

10. Enlightened Shareholder Value: UK Company Law and Corporate Governance

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A. Introduction

Shareholder primacy has long been the dominant theory of company law and corporate governance in the United Kingdom. Initially, shareholder primacy developed from increasingly dispersed share ownership and the separation of ownership and control. A shareholder-oriented understanding of companies was strengthened by the fiduciary duty for directors to act *bona fide* in the best interest of the company, which was interpreted to mean the interest of shareholders as a group. After its landslide victory in the 1997 UK General Election, the New Labour government started a comprehensive review of the scope of company law in the UK. This review devoted a significant amount of time to corporate theory and considered three different options: shareholder value, a pluralist approach, and the enlightened shareholder value theory. The latter was finally adopted and has since been the dominant theory of UK company law and corporate governance.

This chapter traces the historical origins of shareholder primacy in the UK and then critically assesses the implementation of the enlightened shareholder value theory through the UK Companies Act 2006, specifically the duty to promote the success of the company located in section 172 (1), as well as nonfinancial information disclosure duties. Moreover, the chapter situates the doctrinal legal analysis in the institutional context that favours shareholder primacy, such as the market for corporate control and the preference for a soft law approach to corporate governance, particularly through the UK Corporate Governance Code. The final part of this chapter discusses to what extent the UK aligns with, or deviates from, current European approaches to corporate sustainability post-Brexit.

Overall, the chapter shows that shareholder primacy is deeply enshrined in the UK's system of company law and corporate governance – both as a legal norm and as a social norm. The dominance of the shareholder prima-

cy theory in the UK has significant practical impact due to the extensive use of the public limited company as a form of business organisation.

Regarding terminology, the chapter often refers to ‘stakeholder value’ and the ‘pluralist approach’, particularly in relation to the Companies Act of 2006. However, considering the final part of the chapter – which discusses convergence or divergence of the UK with the recent European regulations designed to achieve greater corporate sustainability – reference in this chapter is also frequently made to the term ‘sustainability’.¹ The chapter adopts the definition of Griggs et al., who define sustainability as ‘development that meets the needs of the present while safeguarding Earth’s life-support system, on which the welfare of current and future generations depends’.² This understanding requires amending the three-pillar model of economic, environmental, and social sustainable development as an interlocked concept.

B. Historical perspective: The evolution of shareholder primacy in the United Kingdom

The chapter starts by analysing the reasons why the shareholder primacy theory gained such a strong position in UK company law. This section will examine four different grounds: first, the historic debate about corporate theory and its strong push for shareholder value; second, the common law duty for directors to act *bona fide* in the best interest of the company; third, the existence of a market for corporate control with hostile takeovers; and fourth, the strong preference for a soft law approach to corporate governance.

I. The historic debate about corporate theory

The theory of shareholder primacy (also referred to as ‘shareholder value’ in this chapter) has long been the dominant theory of UK company law

1 In fact, the terms ‘sustainability’ and ‘sustainable development’ are often used interchangeably. See A Rühmkorf (ed) *Nachhaltige Entwicklung im deutschen Recht: Möglichkeiten und Grenzen der Förderung*, (Nomos 2018), p. 9.

2 Griggs et al. *Nature* 2013, 496.

and corporate governance;³ shareholder primacy has dominated corporate law in the United Kingdom since the 1980s.⁴ However, the theoretical aspect of the shareholder primacy theory was developed earlier than the 1980s, and this background helped the theory gain a strong grip on the general thinking about the aims and objectives of companies.

As the owners of shares, shareholders were historically equated with the company; focus on shareholders evolved from 19th century partnership law.⁵ The best point to start from is the Companies Act of 1844, which facilitated the formation of companies. However, for quite a while, the idea of limited liability was not included in the general thinking regarding company law, and the idea of the company being a separate legal entity from its shareholders was not a universally-accepted fact. However, this changed with the realisation that investors needed security, which could only be offered through limited liability.⁶ The concept of the company being a separate legal entity was finally settled in 1897 with the landmark decision of *Salomon v. Salomon*.⁷

A significant development for the discussion on shareholder paradigm was the 'separation of ownership and control', a phrase coined by Berle and Means in the 1930s.⁸ Specifically, Berle and Means stated that managers and shareholders had become divided. In the UK, the exact timing of this separation of ownership and control is controversial.⁹ The traditional view is that families remained in control of companies for the first half of the 20th century.¹⁰ However, it has been argued that, insofar as listed companies in the UK are concerned, the separation of ownership occurred in the early 20th century with increasingly dispersed shareholding.¹¹ Berle and Means base their observation on the fact that shareholders lacked the ability or knowledge to control the corporation, and accordingly, that the shareholders had delegated this role to management. Consequently, the managers (directors) effectively controlled the company, unlike the share-

3 Chiu Law and Financial Markets Review 2016, 173.

4 Key ECFR 2010, 369 (370).

5 Ireland MLR 1999, 32.

6 Gamble/Kelly Corporate Governance 2001, 110 (111).

7 [1897] AC 22.

8 Berle/Means, *The Modern Corporation and Private Property* (Transaction Publishers 1991, originally published in 1932).

9 See for a detailed discussion: Johnston/Segrestin/Hatchuel *Legal Studies* 2019, 75.

10 Chandler, 288 et seq.

11 See Hannah *Business History* 2007, 404 (417).

holders. This situation led to the evolution of professional management in the UK.¹² Managerialism describes the power of professional managers.¹³ An information asymmetry developed between the increasingly dispersed shareholders and the managers – heightened by the increasing size and complexity of companies.

This ‘separation of ownership and control’ is closely linked to one of the main lines of theoretical support for shareholder primacy. The ‘agency theory’ stems from this separation: it views directors as the agents of shareholders (as the owners of the shares and providers of the capital who are the principals).¹⁴ Moreover, the agency theory argues that management should be accountable to shareholders, maximising the shareholders’ investments.¹⁵ This approach would prevent managers from acting in a self-serving way, which is one of the dangers of the information asymmetry between managers and shareholders.¹⁶ As shareholders purchase shares, they are seen as the owners of the company, or at least of the business, which helps classify them as ‘principals’ in this theory.¹⁷

A more recent line of support for shareholder value came via the ‘nexus of contracts theory’, which has further influenced thinking about company law in the Anglo-American world, including the United Kingdom.¹⁸ This theory treats the corporate entity as a ‘legal fiction’ based on explicit and implicit private contracts. All constituents of the corporate entity have contracts with it.¹⁹ However, the only constituents whose claim is not fixed are the shareholders. Other constituents, such as employees, creditors, suppliers, or customers, all have a fixed claim, i.e. the contract determines what they can claim from the corporate entity. In contrast, the shareholders claims are not fixed; shareholders only receive what is left once all other (fixed) claims have been met through dividends (the ‘residual earnings’).²⁰ Arguably, this situation would be unjustified, given that the shareholders provide the capital. In turn, the nexus of contracts theory leads to the

12 Johnston/Segrestin/Hatchuel *Legal Studies* 2019, 75 (77).

13 Johnston, *EBOLR* 2006, 817 (818).

14 Easterbrook/Fischel, p. 37.

15 Sheikh/Rees; *Hutton v West Cork Railway Co. Ltd.* [1883] 23 Ch. D. 654, 673.

16 Hansmann/Kraakman *Geo.L.J.* 2001, 439 (448).

17 See Hansmann, *Journal of Law, Economics and Organisation* 1988, 267.

18 See for the ‘nexus of contracts theory’: Easterbrook/Fischel, p. 12.

19 *ibid.*, p. 37.

