Operationalising A Stakeholder Conception in Company Law

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Abstract and Introduction

UK company law in its arguably insular shareholder-focused framework, has come under questions of fitness for purpose[1] in the continuing litany of corporate malpractices and scandals[2] since the 1992 resolve to reform corporate governance.[3] The excessive focus on shareholder interests, rights and powers in UK company law is starting to reveal failures that not only jeopardise companies' viability but also give rise to adverse social impact. We argue that the shareholder primacy-led foundations for UK company law should be revisited, and that the adoption of a stakeholder conception in company law can be both normatively and positively supported. We suggest the contours of legal reform in company law: to introduce stakeholder covenants with the company, and recalibrate shareholder powers and enforcement. We believe that these key aspects of reform are possible and important to usher in a new framework for company law that will address the efficiency and social legitimacy needs of the company.

A. The Case for Moving From Shareholder Primacy to a Stakeholder Conception in Company Law

The company is the most popular business form in the UK,[4] and modern companies drive many forms of wealth creation,[5] realising the capitalist vision of rewarding productivity fairly in a free market.[6] In the UK, the legal construct of the company is a 'separate legal person'[7]

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[1] See http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/news-parliament-2015/corporate-governance-inquiry-launch-16-17/.

[2] From the failure of Polly Peck, Maxwell and BCCI in the 1990s to the failures of American giants Enron and World.com in the early 2000s, and the failure of Rover in the UK at about the same period, the onset and near-failure of giant banking corporations in 2007-9, and most recently the failure of BHS in the UK in 2016.

[3] The Cadbury Code of Corporate Governance introduced in 1992 in response to the failures of Polly Peck, Maxwell and BCCI.

[4] For example see Companies House, *Statistical Release: Company Register Activities 2014/5.*

[5] It was recognised by the 1960s that much of capitalist industry would be channelled through the institution of the corporation and this remains so today, see JK Galbraith, *The New Industrial State* (1966) setting out the importance of institutional economics.

[6] See for example an exposition of how productive capital is deployed across different actors who are rewarded by domestic or foreign trade, in Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of*

subject to decision-making by the 'Board of Directors'[8] and, to a greater latitude than in many jurisdictions, by shareholders.[9] UK company law is based on shareholder primacy,[10] i.e. treating shareholders as (a)the subjects of directors' accountability,[11] (b) the organ to exercise key powers in certain aspects of decision-making in the company,[12] and (c) the

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Nations (1776, digital reprint Metalibri 2007) at http://www.ibiblio.org/ml/libri/s/SmithA_WealthNations_p.pdf at pp281-293.

[7] Well-established since Salomon v Salomon & Co Ltd [1896] UKHL 1.

[8] For example, Art 3, The Companies (Model Articles) Regulations 2008 in relation to both private and public companies limited by shares reposes the powers of management in the Board of Directors.

[9] For example see the 'reserve' power that shareholders can exercise as a body in the general meeting, Art 4, The Companies (Model Articles) Regulations 2008 in relation to both private and public companies limited by shares. The significantly greater latitude of shareholder powers is discussed in comparison with the US in Christopher Bruner, *Corporate Governance in the Common Law World* (Cambridge: Cambridge University Press 2014).

[10] Andrew Keay, 'Shareholder Primacy in Corporate Law : Can it Survive? Should it Survive?' (2009) at http://ssrn.com/abstract=1498065; Joan Laughrey, Andrew Keay and Luca Cerioni, "Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance" (2008) 8 Journal of Corporate Law Studies 79; in the US see Leo Strine Jnr,'Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit' (2012) 47 Wake Forest Law Review 135.

[11] S172, Companies Act 2006 explicitly provides that directors' duties are to promote the long-term success of the company for the benefit of the members as a whole. This has come to be coined as 'enlightened shareholder value', a long-termist and more inclusive perspective for corporate performance, but revolving around shareholders. But most commentators are of the view that the focus on 'shareholder value' will unlikely introduce any revolutionary move in directors' conduct towards stakeholders, see for eg Paul Davies, 'Enlightened Shareholder Value and the New Responsibilities of Directors' (2005) at http://law.unimelb.edu.au/__data/assets/pdf_file/0014/1710014/94-Enlightened_Shareholder_Value_and_the_New_Responsibilities_of_Directors1.pdf; Richard Williams, 'Enlightened Shareholder Value in UK Company Law' (2012) 35 UNSW Law Journal 360; Andrew Keay,"Section 172(1) of the Companies Act 2006: an Interpretation and Assessment" (2007) 28 Company Lawyer 106; Elaine Lynch, 'Section 172: A Ground-Breaking Reform of Director's Duties, or the Emperor's New Clothes?' (2012) Company Lawyer 196.

[12] Such key aspects include the appointment and removal of directors, see s168, Companies Act 2006; the power to approve of certain transactions such as loans and guarantees to directors or substantial transactions to directors, long-term incentive arrangements and payments for loss of office, see s188ff; the power to ratify directors' breaches of duties or defaults, s239; the power to direct management in a specific matter by special resolution, Art 4, The Companies (Model Articles) Regulations 2008; and a power to approve (or otherwise) directors' remuneration packages on a three-yearly basis, s439A. Shareholders also have extensive powers to determine capital restructuring, such as approval of capital reduction or redemption of shares, s641ff, 659; and are the key organ to determine if a takeover of the company is approved, see John Armour, Simon Deakin and Suzanne J. Konzelmann, 'Shareholder Primacy and the Trajectory of UK Corporate Governance' (2003) at http://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp266.pdf.

constituents whose capital return interests should form the basis for corporate management.[13]

Shareholder primacy is based on the economic conception of the company as a 'nexus of contracts'[14] where shareholders are regarded to have taken on the riskiest bargain in relation to their open-ended commitment of investment in the company.[15] Shareholders' open-ended investment commitment provides the foundation for the company to be organised into an efficient economic organisation.[16] The micro-economic conception of the company provides justification for shareholder primacy in UK company law, although the importance of shareholders has originated from the evolution of company law from partnership law.[17]

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[13] Shareholders are treated by economists as 'residual claimants', meaning that their supply of capital to the company is under an open-ended arrangement which renders them liable to be ultimate losers if the company should fail. The 'residual claimant' status of the shareholders therefore requires protection so that managers do not abuse the privilege of being in control of the use and application of capital. See Armen A Alchian and Harold Demsetz,"Production, Information Costs and Economic Organisation" (1972) 62 The American Economic Rev 777, Oliver Williamson, "Corporate Governance" (1984) 93 Yale Law Journal 1197.

[14] Traced to Ronald Coase, "The Nature of the Firm" (1937) 4 Economica 386-405; the contractarian theory of the company is a firmly held conception of the company by economists who largely support the freedom of bargaining under the organisational umbrella of the corporate form. The firm as a nexus of transactions that are off market because of transaction cost efficiency has become a powerful and lasting conception of the corporation. See egs William A Klein, "The Modern Business Organization: Bargaining Under Constraints" (1982) 91 Yale Law Journal 1521; Fred McChesney, "Contractarianism Without Contracts? Yet Another Critique Of Eisenberg" (1990) 90 Columbia Law Rev 1332; Manuel A Utset, "Towards a Bargaining Theory of the Firm" (1995) 80 Cornell Law Review 540; David Charny, "Hypothetical Bargains: The Normative Structure Of Contract Interpretation" (1991) 89 Michigan Law Review 1815; Stephen Bainbridge, "Community And Statism: A Conservative Contractarian Critique Of Progressive Corporate Law Scholarship" (1997) 82 Cornell Law Review 856.

[15] As shareholders bear the open-ended possibility of loss of their capital and are 'residual claimants', the key risk identified to them is the 'agency problem' as managers have discretion to abuse the application of capital and deviate from shareholders' interests, see M Jensen and W Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 Journal of Financial Economics 305.

[16] Hence the efficient bargaining paradigm in light of shareholders' residual claimant status is that managers must manage the company towards shareholder wealth maximisation, see Frank H Easterbrook and Daniel R Fischel, "The Corporate Contract" in The Economic Structure of Corporate Law (Cambridge Mass: Harvard University Press 1991) at 1ff.

[17] The first private company allowed to be incorporated under the 1844 Joint Stock Companies Act envisages that at least 7 incorporators must be involved and have unlimited liability, therefore evolving out of partnership law. The fusion of the capital providers and management of the company is assumed, as under partnership law, until the 'separation of ownership from control' developed in the UK in the post-war period which also saw significant episodes of company law reform. Brian R Cheffins, *Corporate Ownership and Control: British Business Transformed* (Oxford: OUP 2009).

Shareholder primacy is a narrow and limited premise for company law, as it does not take into account the reality that (a) the economic organisation of the company is made up of many more parts than its 'Board' or shareholders[18] and (b) the societal institution that is the corporation serves multifaceted purposes and carries out activities that have impact beyond creating shareholder returns.[19] The focus on shareholders as the residual claimants of the company may work in a micro-economic model of a small private company,[20] but fails to capture a more complex web of relationships a company can have with other parties that contribute productive capital of different types to the company. Moreover, the gaps and limits in the shareholder primacy ideology can be exploited, culminating in sub-optimal and malpractices in the corporate sector that have social consequences. For example, publicly listed companies are often put under pressure to generate quarter-on-quarter share price returns in order to be aligned with their institutional shareholders' interests, resulting in corporate short-termism which could sacrifice long-term investments in a company in order

[18] Many commentators have pointed out that even taking the nexus of contracts view of the company, there are many suppliers of productive capital into the organisational framework and undue focus on shareholders obscures the firm-specific commitment of capital made by other stakeholders whose interests are not as protected. For eg see Margaret Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Brookings Institute 1994); Arturo Capasso, 'Stakeholder Theory and Corporate Governance: The Role of Intangible Assets' at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=610661 arguing that a resource-based view allows us to more clearly see the extent of committed productive capital other stakeholders offer the company.

[19] The sum of the corporation is often greater than its parts, and to an extent the collective entity of the company, or 'the real entity' interfaces with society (in the form of interdependencies, positive and negative externalities and philanthropy), and politics (eg in the form of political donations) in such a way that the corporation should not merely be treated as an internalised private bargaining phenomenon. See for example, Carl Kaysen, "The Corporation: How Much Power? What Scope?" in Edward S Mason ed, *The Corporation in Modern Society* (Mass: Harvard University Press 1970) at 85; John E Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford: Clarendon Press 1995); Philip Blumberg, "The Politicization of the Corporation" (1971) 26 Business Lawyer 1551; Susanna Kim Ripken, "Corporations Are People Too: A Multi-Dimensional Approach To The Corporate Personhood Puzzle" (2009) 15 Fordham Journal of Corporate and Financial Law 97; Lawrence E Mitchell, "Groundwork Of The Metaphysics Of Corporate Law" (1993) 50 Washington and Lee Law Rev 1477. Also see writings aimed at encouraging the corporation to take up responsible citizenship, see Lawrence E Mitchell (ed), *Progressive Corporate Law* (Boulder: Westview Press 1995); Sally Wheeler, Corporations and the Third Way (Oxford: Hart 2002); Kent Greenfield, "New Principles For Corporate Law" (2005) 1 Hastings Business Law Journal 89; The Failure of Corporate Law (London: The University of Chicago Press 2006). For globally active multinational corporations, some commentators have referred to their footprint as a form of global citizenship, see eg Andrew Crane and Dirk Matten, *Business Ethics: Managing Corporate Citizenship and Sustainability in the Age of Globalization* (Oxford; OUP 2015); Judith Richter and John Borton, *Holding Corporations Accountable: Corporate Conduct, International Codes, and Citizen Action* (Zed Books 2001).

[20] The model used in M Jensen and W Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 Journal of Financial Economics 305.

to boost immediate term earnings and share price.[21] Corporate short-termism can produce undesirable social consequences if the long-term wealth creation potential of companies are undermined.[22]

In the global financial crisis 2007-9, shareholder pressure has been recognised to be influential upon a bank's excessive risk-taking[23] profile or misconduct in aggressive mis-selling.[24] Excessive risk-taking has ultimately culminated in stress or failure for certain banks while mis-selling has cost banks in severe regulatory fines.[25] Banks and financial institutions' narrow-minded concerns for shareholder wealth maximisation are pitted against the social externalities of financial system disruptions and instability, consumer losses and loss of trust.

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[21] Corporate short termism, such as reducing employment expense and research and development investment in order to boost short-term earnings, obscures long-term thinking for the company and in due course could prove destructive for the long-term wealth creation role of the corporate economy see Corporate Values Strategy Group, *Overcoming Short-termism: A Call for a More Responsible Approach to Investment and Business Management* (New York: Aspen Institute Business and Society Programs, 2009), http://www.aspeninstitute.org/publications/overcoming-short-termism-call-more-responsible-approach-investment-business-management; C. Helms, M. Fox and R. Kenagy, 'Corporate Short-Termism: Causes and Remedies' (2012) 23 International and Comparative Company Law Review 45. Further, commentators also find corporate short-termism to be related to greater indifference to stakeholder or corporate responsibility issues, and institutions lack motivation to address social and environmental harms that the company is perpetuating, see E. Duruigbo, 'Tackling Shareholder Short-Termism and Managerial Myopia' (2011-12) 100 Kentucky Law Journal 531; D. Millon, 'Shareholder Social Responsibility' (2012-13) 36 Seattle University Law Review 911; M. T. Moore and E. Walker-Arnott, 'A Fresh Look at Stock Market Short Termism' (2014) 41 Journal of Law and Society 416.

