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Is The UK's Enlightened Shareholder Value (ESV) Model The Answer To The Nagging Corporate Objective Question?

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ABSTRACT

For over three decades now, there has been a raging debate across the globe amongst businessmen, policy-makers, legislators, economists, lawyers etc as to what ought to be appropriate or proper objective or purpose of corporations. In other words, the issue centres of finding out in whose interests a company should be run. Originally, the discussion/argument centred on whether it should be run solely in the economic interests of the company shareholders as shareholder primacy or shareholder wealth maximisation model advocates or whether it should be in the overall interests of all the company's major stakeholders, as advocated by the corporate stakeholder apostles. While the argument was heating up, some writers and countries came up with other models. One of the most popular amongst the new corporate objective model is the one proposed by the UK Company Law Review Steering Group (CLRSG) which was later adopted by the UK Government in its Companies Act 2006 as regards the question of scope of the corporate directors' duties as regards the purpose they will pursue. It is termed 'Enlightened Shareholder Value' (ESV) approach which is more of a 'cross-breed' between the shareholder primacy approach and the pluralist/stakeholder approach. Employing doctrinal research methodology, this work looked into whether this ESV approach is the 'messiah' we have been waiting for insofar as the long nagging corporate objective issue is concerned. It concludes that though ESV model as adopted by the UK is better off than the typical shareholder primacy approach, it has not been able to lay to rest the nagging issue as it still has a lot of shortcomings.

Keywords: Shareholder primacy approach, Enlightened Shareholder Value, Company Shareholders

INTRODUCTION

In 2006, the UK government changed its corporate objective or purpose from the shareholder primacy model to what it called Enlightened Shareholder Primacy (ESV) approach. During the years preceding the coming into force of the said Companies Act 2006, there were high hopes and expectations among many people that the then forth-coming corporate legislation would bring about dramatic changes to the duties of the company directors as it concerns the interests they should be running their companies. The Act has since come into force and it has become important to see whether it actually met the expectations of the people as far as re-ordering the corporate objective or purpose of the country is concerned. This becomes important as some countries were looking forward then to adopting the approach if it works out well in the UK. The work will now progress by discussing the background of the issue that led to the legislation, an appraisal of the legislation to see whether it has introduced the desired or expected changes to the proper corporate objective issue, a summary of the discussion and then the conclusion.

Analytical Background

> …..it seems almost essential if the corporate system is to survive - that the 'control' of the great corporations should develop into purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity.[1]

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[1] Berle, A.A and Means G.C (1932) *The Modern Corporation and Private Property,* New Brunswick and London: Transaction Publishers, at pp 312-313.

The need for the company to act responsibly towards a broader community has been widely and variously canvassed.[2] In many nations today, there is an increase in and a renewed agitation that corporations should integrate not only the interests of the shareholders but those of other stakeholders also in their corporate policy making and execution. The advocates of the wider responsibilities of corporation maintain that the traditional narrow perception that directors owe duties only to their shareholders can no longer be sustained, but should embrace the interests of the other stakeholders.[3] Thus, Dodd argues that companies have both economic and social service roles to play; noting that the company was "permitted and encouraged by the law primarily because it was of service to the community rather than because it was a source of profit to its owners."[4] These advocates are therefore calling for a move away from a strict shareholder-centric to stakeholder-centric approach or model of corporation.

It is good to point out that the UK corporate objective has originally and traditionally been rooted on shareholder primacy approach in that before the coming into force of the UK Companies Act 2006, it was widely understood that the directors' duties both under the common law and in the then Companies Act 1985 were not allowing company directors to take proper account of interests other than those of its shareholders. There was also much emphasis on the short-term rather than the long-term goals of the company, as well as a line of thinking, amongst the UK company directors, that there was no ground or basis for considering any other interests order than those of the shareholders of the company.[5] There were, thus, agitations amongst some thinkers in the country for a shift from this shareholder-centric approach to stakeholder-centric model of corporate purpose or objective.

Thus, in 1973, the UK Government acknowledged the need for the board to discharge its responsibilities not solely towards the shareholders but also towards the wider society:

> The government are specifically recognising, in the context of company law, the generally accepted fact that ownership involves responsibilities as well as rights. This requires company directors, on behalf of the shareholders, to discharge their social responsibilities as well as to protect their legitimate interests. The boards of companies, and their managements, thus have manifest obligation towards all those with whom they have dealings.....[6]

Similarly, in 1998, Hampel Report highlighted the need for companies to be integrative of the interests of stakeholders and that it is in the long-term interests of the company shareholders to do so.[7] As said earlier, in the UK, it has been traditionally accepted that the mission of any commercial company is to maximise economic returns of its shareholders.[8] Any other corporative objective outside this was ancillary to this core purpose. Many people, however, opposed this single-minded operation of companies, arguing that a company is a social institution and that its activities have potential wide impact on other members of the public. In reaction to the wide clamouring for corporate inclusivity, during the review of the 1985 Companies Act, the UK Government had to deeply reconsider the corporate objective in the country - which at that time was rooted on shareholder primacy. In seeking a suitable company law model for the country, the UK Company Law Review Steering Group (CLRSG) was faced with two options - an 'enlightened shareholder value' (ESV) approach and a 'pluralist'[9] approach.[10]

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[2] See for instance, Johnson, L (2013) "Pluralism in Corporate Form: Corporate Law and Benefits Corporation" 25 Regent University L.R 296.

[3] See for instance, Goyder, G (I961) *The Responsible Company*, Oxford: Blackwell, at p 7; Lipton, M and Rosenblum, S (1991) "A New System of Corporate Governance: The Quinquennial Election of Directors" 58 University of Chicago L.R 187, at p 192. Layman Johnson, for instance, maintains that big companies should advance public-serving purposes, not just private gains. See Johnson, L (2013) "Pluralism in Corporate Form: Corporate Law and Benefit Corporation" 25 Regent University Law Review 269.

