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The Limits of Company Law in Saving Our Planet: Rethinking the future of the corporate purpose movement

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The Limits of Company Law in Saving Our Planet: Rethinking the future of the corporate purpose movement

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Abstract
The revival of the corporate purpose debate has once again brought to the forefront the question of whose interests companies should serve. Purposes that focus on shareholder value are increasingly scrutinised in a world grappling with challenges like climate change and the COVID-19 pandemic. While historically company law played a role in shaping corporate purpose by requiring companies to assume certain social responsibilities, this paper argues that it is unrealistic to expect modern company law to shift away from a shareholder orientation. Using English company law as an example, including recent cases such as *BTI 2014 LLC v Sequana and ClientEarth v Shell Plc*, this paper critically examines directors' shareholder-oriented fiduciary duties, shareholders' ultimate control, and other forces that reinforce such a focus. It finds that company law in its current form is not well equipped to address negative externalities or social harms. As a result, proposals like mandating a purpose clause or revising fiduciary duties are unlikely to be effective. The paper concludes that viable tools lie outside the traditional boundary of company law: regulatory regimes in areas such as consumer protection, employment, anti-discrimination, and environmental protection can more effectively impose obligations that ensure directors consider broader stakeholder interests in their decision-making. By shifting the focus towards these external legal frameworks, the paper attempts to guide scholars, commentators, and policymakers towards more effective strategies for promoting corporate responsibility in an era full of pressing global challenges.

Keywords
accountability, corporate purpose, environment, directors' duties, English company law, incentive, purpose clause, shareholder control, shareholder primacy, stakeholder interest

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1. Introduction

Corporate purpose (i.e., in whose interests should a company be run) is a long-standing company law issue, which can be at least traced back to the Berle and Dodd's debate in 1930s.[1] Corporate purpose remains the fundamental question at the heart of corporate governance,[2] and is arguably the most important theoretical and practical company law issue confronting us today as we need it to guide and evaluate corporate behaviour.[3] Despite decades of debate, no consensus is reached. The controversy has indeed intensified recently across the Atlantic.[4]

Faced by climate change and the COVID-19 pandemic among other global crises, companies as the core of our economy are increasingly expected to take wider responsibilities beyond generating profits for their shareholders. The British Academy's *Report on the Future of the Corporation*,[5] the US Business Roundtable's *Statement on the Purpose of a Corporation*,[6] and the World Economic Forum's *Davos Manifesto (2020)*[7] all emphasized that company serves not only its shareholders, but all its stakeholders — employees, customers, suppliers, local

[1] Adolf Berle, *Corporate Powers as Powers in Trust* 44 Harvard Law Review 1049–1074 (1931). E Merrick Dodd, *For Whom Are Corporate Managers Trustees* 45 Harvard Law Review 1145–1163 (1932). Adolf Berle, *For Whom Are Corporate Managers Trustees: A Note* 45 Harvard Law Review 1365–1372 (1932). Berle-Dodd's debate has been viewed as "the beginning point for discussions of corporate purpose". Dalia Mitchell, *From Dodge to eBay: The Elusive Corporate Purpose* 13 Virginia Law & Business Review 155, 179 (2019).

[2] Michael Jensen, *Value Maximisation, Stakeholder Theory, and the Corporate Objective Function* 7 Journal of Applied Corporate Finance 8, 8 (2001).

[3] James Walsh, *Introduction to the "Corporate Objective Revisited" Exchange* 15 Organization Science 349, 349 (2004). In the words of Professor Henry Hu, 'the core objectives animate or should animate every decision a corporation makes.' Henry Hu, *Buffet, Corporate Objectives and the Nature of Sheep* 19 Cardozo Law Review 379, 380 (1997). Moreover, different corporate purposes can lead to different diagnoses and solutions to corporate governance problems. See Steve Letza, Xiuping Sun and James Kirkbride, *Shareholding Versus Stakeholding: A Critical Review of Corporate Governance* 12 Corporate Governance: An International Review 242, 242 (2004). It also argues that purpose is reason that something is created or exits. Also see David Kershaw and Edmund Schuster, *The Purposive Transformation of Corporate Law* 69 American Journal of Comparative Law 478, 479 (2021), where corporate purpose is described as "a driver for corporate behaviour, and perhaps ideally as a catalyst for corporate success".

[4] See, e.g., Brian Cheffins, *The Past, Present and Future of Corporate Purpose* 48 Delaware Journal of Corporate Law (forthcoming) (2023); Paul Davies, *Shareholder Voice and Corporate Purpose: The Purposeless of Mandatory Corporate Purpose Statements,* ECGI Law Working Paper No. 666/2022, http://dx.doi.org/10.2139/ssrn.4285770 (accessed 1 November 2024); Colin Mayer, *The Purpose of Corporate Purpose Statements: A Response to "Shareholder Voice and Corporate Purpose: The Purposeless of Mandatory Corporate Purpose Statements" by Paul Davies,* ECGI Law Working Paper No. 694/2023, http://dx.doi.org/10.2139/ssrn.4397435 (accessed 1 November 2024); Colin Mayer, *Shareholderism Versus Stakeholderism – A Misconceived Contradiction* 106 Cornell Law Review 1859–1879 (2020); Lucian Bebchuk and Roberto Tallarita, *The Illusory Promise of Stakeholder Governance* 106 Cornell Law Review 91–177 (2020); Christopher Bruner, *Corporate Governance Reform and the Sustainability Imperative* 131 Yale Law Journal 1217–1277 (2022).

[5] The British Academy, *Reforming Business for the 21st Century: A Framework for the Future of the Corporation* (2018). The Future of the Corporation programme is the British Academy's review of the role of business in society, which is launched in 2017 and concludes its main phase of activity in 2021. More details can be found at https://www.thebritishacademy.ac.uk/programmes/future-of-the-corporation/about/ (accessed 1 November 2024).

[6] The Business Roundtable, representing the CEOs of America's leading companies, issued a *Statement on the Purpose of a Corporation* in August 2019. This Business Roundtable's statement on corporate purpose acknowledges the importance of stakeholders and commits to deliver value to customers, employees, suppliers, communities in addition to shareholders, https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans (accessed 1 November 2024). This changes their long-standing view that "the principal objective of a business enterprise is to generate economic returns to its owners", as we can see in the Business Roundtable's *Statement on Corporate Governance* made in September 1997, http://www.ralphgomory.com/wp-content/uploads/2018/05/Business-Roundtable-1997.pdf (accessed 1 November 2024).

[7] Klaus Schwab, *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution* (December 2019), https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/ (accessed 1 November 2024).

communities and society at large. It is argued that the purpose of the company is to engage all its stakeholders and create values for them.[8]

Apart from the market discipline and self-regulation, policymakers and legislators are also trying to oblige companies to articulate their own purpose. For example, the UK Corporate Governance Code 2018 requires board of the premium listed companies to establish the company purpose on a comply-or-explain basis.[9] The French Loi Pacte of 2019, which through amending article 1833 of the French Civil Code, mandates all French companies to be managed "in the corporate interest, taking into account the social and environmental concerns linked to its activity".[10] The *Restatement of the Law of Corporate Governance* by the American Law Institute restates the objective of the company with a strong emphasis on stakeholder interests.[11] Given such a trend, the viewpoint suggesting that company law needs to intervene in corporate purpose to safeguard the interests of stakeholders is gaining momentum. For example, it is argued that "legislation would require companies to adopt purposes that aim to benefit people and planet as well as shareholders, and report on their success in so doing."[12] This paper, therefore, revisits the current corporate purpose movement, which is, to some extent, synonymous with stakeholderism due to its emphasis on stakeholder interests or wider interests as opposed to the primary pursuit of narrow financial targets.[13]

While company law did play an important role in shaping corporate purpose by making companies assume certain public or social responsibilities in the past, it is unlikely for company law in any major jurisdiction to have a similar role nowadays. This paper uses English company law as an example and argues that it has a limited role to play in moving directors to serve wider interests or to engage more in environmental, social and governance (ESG) activities.[14] The paper argues that company law in its current form are not well designed to address negative externalities or harms to society and environment beyond the shareholder-director relationship. In other words, company law and corporate governance policies are not the best place to offer

[8] For example, Professor Mayer emphatically asserts the purpose of companies is "to produce solutions to problems of people and planet and in the process to produce profits, but profits are not per se the purpose of companies". Colin Mayer, *Prosperity, Better Business Makes the Greater Good* 109 (Oxford: OUP, 2018).

[9] The UK Financial Reporting Council (FRC) has included the following principle in the revised UK Corporate Governance Code 2018: "(T)he board should establish the company's purpose, values and strategies, and satisfy itself that these and its culture are aligned". FRC, *The UK Corporate Governance Code* (London 2018), https://frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code (accessed 1 November 2024).

[10] Klaus Hopt, *Corporate Purpose and Stakeholder Value – Historical, Economic and Comparative Law Remarks on the Current Debate, Legislative Options and Enforcement Problems,* ECGI Law Working Paper No. 690/2023, http://dx.doi.org/10.2139/ssrn.4390119 (accessed 1 November 2024).

[11] The American Law Institute (ALI) is an association of American lawyers, academics, and practitioners that, among other activities, adopts codes and restatements of the law that are highly influential with US legislators and judges. In May 2022, the ALI membership approved § 2.01 *The Objective of a Corporation* as black letter law.

[12] The British Academy Report, Colin Mayer chaired as a follow-up to his book, claimed that section 172 of the Companies Act 2006 can be changed to "require companies to state their purpose in their articles of association". The British Academy, *Policy & Practice for Purposeful Business: The Final Report* 22 (September 2021).

[13] See, e.g., *Nien-he Hsieh et al., The Social Purpose of Corporations 6(S1) Journal of the British Academy 49, 55 (2018).*

[14] Although this paper primarily focuses on English company law, its conclusions may extend to other Anglo-American jurisdictions, given the not substantially different fiduciary duties imposed upon directors and the control powers conferred to shareholders. For example, Leo Strine, the then vice chancellor of the Delaware Court of Chancery who later became the chief justice of the Delaware Supreme Court, noted "the corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders". Leo Strine*, Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit* 47 Wake Forest Law Review 135, 155 (2012). Similarly, William Chandler, Strine's predecessor and the former Chancellor of the Delaware Court of Chancery, noted that "Directors of a for-profit Delaware corporation cannot deploy a [policy] to defend a business strategy that openly eschews stockholder wealth maximization — at least not consistently with the directors' fiduciary duties under Delaware law" in *eBay Domestic Holdings, Inc. v. Newmark* 16 A.3d 1, 34–35 (Del. Ch. 2010).

solutions to the crises we are facing, and they should thereby not be the regulatory focus of the current corporate purpose movement, or, more broadly, efforts to save our planet. Instead, we need to rely upon regulatory framework outside corporate law and re-conceptualise stakeholder interest into relevant operational risks that directors must face and address.

The remainder of the paper is organised as follows. Section 2 provides a brief historical survey of the evolution of companies and corporate purpose in order to understand why company law could set limitations on corporate activities in the early days. Then, Section 3 critically discusses the role of English company law in shaping the shareholder-centred governance structure. Section 4 continues to examine the position of non-shareholder stakeholders through some recent court cases. Other forces, such as economic incentives and governance rationales, that drive directors to favour shareholders are analysed in Section 5. Section 6 critically considers proposals to mandate corporate purpose clauses in companies' articles and offers some potential ways to promote wider interests outside the realm of company law. The final section concludes.