20 *ibid.*, p. 25.

argument that directors must prioritise the interest of shareholders and focus on maximising return on shareholders' investment.²¹

These different theoretical debates cumulatively lend strong support to the idea that directors must work in the interest of shareholders and maximise shareholder value. The shareholder value theory provides a clear means of measuring the performance of directors.²² Thus, the shareholder value theory helps to address the issues identified by both the agency theory and the nexus of contracts theory. As mentioned, these debates about the role of the company are similar in the USA and the UK and have had a significant impact on corporate doctrine in the UK.

Based on the theoretical justifications of the shareholder value theory, Friedman argued that a director who acts in a socially responsible manner would impose taxes on shareholders when, in fact, he would be an 'employee of a private enterprise'.²³ The consequence of these arguments is a significantly limited scope for directors to pursue goals other than those that maximise shareholder value. In turn, there is only scope to pursue the interests of other stakeholders – including sustainability – when those interests further the business, i.e. when it is done as a 'business case'.

These theoretical debates have shaped the approach to company law in much of the 20th century. However, other developments such as the common law duty to act *bona fide* in the best interest of the company, the market for corporate control, and the soft law approach to corporate government as evidenced by several self-regulatory codes, particularly the UK Corporate Governance Code, helped entrench shareholder value in the UK during the 20th century. Each of these factors will be addressed in the following parts.

II. The common law duty to act *bona fide* in the best interest of the company

Prior to the UK Companies Act of 2006, directors' duties were not codified. The Companies Act of 1985 covered most aspects of the formation and running of companies, but it continued to leave the development of directors' duties up to case law. This is possible in common law jurisdictions as both

21 Hansmann/Kraakman, *Geo.L.J.* 2001, 439 (449).

22 See for a discussion of this point: Keay, 18 et seq.

23 M Friedman, 'The Social Responsibility of Business is to Increase its Profits' *New York Times* (New York 13 September 1970) § 6 Magazine.

statutes and cases are primary sources of law. However, Parliament can always decide to intervene and make laws that replace common law.

Pre-2006, the shareholder value focus of UK company law was found in the fiduciary duty for directors to act *bona fide* in what they considered to be in the best interests of the company.²⁴ The phrase ‘interests of the company’ was equated with ‘shareholders as a general body’, which led to the interpretation of this duty as being focused on shareholder interests.²⁵ Consequently, common law effectively required directors to pursue shareholder value.

In the Companies Act of 2006, directors’ duties were codified. The legislature was careful to find the right balance between the ‘old’ and the ‘new’ when codifying the duties. Section 170 (3) Companies Act 2006 stipulates that the general duties for directors in the Companies Act of 2006 are based on certain common law rules and equitable principles as they apply in relation to directors, and that the Companies Act of 2006 has effect in place of those rules and principles regarding the duties owed to a company by a director. Second, section 170 (4) Companies Act 2006 adds that the general duties must be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be given to the corresponding common law rules and equitable principles in interpreting and applying the general duties. This point in section 170 (4) Companies Act 2006 is important for the doctrinal analysis of the new duty in section 172 (1) Companies Act 2006 to promote the success of the company, as analysis of section 172 (1) refers to the common law where relevant.

III. The market for corporate control

The third important historical reason for the firm grip that the shareholder value theory has on UK company law is its reliance on the market for corporate control. Takeovers (both hostile and voluntary) became an important tool to hold directors accountable for promoting the interests of shareholders.²⁶ The first wave of hostile takeovers in the UK occurred in the

24 See only *Re Smith and Fawcett Ltd* [1942] Ch [304].

25 See *Re Smith & Facett Ltd* [1942] Ch [304], [306]; *Hutton v West Cork Railway Company* (1883) 23 Ch. D. 654; *Parke v Daily News Ltd* [1962] Ch. 927.

26 See Gamble/Kelly, *Corporate Governance* 2001, 110 (112).

early 1950s.²⁷ Hostile takeovers play an important role in the shareholder primacy theory as they serve as a means for controlling the efficiency of boards of directors.²⁸ If boards are underperforming, it is reflected in the share price. This situation attracts outside investors who may be interested in taking over the company by purchasing a majority of the shares. The existing shareholders are then offered more for their shares than current market value.²⁹ The theoretical assumption is that inefficient boards are then replaced by efficient ones and that, consequently, the company will be managed better. This scenario means that the threat of a hostile takeover exercises control over a board and, thus, according to the shareholder value theory, this control over boards benefits society by making companies more efficient.

Regulation of takeovers in the UK is found in different sources, including Part 28 of the Companies Act of 2006 and the City Code on Takeovers and Mergers (referred to as the 'City Code').³⁰ The City Code is issued and administered by the Panel on Takeover and Mergers (referred to as the 'Panel') whose membership is comprised of practitioners and regulatory organisations in the City of London.³¹ It would go beyond the scope of this chapter to fully analyse the rules of the UK Takeover Code, but two points are significant for the analysis here. First, the Panel has overseen takeover regulation in the UK since 1968, the year the City Code was first issued. This means that takeovers have been subject to self-regulation in the UK since 1968. Second, the Code prioritises the interests of shareholders and takes a strict approach towards defensive measures against hostile takeovers through the 'no frustration rule'. General Principle 3 states that

[t]he board of directors of an offeree company must act in the interests of the company as a whole and must not deny the holders of securities the opportunity to decide on the merits of the takeover bid.

Building on General Principle 3, Rule 21 ('Restrictions on Frustrating Action') of the Code stipulates that the board of directors must not take,

27 See Johnston/Segrestin/Hatchuel *Legal Studies* 2019, 75 (91).

28 Armour/Deakin/Konzelmann, *British Journal of Industrial Relations* 2003, 531 (534).

29 See generally on takeovers: Davies, p. 107 et seqq.

30 See for a detailed historical account: Johnston *Cambridge Law Journal* 2007, 422.

31 The Panel comprises up to 34 members, representing a spread of expertise in takeovers, securities markets, industry and commerce, see: The Takeover Panel, Panel membership, available at: <https://www.thetakeoverpanel.org.uk/structure/panel-membership> (last accessed: 15 February 2025).

or agree to take, any restricted action or any other action which could result in the frustration of any offer or *bona fide* possible offer unless it has the approval of shareholders in general meeting or the consent of the Panel. With its strict approach towards defensive measures, the UK Takeover Code helps bidders by pushing directors to pursue shareholder value in order to increase share price and dividends.³² Deakin argues that shareholder primacy as a cultural and social norm in the UK originated in the rise of hostile takeovers in Britain during the 1970s and 1980s³³ which illustrates the significance of the UK's approach towards the market for corporate control in the context of shareholder primacy.