[4] Dodd, E.M (1932) "For Whom are Corporate Managers Trustees?" 45 Harvard L.R 1145, at pp 1147-9.

[5] See Birds, J (2002) "The Reform of United Kingdom Company Law", in John de Lacy (ed.) *The Reform of United Kingdom Company Law*, 149, at p 159.

[6] Department of Trade and Industry, *White Paper, Company Law Reform*, Cmnd 5391, London: Hmso, 1973, at p 5.

[7] *Final Report of the Committee on Corporate Governance* (Hampel Report), Gee Publishing Ltd 1998, at para 1.18.

[8]See Hampel Report (ibid), at para 1.16.

[9] Corporate pluralist approach is an approach that "would allow directors to take all relevant interests into account and give primacy to none." Birds, J (2002) "The Reform of United Kingdom Company Law", in John de Lacy (ed.) *The Reform of United Kingdom Company Law*, 149, at p 159.

Professor Jensen has earlier advised that "it is obvious that we cannot maximise the long-term market value of the corporation if we ignore or maltreat any important constituency. We cannot create value without good relations with customers, employees, financial backers, suppliers, regulators, communities, and so on."[11] The CLRSG seemed to be in agreement with him as it was of the opinion that "the law ought to be revised to bring it into line with existing best practices, encouraging directors to look beyond maximising short term returns to institutional shareholders towards the longer (term) and to recognise the roles that relationships with other stakeholders.....play in the success of the company"[12] After a long deliberations and wide consultations, the CLRSG settled for the former (i.e, ESV) for some reasons which include its consciousness not to undermine the country's economic competitiveness.[13] Another reason for the rejection of pluralist approach by the CLRSG is the issue of enforcement - that is, the alleged practical difficulty in enforcing it.[14] The CLRSG was also hopeful that the ESV approach will achieve more wealth creation for the benefit of all. The UK Government endorsed and adopted the approach in the Companies Act 2006.[15]

The ESV approach, as adopted by the UK, clearly remains based on the shareholder value and involves directors acting in the collective best interests of the shareholders.[16] It however rejects exclusive consideration of short-term financial benefits, and seeks a more inclusive approach that values the building of long-term relationships.[17] It was conceived to pursue "striking a balance between the competing interests of different stakeholders in order to benefit the shareholders in the long run."[18] The CLRSG stressed that the pursuit of the long-term agenda being encouraged here does not mean disregarding the short-term interests of the shareholders; it rather envisages directors taking a balanced approach and that the long-term view should not be paramount over the short-term or vice versa.[19]

At the heart of this is section 172 of the UK Companies Act 2006. In the context of directors' duties, the section illuminates the 'enlightened shareholder value'[20] approach which, as suggested above, can be seen as a compromise between the shareholder primacy and the pluralist approach.[21] Under this approach, the shareholders retain the primacy as board's ultimate priority and cardinal responsibility

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[10] See The UK Company Law Review Steering Group (CLRSG), *The Strategic Framework* (London, DTI, 1999), at chapter 5. See also Birds, (ibid), at pp 159-160.

[11] Jensen, M (2001) "Value Maximisation, Stakeholder Theory and the Corporate Objective Function" 7(3) European Financial Mgt 297, at p 309.

[12] The CLRSG, *Final Report*, Volume 1 DTI (June 2001), at para 3.11.

[13] It should be noted that one of the UK CLRSG's principal objectives was to enact or create "law for a competitive economy", meaning "policies to facilitate productive and creative activities in the most competitive and efficient way possible for the benefit of everyone, with appropriate freedom for managers and others controlling companies." See CLRSG, *The Strategic Framework*, London, DTI, 1999) at p 8. Similarly, Lowry noted that the UK government, by the New Companies Act 2006, sought to make the country "the choice of location for doing business." Lowry, J (2009) "The Duty of Loyalty of Company Directors: Bridging the Accountability Gap through Efficient Disclosure" 68(3) Cambridge L.J 607, at p 608. Equally, the CLRSG stated that the Company Law it intended to produce will be enabling and facilitative, allowing enterprise "to flourish freely in a climate of discipline and accountability" CLRSG, *The Final Report* (London, DTI, 2001), para 9. Consequently, being overly prescriptive or adopting a pluralist approach would have undermined or defeated these stated objectives.

[14] See CLRSG, *Completing the Structure* (London, DTI 2000), para 3.5. Other factors/reasons against the adoption of pluralist approach can be seen at CLRSG, *Developing the Framework* (London, DTI, 2000), at paras 3.20-3.26. See also Eze, J.A (2022) "The Possibility of Imposing Enforceable Legal Duty on the Board with Respect to the Interests of Non-Shareholding Stakeholders" 13(2) NAUJILJ 40; Eze, J.A (2018) "Issues with the Adoption Corporate Pluralist Approach" 1(1) COOUJCPL 231.

[15] The central concept of ESV which the CLRSG recommended and subsequently approved by the UK Government is that though the directors, in corporate decision-making, owe their duty primarily to the company shareholders as a whole, they should be mindful of all matters which have the tendency of influencing the long-term success of the company and should adopt, as much as possible, socially responsible approaches to corporate business activities.

[16] See the CLRSG, *Developing the Framework* (DTI, London, 2000), para. 2.22.

[17] Ibid.

[18] Armour, J, Deakin, S and Konzelmann, S (2003) "Shareholder Primacy and the Trajectory of United Kingdom Corporate Governance" 41 B.J.I.R 531, at p 537.

[19] CLRSG, *Developing the Framework* (London, DTI, 2000), at 35.

[20] The approach is given the name - 'enlightened shareholder value' principally because it requires the board to take into consideration (where appropriate) the interests of the non-shareholding stakeholders.

