european corporate governance institute

The Purposive Transformation of Corporate Law

Law Working Paper N° 616/2021
November 2021

David Kershaw
London School of Economics and Political Science and ECGI

Edmund Schuster
London School of Economics and Political Science

ECGI Working Paper Series in Law

The Purposive Transformation of Corporate Law

Working Paper N° 616/2021
November 2021

David Kershaw
Edmund Schuster

Kershaw is very grateful to the Steering Committee of the Big Innovation Society's Purposeful Company Project for the stimulating conversations about corporate purpose. We are grateful to Luca Enriques, Suren Gomtsian, Jeffrey Gordon, Tom Gosling, Joshua Mitts, Thom Wetzer, Simon Witney, the participants of corporate law seminars at Oxford and Columbia, and the anonymous reviewers for comments on earlier versions of the article.

Abstract

What is the purpose of a corporation? This fundamental question is as old as corporate law itself and traditionally it is asked with reference to the ultimate beneficiaries of a corporation's activities. Modern management theory and the current technology-driven transformation of the economy, however, have breathed new life into the question about corporate purpose. Here, purpose is understood as an animated mission-purpose articulation of the reason for a corporation's existence; an aspirational idea about its existence that has the capacity to bond internal and external stakeholders to the company, inspiring innovation, productivity and customer loyalty. This understanding of corporate purpose offers a pathway to a more inclusive and interconnected form of modern capitalism.

This approach to purpose is now gaining regulatory traction. In December 2018, the United Kingdom's "comply or explain" Corporate Governance Code adopted a provision which provides that "the board should establish the company's purpose." This article takes the UK's regulatory adoption of mission-purpose as a platform from which we can explore the economic and social benefits of purposeful companies and the legal and non-legal conditions that are necessary to support and nurture such companies. The article argues that in the absence of purposeful shareholders corporate law must enable companies to construct a zone of insulation which protects its purpose—whatever it may be—from the pressures of immediate shareholder preferences which can compromise mission-purpose. It argues that in jurisdictions where law and market practice prevents the construction of such a zone of insulation, the economic and social benefits of purposeful companies will be unavailable, as mission-purpose disintegrates into the prosaic or a mere marketing device. This claim generates several theoretical and empirical objections, which the article considers and rejects.

Keywords: Corporate Law, Law and Economics

JEL Classifications:

David Kershaw*
Dean of LSE Law School and Professor of Law
London School of Economics,
Houghton Street
London WC2A 2AE, United Kingdom
e-mail: r.d.kershaw@lse.ac.uk

Edmund Schuster
Associate Professor of Law
LSE Law School
London School of Economics and Political Science
Houghton Street
London WC2A 2AE, United Kingdom
e-mail: E.Schuster@lse.ac.uk

*Corresponding Author

The Purposive Transformation of Corporate Law

DAVID KERSHAW & EDMUND SCHUSTER*

Forthcoming, AMERICAN JOURNAL OF COMPARATIVE LAW (2021)

ABSTRACT

What is the purpose of a corporation? This fundamental question is as old as corporate law itself, and traditionally it is asked with reference to the ultimate beneficiaries of a corporation's activities. Modern management theory and the current technology-driven transformation of the economy, however, have breathed new life into the question about corporate purpose. Here, purpose is understood as an animated mission-purpose articulation of the reason for a corporation's existence; an aspirational idea about its existence that has the capacity to bond internal and external stakeholders to the company, inspiring innovation, productivity, and customer loyalty. This understanding of corporate purpose offers a pathway to a more inclusive and interconnected form of modern capitalism.

This approach to purpose is now gaining regulatory traction. In December 2018, the United Kingdom's "comply or explain" Corporate Governance Code adopted a provision which provides that "the board should establish the company's purpose." This Article takes the United Kingdom's regulatory adoption of mission-purpose as a platform from which we can explore the economic and social benefits of purposeful companies and the legal and non-legal conditions that are necessary to support and nurture such companies. The Article argues that in the absence of purposeful shareholders corporate law must enable companies to construct a zone of insulation which protects its purpose—whatever it may be—from the pressures of immediate shareholder preferences which can compromise mission-purpose. It argues that in jurisdictions where law and market practice prevent the construction of such a zone of insulation, the economic and social benefits of purposeful companies will be unavailable, as mission-purpose disintegrates into the prosaic or a mere marketing device. This claim generates several theoretical and empirical objections, which the Article considers and rejects.

* David Kershaw is Professor of Law, London School of Economics and Political Science, London, United Kingdom. Edmund Schuster is Associate Professor of Law, London School of Economics and Political Science, London, United Kingdom. Kershaw is very grateful to the Steering Committee of the Big Innovation Society's Purposeful Company Project for the stimulating conversations about corporate purpose. We are grateful to Luca Enriques, Suren Gomtsian, Jeffrey Gordon, Tom Gosling, Joshua Mitts, Thom Wetzer, Simon Witney, the participants of corporate law seminars at Oxford and Columbia, and the anonymous reviewers for comments on earlier versions of the Article.

Introduction

What is the purpose of a company? For most corporate lawyers the answer naturally revolves around the question of who should be the ultimate beneficiaries of corporate activity. For many this involves focusing on the generation of profits and the maximization of shareholder wealth. Others take a broader view and include the welfare of other stakeholders, including employees, customers, suppliers, and creditors, and perhaps even the wider community or society within which a business is embedded. On this level, the debate about purpose is as old as corporate law itself, with several venerable signposts including the influential Berle–Dodd debate or Milton Friedman's *The Social Responsibility of Business*.[1] The recent debate about the U.S. Business Roundtable's *Statement on the Purpose of a Corporation*, which for many appears to shift U.S. business's center of gravity from shareholder value to other stakeholder interests, is merely another incarnation of this longstanding debate.[2] However, identifying and debating who are the ultimate beneficiaries of corporate activity—valuable as this may be in some domains—does not typically provide a useful guide for *how* a company should go about its daily business dealings and how it should shape and define its strategy. Just as understanding human life as the pursuit of maximal happiness (or utility) may be useful for certain purposes but in practice is rarely used by anyone as the guiding principle for how to live one's life, the complex social creatures that are today's companies are in practice affected much more by intermediate, often more concrete and inspirational, factors such as their organizational culture and the corporation's business and societal mission.

"Purpose" as a driver for corporate behavior, and perhaps ideally as a catalyst for corporate success, has in recent years received growing attention in the business literature, and the ability to create "purposeful companies" is increasingly seen as essential in a technology- and innovation-driven economy. But this idea of corporate purpose is distinct from the debate about who should be beneficiaries of corporate activity. Robert Quinn and Anjan Thakor, writing in the *Harvard Business Review*, argue, for example, that organizational purpose or "higher purpose" can offer a path to success for companies that struggle to compete and activate their workforce through a traditional value and financial incentive-focused

[1] *See* E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); Adolf A. Berle, Jr., *For Whom Are Corporate Managers Trustees? A Note*, 45 HARV. L. REV. 1365 (1932); Milton Friedman, *The Social Responsibility of Business to Increase Its Profits*, N.Y. TIMES MAG. 33 (1970).

[2] BUS. ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION (Aug. 2019), https://system.businessroundtable.org/app/uploads/sites/5/2021/02/BRT-Statement-on-the-Purpose-of-a-Corporation-Feburary-2021-compressed.pdf. Adopting this approach to corporate purpose *see* also See Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91 (2020). *See also* Edward B. Rock, *For Whom is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. LAW. 363, 389-390 (2021), for a discussion of the Business Roundtable Statement as a political intervention; Colin Mayer, *Shareholderism Versus Stakeholderism – a Misconceived Contradiction. A Comment on 'The Illusory Promise of Stakeholder Governance' by Lucian Bebchuk and Roberto Tallarita*, ECGI Law Working Paper No. 522/2020, https://ssrn.com/abstract=3617847.

approach. For them, a "higher purpose is not about economic exchanges. It reflects something more aspirational. It explains how the people involved with an organization are making a difference, gives them a sense of meaning, and draws their support."[3] Such a *higher* purpose, or *mission*-purpose, seeks to bond a company and its stakeholders to a transformational corporate calling such as, for example, to revolutionize transportation, to organize the world's information, or to eradicate cash payments.[4] Research shows that business leaders generally view such a shared sense of purpose across an organization to be a driver of value and change. For instance, a recent survey conducted by the *Harvard Business Review* and sponsored by Ernst & Young[5] indicates that executives view purpose—which they define as "an aspirational reason for being which inspires and provides a call to action for an organization and its partners and stakeholders and provides benefit to local and global society"—as an important driver of several business metrics generally viewed as essential for corporate success.[6] Similarly, in the United Kingdom, the Purposeful Company Project, an initiative of the Big Innovation Centre, argues that "purpose is key to corporate and economic success." It estimates that the U.K. economy loses in the region of GBP 100 billion a year as a consequence of not taking purpose seriously.[7]

But purposeful companies are not merely a means to the end of corporate success; rather, they are a means of generating such success through a more inclusive and interconnected form of capitalism.[8] They contribute to a more inclusive form of capitalism, because a purposeful focus drives a reordering of the corporate priorities required to support purpose, away from an immediate and ever-present focus on (short-term) profitability and towards sustainable value creation which benefits other stakeholders. Such a reordering, however, is the product, not the focus, of purpose, and varies according to purpose. And purposeful companies contribute to a more interconnected and less solipsistic form of capitalism both because of the bonding effects of purposeful companies among market participants and because mission-purpose typically situates a company and its sense of responsibility within

---

[3] *See, e.g.*, Robert E. Quinn & Anjan V. Thakor, *Creating a Purpose-Driven Organization*, 96 HARV. BUS. REV. 78, 79 (2018).