IV. The soft law approach to corporate governance

The fourth historic reason for shareholder primacy in the UK is its preference for a corporate governance system that is based on self-regulation and soft law. The composition of a company's board of directors is largely untouched by the Companies Act of 2006. The modern corporate governance debate in the UK started in the early 1990s and led to a series of corporate governance reports (Cadbury, Greenbury and Hampel reports). In the absence of statutory rules on board composition, these reports, *inter alia*, often addressed the role of non-executive directors to enhance the 'control' of companies. The 'Cadbury Code' of 1992 was the basis for what is now the 'UK Corporate Governance Code'.³⁴ The hallmark of the UK Corporate Governance Code is the 'comply or explain' approach, which means that the code contains a set of recommendations, but companies are given the flexibility to deviate from those recommendations if they 'explain' why they have chosen to do so.³⁵ By the start of the 2000s, corporate governance in the UK was entrenched in shareholder value.³⁶

More recently, the UK Corporate Governance Code has started to reflect a slightly broader understanding of the company and is no longer exclusively focused on shareholders. The introduction of the latest version of the

32 See Davies, p. 117.

33 See Deakin Corporate Governance 2005, p. 11 et seqq.

34 As with takeover regulation, it would go beyond the scope of this chapter to fully address the composition and structure of the UK's regulation of corporate governance. See for an overview: Davies, p. 36 et seqq.

35 See for an overview: P Davies, p. 36 et seqq.

36 See Sjäffell/Bruner/Johnston, p. 204 (207).

UK Corporate Governance Code of 2024 notes that ‘companies do not exist in isolation’. It also states that companies ‘will need to build and maintain successful relationships with a wide range of stakeholders’ in order ‘to succeed in the long-term’. The tone in the Principles of the Code mirrors this broader conception of companies – evidenced, for example, by Principle 1 of the Code, which states that it is the role of the board ‘to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society’. While the language still expressly mentions shareholder value, it also includes other factors; in fact, it resembles the language of the enlightened shareholder value theory that underpins the Companies Act of 2006.³⁷ The current version of the Code is therefore not a radical shift, but rather a continuation of the legal reality since the Companies Act of 2006.

C. UK Companies Act of 2006: The impact of the enlightened shareholder value theory in practice

This section will critically review the impact of the enlightened shareholder value theory on the Companies Act of 2006. It will start with the Company Law Review process, which considered different corporate theories before adopting the enlightened shareholder value theory. This review of the theoretical foundation of the Companies Act will be followed by a doctrinal assessment of both the duty for directors to promote the success of the company (section 172 Companies Act 2006) and the various nonfinancial information duties in the Act, such as strategic reports and nonfinancial statements.

I. Background: The Company Law Review process leading to the UK Companies Act 2006

The best starting point for understanding both the past and present position of corporate theory in UK company law and corporate governance is the Company Law Review process, which commenced in 1998 and ultimately led to the UK Companies Act of 2006, which is still in force

37 See below for a full analysis of this theory in the context of the UK Companies Act 2006.

today. This Company Law Review process was initiated by the New Labour government after it won the General Election in 1997. As part of its general modernisation agenda, New Labour also aimed to reform UK Company Law and equip it for the 21st century.

In 1998, the Department of Trade and Industry (DTI) launched a process for reviewing Company Law. The Company Law Review was made up of a Steering Group whose membership was comprised of lawyers, businessmen, and academics.³⁸ One of the central objectives of the Company Law Review process was assessing the question of corporate theory.³⁹

The Company Law Review Steering Group addressed the question of whether company law should be reorientated and adopt a corporate theory other than shareholder value. The reason for raising this question was that British companies were often criticised in the 1980s and 1990s for being too short-term fixated.⁴⁰ For example, in 1999, a study by the Institute of Directors showed that many directors thought they were legally required to maximise short-term shareholder benefits to the detriment of long-term profit.⁴¹

In its document, *Modern Company Law for a Competitive Economy: The Strategic Framework*, the Company Law Review Steering Group set out its objective of identifying the scope of company law, i.e. in whose interest companies should be run. Determining which interest should be the objective was paramount to being able to develop a firm theoretical framework for the new Companies Act. It is against this background that the Company Law Review Steering Group comprehensively reviewed corporate theory.

II. The three different theoretical approaches

In reviewing corporate theory, the Company Law Review Steering Group compared the shareholder value theory to the pluralist approach and a third approach, the ‘inclusive approach’.

38 See for an overview of the company law reform process: Keay, p. 14.

39 See for a review of the Company Law Review discussion of corporate theory: A Rühmkorf, p. 32 et seqq.

40 See, for example, Commission on Public Policy and British Business, *Promoting Prosperity: A Business Agenda for Britain* (Vintage 1997).

41 Institute of Directors, *Good Boardroom Practice* (IOD 1999).

1. The shareholder value approach

The Company Law Review Steering Committee acknowledged that the shareholder value approach had been in operation in the UK before.⁴² As outlined above, Anglo-American corporate governance historically was widely considered to follow the theory of shareholder value and, at least since the 1980s, this theory has dominated corporate law in the UK.⁴³ However, prior to the Companies Act of 2006, shareholder primacy was not legally imposed on companies through statutory law. In common law, the shareholder value focus of UK company law was found in the fiduciary duty for directors to act *bona fide* in what they considered to be in the best interests of the company.⁴⁴ The phrase ‘interests of the company’ was equated with ‘shareholders as a general body’, which led to the interpretation of this duty as being focused on shareholder interests.

At the outset of the review process, the Company Law Review noted that shareholders are given rights of control over management by law in return for their investment through the purchase of shares.⁴⁵ The shareholders’ rights over the management should ensure that the company is run in the shareholders’ interest and that the value of their investments will increase.⁴⁶ Given that the theoretical foundations of the shareholder value theory are outlined above, they will not be replicated here. Instead, the next parts will address the two other approaches that the Company Law Review Steering Group considered as alternative frameworks.

2. The pluralist (stakeholder) approach

The Company Law Review Steering Group compared the shareholder primacy approach with the pluralist understanding of the corporation. The pluralist approach is also referred to as ‘stakeholder value’ or the ‘produc-

42 See Company Law Review, *Modern Company Law for a Competitive Economy: The Strategic Framework* (DTI 1999) paras 5.1.4.-5.1.7.

43 Key ECFR 2010, 369 (370); Gamble/Kelly *Corporate Governance* 2001, 110.

44 See only *Re Smith and Fawcett Ltd* [1942] Ch [304].

45 See Company Law Review, *Modern Company Law for a Competitive Economy: The Strategic Framework* (DTI 1999) paras 5.1.4.-5.1.7.

46 *ibid*, para 5.1.5.

tive coalition model'.⁴⁷ The understanding of the term 'stakeholder' is not settled. Freeman defines this term as 'any group or individual who can affect or is affected by the achievement of the organisation's objectives'.⁴⁸ The Company Law Review Steering Group noted that, under the pluralist approach, directors must pursue the interests of all stakeholders of the company and not automatically prioritise shareholders.⁴⁹ Consequently, it is the role of directors to maximise the total creation of wealth in the company as opposed to just profit.⁵⁰

One strong justification for this approach can be found Blair and Stout's 'productive coalition model'. Blair and Stout see the public corporation as 'a team of people who enter into a complex agreement to work together for their mutual gain'.⁵¹ In contrast to the theoretical foundations of the shareholder value theory, they argue that no member of the team takes precedent over other members as all members of the team have agreed to give up control rights.⁵² The board of directors is central to this model, as it is given the control rights over the company. The directors are 'mediating hierarchs' who balance the competing interests of the various members of the team.⁵³ As 'trustees for the corporation itself', the board of directors ensures the functioning of the productive coalition.

