism, the case for prioritising shareholder protection is weakened.[42]

The corporate ownership debate is commonly discussed in terms of which parties are entitled to the company's residual returns. In the 1930s, Berle and Means noted that modern corporate structure "destroyed the unity that we commonly call property" arguably due to enlarged corporations and scattered shareholders unable to scrutinise directors, leading to the shareholders' residual ownership of 'passive' property.[43] Consequently, shareholders surrendering wealth also means surrendering the right that a company be run in their sole interests. Despite this, stakeholderism has been furthered pursuant to fairness principles, requiring that stakeholders providing resources to the company are entitled to residual returns based on their contributions.[44] Blair similarly agrees that shareholders are not the sole recipient of residual returns in a corporate structure of creditors, employees, and suppliers making firm-specific investments relying on the firm's success and subsequently affecting the company's value.[45] By way of example, Becker's human capital theory rationalises employees as a stakeholder group entitled to residual returns because they invest human capital in the company, placing themselves in a precarious position as a result.[46] Other contractarian scholars have however contended that aiding stakeholders without any contractual leverage at the cost of shareholders contradicts the fairness that stakeholder theorists hold to be paramount.[47] Tung explored the option of drafting a contract between shareholders and directors to eradicate the perceived vulnerability of the former, only to find that such a contract would be incomplete due to the inability to specify an exhaustive list of directors' decision-making obligations to shareholders in the context of a developing commercial world.[48] Easterbrook and Fischel explain this phenomenon as one that can be supplemented by SV filling in the gaps in the corporate contract.[49]

A similar financial justification for SV is that it is reducing the agency costs of a corporation. Jensen and Meckling have conceived of agency costs as including monitoring expenditures by principals and

[38] Gerald Garvey and Peter Swan, 'The Economics of Corporate Governance: Beyond the Marshallian Firm' (1994) 1 JCF 139, 140.
[39] Frank Easterbrook and Daniel Fischel, 'The Corporate Contract' (1989) 89 Colum L Rev 1416, 1426. .
[40] Stephen Bainbridge, 'In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green' (1993) 50(3) Washington and Lee L Rev 1423, 1443.
[41] Albert Hirschman, *Exit, Voice, and Loyalty* (HUP 1970).
[42] Virginia Ho, 'Enlightened Shareholder Value: Corporate Governance Beyond the Shareholder-Stakeholder Divide' (2010) 36 JCL 59, 104. .
[43] Adolf Berle and Gardiner Means, *The Modern Corporation & Private Property* (Transaction 1932).
[44] Robert Edward Freeman, *Strategic Management: A Stakeholder Approach* (Pitman/Ballinger 1984) 52.
[45] Margaret Blair and Lynn Stout, 'Director Accountability and the Mediating Role of the Corporate Board' (2001) 79 Washington Univ L Q 403, 418. .
[46] Gary Becker, *Human Capital: A Theoretical and Empirical Analysis with Special Reference to Education* (3rd edn, Univ of Chicago Press 1964).
[47] David Millon, 'Communitarianism in Corporate Law: Foundations and Law Reform Strategies' in Lawrence Mitchell (ed), *Progressive Corporate Law* (Westview 1995) 4.
[48] Fred Tung, 'The New Death of Contract: Creeping Corporate Fiduciary Duties for Creditors' (2008) 45 Emory L J 809, 813.
[49] Frank Easterbrook and Daniel Fischel, *The Economic Structure of Company Law* (HUP 1991) 90.

bonding expenditures by agents. [50] In an agency relationship such as that which exists between directors and shareholders, both parties are utility maximisers and thus the agents, or the directors in this case, may not always act in the best interests of the principal, or the shareholders. Yet, the agency theory also provides that directors, constrained by the fiduciary duties owed, act as agents to the shareholders in running the company in the interests of the latter. In return, shareholders can hold directors accountable when discharging their duties. Seeking to maximise shareholder wealth, SV aims at minimising expenditure. A single-focused corporate objective enables such efficiency via a clear system of resource allocation.[51] This can be attributed to the certainty of implementation attached to a shareholder-focused model, which allows for the stock market to be the objective assessor of management performance in most cases.[52] SV's singular focus on shareholders allows for the most efficient corporate objective system by boosting share price, which has traditionally been argued to be a measure of performance. Proponents of this theory have argued that requiring directors to run the company for the benefit of its shareholders incentivises the latter to monitor directorial decisions, enhancing overall social capital.[53] Lee has even proposed the notion that stakeholders are in fact in a better position accepting SV than accepting stakeholderist or pluralist approaches, as their benefits are improved under a selective and efficient regime.[54]

SV has generally benefited shareholders at the cost of using negative externalities and unchecked social costs, for instance, poor working conditions for employees. However, while the theory fails at complete efficiency, insofar as it may lead to externalising costs to retain wealth for shareholders at an unchecked social cost, departing from SV would simply shift the encumbrance to an increase in agency costs and a decrease in social wealth. Maintaining the agency theory as a rationalisation for the CLRSG's ongoing support of shareholder-oriented models is disputed as directors certainly have no express and arguably no implied contract with the company's shareholders as investors usually make their share purchase from another shareholder, or from the company.[55] The agency theory fails on the grounds stipulated in sections 170(1) and 994,[56] and previously the CA 1948,[57] *Lonrho,*[58] and *Scottish Cooperative Wholesale Society,*[59] stipulating that directors owe their fiduciary duty to the company and to particular shareholders. Furthermore, section 33 renders shareholders and the company as bound to one another, but does not establish contractual links between shareholders and directors.[60] Shareholders may therefore rely on the expectation that directors fulfil the goal of shareholder wealth maximisation solely as designated in the company's constitution and section 172(1). In addition to financial guarantees, the lack of certainty for those falling within the ambit of directors' duties creates 'standard less discretion' with no one objective for directors to focus on.[61] The consequence of this is that much room is left for director opportunism as they are "able to defend any allegation of misconduct with the retort that they balanced interests…and the assertation may not…be challenged as the decision…might well have benefited one or more stakeholders."[62] Since managers care about their jobs, power, and prestige, they have an incentive to accommodate the demands of significant current and potential shareholders, a fact which suggests that the corporate objective is formed, at least in part, by managers promoting their own interests subject to the demands of large shareholders. This view is, however, objectionable as CA 2006[63] codified the rule established by *Aberdeen Railway* that the

