Washington and Lee Law Review

Volume 74 | Issue 2 Article 16

4-1-2017

The Shrinking Scope of CSR in UK Corporate Law

Andrew Johnston
School of Law, University of Sheffield

The Shrinking Scope of CSR in UK Corporate Law

Andrew Johnston*

Table of Contents

Abstract

Through a historical analysis of corporate law reforms in the United Kingdom (UK) during the twentieth and early twenty-first centuries, this paper traces the shrinking scope for corporations to take socially responsible decisions. It offers a detailed examination of the rationales and drivers of the reforms, and shows that, by focusing exclusively on the question of accountability of directors to shareholders, wider social concerns were "bracketed" after 1948, leading to a permanent state of "crisis," which constantly threatens the legitimacy of the corporate law system. Following the

* Professor of Company Law and Corporate Governance, School of Law, University of Sheffield and a member of the Sustainable Market Actors for Responsible Trade (SMART) Project (http://www.uio.no/smart), which is based at the University of Oslo. The SMART Project has received funding from the European Union's Horizon 2020 research and innovation program under grant agreement No. 693642, whose support I gratefully acknowledge. I am also grateful to participants in the Washington and Lee Law Review Lara D. Gass Annual Symposium on "Corporate Law, Governance, and Purpose: A Tribute to the Scholarship of Lyman Johnson and David Millon" for helpful comments and feedback on this Article, as well as to Blanche Segrestin, Beate Sjåfjell and Marc Moore for discussions on this topic. All errors remain my own.

Brexit vote, there are signs that the UK Government is willing to reconsider its historically narrow approach to corporate law by introducing some form of stakeholder representation. This paper concludes that such a change would be a more effective means of integrating social responsibility concerns into the corporate governance process than the current constrained voluntarist approach.

I. Introduction

This Article traces the shrinking scope of Corporate Social Responsibility (CSR) in UK company law from the beginning of the twentieth century. It shows that before 1948 company directors had broad discretion in law to balance the interests of different corporate constituencies, but that the cumulative effect of changes to the law since then has been to transfer ultimate control over corporations' CSR policies from management to shareholders and capital markets. It concludes that shareholders now have an effective veto over the extent to which companies take wider interests into consideration, and suggests that this means that CSR does not currently offer an adequate means of internalizing externalities. If corporations are going to make a contribution to sustainability in its environmental, social and economic dimensions,[1] there is a need for fundamental reforms to corporate law.

The extensive debate about the function and scope of CSR tends to occur in isolation from the legal framing of managerial discretion within corporate law.[2] Under the influence of

1. *See Sustainable Market Actors for Responsible* Trade, U. OSLO (Mar. 1, 2016), http://www.jus.uio.no/ifp/english/research/projects/smart/ (last updated Apr. 3, 2017) (last visited May 1, 2017) (detailing the possible contribution of corporations and other market actors to the achievement of sustainability in its three dimensions is the subject of the SMART project based at the University of Oslo) (on file with the Washington and Lee Law Review).

2. *See, e.g.*, ANDREW CRANE, DIRK MATTEN & LAURA J. SPENCE, CORPORATE SOCIAL RESPONSIBILITY: READINGS AND CASES IN A GLOBAL CONTEXT 22–23 (2008) (noting that a debate occurred whether corporations should pursue the interests of the owners or interests of society as a whole); *see also* ANDREAS RÜHMKORF, CORPORATE SOCIAL RESPONSIBILITY, PRIVATE LAW AND GLOBAL SUPPLY CHAINS 10–11 (2015) (defining corporate social responsibility as "the acknowledgement by companies that they should be accountable not only for their financial

neoclassical law and economics, much of the literature since the 1980s has tended to assume that companies will and should only engage in CSR activities where there is a "business case" for doing so, but without considering the role of the law in limiting CSR in this way.[3] Lyman Johnson and David Millon's work is an important exception within this debate and has consistently interrogated the narrow shareholder primacy focus of corporate law, the social costs theis creates, and the public demand for a wider scope of corporate law in order to ensure greater social responsibility. For example, they identified an incipient change with the emergence of corporate constituency states and other state laws making hostile takeovers more difficult,[4] and, more recently, they argued that the *Burwell v. Hobby Lobby Stores, Inc.*[5] decision clarified that state law does not require corporations to maximize profits.[6] Taking its lead from Johnson and Millon's work, as so many others have done since the early 1990s, this Article contributes to the debate by showing that the scope for CSR in UK corporate law has been shrinking since the middle of the twentieth century.

In 1993, Millon wrote of the crisis arising from the uncertainty surrounding the normative foundations of corporate law in the United States and ongoing challenges to the model of shareholder primacy in particular.[7] Whilst the British Parliament

---

performance, but also for the impact of their activities on society and/or the environment").

3. *See* Archie B. Carroll & Kareem M. Shabana, *The Business Case for Corporate Social Responsibility: A Review of Concepts, Research and Practice*, 12 INT'L J. MGMT. REV. 85, 86–87 (2010), http://f2.washington.edu/fm/sites/default/files/Business%20Case%20for%20CSR%20Review%20of%20Concepts,%20Research%20and%20Practice.pdf (discussing the modern take on CSR).

4. *See* Lyman Johnson & David Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846, 848 (1989) (noting that state takeover laws aim to protect non-shareholders "from the disruptive impact of the corporate restructurings that are thought typically to result from hostile takeover").

5. 134 S. Ct. 2751 (2014).

6. *See* Lyman Johnson & David Millon, *Corporate Law after* Hobby Lobby, 70 BUS. LAW. 1, 7 (2014) (pointing out that on the contrary some companies operate in accordance with "sincerely held religious beliefs and moral principles").

7. *See* David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1374 (1993).

consistently sought to enhance the rights and interests of shareholders in corporate law, the crisis took longer to become manifest, perhaps because UK scholars began to question the normative foundations of their discipline considerably later than their counterparts in the United States. Where challenges to shareholder primacy did occur, as they did during the 1970s, with demands for industrial democracy, they were headed off with little other than cosmetic changes to the law. Nevertheless, that UK company law is in crisis is now abundantly clear. The driver of the crisis is the dynamic identified by Johnson, who argued that when, corporate law brackets out wider concerns in order to focus on one principal concern, the side effects become destructive.[8] As legislators came to focus on director and managerial accountability to shareholders as the principal problem for corporate law to solve, the solutions to that problem, both within company law and in the wider corporate governance system, resulted in the emergence of new problems, namely corporate short-termism and a lack of meaningful social responsibility. The side-effects of the constant pressure on companies to produce shareholder value are becoming ever clearer—the ongoing environmental crisis demonstrates that sustainability cannot be achieved without a contribution from corporate law,[9] whilst the financial crisis showed that external regulation will not protect society from excessive risk-taking in banks whilst executive incentives and shareholder pressure remain unchanged. Pressure is building from scholars, practitioners, and civil society in Europe for changes so that the corporate governance structure may be used to resolve, or at least contribute to the resolution of, these intractable global problems and to ensure environmental, social and economic sustainability.[10]

---

8. *See* Lyman Johnson, *New Approaches to Corporate Law*, 50 WASH. & LEE. L. REV. 1713, 1715 (1993) (discussing the possibility that "the attempted closure within corporate law's modest boundaries truly is a quasi-solution generating socially unacceptable residue problems").

9. *See generally* COMPANY LAW AND SUSTAINABILITY: LEGAL BARRIERS AND OPPORTUNITIES (Beate Sjåfjell & Benjamin Richardson eds., Cambridge Univ. Press 2015).

10. *See, e.g.*, JEROEN VELDMAN, FILIP GREGOR & PAIGE MORROW, CORPORATE GOVERNANCE FOR A CHANGING WORLD: REPORT OF A GLOBAL ROUNDTABLE SERIES 6–8 (2016), http://www.purposeofcorporation.org/corporate-governance-for-a-

This Article traces the "bracketing" effect produced by reforms to UK corporate law, focusing on the reforms of 1948 and 2006, and the abortive reforms of the 1970s, all of which were based on detailed public reviews of the scope of company law. The analysis shows that shareholder primacy was not inherent in corporate law, and that UK legislators and policy-makers worked very hard to ensure that the shareholder interest prevailed over the interests of other constituencies.[11] It shows that one of the key effects of the changing scope of company law has been to transform CSR from an issue which, before 1948, fell almost entirely within the purview of management to one which is managerially-led, but over which shareholders and capital markets now have an effective veto. The 1948 reforms transformed corporate governance by giving the shareholders a right to remove any director by simple majority, regardless of any provisions in the company's constitution. Five years after this change, the hostile takeover burst onto the scene, sidelining the previously dominant notion that managers ought to balance competing interests and focusing their attention on meeting the financial demands of shareholders.[12] During the 1970s, pressures for industrial democracy, and employee board-level participation in particular, were successfully diffused in favor of a toothless duty for directors to consider the interests of employees.[13] In 2006, company law was reformed to remove any remaining ambiguity about the meaning of "the interests of the company," requiring the directors to promote the success of the company for the benefit of its members, the shareholders, but allowing them

---

changing-world_report.pdf (recommending that the content of fiduciary duties, which include "the long-term success of the company, the focus on long-term sustainable value creation, stakeholder interests, and systematic risk" should be clarified in the corporation's "governance documents, strategic objectives, and KPIs"). *But see* Lorraine Talbot, *Trying to Save the World with Company Law: Some Problems*, 36 LEGAL STUD. 513, 514–15 (2016) (describing a more skeptical view on whether corporate law can contribute to achieving these pressing social goals).

11. *See infra* note 149 and accompanying text (describing how § 172 of the Companies Act 2006 mandated that directors must prioritize shareholders' interests).

12. *See infra* Part II (detailing a director's objectives and goals before legislative reform in 1948).

13. *See infra* Part IV (discussing the Bullock Report and subsequent reforms).

to take account of a range of other interests as a means to this end.[14] Introduced at the height of belief in the great moderation and the self-regulatory capacity of markets, the 2006 reforms were expected to put the question of the scope of company law to rest for a generation or more.[15] However, the financial crisis of 2008, and more recently, the historic referendum vote for Britain to leave the European Union, has called into question these comfortable assumptions and focused attention on the social costs which result from corporate law's bracketing of wider interests. In a sign that the crisis has returned, two major consultations on corporate governance reform were launched in late 2016, the first "focusing on executive pay, directors' duties, and the composition of boardrooms, including worker representation and gender balance in executive positions,"[16] the second canvassing, among other things, different possibilities for the representation of stakeholder interests within corporate governance.[17] Post-Brexit, there is considerable debate about the scope of corporate law in the UK, and it is possible that significant legislative changes will be introduced in the near future. If this happens, these changes may make it more likely that companies act in a more socially responsible manner, taking greater responsibility for their impacts on society.

The Article is structured as follows: Part II discusses the legal position before 1948. Part III looks at the reform process from 1945–1948, and the emergence of the hostile takeover. Part IV considers the reforms of the late 1970s. Part V explores the

---

14. *See infra* notes 145–158 and accompanying text (addressing the consequences that the enactment of § 172 had on company law).

15. *See infra* Part IV (discussing how the reform only created more questions than it solved).