The pluralist approach takes a very different theoretical approach than the shareholder value theory towards understanding the firm. The pluralist approach emphasises that individuals owe obligations to each other as a community, independently of contractual obligations.⁵⁴ This argument differs from that of the 'nexus of contracts' theory, outlined above. Proponents of the pluralist approach question whether shareholders are the only constituents that deserve prioritisation. First, shareholders are not the only constituents who invest in the firm and have a stake in it: employees often

47 Blair/Stout Virginia Law Review 1999, 247. See for a discussion of the stakeholder theory: Keay The Enlightened Shareholder Value Principle and Corporate Governance Richmond Law Journal of Global Law & Business 2010, 249.

48 See: Freeman, p. 246. See for an overview of the discussion: Keay, p. 47.

49 Company Law Review, Modern Company Law for a Competitive Economy: The Strategic Framework (DTI 1999) para 5.1.13.

50 J Kay and A Silberston, 'Corporate governance', available at: <http://www.johnkay.com> (last accessed: 15th February 2025).

51 Blair/Stout Virginia Law Review 1999, 247 (278).

52 *ibid*, 277.

53 *ibid*, 281.

54 Millon Wash. & Lee L.Rev. 1993, 1373 (1382).

invest in firm-specific training.⁵⁵ Second, the claim that shareholders are the owners of the company is disputed. Shareholders acquire a title to the shares that they purchase, but not to the company.⁵⁶ Other points of criticisms regarding the shareholder value theory include that: (i) it results in short-termism; and (ii) it disregards the fact that shareholders' interests can diverge.⁵⁷ It would go beyond the scope of this chapter to address all the criticisms of the shareholder value theory in detail.

Regarding the issue of sustainability, the pluralist approach provides directors with significant discretion that they could use to promote aspects of sustainability. At the very least, the pluralist approach does not require directors to place all other issues below shareholder value and therefore enables them to decide on a case-by-case basis what is in the best interest of the company. Blair and Stout further support this view by referring to the business judgment rule and the discretion it gives to the board.⁵⁸

However, following a consultation, the Company Law Review Steering Group decided not to adopt the pluralist approach. It cited several reasons for this decision, including concern that this approach would move directors from their core role as managers of the business towards moral, political, and economic arbiters.⁵⁹ Moreover, it was held that the external benefits of the pluralist approach would be better achieved by specific legislation on issues such as environmental matters.⁶⁰ In practical terms, a concern was that directors would find it difficult to decide which interest to prioritise in the event of a conflict.⁶¹

55 Kelly/Parkinson CfLR 1998, 174 (188).

56 Ireland MLR 1999, 32.

57 See for a more detailed overview: Keay ECFR 2010, p. 369 et seqq.

58 Blair/Stout Virginia Law Review 1999, 247 (320). The business judgment rule is explained in the following way: '...directors of a corporation...are clothed with [the] presumption, which the law accords to them, of being [motivated] in their conduct by a bona fide regard for the interests of the corporation whose affairs the stockholders have committed to their charge...'; see: *Gimbel v. Signal Cos.*, 316 A.2d 599, 608 (Del. Ch. 1974).

59 See Company Law Review, Developing the Framework (2000), para 2.21.

60 Company Law Review, Strategic Framework, paras 5.1.25 – 5.1.29.

61 Company Law Review, Completing the Structure (2000) para 3.5.

3. The inclusive approach (enlightened shareholder value)

Finally, the third approach that was finally adopted by the Company Law Review was called the 'inclusive approach'. The government's White Paper settled on using the inclusive approach.⁶² The inclusive approach was later labelled 'enlightened shareholder value' (abbreviated as 'ESV') which is the fundamental corporate theory used in the UK Companies Act of 2006, as it embodies the duty for directors to promote the success of the company (section 172 Companies Act 2006).⁶³

As was a common approach of the New Labour government at that time, the inclusive approach was a 'third way', i.e. an alternative to the dichotomy between traditional shareholder value and the pluralist approach.⁶⁴ The starting point for this approach is that company law should move away from one of its main critique points, short-termism.⁶⁵ Enlightened shareholder value therefore posits that directors should pursue long-term profit maximisation which would require cooperative relationships with the various non-shareholder stakeholders.⁶⁶ Section 172 of the Companies Act of 2006, which employs this theory in the directors' duties, requires directors to take 'other factors into account' and to consider the interests of other stakeholders such as employees, suppliers, the community, or the environment.⁶⁷ Theoretically, the inclusive approach aims to achieve not just long-termism, but also better relationships with the company's various stakeholders.

However, as the name 'enlightened shareholder value' more explicitly suggests as compared to the name 'inclusive approach', this theory ultimately promotes shareholder value.⁶⁸ At the end of the day, directors must act in the collective best interest of shareholders.⁶⁹ This situation raises the question as to how shareholder value should be 'enlightened' in practice. This point will be addressed in the next section in the legal analysis of the

62 Company Law Review, *The White Paper: Modernising Company Law* (DTI 2002, Cm 5553-I and Cm 5553-II) para 3.3. See for an overview of the background to the adoption of the enlightened shareholder value theory: Key, chapter 3.

63 See for a detailed analysis of the enlightened shareholder value theory: Key.

64 Vasudev/Watson/Millon, p. 69.

65 *ibid.*

66 Roach *Company Lawyer* 2005, 98 (99).

67 See below for a full analysis of section 172 Companies Act 2006.

68 Key *Company Lawyer* 2007, 106 (107).

69 Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework* (DTI 2000) para 2.22.

duty of directors to promote the success of the company under section 172 (1) Companies Act of 2006. Legal analysis of that section will determine whether the scope of the inclusive approach includes promoting sustainability or whether it is simply the shareholder value theory in disguise.

In practical terms, the enlightened shareholder value theory was implemented in the Companies Act of 2006 in two ways: first, in the duty for directors in section 172 (1) Companies Act 2006 and second, in the duty to issue a non-financial report.

III. Directors' duties: the duty to promote the success of the company, section 172 (1) Companies Act of 2006

In this part, the duty to promote the success of the company will be doctrinally assessed to determine what it requires from directors, how it operates, and what enlightened shareholder value means for directors in the context of this duty.

For the doctrinal assessment of section 172 (1) Companies Act 2006, it is important to note that section 170 of the Act stipulates two important rules regarding the relationship between the now-codified directors' duties and the previous common law duties. First, the statutory duties of directors have effect in place of the common law duties;⁷⁰ second, the statutory duties must be interpreted and applied in the same way as common law rules or equitable principles, and regard must be given to the corresponding common law rules and equitable principles in interpreting and applying the general duties.⁷¹ The second provision is the basis for the reference to common law decisions in the interpretation of the section 172 (1) Companies Act 2006 duty below.

1. The duty to promote the success of the company

First, the duty to promote the success of the company will be assessed in order to examine enlightened shareholder value theory means in practice.⁷² Section 172 (1) Companies Act of 2006 reads as follows:

70 Companies Act 2006, s170 (3).

71 Companies Act 2006, s170 (4).

72 See also Rühmkorf, p. 39 et seqq.

172 Duty to promote the success of the company

- (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, and in doing so have regard (amongst other matters) to
 - (a) the likely consequences of any decision in the long term,
 - (b) the interests of the company's employees,
 - (c) the need to foster the company's business relationships with suppliers, customers and others,
 - (d) the impact of the company's operations on the community and the environment,
 - (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
 - (f) the need to act fairly as between members of the company.
- (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
- (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

Initially, this duty can give the impression that it is closely linked to stakeholder interests due to the number of different factors that are mentioned. In fact, these different factors overlap with the different dimensions of sustainability as they range from the employees (b) to the environment (d) and the long-term consequences of any decision (a).