[50] Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) JFE 305.
[51] Robert Hessen, 'A New Concept of Corporations: A Contractual and Private Property Model' (1979) 30 Hastings L J 1327, 1346. .
[52] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 19. .
[53] ibid 24.
[54] Ian Lee, 'Efficiency and Ethics in the Debate About Shareholder Primacy' (2006) 31 DJCL 533, 538.
[55] John Boatright, 'Fiduciary Duties and the Shareholder-Management Relation: Or, What's Special About Shareholders?' (1994) 4 Business Ethics Quarterly 393, 397.
[56] CA 2006.
[57] S 210.
[58] *Lornho Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627, 634.
[59] *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324, 367.
[60] CA 2006.
[61] Michael Jensen, 'Value Maximisation, Stakeholder Theory, and the Corporate Objective Function' (2001) 7 EFM 297, 301.
[62] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 46.
[63] S 177.

fiduciary duty of loyalty prohibits self-dealing.[64] Competitive markets may pressure directors into narrowing their targets, simply covering costs in the short-term. On the other hand, management may only care for larger shareholders since they are arguably the only ones that can threaten the job security of the former.

Whilst SV is driven by the benefit of a single constituency, Hansmann and Kraakman have argued that a corresponding regime increases overall social wealth through efficient resource allocation.[65] In 1995, a study conducted revealed that maximising SV does not conflict with the long-term interests of other stakeholders, making shareholders the only constituency who maximise others' value while maximising their own.[66] Lee explains this collective stakeholder relationship under SV as one of compromise – non-shareholding stakeholders' sacrifice is balanced by the subsequent increase in wealth generated by SV. In order for this hypothesis to be a reality, however, directors must have a long-term focus on shareholder wealth maximisation without externalisation leading to value being moved to shareholders and away from stakeholders. While the legislative shift to long-termism does not guarantee an increase in social welfare, it does provide for a more efficient allocation of scarce resources. Proponents of a shareholder-oriented model are well aware of the doctrinal uncertainties and practical complexities attached to the theory but maintain that the second-best approach is the best the law can establish in the meantime.[67] Irrespective of this, SV has gained and retained its popularity mainly due to its doctrinal clarity and practical certainty, "a single valued metric that is also observable and measurable".[68]

Despite SV being praised for its certainty, its implementation has been slow to take effect in the absence of a systematically accepted denotation. The theory's supposed certainty has tended to face scrutiny due to its lack of a clear time frame in which the objective is intended to be achieved. O'Kelly regards SV to be much less certain than advertised – "a single value…[does] not float free of decisions as to what strategies will count as enhancing shareholder value".[69] This is evident in the common law preceding 2006,[70] and in the CLRSG not clarifying the exact scope of directors' duties under the ESV regime. SV's approach towards corporate governance may not be objective – directors have been seen to contort the malleable theory by "manipulating either the test of profit maximisation or the 'facts' to which the test is applied".[71] While section 172(1) requires directors to consider the "likely consequences of any decision in the long term,"[72] it has failed to assist company lawyers in reaching a consensus on how long exactly short-term and long-term periods are,[73] and to quantify the threshold for a certain action to be adjudged as being in the best interests of shareholders.[74] While the issue of juggling different interests is commonly used as an argument against stakeholder theory, this complication may well arise in the case of SV too. Different shareholder constituencies may have varying interests such as different investment goals and time scales. Doctrinal uncertainties of this kind have led to a clear lack of guidelines with which courts can determine whether or not directors have in fact achieved the objective of SV.[75] SV aims to exclusively serve a constituent element of a company that cannot have a singular interest and, even if it does, cannot usually deliver such purpose proposals to directors. In *Mills,* it was held that different classes of shareholder interests all have to be equally endorsed.[76] In this regard, Keay begs the questions:

[64] *Aberdeen Railway Co v Blaikie Brothers* (1854) 17 D (HL) 20.
[65] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 GLJ 439, 441.
[66] Tom Copeland, Tim Koller, and Jack Murrin, *Valuation, Measuring and Managing* (John Wiley 1995) 22.
[67] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 28.
[68] Anant Sundaram and Andrew Inkpen, 'The Corporate Objective Revisited' (2004) 15 Organization Science 350, 355.
[69] Ciaran O'Kelly, 'History Begins: Shareholder Value, Accountability and the Virtuous State' (2009) 60(1) NILQ 35, 45.
[70] *Brady v Brady* [1987] 3 BCC 535.
[71] Gerald Frug, 'The Ideology of Bureaucracy in American Law' (1984) 97 HLR 1276, 1311.
[72] CA 2006, s 172(1)(a).
[73] Einer Elhauge, 'Sacrificing Corporate Profits in the Public Interest' (2005) 80 NYU L Rev 733, 756.
[74] Jonathan Macey, 'An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties' (1991) 21 Stetson L Rev 23, 25.
[75] Einer Elhauge, 'Sacrificing Corporate Profits in the Public Interest' (2005) 80 NYU L Rev 733, 739.
[76] *Mills v Mills* [1938] 60 CLR 150, 164.

> Are directors to aim to take action that will also benefit only the current shareholder…? If they are to consider the future shareholders, how do managers balance what they do between the interests of the current and future shareholders? Does the theory focus on what the majority shareholders want? But how do you know what they want?[77]

2 Enlightened shareholder value: cementing or modernising shareholder value?

2.1 Section 172(1): codifying the antecedent common law with new terms

The shareholder-stakeholder debate was reignited in the wake of the 2008 financial crisis, during which section 172, amongst others, covering directors' duties became operative. In the build-up to the financial crisis, there was an increased emphasis on the directorial management of risk. In light of this, the CLRSG's review updated the SV model in an attempt to raise efficiency and productivity by stressing the importance and benefits of fostering the full potential of all contributors.[78] In advancing ESV in the Final Report, the CLRSG hoped to achieve wealth maximisation and competitiveness, pursuant to SV, but also encouraged directors, while acting in the collective best interests of shareholders, to build long-term relationships.[79] When deciding whether ESV or pluralist theory, could establish a better corporate objective in corporate governance, ESV was preferred because it could accomplish the aims of a plural approach without the need for a radical, unsupported overthrow of the entire directors' duties regime.[80] This is evident in the CLRSG's view that ESV promotes "the ultimate objective of companies as currently enshrined in law… [because it] is in principle the best means also of securing overall prosperity and welfare".[81] Lord Avebury, in addressing whether ESV is the compromise that was needed amidst the shareholder-stakeholder split, "[recognised] that there is unanimity of approval for this principle on all sides."[82] However, stakeholder theorists like Freeman find this approach to be outdated and far too shallow in the complex context of the modern business world.[83] Despite such views, the stakeholder theory was rejected by the CLRSG because the "distributive economic role on directors….would be uncontrolled if left to directors in the form of…discretion".[84] The prevalence of a shareholder-driven model in the updated corporate governance framework came into question nonetheless. Referred to as "one of the most overrated doctrines in corporate law",[85] its failure to expand on corporate social responsibility ('CSR') concerns, becoming more pronounced in the wake of the fading 1980s' free market attitudes, was condemned.[86] Prior to ESV's enactment, SV had been interpreted to require a manager "to use income solely for the [benefit] of the stockholder, to disclaim any responsibility in the community, to finagle the lowest possible price from his vendors regardless of its effect on them."[87] ESV does not appear to be the radical change required in the 21st century CSR movement. *West Coast Capital* confirmed this legislative stagnation: "[there] there was no equivalent in the earlier Companies Acts, but these sections appear to be little more than set out the pre-existing law on the subject."[88]