[21] See Millon, D (2012) "Enlightened Shareholder Value, Social responsibility and the Redefinition of Corporate Purpose without Law", in P.M Vasudev and S Watson (eds), *Corporate Governance after the Financial Crisis*, GB: Edward Elgar Publishing, 68-96, at p 69.

remains the promotion of their interests.[22] Though ostensibly a version of shareholder value, it is likely to realise a more stakeholder-oriented approach in practice: it maintains profit maximisation as the objective of the company, but subject to developing relationship of trust with stakeholders, as the best way of ensuring sustainability and securing overall prosperity and welfare.[23] This might have prompted Kiarie to proclaim that the ESV approach is the best way forward, arguing that neither shareholder nor stakeholder value is ideal.[24]

The concept of ESV as considered by the CLRSG accepted that maximising shareholder value was and should remain the ultimate objective of corporations.[25] At the same time, the approach encourages the board's developments of deeper thinking about corporate wider responsibilities. Accordingly, the legitimate target of maximising shareholder profits should be tempered by the thinking about and mindful of company's responsibilities to the larger society.[26] It encourages directors to be long-term orientated in their decision making than seeking short-term values or taking the interests of the non-shareholding stakeholders for granted which is not suitable for any sustainable wealth creation.[27] The board is to be mindful of fostering and respecting the common interests of the stakeholders so as to enable a trusting situation develop between them.[28] This will in turn provide the stakeholders with the necessary incentives to co-operate with the company and make firm-specific investments. Obviously, it is in the company's interests to develop a reputation in the wider society as a worthy employer, reliable trading partner or respecter of the environment which might be damaged within the shareholder primacy regime. This will provide further assurance to the stakeholders that the company will pay proper regard to their legitimate expectations.[29] In other words, though the concept still recognises the priority of shareholder interests and (is) thus different from a pluralist approach,[30] it maintains/implies that the interests of shareholders will be best served if companies are responsive to wider group of stakeholders than the single-minded pursuit of shareholder wealth which is traditionally the case under the shareholder primacy approach.[31] This does not mean, however, that it is in shareholders' interests for a relationship to be maintained at all costs. Accordingly, the board can take a decision that will serve the company best by maximising shareholders' wealth, even though that particular decision will hurt the interests of a particular non-shareholding stakeholder group. For instance, the closure of a given plant that is being run at a great loss to the company and it is not possible for the employees concerned to be redeployed. The CLRSG recognised that such a conflict between the interests mentioned in section 172(1)(a)-(f) of the Act, on one hand, and those of the shareholders, on the other, might arise.[32] In such a situation, the board will be guided by the dictates of efficiency and the overriding interests of the shareholders.[33] ESV therefore allows the interests of

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[22] See Keay, A (2013) *The Enlightened Shareholder Value Principle and Corporate Governance*, London: Routledge.

[23] CLRSG, *The Strategic Framework*, para 5.1.12.

[24] Kiarie, S (2006) "At Cross Roads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should United Kingdom Take" 17(11) I.C.C.L.R 329.

[25] CLRSG, *Developing the Framework* (DTI, London, 2000) para 2.22.

[26] Explaining the ESV approach further, the CLRSG stated that under it, the directors were obliged to "achieve the success of the company for the benefit of all the shareholders by taking proper account of all the relevant considerations for that purpose" and this entailed taking "a proper balanced view of the short and long term; the need to sustain effective on-going relationships with employees, customers, suppliers and others" as well as to "consider the impact of its operations on the community and the environment." CLRSG, *Developing the Framework* (DTI, London, 2000), at 12-14. See Generally Keay, A (2007) "Tackling the Issue of Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach" 29 Sydney LR 577, at pp 589-590.

[27] Davies, J "A Guide to Directors' Responsibilities under the Companies Act 2006". See http://www.acca.org.ul/pubs/general/activities/library/business_law/company_law/tech-tp-cdd, p 29.

[28] CLRSG, *Developing the Framework,* (London, DTI 2000), para 5.1.12.

[29] See Parkinson, J (2000) "Corporate Governance: The Company Law Review and Question of 'Scope'" 8 Hume Papers on Public Policy 29, at p 32.

[30] Pluralist approach is rooted on balancing of the respective stakeholders' interests.

[31] See Millon (above, 21), at p 68.

[32] CLRSG, *The Strategic Framework*, 1999, London, DTI, at para 5.1,15. Similarly, in her ministerial statements, Hodge explained that "the Government believe that our ESV approach will be mutually beneficial to business and society. We do not, however, claim that the interests of the company and those of its employees will always be identical; regrettably, it will sometimes be necessary for example, to lay off staff. The drafting.....must therefore clearly point directors towards their overarching objective....." Rt Hon. Margaret Hodge MP (Minister of State for industry and the Region), Companies Act 2006, Duties of Company Directors, Ministerial Statements (London, DTI, June 2007) File 4019.

[33] See Parkinson (above, n 29), at p 33.

the shareholders to retain pre-eminence; but the board can consider the interests of the non-shareholding stakeholders especially if doing so will enhance the overall interests and welfare of the shareholders. The central objective of the model remains to benefit the shareholders;[34] the interest of non-shareholding stakeholders is, thus, not an end in itself but a means to an end. This means that their interests can be sacrificed at anytime if the overall interests of the shareholders so demand.[35]

Consequently, the model may not necessarily provide enough safeguards and protections to the company stakeholders. The said safeguards are imperative for the existence and sustenance of productive relationships, as the stakeholders would want the assurance that whatever sacrifices they are making towards the company will be adequately rewarded when profits are made. They would also need a guarantee of the subsistence and continuity of the relationship. They would not want to be short-changed, or rather, to be used and then dumped when it is time to reap the fruits of their relationships with and commitments to the company. But, the ESV position seems to be that such a relationship should be continued only where it benefits the interests of the shareholders. The benefits accruing to the shareholders, it should be pointed out, need not be immediate: it may be in the long run - as the regime encourages long-termism. Where, however, the co-operative relationships benefit shareholders, the directors are required to do whatever that is reasonably necessary to preserve them. The position of the stakeholders' interests in the relationship is therefore not only secondary but also fragile, precarious and uncertain, since the company can decide at any time that continuing with a particular relationship is no longer in the shareholders' interests, or the company may want to redraw the terms of the relationship to the shareholders' advantage. In any of the either instances, the stakeholders' interests are liable to be sacrificed.[36] The board, who is understood (correctly or incorrectly) to be agents of the shareholders, may therefore find it difficult to convince the other stakeholders that it will not renege on its implicit obligations to them.[37] Thus, the pluralists' insistence on the role of the board should be made chiefly arbitral.

