CAN DIRECTORS OF COMPANIES IN A SHAREHOLDER PRIMACY AND ENHANCED SHAREHOLDER VALUE (ESV) REGIMES BE PUBLIC-SPIRITED? *

Abstract:
The board is the organ of the company that is saddled with the responsibility of managing the company. This includes making most corporate decisions. The said decisions affect not only the shareholders but non-shareholding stakeholders as well. In both shareholder primacy or profit maximisation and Enhanced Shareholder Value (ESV) jurisdictions, the primary duty of the directors is to further or promote the investment interests of the shareholders. The board is not duty-bound to consider the interests of non-shareholding stakeholders unless if doing so will promote or enhance the interests of the shareholders. The decisions or policies of the board in such jurisdictions are thus geared primarily towards discharging this singular responsibility. In fact, in a shareholder primacy regime, it is considered a breach of their fiduciary duty if the directors consider any other interests and, by so doing, shrinks the profits that would otherwise be available to the shareholders. This work sets out to consider/examine if a board in such regimes or jurisdictions can or should be bold enough to consider and integrate the interests of non-shareholding stakeholders, and where the circumstances permit, even prioritise it over and above those of the shareholders. The work observes that though this is not very common, it is very possible as there are ample principles of law and corporate legislative provisions that give a 'willing' board the leeway to do so. It concludes that it is in the overall interests of the shareholders that directors should adopt inclusivity approach even in a shareholder primacy jurisdiction

as doing so has the tendency of, inter alia/; bolstering employees' moral, dedication and commitment to the company and in turn their output; strengthen creditors confidence in the company and thus make more capital available to the company; foster friendlier relationship between the company and its host community and hence safer working environment for the company and its employees; increase the clientele-base of the company as it helps to boost clients' or customers' loyalty and patronage to the company; and reduces government's regulation of the corporation and imposition of heavy fines for breach of the regulations. It is the cherished view of the writer that all these would, in the long-run, translating into higher investment returns for the shareholder.

Introduction:

A corporation[1] has two principal organs – shareholders in general meeting and board of directors. This work considers the potentialities of the board of directors becoming a potent instrument of corporate wider approach, that is, corporate inclusivity and integrativeness of non-shareholding stakeholders' interests in a shareholder primacy and Enhanced Shareholder Value (ESV) jurisdictions. The work suggests that directorial wide discretions vested on the board by the law and the articles of association of most companies, which is further strengthened by the principle of business judgment rule as well as by shareholders' passivity in the management of the company and their apparent non-challant attitude not only to the ways and

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[1] The primary concern of this work is big companies, especially public limited liability companies and multinational companies.

manners the affairs of big companies are being managed by the board but also to the corporate purpose(s) or objective(s) that are being pursued by the board, and coupled with the practical effects of separation of corporate ownership from control in big corporations are sufficient enough for a 'willing' board to avail itself and become stakeholder-oriented. Unfortunately, however, a board may, instead, choose to utilize the opportunities availed to it by these principles to vigorously pursue shareholders' profit maximization agenda. This therefore raises the issue whether legally mandating the board to be integrative as pluralism advocates is the best option. The work proceeds by considering the chief concern of the board in shareholder primacy and ESV jurisdictions.

Promoting or Furthering the Interests of Shareholders: The Primary Concern of Directors in a Shareholders Primacy and ESV Regimes

The board is the organ of the company which performs most of the corporate managerial functions, and takes and executes most of the corporate decisions a number of which affect, directly or indirectly, (and positively or negatively), not only the shareholders of the company but other non-shareholding stakeholders also. This management power is usually vested on the board either by the country's corporate legislation or by the concerned company's articles of association or by both. Where such management powers have been vested on the board by the company's articles, the general meeting cannot interfere with their exercise as the implication of such vesting of powers to the board is that it constitutes a contract by which the shareholders

have agreed that "the directors and the directors alone shall manage"[2] the company.

The appreciable move in the recent times towards large business corporations coupled with the increasing complexity of business have necessitated the board of directors being entrusted with wide discretionary powers. The board has "absolute power to do all things other than those expressly stated to be done by the company shareholders." [3] This directors' wide discretionary powers is strengthened by the fact that they are not agents of the shareholders and cannot, thus, be mandated or compelled by the shareholders on what to do through mere passage of a simple resolution. This is buttressed in *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunninghame*[4] where the court said that it is "established that directors, within their management powers, may take decisions against the wishes of the majority of shareholders, and indeed that the majority of shareholders cannot control them in the exercise of these powers while they remain in office."

It appears apparent that directors are indispensable vehicle in ensuring financial, economic and social stability in the society through effective discharge of their corporate duties. They are, however, human beings, and as such, may not be hundred per cent unblemished in the discharge of their duties. A breach of those duties may leave behind it some resultant hardships on the society, particularly when it ends in the liquidation of the

[2]*Automatic Self-Cleansing Filter Syndicate Company v Cunninghame*, [1906] 2 Ch 34, CA, at p 44, per Cozens-Hardy L.J.
[3]*Ibid.*, at p 42.
[4]*Ibid*. See also *Towcaster Racecourse Co. Ltd v Racecourse Association Ltd* [2003] 1 B.C.L.C. 260; *Gramophone and Typewriter Ltd v Stanley* [1908] 2 K.B 89, at p 105.

company which may be the life wire/blood of a family, community or even a nation; and the attendant incalculable hardship socially, economically and otherwise flowing from such a liquidation to all the stakeholders. It therefore becomes imperative that the exercise of their directorial powers should be regulated[5] and, as much as possible, be exercised in the interests of not only the shareholders, but also those of the non-shareholding stakeholders who contribute towards the corporate success and share in the blunt of corporate mismanagement. Highlighting the far-reaching effects associated with the collapse of companies, The UK Cork Committee[6] averred that-

> A concern for the livelihood and well-being of those dependent upon an enterprise which may well be the life blood of a whole town or even a region is a legitimate factor to which a modern law .... must have regard. The chain reaction consequences upon the failure can potentially be disastrous to creditors, employees and the community that it must not be overlooked.

Despite the possible far-reaching effects of the managerial/ directorial actions and inactions which in most cases transcend the shareholders to the larger society, while performing its directorial function, the board is, in shareholder primacy constituency such as Nigeria, made answerable solely to the shareholders. While in some other constituencies for instance, in a ESV regime like the UK, the board can, if the circumstances so

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[5] Farrar and Hannigan wrote that unfettered, unsupervised and absolute discretion of the board must not be allowed. See Farrar J.H & Hannigan B.M (1998) *Farrar's Company Law*, London: Butterworths, (4th ed.), at p 370.

[6] *Report of the Review Committee on Insolvency Law and Practice*, (Cork Committee Report, 1982 (Cmnd 8558)) at para. 204.

permit (and it will be in the interests of the shareholders to do so), have regard to the interests of the non-shareholding stakeholders, but answerable to shareholders only.[7] In most jurisdictions, no specific mandate is given to them to consider, as a matter of legal obligation, the interests of non-shareholding stakeholders. Thus, defining the meaning of directorship, and their role in a corporate setting, Jessel MR, in *Re Forest of Dean Coal Mining Co*[8] said that they are "merely commercial men, managing a trading concern for the benefit of themselves and all other shareholders in it." Similarly, Companies and Allied Matters Act, 1990, (CAMA), section 283 said that they must "exercise their powers honestly in the interests of the company and all the shareholders..." It is evident in the two citations above that the primary and fundamental concern of the directors in the two jurisdictions is to promote and protect the interests of the shareholders. In fact, the interest of any other stakeholder was not even mentioned in the first instance, talk more of the one that should be prioritised. Even the UK's new statement of directors' duties in the UK Companies Act, (CA) 2006, sections 170-177 begins by saying unequivocally that the various duties set out in the statement are owed by the company directors to their company. Every aspect of the duties is, therefore, to be viewed as representing the directors' duties to his/her company as a collective body. No duty is owed to individual shareholder or to persons outside the company members. That the UK company law was principally shareholder oriented prior to the 2006 Act and that there is (likely) an intention for the *status quo* to continue even after the coming into force of the 2006 Act was demonstrated by the UK Company Law Review Steering Group

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[7] This is referred to as Enhanced Shareholder Value (ESV) approach.
[8][1878] 10 Ch 450, at p 452.

(CLRSG)[9] where the formula adopted was "an obligation on directors to achieve the success of the company *for the benefit of shareholders* by taking proper account of all relevant considerations for that purpose....."[10] Obviously, no proposal to foster or promote any other interests other than those of the shareholders appeared. They can be considered if and only if doing so will foster the interests of the shareholders. There is however the perceived need for a paradigm shift from this singular shareholder concern of directors to wider stakeholders' interests integration.