2. Evolution of Company and Corporate Purpose

As far back as the 16th century, trading companies endowed with legal personality were established through royal charters in England. These early companies, initially chartered by the Crown, primarily engaged in overseas trade, exploration, and colonization. One of the most infamous examples is the East India Company, which received its royal charter in 1600. As the 17th century drew to a close, parliamentary enactments also became a means of creating companies.[15] In the United States, similarly, before the introduction of general incorporation laws, the formation of companies was limited to special acts passed by state legislatures. As David Millon points out, during this era, companies were regarded as artificial entities whose existence was owed to "the positive law of the state" rather than "the private initiatives of individual incorporators".[16] Incorporation was entirely contingent upon the state's concession in this period, underscoring the central role of the state in creating companies. The power to determine whether to grant the requested charter, and if so, upon what terms and for what purposes, resides in the hands of the sovereign actors, such as the state.[17] To a significant degree, companies could be seen as a creature of the state. The state's authority to grant charters for incorporation alone can rationalize its intervention in corporate affairs. Furthermore, the sovereign actors held the power to revoke these charters, and as Ron Harris succinctly summarises, English courts could dissolve unauthorised companies or forfeit misused charters through prerogative judicial writs of *quo warranto* and *scire facias*.[18] The US Supreme Court also affirmed that companies established through special acts of state legislatures may lose its

[15] From the mid-19th century, the Crown only granted charters to non-for-profit company with charitable or educational purposes, such as the Law Society, the Institute of Chartered Accountants and the like. Derek French, Stephen Mayson and Christopher Ryan, *Mayson, French and Ryan on Company Law* 7 (33th edn, OUP, 2017). As Parliament became more powerful, the power to grant charters was gradually transferred to the Parliament from the Crown.
[16] David Millon, *Theories of the Corporation* 39 Duke Law Journal 201, 206 (1990).
[17] Elizabeth Pollman, *The History and Revival of the Corporate Purpose Clause* 99 Texas Law Review 1423, 1430 (2021). Unlike the contemporary notion of a purpose clause, historical examples were often not framed as standardized or singular provisions. Instead, they could appear as a preamble or as a grant of a monopoly or franchise for a specific activity. Ibid.
[18] Ron Harris, *The English East India Company and the History of Company Law* in Ella Gepken-Jager, Gerard van Solinge and Levinus Timmerman (eds), *VOC 1602-2002 – 400 Years of Company Law* 220 (Deventer: Kluwer Legal Publishers, 2005).

franchises "by a misuser or a nonuser of them, and they may be resumed by the government under a judicial judgment upon a *quo warranto* to ascertain and enforce the forfeiture".[19]

The concession for incorporation were contingent on the inclusion of specific regulatory provisions within company charters, aimed at safeguarding the public from exploitative practices.[20] In essence, the grant of incorporation privileges was primarily justified on the premise that companies would contribute to the public good, instances of incorporation primarily serving private interests were uncommon.[21] For instance, in the US during the period from the late 18th century to the mid-19th century, most incorporations were focused on public utility purposes, encompassing areas such as public transportation, financial institutions, and local public services.[22] Such orientation toward serving the public interest may have been a motivating factor for the state in granting incorporation privileges.[23] This is why companies during this era were regarded as "a socially useful instrument for the state to carry out its public policy goals".[24]

With the advent of general incorporation laws, most of the significant limitations on corporate activities were lifted, and the process of incorporation became a straightforward registration matter.[25] Individuals looking to establish a company now had to adhere to only few, and mainly procedural, requirements. This transition challenged the notion of state concession, gradually shifting the perception of companies to the product of individual incorporators' initiatives. Companies began to be seen as creations of private individuals rather than extensions of the sovereign power, and their existence was no longer attributed to the state.[26]

The function of company law has evolved from being public law that regulated social and economic issues stemming from companies to becoming more of a private law framework concentrated on internal corporate governance matters.[27] Consequently, company law has shed

[19] *Terret v Taylor* (1815) 13 U.S. 9 Cranch 43, 51.

[20] These provisions often included requirements such as commencing operations within a designated timeframe, maintaining proper infrastructure and preventing abandonment, setting tolls within prescribed minimum and maximum limits, and ensuring a minimum amount of capital was paid in, among numerous other stipulations. James Hurst, *The Legitimacy of the Business Corporation in the Law of the United States, 1780-1970* 39 (Charlottesville: University Press of Virginia, 1970).

[21] It is found that "no grant was forthcoming without justification in terms of the interests of the state as a whole." Elizabeth Pollman, *The History and Revival of the Corporate Purpose Clause* 99 Texas Law Review 1423, 1434 (2021) quoting Oscar Handlin and Mary Flug Handlin, *Commonwealth: A Study of the Role of Government in the American Economy: Massachusetts, 1774-1861* 74 (New York: New York University Press, 1947).

[22] James Hurst, *The Legitimacy of the Business Corporation in the Law of the United States, 1780-1970* 17 (University Press of Virginia, 1970).

[23] On the other hand, it can be argued that the dependence on state action determines that companies carry some public or social functions.

[24] Anant Sundaram and Andrew Inkpen, *The Corporate Objective Revisited* 15 Organization Science 350, 351 (2004).

[25] The pursuit of "any lawful purpose" was gradually permitted. See, e.g., Elizabeth Pollman, *The History and Revival of the Corporate Purpose Clause* 99 Texas Law Review 1423, 1437–1438 (2021). The move to general incorporation law is viewed as a response to prevent political corruption, where state legislatures manipulated the creation of valuable special privileges for particular companies that were not shared by other companies. Ibid., at 1436. In short, corporate purposes were no longer fixed by legislative statute. Ibid., at 1434–1435.

[26] It is observed that: "General incorporation constituted a sea change from the early years of the business corporation. To incorporate, political influence, and a special act of the (increasingly overburdened) state legislature, were no longer required; grants of public or quasi-public powers from the state to the incorporators were no longer presumed; public utility was no longer the implicit purpose of the corporation; and private profit was no longer a 'reward' for public service, but a legitimate end in its own right." David Guenther, *Of Bodies Politic and Pecuniary: A Brief History of Corporate Purpose* 9 Michigan Business & Entrepreneurial Law Review 1, 65 (2019).

[27] The focus of modern corporate law is not on the interaction between the company and wider society. It is instead focused internally on the obligations and relations within the company. Benedict Sheehy, *Sustainability, Justice and Corporate Law:*

much of its public character, and companies have relinquished many of their public functions. With corporate activities seen as primarily the result of private initiatives, they have increasingly been perceived as inherently private in nature. This shift, in turn, has led to companies being released from the "special regulations designed to protect public welfare".[28]

In the meantime, the state gradually lost the ability and authority to intervene in corporate purposes or demand that companies prioritise serving the public interest, a transition that occurred during the latter half of the 19th century. This underscored the growing emphasis on the initiatives of individual incorporators and their personal gains. As creature of private initiative, companies' conventional obligations and responsibilities to the state and the public were largely disregarded. Restrictions on accumulating economic interests for private individuals were also eliminated. Accordingly, concerns related to social welfare became less relevant, and the primary, if not sole, legitimate focus for a company became the economic interests of its shareholders.[29]

Another crucial aspect that cannot be overlooked in the development of corporate purpose is managerial accountability.[30] For example, at the turn of the 20th century, family control of even the largest industrial enterprises remained the norm in many countries.[31] The question of whose interests companies should serve was not really on the table, because the purpose of the company "was whatever its controlling shareholder or shareholders wanted it to be."[32] It is the rise of the public companies with diversified share ownership and professional corporate managers inspired the debate over corporate purpose.[33]

Ever since Berle and Means's observation of the separation of ownership and control,[34] questions as how to best check managerial deviation and ensure accountability have centred on company law and corporate governance discourses. The agency theory,[35] among others, developed from contractarianism which regarded companies as a nexus of contracts,[36] provided the momentum for the shareholder-oriented corporate purpose. Emphases have been placed on

Redistributing Corporate Rights and Duties to Meet the Challenge of Sustainability 23 European Business Organization Law Review 273, 291 (2022).

[28] David Millon, *Theories of the Corporation* 39 Duke Law Journal 201, 213 (1990).

[29] For example, Davoudi et al argued that "the advent of general incorporation signified the end of the formal link between business corporations and social purpose". Leonardo Davoudi, Christopher McKenna and Rowena Olegario *The Historical Role of the Corporation in Society* 6 (s1) Journal of the British Academy 17, 35 (2018). In their view, unsurprisingly, the exclusive right to incorporate had to be justified by some degree of social purpose prior to the advent of general incorporation. Ibid., at 30.

[30] See, e.g., Henry Hansmann and Mariana Pargendler, *The Evolution of Shareholder Voting Rights: Separation of Ownership and Consumption* 123 Yale Law Journal 948, 950 (2014).

[31] For example, in the UK, family domination was prevalent in public companies at the beginning of the 20th century and continued in many British public companies until the mid-20th century. Leslie Hannah, *The Rise of the Corporate Economy* 54 (London: Methuen, 1976), Leslie Hannah, *Visible and Invisible Hands in Great Britain* in Alfred Chandler and Herman Daems (eds), *Managerial Hierarchies: Comparative Perspectives on the Rise of the Modern Industrial Enterprise* 53 (Cambridge: Harvard University Press, 1980).

[32] Lynn Stout, *The Problem of Corporate Purpose* 48 Issues in Governance Studies 1, 2 (2012).

[33] Ibid.

[34] Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (New Brunswick: Transaction Publishers, 1991, originally published 1932).

[35] Michael Jensen and William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* 3 Journal of Financial Economics 305, 305 (1976).

[36] Armen Alchian and Harold Demsetz, Production, *Information Cost, and Economic Organization* 62 American Economic Review 777, 777–795 (1972).

aligning the managerial interests with shareholder interests in order to control agency costs.[37] The singular focus on shareholder value maximisation is praised for its enforceability and monitorability compared with other pluralist approaches.[38] As famously written by Milton Friedman, the Noble Prizes laurate, "in a free enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has a direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society".[39] The wave of hostile takeovers in the 1980s further pushed directors and executives to pay more attention to the financial demands of shareholders and no longer take shareholder loyalty for granted.[40]

Professor Brian Cheffins provided a cyclical historical narrative of corporate purpose trend.[41] Take the US for instance, large public companies were envisaging a broader corporate mission by the late 1920s, but such a potential stakeholder-friendly shift is "stifled and slowed" by the Great Depression of the 1930s and World War II. The pendulum swings back to the shareholder focus in the 1970s with rise of the Chicago School of free-market economists, when company is deemed as "legal fiction, which serve as a nexus for a set of contracting relationships among individuals",[42] and shareholder primacy is enshrined as the best approach to control managerial unaccountability and reduce the "agency costs" on both shareholders and the society.[43] Now faced by climate change and COVID-19 pandemic among other global crises, companies as the core of our economy are increasingly expected to take wider responsibilities beyond generating profits for their shareholders, so the pendulum swings back to the stakeholder-orientated priority.[44]

Considering the companies' deep historical roots in social purpose, the question, as asked,[45] is whether a responsibility to the wider public should be recognised in its legal status. The following three sections will critically examine the governance structures prescribed by the current English company law as well as the position of non-shareholder stakeholders in directors' decision-making matrix, before answering this question in Section 6.

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[37] As a result, legal rules and strategies are developed with a strong focus on managerial accountability to contain agency costs. See, e.g., Reinier Kraakman et al., *The Anatomy of Corporate Law: A Comparative and Functional Approach* 31 (3rd edn, OUP, 2017).

[38] Michael Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function* 7 Journal of Applied Corporate Finance 8, 11 (2001). The essence of the argument is that directors and their executives are appointed to run the company on behalf of and for the benefit of shareholders.

[39] Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits* 32, 33 (New York Times, 13 September 1970).

[40] There is normally a high turnover rate of top executives following hostile takeovers. See, e.g., Kenneth Martin and John McConnell, *Corporate Performance, Corporate Takeovers, and Management Turnover* 46 Journal of Finance 671–688 (1991).

[41] Brian Cheffins, *The Past, Present and Future of Corporate Purpose* 48 Delaware Journal of Corporate Law (2023).