As noted above, the ESV, as conceived, emphasised the need for directors to be more long-termist in their corporate action and decisions. This rationale is very significant because surveys conducted in 1995 by the RSA Inquiry, Tomorrow's Company,[38] and in 1999 by the Institute of Directors', Good Boardroom Practice[39] show that many directors believe that they were not actually entitled to sacrifice immediate returns for long-term gains, especially if these are speculative or difficult to quantify. It could not be established if the directors' duties (then in place) played any significant impact in making them to be short-termists. Parkinson noted that it was unlikely that the pre-existing duties contributed to the short-termist orientation as the prospects of enforcement in the event of them being long-term focused and therefore could not make enough profits for the shareholders were minimal.[40] It became desirable, however, for the CLRSG to have a formulation that passes across an appropriate message and does not support or reinforce possible predispositions of the board toward short-termism. Hence, the emphasis placed in section 172 of the Act that, while advancing the interests of the shareholders, the directors should take account of the long-term consequences of their directorial acts[41] and of the need for the company to maintain healthy relationships with the stakeholders,[42] as well as the need for the company to be seen by the public as genuinely adopting and maintaining the best corporate practices.

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[34] See Nolan, R.C (2006) "The Continuing Evolution of Shareholder Governance" 65 Cambridge L.J 92, at pp 94-95.

[35] "The duty for the directors to have regard to factors such as the interest of employees, the impact on the community and so on appears to *be part* of the duty to promote the success of the company for shareholders' benefit (the effect of the words 'in so doing'). The factors are not, therefore, independent goals with priority over the promotion of the shareholders' interests objective and should not confer any immunity for such action (that would be a pluralist approach)." Copp, S.F (2009) "CSR and the Companies Act 2006" 29(4) Journal of Economic Affairs 16, at p 19.

[36] See Parkinson (above, n 29), at pp 35-36. It seems that it is to minimise this/such occurrence that the 2006 Act, s 172 enjoins the directors to 'have regard' to the interests of the stakeholders therein enumerated.

[37] See Kay, J and Silberston, A (1995) "Corporate Governance" 84 National Institute of Economic Rev 84, at p 90.

[38] Op cit, at pp 11-12.

[39] Institute of Directors', Good Boardroom Practice: *Company Law Review/The Stakeholder Debate* (London, 1999) at pp 3-5.

[40] Parkinson (above, n 29), at p 33.

[41] UK Companies Act 2006, s 172(1)(a).

[42] Ibid, s 172(1)(b).

The ESV concept as enshrined in the 2006 Act did not go far as the 'pluralist' concept would. Under the ESV as it is currently practiced in the UK, the right of enforcement of the board's duties is, strictly speaking, still reserved for the company itself (as stipulated in the common law case of *Foss v Harbottle),* as no other stakeholder is vested with the right of enforcement of those duties in the law court.[43] Arguably, the duty can be said to be owed to the company itself (that is, general body of members as a whole)[44] and not to any individual member or stakeholder.[45] Pluralist approach would have, however, increased the company's responsibilities and those of its directors with respect to external matters: it would have ensured not only that directors are accountable to non-investing stakeholders, but that they are also *required* to act in non-shareholders' interests. The directors could be liable to those stakeholders if they failed to protect their interests.[46] But, the CLRSG found this approach to be unreasonable, impracticable and undesirable in the country in that it would expose the board to the substantial uncertainty of deciding how to balance the likely competing and conflicting interests of the stakeholders.[47] It also feared that it would create a litigious climate for companies whereby those stakeholders who felt that they had not been treated as they expected from or deserved by the company's board would seek recompense through the courts.[48]

Moreover, the CLRSG emphasized the absence of any effective benchmark against which the court can measure the decisions of the directors - this therefore creates enforceability problem - as there must be enforceable standards to ensure that the directors discharge their directorial stewardship in accordance with the objective of the company.[49] This is in accord, or rather, consistent with the original position of the CLRSG that every system must have safeguards built into it.[50] This enforceability problem has been a serious issue plaguing the stakeholder theory.[51] Apparently, adopting pluralist approach in defining directors' duties in the UK would have warranted/required a more fundamental change in the country's corporate law, especially as regards the directors' duties[52] - in that - while the ESV approach encourages the directors to consider the impact of their policies on the non-shareholding stakeholders in their efforts to produce shareholder value, the pluralist approach would have force the board to consider the interests of stakeholders *in their own right*. In this latter scenario, directors could override shareholders' interests if the need arose, and shareholders would thus become merely one of a number of constituencies whose interests the directors would weigh against each other when making decisions.[53] The CLRSG therefore concluded that pluralist changes in the UK company law might have "unpredictable and damaging effects"[54] on the UK's economy. Copp shared this view, suggesting that the rejection of pluralist approach by the UK Government is "without doubt, consistence with economic efficiency. The dangers of damaging shareholder primacy in the country were recognised – indeed, serious economic implications would have flowed from undermining property rights in the company in such a way."[55] He is obviously delighted that pluralist approach was not adopted as its adoption would have "brought economic disaster" to the country.[56]

The ESV concept has now found itself in the Companies Act 2006, section 172. The section started by repeating the traditional shareholder primacy principle by providing that a director must act in a way he considers, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole.[57]

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[43] See UK Companies Law, s 170.

[44] See *Percival v Wright* [1902] 2 Ch 421, Ch. D.