The impact of ESV was intended to encourage the management of companies for the long-term by deterring boards from exclusively focusing on short-term returns and incentivising them to building long-term relationships with stakeholders.[89] This was to be achieved by codifying the previous common law principles, and clarifying it, most notably by introducing the term 'success' in the legislation for the first

[77] Andrew Keay, 'Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?' (2010) 7 ECFLR 369, 388.
[78] Andrew Keay, *The Corporate Objective* (Edward Elgar 2011) 117.
[79] Andrew Keay, 'Tackling the Issue the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach'' (2011) 29 SLR 577, 590.
[80] DTI, *Modern Company Law for a Competitive Economy: Strategic Framework* (CLR, 1999) para 5.
[81] ibid para 5.
[82] HL Deb 6 February 2006, vol 678, col 265.
[83] Robert Edward Freeman, *Strategic Management: A Stakeholder Approach* (Pitman/Ballinger 1984).
[84] DTI, *Modern Company Law for a Competitive Economy: Developing the Framework* (CLR, 2000) para 2.
[85] D Gordon Smith, 'The Shareholder Primacy Norm' (1998) 23 JCL 277, 323.
[86] Bob Tricker, *Corporate Governance* (3rd edn, OUP 2015) 70.
[87] Robert Anthony, 'The Trouble with Profit Maximisation' (1960) HBR 126, 132.
[88] *West Coast Capital (Lios) Ltd* [2008] CSOH 72 [21].
[89] DTI, *Modern Company Law for a Competitive Economy: Developing the Framework* (CLR, 2000) para 2.

time.[90] Previously, the SV as a theory did not specify whether the increase of shareholder value was in the long or short term and was subsequently deployed to justify short-termism.[91] Section 172(1)(a) creates the duty, when promoting the success of the company, to have regard for "the likely consequences of any decision in the long term".[92] Therefore, there was "no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value".[93] The 2002 draft Bill, in an attempt to address the case law dispute defining the success of the company, stipulated that directors must account for 'all material factors'. These were said to be all likely short-term and long-term consequences of the directors' actions that a person of care and skill would consider relevant. However, this stipulation was subsequently omitted in the passing of the act. Instead, it has been advised that directors continue to comply with their common law duty to exercise reasonable care, skill and diligence in considering the consequences of their actions.[94] ESV thus carried on a criticism of SV – failing to define what 'success' is for the purposes of the legislation. Such reproach mirrors the judicially upheld non-interventionist policy of 'internal management' where the "Court is not required on every Occasion to take the management of every Playhouse and Brewhouse in the Kingdom",[95] leaving the methods in which the success of the company is to be promoted to the director's good faith judgement.[96] Good faith has traditionally been interpreted to connote honesty and propriety.[97] Summers has argued that the expression "has no general meaning of its own…but…serves to exclude many heterogenous forms of bad faith".[98] As for what bad faith entails, it has been understood to be an intentional departure from a duty.[99] Before this, Pennycuick J in *Charterbridge* asked whether an intelligent and honest man in the position of a director of the relevant company, in the given circumstances, would have reasonably believed that the decision was for the benefit of the company.[100] These objective guidelines were not explicitly transplanted into section 172(1) and so it been has argued that the pre-CA common law principles be employed as guidance to supplement section 172(1),[101] instead of solely relying on the provision's subjective test. This view is supported by section 170(3) and 170(4)'s statement that general duties are based on common law rules and equitable principles.[102]

The inclusion of 'success' in the provision, while a small part of the CA 2006, could have a substantial impact on how UK corporations are run, if it is interpreted to mean a long-term increase in value.[103] Furthermore, in the Guidance on Key Clauses to the Company Law Reform Bill,[104] the test determining whether directors have met the threshold of success as per section 172(1) was whether or not the directors considered, in good faith, that their course of action would be mostly likely adopted for the purposes of promoting the company's success, for the members as a whole. While the term 'success' lacks precedent, cases following the enforcement of the CA 2006 have proven the likeliness of courts relying on precursor common law duties such as that of the *bona fide* duty in determining what 'success' means to their company.[105] Lord Goldsmith also responded to questions surrounding the meaning of 'success' in section 172 –

[90] CA 2006, s 172. .
[91] Herbert Simon, 'Theories of Decision-Making in Economics and Behavioral Science' (1959) 49 AER 253, 262.
[92] CA 2006.
[93] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 GLJ 439, 440.
[94] Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach' (2007) 29 SLR 577, 580.
[95] *Carlen v Drury* (1812) 1 Ves & B 154.
[96] *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 BCLC 598.
[97] *Olifent v Australian Wine Industries Ltd* (1996) 14 ACLC 510, 515.
[98] Robert Summers, 'Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code' (1954) 54 VLR 195, 196.
[99] *Re Walt Disney Co Derivative Litigation* (2006) 906 A 2d 27 (Del, S Ct).
[100] *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1969] 3 All ER 1185 , 1194.
[101] Sarah Worthington, 'Reforming Directors' Duties' (2001) 64 MLR 439, 456.
[102] CA 2006.
[103] Patrick Beale, 'Directors Beware' (2007) 157 NLJ 1033.
[104] DTI, *Guidance on Key Clauses to the Company Law Reform Bill* (2005).
[105] *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch).