[4] For a broader consideration of the different ways in which corporate purpose is used by legal scholars, including mission or societal purpose, *see.*, Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?* 99 TEXAS L. REV. 1309 (2021)

[5] *See* HARV. BUS. REV. ANALYTIC SERVS., THE BUSINESS CASE FOR PURPOSE (2015), www.ey.com/Publication/vwLUAssets/ey-the-business-case-for-purpose/$FILE/ey-the-business-case-for-purpose.pdf.

[6] The survey shows that 80% or more of the respondents view "purpose" as resulting in higher employee satisfaction, a higher level of business referrals, more successful business transformations, better products and services, and higher customer loyalty. *See id.*

[7] BIG INNOVATION CTR., THE PURPOSEFUL COMPANY INTERIM REPORT 3–4 (2016), www.biginnovationcentre.com/wp-content/uploads/2019/07/BIC_THE-PURPOSEFUL-COMPANY-INTERIM-REPORT_15.05.2016.pdf.

[8] *See generally* COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD (2018). *See also* Eli Bukspan, *Stakeholder Fairness and Corporate Purpose Through the Lens of Behavioral Economics: Legal Implications (2021) (unpublished manuscript).*

society. Purposeful companies—and by extension economies that rely on them—are likely, therefore, to prove more robust in the face of systemic societal challenges and economic shocks, such as the one we are faced with today from COVID-19.[9]

Not only is this focus on mission-purpose found in modern management theory and corporate think-tank policy papers, there are also signs that it is starting to resonate with investors, with some of the most prominent members of the investment community acknowledging the potential benefits of thinking more deeply about purpose. The CEO of Blackrock, one of the world's largest fund-management companies, recently observed, for example, that "without a sense of purpose, no company either public or private can achieve its full potential."[10]

Supported by this policy and investor consensus, although aspirational, the idea of mission-purpose thus seems relatively uncontroversial. It is, therefore, unsurprising that the growing international consensus around mission-purpose is starting to gain a foothold in law and regulation. In December 2018, the United Kingdom provided one of the first examples of this interaction between the emerging purposive policy consensus and regulatory change. The latest revision of the U.K. Corporate Governance Code now states that "the board should establish the company's purpose, values and strategy and satisfy itself that these and its culture are aligned."[11] Although it does not elaborate on what it means by a "company's purpose," through a process of elimination, this article demonstrates that the "company purpose" the Code refers to is best understood as a mission-purpose, an animated idea of why a company exists similar to the understanding of purpose found in the management and policy literature set out above.

This Article takes this regulatory adoption of purpose as a platform for exploring and delineating the different ways in which "purpose" is deployed in global governance debates, providing clear sight of the fact that while its deployment raises questions about the balance of stakeholder and shareholder interests in corporate decision making, for its modern incarnation this is a second-order issue, where such a balance is variable and tailored to purpose. It allows us to see that modern uses of the term corporate purpose in legal debate and commentary are increasingly *not* reincarnations of the Berle–Dodd debate. Moreover, as a first mover in the regulatory adoption of mission-purpose, the United Kingdom serves as a purposeful laboratory enabling us to identify the corporate legal preconditions for

---

[9] See the preliminary findings on the relationship between ESG policies and firm resilience during the COVID crisis in Rui Albuquerque in Yrjo Koskinen, Shuai Yang & Chendi Zhang, *Resilience of Environmental and Social Stocks: An Analysis of the Exogenous Covid-19 Market Crash*, 9 REV. CORP. FIN. 593 (2020).

[10] *See Larry Fink's 2021 Letter to CEOs*, BLACKROCK, www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (last visited November 7, 2021).

[11] FIN. REPORTING COUNCIL, U.K. CORPORATE GOVERNANCE CODE (July 2018), www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF [hereinafter U.K. CORPORATE GOVERNANCE CODE], Principle 1.B.

effective purposeful companies, preconditions which all jurisdictions must be cognizant of if they wish to promote such companies.

Where corporate purpose is not aligned with immediate shareholder preferences, and where such preferences can be directly or indirectly transmitted into the boardroom, it is likely that purpose will be compromised and become a vacuous marketing slogan rather than a guiding light for the corporation's future development. In such circumstances, any regulatory instruction relating to purpose will be wholly ineffectual. We argue that meaningful purposeful companies can only exist where they operate within a purposive ecology which mediates such shareholder pressures and thereby allows companies to make internal and external credible commitments to their mission-purpose.

There are different ways in which such a purposeful ecology can be provided, and different jurisdictions vary in the toolkits available to them to construct such ecologies. Mechanisms for creating such an ecology may be unconnected (or only indirectly connected) to corporate law rules. For instance, perhaps the simplest route to creating such an ecology is the presence of a controlling shareholder who is committed to a particular mission-purpose. The charisma, status, and perceived importance of senior managers may also carve out some space for a company's pursuit of its purpose, albeit this tends to be time limited. However, in the absence of controlling shareholders—as is common in the United Kingdom and the United States and increasingly common in companies in traditionally blockholding jurisdictions[12]—or exceptional corporate leaders, corporate law rules must take center stage. Corporate law, we argue, must enable companies to construct a purposive legal ecology which provides managers with a *zone of insulation* from nonaligned shareholder pressures.

U.K. corporate law stands out for its unique focus on shareholder value and power. Moreover, the legal rules that provide for this pro-shareholder balance of power are largely mandatory. Where it provides companies with governance flexibility, in practice this is a one-way street in the direction of *more* shareholder power, never less. The United Kingdom's *legal* ecology accordingly supports and fosters an environment conducive to shareholder activism, significantly compromising the establishment of effective purposeful companies and generating clear water between what the Code now says companies should do, and what the law allows them to meaningfully do. Juxtaposed alongside this exploration of U.K. corporate law, the Article considers the degree to which other advanced economy corporate law jurisdictions provide more flexibility to create, or even mandate, a zone of managerial insulation.

This exploration of the legal preconditions to effective mission-purpose also has broader implications for comparative corporate legal theory. Corporate governance scholars have been debating for several decades whether corporate governance systems throughout the world have been, are likely to be, or should converge on one optimal or efficient system.[13]

[12] *See, e.g.*, Wolf-Georg Ringe, *Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG*, 63 AM. J. COMP. L. 493 (2015).

[13] *See, e.g.*, Donald C. Clarke, *Nothing but Wind: The Past and Future of Comparative Corporate Governance*, 59 AM. J. COMP. L. 75 (2011); Franklin A. Gevurtz, *The Globalization of Corporate Law: The End of History or a Never-Ending Story*, 86 WASH. L. REV. 475 (2011).

Henry Hansmann and Renier Kraakman famously made an early call in this regard, arguing that the end of corporate legal history had arrived with the advent of the new millennium in the form of a shareholder-focused settlement.[14] A consideration of the legal preconditions to taking corporate mission-purpose seriously reveals, however, that jurisdictional convergence and harmonization towards a rigid one-size-fits-all end-state are obstacles not objectives. Effective purposeful companies require either an *extra*-legal purposive ecology or *intra*-jurisdictional legal optionality to enable them to legally fashion a purposive ecology. An efficient end of corporate legal history cannot, therefore, involve an endpoint which privileges a set of arrangements or specific corporate constituencies. Moreover, this purposive exploration highlights that comparative corporate law scholars make a category error if they place the United Kingdom and the United States in the box of a "triumphant"[15] shareholder-oriented endpoint. They should be categorized according to the extent to which they allow companies to construct tailored legal ecologies. The only equilibrium outcome of an international dialogue about the optimal design of corporate law, and thus the only stable alternative state to persistent cross-jurisdictional differences, is one which ensures that corporate law offers an adaptive toolbox suitable for a diverse range of companies with different mission-purposes.

For many, however, the optionality which we argue is essential in order for companies to define and pursue a mission-purpose will inevitably result in corrupt and unaccountable corporate governance, generating value destruction which outweighs the possible benefits of purposeful companies. These are weighty objections. Accordingly, the Article considers the theoretical and empirical case against optionality and shows that regulatory neutrality and the resulting governance optionality is the only logical conclusion which we can draw from the persistently mixed and unresolved theoretical position and empirical evidence.

Part I of the Article considers the nature and meaning of mission-purpose through the deployment of corporate purpose in the U.K. Corporate Governance Code, and it considers the ways in which mission-purpose interacts with corporate law's understanding of whose interests should take priority in corporate decision making. In so doing it explores, how mission-purpose can drive value generation, as well as its potential to alter the boundaries of the firm. Part II explores the need for a purposeful ecology to support purpose and the role of a legally constructed zone of insulation. Part III considers and rejects the theoretical and empirical case against purposeful optionality. Part IV presents the theoretical and empirical case for regulatory neutrality.

I. Exploring Company Purpose

A. Mediating Regulatory System Conflict

The starting point for our exploration of purpose in corporate law is the recent changes to the United Kingdom's Corporate Governance Code (the Code), which is a "comply or

---

[14] Henry Hansmann & Renier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

[15] *See id.* at 468.

explain" code relating to the function, composition, and structure of the boards of listed companies.[16] As a consequence of the 2018 revisions to the Code, section 1 of the Code is now entitled "Board Leadership and Company Purpose" (rather than just "Leadership"), highlighting the importance the Code's drafters attach to the concept of purpose. The Code now provides that "the board should establish the company's purpose, values and strategy and satisfy itself that these and its culture are aligned."[17] In its *Guidance on Board Effectiveness*, the Financial Reporting Council (FRC)—the independent regulator in charge of drafting and revising the Code—similarly provides that "an effective board *defines* the company's purpose and then sets a strategy to deliver it" and that "the board is responsible for setting and reconfirming the company's purpose."[18]

No definition is offered of "company purpose" by the Code, nor does the FRC provide any detailed discussion of "company purpose" in its prior consultation documents, reports, or speeches. The 2018 revised *Guidance on Board Effectiveness* does, however, provide that "a company's purpose is the reason for which it exists."[19] How then are we to read and understand the idea of company purpose in the Code?