[45] See the UK Companies Act 2006, s 170, especially s 170(1) and (3)

[46] The approach is based on balancing all corporate stakeholders' interests; and thus elevates non-shareholders to the same pedestal with shareholders. See Millon (above, n 21), at pp 68-69.

[47] CLRSG, *Completing the Structure* (London, DTI, 2000), at 34. See also David (above, n 27).

[48] CLRSG, *Developing the Framework* (London, DTI, March 2000) paras 3.30-3.31.

[49] Keay, A (2010) "The Ultimate Objective of the Company and the Enforcement of the Entity Maximisation and Sustainability Model" 10(1) J.C.L.S 35, at p 36.

[50] CLRSG, *Developing the Framework* (London, DTI, March 2000) para 5.1.30.

[51] See Eze, J.A "Issues with the Adoption of Pluralist Approach" (above, n 14).

[52] CLRSG (above, n 50), at 45.

[53] Ibid, at 37-38.

[54] Ibid, at 45.

[55] Copp (above, n 35), at p 17.

[56] Ibid, at p 21.

[57] See *Re Smith & Fawcett Ltd* [1942] Ch 304, at p 306.

By virtue of the section 172(1), while making their directorial decisions, the board is now required to "have regard" to a non-exhaustive[58] list of matters therein enumerated. They include the:

(a) likely consequences of any decision in the long term;
(b) interest of the company's employees;
(c) need to foster the company's business relationships with suppliers, customers and others;
(d) the impart of the company's operations on the community and the environment;
(e) the desirability of the company maintaining a reputation of high standards of business conduct; and
(f) the need to act fairly as between members of the company.[59]

The term 'have regard' is not defined in the Act; and the Department of Trade and Industry (DTI) Explanatory Notes[60] only said that it will not "be sufficient to pay lip service"[61] to the stipulated factors. Continuing, it added that "in many cases, the directors will need to take action to comply with this aspect of the duty."[62] As courts are generally reluctant to interfere with or decide on commercial business decisions made by the board under the popular principle of business judgment rule,[63] an issue arises as to how a court can be able to ascertain whether or not the directors just paid lip service to the listed factors. Again, what will a court do if it comes to the conclusion that mere lip services were paid to those factors by directors?

The Explanatory Note equally said that 'in having regard to' the enumerated factors, the director's conduct must meet the test of reasonable care, skill and diligence set out in section 174 of the Act. This guidance/interpretation seems not to be correct. If objective/reasonableness test were intended by the framers of the statute to be adopted, why was the provision in the draft Bill annexed to the 2002 White Paper, especially clause 2(b) of Schedule 2 which stipulates that in deciding what would be most likely to promote the company's success, a director must take into consideration "all such factors as a person of care and skill would consider them relevant....." removed in the current section 172(1)? Clear and explicit instruction as to how exactly the directors are going to deal with the stipulated factors in their corporate decision-making is therefore absent; so also is the weight to be attached to the individual factors. It was the UK

Government's intention, it seems, to leave the decision concerning these matters to the board. Probably, the board fulfils its obligations under the section once it has regard to those factors. Thus, reacting to this, Margaret Hodge MP, (who was the Government Minister of State for Industry during the passage of the Bill through the Parliament), said that "we believe it is essential for the weight given to any of the factors to be a matter for the director's good faith judgment. Importantly, the decision is not subject to the reasonableness test."[64] Seemingly, the reason behind this is to ensure that business decisions on, for instance, strategy and tactics are for directors, and not subject to decision by the court - subject, of course, to directors' good faith judgement. This seems to be the retention of the common law position as regards directorial business discretions as per duty of loyalty in *Regentcrest Plc (in liq.) v Cohen*[65]

> The duty imposed on directors to act bona fide in the interests of the company is a subjective one.....The question is not whether, viewed objectively by the

[58] "We have included the words 'amongst other matters.' We want to be clear that the list of factors [for a director to have regard to] is not exhaustive." Lord Goldsmith, *Lords Grand Committee*, 9 May 2006, column 846. See also Arsalidou, D (2007) "Shareholder Primacy in Clause 173 of the Company Law Bill 2006" 28 Company Lawyer 67.

[59] The section accords with the reasoning of the Canadian Supreme Court in *People's Department Stores v Wise* [2004] 3SCR 461, at [42]-[43] where Major and Deschamps JJ explained that "We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of the shareholders, employees, suppliers, creditors, consumers, governments and the environment.....At all Times, directors and officers owe their fiduciary duties to the corporation. The interests of the corporation are not to be confused."

[60] This document was drafted by officers of the DTI when the Bill was introduced into Parliament. See "Guidance on Key Clauses to the Companies Bill" at 17.

[61] At para 328.

[62] Ibid.

[63] For a discussion on the meaning and entailments of this rule, see Eze, J.A (2021) "Can Directors of Companies in a Shareholder Primacy and Enlightened Shareholder Value (ESV) Regimes be Public-Spirited?"3(1) COOUJCPL 21 , at pp 29-33. See also Coetzee, L and Kennedy-good, S (2006) "The Business Judgment Rule" 27(2) Obiter 277.

[64] Rt Hon Hodge, Margaret, *Commons Report*, 17 October 2006, column 789.

[65] [2001] BCC 494, *per* Parker J.

court, the particular act or omission which is challenged was in fact in the interests of the company: still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind.