16. *Corporate Governance Inquiry Launch*, PARLIAMENT (Sept. 16, 2016), http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/news-parliament-2015/corporate-governance-inquiry-launch-16-17/ (last visited May 1, 2017) (on file with the Washington and Lee Law Review); *see also Corporate Governance Inquiry—Publications,* PARLIAMENT, http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/inquiries/parliament-2015/corporate-governance-inquiry/publications/ (last visited May 1, 2017) (tracking the responses to the consultation) (on file with the Washington and Lee Law Review).

17. *See generally* DEP'T FOR BUS., ENERGY, & INDUS. STRATEGY, CORPORATE GOVERNANCE REFORM, GREEN PAPER 34–42 (Nov. 16).

2006 reforms. The conclusion reviews the current position and canvasses the prospect of imminent reforms to UK corporate law.

II. The Law Before 1948

Because of its origins in partnership law, UK company law was always understood to be shareholder-centric. The law required that directors' decisions be oriented towards the interests of the company, with one judge famously stating that, "[t]he law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company."[18] The notion of the "interests of the company" was generally interpreted by commentators as referring to the commercial interests of the shareholders rather than the interests of the separate legal entity,[19] although it was clear that the law allowed the directors to take account of and spend money on interests other than those of shareholders, provided this was "reasonably incidental to the carrying on of the business of the company."[20] Recently, a number of scholars have challenged the conventional understanding of this line of case law by arguing that the interests of the company were never defined by the courts and that these decisions turned on the narrow point that gratuitous payments were void for ultra vires because they

18. Hutton v. West Cork Ry. Co. [1883] 23 Ch. Div. 654, 673; *see also* Parke v. Daily News [1962] Ch. 927, 963 (ruling that a company could not pay gratuities to its employees once it had agreed to sell its business and enter liquidation).

19. *See, e.g.*, J. E. PARKINSON, CORPORATE POWERS AND RESPONSIBILITY: ISSUES IN THE THEORY OF COMPANY LAW 77 [1993] ("The correct position is thus that the corporate entity is a vehicle for benefiting the interests of a specified group or groups. These interests the law has traditionally defined as the interests of the shareholders."); *see also* L.S. Sealy, *Directors' "Wider" Responsibilities—Problems, Conceptual, Practical, and Procedural*, 13 MONASH U. L. REV. 164, 165 (1987) (noting that in the Victorian times the company was regarded as an association of members rather than a legal entity, meaning that the company was a "they" and not "it").

20. *Hutton*, 23 Ch. Div. at 671; *see also* Evans v Brunner, Mond & Co. Ltd. [1921] 1 Ch. 359 (finding that a donation to fund scientific education in universities was legal because the board deemed the donation "essential"); Hampson v. Price's Patent Candle Co. (1876) 45 L. J. Ch. 437 (finding that the directors' decision to pay a gratuitous bonus to the company's employees was legal).

were not reasonably incidental to the business objectives specified in the company's memorandum.[21] Marc Moore argues that the correct interpretation of these cases is that "corporate funds could legitimately be devoted to shareholders and/or employees as the directors reasonably deemed fit for the furtherance of the company's constitutionally specified line(s) of business, so long as the interests of *the business* as such were genuinely being promoted in some way."[22] This is an important reinterpretation of the case law because, as we will see next, it accords with the broad discretion accorded to company directors by the law before 1948.

One reason why the precise contours of managerial discretion, and, in particular, the distinction between considering stakeholders as a means to the end of shareholder gain and considering them as an end in themselves, were never explored by the courts is that, in the past, it was very difficult for shareholders to challenge managerial decisions. Provided that a decision was not *ultra vires*, the courts applied a protean business judgment rule, insisting only that decisions be taken by directors in good faith in what they consider—not what a court may consider—as in the interests of the company, which once again was undefined,[23] and applying a strong presumption that decisions were taken in good faith.[24] In addition, there were

---

21. *See, e.g.*, Marc T. Moore, *Shareholder Primacy, Labour and the Historic Ambivalence of UK Company Law* 19 (Univ. of Cambridge Legal Studies Research Paper Series, Working Paper No. 40/2016, 2016) (equating the court's decision to invalidate these payments with a court's decision to invalidate dividend payments when the company has no distributable profits); Jonathan Mukwiri, *Myth of Shareholder Primacy in English Law*, 24 EUR. BUS. L. REV. 217, 237–238 (2013) (arguing that the "corporate governance of English public companies is based on the entity principle").

22. Moore, *supra* note 21, at 18.

23. *See In re* Smith & Fawcett Ltd. [1942] Ch. 304 (concerning the directors' exercise of their power to refuse to register share transfers, rather than a challenge to a managerial decision).

24. *See* Gresham Life (1872) L.R. 8 Ch. App. 446. The author is not aware of any examples of cases in which a shareholder rebutted the presumption and successfully challenged a managerial decision on this basis. In *Tomkinson v. South-Eastern Ry. Co.* (1887) 35 Ch. Div. 675, a shareholder did successfully challenge a decision by a railway company to contribute to the establishment of the Imperial Institute in London on the grounds that this would "very probably greatly increase the traffic of this company." *Id.* However, the basis of the decision was that this was *ultra vires* because it "clearly would not be a proper

procedural restrictions on the availability of the derivative action, which made it difficult for a shareholder to bring an action for breach of duty against the directors.[25]

The combined effect of these legal doctrines and lacunae meant that there was little pressure on directors from litigation to manage companies exclusively with a view to producing shareholder value. There were, however, two commonly used constitutional mechanisms by which the directors were encouraged to serve the ultimate interests of the shareholders.

First, it was common to include a requirement that directors hold qualification shares, and there is no doubt that this brought the interests of shareholders into greater focus.[26]

Second, the shareholders could remove the directors in accordance with the company's articles, although by default this required a special resolution—75% of the votes cast in the general meeting—something that would normally be very difficult to achieve.[27] Company constitutions also commonly further

---

application of the moneys of a railway company." *Id.* The judge commented that to argue that "any expenditure which may indirectly conduce to the benefit of the company is *intra vires*, seems to me extravagant." *Id.*

25. *See, e.g.*, Foss v. Harbottle (1843) 2 Hare 461, 463 (finding that corporations should normally sue in their own name, but that an exception may be made in the interests of justice where there is 'injury to a corporation by some of its members, for which no adequate remedy remained'); Atwool v. Merryweather (1867) 5 Eq. 464, 467 (developing the possible exception by finding that "'it would not be competent for a majority of the shareholders against a minority' to sanction a fraudulent transaction").

26. *See* Gareth Campbell & John D. Turner, *Substitutes for Legal Protection: Corporate Governance and Dividends in Victorian Britain*, 64 ECON. HIST. REV. 571, 582 (2011) (noting that the majority of companies placed share qualifications upon their directors).

27. *See* PALMER, *supra* note 26, at 195–97 (noting that the default rule provided by Table A was that directors could only be removed by special resolution (Art 65 Table A 1862) or extraordinary resolution (Art 86 Table A 1906; Art 80 Table A 1929), both types of resolution requiring the support of seventy-five percent of those entitled to vote and actually voting in person or by proxy). A special resolution also required a second meeting to confirm the decision by simple majority until 1929. *See id.* at 193 (dispensing with the requirement of a second meeting for a special resolution). Shareholders in listed companies were not necessarily in a better position; even by 1945, the London Stock Exchange only required that all directors of listed companies could be removed by extraordinary resolution. Minutes of Evidence Before the Cohen Committee, Appendix X at 350; *see also* Lance Davis, Larry Neal & Eugene N. White, *How It All Began: The Rise of Listing Requirements on the London, Berlin, Paris, and New York Stock Exchanges*, 38 INT'L J. ACCT. 117, 135 (setting

weakened the accountability of directors to shareholders because of the default rule, going back to the Joint Stock Companies Act 1844, that boards were "staggered" with one third of the directors required to retire each year but available for re-election.[28] Shareholders who wanted to remove directors outside of this cycle had to muster support for an extraordinary resolution, which was difficult because the directors themselves tended to hold all the proxies for the general meeting.[29] Completing the picture of strong managerial discretion, coupled with peripheral and weak shareholders, was the courts' refusal to allow the shareholders to give instructions to the directors by simple majority.[30]

Hence, directors and managers had very broad discretion in law, and this discretion widened further from the beginning of the twentieth century as shareholders gradually became more dispersed, whilst directors increasingly delegated management to professional managers.[31] Some five years before Berle and Means' seminal analysis of the United States, Keynes remarked upon a "most interesting and unnoticed"[32] development in the largest companies, in "which the owners of the capital, i.e. its shareholders, are almost entirely dissociated from the management with the result that the direct personal interest of

out the early rules and regulations of the London Stock Exchange).

28. Companies Act 1862, tbl. A, arts. 58 & 60 (UK); Companies Act 1906, tbl. A, arts 78 & 80 (UK); Companies Act 1929, tbl. A, arts. 73 & 75 (UK).

29. Observation of Justice Cohen in minutes of evidence before the Cohen Committee, para. 7071. *Minutes of evidence taken before the Company Law Amendment Committee*, *17th September 1943–24th November 1944* (HMSO, 1943–1944).

30. *See, e.g.*, Automatic Self-Cleansing Filter Syndicate Co. v. Cuninghame (1906) 2 Ch. 34, § IV (noting that if certain powers are given to directors, then shareholders cannot interfere with "the exercise of those powers"); Gramophone & Typewriter Ltd. v. Stanley (1908) 2 K.B. 89, 105–106 ("The directors are not servants to obey directions given by the shareholders as individuals; . . . They are persons who may by the regulations be entrusted with the control of the business, and if so entrusted they can be dispossessed from that control only by the statutory majority which can alter the articles.").

31. *See* JOHN M. KEYNES, THE END OF LAISSEZ-FAIRE (1926) (noting that there comes a point in the company's existence during which directors "are entirely dissociated from the management" because the company grew too large, and at that point directors begin to look at outside professional help).

32. *Id.*

the latter in the making of great profit becomes quite secondary"[33] so that enterprises were becoming socialized.[34]

The emergence of professionalized management during the first half of the twentieth century had brought with it an ideology of control, which asserted that the function of management was to balance competing interests within the corporate enterprise. Beginning with technical discussions of the role of the manager in guiding production,[35] this ideology quickly developed into the doctrine of scientific management, perhaps most closely associated with Taylor,[36] and the ideology received the seal of approval of the British government in 1919, in large part because it promised to tame the conflict between labor and capital.[37] At the same time, the idea began to emerge that management was developing into a profession,[38] an impartial leadership group

---

33. *Id.*

34. *See id.* (noting that when this stage is reached, directors consider with more regard the reputation of the institution than they consider the maximization of profit for the shareholders).

35. *See* FRANCIS G. BURTON, THE COMMERCIAL MANAGEMENT OF ENGINEERING WORKS 20–25 (1899) (describing that the role of the manager cannot be defined because "he is an autocrat, controlling and directing everyone connected with the concern"); *see also* J. SLATER LEWIS, THE COMMERCIAL ORGANISATION OF FACTORIES 7–11 (1896) (detailing the qualifications and necessary responsibilities of a manager).

36. *See* FREDERICK W. TAYLOR, THE PRINCIPLES OF SCIENTIFIC MANAGEMENT 7–11 (1911) (arguing that the remedy for inefficiency, which affects society, lies in systematic management).

