# Misreading the Directors' Fiduciary Duty of Good Faith

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The fiduciary duty of good faith, now set forth in section 172 of the Companies Act 2006, expressly positions shareholders at the centre of the company's interests, and assigns the priority entitlement to shareholders relative to all other stakeholders. The provision constitutes an attempted codification of the common law duty to act in good faith in the corporate interest, which remains immensely important in interpreting and applying the modern good faith requirement. However, this article submits that a reductive shareholder-determined articulation of the pre-2006 corporate interest seems practically misconceived, if not indeed in some sense conceptually impossible as a managerial behaviour obligation, and represents a departure from the common law that is problematic for contemporary English company law and policy. Instead, the article provides a more functional and nuanced understanding of the salient cases, which focus typically on the company as a body corporate, and the particular free floating commercial objects of that entity.

**KEYWORDS**: Directors' duties; corporate objective; corporate governance

## 1. INTRODUCTION

The nature of the fundamental and enduring debate about the precise goals and responsibilities of company directors and officers has been clear for some time.[1] The almost uniform view in academic and practitioner circles in the United Kingdom and, to an extent, most states in the United States, is that which is commonly referred to as

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[1] On the two dominant conceptions of the corporate objective, see e.g. W. Allen, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 Cardozo Law Review 261, 264-266. On the path dependency of this debate, see W. W. Bratton, 'Berle and Means Reconsidered at the Century's Turn' (2001) 26 Journal of Corporation Law 737, 762.

“shareholder value”.[2] This approach typically positions shareholder interests at the centre of the company law and governance process, and assigns the priority interest to shareholders relative to all other stakeholders. Within this framework of legal and regulatory purpose, once shareholder value is accepted, it is tempting to see that the interests of non-shareholder constituencies can – and should – be more effectively protected through extraneous regulation or wealth redistribution through taxation.[3] Two rationales for shareholder value, which characterise companies as “private”, have garnered widespread approval. First, the principle is often explained, or justified, on the basis that shareholders “own” the company, and are entitled, as ultimate risk bearers, to have it managed for their benefit.[4] What is more, ownership also provides legitimacy to the corporate form itself. So long as it is owned by individuals, the economic and political power of the company is both benign and a safeguard against the intrusion of the state.[5] Second, an alternative paradigm disaggregates the corporate form into no more than freely negotiated contracts, either express or implied, between asocial, self-maximising economic actors involved in the company’s affairs.[6] From this perspective, company law, being the body of rules that

[2] See e.g. ‘J. Armour, S. Deakin, and S. J. Konzelmann, ‘Shareholder Primacy and the Trajectory of UK Corporate Governance’ (2003) 41(3) British Journal of Industrial Relations 531. For a detailed account, and critique, of the various rationales for shareholder primacy, see R. Chen and J. Hanson, ‘The Illusion of Law: The Legitimating Schemas of Modern Policy and Corporate Law’ (2004) 103 Michigan Law Review 1. On the relative ambivalence of U.S. corporate law generally, see e.g. D. G. Baird and M. T. Henderson, ‘Other People’s Money’ (2008) Stanford Law Review 1309, 1312.
[3] H. Hansmann and R. Kraakman, ‘The End of History for Corporate Law’ (2000) 89 Georgetown Law Journal 439, 442; L. Sealy, ‘Directors’ “Wider” Responsibilities – Problems Conceptual, Practical and Procedural’ (1987) 13 Monash Law Review 164, 176.
[4] M. Friedman, ‘The social responsibility of business is to increase its profits’ (1970) The New York Times Magazine at 17. For criticisms of the idea that shareholders ‘own’ the business, see e.g. R. Grantham, ‘The Doctrinal Basis of the Rights of Company Shareholders’ (1998) 57 Cambridge Law Journal 554, 554-555; P. Ireland, ‘Company Law and the Myth of Shareholder Ownership’ (1999) 62 Modern Law Review 32 at 32, 48-49.
[5] M. Stokes, ‘Company Law and Legal Theory’ in W. Twining (ed.), *Legal Theory and Common Law* (Blackwell, 1986), 156-157.
[6] See generally, A. Alchian and H. Demsetz, ‘Production, Information Costs and Economic Organizations’ (1972) 62 American Economic Review 777; M. Jensen and W. Meckling, ‘Managerial Behaviour, agency costs and ownership structure’ (1976) 3 Journal of Financial Economics 305; E. Fama, ‘Agency Problems and the Theory of the Firm’ (1980) 88 Journal of Political Economy’ 228; *The Economic Structure of Corporate Law* (Harvard University Press, 1991). For works suggesting

governs these complex contracts, almost always is – and should be – largely a passive adjunct to the socially optimally contracting process that creates a company.[7] Following on from this, stakeholder-oriented scholarship currently offers a rejoinder to the enduring significance of shareholder value.[8] This approach submits that companies are "public", and have responsibilities to corporate constituencies other than shareholders. At one level, it has been proposed that it is in the interests of shareholders to take account of a social or public expectations and preferences. This view regards the development of long-term relations, trust, and commitment as part of the successful development of companies. However, there is a broader concept that companies should not simply be run in the interests of shareholders; they have responsibilities to other stakeholders, which may on occasion conflict with their objective of shareholder value. This line of argument sees the company as an entity that is distinct from its shareholders, where ownership and control is spread amongst a number of parties.

A significant part of this debate in English law and scholarship has involved the analysis of the fiduciary duty of good faith, which is traditionally presented as an important branch of the duty of loyalty. The duty of good faith plays a pivotal role in focusing directors on the purpose of the company, ensuring that, when directors exercise discretionary administrative power, it is directed towards the company's

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that private contracting alone is unlikely to produce optimal corporate governance arrangements, see e.g. M. Klausner, 'Face and Fiction in Corporate Law and Governance' (2013) 65 Stanford Law Review 1325; W. W. Bratton, 'The "Nexus of Contracts" Corporation: A Critical Appraisal' (1989) 74 Cornell Law Review 1703.

[7] Easterbrook and Fischel, ibid, 15. Cf. the legal positivist approach set forth in M. Eisenberg, *The Structure of the Corporation* (Little, Brown & Co., 1976).

[8] See e.g. J. E. Parkinson, *Corporate Power and Responsibility* (OUP, 1995) 140-141; J. Dine, *The Governance of Corporate Groups* (CUP, 2000), 12-17; R. Edward Freeman, The Politics of Stakeholder Theory: Some Future Directions' (1994) 4 Business Ethics Quarterly 409, 417. On the shortcomings of stakeholder theory, see A. R. Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' (2010) 9(3) Richmond Journal of Global Law & Business 249, 269-298.

interests.[9] Historically, directors' general duties were set out as a mixture of common law rules and equitable principles. Following on from the Companies Act 2006 ("the 2006 Act") receiving Royal Assent on the 8 November 2006 and being enacted into English law, Chapter 2 of Part 10 of the Act codified these duties in statutory form. The duty of good faith is now set out in section 172. Much ink has been spilled over the pages of policy documents, practice briefings, law reviews, monographs, and textbooks about the question of to whom the duty is owed. The consensus reading of the provision is that the substantive content of the codified duty includes an express obligation to shareholders, whom are the presumptive recipients of the provision, and appreciate the priority interest in both economics and governance of the company, to which the interests of other corporate constituencies are secondary. But equally, much confusion remains because this duty, according to an introductory section to the codified general duties, is 'based on certain common law rules and equitable principles' and 'shall be interpreted and applied in the same way as common law rules or equitable principles'.[10] Prior to the 2006 Act, a director of a company owed her fiduciary and common law duties to "the company" as a distinct legal entity.[11] Precisely what equated to the interests of the company was something of a contested matter, with debates among scholars, judges, and policymakers having endured from the nineteenth century to the present day. On one reading of the common law good faith requirement, obiter dicta inheres in a slim number of cases to suggest that companies exist for their shareholders.[12] On another reading, the nature of the subjective good faith review standard required the English courts to defer to the exercise of discretion in managing a company's affairs, and this quiescence, in some

[9] S. Worthington, 'Reforming Directors' Duties' (2001) 64(3) Modern Law Review 439, 447.
[10] CA 2006, s 170(3)-(4).
[11] See e.g. *Peskin v Anderson* [2000] EWCA Civ 326; *Pervical v Wright* [1902] 2 Ch 421.
[12] See below n 44.

sense, precluded wholesale judicial attempts to specify the corporate interest.[13] This account of the law deferring to the exercise of discretion, to some, has implied the idea of the socially responsible company, in which a range of values or 'stakes', along with the interests of shareholders, can be held in balance.[14] Above all else, the issue, in the present context, is that a contest between probabilities of meaning in the pre-existing common law and the modern statutory restatement generates an incontrovertible problem for contemporary English company law and policy.[15]