The following section will critically assess the meaning of the different conditions of section 172 (1) to determine the extent to which this duty provides scope for directors to pursue sustainability. Specifically, the requirements to act in the way: (i) the director considers, in good faith; (ii) is most likely to promote the success of the company; and (iii) having regard to the list of factors provided in the section.

a) Good faith

The starting point for the doctrinal analysis of the duty to promote the success of the company is that the wording of the law refers to the director's 'good faith'.

Section 172 (1) first notes that 'a director of a company must act in the way he considers, in good faith...'. This wording raises the question as to what standard is expected of directors. The phrases 'he considers' and 'in good faith' place the emphasis on the subjective view of the director. Combined, these two phrases give directors a lot of discretion when making decisions in accordance with section 172 (1). Consequently, judges do not have much power to second-guess business decisions.

Considering the corresponding common law rules,⁷³ it is likely that courts would consider relevant case law in determining the meaning of 'good faith' in this section.⁷⁴ Under the common law,⁷⁵ the traditional test was that directors must act '...bona fide in what they consider – not what a court may consider – is in the interest of the company, and not for any collateral purpose'.⁷⁶ This test focuses on the director's 'state of mind'.⁷⁷

After the enactment of the Companies Act of 2006, it was noted in *Cobden Investments Ltd v. RWM Langport Ltd*⁷⁸ that

[t]he perhaps old-fashioned phrase acting 'bona fide in the interests of the company' is reflected in the statutory words acting 'in good faith in a way most likely to promote the success of the company for the benefit of the members as a whole'. They come to the same thing with the modern formulation giving a more readily understood definition of the scope of the duty.⁷⁹

This point was also made in *Iesini v. Westrip Holdings Ltd*.⁸⁰ In *Iesini*, the court held that it was not in the best position to make judgments about the weight of the considerations in section 172 and would only be able to

73 See Companies Act 2006, s170 (4).

74 See Keay Company Lawyer 2011, p- 138 et seqq.

75 see *Smith and Fawcett Ltd* [1942] Ch 304 [306].

76 *ibid*.

77 See *Regentcrest plc v Cohen* [2001] 2 BCLC 80 [105].

78 [2008] EWHC 2810 (Ch) [52].

79 *Cobden Investments Ltd v RWM Langport Ltd, Southern Counties Fresh Foods Limited, Romford Wholesale Meats Limited* [2008] EWHC 2810 (Ch) [52].

80 [2009] EWHC 2526.

make such a judgment if the case were very clear. Otherwise, priority would be given to the directors' subjective judgments. Good faith in section 172 is therefore seen as a continuation of the previous phrase 'bona fide', which was called an 'perhaps old-fashioned phrase' which 'comes to the same thing'.⁸¹

In essence, directors are given significant discretion when deciding what is in the best interest of the company. It is not for the courts to second-guess these decisions, unless there are very rare exceptions. The focus is therefore on the subjective view of directors.

The assessment of 'good faith' as the first constituting element of section 172 therefore indicates that the 'new' duty to promote the success of the company places great emphasis on the subjective view of directors.

b) Success of the company

The second constituting element of section 172 (1) Companies Act 2006 is the phrase 'success of the company for the benefit of the members as a whole'. The term 'success' is not defined in this section.

The Guidance on Key Clauses in the Company Law Reform Bill notes the following about the phrase 'success of the company':

The decision as to what will promote success, and what constitutes such success, is one for the directors' good faith judgment. This ensures that business decisions on, for example, strategy and tactics are for the directors and not subject to decisions by the courts, subject to good faith.⁸²

The wording emphasises that success must be 'for the benefit of the members as a whole'. This clearly indicates the way in which interpretation of 'success' is headed. Again, the common law duty to act *bona fide* in the best interest of the company helps with the interpretation of the statutory wording here: the common law duty to act *bona fide* in the best interest of the company was interpreted as meaning the shareholders collectively,

81 See *Cobden Investments Ltd v RWM Langport Ltd, Southern Counties Fresh Foods Limited, Romford Wholesale Meats Limited* [2008] EWHC 2810 (Ch [52]).

82 DTI, Guidance on Key Clauses to the Company Law Reform Bill (2005) para 63.

i.e. as a general body, which effectively required the directors to pursue shareholder value.⁸³

A similar approach can be taken to the meaning of ‘success’ in the context of section 172 (1). The ‘success’ must be ‘for the members as a whole’. Section 112 Companies Act 2006 defines members as shareholders. The expression ‘members as a whole’ is understood by courts as ‘present and future shareholders’.⁸⁴ The Company Law Review Steering Group interpreted this phrase in a similar way; they included the phrase ‘members as a whole’ to emphasise that directors must work for the collective interests of shareholders and not for one individual member.⁸⁵

c) Having regard to the list of factors

The third constituting element of section 172 (1) Companies Act 2006 is that directors must ‘have regard to’ a list of stakeholder-oriented factors. The factors cover a broad range of stakeholders and issues. First, the list is non-exhaustive. This is indicated by the wording that a director must have regard to the list of factors ‘amongst other matters’. Second, as mentioned above, the listed factors in section 172 (1) Companies Act 2006 overlap with the different dimensions of sustainability as, for example, reference is made to the long-term consequences of decisions. Such long-term consequences of decisions refer to, in turn, all aspects of sustainability: the economic dimension, the environment, and the social (by referencing employees).

At least in theory, the enumeration of these factors allows directors to pursue sustainability in their decision-making. However, in practice, the scope for sustainability is much more limited than a first glance of section 172 might indicate. This is for two main reasons. First, directors must ‘have regard to’ the list of factors when they act, in good faith, for the benefit of the members as a whole, i.e. the shareholders. One can ‘have regard to’ those factors in various ways. Irrespective of how much regard a director has for these factors – and it is not specified by the law how much regard is required – they are ultimately only secondary issues to shareholder value

83 See *Re Smith & Facett Ltd* [1942] Ch [304], [306]; *Hutton v West Cork Railway Company* (1883) 23 Ch. D. 654; *Parke v Daily News Ltd* [1962] Ch. 927.

84 See *Gaiman v National Association for Mental Health* (1971) Ch [317].

85 The Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework* (DTI 2000) para 3–51.

being pursued. The wording of the section indicates a hierarchy between promoting the success of the company for the benefit of the members (which means that directors must effectively pursue shareholder value) and the regard that they must have for the stakeholder interests in the list of factors.⁸⁶

The second reason for this cautious view as to the impact of ‘the list of factors’ for sustainability is that there is no clarity as to what directors must *do*. Unanswered questions are, for example, the extent to which they need to consider stakeholder interests and how they can balance competing stakeholder interests (e.g. a decision benefits employees, but not the environment or vice versa).⁸⁷ While these questions, which are important from a sustainability point of view, have been left open, directors have clarity on two other points: (i) they must ultimately strive to promote shareholder value;⁸⁸ and (ii) they have considerable discretion to do so, as the focus is on the directors’ subjective view. As directors may only consider these factors within the constraints of shareholder value, the wording ‘have regard to’ can be seen as an educational matter, clarifying for directors that they can take other interests into account. From a more theoretical perspective, the combination of prioritising shareholder interests and taking those other factors into account indicates the theory of enlightened shareholder value as the underlying approach for the Companies Act of 2006.