[42] Michael Jensen and William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* 3 Journal of Financial Economics 305, 310 (1976). Similarly, Professor Fama argues: "[T]he firm is just the set of contracts covering the way inputs are joined to create outputs and the way receipts from outputs are shared among inputs." Eugene Fama, *Agency Problems and the Theory of the Firm* 88 Journal of Political Economy 288, 290 (1980).

[43] Ibid., at 305.

[44] Brian Cheffins, *The Past, Present and Future of Corporate Purpose* 48 Delaware Journal of Corporate Law (2023).

[45] Leonardo Davoudi, Christopher McKenna and Rowena Olegario *The Historical Role of the Corporation in Society* 6 (s1) Journal of the British Academy 17, 41 (2018).

3. Role of Company Law

Company law can influence corporate purpose in two principal ways. One approach is by directly specifying whose interest directors should focus or prioritise through the formulation of directors' duties. The other approach is by empowering certain groups of corporate participants to take part in corporate management and governance. Accordingly, powers of these corporate participants and duties of directors together with the liabilities are of vital significance in determining corporate purpose. This section therefore examines the directors' general duties and shareholders' governance power under the English company law.

3.1. Duties Imposed on Directors

Just as companies play a crucial role in the socio-economic landscape, directors are equally indispensable in the internal governance of these companies as they are in general responsible for the management of corporate businesses.

At common law, directors must act *bona fide* in the best interests of the company.[46] This duty is owed to the company rather than to shareholders individually due to the independent legal personality of the company. Directors have discretion to determine what is in the interests of the company and courts would respect directors' business and commercial judgment.[47] Nevertheless, being an artificial legal entity means the requirement to act in the interests of the company does not provide adequate guidance.[48] At the core of the question is whether the interest of the company means the interest of the shareholders. If the answer is yes, then directors are essentially required to manage the business for the benefit of the shareholders.

When considering the nature of the fiduciary relationship between the company and directors, we can find acting in the "interests of the company" is not exactly same as acting in the "interests of the shareholders".[49] However, interests of the company are not infrequently interpreted as the financial well-being of shareholders as a whole.[50] In other words, while the interest of the company and the interest of the shareholders are not necessarily the same things,[51] directors are expected by the common law to run the company in the interest of the shareholders. As summarised by the Company Law Review (CLR),[52] the ultimate purpose of

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[46] Lord Greene MR pointed out that "that directors have to act "bona fide in what they consider… is in the interests of the company…". *Re Smith & Fawcett* [1942] Ch.304, 306.

[47] Ibid. Also per Parker J.: "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 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 directors 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…" *Regentcrest plc v Cohen* [2001] 2 BCLC 80, at para. 120.

[48] It is essential to decide whether the company is to be equated with its members or with other interests.

[49] For example, see Owen J. of the Supreme Court of Western Australia in *The Bell Group Ltd v Westpac Banking Corporation* [2008] WASC 239 at paras. 4394–5.

[50] *Re BSB Holdings Ltd* (No. 2) [1996] 1 BCLC 155, 251 (Eng.).

[51] From an economic perspective, the two types of the interests are not always aligned with each other: shareholders may diversify their idiosyncratic risk by adopting diversified portfolios while the company cannot. This means when acting in the interests of shareholders, directors only have to take systematic risk into account, which may not be in the best interests of the company. See John Armour and Jeffrey Gordon, *Systematic Harms and Shareholder Value* 6 Journal of Legal Analysis 35, 36 (2014).

[52] In March 1998, the then Department of Trade and Industry (DTI) (now the Department for Business, Energy and Industrial Strategy) commissioned a fundamental "Company Law Review" (CLR) led by an independent Steering Group (CLRSG) to consider how core company law could be modernised in order to provide a simple, efficient and cost-effective framework for British business in the 21st century. See *Explanatory Notes* to the Companies Act 2006. CLR is regarded as providing an

companies enshrined in law is to generate maximum value for shareholders,[53] and the law made shareholders' interests ultimately overriding.[54]

For those who believe that the interests of the shareholders should not be overriding or maximising shareholder value is not the means for maximum prosperity and welfare, they argue that company law should be modified to serve a wider range of interests. The proposal to include broader purposes and advance interests of a number of groups without shareholder interests being overriding is strongly opposed by the CLR.[55] The CLR's approach that firmly rejecting that directors shall be obliged to set interests of others above those of shareholders is also favoured by the UK Government in codifying this common law duty.[56] Just as Lord Goldsmith highlighted during the passage of the Companies Bill through Parliament, CLR's approach is right and "resolves any confusion in the minds of directors as to what the interests of the company are".[57]

When it is finally codified as the duty to promote the success of the company under section 172(1) of the Companies Act 2006 (CA 2006), a reference to the shareholders is added after the success of the company.[58] The proposal of omitting such reference to the shareholders, an attempt to avoid the success of the company to be solely defined in terms of the interests of the shareholders, was explicitly rejected.[59] This implies that directors may pursue purposes which they honestly believe are for the success of the company, but any interpretation would be qualified by "for the benefit of its members as a whole".

Now the fiduciary duty imposed on directors by the company law legislation is no longer expressed by reference to "the interests of the company", thereby sidestepping the long-standing problem of identifying the interests of the artificial legal person. As Lord Reed correctly noted that "although the duty is owed to the company, the shareholders are the intended beneficiaries of that duty. To that extent, the common law approach of shareholder primacy is carried forward into the 2006 Act".[60] It is therefore safe to conclude that s.172(1) addresses the question, i.e., whose interests should companies serve, by obliging directors to act in the collective best interests of the shareholders.

Certainly, the present law also adopts an inclusive approach. Whilst directors should operate companies for the benefit of members, namely the shareholders, they must have regard to wider

authoritative assessment of the changes needed for the English company law and its principles and many specific recommendations are reflected in the current Companies Act 2006.

[53] CLRSG, *Modern Company Law for A Competitive Economy: The Strategic Framework* para. 5.1.12 (London: DTI, 1999).

[54] Ibid., para. 5.1.24.

[55] CLRSG, *Modern Company Law for A Competitive Economy: Developing the Framework* para. 2.12 (London: DTI, 2000) and detailed reasons can be found in paras. 3.20–3.36.

[56] The Government agreed that "the basic goal for directors should be the success of the company in the collective best interests of shareholders." *DTI, Modernising Company Law* (White Paper Cm 5553-1), para. 3.3 (July 2002).

[57] House of Lords, Debate 6 February 2006, vol 678, column GC255–6, https://publications.parliament.uk/pa/ld200506/ldhansrd/vo060206/text/60206-29.htm (accessed 1 November 2024).

[58] S.172(1) states: "A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole…".

[59] CLRSG, *Modern Company Law for A Competitive Economy: Developing the Framework* para. 3.52 (London: DTI, 2000). This is contrasted with the Law Commissions' draft, which did not provide further definition after the duty to act "for the benefit of the company" and allowed the directors to determine what these "benefits" are. Ibid.

[60] *BTI 2014 LLC* v *Sequana* [2022] UKSC 25, para. 65.

interests such as company's employees, community and the environment among others.[61] Similar to s.309 of the Companies Act 1985, which required directors to consider the interests of employees in reaching a view of what is in the best interests of the company, the requirement to consider the interests of various stakeholder groups under s.172(1) of the CA 2006 is also essentially of declaratory character.[62] Taking account of other stakeholders' interests is essentially a means to the end of maximising shareholder value under this so-called enlightened shareholder value (ESV) duty. Thus, the inclusivity of s.172(1) cannot change its intrinsic shareholder-orientation.[63]

3.2. Power Conferred to Shareholders

When shareholders purchase shares in a company, the law also confers upon them management control, including rights of appointment and dismissal of directors, control over the company constitution, approval rights for fundamental corporate matters and the ability to propose resolutions at general meetings, among others, to ensure that the proceeds of their investments are managed in their interests.[64]

To begin with, shareholders can vote to determine the composition of the board, namely who can sit on the board. They have the ultimate control over directors' appointments, even when the company's articles gave to the board of directors the right to appoint additional directors.[65] Shareholders are also provided by English company law an entrenched right to dismiss any director by a simple majority of shareholder support.[66] The power to remove directors if shareholders are displeased with their actions serves additional incentives for directors to focus on shareholder demands.[67] It does not imply that if a sub-class of shareholders who happen to select, appoint and remove directors, then directors should focus solely on benefiting that particular group of shareholders.[68] Rather, the general power of shareholders to appoint and remove directors clearly reflects the vital role of the shareholders as a whole in the corporate governance that centres on "the success of the company in the collective best interests of shareholders"[69].

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[61] S.172(1) requires directors in promoting the success of the company for the benefit of its members as a whole shall have regard (amongst other matters) to —

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

[62] See, e.g., fn 77–79 and accompanying text.

[63] More detailed discussion can be found in Section 4 below.

[64] Shareholders can get the benefit of that value either by distribution (e.g., cash dividends) or by the sale of shares, or by realising the value of the undertaking in a winding up. See CLRSG, *Modern Company Law for A Competitive Economy: The Strategic Framework* para. 5.1.5 (London: DTI, 1999).

[65] *Barron v Potter* [1914] 1 Ch. 895; *Foster v Foster* [1916] 1 Ch. 632. Similarly, under the Delaware law, shareholders can vote in director elections, see Delaware General Corporation Law, s. 212,

[66] CA 2006, s.168.

[67] Even in large public companies where shareholdings are essentially dispersed, shareholders do have "real power" to vote to elect or replace directors. Lucian Bebchuk, *The Myth of the Shareholder Franchise* 93 Virginia Law Review 675, 682 (2007). Of course, there will be some impediments, such as costs and staggered boards, to the effectiveness of shareholders' exercising of their vote. Ibid., at 683–694.

[68] Lord Briggs clearly explained this in *BTI 2014 LLC* v *Sequana* [2022] UKSC 25, para. 143. Also see s.172(1)(f) of the CA 2006.

[69] *DTI, Modernising Company Law* (White Paper Cm 5553-1), para. 3.3 (July 2002).

In addition to appoint and dismiss directors for whatever reasons, shareholders are permitted to intervene corporate management by voting to approve or disapprove those fundamental corporate changes or matters that are most likely to cause conflicts of interests between the company and directors.[70] Among which, the right to alter articles of association can be seen as conferring upon shareholders the control power in setting or changing the constitutional rules that govern the running of the company.[71] In this regard, it is both theoretically and practically legitimate for shareholders to articulate the purposes they wish directors to focus within the company's constitution.[72] That is why Lord Goldsmith noted that "… it is essentially for the members of the company to define the objectives that they wish to achieve. Success means what the members collectively want the company to achieve".[73]

Moreover, since the theory of English company law always posits that the board's managerial powers derive from the articles of association rather than from the statutory law, there has never been any doctrinal difficulty with shareholder resolutions that issue binding instructions to the board on managerial matters, provided these resolutions have supermajority shareholder support.[74] Put differently, while directors are generally responsible for the management of corporate businesses for which purpose they may exercise all powers of the company, these delegated powers can be revoked and overridden by shareholders.[75]

Requiring directors to manage companies for the benefit of the shareholders as a whole is also reflected in the powers of shareholders to hold directors to account. Only shareholders can enforce directors' duties by suing non-complying directors in their own name or on the company's behalf.[76] For instance, when directors unlawfully reduce the share capital through unlawful repayments of capital to shareholders, creditors cannot bring any claims against directors until in the liquidation proceedings.[77] Or when insufficient regard has been given to the interests of the company's employees or the environment, these non-shareholder stakeholders could not enforce directors' duties or even formally request directors to consider these relevant interests. As is well known, a duty without corresponding remedies would render the duty toothless and empty.