This article provides a critical evaluation of the English common law approach to regulating discretion. The article submits that the accounts made by the proponents and opponents of shareholder value, and more stakeholder-oriented positions in UK scholarship, are organised by partially contextualised and inadequately analysed representations of the common law duty to act in good faith in the interests of the company. These representations, in turn, form and structure a distorted understanding of English law. Against this backdrop, the article makes three claims about this subject matter. First, it is submitted that the pre-2006 cases customarily regarded as answering the question about the rightful beneficiary of the director's fiduciary duty of good faith, in concrete terms, reveal that the curious equation between a company and its shareholders as a constituency receives little more than a mention in relation to directors' duties. Even in the apparently more pronounced shareholder value decisions, the fact the courts enumerated only *specific* pro-shareholder observations about the company's interests, and often limited those remarks to the particular facts, provides all the more reason to believe the courts had no intention of making

[13] See below nn 45-46.
[14] See below n 47.
[15] This concern about codification is raised in P. Davies and S. Worthington, *Gower & Davies Principles of Modern Company Law* (Sweet and Maxwell, 10th edn., 2016) 504.

shareholder value a de facto right in English law. Similarly, unless otherwise provided for under the company's articles of association, the respective cases reveal a presumptive silencing of an express consideration and protection of social or public interests unaligned to a corporate benefit. Second, this work argues that a closer inspection of the limited number of authorities that consider directly the good faith obligation involve the realisation by the courts that the possession and exercise of executive power formally rests on the exclusive consent of shareholders in general meeting, which unilaterally determine the specific activities for which the company has been formed and substantially grants corporate power to the directors. In this regard, the interests of the shareholder body silently structure the duty to act in the company's interests. However, this is not understood as an inelegant and ineloquent 'maximisation of shareholder value' instruction, but as an arguably more functional and nuanced consideration and protection of the greater corporate 'good', i.e. the flourishing and continuing survival of the company's business. Third, the legislative reform project that resulted in the codification of the duty of good faith is a reminder that statutory drafting in novel circumstances sometimes involves the legislature in re-writing important corporate legal rules, under the impression that it is following orthodox principles. In particular, section 172 subordinates the company's commercial interests to the interests of shareholders as a constituency. Following Berle's call for the company's interests to be regarded along private-individualistic lines,[16] the fact that the English common law has never unequivocally affirmed such an understanding has been increasingly ignored within company law-making and academic circles. Today, appropriate weight to the company's autonomous commercial interest is fading. Without it, there is the risk that the company's ability

[16] See A. A. Berle, 'Corporate Powers as Powers in Trust' (1931) 44 Harvard Law Review 1049; E. Merrick Dodd, 'For Whom are Corporate Managers Trustees?' (1932) 45 Harvard Law Review 1145; A. A. Berle, 'For Whom are Managers Trustees: A Note' (1932) 45 Harvard Law Review 1365.

to preserve or invest resources and capital in long-term projects and to generate value is weakened.

## 2. THE PRESENT LAW ON THE DUTY OF GOOD FAITH

It is scarcely a new or exciting truth that English company law and regulation has always been more shareholder-oriented than the approach adopted in most states in the United States.[17] Whilst in one sense the dominant shareholder value imperative cannot be reduced to a pithy rule of law and enforceable sanction, as Marc Moore reasons, 'there are nonetheless an important collection of rules and principles which mutually establish this functionally significant corporate-managerial norm.' [18] Shareholders do, of course, retain the power to exercise limited control rights under companies' legislation,[19] and to vote on certain other corporate transactions.[20] What is more, the Takeover Code's non-frustration rule and mandatory bid rule mutually establish a pro-shareholder approach to takeover bids,[21] while the UK Listing Rules require prior shareholder approval for all economically significant corporate transactions.[22] But arguably, it is within the legal principle that directors must act in good faith in the interests of the company that shareholder value thinking is regarded to find its most direct and overt expression.[23] As a matter of intellectual history, this

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[17] See above n 2.
[18] M. Moore, 'Shareholder primacy, Labour, and the Historic Ambivalence of UK Company Law' in Harwell Wells (ed), *Research Handbook on the History of Corporate and Company Law* (Edward Elgar, 2018) 145.
[19] See e.g. CA 2006, ss 21 (the right to amend the constitution with a special resolution); s 168 (mandatory 'without cause' removal right); ss 303-305 (the right to call meetings with five per cent of votes); ss 314-316 (the right to circulate resolutions).
[20] CA 2006, Part 10, Ch. 4.
[21] City Code on Takeovers and Mergers, Rules 9 and 21.
[22] See e.g. (in the case of Premium Listed companies) Listing Rules 10 and 11; (but also in the case of all UK-registered companies) CA 2006, ss 177, 182, and 190-196.
[23] The good faith requirement has sometimes been interpreted as a duty to act honestly. On this point, see e.g. *Regentcrest v Cohen* [2001] BCC 494, 101. See also, Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework*, (DTI, 2000) para. 3.50.

duty, 'implicit by law',[24] formed a principal part of a common law and equitable framework of directors' general duties, but is today partially codified under Chapter 2 of Part 10 of the Companies Act 2006.[25] The UK Government's intention with an attempt at codification of directors' general duties was to modernise and refine '[t]he substantial corpus of learning on the nature and scope of these general fiduciary or equitable duties and duties of care and skill',[26] the framework of which, and the rules related thereto, having developed incrementally since formulation by English Chancery courts during the pre-industrial period.[27] In this regard, the transfer of directors' general duties from their existing common law and equitable realm and into the 'arguably more rigid and politically reactive territory of statute law'[28] was commonly viewed as 'a major landmark in the evolutionary history of the duties.'[29]

The duty of good faith, now set out in section 172 of the 2006 Act, establishes the basis of directors' accountability, and plays a pivotal role in focusing directors on the interests of the company, ensuring that, when directors exercise discretionary administrative authority, it is directed towards the company's interests.[30] Typically, the duty is not limited merely to the proscriptive obligations to avoid conflicts and profits, but also contemplates such prescriptive requirements as considering and, in

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[24] *Re Smith & Fawcett Ltd* ([1942] Ch 304, 306; [1942] 2 All ER.542, per Lord Greene M.R.

[25] CA 2006, s 172. Both the Law Commission and the Company Law Review recommended a 'high level' statutory restatement of the common law principles. See Law Commission, *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties*, Law Com. No 261 and Scottish Law Com. No 173, Cm. 4436; Company Law Review, *Modern Company Law for a Competitive Economy: Final Report* (DTI, 2001), Ch. 3 and Annex C.

[26] Davies and Worthington, above n 15, 502. See also, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (Law Commission Consultation Paper 261); Scottish Law Commission Paper No. 173 (September 1999)), at [4.40-4.41].

[27] On effects of codification on the law, see H. R Hahlo, 'Here Lies the Common Law: Rest in Peace' (1967) 30(3) Modern Law Review 241, 244-246.

[28] M. Moore, *Corporate Governance in the Shadow of the State* (Hart, 2013) 190 (and accompanying footnotes).

[29] D. Ahern, 'Directors' Duties, Dry Ink and the Accessibility Agenda [2012] Law Quarterly Review 114, 114. See also, M. Arden, 'Regulating the Conduct of Directors' (2010) 10(1) Journal of Corporate Law Studies 1, 3-4

[30] Worthington, above n 9, 447.

some cases, investigating the company's interests.[31] On this basis, the statutory duty expressly requires that, in exercising his official managerial and control functions, '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 [shareholders] as a whole* [emphasis added].' In doing so, directors are obliged to 'have regard to' a non-exhaustive list of socio-economic criteria (e.g. the company's long-term outlook, employees, customer and supplier relations, the environment), which are valued as merely instrumental (rather than being based upon any ethical or intrinsic significance) to fulfilling the primary element of the duty. Under this approach, known as "enlightened shareholder value",[32] the 2006 Act clearly sets forth on a default mandatory basis[33] the legislative priority of the collective interests of shareholders, to which the less tangible claims of other constituencies or a combination of other constituencies may be taken into account provided that so doing furthers the shareholder focus.[34] The genesis of this apparently narrow conception of the duty of good faith can be traced back to the Company Law Review Steering Committee, which was responsible for making recommendations to the Government as part of this legislative reform project, and its presumptive view that the legal principle, for the law, embodied a pro-shareholder bias.[35] What is more, in spite of public furore about market short-termism post-2008 financial crisis, concerns about

[31] R. Teele Langford, 'Best Interests: Multifaceted But Not Unbounded' (2016) 75(3) Cambridge Law Journal 505, 512-516.