The term "company purpose" is deployed by Anglo-American corporate law in several different ways.[20] Accordingly, to understand the use of the term in the Code we need first to understand the relationship between the meaning of terms in the Code and the meaning of the same terms in U.K. company law. One approach would be to view the relationship of the Code to company law in the way that the U.K. Takeover Panel and the Takeover Appeal Board view the Takeover Code's relationship to company law. For the Panel and the Appeal Board, the Takeover Code is an autonomous system of rules which is not bound by understandings of identical terms set forth in U.K. company law. However, while such company law understandings are not "determinative of the meaning of the Code," in applying these self-standing rules the Panel does "not disregard statements of law which may

---

[16] U.K. CORPORATE GOVERNANCE CODE.

[17] *Id.* sec. 1, principle B.

[18] FIN. REPORTING COUNCIL, GUIDANCE ON BOARD EFFECTIVENESS 11–12 (July 2018), www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF [hereinafter GUIDANCE ON BOARD EFFECTIVENESS].

[19] *Id.* at 12.

[20] In Part I, we explore the meanings of the term corporate purpose in U.K. corporate law, but note that in Delaware law, for example, the term also has several distinct meanings: it is used in the context of (the now defunct) *ultra vires* doctrine (*see* Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 898 at n.71 (1999) (quoting H.W. Ballantine, *Ballantine on Corporations* § 69 (1927)); in the context of the self-serving use of corporate power (Cheff v. Mathes, 92 A.2d 295, 302 (Del. 1964)); in relation to the general interests of the corporation (contained within the notion of a "valid corporate purpose" or a "rational corporate purpose": *see* Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 951, 958 n.14 (Del. 1985)); and in relation to the ultimate beneficiaries of corporate activity (*In re* J.P. Stevens & Co., Inc. S'holders Litig., 542 A.2d 770, 783 (Del. 1988)). See also the exploration of corporate purpose by the U.S. Supreme Court in its *Hobby Lobby* decision (Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682 (2014)), rejecting the idea that the pursuit of corporate purpose is restricted to nonprofit companies.

be helpful."[21] That is, company law's understanding of words and concepts may be useful to the Panel but it is not determinative; at the very least this means that the meanings of concepts are not *dynamically* linked. A similar approach could be taken to the relationship between the U.K. Corporate Governance Code and company law; namely, that the Code provides for a set of self-standing governance recommendations that address the structure and function of the board, matters that have never been directly addressed by U.K. company law. According to this approach, terms deployed in the Governance Code may bear their own Code-specific meaning which may depart from the use of the same terms in U.K. company law, and may evolve independently.

A clear demarcation is, however, more problematic in relation to the Governance Code than it is in relation to the Takeover Code. This demarcation functions to the extent that the purportedly autonomous system of rules covers areas that are clearly not covered by U.K. company law, such as the nature of a takeover offer or the division of executive and nonexecutive director membership of the board. But it is a less plausible account of the relationship between regulatory systems when both regulatory systems overlap in relation to their areas of coverage. In providing that the "board should establish the company's purpose" the Code unavoidably overlaps with U.K. company law's territory. By instructing (recommending) the board to "establish" a purpose, the Code directly touches upon both the exercise of corporate power and the duties that regulate the exercise of that power, most importantly section 172 of the Companies Act 2006, to which section 1 of the Code refers. In relation to the meaning of purpose, therefore, it is not plausible to deploy the dual regulatory systems idea invoked by the Takeover Panel. At a minimum, the use of the term by the FRC must be placed carefully in the context of the use of the term, and related terms, in U.K. company law, *and* its usage must be consistent with its usage in U.K. company law. That does not mean, of course, that it must be interpreted to have the identical meaning to the way it is deployed in U.K. company law, but only that the Code cannot be interpreted so as to give rise to direct conflicts between it and company law. Accordingly, a better regulatory analogy for understanding the relationship between the Corporate Governance Code and company law in relation to such areas of overlap is EU law's technique of minimum harmonization[22]: in a hierarchical order of regulatory norms, the higher order rules (company law) define the boundaries within which the lower order system (the Code) may operate, but within these constraints, terms may acquire a different meaning depending on the context in which they are used.

---

[21] *See* EUROTUNNEL P.L.C., TAKEOVER APPEAL BOARD 2007/2, at 19, www.thetakeoverappealboard.org.uk/wp-content/uploads/2016/12/2007-02.pdf.

[22] *See, e.g.*, CATHERINE BARNARD, THE SUBSTANTIVE LAW OF THE EU: THE FOUR FREEDOMS 586 (5th ed. 2016); Michael Dougan, *Minimum Harmonisation and the Internal Market*, 37 COMMON MKT. L. REV. 853 (2000).

B. The Meaning of a Company's Purpose

1. Purpose and Objects

The Oxford English Dictionary defines "purpose" as either "the reason for which something is done or created or for which something exists," or "a person's sense of resolve or determination."[23] The FRC's understanding of a "company's purpose," set forth in its *Guidance on Board Effectiveness*, appears to borrow directly from this definition: "[A] company's purpose is the reason for which it exists."[24]

Due to the types of disputes coming before English courts, in U.K. company law questions about the reason for which a corporation was created have traditionally been linked to a company's objects. In this context, the reason for which a company was established was to carry out a particular type of business; such business objectives were the "objects" of the company and were included in the company's constitution. Such objects would, for example, provide that a corporation is formed to carry out the business of mechanical engineering, or to carry out the construction of railways. Objects clauses for most U.K. companies became practically defunct during the course of the twentieth century as a result of both broad drafting of the objects clause and, for third parties, legislative interventions. Under the current law,[25] objects restrictions are now entirely irrelevant for most U.K. companies, because company objects are now unrestricted, unless a company's constitutional documents provide otherwise.[26] And even where objects restrictions *are* included in a company's constitution, a director's failure to comply with them merely amounts to a breach of duty.[27]

What is important for our investigation is that, historically, English company law cases on these questions treated the terms "company purpose" and "objects" as synonymous. In the leading case of *Ashbury Railway Carriage & Iron Co. v. Riche*, Lord Cairns stated that "the *purposes for which a company is established* under the [then relevant company law statute] are always looked for in the memorandum of association of the company" (i.e., the company's constitution), and "no attempt shall be made to use the corporate life for any other *purpose* than that which is so specified."[28] The current Companies Act also uses the term "purpose" in a similar type-of-activity way when it provides that a company cannot be formed "for an unlawful purpose"[29] or when it refers to the "purposes of a pension scheme"[30]: one cannot form a company to carry on the business of racketeering; the purpose of a pension scheme

---

[23] "purpose, n." OED Online, September 2021, https://www.oed.com/view/Entry/154972.

[24] *See* GUIDANCE ON BOARD EFFECTIVENESS, *supra* note 18, at 12.

[25] I.e., since the passage of the U.K. Companies Act 2006.

[26] Companies Act 2006, c. 46, § 31(1).

[27] *See id.* § 171(a).

[28] Ashbury Ry. Carriage & Iron Co. v. Riche [1874–1880] All ER Rep. Ext. 2219, 2222, 2225 (emphasis added).

[29] Companies Act 2006 § 7.

[30] *See id.* §§ 139, 140.

is, for example, to generate a targeted return over a specified investment cycle through prudent investment.

Although specified corporate objects are one type of "reason for which the company is created" and therefore a possible meaning of the Code's "company's purpose," the FRC clearly does not mean "purpose" in this narrow, or immediate, company law sense. This legal concept is, as noted, now defunct, and in any event it is clear that the board would have to be empowered by the constitution to be able to establish such objects. It is important to note, however, that any attempt (by companies or regulators) to include what the FRC does mean by purpose in a company's constitution, as has been mooted by the Big Innovation Centre's Purposeful Company project,[31] may without careful differentiation trigger the application of the byzantine legal rules addressing the effects of corporate actions outside of such objects/business purpose.[32]

2. Company Purpose and Directors' Duties

A second way in which U.K. company law deploys the idea of the company's purpose is set forth in section 172 of the Companies Act 2006, which codifies the common law duty that directors must exercise corporate power in good faith to further the company's interests. In contrast to the corporate laws of many other jurisdictions, including, for example, the corporate laws of twenty-five of the fifty U.S. states[33] and a majority of continental European jurisdictions,[34] the U.K. prioritizes the interests of shareholders over other constituencies.[35] Section 172(1) provides that power must be exercised in good faith to promote the success of the company for the benefit of the members. Although neither success for the company nor benefit for the members is defined in section 172(1), success and benefit are generally understood to refer to a "long-term increase in value,"[36] just as, at common law, "company interests" was, absent alternative shareholder instruction, understood to mean long-term value generation.

---

[31] *See* BIG INNOVATION CTR., THE PURPOSEFUL COMPANY POLICY REPORT 13, recommendation 1.2 (2017).

[32] DAVID KERSHAW, COMPANY LAW IN CONTEXT 106–09 (2d ed. 2012).

[33] Charles Hanson, *Other Constituency Statutes: A Search for Perspective*, 46 BUS. LAW. 1355 (1991). *See, e.g.*, N.Y. BUS. CORP. LAW § 717(b); FLA. STAT. ANN. § 607.0830(6).