Some ministerial publications on the statutory statements of directors' duties were made by Margaret Hodge MP by way of guidance as to the underlying intendments of the section. She opined that section 172 can be seen as a dramatic departure from the common law position. According to her, "there are two ways of looking at the statutory statements of the directors' duties: on the one hand it simply codifies the existing common law obligations of company directors; on the other - especially in section 172.....it marks a radical departure in articulating the connection between what is good for a company and what is good for society at large."[66] She added that the said sections intend to bring about corporate (behavioural) change by ensuring that there is a "cultural change in the way in which companies conduct their business."[67]

It is doubtful if the section has actually brought about dramatic departure from the common law position as Hodge alleged. Some commentators have argued that the legislation "does not really change the law."[68] Some of the reasons for this have already been pointed out - the major reason is that the ESV remains premised on shareholder primacy. The statement of Parkinson (who served on the CLRSG) is instructive: "In an ESV regime, a company is equated with its shareholders, and whether their interests are furthered is the ultimate test of policy."[69] Arguably therefore, whatever action the board takes under the ESV that is designed in such a way to ultimately foster shareholders' wealth can hardly be impugned.[70] This is so even if the board did not, in reality, consider (adequately) the interests of the stakeholder groups in its decision-making. Again, the non-shareholding stakeholders are not given the right or means of enforcing a failure on the part of the board to consider duly their interests.[71] The duty is also still anchored on the subjective good faith evaluation by the directors. Arden, however, suggested that "the Companies Act 2006 has struck a new balance between companies and society, and it is hoped that by that new balance companies and society may reconnect,"[72] which echoes closely Margaret Hodge's reading of section 172.

The nomenclature 'enlightened shareholder value' creates the impression that the approach is better than its predecessor. That is, the approach claims to be more 'enlightened' as the board is expected to take interests other than those of the shareholders, as well as the long term interests of the company into consideration when discharging their duties. It is however difficult to accept that the approach made remarkable difference in so far as the interests of the non-shareholding stakeholders are concerned. It seems as if the concept is given that exquisite name to create a semblance of tremendous improvement. In the words of Keay, the approach "does not take the matter very far."[73] The Australia's Corporations and Market Advisory Committee (CAMAC) seems to share the same view when it noted that "The section [s.172] makes clear that directors owe their fiduciary duty only to the shareholders generally, rather than to a range of interest groups, but seeks to provide a broader context for fulfilling that duty."[74] Keay notes that the only 'enlightened' element perceivable from the section

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[66] DTI, Companies Act 2006: *Duties of Company Directors, Ministerial Statements* (London: DTI June 2007), at p 1.

[67] Ibid, at p 2.

[68] Keay (above, n 49), at pp 610-612. See also Wilson, G (2011) "From Black Box to Glocalised Player? Corporate Personality in the Twenty-first Century and the Scope of Law's Regulatory Reach" 62(4) N.I.L.Q 433, at p 448, where he refused to accept that the section "marked a radical departure" from the *status quo ante*.

[69] Parkinson (above, n 29), at p 36.

[70] See Copp (above n 35), at 19.

[71] See CA 2006, s 170.

[72] Arden, M (2010) "Regulating the Conduct of Directors" 10 J.C.L.S 1.

[73] Keay (above, n 26), at p 592.

[74] Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations*, (2006) at pp 103-107, http://www.camac.gov.au/camac.nsf/byHeadline/PDFFinal+Report+2006/$file/CSR_Report.pdf. The present Canadian company legislation - Canada Business Corporations Act, (CBCA), 1985 and recent case law in the country are not only consistence with the UK ESV but also go further. Just as in the UK, the fiduciary duties of directors in Canada are owed to the company itself. See CBCA 1985, s 122(1). In a 2008 landmark case of *BCE Inc v 1976 Debentureholders*, 2008 SCC 69, at para 40, the Supreme Court of Canada interpreted these statutory fiduciary duties to include shareholders, employees,

seems to be the recognition that directors can take into account the interests therein enumerated if they wish and not be sued for doing so; but this is only if the action that they have taken promotes the success of the company for the benefits of the shareholders as a whole. It is doubtful, however, if that makes any appreciable difference from the position under the common law and under the 1985 Act. Based on the decision of Lord Greene in *Re Smith Fawcett Ltd*,[75] the directors have always had the right to take the course of action they honestly believe will further the interests of the shareholders as a whole.[76] This, obviously, entails integrating, or rather, taken into account the interests of the non-shareholding stakeholders if doing so will maximise the wealth of shareholders. So, where then is the difference introduced by the section 172? It must be stressed that under the ESV, the directors cannot pursue a course of action that might be good to the interests of the non-shareholding stakeholders unless it ultimately benefits shareholders. Put, in another way, it seems to be the intendment of the section that a course of action should not be embarked upon if it would not benefit the shareholders, even though it would be beneficial to many non-shareholding stakeholder groups. That the above seems to be in line with the spirit of the section can be found in the statement of Prof Davies (who served in the CLRSG), when he referred to ESV as a "shareholder-centred approach", saying that "the interests of the non-shareholding groups thus need to be considered by the directors, but, of course, *in this shareholder-centred approach*, only to the extent that the protection of those other interests promotes the interests of the shareholders."[77] The ultimate end, arguably, remains the enhancement and promotion of shareholders' interests.[78]

Though not expressly stated, the directors' duty under section 172 to enhance the success of the company for the benefit of the members and the duty to take account of the interests of other constituencies can be seen in a hierarchical order, with the former being regarded more highly than the latter.[79] Thus, it is submitted that the overall effect of the section is that ESV can be classified as a 'shareholders first interpretation.' In the words of Dr Anthony Forsyth: "The basic legal position is quite straightforward: the duty of directors to act in good faith and in the interests of the company.....requires directors to treat *shareholders'* interests as paramount. The interests of employees, or other stakeholders, can be considered in performing these duties – but only where this would be in the company's (*i.e.* the shareholders') interests."[80]

The above argument seemingly received the blessing of Margaret Hodge MP when she said that "a director will not be required to consider any of the factors [in section 172(1)] beyond the point at which to do so would conflict with the *overarching duty* to promote the success of the company."[81] As can be gathered from her statement, directors are to have regard to those factors, but if, while doing so, they find any or all of the factors to be inconsistent with their 'primary duty' of promoting the success of the company for the members, they must certainly do away with those factors in their decision-making. Copp appreciates the spirit behind the section's requirement that the board should "promote the success of the company *for the benefit of the members as a whole*" thus: it is aimed at