[22] BIS, *The Kay Review of UK Equity Markets and Long-Term Decision Making* (Final Report, 23 July 2012).

[23] Andrea Beltratti and René M Stultz, 'Why Did Some Banks Perform Better during the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation' (July 2009) NBER Working Paper No 15180 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1433502; Reint Gropp and Matthias Köhler, 'Bank Owners or Bank Managers: Who is keen on Risk? Evidence from the Financial Crisis' (January 2010) European Business School Research Paper No 10-02 http://ssrn.com/abstract=1555663, Hanna Westman, 'The Role of Ownership Structure and Regulatory Environment in Bank Corporate Governance' (January 2010) http://ssrn.com/abstract=1435041; David H Erkens, Mingyi Hung and Pedro Matos, 'Corporate Governance in the 2007-2008 Financial Crisis: Evidence from Financial Institutions Worldwide' (2012) 18 Journal of Corporate Finance 389.

[24] Eg Ian Crowther and Ismail Erturk, 'Post-Crisis Ban Regulation and Financialised Bank Business Models' in Ismail Ertruk and Daniela Gabor (eds), *The Routledge Companion to Banking Regulation and Reform* (Oxford: Routledge 2016) at chapter 15.

[25] For example, in payment protection insurance, see FSA, 'The Assessment and Redress of Payment Protection Insurance Complaints: Feedback on the further consultation in CP10/6 and final Handbook text' (August 2010) PS10/12 http://www.fsa.gov.uk/pubs/policy/ps10_12.pdf. See Eilis Ferran, 'Regulatory Lessons from the Payment Protection Insurance Mis-Selling Scandal in the UK' (2012) European Business Organisation Law Review 248.

Further, the protection of shareholders' interests often drives companies to organise themselves in group structures in order to partition assets and responsibility for wrong-doing,[26] therefore leaving the victims of corporate externalities to very limited redress.[27] In companies with controlling shareholders, we also observe that such shareholders have been able to marginalise minority shareholders' and stakeholders' interests while extracting benefits from the company.[28] The BHS scandal[29] in the UK which formed a major part of the context for the Parliament's Inquiry[30] into the state of UK corporate governance is an example of excessive wealth transfer by the controlling shareholder at the expense of the company's pension savers and pensioners. It is also well-known that shareholder value is boosted by cutting cost, usually at the expense of employee wages, working conditions or benefits.[31] A case can be made for linking short-termist, ethically questionable and distributively unjust corporate behaviour to the apparent legitimating ideology of shareholder primacy. Indeed, the embrace of shareholder primacy has increasingly subverted the positive elements of a capitalist economic system now dominated by the economic activities carried out under the corporate form.

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[26] Henry Hansmann and Reinier Kraakman, 'Organizational Law as Asset Partitioning' (2000) 44 European Economic Review 807.

[27] Often transnational corporations use thinly capitalised subsidiaries to undertake risky overseas operations so that the other corporate members of the group will be immune from the losses suffered by that subsidiary. The shifting of liability onto the parent company, a process called 'lifting of the corporate veil' is highly difficult to achieve in UK civil litigation, see *Adams v Cape Industries* [1990] Ch 433; 2 WLR 657; [1991] 1 All ER, 929; *Newton-Sealy v AmorGroup Services Ltd and Others* [2008] EWHC 233 (QB)*; Prest v Petrodel Resources Ltd* [2013] UKSC 34. There is no doctrine of 'enterprise liability' in the UK for corporate groups as a whole although some extent of such liability is recognised in the US and Germany. See Meredith Dearborn, 'Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups' (2009) 97 California Law Review 195.

[28] For example 'ENRC 'should have set off alarm bells'', *Financial Times* (22 November 2013); 'Essar Energy panel backs Ruia family's take-private offer', Financial Times (13 May 2014) on how controlling shareholders have prioritised their own interests and could blatantly carry out damaging decisions to minority shareholders and other stakeholders, such as misappropriation where ENRC was concerned, and squeeze-out and delisting in Essar's case. See discussions in R. Barker and I. HY Chiu, 'Protecting Minority Shareholders in Blockholder-Controlled Companies - Critically Evaluating the UK's Enhanced Listing Regime' (2015) Capital Markets Law Journal 98.

[29] House of Commons Work and Pensions and Business, Innovation and Skills Committees, *BHS* (2016) at http://www.publications.parliament.uk/pa/cm201617/cmselect/cmworpen/54/54.pdf.

[30] Parliament Committee on Business, Innovation and Skills, *Corporate Governance Inquiry* (2016) at http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/news-parliament-2015/corporate-governance-inquiry-launch-16-17/.

[31] Benedict Sheehy, "Corporations and Social Cost- The WalMart Case Study" (2004) 24 Journal of Law and Commerce 1.

The embrace of shareholder primacy in company law has become systemically disempowering and marginalising for other productive capital in an economic system that is channelled through the corporate form, such as the intellectual and human capital of employees, reputational capital conferred by the corporation's community, financial markets, media etc, loyalty capital committed by customers, users etc, firm-specific capital such as committed by dedicated suppliers and other forms of capital which could be tangible or intangible resources that the corporation draws upon for its business success.[32] This is because advantage has been taken of the entrenched imbalance in company law in favour of shareholders, and business and corporate practices have been developed along that line, instead of being characterised by restraint or efforts taken to ameliorate such imbalance. Where company share prices have been maintained at high levels over the last couple of decades, real wages have not increased by comparable levels.[33] Where utilities have been privatised to provide more competition and choice for consumers, key negative headlines revolve around excessive executive pay and continued uncompetitive and high levels of utilities bills experienced by customers.[34]

Even if the open-ended commitment of shareholder capital is valuable for the efficient organisation of the company, the law does not need to take the rather extreme position of only enrolling shareholder rights and powers in company law. This imbalance has allowed exploitative practices that benefit shareholders in terms of insulation from responsibility and favourable distribution, raising questions as to the ethics of such practices, which are now referred to as the 'unacceptable face of capitalism'.[35]

The embrace of shareholder primacy has also produced contrary ramifications to the raison d'etre of incorporation, which is to provide a long-termist outfit for the protection of productive activities sustained by investment capital,[36] as discussed in Stout's vision of the

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[32] Arturo Capasso, 'Stakeholder Theory and Corporate Governance: The Role of Intangible Assets' at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=610661; Robert Phillips, 'Stakeholder Legitimacy' (2003) 13 Business Ethics Quarterly 25 on the stakeholders who remain unrecognised in company law.

[33] Greta Krippner, 'Accumulation and the Profits of Finance' and William Lazonick and Mary O'Sullivan, 'Shareholder Value and Corporate Governance' in Ismail Erturk, Julie Froud, Sukhdev Johal, Adam Leaver and Karel Williams (eds), *Financialization At Work: Key Tests and Commentary* (Oxford: Routledge, 2008); Eckhard Hein, 'Finance-dominated Capitalism and Redistribution of Income:A Kaleckian Perspective' (2013) at http://ssrn.com/abstract=2198919; Julie Froud, Sukhdev Johal, Adam Leaver and Karel Williams, *Financialization and Strategy: Narrative and Numbers* (Oxford: Routledge 2006) at chapter 4.

[34] Richard Greenbury, *Report: Directors' Remuneration* (17 Jul 1995); 'High Energy Bills' in a special episode of the BBC's Rip Off Britain (7 June 2016).

[35] Eg 'Philip Green is not the only unacceptable face of capitalism', Financial Times (28 July 2016).

[36] Margaret Blair, 'The Neglected Benefits of the Corporate Form: Entity Status and the Separation of Asset Ownership From Control' (2014) at http://ssrn.com/abstract=563307.

corporation as 'time machine'.[37] Rather, the corporation is a place for extraction of short-term value that can be carried out by those legitimately in power, i.e. executives in the form of excessive levels of pay[38] and shareholders in the form of dividends or capital return or redemption, even if such wealth transfers exceed the company's profits,[39] or depletes the company's long-term investment capital[40] or cash buffer that can be useful to withstand times of stress.[41]

We submit that the shareholder primacy-based modern corporation has developed many faces of flawed capitalism which has now put into doubt the social legitimacy of the modern corporation[42] as well as the capitalist economic order.[43]

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[37] Lynn Stout, 'The Corporation as Time Machine: Intergenerational Equity, Intergenerational Efficiency, and the Corporate Form' (2015) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2556883.

[38] Eg William Forbes, 'CEO Pay in FTSE 100: Pay Inequality, Board Size and Performance' (2012) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2140204; Lisa Goh and Aditi Gupta, 'Executive Compensation, Compensation Consultants, and Shopping for Opinion: Evidence from the UK' (2010) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1577925. Also see High Pay Centre, *Thinking High and Low: Exploring pay disparities in society* at http://highpaycentre.org/pubs/thinking-high-and-low-exploring-pay-disparities-in-society; 'New High Pay Centre report: Executive pay continues to climb at expense of ordinary workers' (2014) at http://highpaycentre.org/pubs/new-high-pay-centre-report-executive-pay-continues-to-climb-at-expense-of-o.

[39] As in the case of BHS, see House of Commons Work and Pensions and Business, Innovation and Skills Committees, *BHS* (2016) at http://www.publications.parliament.uk/pa/cm201617/cmselect/cmworpen/54/54.pdf.

[40] José-Miguel Gaspar, Massimo Massa, Pedro Matos, Rajdeep Patgiri and Zahid Rehman, 'Can Buybacks be a Product of Shorter Shareholder Horizons?' (2005) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=649482; Lee Pinkowitz, Rene M Stultz and Rohan Williamson, 'Is There a U.S High Cash Holdings Puzzle after the Financial Crisis?' (2012) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2064046; Nicoletta Batini and Joshua Felman, 'Why are US Firms Hoarding Money?' IMF, Country Report 11/202 (2011).

[41]). Andrés Ramirez, 'Risk and the Multinational Corporation Revisited: The Case of Natural Disasters and Corporate Cash Holdings' (2011) at http://ssrn.com/abstract=1772969; Tom W Bates, Kathryn M Kahle and Rene M Stultz, 'Why Do U.S. Firms Hold So Much More Cash than They Used To?' (2009) 64 Journal of Finance 1985 on precautionary planning by managers.

[42]. The insular nature of the shareholder-primacy based corporation ignores its social fabric which can lead to anti-social indifference which is yet legitimated under company law, see Ronald Blackwell and Thomas Kochan, 'Restoring Public Purpose to the Private Corporation' (2013) at http://ssrn.com/abstract=2214621; William W Bratton and Michael Wachter, 'Tracking Berle's Footsteps: The Trail of The Modern Corporation's Last Chapter' (2010) 33 Seattle University Law Review 849; Brian M McCall, 'The Corporation as Imperfect Society' (2010) at http://ssrn.com/abstract=1621772.

[43] R. Edward Freeman, Kirsten Martin and Bidhan Parmar, 'Stakeholder Capitalism' (2007) 74 Journal of Business Ethics 303; M. McIntosh, *Thinking the Twenty-First Century: Ideas for the New Political Economy*

The Need for Company Law Reform for Re-orientation towards a Stakeholder Conception of the Company

It is time to recognise the negative distortions in company law that entail from shareholder primacy and embrace a case for reform. Indeed we argue that the foundational economic conception of the company as a 'nexus of contracts', [44] an internal web of transactional arrangements which is taken 'off the market', produces the 'market failure' of imbalance of negotiating power among the 'nexus'. Such market failure is brought about by agency-based economics[45] which narrowly focuses on shareholders and directors, and is echoed in company law. Hence, company law has itself produced distortions, distributing much of the internal political power within the company to the Board and shareholders in such a way that marginalises stakeholders' positions within the firm, forcing stakeholders to maintain relationships with companies *outside of* the inner circle of corporate governance. We suggest that the distortions in corporate governance legitimated by shareholder primacy[46] lie at the root of many corporate malpractices and scandals, as many of these are only possible due to the apparently legitimate exploitation of power *within* the firm.

These imbalances are unlikely to be corrected unless company law intervenes to redress them, therefore ideologically reforming itself. Thus, we disagree with critics who oppose reform implications from 'stakeholder theory' on the basis that excessively heavy lifting is required for such company law reform.[47] We do not think that any legal reform should only be non-disruptive and minimal, especially since the level of social cost associated with corporate malpractices is rather significant. The failure of BHS in 2016 for example has entailed the loss of about 11,000 jobs, not to mention stranded suppliers and other service providers.[48] We believe that insufficient attention has been given to operationalising such a stakeholder conception in company law, and critics who argue that stakeholder theory does not work have not engaged with exploring the design of frameworks to make it work. In this

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(Greenleaf Publishing, Sheffield, 2015); Steffan Roth, 'Free Economy! On 3628800 Alternatives of and to Capitalism' (2015) 27 Journal of Inter-disciplinary Economics 1.

[44] See n10.

[45] M Jensen and W Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 Journal of Financial Economics 305.

[46] Discussed above, and also see Joel Bakan, *The Corporation - The Pathological Pursuit of Profit and Power* (London: Penguin, 2003).