[32] See *Developing the Framework*, above n 23, Ch. 3 and Company Law Review, *Modern Company Law for a Competitive Economy: Completing the Structure* (DTI, 2000), Ch. 3.

[33] The default mandatory status of this provision in the Companies Act 2006 refers to its mandatory and therefore binding status as a fiduciary rule, which could be amended by the corporate contract in respect to any individual company.

[34] D. Attenborough, 'The Neoliberal (Il)legitimacy of the Duty of Loyalty' (2014) 65(4) Northern Ireland Legal Quarterly 405, 418-427; C. M. Bruner, *Corporate Governance in the Common-Law World* (CUP, 2013), 34-35; Moore, above n 28, 191-195.

[35] See Company Law Review, *Modern Company Law for a Competitive Economy: Strategic Framework* (DTI, 1999); Davies and Worthington, above n 15. See also, *Re Southern Counties Fresh Foods Ltd* [2008] EWHC 2810; *Re West Coast Capital (Lios) Ltd* [2008] CSOH 72; *Cobden Investments Ltd v RWM Landport Ltd* [2008] EWHC 2810 (Ch); Odyssey Entertainment Ltd. v Kamp [2012] EWHC 2316 (Ch.).

high levels of executive remuneration, a downward pressure on labour, and the existence of human rights abuses particularly by multi-national companies, the UK government has made clear in the publication of its response to a 2016 Green Paper on corporate governance reform that it has no foreseeable plans to amend the precise wording of section 172.[36]

However, this does not mean that it is all to the good and that re-formulation of the old rules and the adoption of new rules has not thrown the law into a period of uncertainty as to its best reading, based on the difficulties inherent in the nature of language used, of composition, and of legislation generally.[37] The default mandatory shareholder focus of section 172 is accurate so far as it goes, but many open questions remain about the relationship between the statutory formulation of the duty and its common law antecedent. This is because the UK's common law heritage continues to be generally determinative of questions of managerial behaviour in the sphere of this partial and emergent codification of directors' general fiduciary duties. To explain, section 170 prefaces the legislative statement of directors' general duties, and sets out the scope and general nature of these obligations. For us, section 170(4) gives clear recognition to the fact that the new duties are 'based on certain common law rules and equitable principles'.[38] In addition, since it would be 'virtually impossible to express in the words of a statute all the intricacies and nuances of the general law',[39] the same provision expressly stipulates that 'regard shall be had to the corresponding common

[36] Department for Business, Energy and Industrial Strategy (BEIS), *Corporate Governance Reform: The Government Response to the Green Paper Consultation* (August 2017), para. 2.45. But see the Companies (Miscellaneous Reporting) Regulations 2018, which introduce new reporting requirements on, amongst other things, how directors have had regard to the matters set out in section 172(1)(a)-(f) of the Companies Act 2006 in the exercise of their duties.
[37] Hahlo, above n 27, 249.
[38] CA 2006, s 170(3).
[39] Arden, above n 29, 3

law rules and equitable principles in interpreting and applying the general duties.'[40] The pre-2006 case law, therefore, remains immensely important in interpreting and clarifying the content of the codified duties.

Historically, the common law formulation of the duty was owed to "the company" as a distinct legal entity,[41] and it was for a director (and not the court) to decide, in good faith, on how best to further its interests. It need hardly be said that what precisely equates to the company's interests is something of a contested issue, because the expression is regarded to be ill-defined by the courts,[42] with lively and controversial academic debates on this enduring from the nineteenth century to the present day.[43] On one reading of the common law, obiter dicta inheres in a relatively modest number of late-eighteenth to mid-nineteenth century cases to suggest that shareholder interests were a proxy for the company's interests.[44] On another reading, the nature of the review standard to act in subjective good faith in the company's interests, as it has been traditionally understood, was an acknowledged driver of the courts' deferral to the exercise of discretion in managing the company's affairs.[45] No doubt, the courts tended to require, as a proxy for good faith, reasons to support the view that the decision or action furthered that interest goal, whatever it be, but the company's

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[40] Ibid, s 170(4).
[41] See e.g. *Peskin v Anderson* [2000] EWCA Civ 326; *Pervical v Wright* [1902] 2 Ch 421.
[42] A. Dignam and J. Lowry, *Company Law* (9th edn, OUP 2016) 314; Davies and Worthington, above n 15, 540; Moore, above n 28, 191 (and accompanying footnotes); D. D. Prentice, 'Creditor's Interests and Directors' Duties' (1990) 10 OJLS 265, 273; F. G. Rixon, 'Competing Interests and Conflicting Principles: an Examination of the Power of Alteration of Articles of Association' (1986) 49(4) Modern Law Review 446, 448.
[43] For a recent comment on the significance of this debate, see e.g. S. Lombard and T. Joubert, 'The Legislative Response to the Shareholders v Stakeholders Debate: A Comparative Overview' (2014) 14(1) Journal of Corporate Law Studies, 211, 211-213 (and accompanying footnotes). On the political nature of this inquiry, see A. Gamble and G. Kelly, 'The Politics of the Company' in J. Parkinson, A. Gamble, and G. Kelly (eds.), *The Political Economy of the Company* (Hart, 2000) 21.
[44] See e.g. *Strategic Framework*, above n 35, paras. 5.1.4-5.1.5; Davies and Worthington, above n 15, 540-541; D. Kershaw, *Company Law in Context* (OUP, 2nd edn., 2012) 336.
[45] See the picturesque dictum of Lord Eldon LC in *Carlen v Drury* (1812) 1 V & B 154, 158.

interests were cognisable only inferentially through this juridical inquiry.[46] This account of the law deferring to the exercise of discretion, to some, has implied the idea that companies can have positive obligations to secure the well-being of employees, the environment, or other corporate constituencies as ends in their own right.[47] Overall, the upshot of this unsettled understanding of the common law good faith rule is that a dispute between probabilities of meaning, whether limited to the duty's expectation of good faith or from a broader corporate governance perspective, generates a significant jurisprudential problem for contemporary English company law and policy.

## 3. THE PRE-2006 ACT COMMON LAW DUTY TO ACT IN GOOD FAITH

The following section, therefore, provides a critical, and necessary, evaluation of the pre-2006 doctrinal foundations of the duty of good faith under the English common law. It is important to emphasise, by way of a disclaimer, that there is limited authority directly answering the question of which corporate constituencies interests are the company's interests. Notwithstanding, it is argued that accounts about the company's interests equating to the collective interest of shareholders, and alternative views on the rightful beneficiary of directors' duties, are structured by partially contextualised and inadequately analysed representations of the common law duty to act in good faith in the interests of the company. These representations, in turn, form and structure modified understandings of English law.

[46] K. W. Wedderburn, *The Future of Company Law, Corporate Governance, Fat Cats and Workers* (Liverpool Institute of Employment Rights, 2004) 25-26. Of course, the approach the courts adopt when reviewing compliance with the duty follows the existing approach in *Regentcrest v Cohen* [2001] BCC 494.

[47] For a widely supported statement about the ambiguity of English company law, see L. A. Stout, et al, 'The Modern Corporation Statement on Company Law' (2016) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2848833>.

***a. Ignoring the Hutton/Parke decisions***

Undoubtedly, because of the aversion to litigation in UK company law and practice,[48] the academic commentary on the good faith requirement devotes a tremendous amount of attention to a small handful of judicial opinions as being representative of trends in the purpose of companies. There are two often-cited cases that merit our attention. The classic English decision that is customarily interpreted as determinative in this regard is *Hutton v West Cork Railway Co*,[49] decided in 1883, which is a case that turned on the limits of a company to make gratuities to its outgoing board of directors immediately prior to the company's winding up. The judgment is well known, in particular, for Bowen LJ's oft-cited dictum that, 'there are to be no cakes and ale [for employees] except such as are required for the benefit of the company.'[50] This single sentence has been subsequently construed, on the basis of nothing more than an uncritical citation of His Lordship's dicta, as authority for the principle that 'generosity to employees was held to be lawful only if it could be justified by reference to the long-term interests of the shareholders.'[51] Similarly, in the case of *Parke v Daily News Ltd.*,[52] decided in 1962, the question was raised whether it is legitimate on the cessation of the whole or part of the company's business for gratuitous compensation to be paid out of its assets to retrenched employees to relieve hardship and for pension benefits. Plowman J quoted with approval the judgment of Lord Justice Bowen in *Hutton*; in particular, His Lordship went on to state that 'the 'benefit of the company' meant the benefit of the