The Board as a Potential Tool of 'Inclusive' Corporate Stakeholding Approach

Despite the position under the common law and the provisions of CAMA 1990 and the UK's Company Act, 2006 which are arguably shareholder oriented, when one recalls that the board functions as the 'corporate conscience,' setting the overall standards and reviewing major corporate plans from both legal and ethical standpoints, it becomes clearer that it remains very vital (if not indispensable) in making the company a good corporate citizen through its conscientious integration of the societal welfare and wellbeing in its policies. It therefore becomes difficult to appreciate how it should be basically concerned only with the interests of the shareholders. The board, especially of big companies, no doubt, is an indispensable vehicle in ensuring financial, economic, social and even political stability, not only for the shareholders of the company, but for the wider community also through effective and responsive discharge of its directorial duties and other wider responsibilities. As already noted, decisions which *inter alia* hugely shape the company's social

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[9] (CLRSG), *Developing the Framework,* (DTI), March 2000, p 13.
[10] Emphasis is mine.

responsibilities, the country's (if not global) economic development, determine the levels and conditions of employment, have remarkable impacts on the physical environment are customarily taken by company directors and managers. This must have moved Goyder to say that "the social role of the big companies is becoming so important for the community that the way in which the big companies discharge their social responsibilities is of immediate concern to all of us."[11] Of course, the board is the major brain, mind, will and hand[12] through which those companies carry out those social, ethical and economic responsibilities. Mills expounds his view on the directorial task and its wider effects on the society thus- the board "is the keeper of the company's conscience and measure of corporate morality...The effective board meets its creditors on time; does not abuse its suppliers or maltreat its physical environment; is clinically correct with its customers, employees, auditors, analysts, shareholders, lenders and taxmen."[13]

A responsive board is always conscious of the wide impacts of its decisions and industrial activities. Consequently, even in countries where there are no prescriptive and binding laws/duties in place obliging them to be more inclusive, the directors, on their own accord, can choose to be more inclusive/integrative in its policies, and "adopt higher standards of social, ethical or environmental performance." [14] Some established corporate

[11] Goyder, G (1961) *The Responsible Company*, Oxford: Blackwell, at p 7.
[12] See, Lord Denning L.J. in *Bolton (Engineering) Co. Ltd v Graham & Sons* [1957] Q.B. 159, at pp 172-173.
[13] Mills, G (1998) *Controlling Companies,* London: Unwin Hymen, at p 21.
[14] Stone, C.D (1975) *Where the Law Ends: The Social Control of Corporate Behaviour*, New York: Harper and Row, Ch. 18. See also Hung, H (2011) "Directors' Role in CSR: A Stakeholder Perspective" 103 Journal of Business Ethics 385. He observes that corporate directors can help company

principles can aid a stakeholder-oriented board in being integrative. One of them is the wide discretionary powers given to them by virtue of 'business judgment rule'.

Business Judgment Rule[15]

At common law, directors were required to exercise that amount of care which ordinarily careful and prudent men would use in similar circumstances.[16] This common law duty is now codified with some modifications in the UK,[17] and Nigeria.[18] Because this

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manage the interests of its stakeholders, arguing that "the more concerned that corporate directors have for stakeholders, the more likely that they perceive the need to perform their (i.e., directors') CSR role effectively." (*Ibid*) at p 385. See also Wang, J and Dewhirst, D.H (1992) "Boards of Directors and Stakeholder Orientation" 11(2) Journal of Business Ethics 123; Hung, H (1998) "A Typology of the Theories of the Roles of Governing Boards" 6(2) Corporate Governance 101.

[15]It entails that a director should not be held liable for corporate decisions that led to undesirable results, where such decisions were made in good faith, with care and on informed basis and which the director believed were in the interests of the company. See Coetzee, L and Kennedy-good, S (2006) "The Business Judgment Rule" 27(2) Obiter 277.

[16] See, for instance, Romer J in *Re City Equitable Fire Insurance Co Ltd* (1925) CH 407, especially at p 428; *Daniels v Anderson [1995] 13* ACLC 614.

[17] See UK CA 2006, section 174. As is made clear by the said 2006 Act, s 178(2), the duty of care, skill and diligence is not a fiduciary duty. It is a statutory statement of a common law duty imposed on those who assume responsibility for the property and affairs of others, governed thus by the normal common law rules as to liability for negligence. While the crux of fiduciary duty is loyalty/honesty and a breach of fiduciary duty is primarily about disloyalty - mere incompetence is not enough - the common law duty of care and skill is essentially about negligence and incompetence. See *Bristol & West Building Society v Mothew* [1996] 4 All ER 698, at pp 711-712, *per* Millett LJ; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598, at p 618, here, it was noted that "Fiduciary duties are concerned with concepts of honesty and loyalty, not with competence"; Hannigan, B (2008) *Company Law*, (2nd ed.), London: OUP, at p 223.

[18] See CAMA 1990, section 282.

duty of care resembles the tort law concept of reasonable[19] care, one might assume that it is breached once a director acts negligently. But, the concept- 'business judgment rule'- insulates directors from liability for negligence. Thus, in the American case of *Joy v North*[20] it was said that "while it is often stated that corporate directors and officers will be liable for negligence in carrying out their corporate duties, all seem agreed that such a statement is misleading...Whatever the terminology, the fact is that liability is rarely imposed upon corporate directors or officers simply for bad judgment and this reluctance to impose liability for unsuccessful business decisions has been doctrinally labelled the 'business judgment rule.'"[21]

The business judgment rule is a central doctrine in corporate law. It pervades every aspect of the directorial decisions- be it negligence by directors to self-dealing transactions; termination of shareholder litigation; decision to integrate or not to integrate the interests of non-shareholding constituencies *etc*. It is a reflection of the inherent tension between two competing values in corporate governance regime- both of which are very essential

[19] The duty is no longer measured solely by reference to subjective factors. See for instance, *Norman v Theodore Goddard* (1991) BCLC 1028. Here, Hoffmann J accepted a submission that the appropriate test was accurately stated in the UK Insolvency Act (IA) 1986, section 214(4). This decision now informed the drafting of section 174 of the 2006 Companies Act. See also *Re Landhurst Leasing Plc, Secretary of State for Trade and Industry v Ball* [1999] 1 BLCL 286, at p 344. Insolvency Act, 1986, s 214(4) demands that the conduct of a director should be measured against the standard of a reasonably diligent person having both the general knowledge, skill and experience that may reasonably be expected of a person carrying out a similar function as is carried out by that director in relation to the company, and the general knowledge, skill and experience that the director has.

[20] 692 F.2d 880, 885 (2d Cir), cert. Denied, 460 U.S. 1051 (1982).

[21] *Ibid.*

to the survival of the corporation[22]- *viz:* the need to preserve the board's decision-making discretions (and entrepreneurship, that is, business or commercial risk-takings) and the need to hold the directors accountable for their decisions. The latter seemingly attracts more attention in corporate governance owing to the separation of ownership and control witnessed in public companies which has the tendency of giving rise to opportunistic dealings by the board, and therefore raises serious accountability concerns. But, as important as accountability is, the need to allow the board some authorities or discretions in the management of the company's affairs cannot be over-emphasised, as it is essential for efficiency in corporate decision-making and management.[23] As necessary as it is to achieve a good balance between these two competing goals,it is obviously a daunting task to do so. The more you try to hold corporate decision makers to account, the more you interfere with their decision-making process and entrepreneurship. On the other hand, the more discretion you give them, the less accountable they become.[24]

The rule generally avails a director and excuses him/her from liability where he/she: makes the judgment in good faith; for proper purpose; does not have a material personal interest in the subject matter of the judgment; have taken adequate steps to become informed about the subject matter; and the decision is made in the best interests of the company.[25] In arriving at its

[22] Dooley, M. P (1992) "Two Models of Corporate Governance" 47 Company Lawyer 461.

[23]See Bainbridge, S.M (2008) *The New Corporate Governance in Theory and Practice,*New York: OUP, at p 107.