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creditors, consumers, governments and the environment. According to the court, when the board is weighing conflicting corporate interests of the stakeholders, "it falls on the directors of the corporation to resolve them in accordance with the fiduciary duty to act in the best interests of the corporation, viewed as *a good corporate citizen*." (Ibid), at para 81 [emphasis added]. The above reference to 'corporate citizenship' is more suggestive of the communitarian theory than the UK ESV model. Unfortunately, the court neither defined what 'good corporate citizenship' means nor its implication on how directors are to weigh competing corporate interests. But, Bone treated widely the definition, meaning, scope and purpose of corporate citizenship in Bone, J (2011) "Legal Perspectives on Corporate Responsibility: Contractarian or Communitarian Thought?" 24 C.J.L.J 277, at pp 295-303. He contends that it is most likely that socio-ecological objectives will be advanced by Canadian companies today in light of the said SCC decision, as corporate citizenship notion is generally based on communitarian perspective of corporate theory. Ibid, at p 302.

75 [1942] Ch 304, at p 306.

76 See Eze, JA (above n 63)

77 Davies, P.L "Enlightened Shareholder Value and the New Responsibility of Directors" Lecture at University of Melbourne Law School (Inaugural W.E Hearn Lecture), 4 October 2005. Emphasis added.

78 See Hodge, Margaret (MP) Hansard (HC), 17 October 2006, col. 789 where she said that "consideration of the factors will be an integral part of the duty to promote the success of the company for the benefit of the members as a whole."

79 The CLRSG advocated a hierarchy of obligation when it proposed the approach. See CLRSG, *Completing the Structure*, (London DTI, 2000), at para 3.19.

80 Parliamentary Joint Committee on Corporations and Financial Services, Commonwealth of Australia, *Corporate Responsibility: Managing Risk and Creating Value* (2006) at p 51. [Emphasis in original]. www.aph.gov.au/Senate/committee/corporations_ctte/corporate_responsibility/report/report.pdf.

81 *HC Standing Committee* D, Fifteenth Sitting, 11 July 2006, Cols 591-593. Emphasis added.

"clearly demarking that it (the model) is not pluralist – and this is done in striking capitalist fashion."[82]
Section 172 encourages directors to take into consideration the long-term effects of their policies. Arguably, there was nothing in the pre-existing case law that forbade directors from taking into account the long term consequences of their proposed actions or from taking into account the interests of the non-investing stakeholders. Many have, in fact, argued that directors would be acting wisely and in the interests of the company if they consider the (long-term) sustainability of the corporation and the interests of the stakeholders in their decision-making. Of course, the interests of the shareholders are not likely to be enhanced if, for instance, the company's employees are dissatisfied or even embark on strike, or its customers are discontented with the company's products or way of doing business.[83]
As briefly noted above, section 172(1) is weakened by the fact that there is little guidance as to how the board are to act in practice. The section listed a catalogue of factors the board is to consider when performing its duties, but did not give any guidance as to the form the 'regard' should take. The directors are left with no direction as to what they must do in order to comply with the provision[84] and lack guidance on the weight to be given to each factor[85] and how to resolve conflict between the interests of non-shareholding stakeholders set out in that section.[86] Ostensibly, in such a case, the directors are to uphold the particular stakeholder's interest that best align itself with those of the shareholders and adopt the very course of action that will best further the interests of the shareholders. This seems to be the case as their primary obligation under the ESV remains to maximise the shareholders' wealth, but it is less clear what will happen when directors adopt interests of the stakeholder constituencies which will have the same or similar effect on the interests of the company shareholders but which conflict with other stakeholders' interests. In this context, it is not clear if they are to prioritise either of the interests and if so which one they should do so, or whether they are to balance the conflicting/competing stakeholders' interests in line with the stakeholder theory. In this latter scenario it is not clear how such balancing of interests could be conducted, and there are concerns that such balancing exercise could be used for opportunistic actions.[87] It is also feared that as directors get more discretions in deciding what interests to take into account, this will poise more difficulty to the shareholders in monitoring their directorial performance. The directors may also hide under the cloak to resist claims of breach of duty on the basis that what they did was based on a consideration of the interests of one constituency or the other.[88]
Thus, owing to the significant uncertainties introduced by the ESV, the Australian Parliament Joint Committee on Corporations and Financial Services, in its report, rejected it as the approach to be adopted by the country's corporate governance.[89] Similarly, the Australian Senate's Standing Committee on Legal and Constitutional Affairs arrived at the same conclusion (in 1989) when it considered a similar type of approach.[90] Again, the Australia's Corporations and Markets Advisory Committee (CAMAC) seemed to sum everything up when it said that "a non-exhaustive catalogue of

[82] Copp (above, n 35), at p 18.
[83] Keay, A (2012) "The Duty to Promote the Success of the Company: Is it Fit for Purpose in a Post-Financial Crisis World?" in J Loughrey (ed.) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis*, Cheltenham: Edward Elgar, at p 68.
[84] See Parliamentary Joint Committee on Corporations and Financial Services, Commonwealth of Australia, above, n 80), at p 55.
[85] See Keay, A (2009) *Directors' Duties*, Bristol: Jordans, at p 124.
[86] The same concern was expressed with respect to the US 'constituency statutes'. According to Springer, those statutes place burdens on the board to consider a wide range of interests that may conflict with each other without "establishing sufficient standards by which directors may evaluate them." Springer, J.D (1999) "Corporate Constituency Statutes: Hollow Hopes and False Fears" Annual Survey of American Law 85, at p 107.
[87] Roe, M (2001) "The Shareholder Wealth Maximisation Norm and Industrial Organisation" 149(6) University of Pennsylvania L.R 2063, at p 2065.
[88] See Keay (above, n 26), at p 599. It should be recalled that the above are some of the reasons given by shareholder primacy advocates against the adoption of a stakeholder approach; that is it can lead to opportunistic dealings by the directors, managerial shirking, and results to lack of **managerial** accountability as, according to them, accountability to all means accountability to none. See Eze, "Issues with the Adoption of Corporate Pluralist Approach (above n 14)
[89] Parliamentary Joint Committee on Corporations and Financial Services *(*above, n 80), at 55-56.
[90] Commonwealth of Australia, *Company Director's Duties: Report by the Senate Standing Committee on Legal and Constitutional* Affairs (1989) at 91.