[47] John Hendry, 'Missing the Target: Normative Stakeholder Theory and the Corporate Governance Debate' (2001) 11 Business Ethics Quarterly 159; Robert Phillips, R. Edward Freeman, and Andrew C. Wicks, 'What Stakeholder Theory is Not' (2003) 13 Business Ethics Quarterly 479.

[48] 'BHS rescue bid fails with loss of 11,000 jobs', *The Guardian* (2 June 2016). Although it may be argued that such 'slack' from a corporate fallout can be picked up by other competitive players in the market, that is speculative compared to the immediate social effects.

respect, this article seeks to start the journey of considering how a stakeholder conception of the company can be operationalised in company law, in the Sections that follow.

We do not agree that enrolling stakeholders, which are diverse groups would necessarily be disruptive for existing legal structures, create confusion for directors' duties and the corporate objective, and cause the management of the company to descend into the realm of an impossible and dynamic chaos as directors quietly exercise their powers unaccountable to any of the warring factions of stakeholders.[49] Legal reform necessitates adaptation to change and what we propose should not result in the disorderly doomsday picture suggested above. We also do not believe that relying on companies to inculcate stakeholder consciousness as a soft form of business or management ethics[50] is sufficient,[51] as there are no consistent or fundamental motivations for companies to do so across the board, and whether stakeholders can bring their pressure to bear will depend largely on the political economy context relating to particular industry sectors.[52]

In other words, we argue that reforms to company law to redress the imbalance of interests and power entailing from the ideological and legal embrace of shareholder primacy is necessary *and* possible. These are unlikely to arise out of self-governance and self-

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[49] John Argenti, "Stakeholders: The Case Against" (1997) 30(3) Long Range Planning 442; * E Sternberg, *Stakeholding: Betraying the Corporation's Objectives* (London Social Affairs Unit Research Paper No 27).

[50] Timothy L Fort, "Goldilocks And Business Ethics: A Paradigm That Fits "Just Right" (1998) 23 Journal of Corporation Law 245; Michael C Jensen, 'Non-Rational Behavior, Value Conflicts, Stakeholder Theory, and Firm Behavior' in Bradley R. Agle, Thomas Donaldson, R. Edward Freeman, Michael C. Jensen,Ronald K. Mitchell and Donna J. Wood, *Towards Superior Stakeholder Theory* (2008) 18 Business Ethics Quarterly 159; R Edward Freeman, 'Ending the So-Called "Friedman-Freeman" Debate' in Bradley R. Agle, Thomas Donaldson, R. Edward Freeman, Michael C. Jensen,Ronald K. Mitchell and Donna J. Wood, *Towards Superior Stakeholder Theory* (2008) 18 Business Ethics Quarterly 159.

[51] Donna Wood, 'Corporate Responsibility and Stakeholder Theory: Challenging the Neoclassical Paradigm' in Bradley R. Agle, Thomas Donaldson, R. Edward Freeman, Michael C. Jensen, Ronald K. Mitchell and Donna J. Wood, *Towards Superior Stakeholder Theory* (2008) 18 Business Ethics Quarterly 159; Tom Donaldson, 'Two Stories' in Bradley R. Agle, Thomas Donaldson, R. Edward Freeman, Michael C. Jensen,Ronald K. Mitchell and Donna J. Wood, *Towards Superior Stakeholder Theory* (2008) 18 Business Ethics Quarterly 159; Andrew Crane and Trish Ruebottom, 'Stakeholder Theory and Social Identity: Rethinking Stakeholder Identification' (2011) 102 Journal of Business Ethics 77; James A Steib, 'Assessing Freeman's Stakeholder Theory' (2009) 87 Journal of Business Ethics 401.

[52] Some refer this issue to different varieties of capitalism calibrating different relational paradigms between the company and stakeholders based on political context, economic structures and social culture. See generally Peter A Hall and David Soskice, 'An Introduction to the Varieties of Capitalism' in Peter A Hall and David Soskice, *Varieties of Capitalism* (Oxford: Oxford University Press 2001); and see critique in Dorothee Bohle and Béla Greskovits, 'Varieties of Capitalism and Capitalism « tout court »' (2009) 50 European Journal of Sociology 355.

correction. We also believe that such reforms are key to addressing poor internal culture and ethics in companies, and their outward-facing behaviour.

Before we turn to the key aspects of company law reform we propose, we seek to address arguments in principle that may not support such reforms. For example, one may argue that the issues that affect the social legitimacy of the company, such as corporate responsibility for externalities and imbalances in wealth distribution are matters for external regulation. This can be seen in the introduction of the Corporate Homicide and Manslaughter Act 2007 which now has the potential to inflict criminal liability upon companies that cause injury or death to persons they owe a duty of care to. Further externalities relating to health and safety or the environment are better dealt with under precise regulatory obligations.[53] Distributive issues may be dealt with by reforms in employment law, tax law etc. Hence it can be argued that shareholder primacy does not support an imbalanced company law, but that it constitutes much of company law as other stakeholder related issues are more effectively dealt with elsewhere.[54]

Next it can be argued that shareholders are to behave as 'enlightened shareholders' and 'stewards' of savers' capital invested in companies.[55] Hence, shareholder primacy is more benign than is suggested above, and is able to accommodate holistic notions of corporate performance for the long-term. The due consideration of stakeholder interests is necessary to ensure the company's long-term success, and so there is no need to take the view that pursuing shareholder primacy necessarily diverges from stakeholder interests.[56]

Further, it may be argued that the internal culture and ethics of a company is not a matter that can be addressed by company law. Company law can only provide a framework for the distribution of power in decision-making in the company, but the leadership of the company, group/sub-group leadership within a company, its norms, habits and people overall make up

[53] Christopher M Bruner, "Power And Purpose In The "Anglo-American" Corporation" (2010) 50 Virginia Journal of International Law 579.

[54] Above.

[55] The enlightened shareholder value model purports to support shareholder primacy on the basis of their 'long-termist' and 'holistic' interests, being assumed to align with many stakeholders' interests, s172, Companies Act 2006, see discussions in Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Oxford: Routledge, 2012); Paul Davies, "Enlightened Shareholder Value and the New Responsibilities of Directors" (Lecture at the University of Melbourne Law School 2005) at www.cclsr.law.unimelb.edu.au/download.cfm?DownloadFile=BC82395E-09AD-DB76-F1D0B2AFFB41CF9D. On stewardship, see the UK Stewardship Code 2016, but see critique in Iris H-Y Chiu, 'Turning Institutional Investors into "Stewards"- Exploring the Meaning and Objectives in "Stewardship"' (2013) Current Legal Problems 1; Arad Reisberg, 'The UK Stewardship Code: On a road to Nowhere' (2015) 15 The Journal of Corporate Law Studies 217.

[56] Eg see David Wheeler and Maria Silanpaa, "Including the Stakeholders: The Business Case" (1998) 31(2) Long Range Planning 201.

the unique culture of a company which sustains its business enterprise and its social footprint.[57] One cannot be overly prescriptive about such internal organisational matters.

We address the above in turn.

First, although external regulation may address the issues of distribution of liabilities and outcomes, this supposes that state-based agencies are best placed to act in the representative interests of certain stakeholders. In some cases, we agree this is the case, such as in some aspects of environmental regulation where the environment cannot have a 'voice' and the coherent public interest in environmental protection makes it both effective and efficient[58] for state-based agencies to regulate certain corporate conduct and impose regulatory liability. It has also been recognised that an ever-growing landscape of economic life under capitalist and free market principles often necessitates a concomitant growth in 'regulatory capitalism'. Levi-Faur argues that the economic society rests on a bedrock of regulation, a phenomenon known as 'regulatory capitalism'.[59] Regulatory capitalism refers to the existence of governance frameworks that shape economic functioning and protect certain political or social values, representing a landscape where economic functions and needs are facilitated, and where distributive or social goals are also pursued. Braithwaite[60] supports this by arguing that it is a myth that the laissez-faire nature of markets has been allowed to flourish as such in the ideology of neo-liberalism and deregulation. In fact, he argues that the public character of governance continues to exist extensively and has evolved into a form of regulatory capitalism. The latter half of the 20th century has seen the rise in the administrative state in western economies such as the US and UK (developments in the welfare and administrative state in the UK arguably having proliferated under the Labour government elected in 1945),[61] testimony to the necessity of regulatory capitalism. Indeed Omarova et al call for increased corporate regulation to be seen as necessary and socially acceptable to address many of the corporate ills we see today.[62]

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[57] Mayuk Dasgupta, 'Organizational Culture and Firm Performance: A Reflection of Theory, Research and Practice' (2014) at http://ssrn.com/abstract=2435528; Milton C Regan, 'Moral Intuitions and Organizational Culture' (2008) at 51 St. Louis U. L.J. 941 (2006-2007).

[58] A form of transaction cost-efficiency by centralising collective needs to be met by regulatory standards and enforcement, see O Williamson, "Strategising, Economising and Economic Organisation" (1991) 12 Strategic Management Journal 75.

[59] David Levi-Faur, 'The Global Diffusion of Regulatory Capitalism' (2005) 598 *The Annals of the American Academy of Political and Social Science* 12.

[60] John Braithwaite, *Regulatory Capitalism* (Cheltenham: Edward Elgar 2008), 4-29.

[61] William R Cornish and G de N Clark, *Modern Legal History: 1750-1950* (London: Sweet & Maxwell 1989, out of print).

[62] Robert C Hockett and Saule T Omarova, '"Special," Vestigial, or Visionary? What Bank Regulation Tells Us About the Corporation—and Vice Versa' (2016) 39 Seattle University Law Review 453.

However, we do not think that all stakeholder interests can or should be subject to protection only by way of regulatory standards and enforcement. Some stakeholder interests may be at such a scale that does not amount to a public interest concern,[63] and further we cannot assume that regulatory agencies always act as 'protectors' of the public or groups of the public. They may be subject to failings such as capture,[64] or pursue their own agendas that do not necessarily dovetail with certain stakeholder needs.[65] There is no reason why stakeholders should not be provided with protection that can be actionable in private enforcement within company law.

We argue that company law, which already deals extensively with the shareholders (general meeting) – directors (the Board) relationship, is well-placed to provide frameworks for stakeholder relations with the company too. Many stakeholders make firm-specific commitments that are long-termist and ongoing,[66] and would benefit from the establishment of principles for a relational framework *within* and not just *with* the company. The emphasis on developing only shareholders' procedural rights, powers and justice is not justifiable. Further, as company law inherently supports the checking and balancing of power, by subjecting directors to monitoring and accountability, it is an anomaly not to subject shareholders' rights and powers to more controls and balance.[67] Hence, reforms in company law that cater for a wider stakeholder conception could ensure that the interests of any one powerful group may be effectively balanced. We argue in support of such reforms to enhance stakeholders' positions and power in a company, as we believe these will relate ultimately to the substantive outcomes of fairer distribution of responsibility and wealth, mitigation of externalities and improved corporate practices and ethics.

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[63] And the argument applies vice versa too, see Ian B Lee, 'The Role of the Public Interest in Corporate Law' (2012) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1909014.

[64] Eg in financial regulation see Cristie Ford, 'Macro- and Micro-Level Effects on Responsive Financial Regulation' (2011) 44 University of British Columbia Law Review 589; Nicholas Dorn, 'Policy Stances in Financial Market Regulation: Regulator Rapture, Club Rules or Democracy?' in Kern Alexander and Niamh Moloney (eds), *Law Reform and Financial Markets* (Cheltenham: Edward Elgar 2011), 35.

[65] George Stigler, "The Theory of Economic Regulation" (1971) 2 Bell Journal of Economics and Management Science 3, but see Steven P Croley, "Theories Of Regulation: Incorporating The Administrative Process" (1998) 98 Columbia Law Review 1.

[66] Margaret Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Brookings Institute 1994); Arturo Capasso, 'Stakeholder Theory and Corporate Governance: The Role of Intangible Assets' at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=610661.

[67] Robert Flannigan, 'Shareholder Fiduciary Accountability' (2014) Journal of Business Law 1.

Next, the abstract 'enlightened' shareholder does not reflect the reality of many shareholder groups,[68] and it is almost facetious to suggest that the abstract notion encompasses the real needs of stakeholder voice. Besides, the Financial Reporting Council (which administers the Stewardship Code for institutional shareholders who have signed up to it) report cosmetic levels of 'stewardship' behaviour that need to be improved.[69]

Finally, company law has a role in the internal ordering of corporate relations, and is especially relevant as the imbalances that prevail in our current ideology and system of corporate governance have already given rise to dysfunctional corporate cultures.[70] Where corporate culture has been recognised to be dysfunctional and not capable of self-correction, regulatory interventions have taken place in the form of mandatory securities[71] or financial regulation[72] in order address sub-optimalities in internal organisation or responsibility within the company.

We also argue that reforms in company law in support of a stakeholder conception should not merely be limited to the publicly listed company. The publicly listed company may be perceived to have a wider social footprint. We note recent initiatives that are moving towards compelling the publicly listed company to behave in a more holistic manner within the confines of a shareholder primacy framework. For example, corporate transparency must include stakeholder relations and impact issues.[73] Moreover, private companies are

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[68] Analysed in Roger M Barker and Iris H-Y Chiu, *Investment Management and Corporate Governance: The Governance Nexus* (Cheltenham; Edward Elgar 2017, forthcoming).