The question of ‘having regard to’ the list of factors was considered in the case *R. (on the application of People & Planet) v. HM Treasury*.⁸⁹ Here, the case was brought against the government because it had purchased roughly 84 % of the shares of the Royal Bank of Scotland (RBS) during the financial crisis. Activists of the student network, People & Planet, brought the case on the grounds that RBS was a significant provider of the energy sector. In People & Planet’s view, the directors had breached their section 172 (1) Companies Act 2006 duty as they did not have sufficient regard for environmental issues, per factor (d) of the list of factors. People & Planet argued that the government was in breach of section 172 as it had agreed to a policy document outlining the way RBS should be run through a limited company, UK Financial Investments (Ltd).

86 See Rühmkorf, p. 47.

87 See for the conflict between two or more of the factors: Hannigan, p. 10 et seqq.

88 See for this point: Loughrey/Keay, p. 50 (74).

89 [2009] EWHC 3020 (Admin) QBD (Admin).

In essence, the government stated in this policy document that it would not intervene with the legal duty of boards to run the company in the interests of all their shareholders.⁹⁰ The court took a cautious view of the extent to which shareholders (such as here the limited company) could influence the directors' decision-making, noting that shareholders that seek to influence the decisions of the board could only do so within the constraints of the duty to promote the success of the company for benefit of the members as a whole (i.e. shareholders). Any attempt by the government to impose its own policy on climate change on the board of the private company that ran RBS would 'cut across the duties of the board as set out in section 172 (1)'.⁹¹

Despite being a somewhat different set of facts, since the judicial review in *People & Planet's* case was based on the ownership of RBS, the key aspect of the judgment is that shareholder interests prevail in the courts' understanding of section 172 (1) Companies Act 2006. This decision further reaffirms the view taken in this section that the 'list of factors' are secondary to the interests of shareholders.

d) Enforceability

The final remaining question regarding the extent to which section 172 (1) Companies Act 2006 can promote sustainability depends on the enforceability of the duty to promote the success of the company. The above analysis has demonstrated the strong focus of the duty on (i) the shareholder interests and (ii) the director's good faith. These two aspects already significantly limit the scope for any legal actions based on an alleged breach of this duty.

If any action were to be taken, then the proper claimant would be the company (so-called 'proper plaintiff rule').⁹² The board of directors therefore decides whether any action should be pursued against a director who has breached their duty. Additionally, shareholders are given the right to bring a derivative action pursuant to sections 260 Companies Act of 2006, provided that certain conditions for such an action are met. The different

90 *R. (on the Application of People and Planet) v HM Treasury* [2009] EWHC 320 (Admin), [13e.].

91 *ibid*, at para 34.

92 *Foss v Harbottle* (1843) 2 Hare 461.

stakeholders listed in section 172 (1), such as the employees, are omitted from the groups who have legal standing. The two groups that do have legal standing – the directors and, if certain conditions are met, the shareholders – are those that are primarily interested in financial considerations. This situation significantly restricts the practical effect of including the different sustainability-related factors in section 172 (1). This duty has therefore been called ‘a right without a remedy’.⁹³

2. Sustainability and section 172 (1) Companies Act: All talk, but no walk?

Overall, the doctrinal assessment of section 172 (1) Companies Act 2006 provides a rather bleak perspective for the promotion of sustainable development. There is, at least in theory, some scope for directors to consider the different dimensions of sustainability in the form of long-termism, environmental issues, and social aspects. Yet, in practice, shareholder value trumps any attempts to significantly open up boardroom decisions. In the end, the wording of section 172 (1) leaves little room for anything else other than the pursuit of shareholder value. The express inclusion of the list of factors was supposed to ‘enlighten’ shareholder value, but it appears as if this ‘new’ duty is not so new after all. In many ways, it is rather a continuation of the common law case law from the pre-Companies Act of 2006 era that required directors to act *bona fide* in the best interest of the company, i.e. in the best interest of the shareholders.⁹⁴

In sum, the only effect of the wording of the duty to promote the success of the company in section 172 (1) is that it prevents a completely narrow understanding of shareholder value that would not allow directors to take anything else into account. Apart from that, the duty leaves much to be desired and little room for any significant promotion of sustainable development.

93 Loughrey/Keay, p. 50.

94 See *Re Smith and Fawcett Ltd* [1942] Ch 304 [306].

IV. Non-financial reporting: from the business review to the non-financial statement

As the enlightened shareholder value is based on two limbs of the Companies Act of 2006, section 172 and the duty to issue non-financial reporting, this section will now turn to non-financial reporting.⁹⁵ Again, due to space constraints, it is only possible to give a brief overview and assess how the different reporting duties impact corporate theory and the promotion of sustainability in the UK. In addition to the narrative reporting requirements outlined by the Company Law reform for the 2006 Companies Act, the UK has also implemented other relevant disclosure regimes. This chapter will therefore briefly address these regimes, such as, the ‘transparency in supply chains clause’ included in the UK Modern Slavery Act 2015. Generally, the UK is a system that favours nonfinancial information disclosure in its corporate governance system; it relies on information disclosure to steer companies towards promoting sustainability.⁹⁶ These laws are also referred to as ‘narrative reporting’. Such laws are intended to enable directors to explain the company’s performance without numbers and to indicate the future direction of the company’s business.⁹⁷

Originally, the Company Law Review Steering Group had planned to include an Operating and Financial Review (OFR) in the Companies Act, which would have required companies to disclose information about their relationships with stakeholders, including employees, and their projects and programmes insofar as the information was ‘material’.⁹⁸ Such a report would have helped hold directors accountable for the company’s performance.⁹⁹ To that end, directors would have been required to provide ‘more qualitative and forward-looking reporting, in addition to information that is quantitative’.¹⁰⁰ The OFR was eventually abolished in 2005 by Chancellor Gordon Brown, who justified this decision as reducing the burden on companies.¹⁰¹ Johnston criticises this decision, stating that it had ‘startling corporate governance implications’ as, from that point onwards, sharehold-

95 See Keay, p. 14.

96 See B Sjäfjell/Bruner/Johnston, p. 204 et seqq.

97 See generally: Villiers, p. 85 et seqq.

98 See for a full account of the OFR: Johnston EBOR 2006, 817 (829).

99 See Modernising Company Law, Cm 5553, July 2002, para 2.37.

100 See Keay, p. 147 et seqq.

101 See McBarnet/Voiculescu/Campbell/Campbell/Vick, p. 257 et seq.

er value was ‘enshrined as the default purpose of UK company law’ without the information that was supposed to ‘enlighten’ it.¹⁰²

1. Business review

Instead of the OFR, the Companies Act of 2006 employed ‘business review’,¹⁰³ a significantly slimmed-down version of the OFR. This reporting duty required directors to inform members about how they had discharged their duty to promote the success of the company, including the list of factors contained in section 172 (1) Companies Act 2006. The main weakness of the business review approach was that it gave significant discretion to companies as to what they wanted to report, leaving the companies with the freedom to leave out nonfinancial information such as information related to sustainability issues. Research consequently demonstrated the flaws of this reporting regime. For example, Villiers and Aiyegbayo showed that, based on semi-structured interviews with key corporate governance actors like investor relations managers and corporate governance directors from institutional investment firms, the business review approach made little difference to the quality of reports compared to the reports that companies published prior to the Companies Act of 2006.