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[70] For example, certain transactions, such as directors' long-term service contracts, substantial property transactions, loans, quasi-loans and credit transactions, and payments for loss of office etc. in ss.188–231 of the CA2006 need shareholder approval. Besides, the power to allot new shares is also ultimately controlled by shareholders, see CA 2006, ss.549 and 551. In Delaware, shareholders also need to vote on major decisions like the sale of all or substantially all the assets, mergers or dissolution, see Delaware General Corporation Law, ss.271, 251, 275.

[71] Shareholders can amend the company's constitution through a special resolution. CA 2006, s.21. Shareholders in the US can also vote on bylaws and charter amendments, see Delaware General Corporation Law ss.109 and 242.

[72] By the same token, shareholders can also determine what constitutes their interests, whether financial return or otherwise.

[73] House of Lords, Debate 6 February 2006, vol 678, column GC255–6. Also see the discussion on the corporate purpose clause in Section 6.1 below.

[74] Paul Davies, *Shareholder Voice and Corporate Purpose: The Purposelessness of Mandatory Corporate Purpose Statements* in Luca Enriques and Giovanni Strampelli (eds), *Board-Shareholder Dialogue: Policy Debate, Legal Constraints and Best Practices* (Cambridge: CUP, 2024); David Kershaw and Edmund Schuster, *The Purposive Transformation of Corporate Law* 69 American Journal of Comparative Law 478, 507 (2021). This differs in the US, where Leo Strine concluded that the company law in the US "clearly vests the power to manage the corporation in its directors, and not in the stockholders." Leo Strine, *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term*? 66 Business Lawyer 1, 4 (2010).

[75] Apart from the possibility for shareholders to revoke the management powers of the directors collectively through the articles of association, for instance by changing the provision on directors' general authority in the model articles, the removal power, which only requires a simple majority, can serve as a more effective threat and deterrent.

[76] More discussion can be seen in Section 4.2 in relation to *ClientEarth v Shell Plc.* And the situation under the Delaware General Corporation Law is also same, see s.327.

[77] *Re Horsley & Weight Ltd* [1982] Ch 442, 454.

On the other hand, even if directors are about to breach or have breached their fiduciary duties to the company while pursuing shareholder interests, shareholders can authorise the directors' actions or ratify those already completed actions, with an effect to eliminate the possibility of the company bringing any claim against the directors for breaching their duties to the company.[78] As noted by Chief Justice Street in the influential New Zealand case *Kinsela v Russell Kinsela Pty Ltd*: "In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done…"[79] So long as the company is solvent, the shareholders are in substance the company,[80] and they possess the authority to authorise or ratify a transaction that would otherwise constitute a breach of duty by the directors to the company in the absence of such authorisation or ratification.[81]

As a result, the laws governing the formation and management of companies serve the interests of shareholders by granting them the ultimate control over the company.[82] Even if most shareholders do not regularly exercise their voting rights, the allocation of corporate power and their collective ability to exert control over the company would form enough pressure on directors to prioritize shareholders' interests. This implies that even if directors' fiduciary duty were radically changed to more stakeholder-oriented, such as the approach adopted by China[83] and India[84], the prime position of shareholders is hardly challengeable due to the above power conferred to shareholders under the current corporate law framework.[85]

4. Non-shareholder Stakeholders' Interests

The foregoing section demonstrates that English company law places shareholders in the centre within the corporate governance system. It may be argued that while directors' fiduciary duties are shareholder-oriented, they can still be inclusive. For example, under s.172(1) of the CA 2006, directors are required to "have regard to" other stakeholders, such as the interests of the company's employees and the impact of the company's operations on the community and the environment, in promoting the success of the company for the collective best interests of the shareholders. So, will this result in a different outcome?

[78] If an act has been properly authorised or ratified by shareholders, then it no longer constitutes a wrong to the company, and the company cannot pursue a claim in relation to it, either through a derivative claim or otherwise. See, e.g., CA 2006, s.263(2)(c).

[79] *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722, 730.

[80] *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch. 258, 288.

[81] The exception to this, namely when a company becomes insolvent and where there is a shift in the economic interest in the company, will be considered in Section 4.1.

[82] This was concluded by the CLR prior to the enactment of the CA 2006. See CLRSG, *Modern Company Law for A Competitive Economy: The Strategic Framework* para. 5.1.5 (London: DTI, 1999). And it remains true today.

[83] Article 20 of the newly amended *Chinese Company Law 2023* requires directors to "consider the interests of the company's employees, consumers, and other stakeholders and ecological and environmental protection and other public interests, and assume social responsibility".

[84] Section 166(2) of the *India Companies Act 2013* requires directors to act "in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment".

[85] Indeed, the main criticisms against the Chinese and Indian approaches focus on the lack of clarity regarding the enforcement of directors' duties to consider stakeholder interests.

4.1. Creditors

The recent case of *BTI 2014 LLC* v *Sequana*[86] provides an opportunity for the UK Supreme Court to consider the fiduciary duty of directors to act in the interests of the company. As explained above, the statutory expression of the duty to act in the interests of the company in s.172(1) requires directors of commercial companies to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders as a whole, having regard, amongst other matters, to an identified list of considerations. For creditors, the related question is whether the duty to act in the interests of the company requires directors to consider or act in creditors' interests where the company is solvent and not bordering on insolvency.

In this case, directors of Arjo Wiggins Appleton Limited (AWA) paid a dividend of €135 million, nearly all its net assets, to its sole shareholder Sequana SA (Sequana) in May 2009, which extinguished by way of set-off almost the whole of a slightly larger debt that Sequana owed to AWA. At the time the dividend was paid, AWA was solvent, but it had potential environmental liabilities from the extensive pollution of the Lower Fox River. The contingent liabilities of an uncertain amount to clean up the polluted river gave rise to a *real* risk, although not a probability, that AWA might become insolvent at some point in the future. Almost ten years later, the risk materialised and AWA went into insolvent administration in October 2018. BTI 2014 LLC, as AWA's assignee, sought to recover an amount equivalent to the dividend from AWA's directors, on the basis that AWA's directors breached their fiduciary duty to consider the creditors' interests when deciding to distribute the dividend to the sole shareholder in 2009.[87]

Hence, the core issue revolves around whether directors are obliged to *have regard to* the interests of creditors prior to insolvency. It is not in dispute that AWA was not actually or imminently insolvent, nor was insolvency even probable when the payment of the dividend was made in 2009. Therefore, the key question to ask is whether AWA's directors breached their duties by disregarding the interests of creditors when deciding to declare the dividend to Sequana.[88]

Firstly, the contention that the directors' duty to act in the interest of the company's creditors is a free-standing or self-standing duty is unanimously rejected by the Supreme Court.[89] There is no duty owed to creditors that separate from the directors' fiduciary duty to the company and the interests of the creditors are included in the interests of the company.[90] Lord Reed held that the interests of a solvent company are taken to be equivalent to the interests of its shareholders as a whole.[91] The interests of the shareholders would only cease to bear any weight when insolvent liquidation or administration becomes inevitable, at which point the interests of the company would be treated as equivalent to the interests of its creditors as a whole.[92]

[86] [2022] UKSC 25.
[87] Ibid., paras. 115 and 350.
[88] If directors owed a duty to consider or act in the interests of the company's creditors, then AWA's directors may be held liable for disregarding the interests of creditors when deciding to declare the dividend in question.
[89] *BTI 2014 LLC* v *Sequana* [2022] UKSC 25, paras. 11, 155, 205 and 265.
[90] *West Mercia Safetywear Ltd (in liq) v Dodd* [1988] BCLC 250.
[91] *BTI 2014 LLC* v *Sequana* [2022] UKSC 25, para. 11.
[92] Ibid.

When directors are discharging their duty to promote the success of the company under s.172(1), they may be required to consider the interests of the creditors subjected to s.172(3).[93] However, the rule of law only requires a director of an insolvent company or a company which is bordering on insolvency to have proper regard to the interests of its creditors (including prospective creditors).[94] In other words, when a company is solvent and able to meet its liabilities, namely the economic interest as well as the risk of loss in the company remains with the shareholders as a whole, directors' fiduciary duties do not require them to act in creditors' interests or to promote the success of the company for the benefit of creditors.

Even in the circumstances where there is a shift in the economic interest in the company from the shareholders as a whole to include the creditors as a whole when the company is insolvent or bordering on insolvency, the effect of the rule in *West Mercia* is to require the directors to consider the interests of creditors along with those of shareholders.[95] This also implies that the interests of creditors will not get a status of paramount once there is a risk of insolvency,[96] or even when insolvency occurs.[97] Hence, the primary duty to promote the success of the company for the benefit of its shareholders shall not be displaced prior to the actual insolvency.[98]

Other relevant aspects of company law considered here are the rules governing the authorisation/ratification of directors' breach of duty by shareholders. If the interests of creditors need to be considered by directors when making decisions, it would be inconsistent to provide shareholders power to authorise in advance or ratify afterwards a breach of that duty at the same time.

As shown above, the interests of the creditors intrude when the company becomes insolvent.[99] If directors' breach of fiduciary duty affecting the interests of creditors in an insolvency context, shareholders' power to absolve the directors from that breach comes into question. As Lady Arden noted that the ratification principle is subject to any rule of law under s.239(7) of the CA 2006,[100] which clearly includes a rule of law preventing the ratification principle from applying if the company is or would be rendered insolvent.[101] The qualification to the *Duomatic* principle and the now codified authorisation/ratification principle is shareholders cannot authorise or ratify a transaction which would "jeopardise the company's solvency or cause loss to its creditors".[102] In summary, where insolvent liquidation or administration becomes inevitable, the fiduciary duties of the directors to act in the interests of the company or promote

[93] The rule in *West Mercia*, namely the directors' duty to act in the interests of the company will require them, in the context where insolvent liquidation or administration is inevitable, to act in a way they consider in good faith to be in the best interests of the creditors as a whole, after the leading case of *West Mercia Safetywear Ltd (in liq) v Dodd* [1988] BCLC 250, fits the description of the rule of law contained under s.172(3) of the CA 2006.

[94] The rule in *West Mercia* is endorsed by Lord Toulson and Lord Hodge in *Hodge in Bilta (UK) Ltd v Nazir (No 2)* [2015] UKSC 23, para. 123.

[95] Per Lord Reed in *BTI 2014 LLC* v *Sequana* [2022] UKSC 25, para. 11. As known, creditors have the main economic stake in the liquidation process which may be triggered by insolvency, and therefore the interests of creditors must be considered.

[96] Per Lord Briggs (with whom Lord Kitchin agrees), ibid., para. 164.

[97] Ibid., para. 169.

[98] Ibid., para. 189.

[99] *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722, 730.

[100] S.239(7) states "This section does not affect any other enactment or rule of law imposing additional requirements for valid ratification or any rule of law as to acts that are incapable of being ratified by the company".

[101] *BTI 2014 LLC* v *Sequana* [2022] UKSC 25, para. 312.

[102] *Ciban Management Corporation v Citco (BVI) Ltd and another (British Virgin Islands)* [2020] UKPC 21, para. 40.

the success of the company would require them to consider and act in the interests of the creditors,[103] and the breach of this duty cannot be authorised or ratified by shareholders in general meeting.

This means, unless the company is actually insolvent or very near insolvency, directors are free to take actions without first considering the interests of creditors even if this may pose a real risk to the creditors' prospects of being paid. So long as the company remains solvent, directors are only required by English company law to act in interests of the shareholders, and if directors breach any duty while pursuing shareholder interests, shareholders could either authorise the breach or ratify it retrospectively.

The Supreme Court's judgment clarifies that s.172(1) does not create any stand-alone fiduciary duty owed to stakeholders, just as no self-standing duty is owed to company's creditors. Furthermore, the requirement to have regard to the interests of non-shareholder stakeholders would not make any of these interests overriding or displace the interests of the shareholders.