[69] Financial Reporting Council, *Developments in Corporate Governance and Stewardship 2015* (January 2016), 12, available at https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Developments-in-Corporate-Governance-and-Stewa-(1).pdf. This is also largely because many institutions are not incentivised to act as engaged shareholders for a wider social good purpose.

[70] Although Keay finds disparity in corporate practices in terms of stakeholder engagement, much of which is up to the corporate perception of what is important for the industry and its own commercial interests, see Andrew Keay and Rodoula Adamopoulou, 'Shareholder Value and UK Companies: A Positivist Inquiry' (2012) European Business Organisation Law Review 1.

[71] Such as the Sarbanes-Oxley Act 2002 which requires Chief Financial Officers to take personal responsibility for financial statements in order to enhance the veracity of financial reporting, Section 302, Sarbanes-Oxley Act, (Pub.L. 107–204, 116 Stat. 745, enacted July 30, 2002), also known as the "Public Company Accounting Reform and Investor Protection Act".

[72] Such as Art 88, European Capital Requirements Directive.2013, further fleshed out in European Banking Authority, *Guidelines on Internal Control* (2011), UK Prudential Regulation Authority Rulebook, *Compliance and Internal Audit, General Organisational Requirements* (paras 2.2, 2.3, 2.8, 2.9, 4.2); *Risk Control* (paras 2 and 3); Financial Conduct Authority Handbook SYSC 3, 6 and 21; see generally Iris H-Y Chiu, *Regulating from the Inside: The Legal Framework for Internal Control in Banks and Financial Institutions* (Oxford: Hart 2015).

[73] S414A, Companies Act 2006 provides a rounded business review that directors must produce yearly for quoted companies. This is very similar to the non-financial narrative mandatory disclosure under the European Non-financial Disclosure Directive 2015.

not exactly regarded as being in a realm of complete self-governance just because they do not interface with public securities markets. We observe range of corporate regulation that now targets undesirable and unethical corporate behaviour[74] across the board. Indeed, in private companies, the shareholder primacy ethos can be taken to logical extremes due to the lack of scrutiny by markets and regulators and it seems that policy-makers have become concerned about the abuses emanating from such unchecked behaviour. For example, private equity buy-out funds may take a company from public to private in the name of improving the company's performance and prospects.[75] However what happens often in the opacity of a private company context is significant extractive behaviour by buy-out funds coupled with sophisticated financial engineering that produces skewed distribution in favour of the buy-out fund owners.[76] These taken-private companies may remain large, employ significant numbers of people and have a remarkable social footprint. To allow the extremes of shareholder primacy-based behaviour in these large private companies would result in severe imbalances and injustice to stakeholders. Thus, European legislation has acted to prevent buy-out funds from asset stripping their portfolio companies within the short term.[77] Hence, we believe that the ideological and legal reform of the shareholder primacy tenet in company law is timely and applicable for all companies.

As the social appetite for transforming capitalism grows,[78] company law reform is crucial as it addresses the predominant modern engine for economic activities, the company, and can

[74] For example the Bribery Act 2010 that compels all companies to institute due diligence procedures in order to combat bribery and corruption. The Companies Finances Act 2016 also introduces a criminal offence for companies to facilitate decisions of tax evasion.

[75] Ronald W Masulis and Randall S Thomas, 'Does Private Equity Create Wealth?' (2009) University of Chicago Law Review 1; Michael Jensen, 'The Economic Case For Private Equity' (2007) at http://ssrn.com/abstract=963530.

[76] Richard P Nielsen, 'The Private Equity-Leveraged Buyout Form of Finance Capitalism: Ethical and Social Issues, and Potential Reforms' (2008) 18 Business Ethics Quarterly 379; Jonathan Ford, 'Private equity, not the mobile, killed Phones 4U', Financial Times (21 Sep 2014); Frederik Vinten, 'The Performance of Private Equity Buyout Fund Owned Firms' (2007) at http://ssrn.com/abstract=1114603; Wolter Lemstra*and John P.M. Groenewegen, 'Private Equity Leveraged Buyout and Public Values: The bankruptcy of Eircom, Ireland' (2012) at http://ssrn.com/abstract=2032222; Richard P Nielsen, 'The Private Equity-Leveraged Buyout Form of Finance Capitalism: Ethical and Social Issues,and Potential Reforms' (2008) 18 Business Ethics Quarterly 379; William W Bratton, 'Private Equity's Three Lessons for Agency Theory' (2008) 3 Brooklyn Journal of Corporate, Financial & Commercial Law 1; Marc Goergen, Noel O'Sullivan and Geoffrey Wood, 'The Employment Consequences of Private Equity Acquisitions: The Case of Institutional Buy Outs' (2014) at http://ssrn.com/abstract=2459890 question the extent of wealth transfers away from stakeholders to shareholdes under the private equity buy-out model.

[77] Art 30, Alternative Investment Fund Managers' Directive 2011; section 43, UK Financial Services and Markets (The Alternative Fund Managers) Regulations 2013.

[78] Michael Pirson, Claus Dierksmeier, Carlos Largacha and Ulrich Steinworth, Tranforming Capitalism (Rowman and Littlefield International, 2014).

change corporate practices and ethics, therefore directly affecting the shape of the evolving capitalist order that we have today.[79] We propose a blueprint for company law reform consisting of certain key elements in the Sections below, but we recognise that judicial interpretation is needed to flesh out the development and understanding of the nature of and standards for any new obligations introduced. Further there may be detail and ancillary matters that need adjustment which cannot be fully canvassed within the article space. Our blueprint consists of the following key aspects: Section B discusses the introduction of company covenants with stakeholders, supported by corporate transparency. We then discuss the most significant adjustments in company law that should be made pursuant to the new stakeholder conception of company law namely, a new director's duty, enforcement mechanisms against directors and the company, and the scope of shareholder powers as currently provided under company law. These are discussed in Sections B and C. Section D concludes.

B. Covenants with Company Stakeholders

We propose that it should be a best practice for companies to enter into stakeholder covenants with key stakeholders, flanked by an appropriate directors' duty to comply with such covenants if established. It may be queried why this article proposes the use of stakeholder covenants as the main framework for a stakeholder conception of the company, instead of looking to Board representation for stakeholders?

Stakeholder covenants provide a range of options for companies and their stakeholders to structure their relationships, and Board representation could be one of them. Hence we think treating stakeholderism in companies as equivalent to Board representation is too narrow and in some cases inappropriate. For example the lack of financial qualifications on the Co-operative Bank board which had good stakeholder representation nevertheless contributed to its dire capital situation in 2013.[80] Further, Board representation does not sufficiently address stakeholder interests, as it does not address the prevailing power matrix of the general meeting and Board in companies. One of the ramifications of adopting a stakeholder conception of the company would be the recalibration of the balance of powers in the company, and it is argued that the adoption of stakeholder covenants, as argued in this paper, provides a superior and more thorough framework.

First, stakeholder covenants should cover how the company engages with identified groups of stakeholders on an enduring basis. Stakeholder covenants can to an extent be modelled upon the company's constitution, which is a covenant with shareholders. Companies bind themselves to shareholders as a collective body via the company's constitution, which is a contractual document in nature setting out the mutual expectations and responsibilities of

[79] JK Galbraith, *The New Industrial State* (1966) setting out the importance of institutional economics.

[80] Eg see 'Co-op Bank Sheds Four Directors', *The Guardian* (9 Oct 2013).

the company and the general meeting as a whole.[81] This document embodies shareholders' common rights in the general meeting and *vis a vis* the company, and does not represent any one or group of shareholder interests. On a similar basis, stakeholder covenants can be forged with clearly identified groups of stakeholders with common characteristics, dealing with their common interests and responsibilities as a group, leaving matters of individual relevance to contracts with the company beyond the realm of company law. In this respect the company's constitution, which is essentially shareholders' covenant with the company, would not be the exclusive 'covenantal' relationship that the company forges.

We encourage companies to forge stakeholder covenants with their perceived key stakeholders but we are of the view that these covenants should be pursued as a matter of best practice and not as a matter for mandatory law *for now*. This is because making it mandatory for companies to forge stakeholder covenants will necessarily entail questions as to who the stakeholders are, what the covenants must contain and what mandatory procedures are to be provided, prescriptive detail that may not necessarily be best legislated at the moment. Nevertheless, we set out below in this article a range of guidance to answer the above questions, such guidance having been derived in part from voluntary developments so far. Mandatory law in this area can be developed at a more mature stage of company-stakeholder relational development where certain common standards or principles are found to be desirable across the board or where certain common 'bargaining' failures need to be addressed.

Identifying Key Stakeholders

In identifying their relevant key stakeholders for the purposes of forging stakeholder covenants, companies are able to avail themselves of different approaches suggested by stakeholder theorists. Stakeholder theorists have offered various approaches to classifying stakeholders, such as Freeman's[82] initial approach of treating 'owners, managers, local community, employees, suppliers and customers' as key stakeholders. Further, one can refer to Donaldson and Preston's approach of identifying whether stakeholders are important for normative, instrumental or descriptive reasons,[83] or Tao and Sirgy's

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[81] *Wood v Odessa Waterworks* (1889) 42 Ch D 636.

[82] R Edward Freeman, "A Stakeholder Theory of the Modern Corporation" reproduced in Max BE Clarkson ed, *The Corporation and Its Stakeholders* (Univ of Toronto Press 1998) at 125.

[83] T Donaldson and LE Preston, "The Stakeholder Theory of the Corporation" (1995) 20 Academy of Management Review 65.

classification of ‘internal’, ‘external’ and ‘distal’ stakeholders all of which may require different levels of engagement.[84]

Mandatory prescriptions would not be able to capture the richness and variety of approaches to stakeholder salience that comprises of (a) the company’s perspective of relevance in terms of its strategy, reputation and other priorities; and (b) ground-up perspectives from stakeholder groups in terms of their perceived salience to the company concerned. Further, voluntary organisations[85] that already have established credibility in offering frameworks and standards for corporate responsibility may be able to help companies establish stakeholder identification frameworks and engagement processes. Companies can also engage consultants to help them establish tailor-made frameworks and processes.

Companies should identify and forge stakeholder covenants with their key stakeholders, and to make disclosure of the rationale for establishing such covenants, the number and types of covenants established and their contents, including updates to such covenants on a yearly basis. This can be worked into the yearly reporting obligations for all companies alike, and similar exemptions for small companies in the Companies Act 2006 can continue to apply if such companies have minimal stakeholder footprint. Transparency provides an avenue of public accountability for companies in their stakeholder relations, and such transparency, which is not only relevant to securities markets, facilitates a form of social scrutiny that can give rise to useful ‘feedback’ to companies and stakeholder groups alike in developing covenantal relations.[86]

The disadvantages of introducing mandatory lists or criteria for companies to identify their stakeholders would be that lists are often under or over-inclusive and ‘one-size-fits-all’ for any company in question. Further mandatory criteria may only introduce incentives for companies to restructure their stakeholder relations in order not to be captured within the

[84] Tao Gao and M Joseph Sirgy, “Revisiting Sirgy’s Corporate Performance Measurement Model: Towards A Management Audit that Captures Corporate Social Responsibility and Beyond” in José Allouche ed, *Corporate Social Responsibility* V 2 (London: Palgrave Macmillan 2006) at 154

[85] These include organisations such as the Global Reporting Initiative, AAccountability, ISO, SHIFT, corporate responsibility rating agencies such as EIRIS and KLD, stakeholder platforms such as the UN which founded the Global Compact.

[86] Such disclosure may be regarded as extending from the existing disclosure obligations imposed on quoted companies under s414A of the Companies Act dealing with stakeholder relations and impact in the directors’ Strategic Report. However s414A is worded widely, and even with the Financial Reporting Council’s guidance on ‘materiality’ of such narrative reporting (FRC, *Guidance on the Strategic Report* (June 2014) at https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf), it can be argued that the standards of reporting can vary greatly due to subjective interpretation of what is required. The reporting of stakeholder covenants is arguably a refinement, becoming more precise and informative.

criteria, introducing a cat-and-mouse game detracting from spirited compliance with mandatory obligations. For example, if mandatory criteria for attaining the status of a company stakeholder is a sufficiently long-term of contractual engagement such as in supply relationships or employment relationships, companies may introduce tender tournaments for supply contracts in order to avoid labelling any supplier as a stakeholder, or introduce flexible and non-committal employment arrangements that may not be in employees' interests.

However, we are mindful that companies should especially take into account stakeholders who have made 'firm-specific commitments'[87] to the company as commentators have identified them as a group whose fortunes are highly vulnerable to the company's. Such stakeholders often commit themselves to meet the company's needs or in some way contribute to the company's productive processes in such a way as to become interdependent with the company and therefore vulnerable to the company's fortunes. Dedicated or long-term suppliers of particular goods or services may be an example. Long-term creditors are also an example of this group but they are already slightly better protected in company law.[88] Long-term employees of the company are a candidate for this group too and another example in the social media context could be the loyal users of the social media network.