2. Strategic report

Following considerable criticism of the original version and a consultation, the business review approach was replaced by the ‘strategic report’ in 2013 which was intended to complement the financial statements.¹⁰⁴ The strategic report is now found in Chapter 4A of the Companies Act. Under the strategic reporting requirement, directors must prepare a strategic report for each financial year of the company¹⁰⁵ unless they are subject to a small company exemption¹⁰⁶. The strategic report for each financial year of the company must include a ‘section 172(1) statement’¹⁰⁷ that describes how the

102 Johnston EBOR 2006, 817 (832).

103 This reporting duty was found in s415 (1) CA before it was abolished and replaced by the ‘strategic report’.

104 See Financial Reporting Council, Guidance on the strategic report (2014).

105 Companies Act 2006, s414A.

106 Companies Act 2006, s414B.

107 Companies Act 2006, s414 CZA.

directors have regarded the matters set out in section 172(1)(a) to (f) when performing their duty.

Additionally, in the case of a quoted company, the strategic report must also include information about environmental matters (including the impact of the company on the environment), the company's employees, and social, community, and human rights issues. The report must include information about any policies of the company in relation to those matters and the effectiveness of those policies. However, the important caveat for this reporting provision is that these points must only be included 'to the extent necessary for an understanding of the development, performance or position of the company's business'.¹⁰⁸ If the report does not contain information about these issues, then it must at least state which of these kinds of information it does not contain.¹⁰⁹

While the strategic report is a further development of the business review, it is also a rather 'light touch' regulatory tool. Effectively, the strategic report allows companies to choose whether to report on sustainability issues as these can be left out as long as the company discloses this in its report. The strategic report is therefore a rather soft disclosure provision that does not make much of a difference compared to voluntary reporting by companies.

3. Section 172 (1) statement

Although the purpose of the strategic report is to inform members of the company and help them assess how the directors have performed their duty under section 172 (1) Companies Act, a separate statement on s172 (1) is required from companies within the large company accounts regime. The 'section 172 (1) statement' in the Companies Act was introduced in 2019.¹¹⁰ This amendment was part of a transition from the discussion about the scope of s172 (1) to its practical impact.¹¹¹

Affected companies are required to include a statement in their strategic report for a financial year that describes how the directors have had regard to the matters set out in section 172(1)(a) to (f) when performing their

108 Companies Act 2006, s414C (7).

109 Companies Act 2006, s414C (8).

110 This section was introduced through the Companies (Miscellaneous Reporting) Regulations of 2018 (the "Miscellaneous Reporting Regulations").

111 see Hannigan, para 10–35.

duty under section 172. In its guidance on this reporting duty, the Financial Reporting Council notes that the information contained in this statement will depend on the individual circumstances of each company. However, it points out that companies will probably want to include information on some or all of the following: (i) the issues, factors, and stakeholders the directors consider relevant in complying with section 172(1)(a) to (f) of the Companies Act and how they have formed that opinion; (ii) the main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard; and (iii) information on the effect of that regard on the company's decisions and strategies during the financial year.¹¹²

Moreover, the Guidance states that section 172 (1) statements should focus on the matters that are of strategic importance to the company and that the information in the statement should be commensurate with the size and complexity of the company.¹¹³ While principally, specific reporting for section 172 (1) is a positive step forward, it just toys with the existing framework instead than reforming what is ultimately a duty for directors to pursue shareholder value.

4. Non-financial and sustainability information statement

The UK's narrative reporting framework contains further reporting duties. First, prior to Brexit, the UK implemented the EU's nonfinancial information disclosure in the Companies Act, which covered large public-interest companies (i.e. listed companies, banks, insurances) with more than 500 employees.¹¹⁴ Since the UK kept this reporting duty after it exited the European Union, the provision is very similar to those known in EU member states. Companies that fall under this provision are required to issue a 'non-financial statement'. This duty was subsequently amended; since 2022, companies are now required to issue a 'non-financial and sustainability

112 Financial Reporting Council, Section 172 statements: How to make them more useful (2020).

113 *ibid.*

114 see Companies Act of 2006, 414 CA and 414 CB. The UK transposed the Directive through the Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations of 2016, which came into force in mid-December 2016.

information statement'.¹¹⁵ The non-financial and sustainability information statement must contain climate-related financial disclosures of the company.¹¹⁶

The climate-related financial disclosures in this statement, introduced by the amendment, require companies to report on several matters related to climate. These include: a description of how the company identifies, assesses, and manages climate-related risks and opportunities and how these are integrated into the company's overall risk management process; a description of the principal climate-related risks and opportunities arising in connection with the company's operations; an analysis of the resilience of the company's business model and strategy, taking into consideration different climate-related scenarios; and a description of the targets used by the company to manage climate-related risks and to realise climate-related opportunities as well as performance against those targets.¹¹⁷

While this reporting on the climate-related impact of the company is novel and a positive step forward for sustainability, the provision has limitations that are comparable to those of the strategic report: directors can choose not to make these reports where they 'reasonably believe' that disclosure would not be necessary for an understanding of the company's business. In this case, they must provide a clear and reasoned explanation of their reasonable belief.¹¹⁸

5. Slavery and human trafficking statement

Furthermore, the UK introduced a duty to report about human trafficking and modern slavery through the UK Modern Slavery Act of 2015. Section 54 of the UK Modern Slavery Act requires every organisation operating a business in the UK with a total annual turnover of £36 million or more to produce a slavery and human trafficking statement for each financial year of the organisation.¹¹⁹

115 This amendment was introduced through the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022.

116 Companies Act 2006, s414CB.

117 Companies Act 2006, s414CB (2A).

118 Companies Act 2006, s414 CB (4A), (4B).

119 UK Modern Slavery Act 2015, s54 (1).

This slavery and human trafficking statement is

- (a) a statement of the steps the organisation has taken during the financial year to ensure that slavery and human trafficking is not taking place –
 - (i) in any of its supply chains, and
 - (ii) in any part of its own business, or
- (b) a statement that the organisation has taken no such steps.¹²⁰

At the time when it was introduced, this reporting duty was rather novel as it imposed a duty on companies to report about specific human rights issues in their supply chain (i.e. human trafficking and forced labour). However, it has become apparent that this duty gives too much discretion to companies: the companies can effectively decide the ‘if’ and ‘how’ of any steps, i.e. whether they take any steps in the first place and, if so, what steps they take. Finally, the companies may also decide what information they choose to include in their statement. Literature has extensively discussed the weaknesses of this clause¹²¹ and has shown that it has little impact on corporate practices¹²².