[24] See Arrow, K.J (1974), *The Limits of Organisation,* New York: W.W Norton & Co, at p 78

[25] Coetzee, L and Kennedy-good, S (2006) "The Business Judgment Rule" 27(2) Obiter 277. See also South African Companies Act 2008, s 76(4).

decision, the court does not necessarily have to examine the substantive merits of the board's decision. The court does not require the directors to prove either that shareholder wealth maximising consideration(s) is the motivation behind their decision or that the decision in fact benefited the shareholders.[26]Supporters of business judgment rule argue that not only that it creates an exemption from liability; it also serves as motivation for capable persons to accept directorships. Again, it encourages them to engage in risk-taking activities.[27]Of course, business decisions are, most often, complex and made under severe time pressure and under conditions of uncertainty.[28]Thus, in the American Law Institute's Principles of Corporate Governance, business judgment rule was justified by the drafters as being essential to protect "directors and officers from the risks inherent in hindsight reviews of their business decisions" and to avoid "the risk of stifling innovation and venturesome business activities." [29] In other words, it affords the directors wide discretions (in so far as they abide by the ingredients/elements of the rule) in the management of the affairs of the company.

[26] See *Shlensky v Wrigley*, 237 N.E.2d 776, 777-78 (Ill. App. 1968); *Dodge v Ford Motor Co* 170 NW 668 (1919) (Michigan) at p 682; *Brehm v Eisner* 746 A.2d 244 (Del. 2000); *Leslie v Lorillard*, 18 N.E. 363, 365 (N.Y.1888). Here, the court said that "courts will not interfere unless the [directors'] power has been illegally or unconscientiously executed; or unless it be made to appear that the acts were fraudulent or collusive, and destructive of the rights of the [shareholders]. Mere error of judgment is not sufficient....."

[27] Sealy, L.S (1991) "Reforming the Law on Directors' Duties" 12(9) Company Lawyer 175.

[28]See CLRSG: *Developing the Framework* (London, DTI) (2000), at para 3.69.

[29] American Law Institute, Principles of Corporate Governance: Analysis and Recommendations of s 4.01 cmt. D, at 141 (1994).

While those that oppose the rule argue that it could result in accepting standards of conducts which are below an acceptable standard that ought to be required of directors,[30] adding that the exact content of the business judgment rule is difficult to define.[31] Having seen how it became important to allow the board some discretion, we will now consider the possibilities of the board employing it to actualise the inclusivity agenda.

In a Shareholder Primacy and ESV Regimes, Can an 'Inclusive' Board Utilise this Their Wide Discretionary Powers to the Advantage of the Stakeholders?[32]

[30] Coetzee and Kennedy-good, *op cit*, at p 280; Finch, V (1992) "Company Directors: Who Cares about Skill and Care?" 55(2) The Modern Law Review 179; Mackenzie, A.L (1982) "A Company Director's Obligations of Care and Skill" Journal of Business Law 460.

[31] Coetzee and Kennedy-good, (2006) *(ibid)*.

[32] In treating this, we are not ignorant of the potential and actual impacts of market for social control in limiting and restricting the boards' discretion, especially in relation to the non-shareholding stakeholder integration which is the major concern of this research work. No doubt, market constraints set narrower limits on the potential space for corporate responsible actions or behaviours. Though market competitions do not make social responsibility impossible, they do cause disincentives against engaging in it. That is, where trading conditions are competitive, this has the tendency of forcing a company to curtail its scale of social expenditure. Thus, Baumol and Blackman noted that the "business executive who chooses voluntarily to spend until it hurts on the environment, on training the handicapped, or on support of higher education is likely to find that he is vulnerable to undercutting by firms without a social conscience that, by avoiding such outlays, can supply outputs more cheaply." Baumol, W.J and Blackman, S.A.B "Social Policy: Pricing Devices to Aid the Invisible Hand" in Baumol and Blackman, *Perfect Markets and Easy Virtue: Business Ethics and the Invincible Hand* (1991) 46, at p 53. In the words of Kaysen, "only the ability to earn a substantial surplus over costs makes possible a variety of (social) expenditures whose benefits are broad, uncertain, and distant." Kaysen, C

As seen above, the board - both under the common law, company legislation and under the company's articles - is usually vested with wide powers and authority or discretions in the management of the company. Arguably, this wide discretion can be employed to serve the interests of the stakeholders. That the national law and custom does not mandate or impose a duty on the board to integrate the interests and well-being of non-shareholding stakeholders into their corporate policy-making cannot and should not stop a responsible and stakeholder-conscious board from doing so. This is one of the ways by which the directors – who are "the key minds behind corporate decision-making"[33] - can be responsive and a path to 'inclusive' corporate stakeholding. Of course, the integration of the stakeholders' interests depends not only on the national law and custom, but also on the individual company's approach or tradition, in that a company operating in a shareholder primacy jurisdiction can, on its own freewill, decide to adopt an inclusive approach in its corporate policies and activities. Thus, Parkinson averred that where a case is made that companies should act in ethical and socially responsible way, "it does not follow that legal response is necessarily required."[34] It may not be disputed that for the directors to serve shareholders properly- even in a shareholder-oriented jurisdiction/regime- other relevant interests must be taken into account.[35] So, the welfare and interests of the

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(1957) 47 American Economic Review 311, at p 314. See generally, Parkinson, J.E (1993) *Corporate Power and Responsibility*, New York: OUP, at pp 262-263.

[33]Bone, J (2011) "Legal Perspectives on Corporate Responsibility: Contractarian or Communitarian Thought?" 24 Canadian Journal of Law and Jurisprudence 277, at p 298.

[34] Parkinson, J (2000) "Corporate Governance: The Company Law Review and Questions of 'Scope'" 8 Hume Papers on Public Policy 29, at p 45.

[35] Dine, J (2001) *Company Law*, London: Sweet & Maxwell, at p 210.

stakeholders can still receive adequate attention in some companies operating in a country where the national law is exclusively or chiefly shareholder-oriented, as "the law in practice leaves directors with considerable flexibility in safeguarding non-shareholder interests, should they so choose, and is unable in general to discriminate between measures dictated by considerations of long-term profitability or regulatory requirements on the one hand, or by an altruistic concern for those affected by the company's activities on the other."[36]

Lord Greene's view in *Re Smith & Fawett Ltd* that directors should act "in a way he considers, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole"[37] has now been codified in the UK Companies Act 2006, section 172.[38] Obviously, this is a subjective duty as Lord Greene in the above case stressed that the court should not substitute its own view about what course of action the directors should have taken to that of the directors.[39] The directors "must exercise their discretion bona fide in what they consider- not what the court may consider- is in the interests of the company..."[40] The focus here is very much on what the

[36] Parkinson, John (1993) *Corporate Power and Responsibility*, New York: OUP, at p 278.
[37] (1942) Ch 302, at p 306. This principle was restated recently by Arden L.J in *Item Software (UK) Ltd v Fassihi* [2005] 2 B.C.L.C 91 (Civ Div).
[38] See also CAMA 1990, s 279(3).
[39] See also *Regentcrest PLC v Cohen* [2002] 2 BCLC 80; *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 BCLC 598.
[40] *Re Smith and Fawcett Ltd* (1942) Ch 304, at p 306. Some judges and writers are not very comfortable with this subjective test, and sometimes adopt objective test instead. See, for instance, *Chatterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] 1 Ch 62, at p 75; *Shuttleworth v Cox Bros (Maidenhead) Ltd*, [1927] 2 K.B. 9, at p 23.

directors themselves think, and the major ingredient required is 'good faith'. The director(s) involved must be acting not *male fide* but *bona fide*.[41] The issue relates to the directors' state of mind. Thus, in the words of Chancellor Chandler "fiduciaries who acted faithfully and honestly on behalf of those whose interests they represent have are *indeed granted wide latitude* in their efforts to maximise shareholders' investments."[42] There is, therefore no breach of this duty if the directors strongly and honestly believe that they are acting in the best interests of the company.[43]In other words, the directors will not be held liable simply because their action happened to cause injury to the company unless their good faith could not be established.[44] That being the case, the provision/principle seems broad and roomy enough and thereby gives the directors (who wish to) wide discretion to make decisions which will be beneficial to and integrative of the interests of the non-shareholding stakeholders without attracting the condemnation of the shareholders. This is further backed by the fact that it is the board (and not the shareholders) that generally has the final say as to what will serve the interests of the company best.[45] And, the board is not bound to accept the recommendations of the general meeting, in so far as it is acting

[41]*Regentcrest PLC v Cohen* [2001] 2 BCLC 319.

[42](Unreported), August 9, 2005. Emphasis added.

[43]*Regentcrest Plc (ibid).* See also Grantham, R (1993) "The Content of the Director's Duty of Loyalty", J.B.L 149, at p 149.

[44]*Extrasure Travel Insurance Ltd v Scattergood*, (n 39), at p 90. See also Parker J in *Regentcrest PLC*, *op cit*, at pp 124-125. There, he said that if the directors give unequivocal evidence that they honestly believed that they had acted in the best interests of the company and if the evidence were accepted by the court, then there had been no breach.