4.2. Environment

Although, as exhibited above, directors of a solvent company are only required to act in the collective best interests of the shareholders, is it possible to expand the interpretation of stakeholder factors, such as environmental risks, in a way that would affect the success of the company? Here we have the case of *ClientEarth v Shell Plc*.[104]

The claimant of this case, ClientEarth, is a non-profit environmental law organisation in the UK. As discussed in Section 3.2, we know only shareholders can enforce directors' duties and hold them to account for breaches. ClientEarth acquired 27 shares in Shell Plc., and then as a shareholder, brought a derivative claim on behalf of Shell against Shell's directors regarding their acts and omissions relating to Shell's climate change risk management strategy. The alleged breaches mainly concerned Shell's directors' failure to set an appropriate emissions target and mismanagement of the climate risk, namely Shell's directors' carbon intensity targets are inadequate to meet the net zero target and their energy transition strategy does not establish a reasonable basis for achieving the net zero target and are not aligned with the global temperature objective of 1.5°c under the Paris Agreement on Climate Change 2015.[105]

The fundamental disagreements between the two sides, as summarised by Justice Trower, relate to the right way to achieve the net zero 2050 targets that Shell has set itself.[106] Though the primary concern is climate change, ClientEarth was trying to build a case that Shell's directors' current approach to climate risks will ultimately lead to financial risks for Shell and be contrary to the long-term success of the company. For example, ClientEarth criticised Shell's directors' decision to make significant new investments in fossil fuel projects, arguing that the climate risk will cause value destruction of Shell's fossil fuel business and thereby the interests of Shell's shareholders. This is unsurprising. As Lord Justice Bowen noted, "The law does not

[103] See Lord Reed's reasoning in fn 95 above.
[104] *ClientEarth v Shell Plc* [2023] EWHC 1137 (Ch.), [2023] EWHC 1897 (Ch.).
[105] Trower J. categorised the alleged breaches into three categories: apart from the above two categories, the third concerns Shell's directors' failure to comply with a Dutch Order made by the Hague District Court on 26 May 2021. *ClientEarth v Shell Plc* [2023] EWHC 1137, para. 27.
[106] Ibid., para. 47.

say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company".[107] The non-shareholder interests, such as the interests of the environment in the present case, are to be given consideration by the directors "only to the extent that it is desirable to do so in order to promote the success of the company for the benefit of its members as a whole".[108] Hence, there would be no case to answer if the climate change risk cannot be linked to the success of the company or the collective best interest of the shareholders.

However, climate strategies and approaches to respond to climate change risks are essentially commercial decisions for directors of the company. The law is clear in this area: it is always up to the directors themselves to determine, in good faith, how to achieve results that are in the best interests of their members as a whole.[109] The question whether directors of a company are in breach of fiduciary duty is to be judged on the subjective basis, which means as long as directors honestly believed that they were acting in the best interests of the company they were not in breach.[110] As held by Lord Greene in *Re Smith & Fawcett*, "[Director] must exercise their discretion *bona fide* in what they consider — not what a court may consider — is in the interests of the company, and not for any collateral purpose".[111] While the codified s.172(1) includes a list of considerations, such as the likely consequences of any decision in the long term and the impact of the company's operations on the community and the environment in promoting the success of the company for the collective best interests of the shareholders, "the weighing of all these considerations is essentially a commercial decision, which the court is ill-equipped to take".[112] Furthermore, Shell's directors had already set an energy transition strategy in relation to Shell's climate risk management and emission reduction targets, the duty to consider the impact of the company's operations on the community and the environment in promoting Shell's success for the benefit of Shell's shareholders under s.172(1)(d) is therefore discharged as well.[113] Judicial intervention to evaluate the merits of directors' commercial decisions in such context would be improper.

ClientEarth also alleged that Shell's directors' approach to the climate risk falls outside the range of decisions reasonably available to them at the time under s.174 of the CA 2006. This is also rejected because ClientEarth failed to prove that "no reasonable board of directors could properly conclude that the pathway to achievement is the one [Shell's directors] have adopted".[114] Courts, in principle, would not interfere with directors' commercial decisions or any commercial questions regarding the strategy directors have adopted. It would be equally difficult to challenge the reasonableness of directors' commercial decisions.

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[107] *Hutton v West Cork Railway* (1883) 23 Ch. D. 654, 673.

[108] Paul Davies, Sarah Worthington and Christopher Hare, *Principles of Modern Company Law* para. 10-028 (11th edn, London: Sweet & Maxwell, 2021). Hence, it would be acceptable under certain circumstances to impair non-shareholders' interests for the sake of the collective best interests of the shareholders.

[109] *ClientEarth v Shell Plc* [2023] EWHC 1137, para. 47.

[110] *Regentcrest plc v Cohen* [2001] BCC 494, paras. 1 and 120.

[111] *Re Smith & Fawcett* [1942] Ch. 304, 306.

[112] *Iesini v Westrip Holdings Limited* [2010] BCC 420, para. 85.

[113] A more difficult question is whether the outcome of this case would differ if the directors did not adequately consider the impact of the company's operations on the environment and failed to adopt any climate strategy. The application for permission is still likely to be rejected on the ground of ss.263(2)(a), 263(3)(a) and 263(4) of the CA 2006. Furthermore, courts are always reluctant to intervene directors' business judgment unless directors act in bad faith.

[114] *ClientEarth v Shell Plc* [2023] EWHC 1897, para. 64. Per Trower J., "ClientEarth must show a *prima facie* case that there is no basis on which the [Shell's directors] could reasonably have come to the conclusion that the actions they have taken have been in the interests of Shell." *ClientEarth v Shell Plc* [2023] EWHC 1137, para. 26.

As a consequence, ClientEarth failed to establish a *prima facie* case that Shells' directors breached their general duties, and the court rejected ClientEarth's application for permission to continue the derivative claim on the basis of s.263(2)(a), namely a person acting in accordance with s.172 would not seek to continue the claim.[115]

While this case does not directly address the balance between the interests of shareholders and those of the environment or other stakeholders,[116] it does make it more difficult for organisations representing specific stakeholder groups, such as environmental or labour interests, to use derivative claims by acquiring shares to advance their own agendas instead of the success of the company for the collective best interests of the shareholders. Being environmental activist, ClientEarth's ulterior purpose in bringing the case is also identified by the court. As noted by Justice Trower, "it seems to me that where the primary purpose of bringing the claim is an ulterior motive in the form of advancing ClientEarth's own policy agenda with the consequence that, but for that purpose, the claim would not have been brought at all, it will not have been brought in good faith".[117] The hurdle is high for future similar types of activists to establish a *prima facie* case that their company has a good cause of action arising out of its directors' breach of general duties and will cause harm to the shareholders of the company.

5. Other Factors

Apart from imposing shareholder-oriented fiduciary duties on directors and conferring ultimate control rights to shareholders, there are additional forces driving the focus on shareholders. The first of such forces is the economic drive encompassing both pressure and incentive, which further underpin the emphasis on shareholder interests beyond company law. The second main force is the governance drive, namely the practical necessity of maintaining the existing power dynamic within companies.

A. Economic Drive

Irrespective of the historical roles companies had played, the modern company is fundamentally an economic entity that relies on markets for its existence.[118] One prominent characteristic of markets is the ability to allocate resources in a manner that reflects their highest value. In other words, utility maximisation is the law created by the market for all market participants. Failing to follow this market rule would result in serious outcomes. According to the neoclassical model of competitive markets, when an individual company starts to engage in pro-social or "other regarding" activities, it must either raise its prices or

[115] *ClientEarth v Shell Plc* [2023] EWHC 1137, para. 59; *ClientEarth v Shell Plc* [2023] EWHC 1897, para. 84.

[116] Of course, it can be argued that the reluctance for the court to intervene itself reflects the pro-status quo stance, namely the tradition of prioritising shareholder interests.

[117] See *ClientEarth v Shell Plc* [2023] EWHC 1137, para. 64.

[118] This contrasts with the perception that companies were instinctively and inherently social entities, which were prevalent between the 17th and 19th centuries. William Pettigrew and Laursen Brock, *Leadership and the Social Agendas of the Seventeenth-century English Trading Corporation* in William Pettigrew and David Chan Smith (eds), *A History of Socially Responsible Business, c. 1600–1950* 34 (London: Palgrave Macmillan, 2017).

reduce the returns to capital or labour.[119] While raising the prices will lead a decline in demand for its products in product markets, reducing returns to capital in capital markets or labour in labour markets will cause the company to fail to attract the necessary financing or talent to survive in the market.[120]

This is perhaps why even for those who strongly advocate that companies should consider wider interests and actively engage in corporate social responsibility (CSR) activities, like Archie Carroll and his followers, the pursuit of profitability — termed *economic responsibility* by Carroll — is regarded as "first and foremost" social responsibility for companies.[121] To "be committed to being as profitable as possible" and "perform in a manner consistent with maximizing earnings per share" are seen as core of such economic responsibility.[122]

Being profitable, namely the economic responsibility, is regarded as the foundation for other components in the corporate responsibility.[123] With the fading of companies' public nature, the profit motive is established as the primary incentive for entrepreneurship.[124] The general consensus is that any mechanism for enforcing or urging social responsibility upon companies must reckon with a profit motive.[125] Economically, responsibilities that prioritise benefits beyond those of shareholders are often perceived as an additional cost of conducting business, a self-imposed levy that reduces profits for shareholders and potentially leads to economic inefficiencies.[126] Considering shareholders' ability to exit their investments and the pressure of relative performance, namely outperforming their competitors, it is not diffilcult to understand why directors and executives are under pressure to maintain a favourable share price and not to take shareholder loyalty for granted,[127] which in turn contributes to a focus on shareholders.

In addition to the market pressure, the economic incentives that driven by executive compensation practices further encourage directors and executives to manage the company in a way that prioritise actions that boost shareholder value.[128] Performance-based pay, which is

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[119] Jerry Mashaw, *Corporate Social Responsibility: Comments on the Legal and Economic Context of a Continuing Debate* 3 Yale Law & Policy Review 114, 119 (1984).

[120] Ibid.

[121] Archie Carroll, *A Three-Dimensional Conceptual Model of Corporate Performance* 4 Academy of Management Review 497, 500 (1979); Archie Carroll, *The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders* 34 Business Horizons 39, 41 (1991).

[122] Archie Carroll, *The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders* 34 Business Horizons 39, 40 (1991).

[123] Ibid., at 42. This is not surprising as survival in the market is undoubtedly the premise for companies to fulfil any other functions.

[124] Companies are created as economic entities to provide goods and services. Ibid., at 40.

[125] See, e.g., Kenneth Arrow, *Social Responsibility and Economic Efficiency* 21 Public Policy 303, 304 (1973). In fact, CSR literature predominantly focuses on the so-called *business case* to endorse CSR on the basis of its positive correlation with the shareholders' long-term economic gain. See, e.g., David Vogel, *Is There a Market for Virtue? The Business Case for Corporate Social Responsibility* 47 California Management Review 19–45 (2005); Michael Barnett, *Stakeholder Influence Capacity and the Variability of Financial Returns to Corporate Social Responsibility* 32 Academy of Management Review 794–816 (2007); Min-Dong Lee, *Review of the Theories of Corporate Social Responsibility: Its Evolutionary Path and the Road Ahead* 10 International Journal of Management Reviews 53–73 (2008); Sandra Waddock and Samuel Graves, *The Corporate Social Performance — Financial Performance Link* 18 Strategic Management Journal 303–319 (1997); Marc Orlitzky, Frank Schmidt and Sara Rynes, *Corporate Social and Financial Performance: A Meta-Analysis* 24 Organization Studies 403–441(2003).