"it is essentially for the members of the company to define the objective they wish to achieve. Success means what the members collectively want the company to achieve."[106]

The Bank of England has evinced the practice of short-termism in UK corporations: the holding period of shares went down from an average of five years in the 1960s, to less than eight months in 2007.[107] This did not go unnoticed, as the CLRSG later highlighted the support that it received for its initial proposal to include a long-term requirement in the legislation.[108]

Before the scrutiny that followed the financial crisis of 2008, directors have generally favoured short-term returns, which resulted in SV facing objections for allegedly promoting short-termism.[109] Despite section 172(1)(a) requiring directors to have regard to the likely consequences of any decision in the long term, there continues to be a "concomitant fixation on the quarterly earnings of corporations and…share value".[110] For example, post-ESV, the Department of Business, Innovation and Skills issued a consultation document demonstrating that short-termism still exists in equity markets.[111] Evidently, ESV's implementation has lagged in improving self-serving directors as "planning for the long term could make the performance of…managers look decidedly average, as the share price might not increase and higher dividends would not be paid as quickly as if short-term plans were implemented."[112] Arguably, for ESV to enhance its goal of social wealth, a long-term approach requiring indefinite capital commitment to the company and long-term capital growth of the company is needed. Elhauge explains that ESV has disregarded a specific quantification of 'long-term' as it is an imprecise concept that is difficult to provide a monotonal definition for.[113] In omitting to denote this however, the *Gaiman* view stands on meaning both present and future shareholders for the purposes of ensuring directors focus not only on the short-term.[114] Similarly, 'members as a whole' may be interpreted in light of *Provident International Corp* previously construing long-term objectives as ones that benefit both current and future shareholders.[115] This was similarly tested in the Australian High Court, where it was held that the requirement be completely removed from the duty.[116] However, the CLRSG felt that the test was too deeply rooted in UK company law to follow in these footsteps.[117]

Former Minister for Industry and Regions, Margaret Hodge, stated that section 172(1) "[codifies]...for the first time duties around corporate social responsibility…one of the key issues is how we marry the commercial success of…companies and the resulting benefits to…the economy, with sustainability and social justice."[118] This is displayed in the section 172(1) requirement that directors 'have regard to' other stakeholder groups when promoting the success of the company. Here, a novel procedure is created whereby "action otherwise than in good faith, which will now, but does not at common law, include the failure to consider the various factors listed…will be treated as a breach of trust".[119] Still, there is no exhaustive list of what parties are entitled to such consideration and no explanation as to the meaning of such a duty or how it should be carried out. Prior to section 172, there were no restrictions on directors to account for non-shareholding stakeholders' interests so long as they act in good faith in the best interests of the company as a whole. Now, the theoretical and procedural backgrounds of the ESV principle seem to indicate that directors are only to consider stakeholder interests insofar as they

[106] HL Deb 6 February 2006, vol 678, col 255.
[107] Andrew Haldane, 'Patience and Finance' (Oxford China Business Forum, Beijing, 2 September 2010) <https://www.bis.org/review/r100909e.pdf> accessed 22 July 2018.
[108] DTI, *Modern Company Law for a Competitive Economy: Completing the Structure* (CLR, 2000) para 3.
[109] David Millon, 'Why is Corporate Management Obsessed with Quarterly Earnings And What Should Be Done About It?' (2002) 70 George Washington L Rev 980.
[110] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 30.
[111] BIS, 'A Long Term Focus for Corporate Britain: A Summary of Responses' (London, March 2011) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/207536/11-797-summary-responses-long-term-focus-corporate-britain.pdf> accessed 10 August 2018.
[112] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 40.
[113] Einer Elhauge, 'Sacrificing Corporate Profits in the Public Interest' (2005) 80 NYU L Rev 733, 756.
[114] *Gaiman v The National Association for Mental Health* [1971] Ch 317.
[115] *Provident International Corp v International Leasing Corp Ltd* [1969] NSWR 424, 440.
[116] *Gambotto v WCP Ltd* (1995) 182 CLR 432. .
[117] DTI, *Modern Company Law for a Competitive Economy: Completing the Structure* (CLR, 2000) para 5.
[118] HC Deb, 11 July 2006, vol 448, col 559.
[119] John Lowry, 'The Duty of Loyalty of Company Directors Bridging the Accountability Gap through Efficient Disclosure' (2009) 68(3) CLJ 607, 622.

endorse SV – "a purely instrumental concern with constituency interests".[120] Critics have signified that ESV does not differ from SV in failing to designate how much consideration is to be given to the relevant stakeholders, or what action to take when faced with balancing conflicting interests.[121] Equally, Benjamin has argued that the new legislation actually constrains directors to a narrower duty,[122] as the former case law provided unfettered directorial discretion to act in a way which they consider most likely to promote the success of the company for the benefit of its members.[123] Contrariwise, Jensen argues the section created a situation where directors are less accountable for the stewardship of their company's resources.[124] This gives rise to the 'two masters' argument and Sternberg's dual legitimacy query,[125] in that directors are stewards that must have one preference and that preference is arguably to shareholders' interests.[126] Nonetheless, Lord Goldsmith defended the ESV principle as it "resolves any confusion in the mind of directors as to what the interests of the company are, and prevents any inclination to identify those interests with their own. It also prevents confusion between the interests of [shareholders and of stakeholders]."[127]

Critics advocating for further stakeholder voice in interpreting section 172(1) may perhaps find respite outside the provision. For instance, employees are specifically protected by section 247 of the CA 2006, which allows directors to override their section 172 duty to provide for employees upon the cessation or transfer of the company's business. Creditors are safeguarded by the Insolvency Act 1986,[128] while the environment is safeguarded by the Environment Protection Act 1990. As ESV possibly only emanates a real impact when the company is experiencing financial duress, section 172(3) clearly guides directors to act in favour of the interests of creditors, which creates a balancing act in that it excludes all stakeholders, including shareholders. While protection outside the CA 2006 is commonly used to debunk stakeholderism, Tricker explains that the same free market and regulatory instruments may be employed to mediate conflicting interests in a stakeholder or a more enlightened shareholder value model.[129] Similarly, Shepherd addressed the factors listed in section 172(1) in indicating that a director is within his duty to balance different interests if they are conflicted.[130] Still, Hansmann and Kraakman justified shareholder favouritism by their vulnerability.[131] That is, other stakeholders can protect themselves by contract they have with the company, while shareholders lack this protection. This arguably makes shareholders "the only constituency whose relationship with the corporation does not come up for periodic renewal….[other constituencies] have opportunities to renegotiate terms when contracts are renewed."[132]