[45] See the UK Model Articles) Regulations 2008 (SI 2008/3229, art 3 of both Sch 1 and 3. See also a similar provision in CAMA 1990, s 63(3); *Automatic Self-Cleansing Filter Syndicate v Cunninghame (n 2), e*specially at p 42.

within its powers.[46] These leave the directors with the chance to decide whether or not to adopt integrative approach, and they are armed with a defence when they do, in that the integration of the interests of the corporate stakeholders has the tendency of furthering the wealth of the shareholders. This need not be instant. It may appear *prima facie*, especially at the outset, to deplete the wealth of the shareholders, but, in the long-run, it may yield much fruits for the shareholders. This is so especially in those jurisdictions where long-termism is cherished and encouraged.[47] So, the directors who have integrated the interests of the stakeholders can, when challenged, point to the anticipated positive prospects such integrative actions have for the company. Even if where it did not yield the desired results, the directors can still be excused on the ground of business judgement doctrine,[48] unless the integrative actions/decisions taken cannot, in any way, be justified commercially.[49] Of course, there are case laws to the effect that while the directors (under shareholder primacy regime) are to manage their companies with shareholders in mind, they

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[46] See for instance, CAMA 1990, s 63(4); *Automatic Self-Cleansing Filter Syndicate v Cunninghame, ibid. Gramophone and Typewriter Ltd v Stanley (n 4);John Shaw & Sons (Salford) Ltd v Shaw (op cit);; Howard Smith Ltd v Ampol Petroleum Ltd*[1974] AC 821; *Salmon v Quin & Axtens Ltd* [1909] 1 Ch 311, CA.

[47] Enhanced Shareholder Value (ESV) adopted by the UK in 2006 Act seeks a more inclusive approach and encourages the building of long-term relationships. See CLRSG*: Developing the Framework* (DTI, London, 2000), para 2.22.

[48] This is treated above. Thus, it was said in *Re Beloved Wilke's Charity* that "the duty of supervision on the part of this court will be confined to the honesty, integrity, and fairness with which the deliberation has been conducted, and will not extend to the accuracy of the conclusion arrived at." (1851) 3 Mac. & G. 440, at p 448, *per* Lord Turo LC.

[49] See *Brehm v Eisner (n 26); Leslie v Lorillard (n 26)*; *Shlensky v Wrigley (n 26).*

have a reasonable wide discretion in the factors which they may consider in deciding what is going to benefit the company.[50] These factors may include (the consideration of) the interests of the stakeholders.

For reasons already discussed, shareholders hardly police or monitor the board closely, especially in very big corporations. As such, shareholders may only become attentive if the inclusivity programme(s) embarked upon by the board is such that remarkably depleted their share value in the market or their dividends. In reality, it seems not far from the truth that most shareholders are nonchalant about the way the board manages the company as well as its social responsiveness to the interests of the stakeholders. Their basic concern is that a reasonable dividend is paid to them for their investment and/or that the value of the shares of the company in the stock market appreciates appreciably. [51] In fact, the Australian Parliamentary Joint Committee on Corporation and Financial Services observed that most shareholders were happy to support corporate wider/social responsibility as it will lead to shareholder gains, either in the

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[50] See, for instance, *Harlowe's Nominees Property Ltd v Woodside (Lakes Entrance) Oil NL* (1968) 121 CLR 483, at p 493 (Barwich CJ, McTiernan and Kitto JJ); *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288 (BCSC); *People's Department Stores Inc v Wise* [2004] SCC 68, 244 DLR (4th) 564, at p 42 (Major and Deschamps JJ); *Lonrho Ltd v Shell Petroleum Co* Ltd [1980] 1 WLR 627 (HL).

[51] See Berle, A.A and Means, G.C (1932*) The Modern Property and Private Property*, New Brunswick and London: Transaction Publishers, at p 247. Cohen Committee in the UK made a similar observation when it said that shareholders "pay little attention to their investments so long as satisfactory dividends are forthcoming." See Company Law Amendment Committee, Cmd. 6659 (1945), para 7(e).

short or long-run.[52] So, the board of the big companies does not have much excuse to give when it does not integrate the interests of the non-shareholding stakeholders in their policy-making.

Separation of ownership from control is one of the basic attributes of public companies.[53] One of the consequences of investors surrendering the management of their assets to the board is that there is a steady diminish in the number of demands they can make to the board with any assurance that those demands will be met. The shareholders are virtually not in a position to demand that the board should do or refrain from doing any given act[54]unless they either pass a special resolution or amend the articles.[55]In either case, the vote of not less than 75 per cent of the votes cast at the meeting is needed for this to be done.[56] It is obvious that getting the required three-quarters votes is a great upheaval task. Consequently, the ultimate sanction which the members of general meeting can exercise to express their disapproval of a director's managerial conduct is usually to remove[57] him from office after complying with the stipulated

[52] Parliamentary Joint Committee on Corporations and Financial Services, Commonwealth of Australia, *Corporate Responsibility: Managing Risk and Creating* Value (2006), available at www.aph.gov.au/Senate/committee/corporations_ctte/corporate_responsibility/report/report.pdf, at p 50.

[53] In *The Modern Corporation and Private Property*, Berle and Means highlighted that those who own large public companies do not control them and, conversely those who control those companies do not have substantive ownership interests in them. Berle and Means (1932) (n 51). We will treat this in details subsequently.

[54] Berle and Means, ibid, at p 244..

[55]This is discussed above.

[56] UK Companies Act 2006, s 283.

[57] Generally, the power to remove a member of the board from office before the expiration of the director's tenure is "the principal instrument of

statutory procedures.[58] This again, is not an easy task.[59] The situation is seemingly a hopeless one.[60] Thus, in the words of Blair and Stout, directors "are not subject to direct control or supervision by anyone, including the firm's shareholders."[61] It is inherent that the corporate system has ended up breeding/creating huge economic empires and has handed these mighty empires into the hands of a new form of absolutists called the directors. The shareholders have been relegated to the position of mere suppliers of capital, while the new princes of industries (the directors) exercise their powers the way they deem fit. Put in another way, the principle of law that the judgment of the board shall prevail as to the best interests of the company is tantamount to saying that the board has a certificate to sacrifice the interests of the individual shareholders on the altar of economic exigencies of the company - the interpretation of the board as to what

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shareholder control of the board members." The (actual) use of it or the background threat of its use enables the shareholders to put the members of the board on their toes; and induce them to conform to the demands of profit maximisation: Parkinson, J.E (1993) *op cit*, at p 52. But, with the increase in the corporate size of large companies (both in terms of membership and the size of resources under its control) with its attendant separation of ownership from control and the resultant shareholder passivity has caused the weakening and breakdown of this control apparatus, liberating the board, so to say, to pursue its own chosen objectives.

[58] See UK Companies Act 2006, s 168. If other conditions are met, a director can be removed by simple majority vote: see s 168; CAMA 1990, s 262.

[59] The difficulties associated with removing a member of the board from the office before the expiration of his office are discussed towards the end of this work.

[60] Just as under the common law, CAMA 1990, s 63(4) expressly and unequivocally stated that the board is not bound to accept recommendations or suggestions made by members in general meeting.

[61] Blair, M.M and Stout, L.A (1999) "A Team Production Theory of Corporate Law" Va. Law Rev 247.

constitutes an economic exigency being ultimately final. As if that is not enough, in a good number of jurisdictions, the board of public companies is insulated from pressure from non-shareholding stakeholders, such as employees and creditors. At the same time, the diffused nature of shareholding/share-ownership coupled with regulatory impediments to investor activism insulates the board from shareholder pressure.[62] As a result, the directors have "virtually unrestrained freedom to exercise business judgment."[63] Arguably, this vast freedom can be utilised positively by a 'mindful' board by being inclusive and integrative of stakeholders' interests.

More so, the board is likely going to get away with its inclusivity programme by alluding to the long-term interests of the company, as courts have stated that the board may take the long-term well-being of the company into account even in a shareholder primacy regime.[64] This, according to them, is a matter of a commercial

[62]A public company is "a large, complex, and geographically dispersed entity with multiply (shareholders)......with vast number of people with radically asymmetric information and fundamentally competing interests. Under such conditions, collective action problems will prove intractable......." Bainbridge, S.M (2008). *The New Corporate Governance in Theory and Practice*, New York: OUP, at pp 11-12. See also Herman, E.S (1981) *Corporation Control, Corporation Power*, New York, Cambridge University Press, at p 5, where he said that "with larger corporation size come a greater depression of stock ownership, a steady reduction in the power and interest of the shareholders and gradual enhancement of managerial authority."

[63] Bainbridge (2008) *ibid*, at p 11-12.