It may be argued that if stakeholder covenants are a best practice and not as a mandatory obligation, companies would not likely take the initiative to develop stakeholder covenants. This lack of motivation may be due to the cost incurred as first movers in developing such covenants which can then be copied and adopted by other companies. We acknowledge that there may be uptake problems, but the mandatory transparency imposed on companies (not just quoted companies, as suggested earlier) to report on existence (or otherwise) of stakeholder covenants and their contents could create some pressure for companies to justify to their stakeholders any perceived indifference to this issue. Further, companies could also be motivated to take leadership in this area if they perceive a business case or reputational enhancement incentives. Hence, we argue at this stage that we should refrain from mandatorising stakeholder covenants in order to give some time to observe the responses from business practice.

Directors' Duty

Next we recommend that a director's duty can be introduced to support company-stakeholder covenants by requiring directors to ensure that the covenants are complied

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[87] Margaret Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Brookings Institute 1994); Arturo Capasso, 'Stakeholder Theory and Corporate Governance: The Role of Intangible Assets' at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=610661.

[88] *West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30; *Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd* [2002] EWHC 2748.

with if established, similar to the existing directors' duty to adhere to the company's constitution.[89]

One question that may arise is how such a duty is to be enforced. In the current scheme of things, shareholders individually or collectively would be able to enforce the company's constitution *inter se* or against the company.[90] Further, the company can take enforcement action against a director who is responsible for not complying with the company's constitution. This is however subject to the general meeting's approval of the non-adherence,[91] or majority vote at the general meeting by way of ratification.[92] A minority shareholder could in principle mount a derivation action against a director's breach of duty in non-adherence to the constitution, if conditions in the Companies Act are met.[93] These actions available to redress breaches of the company's constitution are however unsuitable for enforcement of stakeholder covenants. Shareholders are not the appropriate constituents to enforce stakeholder covenants or a breach of director's duty in non-adherence to such a covenant, as they may be disinterested or indeed conflicted from doing so. We argue in Section C that in tandem with developing a stakeholder conception in company law, adjustments would have to be made in the current scheme of things so that enforcement rights are distributed more widely where relevant, and shareholders' exclusive powers in certain respects would have to be adjusted. Hence, we envisage that stakeholders as a group should have standing to enforce the covenants against the company and directors. Section C will elaborate on this.

Contents of Stakeholder Covenants

We envisage that stakeholder covenants can contain principles, desired standards and practices on the part of the company, engagement frameworks with the stakeholder group, standards and conduct expected on the part of the stakeholder group, procedural provisions that guide dialogue and decision-making, information disclosure and transparency, and overall, mutual expectations and responsibilities.

The stakeholder covenant should however not be the appropriate location for specific contractual rights or obligations that are derived from stakeholders' commercial relationships, if any, with the company. Further, stakeholder covenants should not be used as a means to compel the divulgence of confidential or commercially sensitive information.

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[89] S171(a), Companies Act 2006.

[90] Eg *Pender v Lushington* (1877) 6 Ch D 70.

[91] *MacDougall v Gardiner* (1875) 1 Ch D 13.

[92] Section 239, Companies Act 2006.

[93] S260-263.

For example, a stakeholder covenant with suppliers should not be the platform for suppliers to compare commercial terms and conditions.

In forging stakeholder covenants, companies and their relevant stakeholder groups can consult the vast body of soft law in standards and best practices so as to establish a desirable set of conduct standards that is meaningful for both parties. At a high level, the UN Global Compact provides a template for internationally optimal standards of conduct of business in relation to human rights, labour, the environment and anti-corruption.[94] In relation to human rights, the UN Guiding Principles[95] flesh out further that companies should respect human rights by instituting policy and operational commitment, including procedural mechanisms and systems to engage with identifying and verifying human rights abuses and to install remediation mechanisms to make redress to the relevant parties. For example, if a company enters into a stakeholder covenant with a local community representative group in the area that it is operating, such a covenant could contain standards of conduct consistent with the international corporate responsibility standards under the Global Compact and UN Guiding Principles. Such international standards provide a template to facilitate consensus in company-stakeholder negotiations. Further, interested stakeholder groups may also be able to hold companies to international standards on particular issues such as anti-corruption[96] or anti-tax-evasion,[97] giving such international soft law a 'harder' status through the mechanism of private legalisation through stakeholder covenants.

International guidelines and soft law specific to particular sectors may also be helpful for groups of stakeholders relevant to certain sectors. For example in activities where conservation interests are important such as in agriculture, fisheries, farming industries, stakeholders interested in conservation or the prevention of externalities could forge covenants with their respective companies based on industry-specific standards introduced such as by the OECD.[98] In the apparel industry where the key issues may concern unequal labour relations who have weak bargaining power or the use of child labour, stakeholders such as labour representation groups could draw from the Cleanclothes.org apparel industry code of conduct to hold companies to specific standards such as commitment to

[94] At https://www.unglobalcompact.org/what-is-gc/mission/principles.

[95] At http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf.

[96] Such as the OECD Anti-Bribery Convention 2009, at http://www.oecd.org/daf/anti-bribery/oecdantibriberyconvention.htm. OECD, *Aggressive Tax Planning in After-Tax Hedging* at p35ff, at http://www.oecd.org/tax/aggressive/after_tax_hedging_report.pdf.

[97] OECD, *Aggressive Tax Planning in After-Tax Hedging* at p35ff, at http://www.oecd.org/tax/aggressive/after_tax_hedging_report.pdf.

[98] www.oecd.org under 'Topics' contains many sector-specific discussions and guidelines for agriculture, health, education, finance, sustainable development, science and technology, chemical safety and industrial sectors.

maintaining decent working conditions and fair contractual terms, engagement with collective bargaining and refraining from using child labour.[99]

Next, an important aspect in stakeholder covenants should relate to stakeholder engagement frameworks that enrol stakeholders' voice and feedback. In this area, a number of organisations have established frameworks for stakeholder engagement which can be studied and adopted. For example, Accountability.org has developed a standard for stakeholder engagement that requires companies to plan for engagement, prepare, implement and review such engagement.[100] Planning includes mapping the relevant stakeholders using clear criteria and indicators, determining the engagement level and boundaries of disclosure, drawing up a plan and process of engagement. Preparing to engage includes mobilising resources and building capacity to engage, and preparing for the risks of such engagement. Implementation involves inviting the relevant stakeholders through the processes for engagement, including briefing stakeholders and giving them a voice through various possible channels. Stakeholder input and feedback should then be analysed to feed into an action plan that should have identifiable outputs and clearly communicated to stakeholders. The action plan should be implemented and the company should then review the implementation, develop follow-up to the plan and regularly communicate the results to stakeholders. The Accountability framework is by far one of the most comprehensive templates. Other frameworks can be found in the ISO's stakeholder engagement standard,[101] which also provides (a) a clear process for circumstances of engagement such as the commencement of a new project, (d) stakeholder identification, (c) equal access to information, (d) timely consultation and (e) the due study of stakeholder feedback in corporate decision-making. For sector-specific initiatives, the Equator principles instituted by banks ensure that borrowers of project finance manage their environmental and social impact risks by adequate stakeholder engagement,[102] including setting up informed engagement and consultation processes with affected stakeholders and a grievance mechanism to address their complaints.

Next, we are of the view that stakeholder covenants can go several steps further than just enrolling stakeholder engagement and voice. Stakeholder covenants can also set out how stakeholders are to be empowered to be part of corporate decision-making processes. This can be efficient for companies whose operations are deeply embedded within stakeholder communities so that likely problems can be resolved with greater effectiveness and

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[99] At https://cleanclothes.org/resources/publications/clean-clothes-campaign-model-code-of-conduct.

[100] This is known as the AA1000SES 2015 at http://www.accountability.org/images/content/8/7/875/AA1000SES%202015.pdf.

[101] ISO, *Engaging Stakeholders and Building Consensus* (at Section 3) at http://www.iso.org/iso/guidance_nsb.pdf.

[102] As of June 2013, at http://www.equator-principles.com/resources/equator_principles_III.pdf.

amicability. For example, where a company is undertaking a major project that affects community, conservation and other interests, a structure can be set up for continuous engagement throughout the duration of the project, such as having stakeholder representatives as observers at risk committee meetings on the Board.

In longer-term and open-ended types of stakeholder relationships such as the employment relationship, there may be a case for stakeholder representation on the Board or in a relevant committee of the Board, such as in nomination, remuneration or risk committees, where long-term issues such as Board succession, executive pay and pay policy and the management of business risks could benefit from stakeholder representation and input. The German co-determination model is a reflection of such ethos, although it has been criticised in terms of supervisory Board inefficiencies and the representation of partisan interests.[103] This model can nevertheless provide learning experience in studying reform, and we can consider sharpening this model by more precisely enrolling employee representation in matters that they have a material stake in, such as in firm-wide remuneration policy or pensions policy, rather than set quotas in the supervisory board. In light of the BHS scandal,[104] it is also queried whether there may be a case for the *ad hoc* enrolment of stakeholders in decision-making on Boards where such decisions affect them significantly. The depletion of BHS' pension pot in favour of massive dividends out of thin profitability is an instance of legal but excessive transfers of wealth that adversely affected a wide range of stakeholders. Such could only be possible as the decision-makers for wealth allocation (the Board and shareholders) exclude the key stakeholders in this issue - the employees, pensioners and the Pensions Regulator.

Stakeholder covenants should also provide for information exchange mechanisms, which include relevant information disclosure *inter se* subject to the needs of confidentiality and commercial sensitivity. In terms of what stakeholders expect to be disclosed from companies, this is an area that is well-developed under the leadership of a number of voluntary organisations such as the Global Reporting Initiative and Accountability.org. The GRI reporting standards[105] have become a market leader, providing a standard template of non-financial reporting in seven areas of company operations that have responsibility implications, i.e. Economic, Labour, Human Capital, Environmental, Social and Product Responsibility. The GRI template provides for how non-financial reporting can be carried

[103] * Horse Siebert, "Corporatist versus Market Approaches to Governance" in Hopt et al (eds), Corporate Governance in Context (Oxford 2005) at p281-294; K Hopt, "Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe" (1994) 14 International Review of Law and Economics 203.

[104] House of Commons Work and Pensions and Business, Innovation and Skills Committees, *BHS* (2016) at http://www.publications.parliament.uk/pa/cm201617/cmselect/cmworpen/54/54.pdf.

[105] G4 Standards, see https://www.globalreporting.org/resourcelibrary/GRIG4-Part1-Reporting-Principles-and-Standard-Disclosures.pdf.

out with regard to policies, conduct, operations and impact. The GRI also provides sector-specific reporting templates for the relevant social responsibility concerns. Further, we are also of the view that reciprocal disclosure obligations should be required of stakeholders *vis a vis* the company, such as stakeholders' declaration of any conflicts of interests. We believe that the mutual transparency is important so that stakeholder engagement is carried out in a way as objectively as possible in order to constructively feed into company decision-making.[106].

Finally, we see stakeholder covenants as including mutual rights, responsibilities and accountability provisions, such as principles of integrity in communications, fair dealing, disclosure of conflicts of interest, due accountability, mutual feedback, complaints-handling and so on. They can also include Freeman's principles[107] of stakeholderism, such as rules regarding entry and exit[108] with respect to the relational paradigm with the company, and the distribution of the cost of engagement.

Legal Status of Stakeholders' Covenants

In terms of the legal stature of the stakeholder covenant, we propose to put it on the same footing as the company's constitution. This means that where stakeholder covenants are established, they should be treated as contractual documents binding the company and its group of stakeholders *inter se*. This is consistent with the stakeholder conception of the company where stakeholders should not be seen as inferior to shareholders, and indeed shareholders are only part of the total 'team'[109] of stakeholders who contribute to the company's wealth creation processes as a whole. A question may arise as to whether multiple constitutional obligations for the company will result in impossibility in giving effect to any constitutional document, as there may be conflicting obligations.

We do not see stakeholder covenants as posing particularly insurmountable and conflicting multiple obligations. Directors and indeed the company are accountable to multiple constituents all the time, including sectoral regulators, the stock exchange, different classes of shareholders. It is part and parcel of directors' responsibilities to chart a coherent course for companies, respecting all relevant obligations and acting in the best interests of the

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[106] See concerns in James Noland and Robert Philips, "Stakeholder Engagement, Discourse Ethics and Strategic Management" (2010) International Journal of Management Reviews 39.

[107] R Edward Freeman, "A Stakeholder Theory of the Modern Corporation" reproduced in Max BE Clarkson ed, *The Corporation and Its Stakeholders* (Univ of Toronto Press 1998) at 125.

[108] The thresholds and criteria for being regarded as 'stakeholders' who are in a position to bargain for a covenant with the company, and in appropriate circumstances, for the cessation of 'stakeholder' status if certain conditions are met, such as the expiry of a particular corporate project in a community.

[109] Margaret M Blair & Lynn A Stout, "A Team Production Theory of Corporate Law" (1999) 85 Virginia. L. Rev. 247.

company as a whole. Further, a recent development in relation to premium-listed companies on the London Stock Exchange also raises the prospect of multiple forms of constitutional governance for companies consistent with what is proposed in this article. In premium-listed companies with controlling shareholders, such companies are mandated to enter into relationship agreements with their controlling shareholders to limit the latter's control and possible abuse of power in order to protect minority shareholders' interests.[110] It has been suggested[111] that the legal status of such agreements may be akin to a constitutional one, although the Listing Rules has designed different enforcement mechanisms for the relationship agreement. We consider it plausible that company constitutional law can be extended to protect a wider range of relational expectations and set out mutual responsibilities. Further, it is disproportionate to argue that challenges in managing multiple relational paradigms should be sufficient to prevent giving stakeholders a position in company law entirely. Such challenges can be managed by reforms in company law (discussed herein) and development in directors' management frameworks, both of which are possible.