2.2 Enlightened shareholder value applied: the business review and the strategic report

The ESV principle lacks much procedural guidance from the legislation and supporting instruments on its implementation. Within the limited judicial consideration of section 172(1), Warren J in *Cobden Investments* held that "it is accepted that a breach will have occurred if it is established that the relevant exercise of power is one which could not be considered by any reasonable director to be in the interests of the company".[133] In discharging their section 172(1) duty, directors continue to be bound to exercise reasonable care, skill, and diligence.[134] Initially, this was ensured by the Operating and Financial Review

[120] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 129.
[121] ibid 27.
[122] Lisa Benjamin, 'The Responsibilities of Carbon Major Companies: Are They (and Is the Law) Doing Enough?' (2016) 5(2) TE Law 353, 358.
[123] *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil NL* (1968) 121 CLR 483, 493. .
[124] Michael Jensen, 'Value Maximisation, Stakeholder Theory and the Corporate Objective Function' (2001) 7(3) EFM 297, 305.
[125] Elaine Sternberg, 'The Defects of Stakeholder Theory' (1997) 5(1) Corporate Governance 3, 4.
[126] Stephen Bainbridge, *The New Corporate Governance in Theory and Practice* (OUP 2008) 66.
[127] HL Deb 6 February 2006, vol 678, col 255.
[128] S 214.
[129] Bob Tricker, *Corporate Governance* (3rd edn, OUP 2015) 66.
[130] *Shepherd v Williamson* [2010] EWHC 2375 (Ch).
[131] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown L J 439, 449.
[132] Oliver Williamson, *The Economic Institution of Capitalism* (Free Press 1985) 304.
[133] *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 [53].
[134] CA 2006, s 174.

('OFR'), aimed at establishing corporate governance objectives via disclosure and transparency. The repeal of the OFR can be seen as another instance of corporate deregulation, which may have led to reinstating most of the OFR's requirements in the BR, such as those of reporting on key performance indicators and principal risks. However, the BR does not require companies to explain the market context and strategy of the company as its predecessor has done. The EU Accounts Modernisation Directive, which was effective in section 417, ensured a balanced analysis of the company's performance to identify principal risks using non-financial indicators.[135] The BR was supplementary to section 172 as it required companies to report, *inter alia,* how directors have operated their section 172 duty. While Section 417 reporting requirements were enacted to assist achieving a sustainable ESV model, empirical evidence has highlighted a dissatisfaction with the preparation of BRs, mainly due to companies engaging in boiler plating the contents.[136] This has caused much advocation for clearer guidance in completing BRs to guarantee ESV'S goal of overall prosperity and establish the BR's purpose of "[providing] the shareholders with the information they needed to exercise effective control…enabling shareholders to assess past performance as well as the directors' view on the company's future prospects".[137] Resultant of much denunciation, section 417's BR has now been replaced by the requirement to produce a Strategic Report, pursuant to section 414C(1).[138] This new obligation similarly requires the preparation of an annual report that assists shareholders in assessing how their company's directors have performed their duties under section 172. Most markedly, the Strategic Report envelopes some of the criticisms that arose when ESV was initially introduced in the CA 2006, such as requiring quoted companies to quantify and disclose on their greenhouse gas emissions.

While ESV does in fact not detach itself too far from SV, it did arguably create a new approach to the stewardship theory in reporting requirements to explain directors' actions and decisions to stakeholders who are not necessarily shareholders. The traditional stewardship theory reflects the views of the corporation as directors being accountable to just the shareholders. Under the new ESV framework, the stewardship theory recognises the need to identify stakeholder interests, while also maintaining their primary duty to shareholders.[139] These updates may still not suffice in modern business practice as corporate bodies continue to increase in size, leading complex corporate structures to lack sufficient transparency and direct accountability directly to the shareholders. Hodge explained that "[for] most directors, who are…[putting] the interests of their company before their own, there will be no need to change their behaviour."[140] The CLRSG did envisage further steps than previous practice in that directors take a balanced approach addressing all stakeholder interests but this has been criticised as an "inherently subjective process".[141] This leaves the legislative standpoint being that none of the stakeholder constituencies provided in section 172(1) have the right to bring forth action against directors in breach of the provision's duty. The second limb of ESV, presented in section 417 and later section 414C(1), similarly does not promise achieving sustainable development in the face of appraisal for its alleged inclusion of stakeholderist concerns.

[135] Council Directive 2003/51/EC of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings [2003] OJ L178/16.
[136] Charlotte Villiers, 'Narrative Reporting and Enlightened Shareholder Value under the Companies Act 2006' in Joan Loughrey (ed), ***Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis*** (Edward Elgar 2012).
[137] ibid 705.
[138] CA 2006 (Strategic Report and Directors' Report) Regulations 2013, SI 2013/1970.
[139] Bob Tricker, *Corporate Governance* (3rd edn, OUP 2015) 66.
[140] DTI, 'Companies Act 2006: Duties of company directors' (Ministerial Statement, London, June 2007) <http://webarchive.nationalarchives.gov.uk/20090609024504/http://www.berr.gov.uk/files/ file40139.pdf> accessed 15 August 2018. .
[141] John Parkinson, 'Models of the Company and the Employment Relationship' (2003) 41 BJIR 481, 498. .

3 The future of corporate objectives in UK companies

3.1 Is the new 'enlightened' facet of the principle an element of stakeholderism?

The factors listed in section 172(1) mark a departure from the more conservative approach of the CA 1985, where reference was made to employees only.[142] The requirement of having regard to such factors "highlights areas of particular importance which reflect wider expectations of responsible business behaviour",[143] which enshrines the 'enlightened' feature of ESV. This new legislative element stirred much controversy,[144] especially as the CA 2006, guidance on Key Clauses issued with the draft Bill in the March 2005 White Paper, and the explanatory notes omitted to issue further direction on this. The general lack of guidance in and around the provision is concerning, specifically in the case of conflicting interests in trying to implement ESV. Three conclusions were arrived at in a study conducted by the Association of Chartered Certified Accountants on the impact of the legislation.[145] First, ESV made neither legal nor practical alterations to the pre-CA 2006 corporate governance model as most UK boards were already adopting similar practices. Second, if this was not the case, directors did not feel pressured to adopt ESV measures as they are not enforceable. Concerns raised over increased litigation in the wake of section 172(1) are misplaced as floodgate mechanisms were implemented since the rule in *Foss v Harbottle.*[146] Finally, directors failed to implement an ESV-friendly decision-making process as they did not have enough guidance to do so, which was an explanation supported by empirical evidence indicating substantial directorial confusion on how to satisfy section 172 compliance.