[64] See, for instance, *Provident International Corporation v International Leasing Corp Ltd* 1969] 1 NSWR 424, at p 440 (*per* Helsham J); *Paramount Communications Inc v Time Inc,* 571 A. 2d 1140 (Del, 1989). See also UK Companies Act 2006, s 172.

judgment on the part of the directors.[65] So, as the shareholders do not care much about the management's managerial decisions which may include the integration of the wider interests in the corporate policy making, and the court is not much inclined towards interfering, any board of a company is arguable (relatively) free to adopt a more stakeholder-oriented approach.

Another legal point that may offer some protection to the integrative board is that in decision-making, the duty of the directors under the shareholder value and ESV approach is ultimately to benefit the members *as a whole*[66]The expression 'members as a whole' has been used on many occasions in the UK company law. It is assumed that the judicial comments on the meaning of the expression would be pressed into service here. Courts have held that it means the present and future shareholders. [67] The CLRSG seemingly accepted this interpretation as it said that directors should not ignore events that may occur after the present members have ceased being

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[65]The ESV also encourages long-termism. See UK CA 2006, s 172(1)(a). See also CLRSG, *Developing the Framework* (London, DTI, 2000), at para 3.54; Lord Goldsmith's speech in the House of Lords Grand Committee, 6 February, 2006, col 258.

[66] See Lord Greene in *Re Smith Fawcett Ltd*, (n 40); the UK Companies Act 2006, section 172(1) and CAMA 1990, section 279(3). Emphasis is mine.

[67] See for example *Brady v Brady* (1987) 3 BCC 535, at p 552 (Megarry J); *Gaiman v National Association for Mental Health* [1971] Ch 317, at p 330 (Nourse J); *Provident International Corporation v International Leasing Corp Ltd [*1969] 1 NSWR 424, at p 440 (Helsham J); *Darvall v North Brick and Tiles Co Ltd* (1987) 12 ACLR 537, at p 554 (Hodgon J). The origin of this proposition is seemingly traceable to the report of the inspector appointed by the Board of Trade to investigate the Savoy Hotel affair. See Board of Trade, *The Savoy Hotel Ltd and the Berkeley Hotel Company Ltd: Investigation under Section 165(b) of the Companies Act 1948: The Report of E Milner Holland QC* (London, HMSO, 1954).

members.[68] If that is correct, then, the action of a board that acts in the interests of the stakeholder constituencies may eventually benefit the future shareholders, even though not the present ones. This seems to afford protection to such a board as it may allude to the long-term benefits of the action (to the future shareholders) when challenged. This is more so in an ESV regime that urges the board to have regard to the long-term interests of the company which is held to mean the long-term interests of the shareholders as a whole, (future shareholders, arguably, inclusive).

The UK Companies Act, section 172 which mirrored the subjective rule[69] of Greene in *Re Smith & Fawcett Ltd* (above) thereby vesting wide discretionary powers on the directors (coupled with the provisions of most company's articles of association that adopts the Companies (Model Articles) Regulation 2008, article 3 of both Schedule 1 and Schedule 3[70] arguably suits perfectly to the analyses given above- (that is, willing board's ability to be integrative of the interests of the stakeholders based on their vast powers and wide discretions in the management of the company). This is further supported by the

[68] CLRSG, *Developing the Framework*, (London, DTI, 2000), at para 3.54.
[69] Note Keay's opinion in Keay, A. (2007) "Section 172(1) of the Companies Act 2006: An Interpretation and Assessment" 8(4) Company Lawyer 106, at p 109 that it is most likely that the courts will follow the trend under the common law where some judges adopted objective instead of subjective test (see, for instance, *Chatterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] 1 Ch 62, at p 75) in the current 2006 Act. He even argued that the Parliament have impliedly accepted the importation of the objective test by virtue of section 170(3) and (4) of the Act. It is doubtful if this could be so. Margaret Hodge MP who was the Government minister responsible for the legislation made it clear that the test applicable, with respect to section 172, is not the reasonableness test. See HC Standing Committee D, Fifteenth Sitting, 11 July 2006, Cols 591-593.
[70] This is the equivalent of Table A, article 70 of the 1985 Act.

fact that ESV seeks to secure a more inclusive approach[71] and the development of relationship of trust with stakeholders.[72]Though the ESV approach is still based on shareholder primacy and requires directors to act in the collective best interests of the shareholders,[73] it is highly doubtful if the board will be harshly condemned if it adopts inclusivity approach as this is obviously its implicit target[74]- as it does not support exclusive consideration of shareholders' interests or short-term financial benefits, but the building of long-term relationships[75] with the stakeholders.

Again, just as was the case under the common law where the test was subjective, 'reasonableness test' will not apply under the current section 172.[76] This is evident in the statement of the UK Government Minister responsible for the legislation, Margaret

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[71] CLSRG,*Developing the Framework* (DTI, London, (2000), para 2.22. This is evident in the CLRSG's preference of the restatement of directors' duties in which there would be an obligation on them to "achieve the success of the company for the benefit of the shareholders by taking proper account of all the relevant considerations for that purpose" including "a proper balanced view of the short and long term, the need to sustain effective ongoing relationships with employees, customers, suppliers and others; and the need to maintain the company's reputation and to consider the impact of its operations on the community and the environment." CLRSG,*Developing the Framework* (London, DTI, 2000), at p 12. See also CLRSG,*Final Report Volume 1* (London, DTI, 2001), at p 41.

[72] CLRSG, (2000) (*ibid*), at para 5.1.12.

[73] CLRSG,*Developing the Framework* (London, DTI, 2000) at para 2.22.

[74] Its explicit target seems to remain the maximisation of shareholders' wealth. See CLRSG, *Developing the Framework* (London, DTI, 2000) para 2.22 above.

[75] (*Ibid*), at para 5.1.12.

[76] See Keay, A (2012) "The Duty to Promote the Success of the Company: Is it Fit for Purpose in a Post-Financial Crisis World?" in J. Loughrey (ed.) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis*, Edward Elgar 64, at p 65.

Hodge MP, when she said, in relation to the said section that "we believe it is essential for the weight given to any factor to be a matter for the director's good judgment. Importantly, the decision is not subject to the reasonableness test."[77] What will matter here therefore is most likely going to remain the state of mind of the directors. Similarly, in *Cobden Investments Ltd v RWM Langport Ltd,*[78] Warren J was of the opinion that the duty in section 172 is subjective, just like its predecessor. This is also evident from the wording of the section- "A director of a company must act in a way that *he considers,* in good faith,would be most likely to promote the success of the company….." [79] This is further confirmed by the Explanatory Notes to the 2006 Act where it is stated that the "decision as to what will promote the success of the company, and what constitutes such success, is one for the director's good faith judgment, and this ensures that business decisions on, for example, strategy and tactics are for the directors, and not subject to decision by the courts, provided directors acted in good faith."[80] As can be seen, the Explanatory Note goes further to buttress the wide discretion given to the board by the section.

Furthermore, the explicit stipulation in section 172 of the 2006 Act that the board should "have regard" to the interests of those stakeholders and other material factors therein listed [81] is seemingly wide to protect any board that has taken an 'inclusive'

[77]*HC Standing Committee* D, Fifteenth Sitting, 11 July, 2006, Cols 591-593.
[78] [2008] EWHC 2810 (Ch), at p [53].
[79] Emphasis is mine.
[80] Explanatory Notes to the Companies Act 2006, at para 327. See also Clause 64 of the Guidance to Key Clauses in the UK Company Law Reform Bill 2005.
[81] The list is not exhaustive.

project/policy in good faith - even though it eventually resulted in the reduction of the wealth of the shareholders - as this seems in line with the spirit of the wordings of the section: it is aimed at ‘integrativeness’ rather than the solitary consideration of the shareholders’ interests. The section can therefore offer a defence to the directors for “almost any *bona fide* decisions at promoting the success of the company.”[82] Of course, when viewed critically, the object of the board’s indulgence in integrative activities/approach is “to protect shareholders’ interests rather than to override them.”[83] Consequently, any board, being the “corporate conscience”[84] can, if it so wishes, be bold and courageous enough to integrate the welfare of the stakeholders in its policy making.

This is arguably, the very intent of the said section 172. That is, it aims at achieving a situation whereby members of the board are given the freehand to determine what is the most appropriate manner to ‘promote the success of the company’ by taking into consideration the respective interests of the various stakeholder

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[82] Lowry, J (2009) “The Duty of Loyalty of Company Directors: Bridging the Accountability Gap through Efficient Disclosure” 68(3) Cambridge L.J 607, at p 621. There is a common law authority to this – *Re Welfab Engineering Ltd* [1990] BCLC 833. Here, Hoffmann J held that the directors’ failure to realise the best price for its freehold premises, which was the company’s major asset, was a bona fide attempt to save the enterprise and the jobs of the employees. Consequently, he dismissed the liquidator’s misfeasance summons brought under the UK Insolvency Act 1986, s 212. See also Lowry, J and Edmunds, R [2003] “The Continuing Value of Relief for Director’s Breach of Duty” M.L.R. 195.