37. *See* Scientific Business Management, Reconstruction Problems 28, Ministry of Reconstruction (HMSO, London 1919) (emphasizing the human aspects of management noting "Taylor's cardinal principle of a mental revolution in employer and worker alike and of their mutuality of interest." Managers should "guide and stimulate them [the employees] towards a higher standard of intellectuality and efficiency in life" and "cultivate the personal interest of the workers.")

38. *See, e.g.*, SIDNEY WEBB, THE WORKS MANAGER TO-DAY: AN ADDRESS PREPARED FOR A SERIES OF PRIVATE GATHERINGS OF WORKS MANAGERS 4–5 (1918) ("In large establishments it demands the undivided attention, not only of one person but of a whole class; and we see evolved specialised and differentiated hierarchy . . . ."). Webb recognized that "the profession of the manager, under whatever designation, is destined, with the ever increasing complication of man's enterprises, to develop a steadily increasing technique and a more and more specialised vocational training of its own." *Id.* at 8. A similar current of thought was developing in the United States. *See* LOUIS D. BRANDEIS, BUSINESS—A PROFESSION 1–6 (1914) (defining an occupation as a profession where it requires intellectual training, "is pursued largely for others and not

which would produce "an actual and living organism in which each living unit is compelled, and is glad to be compelled, to offer his best,"[39] and a public service obligation.[40] Industrialists, such as Seebohm Rowntree, as well as early management theorists, saw managers as holding a balance between labor and capital in pursuit of public or social responsibility.[41] When Berle and Means concluded that the control of the great corporations might "develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community,"[42] they were reflecting the previous forty years of debate about the role of management in productive enterprise, debates that had occurred in parallel in the US and the UK. This conception of management became widely accepted,[43] and as late as 1955, Gower commented that "it has become almost an accepted dogma that management owed duties to 'the four parties to industry' (labor, capital, management, and the community)—a dogma which is repeated

---

merely for one's self" and in which "the amount of financial return is not the accepted measure of success").

39. JOHN LEE, MANAGEMENT: A STUDY OF INDUSTRIAL ORGANIZATION 16 (1921).

40. *See* R.H. TAWNEY, THE ACQUISITIVE SOCIETY 122–23 (1921) (using agriculture as an example to show that the small capital required for agriculture makes it possible for a group of workers to offer their services to the public "without the intervention of an employer"). For industry to be organized as a profession, "it should cease to be conducted by the agents of property-owners for the advantage of property-owners, and should be carried on, instead, for the service of the public" and "the responsibility for the maintenance of the service should rest upon the shoulders of those, from organizer and scientist to labourer, by whom, in effect, the work is conducted." *Id.* at 111. Similar debates were occurring in the United States during the first three decades of the twentieth century. *See, e.g.*, ALLEN KAUFMAN, LAWRENCE ZACHARIAS & MARVIN KARSON, MANAGERS VS. OWNERS: THE STRUGGLE FOR CORPORATE CONTROL IN AMERICAN DEMOCRACY 114–17 (1995); *see also* Mary O'Sullivan, CONTESTS FOR CORPORATE CONTROL 100–02 (2000) (describing the evolution of these debates in the United States).

41. *See* JOHN CHILD, BRITISH MANAGEMENT THOUGHT: A CRITICAL ANALYSIS 52–53 (1969) (arguing that a professional claim for management developed, which included the concept of impartiality in the "pursuit of a public or social responsibility").

42. ADOLF A. BERLE & GARDNER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 356 (1991).

43. *See* Paul Bircher, *Company Law Reform and the Board of Trade*, 18 ACCT. & BUS. RES. 107, 117 (2012) ("[T]he rapidly developing sense that industry is less a matter of the adventuring of private money for profit than the rendering of a public service to the commonwealth.").

indiscriminately in the speeches of right-wing company chairmen and left-wing politicians."[44]

These wider social responsibilities of management were never enshrined in UK corporate law, but were not clearly incompatible with it, and the outer limits of the law were never tested before the courts. While directors were under a duty to act *intra vires* and in good faith in the interests of the company, these elastic notions certainly accommodated any socially responsible decision-making that was capable of producing returns for the shareholders, and, as discussed above, may well have gone further.

III. The Company Law Reforms of 1948

This was the background against which, in 1943, a Committee on Company Law Amendment (known as the Cohen Committee after its chairman) was appointed to review the UK's system of company law.[45] The Cohen Committee was asked "to consider and report what major amendments are desirable in the Companies Act, 1929, and, in particular, to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest."[46] However, the Committee focused most of its attention on the protection of shareholders,[47] and there was no explicit consideration of how the law could provide further safeguards for the public interest. Its 1945 Report recommended many significant changes to company law, including modernizing accounting, prohibiting the use of hidden reserves (so making share prices more reliable), and introducing a new remedy for

---

44. L. C. B. Gower, *Corporate Control: The Battle for the Berkeley*, 68 HARV. L. REV. 1176, 1190 (1955).

45. *See* BD. OF TRADE, REPORT OF THE COMMITTEE ON COMPANY LAW AMENDMENT 7–8 (Cmd. 6659 1943), http://reports.mca.gov.in/Reports/17-Justice%20Cohen%20committee%20report%20of%20the%20committee%20on%20company%20law%20amendment,%201943.pdf (detailing general economic policy as it relates to company law).

46. *Id.* at 7.

47. *See id.* at 10–12 (noting that *ultra vires* protection has proven to be illusory for shareholders).

minority shareholders.[48] However, for our purposes, its most important innovation related to the relationship between shareholders and directors. The Cohen committee was influenced strongly by the emergent separation of ownership and control, and expressed concern that shareholder control had become illusory as "small shareholders who pay little attention to their investments so long as satisfactory dividends are forthcoming."[49] Key members of the Committee, such as the Chairman, Mr. Justice Cohen, and Professor Goodhart, simply assumed that shareholders ought to have more control over directors.[50] The Committee ultimately concluded that it was "desirable to give shareholders greater powers to remove directors with whom they are dissatisfied, than they have at present"[51] and proposed to introduce "a provision, overriding anything to the contrary in the articles of a company, that any director, whether under a service contract or not, should be removable by an ordinary resolution, without prejudice to any contractual right for compensation."[52]

This change generated little debate in Parliament or in the academic literature,[53] and the Labour Party, which was focused

---

48. *See id.* at 72.

> "We propose that the accounts of subsidiaries should be required as far as practicable to be consolidated with, and to be made up to the same date as, the accounts of the holding company, but that there should be excluded the accounts of subsidiaries which in the opinion of the directors of the holding company it would be impracticable or misleading to consolidate."

49. *Id.* at 9.

50. *See Minutes of Evidence Taken Before the Company Law Amendment Committee, 17th September 1943–24th November 1944* (HMSO, 1943–1944). For example, Cohen commented that "[t]he view upon which company law is based, I think, is that the shareholders elect the directors to conduct their business" (para. 7038) and asked "[i]s it not reasonable prima facie that the shareholders out of whose money the remuneration comes, should know what the directors are receiving?" (para. 9741). He also asked whether those upon whom the first loss falls should have greater control (para. 10205). Similarly, Goodhart observed that he considered "the question of shareholders' control" to be "really the most important point in company law," because "in theory the shareholders have complete control through electing the directors." (para. 9479).

51. REPORT OF THE COMMITTEE ON COMPANY LAW AMENDMENT, *supra* note 45, at 79.

52. *Id.* at 80.

53. *See, e.g.*, E. Merrick Dodd, *Report of the Committee on Company Law Amendment*, 58 HARV. L. REV. 1258–1265 (1945) (suggesting that one of the major flaws of American corporate law "is the failure to devise an effective

on its plans to nationalize swathes of British industry, barely engaged with the process of company law reform.[54] Yet, it is no exaggeration to state that the Companies Act 1948 ushered in the modern era of financialized shareholder primacy corporate governance. Before 1948, the hostile takeover was virtually unknown because there were significant obstacles to takeover bids that bypassed the board of directors and were addressed directly to the shareholders.[55] The bidder had to offer a very high price so that "the directors could not say that the bid was inadequate."[56] Shareholders, who had little reliable information about the company's financial position, tended to follow the recommendation of the directors as to whether to accept a bid from an outsider.[57] Most significantly, there was a fundamental asymmetry between incumbent directors who only had to control directly or through other supportive shareholders 25% of the shares in order to prevent a bid of which they did not approve and bidders who had to acquire 75% of the shares to take control of the general meeting and change the board.[58] As a result,

---

remedy for misconduct on the part of those in control of a corporation"); O. Kahn-Freund, *Company Law Reform: A Review of the Report of the Committee on Company Law Amendment*, 9 MOD. L. REV. 235, 238 (1946) ("The Committee did not embark upon an investigation of the corporate entity principle as such and of its implications.").

54. *See* Ben Clift, Andrew Gamble & Michael Harris, *The Labour Party and the Company*, *in* THE POLITICAL ECONOMY OF THE COMPANY 51, 63–64 (John E. Parkinson et al. ed., 2000).

55. *See* James B. Tabb, Accountancy Aspects of the Takeover Bids in Britain 1945–1965 2 (Jan. 1, 1968) (unpublished Ph.D. thesis, University of Sheffield) (citing the technique used by George Hudson, nineteenth century railway owner, who would select "a railway company with declining profits, purchase shares or stock in the company and attend a general meeting where he would expound a scheme to increase the company's profits if the shareholders would replace the existing board") (on file with the Washington and Lee Law Review).

56. *Id.* at 11.

57. *See id.* at 1 ("Directors not wishing their companies to be taken over have developed a variety of defensive measures . . . steps taken before a bid has been made for the company and ad hoc measures to stave off an actual offer.").

58. *See* PALMER, *supra* note 26, at 195–197 (noting that the default rule provided by Table A was that directors could only be removed by special resolution (Art 65 Table A 1862) or extraordinary resolution (Art 86 Table A 1906; Art 80 Table A 1929), both types of resolution requiring the support of seventy-five percent of those entitled to vote and actually voting in person or by proxy).

consensual mergers were the norm, and hostile takeovers were virtually unheard of. Where they did occur, they were motivated by an industrial, and generally anticompetitive, logic.[59]

However, from the early 1950s, shortly after the implementation of the Cohen Committee's reforms in the form of § 184 Companies Act 1948, a wave of hostile takeovers struck British companies.[60] Indeed, between 1948 and 1961, 25% of companies quoted on the London Stock Exchange were taken over by other quoted companies.[61] By leveling the playing field between incumbents and outsiders, the 1948 changes completely changed the dynamics of takeovers by making it much more difficult for company directors to resist takeovers and opening up a wide range of companies to hostile takeover for the first time. The threat of hostile takeover changed managerial practices very quickly. Whilst some companies took defensive measures,[62] others tried to persuade their shareholders not to sell their shares by increasing the dividend, [63] or by taking actions similar to that of a bidder, such as selling off the company's freeholds to an insurance company and leasing them back.[64]

Although Hannah has emphasized the importance of the accounting regime in allowing bidders to identify suitable targets,[65] the argument above suggests that § 184 played a key role in allowing the hostile takeover to become an established

---

59. *See* Tabb, *supra* note 55, at 12 (noting that a rare hostile takeover occurred in 1920, when Lever, who had failed to persuade his competitors to form a cartel with him, made an offer so generous that the board of John Knight Ltd. felt compelled to recommend that their shareholders accept).

60. *See* GEORGE BULL & ANTHONY VICE, BID FOR POWER 29–32 (1961) (describing how Charles Clore launched the first hostile takeover bids in 1953 for the Savoy Hotel and Sears).