We also note that the idea of stakeholder covenants is not entirely new as there are nascent signs of development in other jurisdictions that see this device as useful in securing companies' commitment to social responsibility obligations. SHIFT in particular reports that the Netherlands government is brokering discussions and engagement between companies and stakeholders to forge 'sectoral covenants' that contain common standards and principles for respecting business and human rights relevant to particular sectors.[112]

C. Adjustments in Company Law

The operationalisation of a stakeholder conception in company law necessitates an adjustment in the balance of powers in company law. We argue that in principle, such adjustments have to be made in two areas: shareholders' enforcement rights and shareholders' exclusive powers over certain aspects of company decision-making.[113]

Many of the enforcement rights in company law belong to shareholders, or liquidators at the company's demise. Shareholder enforcement rights include enforcement of the

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[110] Listing Rules 6.1A, discussed in Roger Barker and Iris H-Y Chiu, 'Protecting Minority Shareholders in Blockholder-Controlled Companies – Evaluating the UK's Enhanced Listing Regime in Comparison with Investor Protection Regimes in New York and Hong Kong' (2015) 10 Capital Markets Law Journal 98.

[111] Above.

[112] http://www.shiftproject.org/resources/collaborations/sector-wide-risks-negotiated-covenants-netherlands/.

[113] We do not foresee the lack of resistance from shareholder quarters, such as on the basis that they are best placed or the most efficient relational organ to monitor the company. But we address pro-shareholder primacy arguments in Section A and see this 'political' shift as being possible only with determined law reform.

company's constitution against the company (section 33 of the Companies Act 2006), the right to take derivative actions (sections 260-263), right to petition against unfairly prejudicial treatment (section 994) and the enforcement of other shareholder rights such as rights relating to general meetings[114] and other rights such as pre-emption rights.[115] Although section 172 of the Companies Act requires directors to promote the long-term success of the company as a whole taking into account stakeholders' interests, it is clear that stakeholders do not have enforcement rights against directors if they are of the view that their interests are inadequately taken into account of. The duty remains actionable by the company, or by shareholders in derivative action. This is why a number of commentators are of the view that this director's duty does not deviate from shareholder primacy and would unlikely give effect to a stakeholder conception of company law.[116]

Enforcement of Covenant

In giving effect to our proposed stakeholder conception in company law via the mechanism of stakeholder covenants, we propose that such covenants if established should be accompanied by private rights of enforcement. This includes a right for the relevant group of stakeholders to enforce the covenant directly against the company and enforcement against breaches of the directors' duty we discussed above. First, we propose that a provision similar to section 33 of the Companies Act 2006 be drafted to provide for the covenantal effect between stakeholders as a group and the company. Should such covenants like the company's constitution, also bind members *inter se?*[117] We think there is no reason to exclude that effect as stakeholders can agree to the standards of conduct and accountability *inter se*. For example, a company could have a stakeholder covenant with its group of long-term service suppliers which includes a number of different service providers. The covenant should set out the paradigm and frameworks for the relations between the company and stakeholder group as a whole, but such a covenant may also set out expectations and responsibility within the stakeholder group *inter se*, such as fair dealing.

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[114] For eg s313 of the Companies Act 2006 provides for adequate information rights for shareholders leading up to the general meeting in order to allow them to make an informed decision as to attendance and voting. Inadequacy of such information could result in successful challenge against any resolutions passed at the meeting. See *Tiessen v Henderson* [1899] 1 Ch 861.

[115] S571 relating to disapplication of pre-emption rights which is a matter for shareholders to decide.

[116] *Hedger v Adams* [2015] EWHC 2540 (Ch); Andrew Keay, "Section 172(1) of the Companies Act 2006: an Interpretation and Assessment" (2007) 28 Company Lawyer 106; Joan Laughrey, Andrew Keay and Luca Cerioni, "Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance" (2008) 8 Journal of Corporate Law Studies 79; Elaine Lynch, 'Section 172: A Ground-Breaking Reform of Director's Duties, or the Emperor's New Clothes?' (2012) Company Lawyer 196.

[117] Eg *Borland's Trustee v Steel* [1901] 1 Ch 279.

Company law should set out the scheme of covenant enforcement, akin to enforcement of the company's constitution by shareholders. Such an enforcement scheme, based on expressly agreed standards of conduct, expectations and responsibilities by clearly identified stakeholder groups, is less likely susceptible to critique that stakeholder litigation is open-ended, unpredictable and often frivolous or vexatious.[118] Further, company constitutional enforcement has little room to import of implied terms, thus narrowing down the scope of unpredictable claims or assertions in stakeholder litigation against the company.[119]

Derivative Action against Directors?

Further, the director's duty to adhere to stakeholder covenants if established allows a company to sue an errant or deviant director who is responsible for bringing about the breach of the covenant. Such deviation may be regarded as not in the best interests of the company, and could be actionable as a matter of general fiduciary loyalty, or under an expanded amendment to s171(a) of the Companies Act which currently makes it a director's duty not to deviate from the company's constitution. One question that arises is whether the affected stakeholder group should be able to sue the director directly as well, such as under a derivative action where there may be similar circumstances such as those that give rise to the shareholder's derivative claim.

We think it not implausible to expand the shareholders' statutory derivative action to allow stakeholders to sue in a similar capacity where a breach of a stakeholder covenant has occurred. In principle, the primary cause of action for affected stakeholders is the enforcement of the stakeholder covenant against the company. However if covenantal enforcement is futile, such as where a company has become insolvent, stakeholders may bring a relevant action in director's breach of duty in order to obtain redress.[120] Thus, we think the statutory derivative action could be expanded to accommodate stakeholders' suits against errant directors where a breach of a stakeholder covenant can be established. This is an action we see as contained and proportionate in scope.

One question that may arise is that the above enforcement mechanisms do not address the situation where a group of stakeholders wish to claim redress against the company for failing to enter into a covenant with them. Legal redress may not be the appropriate realm to pursue this problem. Interested groups may look into other forms of engagement including media discussions to bring the matter to the company's attention. However it may

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[118] John Argenti, "Stakeholders: The Case Against" (1997) 30(3) Long Range Planning 442; Alistair Alcock, "The Case Against the Concept of Stakeholders" (1996) 17(6) Company Lawyer 177.

[119] *Bratton Seymour Services Co Ltd v Oxborough* [1992] BCLC 693 [1992] BCC 471, but see *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408 (HL).

[120] *Kiani v Cooper* [2010] EWHC 577 (Ch); *Franbar v Patel: Franbar Holdings Ltd v Patel and others* [2008] EWHC 1534 (Ch); [2008] WLR (D) 220.

be argued that there is a need to seek directors' accountability for their decisions to exclude particular groups, and there would be a lacuna for such accountability if there were no legal actions that can be mounted.

The general principle for directors' discretion to enter into covenants with certain stakeholder groups or otherwise is one that has to be exercised in the best interests of the company. We think that an exclusion of a relevant stakeholder group could *in theory* be questioned in relation to this directors' duty. The enforcement mechanism we propose will be discussed below in relation to a wider perspective on adjustments of shareholders' and Boards' powers in company law.

We turn now to a more fundamental implication of the stakeholder conception of company law, that is, whether existing frameworks for exclusive shareholder powers in company law can continue to be sustained. We argue that a stakeholder conception in company law compels us to revisit areas of exclusive shareholder powers and to consider how these may be more appropriately balanced.

Adjustment of Exclusive Shareholder Powers

At the moment shareholders enjoy key exclusive decision-making powers under the Companies Act 2006 such as in relation to the removal of directors,[121] capital structure decisions such as reduction of capital[122] or share buybacks,[123] ratification decisions involving directors' breach of duties,[124] approval for transactions with directors,[125] and their pay packages,[126] and whether or not to accept a takeover offeror's bid.[127] It may be argued that the framework of shareholder rights and powers is what makes companies in the UK attractive to investors both at home and abroad, and thus, there would be significant

[121] S168 of the Companies Act 2006.

[122] S641(1) for reduction of capital in a private company, exclusive powers lie in the general meeting to approve of this course of action.

[123] S694-701 allow companies to purchase their own shares supported by an ordinary shareholders' resolution at general meeting.

[124] S239 of the Companies Act 2006.

[125] Sections 190-214 dealing with loans to directors and substantial transactions.

[126] S188 of the Companies Act 2006 for long-term incentive schemes, s439A for 3-yearly approval of pay packages as a whole.

[127] For eg the board neutrality rule upheld in the UK that prevents directors from defending the bid and to recommend to shareholders only for their exclusive decision what is in the best interests of the company, *Hogg v. Cramphorn Ltd*[1967]Ch. 254, and more recently the Kraft takeover of Cadbury Plc in the UK, see discussion in Georgina Tsagas, 'A Long-Term Vision for UK Firms? Revisiting the Target Director's Advisory Role Since the Takeover of Cadbury'S PLC' (2014) 14 Journal of Corporate Law Studies 241.

repercussions if company law shifted towards curtailing shareholder powers.[128] We argue however that our proposal is one of rebalancing powers so that some aspects of shareholders' exclusive powers may be shared in light of a stakeholder conception, and so there should not be an exaggerated impression of shareholder marginalisation. Further, as these proposals are meant to strengthen the company as a whole for the long term, shareholders should see such reform as having overall beneficial value, and should not rely on short-termist transfer of wealth from other shareholders or stakeholders as a means of return on investment.

We are of the view that under a stakeholder conception of company law, certain exclusive shareholder powers need to be adjusted to reflect the new matrix that is more inclusive and holistic. For example, we do not think that shareholders' exclusive decision-making power in appointing and removing directors should remain if the Board consists of directors fielded for stakeholder representation purposes, according to the relevant stakeholder covenant. If shareholders could decide on whether to appoint a candidate nominated by a stakeholder group under its covenant or to remove him/her, that has the potential to undermine the legal status and spirit of stakeholder covenants. This does not mean that shareholders lose the right to propose a removal altogether, and we will shortly address the implications of such rebalancing, which involve both the Board and stakeholder groups playing a more prominent role.

Another example: in terms of ratifying directors' breaches of duties, we are of the view that such breaches of duty should not merely be ratified by an ordinary resolution in shareholders' general meeting. There may be stakeholder implications for such breaches of duty, such as negative externalities. Again, we suggest an alternative framework below for ratification below that represents a more balanced calibration of powers in the company.

In terms of shareholders' exclusive powers in capital, pay and takeover decisions, we are of the view that adjustments need to be made. In capital structuring decisions, existing shareholders stand most to gain in a reduction of capital or buyback of shares, but there are, as pointed out in Section A, implications for the long-term investment of the company and the company's ability to withstand cash flow stresses. Hence, shareholders are not the optimal group in fact to decide as they cannot be objective in such decisions. In executive pay decisions, although shareholders have shown some interest in restraining rewards for failures,[129] they are not consistently active in scrutiny,[130] and have been complicit in

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[128] The law and finance proposition, see for eg R La Porta, F Lopez-de-Silanes, A Shleifer and R Vishny, 'Law and Finance' (1998) 106 Journal of Political Economy 1113; R La Porta, F Lopez-de-Silanes and A Shleifer, 'What Works in Securities Laws' (2006) 71 Journal of Finance 1.

[129] 'Boards wake up to a shareholder spring', *Financial Times* (4 May 2012).

[130] Carsten Gerner-Buerle and Thomas Kirschmaier, 'Say on Pay: Do Shareholders Care?' (2016) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2720481.

awarding increasingly eye-watering amounts of executive pay as long as their returns on capital objectives are met.[131] Shareholders do not scrutinise executive pay in terms of whether transfers of wealth to executives is proportionate or in the interests of the company as a whole. The concerns of pay disparity and transfers of wealth are not taken care of in shareholder scrutiny. Finally in takeover situations, shareholders are often tempted to sell out at an attractive premium,[132] and it is only in rare cases that they are persuaded to hold on for the long-term interests of the company.[133] Takeover decisions often affect stakeholders acutely, such as the fate of employees, suppliers and the local community in which the company operates, but they have no voice in the matter at all, a bizarre imbalance that may not be justified when the UK position is compared to other jurisdictions.[134] In all of the above situations, we offer alternatives that are consistent with our proposed framework for recalibration of powers in the company.

We acknowledge that in all of the above cases, exclusive shareholder power in decision-making may be seen as a 'check and balance' against managerial power. However, exclusive shareholder power also brings about skewed consequences and marginalisation of legitimate voices and concerns, such as the selling out of the long-term prospects of nationally significant enterprises (such as the Cadbury takeover case).[135] Nevertheless, making all the above decisions subject to a consensus-based framework for both shareholders and stakeholders may be inefficient, as partisan interests that cannot easily be

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[131] Lucian Bebchuk and Jesse Fried, *Pay without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard University Press 2004); Luc Renneboog and Grzegorz Trojanowski, 'Managerial Remuneration and Disciplining in the UK: A Tale of Two Governance Regimes' (2010) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1723462. But see Mike Strivens et al, 'The Influence of Institutional Investors Over Executive Remuneration in the UK' (2007) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=991590 that finds that institutional investors have a moderating effect on pay aligning it to performance.