[48] D. D. Prentice, 'Some Aspects of the Corporate Governance Debate' in D. D. Prentice and P. R. J. Holland (eds), *Contemporary Issues in Corporate Governance* (Clarendon, 1993), 39.
[49] (1883) Ch D 654.
[50] Ibid, 673. Cf. *Re Horsley & Weight Ltd.* [1982] Ch 442 (now under CA 2006, s 172(2)). But still, it must be acknowledged that such non-commercial provisions were not always viewed favourably in first instance decisions. See *Re Lee, Behrens & Co Ltd* [1932] 2 Ch 46; *Re W & M Roith Ltd* [1967] 1 WLR 432; *Simmonds v Heffer* [1983] BCLC 298.
[51] L. Sealy and S. Worthington, *Cases and Materials in Company Law* (OUP, 11th edn., 2016), 337.
[52] [1962] Ch 927.

shareholders as a general body'.[53] Although Plowman J, remarkably, then went on to stake out an apparently self-contradictory view in the next paragraph of his judgment,[54] the case is regarded to uphold English law's insistence that non-shareholder considerations 'however meritorious, would not… form part of a true legal definition of the interests of the companies'.[55]

As expressed above, the respective decisions in *Hutton* and also the later *Parke* case have been customarily cited as a reasonably accurate juridical articulation of the corporate interest. Notwithstanding, this apparently pro-shareholder interpretation of the good faith requirement in both authorities has had many critics. Some have noted the fact that the court in *Hutton* stopped short of specifying the identity of the rightful beneficiaries directors' fiduciary discretion.[56] Others sought to show that collective shareholder entitlements, relative to the company's employees, were little more than a benign influence on both cases, which were instead decided on reasonably technical ultra vires grounds.[57] In this regard, the respective rulings do not provide a direct statement of the company's interests, whether the inquiry limits itself to expressive legal doctrine or is posed at a more general normative level. Yet, while the academic or practitioner dialogue continues to pivot around these important and influential cases, the *Hutton*/*Parke* rulings are, it is submitted, and contrary to accepted wisdom, of somewhat questionable authority for the purpose of ascertaining the company's

[53] Ibid, 963.
[54] *Parke*, above n 52, 963, where His Lordship said, 'the directors of the defendant company are proposing that a very large part of *its* funds should be given to *its* former employees in order to benefit those employees *rather than the company*, and that is an application of *the company's funds* which the law, as I understand it, will not allow [emphasis added].' This free-floating corporate interest conspicuously left out of account the counterfactual question of any benefit to the shareholders. On this point, see R. Instone, 'The Duty of Directors' [1979] Journal of Business Law 221, 227.
[55] E. M. Holland, *Report of the Second Savoy Hotel Investigation* (London, HMSO, 1954) 23.
[56] A. R. Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge, 2013) 54.
[57] Moore, above n 18, 155-156.

interests. This is because the respective cases fall within the limited "end-game" or insolvency paradigm. The implication that these decisions were influenced or formed by that paradigm is irresistible. Indeed, the good faith obligation requires directors, at a time when the company is insolvent or in the vicinity of insolvency, to take account of the interests of the company's creditors. The reason provided for this position is that if the company is in some form of financial distress, 'the interests of the company are in reality the interests of existing creditors alone.'[58] Thus, at this point, the significant residual value of the company is, in effect, transferred to creditors, who are seen as having the greatest stake in the outcome of the company.[59] Because the respective businesses in *Hutton* and *Parke* were effectively trading with the creditors' money, the directors have an obligation not to sacrifice the residual interest.[60] Accordingly, both cases can be understood this way: since the directors have little to lose where their company is in financial distress, if they engage in gratuitously transferring corporate funds to employees (or, indeed, any other corporate constituency), then the creditors will be the ones to lose out if the payment does not bear fruit for the business of the company.[61]

***b. The company's interests during solvency***

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[58] If authority is required, see e.g. *Brady v Brady* (1988) 3 BCC 535, 552.

[59] See A. Keay, Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66(5) Modern Law Review 665, 668. For the view that several groups could be regarded as exposed to residual risk, see G. Kelly and J. Parkinson, 'The Conceptual Foundations of the Company: A Pluralist Approach' (1998) 2 Company, Financial, and Insolvency Law Review 174.

[60] Keay, Ibid.

[61] Of course, the directors of solvent companies, which have no concerns about insolvent liquidation, might take a more liberal approach to approving strategic choices that have a direct impact on the non-shareholder interests, but this was merely a procedural means towards the ultimate end of enhancing the company's particular business objects.

*Overend & Gurney Co. v Gibb*[62] and *Lagunas Nitrate Co v Lagunas Syndicate*[63] are nineteenth century decisions that provide, it must be said, more direct and conspicuous articulation of the company's interests, but which have been overlooked in the legal literature.[64] This is perhaps because commentators have failed to understand the extent to which the respective rulings have a bearing on English company law outside the scope of standards for reviewing the quality of the business judgment. Notably, although in both cases the business ultimately failed, the decision subjected to review was not made immediately prior to insolvency but rather while the company was a going concern. *Overend* involved one of the largest and long-established banks in the City of London, which was sold to a newly incorporated company, Overend, Gurney & Co. Ltd. The prospectus issued to the public concealed the fact that the business had incurred huge losses as a result of questionable investments and bad debts and had been carried on at a loss for some years. Ultimately, the combination of more generalised economic instability, some unfortunate rumours, and a court case that ruled they could not collect from a debtor led to it being declared insolvent. In this case, Lord Hatherley observed that the company, as a legal entity distinct from its existing shareholders,[65] was formed for the express purpose of carrying into effect the arrangement to acquire and continue what was still considered to be a profitable business notwithstanding debt that continued to weigh upon the concern.[66] For us, what matters is not the reasons-based standards applied to the defendant directors' decision propriety, but rather that the House of Lords' judgment accepted the decision was taken in good faith in the corporate

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[62] (1872) L.R. 5 H.L. 480.
[63] [1899] 2 Ch. 392.
[64] One rare example can be found in D. Kershaw, *The Foundations of Anglo-American Corporate Fiduciary Law* (CUP, 2019) 42-46.
[65] *Overend & Gurney*, above n 62, 489. See also, the dicta of Lord Chelmsford and Lord Westbury, 496, 502.
[66] Ibid, 489.

interest. On this basis, Lord Hatherley, with whom all three other members of the House of Lords agreed,[67] went on to stake out an unmistakably commercial conception of the company's interests which, by implication, is derived from the ultimate purpose of the transaction. His Lordship contemplated an understanding of the corporate interest to which, free from any difficulties that might press upon it at commencement, and by managing it in a better way, a 'flourishing and successful' business concern is central.[68] So understood, when the obligation formulated by the House of Lords is read in the context of the facts of the case, and by the light of the principles that were being laid down by Lord Hatherley when he used the phrase, 'the interests of the company' is plainly seen to have been used to signify the company as an independent entity with an interest in pursuing its particular business objects and sustainability.

A similar separation of the company's commercial interest and corporate constituencies interest occurs in *Lagunas Nitrate Co v Lagunas Syndicate*.[69] In *Lagunas*, a syndicate of investors held nitrate lands in Chilli five years before they promoted and formed a company to purchase part of the lands. Two years after the date of the purchase, it was apparent that the deposits were less rich and more onerous to extract than had been claimed due, among other things, to problems with the local water supply. An action was brought against the directors for breach of duty with a view to the interests of the company in entering into the acquisition. Lindley, MR, and Collins, LJ (with Rigby, LJ dissenting) in the Court of Appeal held that there was no liability for the consequences of errors of judgment on the basis that the directors truly and reasonably believed that what they were doing was for the best interests of

[67] Ibid, 493, 500, 506, as per the dicta of Lord Chelmsford and Lord Westbury.
[68] Ibid, 491.
[69] [1899] 2 Ch. 392.

the company. Lindley MR clearly regards the nitrate company, in its corporate capacity, as an entity distinct from its shareholders, namely referring to persons who 'become shareholders in *it*', the company 'binding *itself*', or companies as '*distinct* commercial bodies [emphasis added]'.[70] In His Lordship's judgment, the independent existence of the company plainly informs his conclusion that, notwithstanding all the difficulties, the directors had 'no necessity, in the interest of the nitrate company, for delay, nor for modifying the contract', not least because 'large profits would be realised by the nitrate company.'[71] In addition to this, Collins LJ, in a concurring judgment, similarly emphasised the independent existence of the company,[72] and it was on this basis that he remarked, 'when the right of such companies to exist and carry out the purpose of their creation, according to the conditions of their constitution, is admitted, it would be unwise to lay down a standard of duty which would make it a practical impossibility to manage the undertaking upon ordinary business lines.'[73] For now, then, the key takeaway point is that the corporate interest, to the Court of Appeal, is understood to signify advancing the particular business objects of the company as a commercial entity, ensuring it develops and flourishes, and safeguarding its longevity.