61. Les Hannah, *Takeover Bids in Britain Before 1950: An Exercise in Business 'Pre-History'*, 16 BUS. HIST. 65, 67 (2006).

62. *See* BULL & VICE, *supra* note 60, at 35–38 (explaining how the directors of Savoy Hotel Ltd. sought to frustrate Clore's bid by preventing him from changing the use of the Berkeley Hotel).

63. *See id.* at 21 (showing that there was a small but significant increase in the percentage and quantity of payments of profits to shareholders between 1953 and 1956).

64. *See* Tabb, *supra* note 55, at 62 (describing the case of Waterlow & Sons Ltd. in 1962 that sold off its head office and distributed the proceeds to shareholders in order to head off an unwelcome takeover).

65. *See generally* Hannah, *supra* note 61.

practice. Whilst there was significant opposition at first, its legitimacy was no longer questioned by policy-makers after the mid-1950s.[66] It gradually gained approval, first from commentators,[67] then from the City of London and the Bank of England.[68] In 1962, the Jenkins Committee,[69] which conducted another of the UK's periodic reviews of company law, also gave broad approval to takeovers as "an essential feature of economic growth and development" and a "convenient method of amalgamation."[70] A minority of that Committee, led by Gower—the leading company law professor at the time—added the further gloss that takeovers were a spur to managerial efficiency.[71] By 1963, the efficiency-enhancing effects of takeovers were beginning to be theorized by economists[72] and, in 1965,

66. *See* David Chambers, *The City and the Corporate Economy Since 1970*, *in* 2 THE CAMBRIDGE ECONOMIC HISTORY OF MODERN BRITAIN 255, 267 (Floud et al. ed., 2014) (noting both how the government and the Bank of England initially expressed opposition to hostile takeovers and how companies struggled to obtain finances to expand; therefore, the takeover technique was slow to spread).

67. *See* Tabb, *supra* note 55, at 256 (citing an argument by *The Economist* that directors using the company's resources for the best economic return were immune from takeover, and that bidders making better use of those resources would "generally be performing an economic service to the community"); *see also* Gower, *supra* note 44, at 1396 (describing the takeover mechanism as "useful"); *see also* BULL & VICE, *supra* note 60, at 26–27 (backing the argument that "the bidder makes the most efficient use of a company's assets," whilst "many boards in the past have tended to adopt excessively long-term schedules.").

68. *See* Richard Roberts, *Regulatory Responses to the Rise of the Market for Corporate Control in Britain in the 1950s*, 34 BUS. HIST. 183, 187–91 (2006) (UK) (describing that in 1953, the Bank of England had expressed opposition to the emerging hostile takeover, but by 1958 gave its approval).

69. REPORT OF THE COMPANY LAW COMMITTEE, 1962, Cmnd. 1749 (UK).

70. *Id.*

71. *See id.* at 209 (noting that "efficient directors who have treated their shareholders fairly and frankly should have little to fear from a raider" and they should not be allowed to protect themselves against this remote risk by issuing non-voting shares and "converting themselves into a self-perpetuating oligarchy").

72. *See* Robin Marris, *A Model of the "Managerial" Enterprise*, 77(2) Q.J. ECON. 185, 190 (1963) (UK) (recognizing that the takeover was an essential means by which management control over the firm's resources could be loosened and transferred to a more efficient controller).

Manne developed the notion of the market for corporate control in the United States.[73]

The Cohen Committee's changes greatly limited the scope for corporate social responsibility. Whilst managers still had considerable legal latitude to take account of, or balance, a range of social interests, they were in practice subject to considerable market pressure to prioritize returns to shareholders. The result was that social responsibility initiatives were only possible where they did not affect the market price of the company's shares, opening the company to the threat of hostile takeover. Whilst managers were much less vocal about their social responsibilities after the effects of the 1948 changes became clear, we will see in the next section that social expectations regarding corporate responsibility did not go away; they simply changed form.

IV. 1970s Industrial Democracy Reforms

This Part traces how political pressure for industrial democracy during the 1970s ultimately resulted only in a toothless duty requiring directors to consider the interests of employees. Wedderburn notes that the British debate about corporate social responsibility "became in the 1970s a debate mainly about 'industrial democracy.'"[74] However, industrial democracy was "a banner carried not only by varied but often opposed groups,"[75] comprising a variety of different demands, ranging from greater trade union involvement in decisions,[76] to

---

73. *See* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965) ("A fundamental premise underlying the market for corporate control is the existence of a high positive correlation between corporate managerial efficiency and the market price of shares of that company.").

74. Lord Wedderburn, *The Legal Development of Corporate Responsibility: For Whom will Corporate Managers be Trustees?*, *in* CORPORATE GOVERNANCE AND DIRECTORS' LIABILITIES 3, 32–33 (Klaus J. Hopt & Gunther Teubner eds., De Gruyter 1985).

75. Robert Kilroy-Silk, *Contemporary Theories of Industrial Democracy*, 41 POL. Q. 169, 180 (1970).

76. *See* Wedderburn, *supra* note 74, at 34–35. However, the Labour Party in 1967 insisted that industrial democracy should be achieved through a single channel of representation, that is, trade unions, with participation in a wider range of decisions based on information and recognition. *See generally* LABOUR

experiments with worker representatives on boards,[77] to legally mandated worker directors.[78]

Under the Conservative government of the early 1970s, the strong opposition to industrial democracy on the part of management and the financial sector found expression in the Confederation of British Industry's Watkinson Report.[79] The group had been asked to "examine factors which might be expected to assist the direction and control of public companies, examine the role, responsibilities and structure of boards of public companies" and "consider corporate behaviour towards interests other than those of the shareholders and providers of finance, including employees, creditors, customers and the community at large."[80] Given the UK's accession to the EEC in 1973, the report strongly opposed the proposed Fifth Company Law Directive, which threatened to mandate German-style co-determination for all large companies.[81] More importantly, it laid down a blueprint for both corporate governance and corporate social responsibility, which acted as a starting point for the Cadbury Committee,[82] and so has endured to the present day.

PARTY, REPORT OF THE LABOUR PARTY WORKING PARTY ON INDUSTRIAL DEMOCRACY (1967).

77. *See* DONOVAN, REPORT OF THE ROYAL COMMISSION ON TRADE UNION AND EMPLOYERS' ASSOCIATIONS, 1968, Cmnd. 3623, at para 1004 (UK) [hereinafter DONOVAN REPORT] (detailing the recommendations of a minority to the Donovan Report). The Labour Government stated in January 1969 that it favored experiments with appointment of worker representatives to boards and would hold consultations as to how they might be facilitated. *See* IN PLACE OF STRIFE: A POLICY FOR INDUSTRIAL RELATIONS, 1969, Cmnd. 3888, at para 49 (UK).

78. *See* DONOVAN REPORT, *supra* note 77, para 1005, (a minority of the Committee calling for legislation that requires at least two workers' directors to act as "guardians of the workers' interest at the stage when company policy is being formulated . . . and should in all other respects exercise the rights and responsibilities of non-executive directors of companies to which they are appointed").

79. *See generally* CONFEDERATION OF BRITISH INDUS., A NEW LOOK AT THE RESPONSIBILITIES OF THE BRITISH PUBLIC COMPANY: AN INTERIM REPORT FOR DISCUSSION (1973) [hereinafter WATKINSON REPORT].

80. *Id.* at 1.

81. *See id.* at 3 (proposing instead a two-tier board of directors). In large part as a result of British opposition, the Fifth Company Law Directive was never introduced.

82. *See Minutes of the Second Meeting of the CBI Steering Group on Long-Termism and Corporate Governance,* CBI, http://cadbury.cjbs.archios.info/_media/files/CAD-01077.pdf (recording that Sir Adrian Cadbury stated that

It started from the (legally incorrect) premise that "companies are legally owned by their shareholders" and so "the paramount interest of the company must continue to be to serve the long term interests of the shareholders."[83] It recommended including non-executive directors on corporate boards as a means of bringing an outside perspective to the company and of reassuring shareholders and called for action be taken to encourage this.[84] However, out of enlightened self-interest and to ensure corporate integrity, directors should consider all relevant interests, including shareholders, employees, customers, creditors and the public,[85] and should give more publicity to the fact that "they spend time and money on the public interest in ways not required by law and not offering early financial benefit."[86] These recommendations were reflected in a 1973 White Paper, which also recognized that company directors should "on behalf of the shareholders . . . discharge their social responsibilities" and therefore "have a manifest obligation towards all those with whom they have dealings—and none more so than the employees of the company."[87] Whilst a Green Paper was promised to address

the Watkinson Report was "a useful starting point for his own study," and that he asked the CBI Steering Group to suggest "a working definition of the term 'corporate governance'").

83. WATKINSON REPORT, *supra* note 79, at 5.

84. *See id.* at 13 (stating that the arguments in favor of including non-executive directors onto boards should be given wider publicity). This paralleled the SEC's drive for more non-executives during the early 1970s. In the UK, a number of private member's bills sought, between 1971 and 1976, to introduce this as a legal requirement. For example: "A bill to require certain companies to appoint non-executive directors; to require such directors jointly to present independent annual reports to the shareholders; and for purposes connected therewith." 20th Century House of Commons Sessional Papers, 197–1972, Vol. I, at 385. Rhys Williams repeatedly sought to reintroduce his bill in the years that followed. *See, e.g.*, 26 March 1975, Parl Deb HC vol. 889 (UK) at 509.

85. *See id.* at 6 (defining "enlightened self interest" as a balance between the company's interests and that of others "in a way that a man of integrity and good will would do in the conduct of his own private business"); *see also id.* at 16–17 (noting that each member of a board must consider interests such as those "of shareholders, of all employees, of customers, of creditors and the public").

86. *Id.* at 24.

87. DEPARTMENT OF TRADE AND INDUSTRY, COMPANY LAW REFORM, 1973, Cmnd. 5391, at 5 (UK).

the question of employee participation, it appears that this was never published.

With the re-election of a Labour Government in 1975, the pendulum apparently swung away from voluntary CSR and back towards employee representation, as the Bullock Committee was appointed with the mandate to consider how a "radical extension of industrial democracy into the control of companies by means of representation on boards of directors" could best be achieved.[88] It ultimately recommended a 2x+y formulation, with shareholders and employees each appointing x directors, and the two groups jointly appointing y expert, co-opted directors.[89] This would allow for deadlocks to be broken, but more importantly, the co-opted directors would bring the benefits of NEDs, in terms of external perspective, to the codetermined board.[90] It recommended that codetermination should take place on a unitary board, provided that a sufficient majority of employees voted for it.[91] A dissenting minority preferred to recommend a two-tier system, with the supervisory board consisting of one third each of employee representatives, shareholder representatives, and independent members.[92]

Alongside this recommendation, the Report also suggested that "all directors should continue to be required to act in the best interests of the company, but that in doing so they should take into account the interests of the company's employees as well as

---

88. DEPARTMENT OF TRADE, REPORT OF THE COMMITTEE OF INQUIRY ON INDUSTRIAL DEMOCRACY, 1977, Cmnd. 6706 (UK) [hereinafter BULLOCK REPORT]. *See* James Moher & Alastair Reid, *Democracy in the Workplace—The Bullock Report Revisited,* HIST. & POL'Y (June 9, 2010), http://www.historyandpolicy.org/trade-union-forum/meeting/democracy-in-the-workplace-the-bullock-report-revisited (last visited May 1, 2017) (discussing the historical background leading up to the Bullock Committee) (on file with the Washington and Lee Law Review).