[126] Kenneth Walters, *Corporate Social Responsibility and Political Ideology* 19 California Management Review 40, 42 (1977). Economics is regarded as the science of human choice, and the central economic problem, in all instances, revolves around how to optimise the value of production.

[127] Similar to the pressure exerted by the hostile takeover, managers here are also under the pressure to keep their job.

[128] Since 1993, the US Congress amended the tax code to encourage companies to tie the bulk of their executives' compensation to the share price as a means of "tying pay to performance". Equity-based compensation rose significantly over the past three decades. Recent research also suggests that there is an increasing use of equity-based compensation to replace

designed to align executives' interests with those of the company, ties executives' pay to corporate performance measured by the share price.[129] In other words, the current executive pay patterns remain strongly biased in favour of the shareholders, and it would be difficult, if not impossible, to expect executives refrain from favouring shareholders. Moreover, shareholders' say on pay, namely the requirement of shareholders' approval of directors' remuneration in publicly traded companies,[130] provide further incentive. On a different note, from a psychological standpoint, directors and executives may also find it easier to justify high pay awarded to themselves by linking it to increases in share prices rather than fulfilling other stakeholders' demands.[131]

B. Governance Drive

Lady Arden, who was a member of the CLRSG and chairman of the Law Commission of England and Wales, when their work formed the basis for the codification of directors' duties in the Companies Act 2006, notes

> … the shareholders are the directors' point of focus: the shareholders occupy prime position. This reflects the fact that the company will be managed by the directors, whom the shareholders appoint, and it is the shareholders who in general bear the risk that their capital will be lost first, and the further fact, which is important from the point of view of ensuring corporate competitiveness and the efficiency of the law, that the shareholders are in the best position to monitor the actions of the directors and to enforce the duties they owe. Moreover, the 2006 Act adopts a new procedure for derivative actions brought by shareholders against directors for the benefit of the company. The right to take such proceedings has only ever been vested in shareholders while the company is a going concern. The aim of the company's existence is thus to maximise shareholder value, subject however to the certain features, which result in the concept of ESV.[132]

Instead of reiterating shareholders' ultimate control over companies, the primary task of this subsection is to emphasize the governance rationale behind granting shareholders such control.

Shareholders can obtain the governance rights in terms of voting is not just because they have the most stake in the company and will be affected by the corporate decisions. Other stakeholders such as employees, creditors, suppliers and the like would also be affected by corporate decisions in one way or another, but they are normally not allowed to participate in corporate governance. The conventional wisdom places the emphasis on shareholders' residual proprietary claim, which leads them to have the best incentive to exercise discretion and oversight, compared to other stakeholders as fixed claimant.[133] Such incentives largely ensure

cash wages for corporate employees. See, e.g., Andrea Eisfeldt, Antonio Falato and Mindy Xiaolan, *Human Capitalists*, NBER Working Paper 28815, https://www.nber.org/papers/w28815 (accessed 1 November 2024).

[129] "Incentivize" executives and directors by tying their pay to share price are commonly used, together with shareholder empowerment and board disempowerment, to tackle "every corporate ill". Lynn Stout, *The Problem of Corporate Purpose* 48 Issues in Governance Studies 1, 3 (2012).

[130] CA 2006, s.439 requires an advisory shareholder vote on directors' remuneration report, and s.439A, which is inserted by the Enterprise and Regulatory Reform Act 2013, further requires a binding shareholder vote on directors' remuneration policy at least every three years.

[131] For example, better financial performance is obviously a more legitimate reason, compared with "employees are happier", when awarding pay increase or bonus.

[132] *BTI 2014 LLC* v *Sequana* [2022] UKSC 25, para. 386.

[133] The right to residual proprietary claims against incomes generated by the company provides shareholders with a very different incentive compared to holders of the so-called fixed claims such as monthly salaries, interest payments and the like. Shareholders as residual proprietary claimants are entitled to "every penny of profit left over after the firm's contractual

shareholders' preferences are homogeneous and can be aggregated into a consistent system of choices. On the other side, the heterogeneous nature of stakeholders determines their heterogeneous preferences would hardly be translated into a consistent group of choice.

Accordingly, even for those who prefer pluralism or believe the company shall enhance the quality of life in its local communities, the environmental protection, the safety and security of its employees and workers in its supply chains, and the health of its customers beyond increasing its share prices, they still believe directors should only be elected by shareholders,[134] as it is difficult to find a readily manageable standard for the potential stakeholder voting. Perhaps allowing non-shareholder stakeholders to elect directors of boards is likely to create more problems than it solves. Given the divergent preferences among stakeholders, a board composed of directors focusing on diverse and occasionally conflicting preferences could lead to deadlocks and significant dysfunction in the decision-making process.[135] As known, lack of consistent choices for a company would be self-destruct.[136]

On the other hand, when shareholders are granted governance rights over the company, allowing them to determine the composition of the board and major corporate matters, it is unrealistic to expect directors to deviate from the shareholder focus. Because of the lack of a viable alternative governance model that can confer power to stakeholders other than shareholders to determine the composition of the board, it would be difficult to challenge directors' focus on shareholders.

A three-tiered board structure has also been proposed, comprising a strategic board focused on business strategy, operations and finance; an environmental board focused on the ecological sustainability of operations; and a social board focused on concerns of current employee, broad community and future generations.[137] This proposed structure aims to ensure environmental and social matters are given due consideration. However, given the challenges associated with implanting a two-tiered board system in the jurisdictions like the UK and the US, the prospect of moving to a three-tiered model appears unlikely. Furthermore, if shareholders retain the ultimate authority to appoint and remove directors — including those serving on the environmental and social boards — meaningful change may be difficult to achieve.

Apart from electing directors, as discussed in the foregoing sections, shareholders' governance rights also encompass control over major corporate matters, make proposals in general meetings, enforce directors' duties, authorise or ratify directors' non-compliance, among others. Merely changing one aspect is clearly far from adequate. For instance, even if non-

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obligations to creditors, suppliers, and employees have been met". Margaret Blair and Lynn Stout, *Specific Investment: Explaining Anomalies in Corporate Law*31 *Journal of Corporation Law* 719, 728 (2006) referred to Robert Clark, *Corporate Law* 594–602 (London: Little Brown, 1986). The economic foundation for the power allocation between residual claimants and others is also highlighted by Easterbrook and Fischel at the end of 1980s. Frank Easterbrook and Daniel Fischel, *The Corporate Contract* 89 Columbia Law Review 1416, 1446–1447 (1989).

[134] See, e.g., Colin Mayer, *Shareholderism versus Stakeholderism — a Misconceived Contradiction. A Comment on "The Illusory Promise of Stakeholder Governance" by Lucian Bebchuk and Roberto Tallarita*, ECGI Law Working Paper No. 522/2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3617847 (accessed 1 November 2024).

[135] Lucian Bebchuk and Roberto Tallarita, *The Illusory Promise of Stakeholder Governance* 106 Cornell Law Review 91, 163 (2020).

[136] See, e.g., Frank Easterbrook and Daniel Fischel, *Voting in Corporate Law* 26 Journal of Law & Economics 395, 405 (1983).

[137] Benedict Sheehy, *Sustainability, Justice and Corporate Law: Redistributing Corporate Rights and Duties to Meet the Challenge of Sustainability* 23 European Business Organization Law Review 273, 298–299 (2022).

shareholder stakeholder could elect directors, they would still lack the ability to hold them to account under the current system, thereby lacking any formal remedy when directors fail to consider their interests or other wider interests.

The potential danger lies in enabling directors to deviate from the shareholder orientation without effective remedies for the potential abuse of such discretion by directors.[138] If we struggle to design a viable model for stakeholders to nominate and elect director, how can we establish a system for them to enforce director accountability? More importantly, what would serve as the foundation for such enforcement under the current legal system? Allowing stakeholders rights similar to those of shareholders, such as proposing resolutions and approving significant transactions at general meetings, would neither be workable in practice nor justifiable in law.[139] The inherent dilemmas within the governance model would hinder any material shift away from the current power dynamics within companies.

By contrast to disempower shareholders, empowering shareholders in the internal governance is indeed seen by professionals, lawyers and policymakers as the optimal solution for addressing the agency problem caused by managerial unaccountability.[140] The requirement for shareholder approval of fundamental corporate changes and certain transactions under current company law serves as a crucial mechanism to ensure accountability and prevent self-interested actions. Such governance drive, together with performance-based compensation among other economic incentives or pressure discussed earlier, further motivate directors and executive officers to prioritise the interests of shareholders beyond the company law framework.

6. The Way Forward

The obstacles to moving towards less shareholder-centred corporate purposes, let alone stakeholder-oriented purposes, shall now be evident. This section first examines the feasibility and effectiveness regarding proposals to insert purpose clauses, and then offers some potential solutions to promote wider interests and more responsible corporate behaviour out of the company law box.

6.1. Corporate Purpose Clause

Corporate purpose clause is not new for company lawyers. Before the enactment of the Companies Act 2006, a company was always required by legislation to include a statement of

[138] Though the provisions against the directors furthering their own interests would remain in place.

[139] For example, a stakeholder organ that would exercise the voting rights currently granted to shareholders, as proposed by Sheehy, would not work in practice or be justified. See Benedict Sheehy, *Sustainability, Justice and Corporate Law: Redistributing Corporate Rights and Duties to Meet the Challenge of Sustainability* 23 European Business Organization Law Review 273, 301 (2022).

[140] In the words of Professor Bainbridge, “virtually all of the reforms mandated after the crisis were designed to empower shareholders”. Stephen Bainbridge, *Corporate Governance after the Financial Crisis* 13 (Oxford: OUP, 2012). Similarly, Daniel Attenborough observes that both the European Commission and the US have taken steps to empower shareholders to address the governance problems in the post-crisis era. In short, shareholder empowerment is seen as the alternative to a more stringent rules-based approach. Daniel Attenborough, *The Various Concept of Shareholder Voting Rights* 14 European Business Organization Law Review 147, 154–155 (2013). The recent rise of the shareholder stewardship also focuses on making shareholder more active and play a larger role in the internal governance. See, e.g., Dionysia Katelouzou and Dan Puchniak (eds), *Global Shareholder Stewardship* (Cambridge: CUP, 2022). This is why, although empowering shareholder is not a silver bullet, it remains a widely adopted approach as there are no obvious alternatives. Eva Micheler, *Company Law: A Real Entity Theory* 236 (Oxford: OUP, 2021).

its objects in its constitutional document. If acting outside these objects, any action of the directors would *ultra vires* the company and hence void.[141] Now, according to s.31 of the CA 2006, companies are no longer required to set its objects, and unless they choose otherwise, their objects will be unrestricted, which means they will have unlimited legal capacity. Further, s.39 provides that the validity of a company's actions cannot be questioned on the basis of lack of capacity due to any provision in the company's constitution, which effectively abolishes the *ultra vires* doctrine and renders object clauses irrelevant in company law for serving specific strategic interests.[142]

Meanwhile, the object clause is part of the company's constitution and can be amended in the same way as altering any provisions of the articles of association.[143] Consequently, they are controlled and determined by shareholders collectively. This is consistent with the power and governance rights conferred to shareholders, as discussed in Section 3.2, that enable them to define the objects they wish their company to achieve.