[83] Parkinson, J (2003) “Disclosure and Corporate Social and Environmental Performance: Competitiveness and Enterprise in a Broader Social Frame” 3J.C.L.S. 3, at p 34.

[84] Institute of Directors, Guideline for Directors, (Directors’ Publication, 1995), 6th ed., at p 15.

groups and other factors such as the peculiar situation of the corporation or its socio-economic condition at that particular moment.[85] If integrating or even given priority to the interests of a given non-shareholding stakeholder constituency is what will best promote the success of the company at the particular time, the board is arguably free to adopt that line of decision. Directors can therefore be tools of corporate inclusivity even when they are operating in shareholder primacy or ESV regimes.

It is clear, from the above, that we now need to consider the implications of the duty (originally a common law duty, now codified under section 171(b) Companies Act 2006 and CAMA 1990, section 279(5)) imposed on the directors to exercise their directorial powers (and discretions) for the proper purposes for which they were invested to this directors' wide discretion. Centrally, this is a question of whether it prevents directors from being inclusive where the corporate legislation in place is shareholder-oriented, thereby mandating them to maximize the shareholders' profit.

The duty insists that the directors should not act in self-interests or for collateral purposes. While directors may have wide managerial powers vested on them by the company's articles and may only be constrained by a subjective *bona fide* test, proper purpose doctrine affords some measure of control. The doctrine examines objectively the directors' purpose while giving due credit to their business judgment. Thus, Lord Wilberforce in *Howard Smith Ltd v Ampol Petroleum Ltd*[86] said that "the court will necessarily give credit to the bona fide opinion of directors,

[85]Ho, J.K.S (2010) "Is Section 172 of the Companies Act 2006 the Guidance for CSR?" 31(7) Comp Lawyer 107, at pp 112-113.
[86] [1974] A.C. 821.

if such is found to exist, and will respect their judgment as a matter of management; having done this, the ultimate conclusion has to be as to the side a fairly broad line on which the case falls."[87]

It is well established that the powers given to the directors by the company's articles are held in trust for the company by the directors. It must not therefore be exercised for any other purpose other than that for which it was conferred, otherwise the transaction/programme or decision concerned may be avoided notwithstanding the directors' claim that they honestly believe it to be in the best interests of the company.[88] Arguably, the integration of the interests of the non-shareholding stakeholders in a shareholder primacy regime, and even in ESV arguably may be viewed as the utilization of the board's power for a purpose different from that for which it is vested on them- which is to maximize the shareholders profits- especially where it did not achieve the profit-maximising objective. A case in point is *Dodge v FordMotor Co.*[89] But, when it is looked at critically, such exercise of powers and discretions is not an improper utilization of power. The end target remains to swell up the pool available to the shareholders at the end of the day. Undoubtedly, stakeholders play great and important role towards the success or otherwise of the company. If the company's relationships with them are well

[87]*Ibid.* at 1134; Sealy, L.S. (1989) "'Bona fide' and 'Proper Purpose' in Corporate Decision" 15 Mon ULR 265.
[88] See *Percy v S. Mills & Co*. [1920] 1 Ch 77; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] A.C. 821; *Bishopsgate Investment Management Ltd v Maxwell (No 2)* [1993] B.C.L.C. 1282; *Punt v Symons & Co. Ltd* [1903] 2 Ch 6; *Hogg v Cramphorn Ltd* [1967] Ch. 254.
[89](n 26).

managed and their interests taking adequate care of, the company will reap the fruits in the long run.

The above duty seems to be a qualification of the (subjective) duty imposed on the directors in *Re Smith and Fawcett*[90] to act in what they believe to be in the best interests of the company. But it is doubtful if the said duty- to exercise their powers for proper purpose- can stop a board that is stakeholder-oriented from embarking on inclusive programmes in so far as they are acting honestly. The determining factor, as already noted is the genuineness of the directors' motives. Obviously, what the above duty intends to forbid is the directors becoming self-serving[91] or using their powers and discretions for extraneous purposes, or to favour a given individual or individuals. But, the inclusivity we are talking about here is treating fairly and ethically the interests of the stakeholders involved as an entity/group/collectively.

In summary, under the common law, it is for the directors to decide, in good faith, what actions would most likely promote the success of the company for the benefit of its members. [92] Practically, corporations face different challenges at different era and at different stages of their operation. It therefore made business sense that it should be left to directors themselves to

[90][1942] Ch. 304, C.A.

[91] A typical example is the case of *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1995] BCC 1000; [1996] Ch 274, where, in a board meeting which was attended by only two persons - the defendant who was the company's sole director and the company's secretary, it was resolved that the defendant's service contract with the company be terminated and the sum of £199,892 be paid to him in compensation. Held, he was acting exclusively to promote his selfish interest.

[92]*Re Smith & Fawcett Ltd* [1942] Ch. 304, CA; *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 CA (Civ Div).

decide which interests ought to deserve more consideration depending upon the circumstances of the particular case.[93] Arguably, this situation is what CLRSG aimed at maintaining/retaining when it adopted ESV approach. Obviously, ESV approach, through section 172, statutorily gives greater flexibility and wider discretions to the board in balancing competing interests; as well as in integrating the interests of the stakeholders as the business/commercial situation of a given time dictates. In so far as directors can show that they have made a good faith judgment, having considered all the relevant factors in coming to that decision, and show how the 'integrative' programme/project can potentially benefit the company in future, they are arguably not in breach of the law.[94]Having seen how wide discretions vested on the board of big corporations can be instrumental to the inclusivity agenda, we turn our attention to whether its 'twin brother' -separation of ownership from control - can achieve a similar objective.

Separation of Ownership and Control in Public Companies

> With larger corporation size[95] comes a greater depression of stock ownership, a steady reduction in the power and interest of the shareholders, and

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[93]See Sealy, L.S. and Worthington, S (2008) *Cases and Materials in Company Law*, (8th ed.) Oxford: OUP, at pp 293-294.

[94]See Ho, J.K.S (2010) (n 85), at p 112

[95]There are a number of studies which demonstrated that it is over-simplistic to assume that there is necessarily complete separation of ownership and control in all large companies. (See, for instance, Herman E.S (1981), *Corporation Control, Corporation Power*, New York: CUP). Where the founders of a company, for instance, retain a significant proportion of the company's share capital after it has gone public, they may still be in a position to exercise considerable control in their capacity as shareholders.

> gradual enhancement of managerial authority, this is a separation of ownership from control.[96]

Separation of ownership from control has given rise to 'management control', which is a situation where ownership is so widely distributed that no individual or small group has an interest large enough to dominate the affairs of the company; thus, the existing management will be in a position to become a self-perpetuating body. The background being that when the shareholders receive the proxy forms for the election of the board, most of them (having insignificant stake in the company) will either not bother to vote or will sign the proxy form giving their vote to the proxy committee, which itself will have been nominated by the management. It will reappoint the management. Vesting decision-making powers on the directors and managers of the company encourages the shareholders to be passive. On the positive side, it prevents the chaos that may arise if all the shareholders were to be personally involved in the day-to-day decision making and management of the company; facilitates the emergence and growth of big companies and makes it easier for the companies to secure funds.[97] It also enabled the companies to hire the best qualified and experienced managerial hands/team to run the business instead of basing their criterion on the ground of the person's ability to finance the company as is usually the case in a small or family business. It also gave rise to what may be referred to as 'centralised management' which helps to promote efficiency in the management of big companies with numerous shareholders. Imagine how slow and sluggish decision-

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[96]Herman, E.S (1981) *Ibid.*, at p. 5.

[97] Blair, M (1993) *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century*, Washington: The Brookings Institute, at p 96.

making will be if all the shareholders of a big company were to convoke and partake personally/individually in making decisions for the company. Ostensibly, this would have made corporate management impossible. [98] Whatever management decision reached under that kind of a situation will perhaps be inexpert as those who have management prowess may not have the opportunity to speak in such meetings, or may not commit the time necessary to understand and master the peculiar situation of that particular company to enable them make informed contributions at the meeting.[99] In such a large company where nobody has a substantive financial stake in the enterprise, free-riding will be rampant. The zeal for any of the shareholders to invest substantial personal time, efforts and resources in fashioning out what is the best course of action for the company may be absent.[100]

As already discussed, one of the main negative effects of this separation of ownership and control, Berle and Means argued, was that the interests of the shareholders and those of the management may diverge,[101] in that management might pursue

[98] The situation therefore demands for, or rather necessitated a smaller group of experienced management team capable of fast and speedy decision-making to be put in charge of the corporation: "Under conditions of widely dispersed information and the need for speed in decisions, authoritative control at the tactical level is essential for success." Arrow, K.J (1974) *The Limits of Organisation*, New York: W.W Norton & Co, at p 69.