Perhaps the leading authority that is customarily regarded to conflate the duty of good faith with promoting the exclusive and collective interests of shareholders is the Court of Appeal's ruling in the 1951 case of *Greenhalgh v Arderne Cinemas Ltd*.[74] In particular, Lord Evershed MR, with whose judgment the other members of the court agreed, apparently ruled out a free floating corporate interest when he said that 'the

[70] Ibid, 422, 426, 432.
[71] Ibid, 437-438.
[72] Ibid, 463.
[73] Ibid, 465.
[74] [1951] Ch 286.

phrase, "interests of the company as a whole", does not mean the company as a [distinct] commercial entity,' but rather 'it means the [shareholders] as a general body.'[75] This quotation from the ruling is cited in most texts and commentaries as evidence that English company law requires companies to have a profit maximisaing objective, and that managers and directors have a legal duty to put shareholder interests above all others and no legal authority to serve any other interests. But clearly, those who seek to rely upon the above dictum as authority for the shareholder primacy position typically ignore two important points. First, Evershed MR's comments were expressly confined to 'such a case as present',[76] as opposed to stipulating any sort of general principle of application.[77] This observation is reflected in an earlier authority, decided on different facts, where Evershed MR this time *rejected* the notion that shareholders were the owners of the company because, to His Lordship, '[t]he [company] is something different from the totality of the shareholding.'[78] Accordingly, stripped of the "story" about the case, the well-worn dictum in *Greenhalgh* is, it must be said, no authority for the suggestion that the shareholders interests are the corporate interest. Second, the case involves a minority-majority shareholder dispute over whether a resolution to amend the company's articles of association was taken in the company's interests.[79] Although the same meaning of the 'interests of the company' applied when an issue was solely one of the

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[75] Ibid, 291.
[76] [1951] Ch 286, 291.
[77] D. Attenborough, 'How directors should act when owing duties to the companies' shareholders: why we need to stop applying *Greenhalgh*' (2009) 20(10) International Company and Commercial Law Review 339, 344. For recognition in subsequent decisions of the nature of Evershed MR's context-specific comments, see e.g. *Re Halt Garage Ltd.* [1982] 3 All E.R. 1016 (Ch.D.). Many years later, Nourse LJ adopted a fundamentally similar approach in *Brady v Brady*, above n 58, 552.
[78] *Short v Treasury Commissioner*s [1948] 1 KB 116, 122. For a similar approach, see *Tate Access Floors Inc. v Boswell* [1991] Ch 512, 531, per Browne-Wilkinson VC.
[79] R. W. Parsons, 'The Director's Duty of Good Faith' (1967) 5 Melbourne University Law Review 395, 423. See also, Keay, above n 56, 55.

duties of directors,[80] the authority itself would appear to relate specifically to an examination of the power of shareholders acting in general meeting to alter the constitution, rather than to address the question of which corporate constituencies interests are the company's interests.[81]

Such criticisms notwithstanding, our account of *Greenhalgh* remains unfinished without discussing one further dimension to the case. This is a related, although often overlooked, issue about the bearing of the judicial test for establishing whether a proposed constitutional amendment is, in the honest opinion of those who voted in its favour, for the benefit of the elusive 'individual hypothetical shareholder'.[82] This is a person whose existence, in the words of Ross Parsons, 'is asserted with monotonous repetition in the law reports, but who remains singularly lacking in substance.'[83] It is submitted, however, that the question of whether what is proposed is for that person's benefit is in substantial character, so to speak, a rhetorical device to identify and give significance to the law's conception of what is thought to be in the commercial interests of the company's business *as a going concern*.[84] On the facts of the case, the proposed shareholder resolution to alter the articles of association was to enable existing shareholders to sell the business of the company to a purchaser outside the company who had offered to buy all of its shares. In this regard, the purpose of giving effect to the particular transaction was, it would seem, reasonably incidental to the ultimate end of the prosperity and continuation of the company's productive business or, at the least, to enable the perceived governance dispute to be resolved

[80] J. Birds, D. Attenborough, M. Leiser, M. Solinas, M. R. Varney, and Z. Zhang, *Boyle & Birds' Company Law* (Sweet & Maxwell, 10th edn., 2019), [ ].
[81] Attenborough, above n 77, 343.
[82] *Greenhalgh*, above n 76, 291.
[83] Parsons, above n 79, 396.
[84] *Greenhalgh*, above n 76, 291.

before it occasioned costs to its capital and assets. The idea that corporate power must be exercised in pursuit of the company's specified business objects and act with good faith towards it implies, in turn, that the interests of shareholders, or the particular interests of employees, consumers, and the public at large, do not practically enter the business calculus.[85]

One of the most recent cases that is commonly cited in support of the proposition that the collective interests of shareholders are the company's interests is *Gaiman v National Association for Mental Health*.[86] In simple terms, the case involves the unsuccessfully contested exercise of the managerial power, derived from the articles of association, to expel certain members of a company that carried out charitable activities. The question, then, is whether the defendant directors had exercised that power of expulsion for the purpose for which it was conferred, and whether it had been exercised in good faith in the best interests of the company. In holding that the directors exercised corporate power in good faith in the corporate interest, Megarry J referenced the collective membership focus of the 'interests of the company', put forward by Lord Evershed in *Greenhalgh*, describing it as 'a helpful expression of a human equivalent.'[87] However, it is questionable the extent to which the dicta in *Greenhalgh*, formulated in the context of a private company, applies to the special circumstances of a non-profit-making company limited by guarantee.[88] Similarly, *Greenhalgh* deals with wholly distinctive circumstances that could not be more

[85] A notable exception is in the context of majority expropriation of the minority shareholder. See *Shuttleworth v Cox Brothers & Co. (Maidenhead)* [1927] 2 KB 9; *Dafen Tinplate Co. v Llanelly Steel Co*. [1920] 1 Ch 154.
[86] [1971] Ch 317.
[87] Ibid, 330-331
[88] L. S. Sealy, '"Bona Fides" and "Proper Purposes" in Corporate Decisions' (1989) 15(3) Monash University Law Review 265, 271.

incompatible with the scenario in *Gaiman*.[89] On the contrary, when the judgment of Megarry J is read in its entirety, this dictum, identifying the company with the general body of shareholders, is arguably a slip of the pen, or represents the status of a useful metaphor or analogy, involving a momentary transference of meaning in the use of the same word. If that be so, there can be no doubt that wherever in the passage His Lordship speaks of the company, he means the "body corporate"[90] and that when he speaks of the benefit of the company, he means the duty of directors to the company is to do their best to promote moral and active support for the association, increase its revenue, and realise the association's particular purpose or vision.[91]

***c. Summarising the common law corporate interest***

To summarise the position so far, the common law conceptualisation of the duty of good faith, in some respect, embodies a time-factor that arguably already protects non-shareholder corporate constituencies, albeit in *implicit* terms, in the sense that the directors may, and indeed must, direct their efforts towards securing the prosperity and longevity of the company's particular business objects. In this regard, the law requires, at the least, that the directors ensure there is an entity in existence on a continuing basis, thus offering less tangible benefits on a continuing basis and also furthering or protecting the interests of other persons or groups. In more direct terms, a commercial company could, of course, elect to define its interests differently in its articles, i.e. to be run in the interests of other corporate constituencies or a combination of constituencies.[92] This would avoid the law's requirement that gifts of corporate monies made under implied or ancillary powers must be both made in good

[89] D. Prentice, 'Expulsion of Members from a Company' (1970) 33(6) Modern Law Review 700, 701-702.
[90] *Gaiman*, above n 86, 335-336.
[91] Ibid, 132, 338-339.
[92] *Re Horsley & Weight Ltd*, above n 51.

faith and of benefit to and for the company. Such possibilities notwithstanding, the analysis above illustrates that stakeholder-oriented scholarship has increasingly ignored an absence of descriptive support, in *explicit* terms, for the good faith obligation to deploy corporate power to provide equal weighting to other corporate constituencies in furthering the company's interests.[93] In fact, the interests of non-shareholder constituencies, so far as the corporate interest is concerned, might as well not exist: directors cannot, in exercising their powers, take account directly of the interests of these individuals or groups *in their own right*. Undoubtedly, the limited number of often-cited authorities that have been interpreted as affirming a social or public conceptulisation of the company's interests have only marginal or no direct influence on the issue of the proper beneficiary of directors' fiduciary discretion,[94] and often involve relatively unique incidents of what might be regarded as corporate social responsibility *immediately prior to the cessation of the whole or part of the company's business*.[95] We must be cautious, therefore, not to draw any reductive or inferential conclusions. More generally, and with a wider historical sweep, there is little evidence elsewhere in the principles and policies of the common law, or the prominent legal-institutional features of English corporate governance, of an overt and intelligible inclination towards laying down rules that directly promote or protect social or ethical decisions in the corporate context.