[34] CARSTEN GERNER-BEUERLE, PHILLIP PAECH & EDMUND SCHUSTER, STUDY ON DIRECTORS' DUTIES AND LIABILITY (2013), https://ssrn.com/abstract=3886382.

[35] For a recent analysis of the extent to which national company law prescribes shareholderism see Amir N. Licht, *Varieties of shareholderism: three views of the corporate purpose cathedral*, in Research handbook on corporate purpose and personhood 387, 391-97 (Elizabeth Pollman & Robert B. Thompson eds., 2021).

[36] DEP'T OF TRADE & INDUS. (DTI), COMPANIES ACT 2006—DUTIES OF COMPANY DIRECTORS: MINISTERIAL STATEMENTS (2007), https://webarchive.nationalarchives.gov.uk/20070628230000/http://www.dti.gov.uk/files/file40139.pdf.

For section 172(1) a "company's purpose"—the reason it exists—is to further shareholder interests. Subsection (1) does not deploy the concept of "company purpose," however, subsection (2) does, and also makes it clear that "company purpose" through the lens of section 172(1) means to further shareholder interests. Section 172(2) clarifies—as was the case at common law—that the pro-shareholder position articulated in subsection (1) is a default rule. It provides: "[W]here 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*."[37] "Purpose" here means "company interest" as it was used at common law and with which section 172 must be interpreted consistently.[38] Note, in particular, the "purposes of the company" may be altered to contain "purposes *other than the benefit of the members*," i.e., purposes that focus on the benefit to other groups.

If section 172's understanding of purpose is what the Code means by "a company's purpose"—and, as noted above, *at a minimum* it has to *include*, and be compatible with, this company law's understanding of the term—a question mark is raised about the legal validity of the Code's instruction (recommendation): Can the Board *establish* company purpose within its Companies Act meaning? Although this involves a fundamental question of U.K. company law, it is a question which has received little scholarly attention. The stronger position is that to make use of section 172(2) and to alter the corporate objective/interest in a way that deprioritizes shareholder interests as the ultimate interests of the company, would require shareholder action. Intuitively, as changing the corporate purpose is a fundamental change to the corporation, such shareholder action should involve an amendment to the articles of association, which would require the support of 75% of the votes cast in a general meeting. This position was adopted by the U.K. government in its recent response to its Green Paper on Corporate Governance,[39] and was the position taken by the *Company Law Review*, whose report was central to the 2006 Act reforms.[40]

A weak case can also be made that board approval alone could provide for a change in corporate purpose in this sense. Typical articles of association, in large companies at least, provide for the complete delegation of corporate power to the board to manage the business and affairs of the company: to exercise all the powers of the company with no reservation of

---

[37] Companies Act 2006, c. 46, § 172(2) (emphasis added).

[38] *See id.* § 170(4).

[39] Observing that company purpose means "its shareholders, unless the company has set out a different purpose in its articles." DEP'T FOR BUS., ENERGY & INDUS. STRATEGY, CORPORATE GOVERNANCE REFORM: THE GOVERNMENT RESPONSE TO THE GREEN PAPER CONSULTATION ¶ 2.34 (2017), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/640470/corporate-governance-reform-government-response.pdf.

[40] CO. L. REV. STEERING GRP., DEVELOPING THE FRAMEWORK ¶ 3.49 (2000) (observing that "it is for the constitution, and the decisions under it, to lay down as appropriate the success-model of the company").

corporate power to shareholders.[41] Read literally, the determination of company purpose pursuant to section 172(2) could fall within that power delegation: if the board can exercise all the powers of the corporation it is empowered to determine for whose benefit corporate power is exercised. Indeed, the Explanatory Notes to the Companies Act 2006—produced by the U.K.'s Department of Business following royal assent—adopts this interpretation, observing in relation to its explanation of section 172(2) that "it is a matter for the good faith judgment of the directors as to what those purposes are."[42] But doubt is readily cast on this interpretation. English courts have often interpreted limits on the delegation of power to the board from the shareholders that cannot be found in the literal meaning of the delegation provision. Such interventions are more common where, as here, the issue is of structural or fundamental importance to the corporation.[43]

But this analysis leaves a puzzle in its wake. If the board is not capable of establishing "company purpose" in this sense, then either the Code's instruction is incompatible with U.K. company law, or "company purpose" must mean something more than that—something more in relation to which the board *does* have control.

3. Company Purpose Beyond Company Law: Mission-Purpose

Purpose for the FRC combines the sense, in corporate translation, of both of the Oxford English Dictionary definitions provided above—it is both the prosaic reason for the corporation's existence and, in addition, its "sense of resolve or determination." Purpose then is about what the company does—to provide taxi services, to provide web search-engine services, to build telecommunications products, to provide banking services—but it is an animated version of what it does—a corporate and societal mission which levitates out of what it prosaically does and around which the actions of its directors, managers, and employees can coalesce. It is to the corporate legal idea of a company's objects what trademarks and trade names are to simple words and signs, and what, for most people, principles and values are to reasoned behavior. They bring them alive and give them a meaning and a reality beyond those signs and letters; they operate, at a minimum, as useful heuristics to guide decisions where the uncertainties of life render it impossible to predict with any certainty the consequences of one's actions.

These animated corporate purposes are often reduced to simple one sentence ideas. For Google, its stated mission-purpose is "to organize the world's information and to make it universally accessible and useful"[44]; for Facebook, to "give people the power to build

[41] Although articles typically provide for shareholder instruction rights: *see* Companies (Model Articles) Regulations 2008, SI 2008/3229, art. 4 (hereinafter Model Articles for Public Companies).

[42] Companies Act 2006, explanatory notes to § 172.

[43] See, for example, the case law on the proper purpose doctrine: *e.g.*, Hogg v. Cramphorn [1967] Ch 254.

[44] Google (n.d.), https://about.google/ .

community and bring the world closer together";[45] for Unilever, "to add vitality to life . . . and meet every day needs for nutrition, hygiene and personal care with brands that help people feel good, look good and get more out of life";[46] for the Royal Bank of Scotland, "to serve customers well."[47] The effectiveness of these purpose-missions is a function of the extent to which they are both precise and instructive enough to be meaningful and to connect to everyday business activity and decision making, but also sufficiently abstract and aspirational enough to inspire. There are no parameters for such purposes, apart from lawful activity. They can be animated ideas about, for example, transformative technology, getting rich, helping others, saving the environment, or providing high-tech weaponry. This conception of purpose is politically and socially neutral and does not need to be defined beyond understanding its nature. The revised U.K. Corporate Governance Code wisely eschews a definition. Indeed, any attempt to more precisely define it will politically position purpose and will retire the idea to the quagmire of politicized conflict about the corporate purposes we do and do not approve of.

Purposeful companies that attempt to live and breathe their mission-purpose subordinate (immediate) constituency interests, including those of shareholders, to purpose.[48] Moreover, such mission-purposes are often, although need not necessarily be, altruistic in the sense that they focus on the company's contribution to society and how the company's activities affect others in a way that does not directly feed back to the company's bottom line; for such purposeful companies a broader goal is elevated above individual corporate gain. However, although in these respects purposeful companies formally demote or background shareholder value and wealth generation, they are far from indifferent to wealth generation. On the contrary, a purposeful focus offers pathways to value generation that are closed to non-purposeful value-focused companies.

Purpose offers several means of bonding the company to external corporate constituencies. In making a commitment that a company's path to value creation will be guided by such a purpose, purpose has the potential to generate customer loyalty, even infatuation. For example, a company whose mission-purpose is to produce the most innovative mobile phone, or a car company whose mission-purpose is "to accelerate the world's transition to

[45] Facebook (n.d.), *What is Facebook's mission statement?*, https://investor.fb.com/resources/default.aspx (last accessed Nov. 7, 2021).

[46] Unilever, *Unilever puts vitality at core of new mission* (Feb 12, 2004), https://www.unilever.com/news/press-releases/2004/04-02-12-Unilever-puts-vitality-at-core-of-new-mission.html.

[47] *See* ROYAL BANK OF SCOTLAND, ANNUAL REPORT 2 (2018)..

[48] For instance, Amazon Founder and CEO Jeff Bezos, in a 1999 interview, argued that focusing on customer experience and thus deprioritizing shareholder interests should not be a concern for investors, as their interests will be aligned with customers "in the long term." *See* Jordan Malter, *Jeff Bezos Has an Ambitious Vision for Amazon in 1999 Interview*, CNN (Feb. 8, 2019), www.cnbc.com/2019/02/08/jeff-bezos-1999-interview-on-amazon-before-the-dotcom-bubble-burst.html.

sustainable energy,"[49] offer customers a shared technological, and in some cases a shared ethical and identity-forming journey, a journey that may enhance loyalty, and thus enable premium pricing. Purpose also facilitates customer bonding by rendering a company's future courses of actions more predictable and reliable. A bank whose lived purpose is to "treat customers well" enables customer bonding which reduces customers' transaction costs (and thereby enhances customer loyalty), because such bonding enables, for example, customers to trust that a complex new financial product is designed to benefit them and not to fleece their ignorance. Similarly, a company that is "never knowingly undersold"[50] offers a contract-like commitment through purpose, thereby enhancing loyalty by increasing customer confidence in transacting with the company and reducing their desire to shop around; likewise, a company whose driving mission is to provide a platform that reduces the cost of, and therefore increases ease of access to, consumer products—"to be the earth's most consumer centric company"[51]—can generate trust and loyalty in that platform.