Overall, this section has demonstrated that the UK’s strong focus and reliance on disclosure laws is an instrument to ‘enlighten’ shareholder value. However, while disclosure laws can vary in terms of scope and stringency, they are generally a softer form of regulation that is not ‘heavily interventionist’.¹²³ They are a ‘communicative-based tool’.¹²⁴ Recent amendments to UK corporate governance that were intended to promote more sustainability have tended to take the form of disclosure laws, such as the recent statement on section 172 (1) Companies Act 2006 and the inclusion of climate aspects in the non-financial statements. Despite the (still increasing) quantity of non-financial information disclosure duties, its quality and reliability continue to be weak.¹²⁵

120 UK Modern Slavery Act 2015, s54 (4).

121 Iqbal Company Lawyer 2018, 3; Okoye, *International Company and Commercial Law Review* 2017, 196.

122 see LeBaron/Rühmkorf, *Global Policy* 2017, 15.

123 Baldwin/Cave, p. 49.

124 Morgan/Yeung, p. 96.

125 see, for example, Sjäffjell/Bruner/Johnston, p. 217.

D. After Brexit: convergence or divergence with European developments towards more sustainable companies?

This section will shift focus to the relationship of the UK with the recent European trend towards promoting greater corporate sustainability. This question is particularly interesting in the case of the UK given its exit from the European Union and the recent wave of European directives and regulations as part of the ‘European Green Deal’.

First, post-Brexit, the UK is under no obligation to implement any of the regulations that are part of the Green Deal. The non-financial statement in section 414 of the Companies Act, discussed above, is a reminder of the UK’s membership of the European Union as it was implemented when the UK was still an EU member. In fact, the UK is now free to diverge from this obligation which means that in addition to not following any new pieces of EU legislation, it can also decide to remove or amend existing regulations that it implemented in its national law during EU membership.

Therefore, the recent significant developments at the EU level concerning sustainability, including the Corporate Sustainability Reporting Directive (CSRD), the Corporate Sustainability Due Diligence Directive (CSD-DD), and the Taxonomy Regulation do not directly affect the UK. However, some of these regulations can apply to UK companies; for example, the CSDDD also applies to non-EU companies with a turnover of at least €450 million in the EU.¹²⁶ Other regulations will indirectly affect UK companies: UK companies may be suppliers to EU companies, and these EU companies may then ask their suppliers to adhere to certain contractual assurances on sustainability as part of their own compliance with EU laws. Accordingly, it is incorrect to assume that these European developments have no impact on the UK whatsoever, though the impact now is less direct than it would have been pre-Brexit.

Notwithstanding these general points on the EU-UK relationship, this chapter has shown that the scope for sustainability in the UK was already narrow before Brexit. Even though the enlightened shareholder value, as the approach underlying the Companies Act of 2006, intended to broaden considerations, the theory and practice of company law in the UK remains deeply entrenched in shareholder value. The duty to promote the success of the company in section 172 (1) Companies Act 2006 has had little impact in

126 Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence, 5.7.2024, Article 2 (2).

practice and the various forms of non-financial information disclosure laws in the UK continue to tinker with problems rather than solve them.

There are proposals on the table as to how UK company law could be made more sustainable.¹²⁷ For example, a meaningful reform of section 172 (1) could end the prioritisation of shareholder value and instead rely on directors to balance competing stakeholder interests on a case-by-case basis while operating within the planetary boundaries.¹²⁸ Such a move would end the legal norm of shareholder value. However, to reform the social norm of shareholder value, it would be necessary to address its wider institutional entrenchment in the UK, including the *laissez faire* approach to business regulation, the soft law approach to corporate governance, and the incentive structures that the market for corporate control sets.

In addition to these points, the UK has fallen behind other European countries in sustainability-related laws, and not just because of Brexit. Despite its weaknesses, when the UK Modern Slavery Act of 2015 was enacted, its reporting duty in section 54 was one of the first attempts to address human rights abuses in global supply chains. However, since then, the political and legal developments in sustainability have moved on, with other countries such as France and Germany passing laws that impose mandatory human rights due diligence on companies. The UK has not followed this trend but rather has continued with its preference for information disclosure. This is evidenced by the lack of amendments to the Modern Slavery Act of 2015, coupled with the introduction of climate-related financial disclosures in the non-financial statement. Moreover, rather than significantly reforming section 172 (1) itself, the UK introduced a separate statement requirement for large companies. This fact alone exemplifies the reluctance of the UK to intervene with business and its continued preference for self-regulation.

For that reason, there are significant doubts as to whether the UK is ready for any significant change. The quantity of disclosure laws that were analysed in this chapter show the strong preference the UK has for this legislative tool. In the words of Andrew Johnston, any significant change would require 'experimentation in corporate governance' rather than 'the tried (and failed) prescription of more information disclosure'.¹²⁹

127 Johnston *European Company Law* 2014, 63.

128 Sjäffjell *Sustainability* 2020, 6245.

129 Sjäffjell/Bruner/Johnston, p. 217.

E. Conclusion

This chapter has shown that, both historically and presently, the UK is firmly entrenched in the shareholder value theory. Prior to the Companies Act of 2006, shareholder value was largely a social norm.¹³⁰ The practical importance of shareholder value in company law and corporate governance was supported by the common law duty to act *bona fide* in the best interest of the company, and it has become enshrined in the UK through the market for corporate control (via hostile takeovers) and the soft law approach to corporate governance.

The Company Law Review process devoted significant time to considering corporate doctrine for the Companies Act of 2006. It reviewed three different approaches: shareholder value, a pluralist approach, and an inclusive approach (which was termed ‘enlightened shareholder value’). The Act eventually adopted the enlightened shareholder value theory as a ‘third way’, which would overcome the dichotomy between pure shareholder value and stakeholder value. The idea of a ‘third way’ was reflective of what the New Labour government often did at that time. However, the doctrinal analysis of the present state of UK company law and corporate governance in this chapter has shown that there is very little that is enlightened. Rather, the two main limbs of the enlightened shareholder value theory do very little to promote considerations other than those of shareholders.

The duty to promote the success of the company in section 172 (1) Companies Act 2006 legally imposes shareholder value on directors by requiring them to work for the benefit of the ‘members as a whole’ (i.e. the shareholders); they only need to ‘have regard to’ other factors with little specification as to how this should be done. The second limb, nonfinancial reporting duties, appear to be a popular legislative choice in the UK when it comes to addressing the impacts of companies on sustainability issues. However, while there is a high quantity of reporting, there is little quality. The disclosure regime in the Companies Act implemented by the strategic report (the nonfinancial and sustainability statement and the section 172 statement) was shown to be weak and ineffective. Further, nonfinancial reporting duties outside of the Companies Act, like the ‘human trafficking and modern slavery statement’ (required by the UK Modern Slavery Act of 2015), adds to the list of ‘light touch’ regulation that does little to improve the sustainability record of companies.

130 See Sjäfjell/Richardson/Sjäfjell/Johnston/Anker-Sorensen/Millon, p. 95 et seqq.

After Brexit, the outlook is somewhat bleak, as the UK is no longer subject to European requirements. Therefore, the UK is not directly affected by the European Green Deal and its range of different new directives and regulations, including the Corporate Sustainability Reporting Directive and the Corporate Sustainability Due Diligence Directive. While some of these regulations might be slimmed down via the ‘Omnibus package’, they are still a step in the right direction that the UK is not subject to. It remains to be seen whether the UK will follow any of these European developments towards more sustainable corporate governance, or if instead, it will continue to follow a soft-touch regulatory approach based on shareholder value and disclosure laws.

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10. Enlightened Shareholder Value: UK Company Law and Corporate Governance

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