89. *See id.* (balancing the ideologies of the trade unions and the shareholders).

90. *See* BULLOCK REPORT, *supra* note 88, at 97, 98 (discussing the advantages of the Committee's recommendations in terms of avoiding shareholder factions and deadlock).

91. *See id.* at 161 ("[W]e believe that all employees should be involved in a ballot and that if a sufficient majority is obtained, then the process of reconstituting the board should take place.").

92. *See id.* at 178 (detailing the Dissent's proposed composition of the Supervisory Board).

its shareholders."[93] This reform was considered "long overdue, whether or not employee representatives are put on boards."[94] This proposed change reflected the Committee's understanding that the role of company directors was one of "balancing a number of interests."[95] This would not change when employees were represented on boards, and directors would still be required "to weigh up the differing and conflicting interests in the company in order to reach decisions which they genuinely believe to be in the company's overall best interest."[96]

The UK Labour Government responded to Bullock in a 1978 White Paper emphasizing the importance of giving employees "a share in the decisions within their company or firm, and therefore a share in the responsibility for making it a success" because this would replace "defensive co-existence" with a "positive partnership between management and workers."[97] It proposed to make a two-tier board an option, with employee and shareholder representatives on the "policy board" setting pay, monitoring performance, supervising the financial affairs and so on, whilst day-to-day management would be carried out by the management board.[98] The precise scope of employee participation was to be determined through negotiations, with a statutory right to board level representation in companies employing more than 2,000 employees where no agreement was reached after a number of years.[99] As for the composition of the board, it suggested that, in light of ongoing disagreements, "[a] reasonable first step would

---

93. *Id.* at 84.

94. *Id.* at 62. Similar proposals had been made in the abortive Companies Bills of 1973 (permissive) and 1976 and in the Industrial Democracy Bill 1975, which would have required directors to consider employee interests, as well as employee representation on boards. Whilst this bill had strong support, it was aborted when the government announced its intention to introduce legislation on industrial democracy in 1976–77. *See* Ben Clift, Andrew Gamble & Michael Harris, *The Labour Party and the Company*, *in* THE POLITICAL ECONOMY OF THE COMPANY 51, 75 (John Parkinson, Andrew Gamble & Gavin Kelly eds., 2000) (providing the political history of various Companies Bills).

95. BULLOCK REPORT, *supra* note 88, at 85.

96. *Id.*

97. INDUSTRIAL DEMOCRACY, 1978, Cmnd. 7231, ¶ 1 (UK).

98. *See id.* ¶ 24 (outlining the proposed two-tiered board structure).

99. *See id.* ¶¶ 26–27 (proposing a structure of employee board participation and a three to four-year timeframe in which these decisions should be made).

be to give employees the right to appoint up to one third of the members of the policy board in the proposed two tier system."[100]

These proposals fell off the agenda during the Winter of Discontent of 1978–79, and the Labour Government was replaced by a Conservative one in 1979.[101] However, the proposal to require directors to consider employee interests remained live. The proposal had been included in a proposed statutory statement of directors' duties,[102] and in the Companies Bill 1978, which envisaged the provision operating as a safe harbor for company directors in proceedings for breach of duty, although it never became law.[103] Despite the change of government, the provision was introduced as Section 46(1) of the Companies Act 1980, which ultimately became Section 309(1) of Companies Act 1985. It stated that:

---

100. *Id.* ¶ 32. This essentially adopted the position taken by the minority in the Bullock Report, and was driven by rifts within the Labour Party as to the effect of industrial democracy on business confidence. *See* Jim Phillips, Tran*sactions, Interaction and Inaction: Industrial Democracy in the UK in the 1970s*, 18 EUR. BUS. HIST. ASS'N CONF., FRANKFURT, GER. (2008), http://www.ebha.org/ebha2008/papers/Phillips_ebha_2008.pdf ("Bullock's remnants were duly lost amid the political, economic and industrial turbulence of the 1978–9 'Winter of Discontent' . . . .").

101. *See* Phillips, *supra* note 100, at 18–19 ("[T]he political discrediting of the Labour government and its defeat to Margaret Thatcher's Conservative party in the 1979 General Election, can be traced directly to the abandonment of the industrial democracy agenda . . . .").

102. *See* DEPARTMENT OF TRADE, THE CONDUCT OF COMPANY DIRECTORS, 1977, Cmnd. 7037, ¶ 5 (UK) ("The statutory definition of the duty of directors will require directors to take into account the interests of employees as well as of shareholders.").

103. *See* Companies Bill 1978, HL Bill [2 47/5] cl. 46(2) (Gr. Brit)

> Where in any proceedings it falls to a court to determine whether a director of a company is in breach of his duty to have regard, in the performance of his functions, to the interests of the company's members, the court shall take into account the fact that the director is also required to comply with the duty imposed by this section.

As Lord Mishcon explained in the House of Lords:

> The section was "deemed to be a shield for the directors and not a spear. In other words . . . if a director is criticised, indeed is attacked in the courts, for not having fulfilled duties to the members of the company solely in their interests because he has taken into account the interests of employees, which may slightly or substantially derogate in a certain case from the interests of the members, it shall be taken into account that the director had this statutory duty.

407 Parl Deb HL (5th ser.) (1980) cols. 1017–27, at 1021–22 (UK).

> The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members.[104]

However, the provision was weakened with the omission of the safe harbor provision, leaving only a duty owed to, and enforceable by, the company.[105] The Government explained that it was concerned not to "open up an easy route for frivolous or obstructive actions in the courts," and that it viewed the section as declaratory of existing best practice.[106] Sealy later commented that the section was introduced "perhaps in an attempt to appease the pressure for more comprehensive reform."[107]

Section 309 did not have much impact on the wider landscape of corporate law. Whilst it broadened the definition of the "interests of the company," giving the directors greater protection against shareholder claims of unfair prejudice or unlawful financial assistance,[108] no director ever faced liability for failing to consider the interests of employees. Various reasons may be suggested for this.

Since the duty was owed to the company, employees faced enforcement problems.[109] In addition, there were doubts about

---

104. Companies Act 1985, c. 6, § 309(1) (repealed 2007) (UK).

105. *See id.* § 309(2) (providing that "the duty imposed by this section on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors").

106. 972 Parl Deb HC (5th ser.) (1979) cols. 52–160, at 62 (UK). Cecil Parkinson stated that the section would "confirm the care with which responsible boards already consider the interests of their employees and act as an encouragement for others to do the same." *Id.*

107. L. S. Sealy, *Directors' "Wider" Responsibilities—Problems Conceptual, Practical and Procedural*, 13 MONASH U. L. REV. 164, 171 (1987).

108. The courts recognized that the directors' duty to act in the "interests of the company" had been broadened by Section 309 so that "the company is more than just the sum total of its members." Fulham Football Club Ltd. v. Cabra Estates plc [1992] 1 BCLC 363, 379 (Gr. Brit.); *see also* Brady v. Brady [1989] AC 755, 778 (UK) (describing the term "purpose" as capable of "several different meanings" in the Companies Act 1985 (UK)). In *In re Saul D Harrison & Sons plc* [1994] BCC 475, 483 (UK), the Court of Appeal held that the directors of a struggling company were lawfully entitled, among other things, to take account of the benefits to employees of the business continuing alongside the interest of the shareholders in the company becoming profitable.

109. The difficulties of enforcement were quickly recognized by

whether a remedy could realistically be ordered,[110] and Villiers suggests that the obligation was merely procedural, requiring the directors to consider employee interests, but allowing them to disregard them where they were "not compatible with the company's or shareholders' interests."[111] Finally, as we saw above, the courts had long taken an approach akin to that embodied in the business judgment rule and rarely called into question the substance of corporate decision-making.[112]

Beyond these important considerations, it is submitted that the main reason that Section 309 did not produce any meaningful effect on the way companies are governed was that it did not operate in the hostile takeover context. Unlike the corporate constituency statutes introduced at state level in the late 1980s,

---

commentators. Prentice thought that employees would have to enforce the duty by becoming shareholders. *See* D. D. Prentice, *A Company and Its Employees; The Companies Act 1980*, 10 INDUS. L.J. 1, 4–5 (1981) (discussing shareholder power over directors compared to employees). Even if they became shareholders, they would have to contend with the complexities of the judge-made rules regulating the derivative action (i.e., it would be unlikely that the majority of independent shareholders would support an action against the directors or that the wrong would be unratifiable). *See* Prudential Assurance Co. v. Newman Industries (No. 2) [1982] Ch. 204, 222–23 (describing challenges individual shareholders face when bringing suits against directors); Smith v. Croft (No. 2) [1988] Ch. 114, 120 (discussing the difficulty in forming consensus between various groups of shareholders with divergent interests). For further discussion of this point, see Charlotte Villiers, *Section 309 of the Companies Act 1985: Is it Time for a Reappraisal?*, *in* LEGAL REGULATION OF THE EMPLOYMENT RELATION 593, 596–97 (Hugh Collins, Paul Davies & Roger Rideout eds., Kluwer Law Int'l. 2000).

110. Sealy recognized that this was a duty without a corresponding remedy, so that the section was "empty." *See* Sealy, *supra* note 107, at 177 (asking what a court could "be asked to do for them, supposing that it is established that insufficient regard has been had to their interests"). Prentice suggested that the only suitable remedy appeared to be the courts ordering the directors to reconsider their decision, something akin to an administrative law remedy. *See* Prentice, *supra* note 109, at 5 ("If the action is timeous, probably the only remedial option open to the courts will be an order that the directors reconsider their decision taking into consideration the employees' interests.").

111. Villiers, *supra* note 109, at 595–96.

112. *See supra* notes 23–24 and accompanying text (describing historical latitude applied to cases involving the business judgment rule). If the decision was taken in good faith (which was strongly presumed), and the directors could show that they had had "regard to" the interests of employees, this would certainly suffice to exonerate them from any claim for breach of duty to the company.

which Johnson and Millon viewed as aiming "to displace the standard but now inadequate narrative,"[113] both in the takeover context and beyond,[114] Section 309 had no effect in relation to hostile takeovers, as directors' ability to contest takeovers was always hamstrung. In addressing the legality of any defensive response to an unwelcome takeover, the common law focused on the purpose for which directors made decisions, and ruled unlawful issues of shares intended to interfere with the exercise of majority shareholder's rights in a takeover context.[115] Unlike Delaware, the common law never moved "toward a notion of directorial responsibility tethered to the welfare of the overall corporate enterprise."[116] In principle, the courts could have responded to the introduction of Section 309 by changing their approach to takeover regulation, allowing defensive measures intended to protect the interests of employees. However, the introduction of the City Code on Takeovers and Mergers in 1968 had already closed off the flow of takeover cases to the courts.[117] The City Code prohibited the directors from doing anything that might frustrate the offer or deny the shareholders the opportunity to decide on the takeover, a far wider prohibition

---

113. Lyman Johnson & David Millon, *Corporate Takeovers and Corporate Law: Who's in Control*, 61 GEO. WASH. L. REV. 1177, 1179 (1993).