Simultaneously, the direct equation between the interests of shareholders alone and the company's interests receives little more than a mention in relation to the good faith requirement, though countless texts and commentaries have since described it as

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[93] For a representative example, see e.g. Stout, et al, above n 47.
[94] Moore, above n 18, 153-154.
[95] Ibid, 155.

an established legal principle.[96] No doubt, given the unincorporated partnership origins of the "modern" company, and the continued use in contemporary English legal parlance of "companies" and "company law", there will always be room to argue that the discipline continues to reflect an implicit and enduring acceptance of mutual shareholder agreement, rather than being predicated on free-floating notions of the corporate interest.[97] Yet it should be borne in mind that the House of Lords' ruling in *Salomon v Salomon & Co Ltd.*,[98] which gave effect to the doctrine of corporate personality established in the Companies Act 1862,[99] gives credence to the view that the law had already internalised the existence of the company as an entity before all of the key cases were decided. As well, it is precisely because directors, in exercising their managerial and policy-making powers, owe no direct duty to shareholders as such,[100] and because their duty to the company cannot be reformulated as a duty to shareholders, that the rule in *Foss v Harbottle*[101] survives. This conceptualisation is maintained, in concrete terms, in cases like *Greenhalgh*, in the sense that the fact the Court of Appeal enumerated only *specific* pro-shareholder observations about the interests of the company, and often confined those utterances to the case at hand,

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[96] For a representative sample, see Davies and Worthington, above n 15, 16-1; *The Strategic Framework*, above n 35; R. Goddard, 'Modernising Company Law: The Government's White Paper' (2003) 66(3) Modern Law Review 402, 405; Lord Wedderburn, 'Companies and Employees: Common Law or Social Dimension?' (1993) 109 Law Quarterly Review 220, 230-231; J. Parkinson, above n 8, 77.

[97] L. C. B. Gower, 'Some Contrasts Between British and American Corporate Law' (1956) 69(8) Harvard Law Review 1369.

[98] [1987] AC 22.

[99] CA 1856, s 6. On this point, see P. Ireland, I. Griggs-Spall, and D. Kelly, 'The Conceptual Foundations of Modern Company Law' (1987) 14(1) Journal of Law and Society 149, 149-150.

[100] On the co-existence of context-dependent and personal duty-type relationships that might arise between a director and shareholder or any other constituency, see Davies and Worthington, above n 15, 507-509.

[101] (1843) 67 ER 189. See also, *Lee v Lee's Air Farming Ltd.* [1961] AC 12, 25; *Salomon v Salomon and Co Ltd.* [1897] AC 22, 30; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 157. On the descriptive support for the entity concept in the UK, the US, and other jurisdictions, see G. Mark, 'The Personification of the Business Corporation in American Law (1987) 54 University of Chicago Law Review 1441, 1465.

provides all the more reason to believe the court had no intention of making the collective interests of shareholders a de facto right in the common law.

Properly understood, the juridical articulation of the directors' proper fiduciary objective is, it is submitted, organised around the conception and underlying power structure of a UK company.[102] Although, strictly speaking, the distribution of corporate power in UK companies consists largely of internal default rules, most typically set out in the articles of association, the effect of these simple and facultative rules is to produce a broadly similar type of governance structure. Obviously, the directors occupy a pre-eminent position in the management of the company's affairs.[103] The directors, who are subject to a mandatory 'without cause' removal right,[104] cannot be controlled by the shareholders in general meeting as if they were delegates or agents.[105] However, it is the shareholders in general meeting, through their exclusive province over the contents of the articles, which unilaterally determine the specific activities for which the company has been formed and substantially grants corporate power to the directors.[106] In any delegation of power setting, of course, it is an established legal principle that the delegate has a good faith obligation to further the delegator's interests. On this view, the sovereign interests of the shareholders as a constituency, it might be inferred, silently structure the director's exercise of that power. To be clear, in the limited number of cases, analysed above, the delegation of corporate power inference is not understood as driving a crude and impractical "maximisation of shareholder value" instruction. On the contrary, although the courts' have often stopped short of providing conclusive answers to the core question

[102] I am particularly grateful to the anonymous JCLS reviewer for making this point to me.
[103] Companies (Model Articles) Regulations 2008, Art. 3.
[104] CA 2006, s 168.
[105] See e.g. *Gramophone and Typewriter Ltd v Stanley* (1908) 2 KB 89.
[106] CA 2006, s 33.

of the company's interests,[107] and taken in itself the phrase is an ambiguous one,[108] the essential nature of the courts' diction still settles on the arguably more functional and nuanced autonomous commercial interests of the company, and what would enhance the prosperity and continuing survival of its particular business objects. Any benefits for shareholders, in addition to other individuals or groups with less tangible claims against the company, flow from that very object.

Now there is in one respect in which, when a commercial company is formed with the object of making profits, at some point of financial stability its continuing interests, as an independent legal entity, usually coincide with that of its shareholders.[109] In such a case, and to that extent, it can be said that the actions of the directors must be *capable* of producing some return for the shareholders, who retain the residual interest when the company is solvent. However, the extensive role played by the good faith requirement in focusing directors on the company *as a commercial entity* and what will enhance *its* assets and resources, for the law, does not mean that the corporate interest is necessarily measured by how much profit has been made for both shareholders as a group or the interests of a section of that group. On many issues, the company's particular business objects and its shareholder interest in share value diverge, to the extent that a company pursuing only shareholder value might transfer value away from the business enterprise or fail to be able to meet its obligations. In this way, as Ross Grantham notes, 'even in those cases that pit shareholders against each other, if the commercial interests of the company *as an entity* are relevant it seems that the corporate interest will not be defined exclusively in terms of

[107] See above n 42.
[108] *Brady v Brady*, above n 58, 552.
[109] Parkinson, above n 8, 77.

shareholder interests [emphasis added].'[110] On this view, the interests of shareholders can remain justifiably unsatisfied or prejudiced by the directors if this is reasonably required in the interests of the company's particular line of business. Accordingly, for example, the board is required to avoid actions such as trimming labour costs, economising on health and safety matters that can put the workforce and the community in danger, the delaying of the payment of creditors and gambling with the company's fortunes, which can entail correspondingly negative implications for corporate financial performance, just to pay a higher dividend and/or to justify a higher share price unaligned to corporate benefit. Above all else, safeguarding and expanding the company as a going concern never ceases to be a proper and necessary point of reference, to which any continuing interests of the actual shareholders, or non-shareholder corporate constituencies, are divined from the commercial interests of the company as a going concern. It is arguable that in doing this the common law formulation requires corporate boards, first and foremost, to ensure the business of entity exists on a continuing basis.

## 4. IMPLICATIONS FOR COMPANY LAW AND SCHOLARSHIP

We explained above that section 172 of the 2006 Act restated the common law duty of good faith as a default mandatory rule to promote the company's success for the exclusive benefit of shareholders.[111] This test for specifying the propriety of directorial conduct under the equitable fiduciary doctrine is apparently based on the common law heritage of regulating managerial discretion, which continues to be generally determinative of the interpretation and application of the codified duty.[112] The common good faith obligation was, it will be recalled, relatively simple: in all

[110] Grantham, above n 4, 568. See also, Sealy, above n 88, 270.
[111] See sources cited in nn 25-36 above (and accompanying text).
[112] See sources cited in nn 37-40 above (and accompanying text).

areas, directors were expected to act in good faith in the 'interests of the company'. However, if we consider the essential compatibility of the 2006 Act and common law position, the attempt at codification of the duty of good faith is a reminder that statutory drafting in novel circumstances sometimes involves the legislature in re-writing important corporate legal rules, under the impression that it is following orthodox principles. In particular, section 172 subordinates the company's commercial interests to the interests of shareholders as a constituency. Following Berle's call for the company's interests to be regarded along private-individualistic lines, the fact that the English common law has never directly affirmed such an understanding has been increasingly ignored within academic or law-making circles. Today, appropriate weight to this free-floating commercial interest is disappearing. Without it, there is the risk that the company's ability to preserve or invest resources and capital in long-term projects and to generate value is weakened. This is the topic of separate papers, but in the context of an overview of the general problem a number of doctrinal and normative observations can be made.