interests to be taken into account serves little useful purpose for directors and affords them no guidance on how various interests are to be weighed, prioritised and reconciled.....The Committee considers that.....to require or permit directors to have regard to certain matters or the interests of certain classes of stakeholders, could in fact be counterproductive. There is a real danger that such a provision would blur rather than clarify the purpose that directors are to serve. In so doing, it could make directors less accountable to shareholders without significantly enhancing the rights of other parties."[91]

In summary, one of the key reasons for rejecting the pluralist approach (according to CLRSG) was that it would require the board to take into account a multitude of constituents' interests thereby conferring un-policed discretion to the directors.[92] It is ironic that the CLRSG drafted (and the UK Government adopted it) a virtually un-policed discretion to directors under section 172.[93] By virtue of the said section, the board is granted a seemingly unfettered discretion as to what actions they take provided that they are acting in a way that they consider in good faith would most likely promote the success of the company for the benefit of the members as a whole. The CLRSG refused to accept pluralist because it would, among other things, involve directors having to 'formally' consider the interests of stakeholder constituencies, and also because it would give no formal remedy to the stakeholders for abuse by the directors.[94] Apparently, these are what we ended up having in section 172 – the only difference being that the consideration of those interests under the section would seemingly be done 'informally'. Arguably, the section will have many similar shortcomings which the CLRSG identified with the pluralist approach.

It is feared that pluralist approach would leave directors in a position of not being accountable for their stewardship.[95] Under the shareholder value principle, the directors are accountable solely to the shareholders. It appears that this accountability to the shareholders has been diluted by section 172 in that the section does not circumscribe the directors' discretion in determining what will promote the success of the company in any appreciable way. While accountability to the shareholders is apparently diluted, there is no commensurate creation of accountability to the stakeholders as the stakeholders have no 'stand to sue' in the event of the directors not having regard to the factors therein listed. It has thus been argued that section 172 arms directors with weapons to defend themselves when their actions are challenged. It gives them "a get out of jail free card" in that it permits them to defend themselves against allegation of breach levelled against them by shareholders by claiming that they acted in the way they did because they were considering the interests of non-shareholding stakeholder constituencies in deciding what would promote the success of the company.

During the debate on the Company Law Reform Bill in 2006 in the House of Lords, Lord Goldsmith said that Government believes that ESV principle is good and proper since 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 those who depends on the company and those of the members."[96] As can be deduced from the foregoing analysis, it is doubtful if section 172 has erased the confusion in the minds of the board or anyone else. This seems to be in line with the report of an Australian Joint Parliamentary Committee on Corporations and Financial Services in 2006[97] which alleged that the said section 172 introduced "great uncertainty."[98] The above discussions suggest that it is highly questionable if section 172 has made adequate provisions for the protection and enhancement of stakeholders' interests.

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[91] Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations*, (2006), at 111-112. www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2006/$file/CSR_Report/pdf.

[92] CLRSG, *Developing the Framework* (London, DTI, 2000) at para 3.24.

[93] See Keay (above, n 83), at p 83.

[94] CLRSG*, Strategic Framework* (London, DTI, 1999) at paras 5.1.21, and 5.1.30.

[95] Jensen (above, n 11), at p 305.

[96] Lords Grand Committee, 6 February 2006, column 255.

[97] The Committee was consideration whether to recommend changes to Australian company law.

[98] *Corporate Responsibility: Managing Risk and Creating Value*, June 2006, at para 4.46, accessible at http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/2004-07/corporate_responsibility/report/index.htm

CONCLUSION

Having said all these, though ESV approach may not be as effective in the protection and integration of the interests of the corporate non-shareholder constituencies, it is not necessarily a bad corporate approach, in toto, as it tries to re-orient the company board away from the strict and wholesome consideration, furthering, promotion and unwavering maximisation of the economic interests of the company shareholders to the detriment of those of the other stakeholder groups as shareholder primacy model/approach does. It also explicitly and unequivocally encourages long-termism and discourages short-termism with its attendant fixating of the board on the short-term targets of the company which hardly (if it ever does at all) support the integration and due consideration of the interests of other corporate stakeholders and building of sustainable cordial relationship with the stakeholder – a relationship very much needed for the long-term sustainability and survival of the company.

The 'acceptance' of the approach in some quarters is strengthened by the fact that it is built around extensive and comprehensive corporate disclosure under section 417 of the Act, under the label of 'Business Review'.[99] It should be recalled that sections 172 and 417 of the UK'S Companies Act, 2006 jointly made up the country's corporate approach termed 'ESV'. This said s 417 emphasises the need for and demands that the board (of certain companies) should disclose in details, its consideration and integration of those stakeholders' interests which were listed in s 172(1)(a)-(f) of the Act, as well as a disclosure of other relevant information required of them by the said section. The relevance of such a disclosure (in causing a company to adopt corporate best practices, ethical and integrative approach) may not be doubted as it will, among other things, help the public, especially the activist-shareholders, socially-minded institutional investors, critics and social monitors to know what the company is doing, especially as regards its integration of the interests of the corporate stakeholders, and adoption of ethical and environmental friendly corporate approach.

[99] The aim of the business review is to keep the members of the company and other relevant constituencies informed about the activities of the company especially those of its board of directors. It was introduced to, among other reasons, "inform members of the company and help them assess how the directors have performed their duty under s 172" of the Act. See Keay, A (2012) "The Duty to Promote the Success of the Company: Is it Fit for Purpose in a Post-Financial Crisis World?" in J. Loughrey (ed) Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis, Cheltenham: Edward Elgar, at p 61.