Purpose also enables bonding with external corporate constituencies by providing a credible commitment to safeguard a third party's relationship with specific investments, which cannot efficiently be safeguarded through contract. In relation to suppliers, transaction cost economics[52] has shown us how the efficient boundaries of the firm are the product of the costs of market contracting where contracting parties need, and are asked to make, costly relationship-specific investments—investments whose value is in part dependent on an ongoing relationship and which are therefore exposed to opportunistic ex-post expropriation. Committing to purpose offers a means of bonding supplier relationships, particularly where suppliers have a related purpose, by decreasing the likelihood that relationship commitments will be expropriated by value-driven decisions. In this way, committed purpose has the capacity to alter the boundaries of the firm and allows companies to prosper where market contracting is costly, precisely because of suppliers' fears about the expropriation of their relationship-specific investments. Consider, for example, the potential effects of purposeful bonding between a battery manufacturer and a car company, where the battery manufacturer is asked to invest in the production of bespoke batteries for the electric car company's new model. Any ex-post opportunistic expropriation of the investment not only damages the battery supplier, but it also visibly undermines the electric car company's purposive commitment as the action puts profit above purpose, and visibly undermines their shared commitment and journey to a world whose energy usage is sustainable. This can render opportunism much costlier, as it more directly affects the company's ability to

---

[49] Which is Tesla's mission purpose: *see About Tesla*, TESLA, www.tesla.com/en_GB/about (last visited June 4, 2019).

[50] The promise of the U.K. retail company John Lewis & Partners to its customers; *see Never Knowingly Undersold*, JOHN LEWIS, https://www.johnlewis.com/customer-services/prices-and-payment/never-knowingly-undersold (last visited November 4, 2021).

[51] Amazon's mission statement: *see Working at Amazon*, AMAZON, www.amazon.jobs/en/working/working-amazon (last visited June 4, 2019).

[52] For a classic account, see Ronald Coase, *The Nature of the Firm*, 16 ECONOMETRICA 386 (1937); OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS AND RELATIONAL CONTRACTING (1985).

credibly bond around purpose with other external and internal stakeholders in the future. Most occasions to engage in opportunistic behavior in relation to one relationship are not, therefore, likely to be profitable enough to risk an organization's perceived commitment to its own stated purposes. In this way, corporate purpose can serve a role akin to an internalized reputational intermediary, mediating incentives of the different stakeholders in a manner ascertainable by everyone at comparably low cost. For consumer-facing companies, a version of this can arguably already be observed as a consequence of the widespread use of social media: the risk that actions taken in the context of individual, and economically insignificant, customer relationships can widely be observed and interpreted as proxies for a company's "values" has undoubtedly had a transformative effect on how many companies interact with their customers.

Within the firm, company purpose also provides for stakeholder bonding. Purpose provides a fulcrum around which the corporation can build *intra*-firm cultural norms supportive of the mission-purpose, in a way that a prosaic understanding of business purpose cannot. This idea of purpose and its cultural transportation has the capacity to drive corporate and economic success, as a more meaningful corporate life for employees drives engagement with work, enhancing innovation and productivity; moreover, as with supplier bonding, a commitment to purpose reduces the probability of the ex-post expropriation of employee firm-specific investments, thereby incentivizing those investments and their positive productivity effects. The position that purpose enhances employee productivity and innovation is supported by recent empirical evidence that finds a positive correlation between purpose, middle management behavior, and financial performance.[53]

However, it is not easy to pin down with certainty that this animated idea of "company purpose" is what the FRC intends by its deployment. This understanding rests on the view that it has to be distinct from (but consistent with) its meanings within U.K. company law or its deployment is wholly redundant (and inaccurate). It also resonates with the contemporary purposive discursive milieu[54]—found in think-tank and research reports (from, for example, the Big Innovation Centre's "Purposeful Company" Project, Tomorrow's Company, or the recent *Harvard Business Review*/Ernst & Young survey[55]), pronouncements of leading managers (such as the U.S. Business Roundtable),[56] and popular

[53] *See* Claudine Gartenberg et al., *Corporate Purpose and Financial Performance*, 30 ORG. SCI. 1 (2019). *See also* Alex Edmans, *Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices*, 101 J. FIN. ECON. 621 (2011).

[54] Tomorrow's Company, in a report on corporate purpose, observes that "phrases like 'purpose driven companies' or 'purpose driven culture' now abound": TOMORROW'S CO., THE COURAGE OF THEIR CONVICTIONS: HOW PURPOSEFUL COMPANIES CAN PROSPER IN AN UNCERTAIN WORLD 6 (2018).

[55] *See* HARV. BUS. REV. ANALYTIC SERVS., *supra* note 5.

[56] BUS. ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION (2019), https://opportunity.businessroundtable.org/wp-content/uploads/2019/09/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures-1.pdf.

management theory.[57] For the Big Innovation Centre's Purposeful Company Project, for example, "purpose animates people and drives innovative performance";[58] for the *Harvard Business Review Analytic*, purpose is "an aspirational reason for being which inspires and provides a call to action for an organization and its partners and stakeholders and provides benefit to local and global society."[59] Recently, and to much acclaim, Larry Fink, CEO of Blackrock, one of the world's largest fund-management companies, observed that "without a *sense* of purpose, no company either public or private can achieve its full potential" and that "the board is essential to helping a company articulate and pursue its purpose."[60]

C. *Is Mission-Purpose Compatible with Section 172?*

While this animated idea of "company purpose" deployed by the FRC is distinct from company law's understanding, it must, as noted above, be consistent with it. If it is *not* the FRC's view that in establishing purpose the board is empowered to realign the priority of constituency interests which corporate activity should serve, then how and does the shareholder priority objective set forth in section 172(1) fit with these modern ideas of corporate mission-purpose, where purpose comes first?

On the face of the provision it appears that it does not. Commitment to purpose requires that purpose comes first, prior to stakeholder (including shareholder) interests, and that the priority and balance of stakeholder interests must serve purpose. Moreover, the matrix of stakeholder interests that support purpose and inform decision making may not be—indeed are unlikely to be—shareholder dominated. Section 172(1)'s requirement that directors must prioritize shareholders would, therefore, undermine an ostensible commitment to purpose as it will be compromised by shareholder-promoting decisions that are legally required by honest directors.[61] Over time these effects will breed market and stakeholder

---

[57] *See, e.g.*, ROSABETH M. KANTER, SUPERCORP: HOW VANGUARD COMPANIES CREATE INNOVATION, PROFITS GROWTH AND SOCIAL GOOD (2013); PERRY PASCARELLA & MARK A. FROHMAN, THE PURPOSE-DRIVEN ORGANISATION: UNLEASHING THE POWER OF DIRECTION AND COMMITMENT (1989); GURNEK BAINS, MEANINGFUL INC: THE BLUEPRINT FOR BUSINESS SUCCESS IN THE 21ST CENTURY (2007).

[58] BIG INNOVATION CTR., THE PURPOSEFUL COMPANY INTERIM REPORT 24 (2016).

[59] *See* HARV. BUS. REV. ANALYTIC SERVS., *supra* note 5.

[60] Larry Fink, *Letter to CEOs*, WACHTELL, LIPTON, ROSEN & KATZ (Jan. 12, 2018), www.wlrk.com/files/2018/BLKCEOLetter2018.pdf (emphasis added).

[61] Note that as a standard of liability, section 172 operates in practice in a similar way to the U.S. business judgment rule, as a plausibility or rationality standard. *See* DAVID KERSHAW, THE FOUNDATIONS OF ANGLO-AMERICAN FIDUCIARY LAW 23–134 (2018). Accordingly, directorial exposure to liability for acting in a way that is inconsistent with section 172 is very low, providing significant room to demote shareholder value in decision making without incurring any real risk of liability. However, our point here is that as a standard of expectation for an honest director who is committed to acting in accordance with her legal obligations, section 172 will drive purposive compromise. Given the overweighting of nonexecutive directors on modern boards, the reputational incentives of those directors, and the limited "skin-in-the-game" of those directors (*see*

skepticism about the ability of U.K. companies to credibly commit to purpose and to use purpose to bond with external and internal stakeholders.

There are, however, ways of reading and applying section 172(1) that appear to create some space for real purposive orientation. It would, for example, be possible for the board of a company subject to section 172(1) to attempt to commit to purpose and to re-arrange its decision-making stakeholder priorities around such purpose in the name of *ultimately* making money. That is, consistent with section 172(1), a board could specify a corporate mission-purpose and alter the immediate decision-making matrix to demote shareholder value in decision making by the board or any employee, *provided that the directors are of the honest view that such a purpose and priority hierarchy benefits shareholder value in the long run*. Note that this is distinct from the idea of enlightened shareholder value, which acknowledges that in decision making other interests may be furthered provided that doing so enhances value. With such a "reject money to make money" purpose, shareholders in decision making are deprioritized and corporate decision making takes place through a pluralistic purposive matrix. Indeed, such a "reject money to make money" purpose shows us perhaps that the distinction between enlightened shareholder value and pluralism is not as binary as we typically envisage. However, this approach is not an easily available panacea for creating purposeful companies. Whether such a Ulysses pact is available at all depends on the labor, product, and supplier markets the company operates in, and the expected benefits of mission-purpose from, *inter alia*, specific investment-inducing relationships with stakeholders, and company brand or reputation. Moreover, once adopted its success depends on a company's ability to commit to and economically entrench purpose *outside of company law*—which in practice is difficult to effect.

At the point in time where such a purpose is initially articulated, it will, *ex hypothesi*, be compatible with section 172(1) as it is focused on corporate purpose as a path to long-term value generation. The problem introduced by section 172(1), and by mandatory rules on shareholder powers in U.K. company law,[62] is one of continuing commitment to purpose. While section 172(1)'s overweighted shareholder presence can be made to leave the decision-making room to be replaced by the board's specified priority matrix, in practice it has a legal right to stand outside the boardroom and is always ready to break down the door when it becomes clear that the purposive focus is not value maximizing.