***a. Doctrinal implications of a misstated corporate interest***

On a doctrinal level, a starting-point for our inquiry into this legal innovation is the inevitable question of whether an express focus on shareholder interests was self-identified as a deliberate and consequential restatement of the law on directors' general fiduciary duties. Certainly, if the wording of the 2006 Act replaces the common law,[113] but is to be interpreted and applied in light of those pre-existing duties,[114] it would appear to create a presumption that the Company Law Review did

[113] CA 2006, s 170(3).
[114] CA 2006, s 170(4).

not envisage significant reformation of directors' general duties.[115] In this regard, the Company Law Review decided, relatively quickly, that the codified duty of good faith should retain, what was in its view, the apparent shareholder focus from the common law, and that the enlightened shareholder value formulation was merely taking the pre-existing common law duty and 'making its true character' more explicit in statute.[116] As well, the UK government stated explicitly during the passage of the legislation that the codified duties simply 'clarified' rather than amended the common law.[117] Yet on the present state of the evidence, although the codified duty's narrowing of focus on the collective interests of shareholders was regarded as a conscious and rather banal political choice, it arguably lays down rules that are legal rules in their own right, based independently of the common law, and challenges the formerly orthodox judicial articulation of the 'interests of the company'.

No doubt, regardless of whether the corporate interest at common law is closely identified with the commercial interests of the company's particular business, or a much more specific obligation to consider and protect the general body of shareholders, the continuing relevance of a subjective good faith *review standard* is, in practice, likely to result in the same undemanding judicial test for determining conformance with the legal duty.[118] However, while there is much in the codified duty that is clearer and more authoritative, taken too literally, the restated *conduct standard* that is expected of directors is a significant doctrinal concern for two principal reasons. First and foremost, this is considered to be the case, in particular, in the

[115] A. Alcock, 'An Accidental Change to Directors' Duties?' (2009) 20 Company Lawyer 362, 362.
[116] *Strategic Framework*, above n 35, para. 5.1.
[117] United Kingdom, Parliamentary Debate, House of Lords, 9 May 2006, vol 681, col 840; United Kingdom, Parliamentary Debate, House of Lords, 6 Feb 2006, vol 678, col GC255.
[118] See *Prudential Assurance Co. Ltd. v Newman Industries Ltd (No. 2)[*1982] Ch. 204. See also, A. R. Keay, 'Section 172(1) of the Companies Act 2006: An Interpretation and Assessment' (2007) 28 Company Lawyer 106.

limited range of post-2006 decisions involving section 172 (outside of derivative action proceedings), which have failed to approach statutory interpretation in a purposive and complete way in respect to the question of what was the proper common law reasoning of the corporate interest. Instead, the courts have preferred to accept the unanalysed assumption that the interests of the general body of shareholders were the company's interests.[119] Contrary to popular thought on the codified duties,[120] an important, though undesirable, effect of the continuing misstatement of the common law articulation of the corporate interest might be the recognition of an as yet incompletely conceptualised conduct standard change. To the extent this view is correct, the failure to provide adequate guidance on the general law could misdirect directors when deploying corporate power to carry out of their functions. For example, in the areas of apportioning surplus funds[121] or corporate acquisitions and restructurings,[122] if not in others, there are, in the entity-first understanding of the corporate interest, many options available to directors that will permit the company's particular business to flourish and to sustain it. In contrast, it would seem that a board is expected under section 172 to consider and protect the corporate entity's assets and capital as merely a procedural means towards the ultimate end of enhancing shareholder value, which, itself, is neither the equivalent of entity prosperity and longevity nor a reasonable proxy for business value.[123]

[119] See above n 35.
[120] Arden, above n 29, 3-4.
[121] A. R. Keay, 'Ascertaining The Corporate Objective: An Entity Maximisation and Sustainability Model' (71(5) Modern Law Review 663, 694-696.
[122] See e.g. G. Tsagas, 'A Long-Term Vision for UK Firms? Reconsidering Target Directors' Advisory Role Post the Takeover of Cadbury's plc' (2014) 14(1) Journal of Corporate Law Studies 241; Parkinson, above n 8, 78-79.
[123] J. E. Fisch, 'Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy' 31 (2006) Journal of Corporation Law 637, 643-644.

Second, since the late-1970s and early 1980s, with the convergence of global financial deregulation and new information technologies, capital markets have been transformed. In this area, the contentious label of 'globalisation' seems appropriate, not least because electronic trading has created truly global financial markets that are able to move instantaneously enormous amounts of money around the world. In this process, the international trade in shares has also escalated. These developments have led to a significant change in ownership distribution and complementary changes in corporate governance. Due to the increasing use of financial intermediaries,[124] which generate 'investment chains' between the shareholder (or, more aptly, the 'beneficial owner' of shares) and the UK companies they invest, modern share ownership is typically far less direct and increasingly ambiguous than it was fifty years ago.[125] Properly understood, actual and potential intermediaries, and beneficial owners, might each have different priorities or interests in any given strategic action before the board. Of course, intermediation has both good and bad aspects, which have been discussed elsewhere.[126] For us, in spite of its purported attempt to 'enlighten' corporate boards,[127] the restatement of the entity-first corporate interest as a shareholder-first interest, perhaps counter-intuitively, generates a reductive shareholder agenda that is not free from ambiguity and tension in the modern corporate legal landscape. As Eric Orts has remarked, 'shareholders have different time and risk preferences that managers must somehow factor together, if they are to

[124] On the main types of institutional shareholder likely seen in UK public companies, see J. Kay, *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July, 2012), 32. See also. P. L. Davies, 'Shareholders in the United Kingdom' in R. Thomas and J. Hill (eds.), *Research Handbook on Shareholder Power* (Edward Elgar, 2015), 355.
[125] Kay Review, ibid, 30. For a critique of the view that modern shareholder ownership is homogenous and predictable, see L. A. Stout, *The Shareholder Value Myth* (Berrett-Koehler, 2012) 8-9.
[126] Kay Review, ibid, 11, 22.
[127] *Developing the Framework*, above n 23, para. 2.21.

represent fairly the artificially unified interests of "the shareholders" in general.'[128] As reformulated, it is plainly arguable, therefore, that a good faith rule, which ensures that, when directors exercise discretionary power, they use company assets and resources only for the benefit of an apparently mythical shareholder interest in share value, seems practically misconceived, if not indeed in some sense conceptually impossible.

***b. Normative implications of a misstated corporate interest***

On a normative level, this account of specifying the ultimate corporate objective explicitly in terms of promoting the company's success for the exclusive benefit of its shareholders as a constituency would not be complete without a brief comment about the possible normative effects of a mistaken assumption that shareholder interests are the company's interests. No doubt, there are powerfully influential deontological[129] and consequentialist[130] arguments to explain or encourage increasing share value as the default and exclusive objective of company law.[131] It is fair to say that most are, in some way, informed by the economic managerial 'agency' problem in company law, and the pronounced distrust of directors' discretionary administrative authority.[132] In this regard, it is perhaps entirely understandable that the protection of shareholders, and the control of shareholders over management have been previously described as 'the vital corporate problems' of the twentieth and twenty-first centuries.[133] Of course, the fact that directors exclusively represent shareholder interests does not necessarily,

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[128] E. Orts, 'The Complexity and Legitimacy of Corporate Law' (1993) 50 Washington and Lee Law Review 1565, 1591.
[129] See above n 4.
[130] See above n 6.
[131] S. Gilson, 'Separation and the Function of Corporation Law' (2005) 2(1) Berkeley Business Law Journal 141, 145.
[132] For a useful analysis of agency problems in company law, see R. Kraakman, et al, *The Anatomy of Corporate Law* (OUP, 3rd edn., 2016) at Ch. 2.
[133] L. C. B. Gower, ' Some Contrast Between British and American Corporate Law' (1956) 69(8) Harvard Law Review 1369, 1381.

at the same time, mean consistently acting partially and to the detriment of the company's profitable and sustainable business. Specifying, when a commercial company is formed for the basis of making profits, as mentioned above, at some point of financial stability its continuing interests in the business flourishing usually coincide with that of its shareholders. However, even if the corporate entity's interest in growth and prosperity and shareholder interest in share value is, in many cases, aligned, sometimes they are not. In this regard, the normative arguments against the shareholder value approach are a cause for concern. The analysis below provides merely a flavour of its weaknesses.