[132] see John Armour, Simon Deakin and Suzanne J. Konzelmann, 'Shareholder Primacy and the Trajectory of UK Corporate Governance' (2003) at http://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp266.pdf, Wai Yee Wan, 'Takeovers and Countering Short-Termism in Target Boardrooms' (2013) 34 Company Lawyer 43.

[133] Such as in the failed bid that Pfizer made for Astra Zeneca in 2014, see 'Pfizer drops bid for Astra Zeneca', *BBC News* (26 May 2014).

[134] Wai Yee Wan, 'Takeovers and Countering Short-Termism in Target Boardrooms' (2013) 34 Company Lawyer 43; Georgina Tsagas, 'Reflecting on the Value of Socially Responsible Practices Post Takeover of Cadbury's Plc by Kraft Foods Inc: Implications for the Revision of the EU Takeover Directive'. (2012) 9 European Company Law 70-80.

[135] Tsagas (2012), above.

reconciled results in deadlocks in company decision-making.[136] Furthermore, introducing such consensus-based frameworks marginalises directors, whose professional judgment and decision-making powers should be more constructively utilised subject to appropriate constraints for the agency-based concerns.

Hence, in this recalibration of the power matrix of the company, it is not just about adjustment of shareholder powers, but about how power is distributed and exercised in ways that are both efficient and holistic. In so doing, we must not forget the Board, and we argue that there is a need to consider enhancing Board responsibilities and powers to mediate the new inclusive stakeholder framework, but also to act as an efficient decision-maker supported by robust accountability and enforcement mechanisms.[137]

Implications for Power Matrix in Company Law as a Whole

(a) Enhanced Board Leadership Supported by Increased Accountability

First, we see it as inevitable that some of the decisions exclusively reserved to shareholders discussed above would need leadership from the Board in a pluralistic relational paradigm including stakeholders. This means that the Board would become the primary organ to make decisions in many matters, but we advocate an expansion to the Board's duty to consult and to be accountable in order to provide balance to enhanced powers.

For example, in replacing shareholders' powers to exclusively appoint or remove Board members, there is a case for arguing that both shareholders and stakeholders should have rights of nomination. Stakeholders' rights of nomination should be set out within the terms of the relevant stakeholder covenant.

As these rights become dispersed among different groups, the need for mediation arises in the needs of efficiency. We argue that the approval of Board members should be vested in the ***nomination committee*** of the Board, which must provide a reasoned statement of satisfaction that the appointed candidate's profile would serve the best interests of the company.

Shareholders should also not exercise exclusive powers to remove directors[138] or this may undermine the appointment of stakeholder-nominated directors and the stature of

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[136] Arrow's critique that aggregation of preferences is not necessarily optimal decision-making in an organisation, discussed in Liza Rybak, 'Takeover Regulation and Inclusive Corporate Governance: A Social-Choice Theoretical Analysis' (2010) 10 Journal of Corporate Law Studies 407.

[137] This model is arguably consistent with Colin Mayer, *Firm Commitment* (Oxford; OUP 2013) and the director primacy supported by the team production theorists see Margaret M Blair & Lynn A Stout, "A Team Production Theory of Corporate Law" (1999) 85 Virginia. L. Rev. 247.

[138] Section 168, Companies Act 2006.

stakeholder covenants. We envisage that both shareholders or stakeholders have the right to propose removal, but that the nomination committee should make a final reasoned decision based on the best interests of the company as a whole. The nomination committee should consult shareholders and stakeholders extensively and provide a reasoned explanation to all. The implication from the above examples is that the adjustment of certain shareholder exclusive powers may concomitantly enhance the decision-making power of the Board. This is because in the alternative, enrolling consensus-based decision making among all stakeholder groups including shareholders may result in cumbersome and deadlocked processes. However the Board's role should be accompanied by clear procedural provisions for transparency and accountability.

Another example is in the adjustment of exclusive shareholder power in capital structuring or executive pay. At a very high level, many of these matters relate to preferences in terms of transfer of wealth/benefits. Hence, we propose that although shareholders or stakeholders have the right to move such proposals, they should be considered and consolidated by the Board acting a mediating mechanism and decision-maker whose accountability must be robust (a point we will turn to shortly).

For example, company law could mandate that all Boards maintain an Ethics committee comprising of a group of independent directors, who would be responsible for scrutinising the objectives for and implications of any transfer of wealth decisions. The Ethics committee could be responsible for consulting shareholders and stakeholders thoroughly and for producing a reasoned recommendation to the Board on the appropriate course of action. The duty to consult is well-established to be procedural and does not rob the discretion of the committee[139] from making a recommendation to the Board after due consideration of all representations. The committee can be made responsible for information analysis to all stakeholder groups, discussing the long-term implications of any transfers of wealth or benefits, and the bases for such transfers, whether in terms of efficiency, public interest, common good or distributive justice.

Although we accept that as a matter of efficiency, the Board may be the final location to make certain decisions, we do not merely support director primacy[140] as the organ that substitutes and centralises decision-making on behalf of all 'capital' providers.

Our model recognises that different factions of agency can persist so the goals of holistic inclusion must be countervailed by restraint on all sides. We see shareholders and stakeholders 'restrained' by having their 'rights' mediated by Board consideration, instead of the previous regime where majority voting by shareholders would carry the day. On the

[139] See *Rusal v The London Metal Exchange* [2014] EWCA Civ 1271.

[140] Such as in Stephen M Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2002) 97 Northwestern University Law Review 547.

part of the Board, we see 'restraint' as being effected by greater requirements in the duty to consult, reasoned accountability and *ex post* enforcement (to be discussed shortly). Board decisions are further underpinned by regular monitoring and accountability through the channels of stakeholder covenants and the reservation of inclusive procedures for decision-making that we will discuss shortly. Hence, our model is one where professional managerial capacity is expected and also empowered, but also where the relational paradigms in a company reflect more accurately, a diverse and more complex eco-system involving stakeholders, comprising of an overall system of checks and balances,[141] a system that is more sophisticated and less simplistic than under the existing scheme of things, but nonetheless adequately matches the complexity of a company's social profile and footprint. Hence, we envisage an effective and empowered Board underpinned by input monitoring and by legal redress as we shall discuss shortly.

(b) Legal Reforms for Effective Directors on an Enhanced Board

Board reforms are essential to ensure that Boards are effective to undertake the enhanced powers under our proposed adjustments to the power matrix in company law. Such Board reforms would need to be supported by reforms in company law.

Reform of s172, UK Companies Act 2006 and Legalisation of Board Responsibilities

Directors' conduct is currently governed by standards of loyalty, good faith, care and skill. We are of the view that these conduct standards remain relevant in order to constrain the exercise of powers within appropriate proscriptions and care. We support the duty to adhere to the company's constitution and have advocated the extension to adherence to stakeholder covenants generally. We think the current section 172 of the UK Companies Act 2006[142] should be replaced, as such directors' duty is singularly focused on shareholder primacy and fails to capture the modern complexities of Board responsibilities. Directors should be subject to a duty to engage in decision-making as a form of stewardship in their exercise of professional judgment towards the long-term good of the company as a whole, a notion endorsed by eminent commentators many years ago.[143]

Company law should set out principles of Board responsibility, similar to that adopted in the UK Corporate Governance Code which applies to premium-listed companies on the London Stock Exchange. These responsibilities deal with strategic leadership on the Board, critical

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[141] For eg see Al-Hawamdeh et al, *Complexity Theory and Corporate Governance* (Chelternham: Edward Elgar 2010).

[142] which sets out a directors' duty to promote the long-term success of the company for members as a whole and having regard to stakeholders for that purpose.

[143] William W Bratton and Michael Wachter, 'Tracking Berle's Footsteps: The Trail of The Modern Corporation's Last Chapter' (2010) 33 Seattle University Law Review 849 on Berle's vision of the publicly interested manager; and also E Merrick Dodd, 'For Whom Are Corporate Managers Trustees?' (1932) 45 Harvard Law Review 1145.

discussion, appropriate risk appetite and management.[144] We think appropriate stakeholder management should be added to the list. Board responsibilities should also include articulating the roles of committees of the Board, such as nomination, remuneration, risk, ethics or audit committees. The legalisation of Board responsibilities is not an entirely novel approach. Indeed in the financial sector, Board responsibilities have been legalised. In the aftermath of the global financial crisis, the failure of bank Boards to appreciate certain risk-taking and the observed disengagement or ineptitude on bank Boards[145] have led policy-makers to prescribe certain Board responsibilities as a matter of regulation,[146] such as attention to strategic matters, adequate risk management and internal control, and comprehensive information reporting within the company. Of course the legalisation of board responsibilities in the financial sector is actionable by the relevant financial regulator, and is not a company law development as such. However, such developments can open the way for further thinking about how regulatory governance that reaches into the organisation can interface with the governance frameworks in company law.

A concomitant director's duty to adhere to the articulated Board or committee charter of responsibilities[147] should also be introduced. We believe this to be necessary as directors' omission to consider or take action is not adequately covered in the directors' duties regime such as in the scope of the duty of 'care and skill'. For example, during the UK banking crisis of 2007-9, Northern Rock's Board allowed executive management to operate a highly risky model of wholesale funding, and it was revealed that the Board of the Royal Bank of Scotland hastily approved of the acquisition of ABN-AMRO which proved to be fatal to the bank's fortunes.[148] Directors on both Boards have not been subject to any enforcement for

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[144] UK Corporate Governance Code 2016 at https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-April-2016.pdf.

[145] Hamid Mehran, Alan Morrison, and Joel Shapiro, 'Corporate Governance and Banks: What Have We Learned from the Financial Crisis?' (June 2011) Federal Reserve Bank of New York Staff Report No 502 http://ssrn.com/abstract=1880009; Harald Hau and Marcel P Thum, 'Subprime Crisis and Board (In-)Competence: Private vs. Public Banks in Germany' (2009) 24 Economic Policy 701; David Walker, 'A Review of Corporate Governance in UK Banks and other Financial industry Entities: Final recommendations' (26 November 2009) http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf.

[146] Art 76, European Capital Requirements Directive 2013, transposed in PRA Rulebook, *General Organisational Requirements.*

[147] Board responsibility matters are of a collective responsibility nature and not susceptible to being actionable as any individual director's duty, whose nature relates to individual conduct. Directors' duties deal with circumspection in individual conduct that can moderate directors' exercise of powers and decision-making in order not to adversely affect the company's interests, see for eg the character of fiduciary loyalty for eg in *Re Smith & Fawcett Ltd* [1942] Ch 304.

[148] FSA Internal Audit Division, *The Supervision of Northern Rock: A Lessons Learned Review* (March 2008); FSA, *The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report* (Dec 2011).

failures of duties largely because these directors would unlikely be regarded as having fallen short of due care and skill, or not having acted in the best interests of the company. As commented,[149] the directors mentioned above would likely have been regarded as pursuing a business strategy in good faith, and indeed upon the advice of professionally appointed experts, therefore not falling short of the requirements of sections 172 or 174 of the Companies Act 2006.

However, these directors clearly did not address their minds to risk management issues and failed to appreciate the wider sectoral risk implications of their institutions' excessive risk-taking.[150] Hence, regulatory reforms in the financial sector have now introduced Board responsibility for risk management,[151] as well as individual senior executive responsibility,[152] so that the failure of such responsibility may be made accountable through personal liability.[153] This regulatory regime compensates for the lacuna in the general directors' duties regime in company law but introduces duplication for directors' responsibilities and some uneasy interfaces.[154] There is a lesson to be learnt here with regard to whether directors' duties in company law should be reformed to include responsibility-oriented obligations, and not just conduct-oriented obligations. Examples of responsibility-oriented obligations can be derived from the Board responsibilities statements already developed in the UK Corporate Governance Code,[155] and some measure of inspiration can also be derived where relevant from the maps of responsibility for senior executives in banks and financial institutions drawn up by the relevant financial regulators.[156]

Qualities and Suitability of Directors

Further, we believe that directors should be more robustly vetted to have certain qualities appropriate for the Board position to be assumed. Directors need to be both competent and

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[149] Iris H-Y Chiu, "Directors in the Financial Services Sector: Regulatory Duties and Directors' Duties in Corporate Law- An Interface or Bifurcation?" (2016) Journal of Business Law 465.

[150] David Walker, 'A Review of Corporate Governance in UK Banks and other Financial industry Entities: Final recommendations' (26 November 2009) http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf.

[151] For eg Prudential Regulation Authority, *PRA Rulebook: General Organisational Requirements,* transposing Art 88 of the EU Capital Requirements Directive 2013.

[152] PRA *Rulebook: Allocation of Reponsibilities*, para 4.

[153] Known as the senior managers regime,s59ZA and 66A of the Financial Services and Markets Act.

[154] Iris H-Y Chiu, "Directors in the Financial Services Sector: Regulatory Duties and Directors' Duties in Corporate Law- An Interface or Bifurcation?" (2016) Journal of Business Law 465.