While company law cannot dictate companies' purposes, as these are fundamentally commercial decisions, some argue that there should be a requirement for directors to include a corporate purpose statement or clause. To place the purpose-adopting duty on the board may be seen the second-best option for those who believe that directors shall run the company for a wider range of interests. Although it is not possible to prescribe a corporate purpose clause that advances the interests of multiple groups without prioritising shareholders' interests, it is believed that having such a clause could indirectly nudge corporate behaviour to be more mindful of broader considerations. Different from the traditional object clause, which is mainly used to limit corporate capacity and directors' authority, the purpose is now referred to whose interests should companies serve, namely who are the ultimate beneficiaries of corporate activities. For example, Colin Mayer asserts that company law should be reformed to mandate companies to articulate their purposes that can be associated with society and natural world, in order to "produce profitable solutions to the problems of people and planet" but not to "profit from producing problems for people or planet".[144]

The lesson from the history of mandatory object clause under earlier company law legislations shall be still vivid, it is prevalent for companies to draft very broad object clause in order to cover a variety of different businesses prior to the enactment of the Companies Act 2006. Therefore, even the board can be forced to adopt a purpose clause or statement, they may adopt the least constraining formula they can devise.[145] Besides, when dealing with the complex of relationships and resources that constitute the company's undertaking, directors will always have wide discretion as to how best to achieve the corporate purpose even if a pro-stakeholder

[141] *Re Land Allotment Co* [1894] 1 Ch. 616 (CA). Under the *ultra vires* doctrine, companies have to confine their activities to the specific purpose contained in the object clause, and activities outside the scope could be void *ab initio.*

[142] CA2006, s.39(1) sates "The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution." Nevertheless, a well-drafted object clause may internally restrict the discretion of directors internally through defining the scope of the company's success.

[143] CA 2006, s.31(2).

[144] Colin Mayer, *The Future of the Corporation and the Economics of Purpose* 53 Journal of Management Studies 887, 889 (2021); Colin Mayer*, Prosperity, Better Business Makes the Greater Good* 11 and 22–23 (Oxford: OUP, 2018).

[145] Paul Davies, *Shareholder Voice and Corporate Purpose: The Purposelessness of Mandatory Corporate Purpose Statements* in Luca Enriques and Giovanni Strampelli (eds), *Board-Shareholder Dialogue: Policy Debate, Legal Constraints and Best Practices* 46–90 (Cambridge: CUP, 2024). For instance, companies will likely use their lawyers' drafting skills to navigate around any required purpose statements.

purpose is adopted.[146] Moreover, any attempt for the state to determine commercial companies' purpose would amount to overturn the underlying principle since the first modern UK Companies Act in 1844 that "incorporation of the purpose of carrying on business should not require the approval by the state of those business goals".[147]

As emphasised above, the scope and formulation of any proposed corporate purpose clause would be determined by the shareholders either in the company's articles on initial incorporation or through subsequent amendments by shareholder resolutions in general meetings.[148] Any hope that shareholder-chosen purposes would commit to non-shareholder goals is likely to result in many uncertainties, if not illusions. In other words, if shareholders are not willing to adopt pro-stakeholder purposes, any requirement of a purpose clause would be fruitless.[149]

The UK is a first mover in the regulatory recognition of this idea of purpose clause. The current Corporate Governance Code 2018 introduced a new principle that "the board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned."[150] Before examining this new requirement, it is noteworthy that the Corporate Governance Codes apply only to companies with a premium listing on the London Stock Exchange (LSE) and adopt a "comply or explain" approach, based on the belief that one size does not fit all.

Despite "purpose" is not defined in the 2018 Code,[151] it can be best understood as a mission-purpose.[152] The revised Corporate Governance Code 2024, which would come into force from 2025, further requires the board to include in the annual report how environmental and social matters are taken into account in the delivery of its strategy, including its climate ambitions and transition planning.[153] Therefore, the corporate purpose requirement under the Corporate Governance Codes is consistent with Mayer's proposal that wider interests shall be pursued by the directors when making corporate decisions.

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[146] The business judgment rule and the subjectivity of directors' fiduciary duties, as discussed in fn 110–112 and the accompanying texts, would imply that courts are unlikely to intervene.

[147] Paul Davies, *Shareholder Voice and Corporate Purpose: The Purposelessness of Mandatory Corporate Purpose Statements* in Luca Enriques and Giovanni Strampelli (eds), *Board-Shareholder Dialogue: Policy Debate, Legal Constraints and Best Practices* (Cambridge: CUP, 2024).

[148] Hence, any proposal for directors to adopt a corporate purpose clause would contravene the long-standing principles of English company law and constitutes a usurpation of shareholders' constitutional rights.

[149] On the other hand, if they are already willing and ready to adopt pro-stakeholder purposes, they can always do so without any purpose-adopting duty.

[150] FRC, *The UK Corporate Governance Code* (London 2018), https://media.frc.org.uk/documents/UK_Corporate_Governance_Code_2018.pdf (accessed 1 November 2024). However, the provision is criticised "although meritorious in expression, are, in practice, meaningless in application" and would lead to "superficial compliance". Bobby Reddy, *Thinking Outside the Box – Eliminating the Perniciousness of Box-Ticking in the New Corporate Governance Code* 82 Modern Law Review 692, 707 and 709 (2019).

[151] The Corporate Governance Code Guidance states that "A company's purpose is the reason for which it exists". https://www.frc.org.uk/library/standards-codes-policy/corporate-governance/corporate-governance-code-guidance/ (accessed 1 November 2024).

[152] See, e.g., David Kershaw and Edmund Schuster, *The Purposive Transformation of Corporate Law* 69 American Journal of Comparative Law 478, 486 (2021).

[153] FRC, *The UK Corporate Governance Code* (London 2024), available at https://media.frc.org.uk/documents/UK_Corporate_Governance_Code_2024_kRCm5ss.pdf (accessed 1 November 2024). Under the 2018 Code, the board is only required to include how its governance contributes to the delivery of its strategy.

S.172(2) of the CA 2006, which states "Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, [s.172(1)] has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes", may be seen to provide some flexibility for "other-regarding" purposes. While this can provide some assurance that the company law statue is not overridden by lower order rules, s.172(2) is rarely, if ever, deployed.[154] More importantly, as analysed above, English company law places shareholders in the prime position, thereby, unless the entire system is overhauled, any single change would be of limited effect.[155]

Let's look at some of the largest companies by market capitalization listed on the LSE,[156] and we can find most have already adopted a statement of purpose in their annual accounts to comply with the requirements set out in the 2018 Code. For example, Shell Plc's purpose is "To power progress together by providing more and cleaner energy solutions"; the purpose of AstraZeneca Plc is "We push the boundaries of science to deliver life-changing medicines"; HSBC Holdings Plc's purpose is "Opening up a world of opportunity"; and Unilever Plc's purpose is "To make sustainable living commonplace".[157] However, none of these companies has yet included a purpose clause in their articles of association.

Legally, the effectiveness of these purpose statements is doubtful. While all the above purposes are aspirational, they share a common ground of being too abstract, therefore lacking concrete guidance and enforceability in terms of directors' fiduciary duties, making them more akin to statements of mission. Unsurprisingly, these purposes are not intended to challenge the prime position of shareholders under the existing system, either directly or indirectly.[158] More importantly, shareholders have the ultimate power over the company, which certainly include the authority to set the corporate purpose. When purposes set by shareholders clash with purposes adopted by the board, the former will prevail.

Is it then possible for shareholders to proactively use their governance rights and influence to make their companies serve wider interests that do not necessarily maximise their own wealth? There may be no quick answer to this question. There are certainly a category of investors seeking social impact and are willing to trade off impact against return.[159] If the majority of shareholders in a company fall into this category, there would be no need to alter the existing institutional framework. Shareholders, through their current powers and influence, could effectively drive the company to be managed in a manner that aligns with and serves broader

[154] See, e.g., David Kershaw and Edmund Schuster, *The Purposive Transformation of Corporate Law* 69 American Journal of Comparative Law 478, 498 (2021).

[155] In other words, suggestions that the Certified B Corporations' requirement, which does not prioritise shareholder interests, can be aligned with s.172(2), and hence make material changes shall be treated more cautiously. See, e.g., Adefolake Adeyeye, *Certified B Corps: An Examination of a Standard Based Approach to Stakeholder Governance* 35 European Business Law Review 755, 771–772 (2024).

[156] LSE, *Prices and Markets Data*, https://www.londonstockexchange.com/live-markets/market-data-dashboard/price-explorer (accessed 1 November 2024).

[157] The data were manually collected by the author by reading the companies' annual accounts, which are deposited in the Companies House database, https://find-and-update.company-information.service.gov.uk/ (accessed 1 November 2024).

[158] This is why it is argued that such mission purposes may become a superficial marketing device.

[159] It is argued that these shareholders have increasingly gravitated towards a corporate focus on social purpose, driven by a growing belief that prioritising other stakeholders and broader social goals is more aligned with ensuring the long-term health of the corporate enterprise than a narrow focus solely on shareholder profit. Lisa Fairfax, *The Shareholder-Stakeholder Alliance: Exposing the Link between Shareholder Power and the Rise of a Corporate Social Purpose* in Elizabeth Pollman and Robert Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* 111 (Cheltenham: Edward Elgar Publishing, 2021).

stakeholder interests. However, there is a lack of empirical evidence supporting the notion that shareholders as a whole are willing to use their power to do this.[160] Shareholders will have no incentive to systematically change their voting preferences and voluntarily exercise their control to cause directors to prioritise other stakeholders. In other words, while many institutional investors have gravitated towards the view that companies should consider issues beyond shareholders and profit,[161] when it comes to taking concrete actions, they often fail to follow through. Secondly, requesting shareholders to vote for other stakeholders' interests may fundamentally contradict the economic foundation of the allocation of the corporate voting powers within modern companies, as suggested by Easterbrook and Fischel among others.[162]

In a nutshell, while a corporate purpose clause may serve as a statement of corporate commitment (if any), it alone would hardly make any material difference to the current regime.

6.2. Approaches outside the Corporate Law Box

Company law is not the only tool at our disposal. Laws in other areas can be employed to influence or constrain corporate operation through incentives and liability, without necessarily interfering with the shareholder focus or profit motivation of companies. Despite the persistence of the various drives as discussed above, laws can still play a role in providing accountability for companies and controlling negative externalities including harms to the society.[163] On the other hand, companies must adhere to the law to operate, which includes paying taxes, refraining from using child or forced labour, complying with minimum wage requirements, and fulfilling other legal obligations.[164] Accordingly, environmental law, consumer law and labour law are more appropriate forums for addressing the interests of the environment, consumers and employees. For the interests of creditors, insolvency law undoubtedly offers more protection compared to company law.[165] Consequently, we should not solely focus on company law or corporate governance codes to address stakeholder groups' interests.[166]

While modern company law and corporate governance policies inherently focus on the obligations and relations within the company instead of negative externalities, other laws can serve as a qualification for shareholder-oriented fiduciary duties. Take forced labour issue as

[160] Even the modest shifts towards stakeholder interests are not currently receiving significant shareholder support. For instance, proposals from some activist shareholders seeking companies to report on their commitment to the Business Roundtable's revised *Statement on the Purpose of a Corporation* have received minimal backing from other shareholders. See Jill Fisch, *Purpose Proposals* 1 University of Chicago Business Law Review 113, 130–131 (2022).

[161] See Lisa Fairfax, *The Shareholder-Stakeholder Alliance: Exposing the Link between Shareholder Power and the Rise of a Corporate Social Purpose* in Elizabeth Pollman and Robert Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* 112 (Cheltenham: Edward Elgar Publishing, 2021).

[162] Despite situations of shareholders proposing and voting for some "other regarding" activities occasionally happening now, when shareholders exercising their control in seeking values not related to their residual profits becomes the norm, the justification for shareholder participation (namely, their voting right) will not work anymore. See, e.g., Min Yan, *Shareholder Control in the Context of Corporate Social Responsibility — A Fundamental Challenge to Modern Corporations* 50 Hong Kong Law Journal 1057, 1075 (2020). Also see fn 133 above and accompanying text.

[163] Compliance would be motivated by the desire to avoid liability.

[164] Even Milton Friedman, who famously argued that the only responsibility of the firm is to use its resources and engage in activities to maximize its profits, also accepted that companies must conform to the basic rules of society. See Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits* 32, 33 (*New York Times* 13 September 1970).