Perhaps unsurprisingly, it is difficult to measure and empirically test a link between the idea that shareholders might prefer short-term value maximisation and the negative economic downside for companies, investors, and the economy.[134] Against this backdrop, the concerns about short-termism might seem exaggerated.[135] However, there remains an on-going and significant furore in academic[136] and business circles[137] that the possibility of a causal connection must be taken seriously. While logically a mistaken assumption about the corporate interest, which prioritises

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[134] The limited evidence is, in fact, mixed. For a representative event study that market pressures can lead corporate boards to act in ways that boost the short-term share price at the expense of long-term value, see I. D. Dichev, J. R. Graham, C. R Harvey, and S. Rajgopal, 'Earnings Quality: Evidence from the Field' (2013) 56(2) Journal of Accounting and Economics 1. Cf. M. J. Roe ,'Stock Market Short-Termism's Impact' (2018) ECGI Working Paper 426/2018 <https://ecgi.global/sites/default/files/working_papers/documents/finalroe.pdf> accessed 4 April 2019.

[135] Roe, ibid; L. A. Bebchuk, A. Brav, and W. Jiang, 'The Long-Term Effects of Hedge Fund Activism' (2015) 115 Columbia Law Review 1085; J. M. Fried and C. C. Y. Wang, 'Short-Termism and Capital Flows' (2019) 8(1) The Review of Corporate Finance Studies 207.

[136] M. Moore and E. Walker-Arnott, 'A Fresh Look at Market Short-termism' (2014) 41 Journal of Law and Society 416; L. Talbot, 'Why Shareholders Shouldn't Vote: A Marxist-progressive Critique of Shareholder Empowerment (2013) 76(5) Modern Law Review 791; W. W. Bratton and M. L. Wachter, 'The Case Against Shareholder Empowerment' (2010) 158 University of Pennsylvania Law Review 653; L. A. Stout, 'On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)' (2013) 36(2) Seattle University Law Review 1169.

[137] Recently, the chief executive of a US public company, Tesla, detailed his plans to take the company private in order to insulate Tesla from market short-termism. See <https://www.tesla.com/en_GB/blog/taking-tesla-private> accessed 4 April 2019.

collective shareholder interests, should not necessarily generate short-termism, as Andrew Keay notes, ‘with a concomitant fixation on the quarterly earnings of companies and their share value, in practice this has often occurred.’[138] Indeed, Moore and Arnott observe that the pressure to keep share price high has often driven public companies to adopt strategies that ultimately undervalue long-term profit opportunities, to sell vital assets for short-term effect on a company’s periodic revenue or cost profile, to cut back on product support and on research and development, or taking on excessive risks and excessive leverage.[139] Recently, the unhealthy focus on short-termism was a point made by the then Business, Innovation, and Skills business select committee members in their review of Kraft’s takeover of Cadbury. Most interesting is the committee’s criticism of the takeover process in the UK and the fact that Cadbury’s fate was ‘ultimately decided by institutional investors motivated by short-term profits rather than those investors who had the company’s long-term interests at heart.’[140]

Other critics, meanwhile, might be inclined to think that Parliament is entitled to command the courts to change the rules, even retrospectively, but Parliament should not make the common law different from what the judges say it is any more than it can alter a historical fact.[141] Of central importance in this regard is the fact that the effects of a mistaken assumption about interest expectation contributes to a contentious exclusive shareholder agenda, which is, it must be said, very limited in its focus. Although it is often viewed as a normatively appropriate basis for evaluating

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[138] Keay, above n 121, 671.
[139] Moore and Walker-Arnott, above n 136, 431.
[140] Business, Innovation and Skills Committee, *Mergers, acquisitions and takeovers: the takeover of Cadbury by Kraft* (HC, 2009-10, 234) 23.
[141] P. S. Atiyah, Common Law and Statute’ (1985) 48(1) Modern Law Review 1, 19.

the efficiency of company law,[142] this is an empirically contestable common assumption,[143] not least because a focus on shareholder value risks legitimising managerial behaviour that may ultimately destroy business value.[144] The recent corporate failures of RBS and Carillion provide examples of shareholder value driving corporate boards to concentrate on increasing revenue, profits, assets, and leverage, rather than on the corporate interest of capital growth, liquidity, and asset quality. Indeed, within a year prior to collapse both companies hiked their dividend in spite of revealing bad debts and/or selling assets to fill the dividend gap.[145] This shareholder value approach is also problematic in that directors might choose to pursue inefficient or high-risk investment practices where the company is close to falling into an insolvent position from which it cannot escape.[146] In such situations, shareholders will probably prefer that directors not invest in certain projects with positive net present value because the net present value generated by these projects, though positive, will not produce optimal (or at least sufficiently high) benefits that will go to shareholders, who are secondary to creditors when it comes to distribution

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142 For discussions of maximising share value as efficient, see Easterbrook and Fischel, above n 6, 38; M. Lipton and S. A. Rosenblum, 'A New System of Corporate Governance: The Quinquennial Election of Directors' (1991) 58 University of Chicago Law Review 187, 203-205; J. H. Matheson and A. Olsen 'Corporate Law and the Long-term Shareholder Model of Corporate Governance' (1992) 76 Minnesota Law Review 1313, 1329.

143 Fisch, above n 123, 644; E. Elhauge, 'Sacrificing Corporate Profits in the Public Interest' (2005) 80 New York University Law Review 733, 776; T. A. Smith, 'The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty' (1999) 98 Michigan Law Review 214, 221-225; J. Coffee, 'Shareholders Versus Managers: The Strain in the Corporate Web?' (1986) 85 Michigan Law Review 1, 91.

144 See e.g., C. O'Kelly, 'History Begins: Shareholder Value, Accountability and the Virtuous State' (2009) 60 Northern Ireland Legal Quarterly 35, 49; W. W. Bratton, 'Enron and the Darker Side of Shareholder Value' (2002) 76 Tulane Law Review 1275, 1284.

145 See e.g. J. Plimmer and J. Ford, 'Carillion ran up debts and sold assets to fill £217m dividend gap' Financial Times (London, 26 January 2018) <https://www.ft.com/content/f5bbf3a2-01e0-11e8-9650-9c0ad2d7c5b5>; Stephen Seawright, 'RBS Raises Payout after Profit Growth' The Telegraph (London, 1 March 2007) <https://www.telegraph.co.uk/finance/2805052/RBS-raises-payout-after-profit-growth.html> accessed 4 April 2019.

146 M. Jensen and W. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305.

of the company's funds.[147] In such a scenario, the shareholders might prefer to "roll the dice" with the company's fortunes for they have nothing to lose.[148] This approach is, it must be said, incompatible and antagonistic to the entity-first corporate interest that was articulated by the common law.

## 5. CONCLUSION

This article examined the operational capacity of an important principle of company law, which is central the test for determining the propriety of directors' exercise of corporate power under the equitable fiduciary doctrine. In particular, it analysed the common law duty of good faith, which remains practically significant in interpreting and clarifying the content of the attempted codification set forth in section 172 of the 2006 Act. While the statutory duty restates the judicially determined test of acting in the 'interests of the company' as an express requirement to promote the success of the company for the exclusive benefit of shareholders, the path of the common law took a different approach in respect to interpreting this expression. In closer inspection to the limited range of pre-2006 cases directly addressing the ultimate objective of companies, three salient and authoritative points emerge. First, there were no appropriate circumstances in which the directors might legitimately advance the interest of shareholders or, for that matter, any other groups or entities involved in corporate activities. No doubt, it might be inferred that shareholder sovereign control of the nature and extent of directorial authority silently structures the cases. Yet the corporate interest does not ultimately come down to a reductive 'maximisation of shareholder value' instruction. Second, and contrarily, common law reasoning about

[147] S. C. Myers, 'Determinants of Corporate Borrowing' (1977) 5 Journal of Financial Economics 147. See also, R. Stulz and H. Johnson, 'An Analysis of Secured Debt' (1985) 14 Journal of Financial Economics 501; E. Berkovitch and E. H. Kim,'Financial Contracting and Leverage-induced Over-and Underinvestment Incentives' (1990) 45 Journal of Finance 765.
[148] Keay, above n 121, 673.

the corporate interest evidently informs a more functional and nuanced conceptualisation of the company as an autonomous commercial entity, to which directors must advance the prosperity and continuing survival of its particular business objects. Any benefits for shareholders flow from that very object. Third, Parliament and the common law's encounter with the good faith obligation might be framed, as this article submits, as antagonistic alternatives, or mutually exclusive directions of travel, rather than understood as a single coherent, integral body of law. Instead of assisting us in assessing the propriety of managerial conduct, the interaction between common law and statute law with respect to the pivotal role played by the good faith doctrine is likely to require cautious and coherent development in the case law in the absence of further legislative reform.