114. *See* David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223, 240–48 (1991) (positing about the constituency statute's impact on conceptions of a director's duty); Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 35–47 (1992) (discussing the judicial application of the duty of care and the business judgment rule).

115. *See* Howard Smith Ltd. . Ampol Petroleum Ltd. (1974) AC 821, 838 (appeal taken from S.C.N.S.W.) (concluding that "it must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist"); Hogg v. Cramphorn Ltd. (1967) Ch. 254, 268 (noting the directors would not be permitted to use their power "to interfere with the exercise by the majority of its constitutional rights");.

116. Johnson & Millon, *supra* note 113, at 1198.

117. In an exceptional takeover case, which fell outside the scope of the City Code, the Scottish Court of Session ruled that the directors owed their duties to the company—which encompassed present and future shareholders, as well as employees—and not merely to the current shareholders. *See* Dawson Int'l plc v. Coats Patons plc (1988) 4 BCC 305, 313 ("[T]here appears to be no reason why 'members' should hot [*sic*] be capable of applying to future as well as to present members of the company.").

than that developed at common law.[118] Hence, even if widening the definition of the interests of the company in Section 309 theoretically may have given directors greater discretion in law to defend against hostile takeovers,[119] this was truncated in practice by the City Code, which drew its force not from law, but from the City of London's self-regulatory capacity, with those who violated its provisions denied access to financial services in the future.[120]

Accordingly, Section 309 remained, at best, as a source of legitimation of any stakeholder management practices which had survived the rise of the hostile takeover,[121] and, at worst, a mere "window-dressing."[122] For Sealy, it was "either one of the most incompetent or one of the most cynical pieces of drafting on record."[123] The section proclaimed that UK corporate law had a wider scope, but, as a permissive provision, was effectively redundant in practice because the forces of the wider corporate governance system created ever greater pressure to prioritize the short-term interests of shareholders.

Following this change, the early 1980s saw a recession and political pressure for industrial democracy abated,[124] whilst trade

---

118. For further discussion of the way in which the City Code superseded the common law, see generally Andrew Johnston, *Takeover Regulation: Historical and Theoretical Perspectives on the City Code*, 66 CAMBRIDGE L.J. 422 (2007) (theorizing about the origins and purpose behind the advent of the City Codes, specifically the prohibition on defensive measures).

119. For a discussion of the approach the courts might have taken where directors sought to defend a defensive issue of shares on the basis that this was in the interests of the employees, see Prentice, *supra* note 109, at 3–4 (arguing that directors may be able to "fend off a take-over claiming that that they were acting out of consideration for the welfare of the company's employees").

120. *See* Johnston, *supra* note 118, at 443 (detailing the current prohibition on defensive measures in the London City Code).

121. For discussion of this in the context of US corporate constituency statutes, see Orts, *supra* note 114, at 44 (providing support for the influence of corporate constituency statutes in legitimating business decisions).

122. John Birds, *Making Directors Do Their Duties*, 1 COMPANY LAW. 67, 73 (1980).

123. Sealy, *supra* note 107, at 177.

124. Wedderburn, *supra* note 74, at 40 ("[T]he savage onslaught of the recession stifled—whether temporarily or not we cannot know—the debate about 'industrial democracy'."); *see also* Lord Wedderburn, *Trust, Corporation and the Worker*, 23 OSGOODE HALL L.J. 203, 249 (1985) ("When an economy, like the British, is turned geriatric . . . the maximisation of profit leaves little space for social experiment.").

unions were progressively weakened under the Thatcher government. It was during this period that companies began to embrace CSR in earnest,[125] but the scope of company law remained undisturbed until the Company Law Review process which took place over a number of years at the beginning of the twenty-first century.

V. The 2006 Reforms

The review process that led to the 2006 reforms was led by a Company Law Review Steering Group (CLRSG). The review was unique in the long history of UK company law reviews in that it began by consulting the public on the "scope" of company law, and explicitly setting out its guiding assumptions about the purpose of companies. Whilst CSR was not discussed, the "enlightened shareholder value" (ESV) approach adopted by the CLRSG implicitly assumes that corporations will be pushed by reputational considerations to behave in a socially responsible manner.[126] The 2006 reforms were introduced at the high point of political belief in the capacity of markets to self-regulate and to steer business towards the public good, with the "great moderation" coming to an abrupt end shortly afterwards with the onset of the global financial crisis.

The CLRSG began from the position that, under the existing law, "[c]ompanies are formed and managed for the benefit of shareholders," subject to safeguards for creditors, and with "public disclosure of information" operating "for the benefit of the community as a whole."[127] Easterbrook and Fischel were cited as providing the main economic justification for shareholders' ultimate control of the undertaking in the form of shareholders

---

125. *See* Daniel Kinderman, *'Free Us up so We Can Be Responsible!' The Co-Evolution of Corporate Social Responsibility and Neo-Liberalism in the UK, 1977–2010*, 10 SOCIO-ECONOMIC REV. 29, 29 (2012) ("As power shifted away from unions and to employers, some prominent businessmen committed themselves to Corporate Social Responsibility (CSR).").

126. *See* COMPANY L. REV. STEERING GRP., MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: THE STRATEGIC FRAMEWORK §§ 5.1.12, 17–23 (1999) [hereinafter CLRSG, THE STRATEGIC FRAMEWORK] (outlining the enlightened shareholder value approach).

127. *Id.* § 5.1.4.

having "greatest exposure to residual risk as a result of mismanagement . . . and are therefore best qualified to ensure proper stewardship."[128]

The CLRSG contrasted ESV with two alternatives: (1) an "exclusive focus on the short-term bottom line"; and (2) pluralism, under which company law would require companies "to serve a wider range of interests, not subordinate to, or as a means of achieving, shareholder value . . . but as valid in their own right."[129] Whilst the review rehearsed arguments akin to those of team production theory,[130] and in particular the issue of firm-specific investments,[131] it, like Blair and Stout, concluded that company law could facilitate these developments without radical change. ESV would "provide an adequate environment for the development of such relationships,"[132] whilst the normal bargaining process is not "incapable of generating appropriate safeguards."[133] Furthermore, any "deficiencies in this area . . . are best made good by changes in other areas of the law and public policy."[134] Pluralism, in contrast, would threaten to undermine accountability and "dangerously distract management into a political balancing style at the expense of economic growth and international competitiveness."[135] After public consultation, pluralism was ultimately rejected on the basis that a "very substantial majority of responses (in number and in weight) favored retaining the basic rule that directors should operate companies for the benefit of members (ie normally shareholders),"

---

128. *Id.* at 34 n.23.

129. *Id.* §§ 5.1.12–13.

130. *See generally* Margaret M. Blair & Lynn A. Stout, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743 (1999) (reviewing team production theory).

131. CLRSG, THE STRATEGIC FRAMEWORK, *supra* note 126, § 5.1.24 ("The pluralist view asserts that present law . . . fails to cater for these considerations, because such firm-specific investments are best regarded as assets of the company . . . distinct from its members.").

132. *Id.* § 5.1.25.

133. *Id.* § 5.1.26.

134. *Id.* § 5.1.27. For a thorough critique of this argument, and the assumption that "corporate law . . . is a residuary or 'default' intellectual field, taking up only (and all of) what is not dealt with elsewhere," see Johnson, *supra* note 8, at 1718.

135. CLRSG, THE STRATEGIC FRAMEWORK, *supra* note 126, § 5.1.28.

although "there was also very strong support for the view that this needed to be framed in an 'inclusive' way."[136] Similarly, a "substantial majority" accepted the arguments against pluralism and opposed empowering directors to "set interests of others above those of shareholders."[137]

Having decided to implement ESV, the CLRSG recommended a number of changes, including: (1) "an obligation on directors to achieve the success of the company for the benefit of shareholders by taking proper account of all the relevant considerations for that purpose"[138] (an "inclusive" duty which ultimately became Section 172 CA 2006); (2) an obligation for large companies to produce an Operating and Financial Review, which would provide qualitative and "forward looking" information to the markets, enabling them to assess the strategies adopted by the company and the prospect of them being achieved;[139] and (3) flexibility to allow companies to define scope and purposes and, therefore, the objectives of shareholders.[140] The group hinted that reputation would bridge the gap between ESV and pluralism,[141] claiming that the "overall objective should be pluralist in the sense that companies should be run in a way which maximizes overall competitiveness and wealth and welfare for all," but without "turning company directors from business decision makers into moral, political or economic arbiters."[142] So in the end, there was no significant change to company law. This was unsurprising because, as Wedderburn noted in 1985, the argument that taking account of a wider range of interests would produce long-term

136. COMPANY L. REV. STEERING GRP., MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: DEVELOPING THE FRAMEWORK § 2.11 (2000) [hereinafter CLRSG, DEVELOPING THE FRAMEWORK].

137. *Id.* § 2.12.

138. *Id.* § 2.19.

139. *See id.* §§ 5.77–79 (discussing recommendations for the provision of qualitative information by big companies to better inform markets).

140. *See id.* § 2.19 (providing that while directors would be under a duty to obey the constitution, a wide statement of purpose would still not allow the directors to prefer the interests of other constituencies over those of shareholders).

141. *See id.* at 14 n.8 (citing the Chairman and CEO of Shell UK Ltd's prediction that reputation could be the "missing link" between ESV and pluralism).

142. *Id.* § 2.21.

shareholder value was "the customary British route to a gentlemanly silence on the problem."[143]

The effect of Section 172 is to require that decisions are motivated by the directors' honest beliefs that they will benefit the shareholders,[144] whilst the directors should "have regard" to those other interests and considerations (whether listed or not) which will produce the best result for the shareholders. Section 172, for the first time, enshrined shareholder primacy explicitly in law.[145] Prior to the 2006 Act, as noted above, many commentators understood the "interests of the company" to refer to the interests of the shareholders collectively.[146] For them, Section 172 was simply a codification of the existing law. So, for example, Keay concludes that the section is not fit for its purpose—to ensure that directors run companies for long-term prosperity rather than just for short term gains—since it merely reflects, and does no more, than the previous law.[147] However, if,

143. Wedderburn, *supra* note 74, at 11.

144. The CLR rejected omitting a reference to the interests of "members" in Section 172 because "it would allow directors a discretionary power to set any interest above that of shareholders whenever their view of what constitutes 'the company's success' required it." CLRSG, DEVELOPING THE FRAMEWORK, *supra* note 136, § 3.52; *see also* Andrew Keay, *Moving Toward Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado About Little?*, 22 EUR. BUS. L. REV. 1, 31 (2011) ("With directors having greater discretion . . . directors might resist claims of breach of duty on the basis that what they did was based on a consideration of the interests of one or more constituencies that are mentioned in section 172.").

145. *See* Talbot, *supra* note 10, at 515 (asserting that section 172 provides a "bald shareholder primacy norm"). Andrew Haldane of the Bank of England comments that "for the first time in history, shareholder primacy had been hard-wired into companies' statutory purposes." *See generally* Andrew Haldane, Chief Economist, Bank of Eng., Who Owns a Company?, Speech at the University of Edinburgh Corporate Finance Conference 9 (May 22, 2015), http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech833.pdf.

146. *See supra* note 127 and accompanying text (discussing previous notions of company duty).