[165] Involuntary creditors can choose to rely upon tort law to seek remedies.

[166] It is argued that corporate law in its current form is contributing rather than fixing climate crisis and social inequality among other challenges we are facing. See, e.g., Benedict Sheehy, *Sustainability, Justice and Corporate Law: Redistributing Corporate Rights and Duties to Meet the Challenge of Sustainability* 23 European Business Organization Law Review 273, 307 (2022).

an example, instead of changing directors' general duties, the government introduced the Modern Slavery Act 2015, which requires companies over a certain size to disclose each year the actions they have taken to ensure that both their business and supply chains are slavery-free[167] Failure to comply with the requirement to publish slavery disclosures will lead to serious adverse consequences. Directors of non-complying companies also potentially face challenges regarding their general duty of care, and their duty to promote the success of the company due to the significant fines, reputational damage, and other consequences that may arise from such non-compliance. Therefore, the Modern Slavery Act in this case is more effective than amending the fiduciary duties under the company law to mitigate the employment of forced labour across the supply chains.[168]

Or a general environmental duty of care imposed by international environmental agreements or domestic laws can avoid the difficult question of balancing between shareholder interests and environmental interests during the decision making.[169] Even within the shareholder primacy model, directors are never obligated to pursue shareholder interests in violation of the law.[170]

Despite regulatory gaps exist, such as under-specification of regulatory terms and under-enforcement of regulations,[171] proposals to rely on laws other than company law remain a viable solution to ensure that directors take into account of wider interests when making corporate decisions. First, regulatory intervention can in general induce internal corporate compliance and help internalise costs to prevent those undesired activities.[172] Secondly, specific requirements imposed by these laws can indeed reimagine stakeholder interests as relevant risks that directors must face and address. For instance, the interest of the environment in the traditional purpose debate can become environment risks if the environmental protection legislation more strictly regulates emission and pollution with serious adverse consequences for non-compliance. While directors would still have wide discretion as to how to run companies,[173] this shift means directors must not only consider these factors but respond to them as they would to other substantial business risk in their decision-making process. Failing to deal with such risks would also potentially lead directors to breach their general duty of care, skill and diligence, so it can fundamentally transform directors' decision-making methodologies.

Jumping out of the company law box can also include addressing foreign companies that not incorporated under the UK Companies Acts but operated in the UK. As known, company law

[167] Modern Slavery Act 2015, s.54.

[168] While there is no consensus on the effectiveness of the Modern Slavery Act 2015 in addressing slavery issues in the short term, it is agreed that the Act has the potential to contribute to long-term solutions. See, e.g., Muhammad Azizul Islam and Chris Van Staden, *Modern Slavery Disclosure Regulation and Global Supply Chains: Insights from Stakeholder Narratives on the UK Modern Slavery Act* 182 Journal of Business Ethics 455, 473 (2002). This is not to suggest that the 2015 Act can address all slavery-related issues, rather it illustrates that other areas of law may have a more direct impact on driving behavioral change than relying solely on directors' fiduciary duties.

[169] Criminal law can also be involved here for large-scale environmental and ecological damages.

[170] See, e.g., fn 163 above.

[171] See, e.g., John Armour and Jeffrey Gordon, *Systematic Harms and Shareholder Value* 6 Journal of Legal Analysis 35, 48 (2014).

[172] It is argued that "Where firms pay penalties for socially harmful activities, then the shareholders are forced to internalize the costs, and managers who are focused on profits are thereby also made to focus on compliance." John Armour, Jeffrey Gordon and Geeyoung Min, *Taking Compliance Seriously* 37 Yale Journal on Regulation 1, 12 (2020).

[173] See fn 110–112 and accompanying text.

measures such as requiring a purpose clause or revised fiduciary duty may not necessarily apply to these foreign companies. However, other areas of law targeting specific actions can offer more flexibilities in this regard.

Commentators may rightly have concerns about the growing expectations on state capacity to tackle diverse issues related to the common good. At the same time, external regulations may be inadequate in areas that depend on trust and mutual cooperation. For instance, if directors unilaterally end a long-term cooperative relationship with a supplier purely to maximise shareholder interests, contract or trade law would offer limited recourse, as no statutory remedies would cover such actions.[174] In contrast, internal governance has comparative advantages over external regulation in addressing externalities.[175] Alongside mandatory regulations, soft-law approaches should also be employed to influence corporate behaviour since these methods can often be more timely, proactive, and adaptable to emerging challenges. Corporate self-regulations and codes of conduct serve as effective examples. However, regulatory interventions with binding normative content and a deterrent effect beyond the company law framework are essential to ensure certain bottom lines, especially those of primary concern to society.

Another effective method is disclosure, which plays a crucial role in ensuring corporate accountability.[176] Increased transparency strengthens regulatory measures by making corporate practices visible and open to public scrutiny — a factor that becomes especially vital for self-regulations and other soft-law approaches. Enhanced disclosure requirement can also indirectly influence directors to make more conscientious decisions and lead their companies more responsibly.

Moreover, disclosure obligations offer a way to address corporate governance challenges without the need to reconfigure directors' general duties or redistribute corporate control within companies. By enhancing the transparency and comprehensiveness of non-financial information (e.g., ESG information) disclosed, directors will be compelled to consider more carefully the impact of their company on the environment, society, and other stakeholders when fulfilling their directors' duties. Take the climate change risk for example, once environment information is mandated for disclosure and becomes more readily accessible, public pressure along with market forces would help discipline corporate behaviour,[177] thereby constraining directors' intended and unintended focus on shareholder value. In other words, regardless of the specifications of directors' fiduciary duties and shareholders' control rights under the current governance structure, wider public accountability may be achieved through improved

[174] For example, in *Baird Textile Holdings Ltd v. Marks & Spencer plc* [2001] EWCA CIV 274, when Marks & Spencer (M&S) unilaterally terminated the long-term relationship with one of its major suppliers, Baird Textile Holdings, contract law could do nothing to protect the vulnerable stakeholders. Nevertheless, most suppliers and other stakeholders would wish to maintain a long-term co-operative relationship with the company, especially after making a significant firm-specific investment.

[175] Firstly, directors possess greater information and expertise regarding their projects than legislators and policymakers, making it more challenging for outsiders to design effective regulations to guide directors' behaviour. Additionally, external regulations are often more costly than internal adjustments for achieving the same outcomes, partly due to the higher ongoing enforcement costs associated with external regulation compared to implementing internal governance measures.

[176] See, e.g., Iris Chiu, *Operationalising a Stakeholder Conception in Company Law* 10 Law and Financial Markets Review 173, 177 (2016).

[177] From a more positive perspective, increased transparency can help those responsible companies to differentiate themselves from, and compete with, those irresponsible ones.

company reporting.[178] Further, disclosure requirements can also be leveraged alongside other areas of law to enhance enforcement.[179]

In short, corporate laws are not well designed to deal with social injustice, public or environmental issues, and focus on changing fiduciary duties to save our planet would not be effective.[180] However, this is not to suggest that company law becomes irrelevant. While regulations and laws out of the company law framework can set bottom lines with legal consequences for corporate behaviour, corporate law and governance can internalise those requirements imposed on companies to responsibilities of those who run companies through, for example, directors' general duties.

7. Conclusion

While corporate law historically played an important role in compelling companies to assume certain social responsibilities and serve the public interest, restoring these public or social functions of companies would be difficult now. As the law currently stands, the shareholders are the intended beneficiaries of directors' fiduciary obligations, in particular the duty to promote the success of the company is now qualified by "for the benefit of its members as a whole". So long as the company is going and solvent, the interests of the shareholders will not be displaced by any other stakeholder interests. Moreover, the prime position of shareholders is also strengthened by shareholders' control over the company through their ability to determine the composition of the board, namely selecting, appointing and dismissing directors and their ability to ratify the wrongs that have been done to the company by the directors, or choose to sue those non-complying directors either in their own name or on behalf of the company. Shareholders' approval is required by law for fundamental corporate changes or matters that are most likely to cause conflicts of interest between directors and the company. Pressure from various markets (capital, labour, product, etc.) also drives directors to favour shareholders in order to keep their jobs, not to mention shareholders' influence over executive pay. The prevalent performance-based compensation and stock options further align the private interests of directors and executives with those of shareholders.

Without sweeping reforms of the fundamentals of directors' general duties and the rights conferred to shareholders, expecting directors to refrain from favouring shareholders would be wishful thinking. However, any proposal to change any single aspect of them would be a very

[178] Furthermore, assisted by the technological advancement and development of business models, in the future multistakeholder participation may also be achieved outside the realm of company law. However, any in-depth discussion of this is outside the scope of this paper.

[179] For example, the Independent Anti-Slavery Commissioner has recommended that the modern slavery statement, mandated under the Modern Slavery Act 2015, be referenced in corporate annual reports. This serves as a valuable illustration of how disclosure requirements can be integrated with other areas of law to enhance compliance. See Secretary of State for the Home Department, *Independent Review of the Modern Slavery Act 2015: Final Report* (May 2019). In addition, third-party certification can also help to ensure the standard and quality of the reports.

[180] While English Company Law is used as the main example in this paper, a similar argument can be made in relation to Delaware corporate law in the United States, where the emphasis on shareholder primacy similarly restricts directors from giving due consideration to stakeholder interests or wider societal concerns. See, e.g., Jill Fisch, *Purpose Proposals* 1 The University of Chicago Business Law Review 113, 142 (2022); Edward Rock, *Business Purpose and the Objective of the Corporation* in Elizabeth Pollman and Robert Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* 33 (Cheltenham: Edward Elgar Publishing, 2021).

radical move and unlikely to get wide support,[181] and removing the ultimate control of the shareholders could even potentially breach the provisions of Article 1 of the First Protocol to the *European Convention on Human Rights,* which protects the right to property.[182]

Thus, company law and governance policies have limited role in dealing with negative externalities as they are designed to focus on the internal power dynamic within the organisation, discussions should therefore not be constrained to modify directors' fiduciary duties, such as inserting a purpose clause or other-regarding requirement under company law, to address the current global challenges and crises.[183] Scholars, commentators and policymakers have to shift their focus to tools outside the company law box when seeking the most effective approaches to make companies more responsible and sustainable in order to save our planet. The regulatory regimes of consumer protection laws, employment laws, anti-discrimination laws, and environmental protection laws, among others, can be employed to mandating companies to refrain from harmful behaviours and externalising costs to other stakeholders. Laws and regulations beyond company law box can play a more effective role in imposing obligations of compliance and disclosure, ensuring directors not only consider wider interests but also weigh the relevant stakeholder interests in the decision making.

[181] CLRSG concluded that even proposals to alter board composition to require wider representation alone would be very radical change to British corporate culture and unlikely to command wide support. CLRSG, *Modern Company Law for A Competitive Economy: The Strategic Framework* para. 5.1.32 (London: DTI, 1999).

[182] This would inevitably impair the value of shareholder interests, ibid.

[183] This does not suggest that company law cannot be changed in this regard. If, in the future, there is growing public support for radical changes to the current shareholder-centric model, company law can and will undergo significant reforms to ensure that directors' fiduciary duties meaningfully include other stakeholders and that shareholder interests no longer prevail. This is, however, unlikely to happen anytime soon. Instead, we may also consider other organisational form for purpose-driven businesses rather than seeking to modify directors' duties intrinsically in the traditional corporate form. As Professor Rock has argued, the traditional corporate form may not be the most suitable organizational structure for purpose-driven businesses. With the rise of benefit corporations, there is less pressure to alter the traditional corporate form to accommodate social or environmental goals. See Edward Rock, *Business Purpose and the Objective of the Corporation* in Elizabeth Pollman and Robert Thompson (eds), *Research Handbook on Corporate Purpose and Personhood* 45 (Cheltenham: Edward Elgar Publishing, 2021).