Whether the CA made any substantive changes to the previous legal position is questionable, and whether codifying legislation was the appropriate measure in modern corporate governance is even more so. To this end, Lord Hodgson has confirmed that the legislation only codifies the preceding common law principles, and in a form that makes no alteration to the existing legal position.[147] ESV's new duty was proposed to drive corporate objective models to "not quite pluralist…but rather a…European model where there are a group of stakeholders…involved".[148] Years after its enactment, such optimism has simmered down to modestly viewing the provision as a start in a movement towards a more stakeholder-conscious corporate governance. This has been explained as ESV acting as a middle ground between the two opposing theories of SV and stakeholderism by discriminating between competing constituency interests, unlike the preceding SV regime. Nonetheless, SV proponents have jumped out to differentiate between SV, promoting long-termism and promoting stakeholderism, as the latter displaces SV altogether.[149] The Government has previously indicated a stakeholder approach to be fostered upon the provision's implementation in asserting that "companies [are] to create wealth while respecting the environment and exercising responsibility towards society and the local communities in which they operate."[150] While further formal support for a more pluralist approach has been limited since, there remains hope for more stakeholder inclusion in the UK amidst national non-governmental organisations, such as CARE International, advocating for the cause. Alternatively, it may also be argued that due to the long-standing shareholder-focused corporate governance model of the UK, it will prove difficult to go any further than ESV in the meantime.

[142] S 309.
[143] Explanatory Notes to the Companies Act 2006, para 326.
[144] HL Deb 6 February 2006, vol 678, col 263.
[145] Samantha Fettiplace and Rebecca Addis, 'Evaluation of the Companies Act 2006' (Case Study 7, London, 2 August 2010) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31655/10-1360-evaluation-companies-act-2006-volume-1.pdf> accessed 25 June 2018.
[146] (1843) 67 ER 189.
[147] HL Deb 9 May 2006, ser 5, col 169.
[148] ibid.
[149] Michael Jensen, 'Value Maximisation, Stakeholder Theory, and the Corporate Objective Function' (2001) 7 EFM 297.
[150] DTI, *Draft Regulations on the Operating and Financial Review and Directors' Report: A Consultation Document* (London, 2005).

A similar approach to the UK's ESV framework is present in the US, [151] whereby the Delaware judiciary have consistently held that directors are within their duties to have regard to other stakeholder interests besides shareholders' given that such consideration will assist the generation of wealth for the shareholders.[152] Similarly, the jurisdiction's 'constituency statutes', or stakeholder statutes, allow directors to consider non-shareholder interests in making decisions within their capacity as directors. Ironically, their similarity to the UK's ESV is also evident in that both have received criticism for not being a substantive development in their respective corporate laws, as they serve as mere educational value.[153] In relation to further example for the UK model in the future, there is a real concern that corporate directors will use stakeholders' interests as a cloak for decisions advancing their own interests. There have been instances of managers hypocritically lobbying legislators in favour of constituency statutes in the US but who have also opposed other work protection laws for employees.[154] As the principle's counterparts are just as vague in other constituencies such as Canada and the US, it is unlikely that a respective procedural transplant in the UK would make much difference. Conversely, the approaches of continental Europe's more rigid civil law systems on corporate objectives have long been codified to include less protection to shareholders than in Anglo-American jurisdictions. [155]

Jurisdictions in continental Europe, such as Germany, recognise the corporation as a public body encompassing a wide range of stakeholder groups, which ultimately separates the corporate body from its shareholders and stakeholders. Kay has called for the adoption of the German conception of the company as "a community in itself and an organisation in turn embedded in a community" where directors are trustees of the company's assets, which include stakeholder groups.[156] This would permit the UK corporation to be "an organic model of corporate behaviour which gives to the corporation life independent from its shareholders or stakeholders….[as] an end in itself".[157] Correspondingly, Parkinson proposed the adoption of a two-tier board similar to that in Germany to represent stakeholder groups.[158] Hansmann and Kraakman have found faults in advocating for a more continental European-like stakeholder system, where evidence has surfaced that could indicate that those systems are beginning to lean towards a more Anglo-American one sustained within SV.[159] However, this stood before the 21st century Anglo-American financial scandals, such as the downfall of Northern Rock in the UK and the Lehman Bros in the US, and has since been compromised by the more interventionist regulations that followed. Such downfalls similarly resulted in further questioning of Anglo-American corporate governance systems.

A fundamental change in corporate governance is unlikely, as the UK's long-standing SV approach is deeply rooted in the corporate governance traditions of the jurisdiction. These include the economic function of the separate entity rule, the political function of promoting competitive practices, and the market for corporate control.[160] For ESV, to make a substantial dent in the consolidated law, Keay and Zhang propose that derivative proceedings be allowed for non-shareholding stakeholders as well.[161] Here, the applicant could argue that the directors failed to have regard to one or more of the factors in section 172(1). It is noted that "each case would have to be considered on its merits, in due course a clear line of reasoning is likely to develop."[162] Inopportunely, the accountability flaw was also evident in previous company legislation,[163] and such a pattern indicates that it is unlikely that the UK is ready to

[151] *Dodge v Ford Motor Co* 204 Mich 459, 170 NW 668 (Mich 1919).
[152] *Revlon Inc v MacAndrews & Forbes Holdings Inc* 506 A 2d 173 (Del 1986).
[153] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 201.
[154] Stephen Bainbridge, 'In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green' (1993) 50(3) Washington and Lee L Rev 1423, 1445.
[155] Bob Tricker, *Corporate Governance* (3rd edn, OUP 2015) 66.
[156] John Kay and Aubrey Silberston, 'Corporate Governance' (1995) 153(1) National Institute Econ Rev 84, 86. .
[157] ibid 91.
[158] John Parkinson, 'Company Law and Stakeholder Governance' in Gavin Kelly, Dominic Kelly, and Andrew Gamble (eds), *Stakeholder Capitalism* (Macmillan 1997). .
[159] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 GLJ 439. .
[160] Anant Sundaram and Andrew Inkpen, 'The Corporate Objective Revisited' (2004) 15 Organization Science 350, 352.
[161] Andrew Keay and Hao Zhang, 'An Analysis of Enlightened Shareholder Value in Light of Ex Post Opportunism and Incomplete Law' (2011) 4 ECFR 445, 469.
[162] ibid 474.
[163] CA 1985, s 309. .

introduce rights to initiate derivative actions to non-shareholders. While stakeholderism has long been viewed as a political intervention rather than an economic theory,[164] Blair's economic adoption of stakeholderism can be employed towards a more enlightened outlook on stakeholder interests.[165] Her paper, published in 1995, becomes even more relevant in the argument that the current model of corporate governance is made on broad assumptions about how wealth is created, captured, and distributed in business enterprises. Similar to ESV, this argument accepts shareholders as principals and subsequent residual claimants of a fiduciary relationship with directors as they invest in productive assets and bear the risk of the company's success, but also accepts residual claims for non-shareholders as they too make investments affecting the value of the company.