147. *See* Andrew Keay, *The Duty to Promote the Success of the Company: Is It Fit for Purpose?* 13 (Univ. of Leeds Sch. of Law, Ctr. for Bus. Law & Practice, Working Paper, 2010), https://papers.ssrn.com/sol3/papers.cfm?abstract-id=1662411 ("If all [Section] 172 does is to reflect the previous duty it is not fit for purpose as the Government had expectations that the section would achieve more than the previous duty did.").

as suggested above, the "interests of the company" was never clearly defined in the context of directors' duties,[148] then this was a more significant change because the law became narrower and stricter. Although Section 172 does provide directors with guidance as to how to run the company in a way that is likely to produce returns for shareholders in the longer term,[149] they now have a clear and unequivocal, legally-binding mandate that shareholder interests must take priority.[150]

However, the importance of this change should not be overstated for two reasons. First, the change is probably more important on a rhetorical and ideological level than in terms of enforcement. In principle, a decision which benefits one or more stakeholder groups at the expense of the shareholders could be challenged in court by one or more shareholders via a derivative action, although this would be unlikely to succeed, both because of the long standing implicit business judgment rule protecting good faith decisions (in other words the directors could argue that favoring the stakeholder group was simply an aspect of a longer term strategy intended to produce benefits for the shareholders), and because it would be very difficult for a complaining shareholder to prove loss to the company for which the director is responsible (the courts recognize that directors are hired to take business risks in order to produce returns for the shareholders).

Second, like the original common law and Section 309 before it, Section 172 will do little—if anything—to insulate directors against the pressures from the wider corporate governance system, or to steer them towards longer-term decision-making.[151]

---

148. *See supra* notes 18–21 and accompanying text (describing the historic ambiguity of the term "interests of the company").

149. *See* Companies Act 2006, c. 46, § 172(1)(a)–(f) (UK) (listing considerations directors should make when promoting the success of their companies).

150. *See id.* § 172(1) ("A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole . . . .").

151. This danger was exacerbated by the abandonment of the Operating and Financial Review, which was supposed to provide the markets with better information in order to give directors the scope to take a long-term view, and its replacement with a watered down Business Review and then Strategic Report. *See generally* Andrew Johnston, *After the OFR: Will UK Shareholder Value Still*

Although both the 2006 reforms and the 2010 soft law Stewardship Code[152] are premised upon the assumption that shareholders will steer companies towards a long-term approach, there are signs that, at present, shareholder engagement is actually having the opposite effect. As Millon points out, the chase for yield since the financial crisis means that institutional shareholders, which conventionally assumed returns of around 8% in order to meet their liabilities, are increasing pressure on managers to maximize quarterly returns.[153] Dallas shows how financial firms may put pressure on corporate management to increase payouts to shareholders either by their trading activities, which put pressure on market prices, or by the "use, or threatened use, of their shareholder voting power."[154] To make matters worse, the institutional investors with the longest time frames—pension funds and insurance companies—have been divesting from equities in favor of alternative investments such as hedge funds and private equity, both of which take a more activist approach to scrutinizing management, but prioritize short term returns.[155] This creates a danger that the reforms since 2006 will actually result in greater short-termism and further reduce the willingness of corporations voluntarily to

---

Be Enlightened?, 7 EUR. BUS. ORG. L. REV. 817 (2006) (discussing the rationale for and abandonment of the Operating and Financial Review).

152. The Stewardship Code aims to encourage shareholders to engage with the companies in which they own shares "to promote the long term success of companies in such a way that the ultimate providers of capital also prosper." FIN. REPORTING COUNCIL, THE UK STEWARDSHIP CODE 1 (2010, rev. 2012).

153. *See* David Millon, *Shareholder Social Responsibility*, 36 SEATTLE U. L. REV. 911, 931 (2013) ("To meet their current obligations, public pension funds have historically assumed an annual rate of return of 8% . . . .").

154. *See* Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 264, 306–09 (2012) (detailing the use of nonfinancial firms as "arbitrage opportunities" via threats of the exercise of shareholder power).

155. *See OECD Business and Finance Outlook 2015*, ORG. FOR ECON. CO-OPERATION & DEV. 120–21 (2015), http://www.keepeek.com/Digital-Asset-Management/oecd/finance-and-investment/oecd-business-and-finance-outlook-2015_9789264234291-en#.WNMQa4QppPU (last visited May 1, 2017) (showing that UK institutional investors have, since 2008, been divesting equity holdings and investing in "other" assets such as private equity, derivatives and structured products in a "search for yield") (on file with the Washington and Lee Law Review).

embrace social responsibility and address the social costs their activities create.

Decisions that do not contribute to short-term shareholder value and that directors cannot justify in dialogue with shareholders either informally or in general meeting will be sanctioned by declining share prices, resulting in foregone bonuses and the threat of hostile takeover. We saw above that, both under the original common law and under Section 309, which broadened the notion of the "interests of the company," it was arguably permissible for directors to take decisions that benefitted employees over shareholders.[156] However, both the original common law and Section 309 were deprived of most of their utility in terms of reinforcing managerial discretion because markets asserted control over managers following the 1948 reforms.[157] Likewise, Section 172 is unlikely to have much effect in the context of a form of corporate governance that incentivizes and threatens corporate directors to prioritize the short-term financial interests of shareholders. For example, in the aftermath of the financial crisis, it is difficult to argue that Section 172 played any meaningful role in constraining short-termism on the part of directors, or limiting the possible impacts on third parties. Shareholders pushed for more risk-taking on the part of banks, and highly incentivized executives were only too happy to oblige.[158] As policymakers appear to be committed to addressing the perceived problem of short-termism by further empowering shareholders, Section 172 will become even less relevant as shareholders exercise greater direct and indirect influence over executives.[159]

---

156. *See supra* note 21 and accompanying text (arguing that unsettled case law may have allowed for a wider notion of company interests).

157. *See* discussion *supra* Part III (detailing the 1948 company law reforms).

158. *See Report of the High Level Group on Financial Supervision in the EU*, at 10 (Feb. 5, 2009), http://ec.europa.eu/internal_market/finances//docs/de_larosiere_report_en.pdf ("[S]hareholders' pressure on management to deliver higher share prices and dividends for investors meant that exceeding expected quarterly earnings became the benchmark . . . .").

159. Since the financial crisis, the UK has witnessed the introduction of the Stewardship Code, a soft law initiative, which seeks to encourage shareholder engagement with companies. *Supra* note 152. In addition, a binding shareholder vote on companies' executive pay policies was introduced. *See* Enterprise and Regulatory Reform Act 2013 § 79(4) (UK) (inserting § 439A into the Companies

The reformed UK law stands in marked contrast to the position under US law—argued by Johnson and Millon—that the Supreme Court in *Hobby Lobby* provides a "highly persuasive if not authoritative" opinion that state law is permissive.[160] Therefore, "such avowed goals as social justice, environmental concerns, and employee welfare . . . are valid ends in themselves, not merely means toward the goal of profits."[161] In contrast to changes in US state law that permit or require directors to consider wider interests, Section 172 explicitly fixes shareholder primacy as the goal of companies, restricting managerial discretion and legitimating the wider social norm that managers should maximize shareholder value.[162] As a result of the changes during the course of the twentieth century, which culminated in Section 172, CSR is now confined to practices that are acceptable to the shareholders and the capital markets. Companies' CSR practices have of course long reflected this, with companies

---

Act 2006); *see also* Companies Act 2006 § 439A (UK) (requiring shareholders to approve, by ordinary resolution, the directors' remuneration policy as detailed in Directors' Remuneration Report). Most recently, on December 16th, 2016, agreement was reached within the EU on revisions to the Shareholder Rights' Directive, requiring companies to develop binding pay policies for executives, to be approved by the shareholders. The policy must "contribute to the business strategy, long-term interests and sustainability of the company and explain how it does so." European Scrutiny Committee, *Proposal for a Directive Amending Directive 2007/36 as Regards the Encouragement of Long-Term Shareholder Engagement and Directive 2013/34 as Regards Certain Elements of the Corporate Governance Statement*, COM (14) 213 (Mar. 3, 2017), https://www.publications.parliament.uk/pa/cm201617/cmselect/cmeuleg/71-xxxi/7115.htm. At the time of going to press, the full text of the Directive was not publicly available, but for a summary see European Council Press Release 738/16, 'Shareholders' rights in EU companies: Presidency strikes deal with Parliament' (Dec. 9, 2016), http://www.consilium.europa.eu/en/press/press-releases/2016/12/16-shareholders-rights-eu-companies/. For further background on the revisions to the Shareholder Rights Directive, see FRANK BOLD, SHAREHOLDER RIGHTS DIRECTIVE POLICY BRIEF (2016), http://www.purposeofcorporation.org/documents/briefing-shareholder-rights-directive.pdf.

160. Johnson & Millon, *supra* note 6, at 22 (2015).

161. *Id.*

162. *See* Companies Act 2006, c. 46, § 172(1) (UK) ("A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole . . . .").

producing glossy CSR reports that pay little attention to impacts and are more akin to "impression management."

VI. Conclusion: The Prospects for CSR

This Article has shown that changes to company law since 1948, and the changes to corporate governance that followed, have gradually reduced the scope for managerial-led CSR initiatives. More recently, however, CSR has come to be viewed in policy and academic debates as a means of governance of economic activity in pursuit of both economic efficiency and social justice. This can be seen most starkly in the European Commission's changing definition of CSR, which moved from purely voluntary action on the part of companies intended to make the world a better place[163] to action by companies to address their impacts on society.[164] These developments are important conceptually, not least because a focus on impacts ensures the "relevance" of CSR activities[165] and avoids the critique that managers who engage in charitable or philanthropic CSR are imposing agency costs on shareholders by "not spend[ing] the profits on CSR in precisely the way that equity holders would have spent them."[166] Moreover, a focus on externalities provides a clear economic efficiency rationale for

163. *See Commission Green Paper on Promoting a European Framework for Corporate Social Responsibility*, at 8, COM (2001) 366 final, (July 18, 2001) (defining CSR as "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis").

164. *See A Renewed EU Strategy for Corporate Social Responsibility, Communication from the Commission*, at 3, COM (2011) 681 final (Oct. 25, 2011) (referring to CSR as "the responsibility of enterprises for their impacts on society," and requiring that corporations "have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy").

165. *See* Donna J. Wood, *Corporate Social Performance Revisited*, 16 ACAD. MGMT. REV. 691, 698 (1991) ("[P]ublic responsibility can be translated into a broader *rule of relevance*.").

166. Jerry L. Mashaw, *The Economic Context of Corporate Social Responsibility*, *in* CORPORATE GOVERNANCE AND DIRECTOR'S LIABILITIES 55, 61 (Klaus J. Hopt & Gunther Teubner eds., De Gruyter 1985); *see also* Jerry L. Mashaw, *Corporate Social Responsibility: Comments on the Legal and Economic Context of a Continuing Debate*, 3 YALE L. & POL'Y REV. 114, 124 (1984).