[99] See Cheffins, B.R (2002) "Corporate Law and Ownership Structure: A Darwinian Link?" 25(2) University of New South Wales Law Journal 342; Fama, F and Jensen, M.C. (1983) "Separation of Ownership and Control" 26 Journal of Law and Economics 301, especially at p 306.

[100] See Davies, P. (2010) *Introduction to Company Law,* New York: OUP, (2nd ed.), at pp 12 and 104.

[101] Berle and Means (1932) (n 51), at p 6.

their own (selfish or extraneous) goals of personal profit, prestige or power[102] instead of the profit maximisation objective, thereby reducing the profits that would otherwise be available to the shareholders. [103] The emergence of an effective and efficient secondary stock market coupled with the resulting liquidity of corporate stock made investment in the shares an especially attractive enterprise, which in turn made selling shares to the public an attractive financing mechanism for the public companies. Shares were purchased by diversified and dispersed share-owners.

As is evident from the above, one of the major consequences of this separation of ownership from control, taken together with the dispersion of share ownership, is that shareholders would no longer be in control of the direction of the company. This is left in the hands of directors and managers who have functional control of the company, though they, in most cases, have relatively small or even no personal shareholdings. This gives rise to agency problems and agency-related costs. Large dispersed

[102] See Jensen, M.C and Meckling, W.H (1976) "The Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" 3 Journal of Financial Economics 305. But, there are certain disciplining mechanisms that aid in checking, deterring or reducing managerial self-serving behaviours. They include the capital and product markets, internal and external employment markets and the market for corporate control. See Short, Helen (1994) "Ownership, Control, Financial Structure and the Performance of Firms" 8 Journal of Economic Survey 203, at pp 204-205; Bainbridge, S.M and Warren, W.D (2008) "Investor Activism: Reshaping the Playing Field?" 3, at p 7. Available at, date accessed 5/10/2020.

[103] The appreciation that large companies are prone to inefficiency owing to the fact that management of that sort of corporation is not in the hands of the real owners but those of hired professional managers has a long history. See the observation in the Eighteenth Century by Smith, A (1776) *An Inquiry into the Nature and Causes of the Wealth of Nations*, book II, at p 233.

shareholders, in turn, have neither the means nor the incentive to monitor these powerful managers.[104]

In other words, since public company is characterised by separation of ownership from control, fears arose in that the directors may be tempted to consider or project their own selfish-interests over and above those of the company and other stakeholders.[105] Because of the frailty of human nature, this concern may not be ill-founded after all. Owing to the inestimable roles vested on the directors in the management of the company, making them to be extremely crucial in the success or otherwise of the company; coupled with the enormity of powers at their disposal which ultimately leaves the corporate success or failure in their hands, they may be tempted to act like demigods.[106] The happiness and fulfilment or otherwise of the corporate stakeholders therefore depends extensively on how judicious and judicial they discharge those duties

It should be recalled that Berle and Means averred that the separation of ownership from control produces a condition where "the interests of owners and of ultimate managers may, and often

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104 See Dignam, A. & Lowry, J. (2010) *Company Law,* New York: OUP, at pp 256-7; Jensen, M.C and Meckling, W.H (1976) *op cit*.

[105] The explanation given by Eisenberg is germane here. He said that every agent has a potential interest "in working at a slack pace and in avoiding the effort and discomfort involved in adapting to changed circumstances, such as the emergency of new technologies. This is the problem known as *shirking*. All agents have a potential interest in diverting the principal's assets to their own use through unfair dealing. This is the problem of *traditional conflict of interest*." Eisenberg, M.A (1989) *op cit*, at p 1471.

[106] But, the relevance attached to a sense of professionalism and self-esteem on the part of the members of the board which can make them to act decently cannot be ignored.

do, diverge, and where many of the checks which formerly operated to limit the use of power disappear."[107] This development does not sound very good for the corporation. This, however, raises a crucial issue as to whether there is a way these situations, (that is, separation of ownership from control, and reduction or absence of shareholders' checks) can be positively utilised by the directors to become more integrative of and attentive to the non-shareholders' interests in their decision makings. This is the crux of our concern here.We will return to it later.

The perception of corporate entity today is changing. It is no longer seen solely as a legal device by which the individuals carry on their private business transactions. But rather, a more complex device that affects and is affected by a host of players.[108] Some companies have become so big and influential, employing millions of people, having millions of shareholders, controlling billions of dollars that they can rightly be called "economic empires - empires bounded by no geographical limits, but held together by centralised control."[109] The day-to-day activities of

[107] Berle, A.A, and Means, G.C (1932), *The Modern Corporation and Private Property*, (Transaction Publishers, at p 7.

[108] Proponents of shareholder primacy view and treat corporate governance as a specie of private law. As such, the separation of ownership from control does not in itself necessitate State intervention in corporate governance. This is in contrast with the view of the proponents of stakeholder approach who treat corporate governance as a specie of public law, such that separation of ownership from control is essentially a justification for regulating corporate governance so as to achieve social goals distinct from and unrelated to profit maximisation. See Bratton, W.W (2001) "Berle and Means Reconsidered at the Century's End" Journal of Corporate Law 737, at pp 760-761; Mitchell, L.E (1993) "Private Law, Public Interests? The ALI Principles of Corporate Governance" 61 George Washington Law Review 871, at p 876.

[109] Berle and Means, (n 107)., at p 5.

these companies influence or are influenced positively or negatively by these stakeholders. In other words, public company is increasingly acquiring greater significance; its impacts on the life of the nation(s) and of individuals (shareholders and non-shareholders alike) are increasingly multiplying. This arguably imposes more responsibilities on the company to act more responsibly and more inclusively, not solely in the interests of the shareholders, but also - to some extent, at least - in the interests of the stakeholders.

Traditionally, being a private enterprise, company has rested upon the self-interest of the owners. This self-interest is held in check only by competition and the economic conditions of demand and supply. Government only comes in to regulate here and there when it becomes extremely imperative. In some quarters, the said self-interest has long been seen as the best guarantee of economic efficiency. This group of thinkers strongly believe that if the individual members of the company are protected in their right both to use their own property as they see fit and to receive and enjoy the full fruits of its use, their desire for personal gains or profits can be relied upon as an effective incentive to their efficient use of any corporate property they may possess. This must have informed the government[110] and the

[110] The report of Cadbury's Committee, UK, is instructive here. The Committee noted that "The country's economy depends on the drive and efficiency of its companies. Thus the effectiveness with which their boards discharge their responsibilities determines Britain's competitive position. They must be free to drive their companies forward, but exercise that freedom within a framework of effective accountability. This is the essence of any system of good corporate governance."- *The Report of the Committee on the Financial Aspects of Corporate Governance* ("the Cadbury Report") (London: Gee, 1992), para1.1.

court[111] not to interfere 'unduly' in the management of the enterprise. This lack of interference is beneficial to the growth of private enterprise as it gives motivation/encouragement and business and economic freedom to the investors. On the other hand, however, it, in some cases, leaves the corporate stakeholders at the mercy of the managers/directors of the enterprise.

This vast economic power in the hands of a few directors and managers who control big companies is therefore a great force which has the tendency to harm or benefit a multitude of individuals, affect a whole region or even a nation, shift the tides/currents of trade, bring ruin to one community and prosperity to the other. Big corporations have passed far beyond the realm of private enterprises, but have become more nearly "social institutions."[112] Having graduated from small private enterprises to gigantic institutions, it may not be out of place if companies are expected, (as 'social institutions') to contribute more positively to the social and general welfare of not only the shareholders but also the wider society in which they operate, hence our quest to find out in this work whether there is a way corporations can be made to be more responsive to the non-shareholding stakeholders' interests and concerns.

The corporate system is dynamic, continuously and constantly building itself into greater aggregates through merger, acquisition, consolidation etc. This has necessitated a change to

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[111] It is not fair for the court to review, with the benefit of hindsight, the board's decisions, and the courts are not well-placed to judge entrepreneurship, as they "are not business experts." *Dodge v Ford Motor Co*, (n 26), at p 685.