3.2 Rebranding SV as ESV: the first of many updates?

In its conception, ESV received mixed reviews from company lawyers, and general disappointment from the NGO community.[166] For instance, Amnesty International and Friends of the Earth have proposed an alternative framework.[167] Similar to ESV, the proposal does not displace SV but provides stakeholder interests with a higher priority by enforcing stronger disclosure rules and clearer enforcement provisions. An alternative analysis of the impact of ESV's operation is the one seen from the perspective of Bainbridge's 'director primacy' principle.[168] That is, directors are not a mere agent of the shareholders but guardians serving the various contracts that make up the corporation.[169] ESV may have arguably driven UK corporate governance as director-centric rather than shareholder-centric. That is, directors have always been able to consider stakeholder interests and the CA 2006 now expressly provides a wide discretion in their decision-making. The majority, however, have argued that ESV "merely constitutes a rebranding of shareholder primacy, which has often been seen as a harsh aspect of capitalism and…devoid of any moral basis…to make it…more palatable to those who adhere to stakeholderism."[170] The new law obligates directors to implement an ESV regime, where they must simultaneously continue to uphold SV by promoting the success of their company for the benefit of the members as a whole and ensure they have regards to section 172(1)'s listed factors to demonstrate enlightenment. The CA 2006 aimed to enshrine ESV as prevalent in preceding common law where no restriction was imposed on directors to consider interests outside of those of shareholders. This is evident in the Supreme Court of Canada's holding that directors have a duty to act in the best interests of the corporation, with the best interests of the company explicitly explained as maximising the value of the corporation by acting in the best interests of all constituencies.[171] Others have viewed ESV more positively in that it has curated the path towards a more stakeholder-centric construct of UK corporate governance. While it does not add much to what was already there, ESV does warrant a statutory footing for the consideration of stakeholder interests in their explicit mention in the legislation for the first time.

Pistor and Xu's modernised approach to the incomplete law theory can explain the provisions of ESV as a residual 'law making and law enforcement powers', with the preceding common law acting as the 'original' law, that is a means of interpretation adapting to changing circumstances which would allow the new legislation to extend to a varied and large number of cases in a consistent manner over a prolonged period of time.[172] Keay and Zhang interpret such laws to use "non-specific wording and [produce] a lack of clarity as to…boundaries…[and are] based on the theory of incomplete contracts."[173] Section 172(1) is incomplete law in the sense that legislators have established a general, 'catch-all' principle, that is the principle of due consideration for stakeholder interests, to sanction unforeseeable

[164] Gavin Kelly, Dominic Kelly, and Andrew Gamble, *Stakeholder Capitalism* (Macmillan 1997). .
[165] Margaret Blair, 'Rethinking Assumptions Behind Corporate Governance' (1995) 38(6) Challenge 12, 15.
[166] Alan Dignam and John Lowry, *Company Law* (9th edn, OUP 2016) 410.
[167] Corporate Responsibility HC Bill (2003) [129].
[168] Stephen Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 97(2) Nw U L Rev 547.
[169] ibid 605.
[170] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) 278.
[171] *People's Department Stores v Wise* [2004] SCC 68.
[172] Katharina Pistor and Chenggang Xu, 'Incomplete Law' (2003) 35 NYU J Intl L and Pol 931.
[173] Andrew Keay and Hao Zhang, 'An Analysis of Enlightened Shareholder Value in Light of Ex Post Opportunism and Incomplete Law' (2011) 4 ECFR 445, 474.

actions that result in an outcome that the law is aiming to prevent. The 'enlightened' element of requiring directors to have regard to other factors besides shareholder interests has been reframed as the principle of due consideration for the interests of stakeholders which introduced a debatably new concept into UK company law, warranting more caution than if the legislation was merely codifying.[174] However, this created the problem of uncertainty in "that the law will not deter sufficiently or at all the commission of the action that is not sanctioned, or it will not sufficiently set out what action is prescribed", such as what directors and shareholders are to do in having regard to stakeholder interests.[175] Alternatively, incomplete prescriptions of the principle of due consideration may result "in *ex post* stakeholder-opportunism against the shareholders".[176] While legislators could have captured more contingencies by extending their list, that would not be a realistic reflection of the complex and varied nature of modern business relationships. Thus, the incomplete law, that is, section 172(1) will be made more complete with gradual trial and error by the courts.[177] The legislation has been tested in courts,[178] and merely confirmed the pre-existing position in "effectively [succeeding] the duty at common law that the director had to act in good faith in the best interests of the company."[179] The CLRSG itself has agreed that section 172 would not make an immediately substantial impact on the law, as it was simply intended to "influence…the climate of decision making".[180] However, this did not suffice for contenders for a more inclusive approach.

A few years after the enactment of the CA 2006, Keay and Adamopoulou examined the published documents of 50 of the 100 FTSE companies in order to ascertain whether SV remains a proponent in their corporate governance.[181] The results of this empirical study were tripartite. Thirty-six percent of the companies in question upheld the SV model, while also stressing the importance of CSR and maintaining good relations with their non-shareholding stakeholders.[182] The extent and impact of such stakeholder consideration could not be pinpointed in the documents and therefore the authors could not ascertain whether it was rhetoric or actual. Nonetheless, as large, listed companies are usually scrutinised by various entities, Keay and Adomopoulou argue that such statements cannot be pure rhetoric as "it is unlikely that these companies would be as successful as they are or that their statements would remain unchallenged in public."[183] All in all, the first partite appears to be aligned with the value set out in section 172(1). The second group, constituting twenty percent of the companies in the study, set out in the research, outlined their corporate purpose as for the benefit of all their stakeholders, thus embracing varieties of stakeholderism.[184] The final group of companies, constituting forty-four percent of the total studied, did not sustain SV nor stakeholderism in not setting any constituency's interests as their objective.[185] Instead, there was an emphasis on growth, leadership, development, or profit.[186] Nonetheless, the study noted that this group of corporations must still adhere to section 172 to avoid shareholders bringing forth derivative action against the directors on the basis of breach of duty.[187] Evidently, the majority of the companies in the study embrace a SV oriented model, and more interestingly, "have some corporate objective other than either of the predominant theories that define the objective of companies."[188] Perhaps this is indicative of a reality where SV remains