CSR.[167] However, they also suffer from a significant omission: they are silent on the question of when companies should address their impacts. There is no discussion of the distinction between "ethical" and "strategic" CSR,[168] or, to put it more bluntly, there is no guidance as to what companies should do where there is no "business case" for internalizing an externality. The closest thing to guidance to be found in the various policy documents is contained in ISO 26000, which suggests that companies should internalize their impacts where society expects them to do this, and that successful companies are socially responsible.[169] In other words, companies will be steered by markets to internalize their externalities to an appropriate extent, leaving us squarely within the realms of the "business case" for CSR.[170]

This failure to discuss the limits of corporate responsibility for impacts may be pragmatic, with policymakers keen not to deter corporations from the impact agenda by emphasizing the possibility of profit sacrifice. Likewise, CSR is no longer a matter for management alone: the legal and policy changes during the second half of the twentieth century progressively empowered shareholders and became a key limiter of CSR activities. Rather than a legal distinction between "ethical" and "strategic" CSR, it is suggested that the key distinction in practice is now between CSR practices that empowered shareholders will tolerate, and those that they will not tolerate.

---

167. *See, e.g.*, Andrew Johnston, *Facing Up to Social Cost: The Real Meaning of Corporate Social Responsibility*, 20 GRIFFITH L. REV. 221, 239 (2011) (arguing that voluntary identification and internalization of externalities is another way of governing them, alongside taxes, regulation and Coasean bargaining). For a more sceptical view of the usefulness of the externality concept, see generally Claire A. Hill, *The Rhetoric of Negative Externalities*, 39 SEATTLE U. L. REV. 517 (2016) (asserting that there are serious questions as to how it should be operationalized).

168. Johnson & Millon, *supra* note 6, at 30 (assessing the various motivations behind a corporation's interest in CSR).

169. *See ISO 26000—Social Responsibility*, INTERNAL ORG. FOR STANDARDIZATION, http://www.iso.org/iso/home/standards/iso26000.htm (last visited May 1, 2017) ("Business and organization do not operate in a vacuum. Their relationship to the society and environment in which they operate is a critical factor in their ability to continue to operate effectively.") (on file with the Washington and Lee Law Review).

170. *See* Andrew Johnston, *ISO 26000: Guiding Companies to Sustainability Through Social Responsibility?*, 9 EUR. COMPANY L. 110, 117 (2012) (evaluating the ISO's focus on "business benefits" as a way to encourage CSR).

Looking at the practice of large corporations, it appears that shareholders will tolerate CSR activities that are either inexpensive, or that managers can credibly claim will result in direct benefits to shareholders (perhaps because they are a core part of the strategy or because there is a clearly perceived reputational benefit to a particular corporation),[171] or, ideally, both. Beyond this, there is not much scope for CSR that reduces profitability in order to internalize externalities. This has long been recognized by economists, who argue that a corporation that wants to engage in CSR activities, but is operating in competitive markets, facing the same cost functions as its competitors and elastic demand for its products, will have to "either raise its prices, and face a drastic decline in demand for its products, or it must reduce the returns to capital or labor."[172] Consumers may be willing to pay a higher price for a product that is marketed on the basis of its CSR characteristics, although the evidence is that this willingness is patchy.[173] Moreover, with households highly indebted, inflation barely above zero in many Western economies, and myriad products competing for spare household cash flow, it seems unlikely that CSR will expand on the basis of consumer market pressure. With returns to labor slashed during the long period of offshoring of production that has characterized globalization since the 1980s, there is little scope for companies to address their social and environment impacts by further cutting returns to labor. As a result of the reforms discussed in this Article, companies are under considerable market pressure to maximize shareholder value, making it very difficult to reduce to returns to shareholders in the absence of far-reaching reforms to the scope of corporate law and takeover regulation. Similarly, returns to senior executives might be reduced, but this seems unlikely without significant reforms to the composition of remuneration committees.

---

171. *See* Johnston, *supra* note 167, at 222 (describing the "business case for CSR" as promoting a "win-win" in which "corporations are seen as 'doing good,'" thereby enhancing their reputation).

172. Mashaw, *supra* note 166, at 60.

173. *See* DAVID VOGEL, THE MARKET FOR VIRTUE 47–49 (2005) (detailing the tension between a consumer's desire to contribute to socially responsible companies and their desire to purchase more affordable products).

The result is that CSR has effectively been reduced to either a marketing or defensive exercise,[174] and cannot become either a comprehensive mechanism for governing externalities[175] or even a credible means of legitimating corporate capitalism in the face of its impacts on society.[176] This leads to the pessimistic conclusion that, under current political economic conditions (i.e., quantitative easing, zero interest rate policy, household indebtedness, large pension fund liabilities and activist shareholders), companies will not voluntarily take decisions which further sustainability. Hence, there is a pressing need to identify the "countervailing forces" that will create pressure for true social responsibility.[177] A broader mandate to consider sustainability in decision-making,[178] coupled with wider powers of appointment and representation on corporate boards, would be one way of steering companies towards taking account of the social and environmental costs of their activities.

What, then, is the prospect of reforms in the UK that would steer companies towards greater social responsibility? Until

174. *See* Marc T. Jones, *Missing the Forest for the Trees: A Critique of the Social Responsibility Concept and Discourse*, 35 BUS. & SOC'Y 7, 29 (1996) (describing corporate CSR budgets as funding activities which are "essentially high-profile public relations advertisements that the organization uses to differentiate itself from its competitors and pre-empt government regulations").

175. As Reich put it, capital markets are "notoriously impatient, and are becoming less patient all the time. Most of today's institutional investors have no particular interest in a 'long term' that extends much beyond the next quarter, if that long." Robert B. Reich, *The New Meaning of Corporate Social Responsibility*, 40 CAL. MGMT. REV. 1, 12 (1998).

176. *See* Wood, *supra* note 165, at 695–96 (exploring the principle behind societal grants of "legitimacy" on businesses); Jones, *supra* note 174, at 7–8 (discussing a capitalist society's need to justify negative externalities in the market place).

177. *See* Jones, *supra* note 174, at 34 ("[T]o propose that business organization will behave in a socially responsible manner as the result of external pressure . . . is a very different, more theoretically plausible and empirically sustainable position.").

178. *See* Beate Sjåfjell, Andrew Johnston, Linn Anker-Sørensen & David Millon, *Shareholder Primacy: the Main Barrier to Sustainable Companies*, *in* COMPANY LAW AND SUSTAINABILITY: LEGAL BARRIERS AND OPPORTUNITIES 126, 146–47 (Beate Sjåfjell & Benjamin J. Richardson eds., 2015) ("[N]ational companies acts should state that the societal purpose of companies is to create sustainable value within the planetary boundaries. Such a redefined purpose of companies would need to be operationalised through integration of such a goal into the duties of the board.").

recently, there was little likelihood of such a change, with the "classic argument" for single constituency accountability holding a firm grip on policymakers, despite its "bracketing" effects. However, this Article can end on a positive note by pointing to tentative signs of change in the wake of the UK's referendum decision to leave the European Union. Surprisingly, given its historical opposition to the EU's attempts to widen the scope of corporate governance, the UK is now considering far-reaching changes to corporate governance, including the reconstitution of boards and remuneration committees to include employee representatives. During her campaign to become Prime Minister in the aftermath of Brexit, Theresa May stated, "I want to see changes in the way that big business is governed . . . . So if I'm Prime Minister, we're going to change that system—and we're going to have not just consumers represented on company boards, but employees as well."[179] An initial Parliamentary inquiry was launched in September 2016,[180] and the new Prime Minister announced that plans to put both consumers and workers on boards would be published before the end of the year.[181] However, this commitment was withdrawn shortly afterwards.[182] A Green

179. Theresa May, Member of Parliament, HOUSE OF COMMONS, *We Can Make Britain a Country that Works for Everyone* (July 11, 2016) (on file with the Washington and Lee Law Review).

180. *See Corporate Government Inquiry Launched*, COMMONS SELECT COMM. (Sep. 16, 2016), http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/news-parliament-2015/corporate-governance-inquiry-launch-16-17/ (last visited May 1, 2017) ("The . . . Committee has today launched an inquiry on corporate governance, focussing [*sic*] on executive pay, directors duties, and the composition of boardrooms, including worker representation and gender balance in executive positions.") (on file with the Washington and Lee Law Review); *see also Corporate Governance Inquiry—Publications,* PARLIAMENT, http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/inquiries/parliament-2015/corporate-governance-inquiry/publications/ (last visited May 1, 2017) (tracking the responses to the consultation) (on file with the Washington and Lee Law Review).

181. *See* Theresa May, Prime Minister, U.K., Keynote Speech at Conservative Party Conference (Oct. 5, 2016).

182. Theresa May, Keynote Speech to Confederation of British Industry (Nov. 21, 2016) ("While it is important that the voices of workers and consumers should be represented, I can categorically tell you that this is not about mandating works councils, or the direct appointment of workers or trade union representatives on boards . . . ."); *see also* Helen Warrell & Jim Pickard, *Plan for UK to Put Workers on Company Boards Falters*, FIN. TIMES (Oct. 31, 2016),

Paper on *Corporate Governance Reform* followed in November 2016, [183] canvassing, among other things, different possibilities for the representation of stakeholder interests within corporate governance, including "stakeholder advisory panels,"[184] designating non-executive directors "to ensure that the voices of key interested groups, especially that of employees, is [sic] being heard at board level,"[185] and strengthening reporting requirements.[186] However, direct stakeholder representation on boards would remain a voluntary matter, with the Government "not proposing mandate the direct appointment of employees or other interested parties to company boards."[187]

In brief, post-Brexit, and following other recent scandals that have undermined public trust in the way large companies are governed,[188] UK corporate governance policy is now highly unpredictable. The current status quo is unlikely to persist, and limited reforms that broaden the scope of corporate law now look possible. Reforms that embed wider social responsibilities in law would represent a marked improvement on the current

---

https://www.ft.com/content/22128636-9ece-11e6-891e-abe238dee8e2 (last visited May 1, 2017) (reporting that ministers are "looking at ways to water down Theresa May's pledge") (on file with the Washington and Lee Law Review).

183. *See* CORPORATE GOVERNANCE REFORM, GREEN PAPER, *supra* note 17, at 34–42.

184. *Id.*at 38–39.

185. *Id.* at 39–40.

186. *Id.* at 40–41.

187. *Id.* at 40.

188. To give two recent examples, BHS, a privately-held chain of clothing stores, failed in June 2016 with a pension fund deficit of £571m. *See* Mark Vandevelde & Kate Allen, *Philip Green Pays £363m into Stricken BHS Pension Fund*, FIN. TIMES (Feb. 28, 2017), https://www.ft.com/content/d62e97d0-fdc5-11e6-96f8-3700c5664d30 (last visited May 1, 2017) (on file with the Washington and Lee Law Review). Sports Direct, a chain of listed sports apparel stores admitted using "potentially oppressive" workplace practices, and, under considerable political pressure, agreed voluntarily to put an employee representative on the board. *See* Nathalie Thomas, *Sports Direct Admits some Work Policies are "Potentially Oppressive"*, FIN. TIMES (Sept. 6, 2016), https://www.ft.com/content/6b10a343-cb80-3c98-b4e2-4607ad3437a9 (last visited May 1, 2017) (on file with the Washington and Lee Law Review); *see also* Mark Vandevelde, *Sports Direct to Appoint Worker Representative to Board*, FIN. TIMES (Mar. 9, 2017), https://www.ft.com/content/d4d713ca-04ab-11e7-ace0-1ce02ef0def9 (last visited May 1 2017) (on file with the Washington and Lee Law Review).

constrained voluntarist approach to CSR. They would make it more likely that companies will take greater responsibility for the impacts on society, reversing some of the legal changes that, since 1948, have greatly reduced the scope of CSR.