[155] Such as UK Corporate Governance Code 2016, Sections A.1, C.1, C.2.

[156] Eg PRA *Rulebook: Allocation of Responsibilities;* Financial Conduct Authority, *FCA Handbook* at SYSC 2.

independent, and adequately trained in the specific matters in relation to the business. Although we do not think that directorial qualifications can be prescribed as the needs of different businesses vary, all directors, whether shareholder, stakeholder-nominated or independent must satisfy the nomination committee of the Board of the suitability of their profile.[157]

Mayer also highlights the importance of independence being a predominant quality on the Board[158] as strengthening directorial independence and quality of leadership is essential to ensuring a long-term focus for the company away from the perverse motivations stoked by shareholder primacy. The nomination committee should articulate and perhaps have a map of responsibilities for the different directorial positions on the Board, and have responsibility for ensuring that directors are suitable for their roles on the Board or relevant committee of the Board and professionally competent for those roles. We support the rejuvenation of directorial decision-making as expert professional judgments which are as objectively optimal as possible.[159] Further, it may also be suggested that diversity policies of recruitment to the Board that further the Board's optimality in competence and objectivity should be encouraged.[160]

Board Composition

The suitability of directors should also be viewed as a holistic issue of Board composition, ensuring that the Board contains a balanced and adequate slate of skills and perspectives to act in the best interests of the company as a whole. The nomination committee plays a key role in ensuring optimal board composition. The nomination committee should comprise of independent directors who are qualified and dedicated to selecting an optimal Board composition and reviewing this regularly. Further, the nomination committee should make recommendations in terms of appointments to the various committees of the Board tasked to look after specific issues, such as remuneration, audit and risk. Further, as suggested earlier, we advocate that there should be a mandatory ethics and compliance committee which could look into issues of legal risk and responsibility, social and ethical responsibility and relations with stakeholders.

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[157] Egs of general training are the Director Competence Framework introduced by the UK Institute of Directors. Educational qualifications in business such as the MBA and other specialist qualifications such as a charter in relevant professional qualifications appropriate for the business could also be useful.

[158] Colin Mayer, *Firm Commitment* (Oxford: OUP 2013).

[159] For eg see Peter F Drucker's vision of the manager in *The Practice of Management* (1954 Rep 1999 Harper Collins); *Management: Tasks, Responsibilities, Practices* (Truman Talley 1986).

[160] For eg an overview of the types and pros and cons of board diversity see Daniel Ferreira, 'Board Diversity' (2010) at http://personal.lse.ac.uk/FERREIRD/Board%20Diversity%20version%201.pdf.

The enhancement of Board powers may be regarded as inadequately balanced if only framed by clearer responsibilities and expectations suggested above. We propose this new framework should be further supported in three ways. One is that directors should not be entrenched, and should have defined terms of tenure with limited renewal possibilities. Second, company law should provide for certain circumstances of inclusive decision-making where appropriate so that centralisation upon the Board is not excessive. The third is the design of appropriate enforcement mechanisms against directors.

(c) Tenure of Directors

We do not at this stage suggest prescriptive terms of tenure for directors, but we do not think short terms like a year or two especially in publicly listed companies are conducive to long-term thinking. Indeed a slate of three-to-five years perhaps extendable to eight years may strike the balance between incentivising directors to behave in a long-termist manner while not encouraging complacency that comes with entrenchment. This is underpinned by the right of shareholders and stakeholders to propose removal, as discussed above. In smaller private companies we see the possibility of longer terms of tenure as directors may also be controlling/founding shareholders and have a great interest in the long-term success of the company. We do not think there should be a compulsion to replace all such directors, as indeed they may be dedicated and constructive,[161] but controlling director/shareholders may need to be checked by independent elements on the Board and the company's stakeholders via covenants.

(d) Directors' Duty to act in Public or Overall Interest?

It may be queried, since directors are to be in a position of enhanced powers, whether they should be subject to a duty to act for the 'overall good' or 'public interest' of the company? We do not advocate the institution of such a duty. Company law already requires directors to act in the company's interest, i.e to consider the company as a whole. Although the current section 172 of the Companies Act draws equivalence between shareholders' as a body and the company as a whole, antecedent case law in the UK[162] arguably adopts a wider understanding of 'company as a whole'. As we propose the repeal of section 172, the default position reverts to section 170 of the Companies Act which states quite clearly that directors' duties are owed to the company.

We also do not think instituting a directors' duty in the public interest is appropriate as the company's interest is not necessarily public interest, just as the company may not be expected to provide public goods. We refer to the example of the Irish institution of public interest directors after the extraordinary state bailout of certain banks. Even then, the UK

[161] M. T. Moore and E. Walker-Arnott, 'A Fresh Look at Stock Market Short Termism' (2014) 41 Journal of Law and Society 416.

[162] Peskin v Anderson [2000] EWCA Civ 326.

did not adopt this approach as this could mean that state owners of corporations are legally permitted to manipulate the corporate objective through appointment of 'public interest directors'. The Irish approach is according to commentators still replete with legal anomalies and possible pitfalls.[163]

(e) Proposal for Company-wide Consensual Decision-making in Specific Instances

We think there are circumstances where an inclusive decision-making procedure involving all stakeholder groups may be warranted. For example, in exercising the power to ratify directors' breaches of duties, we are of the view that a more inclusive procedure for ratifying such irregularity must be convened. There may be stakeholder implications for such breaches of duty, such as negative externalities to different extents for different stakeholders. This suggestion may seem rather cumbersome but the apparent increased inconvenience of more inclusive procedures may be outweighed by reasons of appropriate justice for those made to bear the company's externalised cost. Hence, we are of the view that ratification proposals must be approved by the majority of all stakeholder groups. Such procedural demands could also compel directors to be more cautious in their decision-making and discharge of their duties, bringing in an impact of a virtuous circle.

Another situation we believe appropriate for inclusive decision-making is in business restructuring of the company. These episodes are not frequent by nature and often involve key turning points in the company's business and structure. We believe that inclusive procedures should be designed to enrol stakeholder voice and even decision-making in these circumstances, as these episodes often fundamentally affect stakeholder relations with the company. Further, they do not occur so frequently as to justify arguments in relation to being cumbersome.

However, it could be argued that (a) stakeholder covenants, including shareholders' constitution with the company can be drafted to apportion decision-making powers within the company, therefore undermining Board responsibilities, and (b) inclusive decision-making procedures cannot be made mandatory as there is no mandatory obligation to identify stakeholders.

We think reforms in company law are necessary to address (a) and (b). In adjusting the power matrix in the company, we are necessarily introducing a new binary, not one between the Board and the general meeting, but one between stakeholder-centric issues and 'whole-company' issues. By streamlining all stakeholder relations with the company (including shareholders' relations) to be covenant-based, it is important that stakeholder covenants only relate to matters that do not have implications for other stakeholder groups, or else such covenants can be used as arenas for competing interests to grab decision-

[163] Blanaid Clark and Gail E Henderson, 'Directors as Guardians of the Public Interest: Lessons from the Irish Banking Crisis' (2016) 16 Journal of Corporate Law Studies 187.

making power over issues that may affect wider groups of stakeholders. In other words, shareholder covenants should not be used to reintroduce preserves of exclusive power where inappropriate. We see a need for company law to provide that stakeholder covenants cannot include certain matters, such as capital decisions, executive pay, ratification of directors' breaches of duty, related party transactions, takeover offers, management-type decisions and the appointment of external gatekeepers such as the external auditor.

We acknowledge that where (b) is concerned, inclusive decision-making procedures can only include already identified stakeholder groups by companies, i.e. those in covenantal relationships as those are regarded as integral and long-termist enough by the company to be accorded relational status. This brings us back to how excluded stakeholders may challenge their exclusion, and reforms to enforcement against directors.

(f) Reform Proposal for Enforcement against Directors

The reforms suggested in this article contain shareholder and stakeholder enforcement against companies within the framework of their respective covenants but our proposals also concomitantly enhance Board responsibility and power over 'whole company' issues. How is directorial discretion in the latter to be made accountable?

We believe that shareholder and stakeholder groups are both interested in calling directors to account for breaches of duty although their interests do not always coincide. Hence, we are of the view that although the company remains the primary person to sue in enforcing directors' duties, the derivative action should be constituted as a form of enforcement that allows shareholders or stakeholders to sue in respect of breaches of directors' duty if there are circumstances that prevent the company from suing. Thus, consistent with our proposal above in adjustment of shareholders' exclusive powers, we consider the right to take a derivative action to be one that needs to be reformed to conform to the stakeholder conception of company law. This is necessary as shareholders should not be relied upon for enforcement in all relevant cases.

Enforcement of Directors' Duties- The Public Interest Dimension

We recognise that private enforcement by shareholders extended to covenantal stakeholders above may not address issues such as grievances of excluded stakeholder groups. We think it is plausible to introduce a form of 'public interest litigation' that can primarily be actionable by excluded groups which would like to challenge their exclusion. This action can be framed to be subject to the same barriers as currently established for derivative actions[164] in order to weed out frivolous and vexatious litigation without real merit.

[164] Section 263(3) of the Companies Act 2006.

If a company is a publicly traded company, we believe that the securities regulator would have a role to play in standard-setting as well as enforcement aspects relating to a stakeholder conception in corporate governance. Securities regulators increasingly see the relevance of corporate governance to listing standards, [165] and are in a position to further refine the standards for a stakeholder conception in publicly listed companies and to enforce them. We will not pursue this tangent in detail in this article as we focus on company law across the board. However we see the potential of securities regulator led enforcement where companies have excluded certain stakeholders or are in breach of corporate governance standards. Where shareholders and stakeholders may have less clout or bargaining power, the regulator's intervention, where appropriate, could be highly constructive.

It is queried whether shareholders or stakeholders should be able to take actions to challenge a company's entering into a stakeholder covenant. We do not think such actions are impossible or ought to be excluded, although such actions may appear to be contests between different factions of stakeholders and can be damaging and disruptive for the company. However we are of the view that the procedural barriers discussed above as found in section 263(3) of the Companies Act 2006 ought to be able to weed out unmeritorious allegations. For example, an application of section 263(3) criteria would require that claimants prove that a hypothetical reasonable director would think it in the best interests of the company to pursue the claim, or that the claim is pursued in good faith,[166] a burden for the claimant to discharge.[167]

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[165] The corporate governance regime supported by listing regimes is a key factor that underpins the attractiveness of a securities markets and explains why securities regulators have forayed into regulating or introducing soft law for corporate governance norms. See Andreas Charitou, Christodoulos Louca and Stelios Panayides, 'Cross-Listing, Bonding Hypothesis and Corporate Governance' (2007) 34 Journal of Business Finance and Accounting 1281 and at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=949827; Tobias H. Tröger, 'Corporate Governance in a Viable Market for Secondary Listings' (2007) 10 University of Pennsylvania Journal of Business and Employment Law 89, discussing the inseparability of corporate governance standards from securities regulation, therefore having a branding effect for the securities market concerned. On the adoption of corporate governance standards by the SEC, see J Robert Borwn Jnr, 'Corporate Governance, the Securities and Exchange Commission, and the Limits of Disclosure' (2007) 57 Catholic University Law Review 45; Robert B Thompson, 'Corporate Federalism in the Administrative State: The SEC's Discretion to Move the Line Between the State and Federal Realms of Corporate Governance' (2007) 82 Notre Dame Law Review 1143 and Timothy de Lizza, 'The Incoherency of American Corporate Governance and the Need for Federal Standards' (2007) 34 Fordham Urban Law Journal 1111; but see Renee B Jones, 'Does Federalism Matter? Its Perplexing Role in the Corporate Governance Debate' (2007) 41 Wake Forest Law Review 879. More generally on international convergence in accepting corporate governance standards as part of securities regulation see Luigi Zingales, 'The Future of Securities Regulation' (2009) 47 Journal of Accounting Research 391.

[166] S263(3)(a) of the Companies Act 2006.

[167] *Stainer v Lee* [2010] EWHC 1539 (Ch); *Bridge v Daley et al* [2015] EWHC 2121 (Ch).

In sum, we believe that an expansion of directors' duties towards responsibilities-oriented content, and the introduction of expanded enforcement avenues available to all stakeholders and those who challenge their exclusion, would provide a robust regime for legal redress against directors who enjoy a wider berth of power under our proposals. This would bring in a new system of corporate governance. Of course the sum of our reforms requires some heavy lifting and new interpretive jurisprudence from courts, although we have pointed out how existing legal and regulatory frameworks provide lessons for analogous interpretation.

D. Conclusion

Many debates in company law revolve around the theoretical and normative bases for shareholder primacy and stakeholderism and essentially, the contest between the two. This essay is in support of a stakeholder conception of company law but argues that we need to courageously imagine its operationalisation so that the 'current scheme of things' does not operate as a *per se* barrier to reform. In light of the perversities and negative externalities that have entailed from corporate conduct that is only on the basis of narrowly-framed shareholder primacy, we argue that it is time for reform, and that a blueprint for such can be set out. The blueprint proposed in this essay requires adjustment of the power matrix in company law but envisages professionally competent and dedicated managers supported by more complex channels of consultation, monitoring and enforcement. It is intended to support the company as the modern engine of wealth creation, as both an efficient economic organisation and a legitimate societal institution.