[174] ibid 446.
[175] ibid 460.
[176] ibid.
[177] ibid 461.
[178] *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch).
[179] Andrew Keay and Hao Zhang, 'An Analysis of Enlightened Shareholder Value in Light of Ex Post Opportunism and Incomplete Law' (2011) 4 ECFR 445, 462.
[180] DTI, *Modern Company Law for a Competitive Economy: Developing the Framework* (CLR, 2000) para 5.
[181] Andrew Keay and Rodoula Adamopoulou, 'Shareholder Value and UK Companies: A Positivist Inquiry' (2012) 13 EBOR 1.
[182] ibid 16.
[183] ibid 24.
[184] ibid 16.
[185] ibid 17.
[186] ibid.
[187] CA 2006, ss 260-263.
[188] Andrew Keay and Rodoula Adamopoulou, 'Shareholder Value and UK Companies: A Positivist Inquiry' (2012) 13 EBOR 1, 25.

influential in the twenty-first century, but not as powerful an influence as neo-classical literature from the 1980s and 1990s indicate.[189]

On 11 June 2018, the Government proposed draft regulations to introduce new reporting requirements on how directors satisfied their section 172(1) duty to have regard to a larger constituency of stakeholders.[190] This falls in line with previous efforts, including the Stewardship Code, to increase long-term perspectives amongst shareholders and directors. The regulations apply to financial years of companies beginning on or after 1 January 2019 and are allied with the 2017 proposals set out by the Department for Business, Energy and Industrial Strategy Committee's ('BEIS') Response Paper[191] to its 2016 Green Paper discussing options for reform.[192] The Green Paper encouraged enhanced reporting on stakeholder engagement amongst its options for reform, which stimulated further debate on the wording in section 172. The subsequent Response Paper found that there was mass agreement on this point as it would optimise the operation of section 172, which was reminiscent of the 2018 draft regulations' requirements. However, this did not imply that the Government was ready to amend the CA 2006 but did stress the importance of further guidance for all UK-incorporated companies of all sizes on how the ESV move should operate in practice. One of the actions set out in the Response Paper is that companies need to explain how their directors comply with their section 172 duties of having regard to employee interests and fostering business relationships with suppliers, customers, and other stakeholder groups. In the same year, the Financial Reporting Council published a consultation draft of its Guidance on the Strategic Report on how to enhance the relationship between the strategic report and the section 172 duty.[193]

The Government, in addition to its own efforts, has sponsored industry initiatives supporting similar goals, such as the Institute of Chartered Secretaries and Administrators and the Investment Association 2017 initiative to boards to guarantee a better comprehension of stakeholder needs, as set out in section 172(1), and how they should be engaged into corporate decision making.[194] Likewise, the BEIS Parliamentary Select Committee published a report reviewing the UK's corporate governance framework, also advocating for a more narrative reporting on stakeholder corporate engagement. These directions have been reinforced in court, with the High Court holding that section 172(1) may be modified by section 172(2) in cases of companies having objects that extend beyond promoting shareholder benefit.[195] Such varied guidance from both Government and industry bodies is suggestive of a steady movement towards a more comprehensive ESV framework for UK companies.

Conclusion

Prima facie, ESV resembles traditional Anglo-American corporate governance, as even the name suggests it is founded upon a SV paradigm.[196] Upon further assessment, it is clear that ESV aims to propitiate economic and political pressure groups seeking to adopt a more inclusive model of corporate governance in the UK, and has been referred to as an 'intermediate strategy', being pluralist in objective but traditionalist in substance.[197] Whether this can truly be seen as a disruption to the status quo of traditional SV is debatable however, as the legislation has only gone beyond the borders of common law principles to include the new 'enlightened' feature, which, while lacking sufficient precedent, could be nothing more than a formality in the meantime. Thus, the current situation necessitates nothing more

[189] Mary O'Sullivan, *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany* (OUP 2000) 41.
[190] Companies (Miscellaneous Reporting) Regulations 2018, SI 2018/528.
[191] BEIS, *Corporate Governance Reform: The Government response to the green paper consultation* (2017).
[192] BEIS, *Corporate Governance Reform* (Green Paper, 2016).
[193] FRC, 'FRC Consults on Non-Financial Reporting Guidance' (Press Release PN 42/17, London, 5 August 2017) <https://www.frc.org.uk/news/august-2017/frc-consults-on-non-financial-reporting-guidance> accessed 2 August 2018.
[194] IA and ICSA, 'Investors and Companies Unite to Help Boards Take Account of Employee and Other Stakeholder Views' (News release, London, 13 January 2017) <https://www.icsa.org.uk/about-us/press-office/news-releases/investors-and-companies-unite-to-help-boards-take-account-of-employee-and-other-stakeholder-views> accessed 10 August 2018.
[195] *Stimpson v Southern Private Landlords Association* [2009] EWHC 2072.
[196] Virginia Ho, '"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide' (2010) 36 JCL 59, 60.
[197] Sarah Worthington, 'Reforming Directors' Duties' (2001) 64(3) MLR 439, 445.

than mere consideration of stakeholder interests, rather than going so far as to require a type of accountability. The judiciary must do more than rely on ESV provisions if they wish to direct UK companies towards a European inclusive system, as there is no 'quick fix' in corporate law for something as deep-seated as SV. Much apprehension does remain although, regarding directors' duties. Diluting these from purely shareholder-oriented to a model of accountability to other stakeholders is seen to be risky due to it fundamentally modifying the contractual and legal basis of the UK corporate sphere. This paper outlines the key points raised in the shareholder-stakeholder paradigm to clarify the underlying pressures that contributed to legislating a common corporate objective in the UK, as enshrined mainly in section 172(1) of the CA 2006. In examining whether ESV's 'enlightened' aspect has challenged any of the boundaries of the case-law grounded SV doctrine, it has been found that a large portion of UK companies adhere to ESV-like corporate objectives in promoting shareholder wealth maximisation as well as in upholding long-term business relationships. This paper maintains that despite legislators' omissions to formulate a more innovative, elaborate, and enforceable model of corporate governance, ESV has provided an enshrined normative function within legal changes in this sphere, the effect of which has been the beginning of the promotion of long-termism over short-termism.

Reem Kabour completed a LLB with First Class Honours at the University of Leeds and completed the LLM in Corporate Law at University College London.