This "reject money to make money" strategy will thus only enable the creation of purposeful companies if the board can ensure that it no longer possesses the powers to reverse course and betray the stated purpose. A board cannot, of course, legally sign away the powers delegated to it by the shareholders or its obligations in relation to the exercise of those powers; but it *can*—in perfect duty compliance—seek to put into place arrangements that impose a heavy direct or indirect financial penalty on the company changing course in the

---

U.K. CORPORATE GOVERNANCE CODE, *supra* note 11, at 6, provision 10), it seems plausible that the vast majority of such directors will seek to comply with the expectation.

[62] *See infra* Part II.B.

future, thereby removing the net-benefits of shareholders reclaiming their rights to a more immediately shareholder-focused path to value creation.

Such financial penalties may arise as a result of reputational damage to the company's purposive brand—reducing, for example, the pricing, strategic, and firm-boundary benefits arising from external bonding[63]—but they can also be given contractual force. This is precisely the reason why boards can, in principle,[64] use this strategy of "contracting for penalties" as a powerful defense against hostile takeovers.[65] Accepting the risk of such future penalties, or the associated costs of not having a full range of commercially viable options to choose from in the future, need not be in conflict with section 172(1) as long as ex ante directors attach a positive net value to them.

Such economic entrenchment of purpose, however, will not typically provide an efficient pathway to creating purposeful companies. First, the type of legally enforceable contractual promises necessary to protect purpose will often be too rigid, which risks turning the company's purpose into a prison easily exploited by rent-seeking counterparties. Where they are flexible enough to avoid this pitfall they will necessarily leave room for future shareholder-focused opportunistic behavior by the company. This is, of course, hardly a surprise: in a way, this observation just restates the argument that a company's relationships with its various stakeholders are too complex to be governed by fully contingent, complete contracts—a fact that according to one view explains the existence of the firm, and thus the relevance of company law, in the first place.[66] Moreover, in many circumstances, no contractual penalty will be available, since companies may seek to define their purpose in a way that does not map onto any legal relationship with a specific counterparty, such as in the case of commitment to ethical values or, more generally, purposes connected to general welfare. Second, reputational entrenchment is always partial as it will not be effective in relation to shareholder-prioritized decisions that provide no clear signal—or one with a significant time delay—to counterparties that purpose has been compromised (and therefore no cost sanction). Accordingly, the attempt to entrench a section 172 "reject money to make money" purpose cannot consistently be relied upon to ensure that shareholders will not break down the door. Mission-purpose, and the economic and social benefits it may offer, will as a result be undermined.

---

[63] *See supra* text accompanying notes 49–50.

[64] Subject to whether such defenses are permissible under the applicable company and takeover law rules.

[65] This happened in the takeover of PeopleSoft by Oracle. PeopleSoft adopted a contractual "Customer Assurance Program" (CAP) to ensure that, even after a change of control, the expectations of PeopleSoft's customers would be met. The CAP was designed to make it extremely costly for the acquirer to change the services the target provided to its customers, arguably providing contractual protection for the implicit promises PeopleSoft had previously made: see in detail Jennifer Arlen, *Regulating Post-Bid Embedded Defenses: Lessons from Oracle Versus PeopleSoft*, 12 HARV. NEGOTIATION L. REV. 71 (2007).

[66] Sandy Grossman & Oliver Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691 (1986).

A second interpretation of section 172(1) may also allow us, again to a limited extent, to view it as supportive rather than inimical to purposeful companies. As noted above, the section 172(1) terms "success" and "benefit" are most likely to be interpreted through the lens of shareholders' preferences and interests. Typically, this is understood through the lens of value. This is intuitive if we think of widely held companies populated by investors that provide for collective investment and whose ultimate beneficiaries have many divergent preferences and interests but are united in the desire to enhance their wealth. However, if one considers the initial stages of a purposive company's life, where a founding shareholder establishes the company, its purpose, values, and priority matrix, then shareholder "benefit" necessarily must reflect that purpose and priority matrix. A board of such a company whose decisions maximized value to the detriment of purpose and in contravention of that priority matrix would not be acting "for the benefit" of that founding shareholder. A question then arises as to whether the conception of shareholder "benefit" necessarily has to change as the makeup of the shareholder body changes. Why should the idea of shareholder benefit be fungible in the absence of explicit contrary intent? Why would it not be fixed in the image of those who created the company and its purpose and then (until actively amended) those shareholders who bought shares in a company umbilically connected to that purpose? If shareholder benefit can be understood through the lens of commitment to original purpose, then a priority matrix which in the board's view is consistent with that purpose (which may include a pluralistic demotion of shareholder value interests) is congruent with shareholder benefit. This would not require that we revisit the law's understanding of interests (and, therefore, benefit) which understands it through the lens only of current and future shareholders, because the idea of purpose and of benefit would, in the absence of contrary intention, be transported by contract.

Thinking about benefit and interest in this way also allows us to see that section 172(1) supports a company's purposive reorientation and an adapted shareholder demoting decision-making matrix where the current shareholder body consists of (non-founder) purposive shareholders. If a company's shareholders, or at least a majority of those shareholders, self-identify as purposeful shareholders, then shareholder "benefit" for them should be understood through the lens of the furtherance of purpose. Implicitly, their commitment to purpose contains an inbuilt deference to the decision-making matrix necessary to further that purpose (and the shareholder's purposive benefit). Consider in this regard Larry Fink's (Blackrock's CEO) 2018 "Letter to CEOs":

> *Indeed, the public expectations of your company have never been greater. Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate.*[67]

However, there are clear limits on the extent to which boards can interpret benefit in this way. It requires either a purposeful founder who sells shares in the company with a

---

[67] *See* Fink, *supra* note 60.

continuing commitment to purpose, or a large section of the shareholder body whose commitment to purpose is genuine, interpretable, and consistent—factors which will rarely converge.

To an imperfect degree, and with a significant amount of intellectual effort, it is possible, therefore, to interpret and apply section 172(1) in ways which are consistent with a purposeful orientation, although such approaches will not be available to all companies and will only enable limited commitment to a mission-purpose. Moreover, clear and effortless purposive flexibility is offered by section 172(2), although it is rarely used and is typically viewed as a means of adapting the corporate form for charitable bodies and nonprofits. Nevertheless, although purposeful flexibility is available through section 172(1) "reject money to make money" purposes or explicit de-prioritization through section 172(2), neither are likely to be readily deployed, which will in practice render the FRC's call to purpose perfunctory, generating marketing slogans but few truly purposeful companies. As Russell Korobkin has argued, the substantive starting position taken by a default rule is "anointed" by rule makers as "more desirable."[68] Relying on behavioral psychologists' identification of "status quo bias,"[69] he argues that "contracting parties view default terms as part of the status quo, and they prefer the status quo to alternative states, all other things being equal."[70] Accordingly, defaults influence management's sense of what they should do, and influence and form the advice they receive from their lawyers; they are also likely to shape the expectations of shareholders and their willingness to consider alternative arrangements. The default status of section 172(1) and its explicit shareholder focus will in practice, therefore, inhibit both the exploration of an alternative section 172(2) purpose or the adoption of section 172(1) "reject money to make money" purposes.

To break the normalization effect of the section 172(1) default, the FRC could require companies to explore the compatibility of section 172(1) and its shareholder prioritization with their corporate purpose and to disclose their reasoning and conclusions. It seems unlikely, however, that this would be enough to break the status-quo bias. Taking purposeful companies more seriously may, therefore, require the legislature to consider altering the default structure of section 172 to normalize alternative priority matrices by forcing companies to either make a choice among several defaults or to require them to produce their own.[71]

---

[68] Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 611–12 (1998).

[69] *See generally* William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7 (1988).

[70] Korobkin, supra note 68, at 612.

[71] We discuss further in Part II.B the biases generated by default rules.

II. The Purposeful Ecology of Purposeful Companies

A. The Zone of Insulation

Consider a financial institution which states that its purpose is “to put customers first” as the ultimate beneficiaries of its actions, with employees and shareholders given equal importance *after* customers. In the alternative, consider a payment technology company whose purpose is to “eradicate real cash payments,” and which elevates the interests of employees above those of shareholders in its decision making, “because innovation, and the human capital that drives innovation, is hardwired to our long-term success.” Both companies have opted out of the section 172(1) default, to provide for a decision-making matrix that supports purpose but demotes shareholders. Where, *ex hypothesi*, such companies are subject to (i) a diversified shareholder base, (ii) strong shareholder rights, (iii) a high probability that such rights will be exercised formally or informally, and/or (iv) market pressures to conform to shareholder interests, it is likely that at the board and senior management level shareholder interests will be heavily weighted regardless of either the stated corporate purpose or the balance of decision-making interests provided to effect such purpose.

In a purposeful company subject to such an incentive structure there are multiple available mechanisms for shareholders to transmit their preferences into the boardroom and to senior management[72]: for example, where a board is exposed to, or fears, activist shareholder intervention focused on shareholder value initiatives.[73] Such initiatives range, *inter alia*, from enhanced dividend payments, restructurings, and divestments, to the appointment of directors more likely to demand such actions, and ultimately to the replacement of managers more likely to pursue such actions.[74] A similar effect will be generated where the board and management fears exposure to a takeover offer—which of course is the whole point of the classic view of the market for corporate control. Such exposure may drive non-purposeful decision making where, for example, such actions may render the company less attractive to a likely bidder, or where such actions have positive short- to medium-term accounting effects that keeps the company off the radar of such bidders. Work by Denis and Denis shows that management removals are strongly correlated with “some form of corporate control activity”[75] in the year prior to the removal, suggesting that boards act preemptively to disincentivize control activity, and that they are, therefore, highly sensitive to accounting and value effects that could trigger/disincentivize such activity. These transmission effects are

---

[72] Mark J. Roe, *Corporate Short-Termism: In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977 (2013) (discussing “transmission mechanisms” in the context of short-termism).