[112] Berle and Means, (n 107), at p 46.

the basic conditions - that is, as a purely private economic entity - which the thinking of the past about corporation has assumed and instead perceives it as a social entity, owing certain responsibilities to its stakeholders. This is particularly so as the individual investors, (who were traditionally viewed as the owners of the company, doubled as managers of the company than - which was the main basis for the justification that they should be the chief/sole beneficiaries of the corporate profits), no longer partake in the management of the company. [113] This consequently challenges the fundamental economic principle of individual investor initiative in corporate enterprises and raises for re-examination the question of the motive force back of industry, and the ends, or interests for which modern companies should be run. Berle and Means seem to have agreed with this (that is, that individual shareholders who have surrendered the management of the enterprise to professional managers have relinquished their right/claim to complete right over the proceeds of the investment) when they asserted that the said surrender has destroyed the "old atom of ownership" [114] "which formerly bracketed full power (of manual disposition) with complete right to enjoy the use, the fruits and the proceeds of physical assets." The traditional position was also supported by the fact that the active shareholders then had responsibilities with respect to the enterprise and its physical assets. Berle and Means conceded that this is no longer the case with the investors in the big companies

[113] That is, during that era under discourse, the shareholders of the companies were not mere suppliers of capital to the company through their share purchases; they were managers of the company also. Currently, however, majority of those who control the destinies of a typical modern company own so insignificant a fraction of the company's shares.
[114] Berle, A.A and Means, G.C (n 107), p 8.

nowadays.[115] The only responsibility they now bear is to contribute whatever remains unpaid in their shareholding in the event of the company becoming insolvent. The pertinent question that now begs for an answer is whether the shareholders should continue to be the sole reapers of the fruits of a big corporation without any other responsibilities apart from the fact that they are residual risk takers. This now takes us to the main thing we are interested in under this subheading – if the resultant divergent of ownership and control can aid the board to be more inclusive in its policies.

Can Separation of Ownership and Control Be Positively Utilised by Directors to Integrate the Interests of Non-investing Stakeholders?

> ......If we accept that there has been a divorce between ownership and control in the typical large company, then management has escaped effective shareholder supervision and hence possesses a broad discretion as to the ends for which the company's power (and resources) shall be used.[116]

For reasons some of which have already been discussed, centralised decision making has become a defining characteristic of public companies. In such companies, the board of directors and its subordinate top management team serve as the central decision-making agency. This, in effect, allows the management to constantly and, more importantly, unilaterally rewrite certain terms of the contract between the company and its various constituents. The board can be able to do this because the situations discussed above together with the articles of most

[115] *Ibid*., at p 64.

[116] Parkinson, J.E (1993) (n 36), at p 34.

companies have armed the board with wide powers and discretions.[117] In fact, their discretion is so broad that it effectively means that the board is in total control of these companies. Shareholders have been reduced to, or rather, have reduced themselves to peepers, peeping - not even regularly but – occasionally through/from an obscured glass-window at the board who manages their investments. There, therefore, appear to be the chances that a stakeholder-conscious board can be able to utilise these developments (separation of ownership and control and shareholder passivity) to integrate the interests of the non-shareholding stakeholders.

Conclusion:

Shareholders are "no longer able to shape the purpose for which the business is run, that is, they are unable to oblige management to maximise profits."[118]It seems plausible that a board of directors that is mindful of the interests of the non-shareholding stakeholder groups may avail itself of the opportunity created by separation of ownership from control to be considerate and integrative of the interests of the non-shareholding constituencies. The writer is of the opinion that reduction in monitoring or

[117] That the board has wide discretionary powers and the alleged fact that the members are generally passive do not necessarily mean that the directors can do whatever they want as the potency and import of market constraints, that is, market for corporate control, cannot be ignored. Although these factors leave the board with considerable discretion, it is beyond doubt that market forces or constraints set narrower limits on the potential space for directorial responsible, ethical, inclusive or altruistic actions. See Parkinson, J (1993) (n 36), at p 263. Manne and Wallich are of the view that the limit to board's discretion is set by the costs that would have to be incurred by a non-altruistic bidder in order to remove the directors. See Manne, H.G and Wallich, H.C (1972) *The Modern Corporation and Social Responsibility,* Washington: American Enterprise Institute, at pp 15-20.

[118] Parkinson, J (1993) (n 36), at p 56.

policing the directors, coupled with their wide discretionary powers and the principle of business judgment rule, can be positively utilised by the board to make corporate policies and decisions that may benefit the stakeholder groups. Statutorily, the shareholders usually meet once in a year (that is, Annual General Meeting (AGM)), or where the situation demands, any other time upon the summoning of extra-ordinary general meeting(s) (EGM).[119] Apart from at these meetings, it is only few shareholders (especially the big investors) who devote much time to study, appreciate and understand the works, policies and agendas or targets of the management team. The prime concern of majority of shareholders is the dividends paid to them at the end of the company's corporate year and the position of the

[119] The AGM (and EGM) are the most viable platform for shareholders to exert their influence in the company. (Amao, O and Ameshi, K (2008) "Galvanising Shareholder Activism" *op cit*, at p 126). Effective exercise of shareholders' powers demand that as many shareholders as possible attend those meetings and participate in the voting process. (See European Commission, "Fostering an Appropriate Regime for Shareholders' Rights: Second Consultation by the Services of the Internal Market Directorate General" MARKT/13.05.2005). Unfortunately, a number of shareholders do not avail themselves the opportunity of these meetings. The situation is even worse in Nigeria as the problem is double-barrelled in that country in that - added to the above-mentioned issue, a survey carried out by Oyejide and Soyibo scored Nigeria poorly on fair conduct of shareholders' meeting when compared to other emerging markets in the Middle East and North Africa. Oyejide, T.A and Soyibo, A (2001) "Corporate Governance in Nigeria", Paper Presented at the Conference on Corporate Governance, Accra, Ghana, 29-30 January, 2001. It is alleged that such shareholders' meeting are, sometimes, tainted with corruption by the leaders of the shareholders' association of the company concerned. See Gabriel, O (2006) "Bunmi Oni Caught in Financial Numbers Game, How Many more are Out there 1", Vanguard Newspaper, Nigeria, December 18, 2006.

company's shares at the **stock market.**[120]These and other similar issues therefore afford the 'willing' board the opportunity to consider and integrate the interests of the non-shareholding stakeholders even in a shareholder primacy or wealth maximisation regime. In other words, shareholder passivity and inactivity resulting from the above-mentioned (and other similar) factors enable the directors to pursue goals of their own choosing/choice. The said goals may not necessarily be furthering the selfish interests of the members of the board (though this cannot be completely ruled out). Berle and Means were of the view that there is also the possibility or tendency that instead of furthering their own interests or those of the shareholders, directors might act in the interests of the society as a whole, thus evolving into a "purely neutral technocracy balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity."[121]Thus, the two principles –separation of ownership from control and directorial discretions/business judgment - can proof effective weapons in the hands of a board that wants to champion not only the cause of the shareholders but also those of the non-shareholding stakeholders.[122]In the words

[120] See the observation of Cohen Committee, UK - Company Law Amendment Committee, Cmd 6659 (1945), at para 7(e). The Jenkins Committee, UK, held the view that the position was very much the same in 1962 as it was in 1945. See the Committee's report - Report of the Company Law Committee, Cmd. 1747 (1962) para 106.
[121] Berle, A.A and Means, G.C (1967) *The Modern Corporation and Private Property* (revised edn), at pp 312-313. See also Berle, A. A (1954) *The 20th Century Capitalist Revolution* New York: Harcourt, at pp 61-115; 164-188.
[122] This work has treated how directorial/managerial wide discretion can be used to integrate the interests of the stakeholders earlier. Because of the closeness of the two principles, most of the arguments/points raised there are virtually applicable here.

of Pritchett, when business judgment rule is "combined with a broad view of corporate long-term profit......(it creates) a very broad range of corporate ethical activities allowable under the current law's overriding standard that corporate activity be profit maximising."[123] Such 'allowable' activities apparently include the integration of corporate wider or social responsibilities in corporate policy makings and implementations.

The arguments put forward above is premised on the assumption that the board is 'willing' and determined to avail itself the opportunities availed to it by those principles to be integrative of the stakeholders' interests. What then calls to mind is as regards a situation whereby a board decides instead to use the opportunities afforded to it by those two principles to vigorously pursue profit maximising objectives. This therefore raises the issue whether mandating the board to be integrative – as advocated by pluralism - is the best option.

[123] Pritchett, MJ III (1983) "Corporate Ethics and Corporate Governance: A Critic of the ALI Statement on Corporate Governance Section 2.01(b)" 71 California Law Review 994.