[73] For a fascinating and detailed account on the effects of the transmission of those pressures at DU Pont Inc., see Leo E. Strine, *Corporate Power Is Corporate Purpose I: Evidence from My Home Town*, 33 OXFORD REV. ECON. POL’Y 176 (2017).

[74] For a recent exploration of these activist effects, see John C. Coffee, Jr., *Preserving the Corporate Superego in a Time of Stress: An Essay on Ethics and Economics*, 33 OXFORD REV. ECON. POL’Y 221, 224–34 (2017) .

[75] David J. Denis & Diane K. Denis, *Performance Changes Following Top Management Dismissals*, 50 J. FIN. 1029, 1030-31 (1995).

amplified or dampened by a company's legal and ownership ecology. Where the structural incentives generated by the legal and ownership ecology amplify these effects it is likely to undermine serious engagement by directors and senior managers with a purpose that it is not aligned with these effects.

Of course, in some purposeful companies, the company's contractual commitments to purpose or its reputation as a purposeful company may create a barrier to some immediate value pressures. The nature and limits of such contractual restrictions were discussed above and are equally applicable here.[76] The extent to which reputational barriers can have a quasi-insulating effect, and thus create room for a credible commitment to purpose, depends on the visibility, immediacy, and magnitude of the value penalty stakeholders can impose on the company for breaching its purposive commitment.

For example, while margins may be improved as a consequence of a company moving its production overseas, a clothing company which ties its mission-purpose to a specific location, tradition, or production method may well be protected from value pressure to go down this path, as customers will quickly identify their lack of commitment to this purpose as indicative of the "character" of the firm, and discipline the company through their purchasing power.[77] However, decisions that compromise purpose to further shareholder value will often be less visible; indeed masking these compromises though public relations is arguably a business in itself. They can also take time to become visible and the stakeholder sanction will therefore be delayed, reducing the value of the penalty. Consider in this regard the sale of complex financial products or the internal investment tradeoffs that are made as a result of an increased dividend. Finally, the magnitude of a reputational penalty will not necessarily, or even typically, be proportional to the value that reneging on a purposive commitment may unlock—that is, reputational penalties do not scale. For instance, the quasi-insulating effect of reputational bonding to purpose is likely to be weakest for transformative corporate events. These are most likely to both unlock significant value for shareholders and collide most directly with a previously stated, reputationally enforced company purpose. This may be true in the context of an acquisition, where—depending on the circumstances—the target's reputation may no longer be of major concern to the acquirer, and in any event the potential shareholder value generated in these circumstances may easily outweigh any reputational penalty. Similarly, where a company decides to leave a specific market or community, the cost of reputational penalties to the firm may be

---

[76] *See supra* text accompanying notes 62–63.

[77] See also e.g. the public outcry over Tesla's investment in Bitcoin, which was widely perceived as incompatible with its stated mission purpose of "accelerat[ing] the world's transition to sustainable energy" (see Gillian Tett, Billy Nauman, Patrick Temple-West & Andrew Edgecliffe-Johnson, *Tesla's bitcoin buy undercuts company's green credentials* FIN. TIMES (Feb. 10, 2021), https://www.ft.com/content/399563b1-761c-45fc-9412-d4aa9b9df11f). Tesla later reversed its decision to accept payment in Bitcoin citing environmental concerns (see Richard Waters, *Musk says Tesla no longer plans to accept payment in bitcoin* FIN. TIMES (May 13, 2021), https://www.ft.com/content/052853fa-9816-4624-8dd3-6321c01ac875).

particularly low. This is exacerbated by the fact that consumers often ascribe reputation not to companies, but to brand names.[78]

Purposeful bonding with stakeholders and the intra-firm diffusion of purpose through a purposeful culture[79] will, therefore, struggle to establish themselves in a context where decision makers are responsive to such immediate shareholder primacy pressures and where the selected purpose requires a different priority and balance of constituency interests. In order for senior decision makers to give real and consistent regard to the corporate purpose, as well as to the interests of non-shareholder groups pivotal to such selected purpose, a purposeful company must, ideally, be embedded in a purposeful ecology: an ecology of incentives that supports and does not compromise purpose.

The most effective way of providing for such a supportive ecology is through purposeful controlling shareholders who are committed to the company's mission-purpose. This is evidenced, for instance, by the frequency with which relatively young, founder-controlled technology firms have boldly stated corporate purposes upon going public, sometimes explicitly warning investors of the potential consequences of the company's commitment to purpose.[80] Purposeful blockholders do not, however, have to be founders or families. A good, although unusual, example of a purposeful blockholder in the United Kingdom is the U.K. state's majority position in the Royal Bank of Scotland (RBS). As majority shareholder, the state provides RBS with a medium-long-term controlling shareholder which is highly sensitive to public and media critique of bank behavior vis-à-vis customers and employees, thereby aligning its shareholder interests with RBS's customer-focused other-regarding purpose and values.[81] Furthermore, it provides RBS with a shareholder who is also its ultimate back-stop creditor, thereby removing risk-taking pressure which arises from diversified shareholders who rationally want to exploit the state's too-big-to-fail subsidy.[82] Similarly, private, long-term purposive blockholders could also provide for a purposeful ecology.[83] Jurisdictions with strong blockholding traditions, such as Germany, France, or

---

[78] Which is the reason why brands are valuable and are sometimes transferred independently of the underlying business that currently uses it. *See generally*, *e.g.*, Michael A. Wiles et al., *The Effect of Brand Acquisition and Disposal on Stock Returns*, 76 J. MARKETING 38 (2012).

[79] On the preconditions for the generation of firm cultural norms, see Dan Awrey et al., *Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?*, 38 DEL. J. CORP. L. 191 (2013).

[80] *See, e.g.*, Larry Page & Sergey Brin, "An Owner's Manual" for Google's Shareholders, Registration No. 333-114984 (2004), www.sec.gov/Archives/edgar/data/1288776/000119312504143377/d424b4.htm.

[81] RBS's mission-purpose is "to treat customers well." *See* ROYAL BANK OF SCOTLAND, ANNUAL REPORT 2 (2018).

[82] *See* Daniel Ferreira et al., *Measuring Management Insulation from Shareholder Pressure* (London School Econ. Legal Stud. Working Paper No. 1, 2016).

[83] Some of the financial literature defines blockholding as shareholders with a greater than 5% shareholding. *See, e.g.*, Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377 (2009). Here we use the term as it has traditionally been used in the

Italy,[84] are accordingly well placed to provide companies with a supportive purposive ecology. However, private controlling blockholders in large companies are a rare phenomenon in large U.K. companies, and the investment, legal, and regulatory barriers to enabling them, even over a long-term horizon, are significant,[85] as are the costs of long-term 100% ownership, which would forgo the liquidity, financing, and exit options of stock market listing.

We might also look to smaller purposive institutional shareholders to provide such a purposive ecology in the absence of large private blockholding. Would a critical mass of investors and their fund managers who ostensibly commit to purposeful companies provide an equivalent ecology?[86] There are strong grounds to be skeptical; it seems likely that prevailing fund-management incentive structures will render such purposive commitments hortatory at best. It has been argued[87] that the importance for traditional active fund managers (in retaining and originating mandates) of their relative performance as compared to other fund managers generates a sell bias into a premium offer, even when on the fundamentals the rational fund manager would reject the offer. If fund-management-relative-performance incentives trump fundamental value, they also trump commitments to purpose and to long-term value through purpose. The effect of this incentive structure is that it undermines purpose because it enhances the sensitivity of the board and management to actions that could place the company on the takeover radar, as they cannot trust their shareholders (fund managers) to follow their lead on the value of the bid and on the future of the target as an independent purposeful company, *even when those fund managers actually trust management and even when they honestly believe in the commitment to purpose.* Similarly, in relation to institutional shareholder activism, modern ownership and investment arrangements can enhance the power of the activist value-driven shareholder. Of particular importance in this regard is the ability of hedge funds to trigger wolf-pack[88] buying activity, and to trigger a sell bias to the wolfpack generated by the fund manager's relative performance concerns, which incentivize taking short-term profits on the price rise

corporate law context to refer to large individual, family, or corporate owners that alone have de facto control of the company.

[84] *See* Julian Franks & Colin Mayer, *Evolution of Ownership and Control Around the World: The Changing Face of Capitalism* (Eur. Corp. Governance Inst. Working Paper No. 503/2017, 2017), https://ssrn.com/abstract=2954589.

[85] Most importantly in this regard, the mandatory bid rule in Rule 9 of the U.K. Takeover Code, but also the strong related party regulation that inhibits realizing private benefits of control, for example Listing Rule 11 on related party transactions. *See* Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537 (2004).

[86] *See supra* text accompanying note 64.

[87] DAVID KERSHAW, PRINCIPLES OF TAKEOVER REGULATION 341–47 (2016).

[88] *See* Coffee, *supra* note 70, at 232–33 (describing the operation and effects of wolf packs).

generated by the activism.[89] These sell biases are wholly unaffected by long-term regulatory solutions such as giving long-term shareholders more voting rights; it is precisely those long-term shareholders that exit on the takeover or activist activity. It is not possible therefore for corporate ownership to provide a purposeful ecology in widely held companies where fund manager intermediaries make the investment decisions.

Where the market provides for the transmission of value preferences to the boards of purposeful companies and those companies do not benefit from a purposive ownership ecology, such companies will not remain purposeful unless the board and senior management are provided with a "zone of insulation" from shareholder value pressures. This "zone of insulation" must ensure that the board and senior decision makers feel that they can confidently resist direct and indirect shareholder value pressure which is inconsistent with the pursuit of purpose without such resistance significantly enhancing the probability that they will lose their jobs in the short to immediate term. That is, the corporate ecosystem must give the board and senior managers time to demonstrate that their purposive vision reaps benefits for all. It does not remove accountability to shareholders, but it dampens receptivity to their immediate demands. It is noteworthy that U.K. and European regulators have acknowledged the importance of such a zone of insulation from value pressures in the context of ring-fencing retail banking activity.[90]

There are different ways (of variable effectiveness) in which this zone of insulation can be provided. A CEO who is considered by investors to be vital to the success of the company is in a position to resist investor pressure over the medium term. This is a zone of insulation created by exceptional individual capability. Ignoring their ownership stakes, consider in this regard, Jeff Bezos at Amazon, Larry Page and Sergey Brin at Alphabet, or the late Steve Jobs at post-iPhone Apple. Of course, in a world in which the tenure periods for CEOs are decreasing,[91] there are a very small number of CEOs who benefit from such *capability*

---

[89] *See* Robin M. Greenwood & Michael Shor, *Investor Activism and Takeovers*, 92 J. FIN. ECON. 362 (2009) (showing that the price increase on announcement of an activist event is connected to the increased probability of takeover for the target). *See also* Alon Brav et al., *Hedge Fund Activism*, 63 J. FIN. 1729 (2008).

[90] *See, e.g.*, Financial Services and Markets Act 2000 (hereinafter FSMA) sec. 142(H)(5)(d); Prudential Regulatory Authority PRA Rulebook: CRR Firms and Non-Authorised Persons: Ring-Fenced Bodies Instrument 2016/26, rr. 4.1, 4.2 (providing for independent directors in ring-fenced banks). *See* Thom Wetzer, *In Two Minds: The Governance of Ring Fenced Banks*, 19 J. CORP. L. STUD. 197, 226–30 (2018). *See also Proposal for a Regulation of the European Parliament and of the Council on Structural Measures Improving the Resilience of EU Credit Institutions*, COM(2014) 43 final, art. 13(8)–(9) (Jan. 29, 2014).

[91] *See* Dan Marcec, *CEO Turnover Rates*, HARV. L. SCHOOL F. CORP. GOVERNANCE & FIN. REG. (Feb. 12, 2018), https://corpgov.law.harvard.edu/2018/02/12/ceo-tenure-rates.

insulation. Moreover, as Travis Kalanick (Uber)[92] or Adam Neumann (WeWork)[93] can testify, such capability insulation can quickly evaporate as a result of reputational damage.

A zone of insulation can also be created through control-enhancing structures, such as dual-class shares where a class of shares carries multiple voting rights, and those shares are held by managers or purposeful shareholders. Such voting arrangements have recently come to prominence in the United States where they have become common place for young, technology-focused companies dominated by their founders. Competition to attract such listings has driven several exchanges, including the Hong Kong and Singapore Stock Exchanges,[94] to loosen prior prohibitions on dual class arrangements.[95] However, in many jurisdictions such arrangements remain frowned upon and unlawful.[96] Indeed, in the relatively recent past European regulators have explored the possibility of a pan-EU mandatory one-share one-vote requirement.[97]

In the United Kingdom, until 2014, these mechanisms were not restricted or prohibited, although they were discouraged by institutional investors in relation to publicly traded companies.[98] In 2014, the U.K.'s Financial Conduct Authority provided for a prohibition, in Listing Principle 7, on disproportionate voting arrangements for Premium-Listed companies,[99] although such rights remain available pursuant to U.K. company law and are consistent with the Financial Conduct Authority's (FCA) listing rules where such companies only have a (lower tier) Standard Listing. Access to these mechanisms is thus bundled with other rules, such as lower disclosure standards, and companies opting for the lower Standard Listing will not be included in the most commonly used indices, thus affecting the liquidity and volatility of the company's shares. Whether such lower liquidity

---

[92] Aliya Ram & Hannah Murphy, *Highlights of Kalanick's Tumultuous Tenure*, FIN. TIMES (June 21, 2017), URL.

[93] Eric Platt & James Fontanella-Khan, *WeWork's Adam Neumann to Step Down as Chief Executive* FIN. TIMES (Sept. 24, 2019), https://www.ft.com/content/7f8cda1a-566a-11e7-9fed-c19e2700005f.

[94] Sing. Exchange Mainboard Rules, r. 210(10), http://rulebook.sgx.com/rulebook/mainboard-rules [hereinafter SGX Mainboard Rules].

[95] H.K. Exchange Listing Rules, ch. 8A ("Equity Securities").

[96] *See, e.g.*, Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BUNDESGESETZBLATT [BGBL.] I at 1089, *amended by* BGBL. I at 2586, § 12(2) (July 23, 2013).

[97] Comm'n Eur. Comms., *Impact Assessment on the Proportionality Between Capital and Control in Listed Companies*, SEC (2007) 1705 (Dec. 12, 2007).

[98] *See* Attracta Mooney & Robin Wigglesworth, *Google, Facebook and Snap Challenge Governance Standards*, FIN. TIMES (May 27, 2018), www.ft.com/content/ab860f60-5f5b-11e8-ad91-e01af256df68 (reporting the views of Standard Life Aberdeen: "[O]ne share, one vote is the bedrock of corporate governance. It has always been the case that you should have one vote for every share you own.").

[99] Fin. Conduct Authority, Listing Rules (Listing Regime Enhancements) Instrument, FCA 2014/33 (2014).

poses a problem for a company's ongoing operations is, however, open to debate.[100] Nevertheless, the FCA has recently proposed allowing companies a limited form of dual-class share structure whilst retaining a premium listing .[101] Under the proposed rule, companies IPO-ing on U.K. public markets could use a dual-class share structure, provided that the weighted voting ratio does not exceed 20:1, that the shares are held by directors of the company, and that the weighted voting *only* applies where the holder of the shares faces removal, as well as in hostile takeover situations. The rights would have to effectively be non-transferable (i.e. the shares would convert to ordinary shares upon transfer to a non-director), and they would have to expire within five years of listing for the company to maintain its premium listing.[102] Importantly, the proposal would not ensure continued board control by the founder, since weighted voting would not apply to director appointments, and could not be used when the removal of another director is on the ballot. Moreover, the five-year time limitation will place a limit on how this structure can be leveraged for giving effect to a company's mission purpose while maintaining its premium listing. Accordingly, even if implemented by the FCA the proposal will not significantly change the U.K.'s corporate landscape. Where companies wish to deploy an effective dual class share structures they will continue to rely on a standard listing and may do so if they are unconcerned about any liquidity and volatility effects, the risk that the bundle of lower disclosure standards and disproportionate voting rights may generate a lower valuation, and if they are in a position (depending on the attractiveness of their offering) to ignore the disapproval and resistance of many investors, resistance which is also gaining momentum in the United States and consolidating elsewhere with the recent IPO of Snap Inc. and WeWork's failed IPO.[103] And, of course, in practice such an option is only available to founders who IPO their company. For other companies that already have such a one-share one-vote structure, although a restructuring providing for such weighted voting rights is theoretically available with shareholder approval and shifting the standard segment, it is highly unlikely to find sufficient support among the institutional shareholder base who would be sacrificing their voting rights for an ownership structure which most of them disapprove of, although it is

---

[100] *See* Vivian W. Fang et al., *Does Liquidity Enhance or Impede Firm Innovation?*, 69 J. FIN. 2085 (2015) (showing that liquidity appears to hinder the promotion of innovation as a result of the increased exposure to takeover and weak fundamental analysis by institutional shareholders).

[101] FCA, Primary Markets Effectiveness Review 29 (2021), https://www.fca.org.uk/publication/consultation/cp21-21.pdf.

[102] *Id.*

[103] For example, for the recent decision of S&P to exclude such companies, see Nicole Bullock, *Companies with Multiple Share Classes Blocked from Joining S&P 500*, FIN. TIMES (Aug. 1, 2017), https://www.ft.com/content/993e4c11-8729-3168-a280-69e1d400b1bc (last accessed Nov. 6, 2021); Shannon Bond, *Investors Call for Lyft to Scrap Dual-Class Share Structure Plans*, FIN. TIMES (Mar. 17, 2019), https://www.ft.com/content/7d26dca6-4747-11e9-b168-96a37d002cd3 (last accessed Nov. 6, 2021).

noteworthy in this regard that some companies and blockholders have found workarounds to achieve similar effects in some European jurisdictions.[104]

For a company that is prevented by regulation or market norms from crafting a zone of insulation through dual-class voting shares, the primary determinant of whether such a zone of insulation can be created is corporate law. The basic rules of corporate law provide for robust structural incentives that, in the absence of other forms of insulation discussed above, inevitably mold the behavior of corporate directors and managers. They provide a legal ecosystem within which managers operate. Like all ecosystems, a corporate legal ecosystem is conducive to the survival of some institutional organisms but not others, and conducive to the effectiveness of some forms of corporate purpose and the evisceration of others. There is no neutral legal ecology between different constituencies apart from an improbable (in a commercial company) situation in which no constituency exercises any rights and influence over the board and management—credit unions and mutual banking corporations offer examples of such neutral legal ecologies. In relation to commercial companies, it is clear that *any legal ecology will have a clear shareholder bias*, where shareholders are solely responsible for the election of directors. However, that does not mean that all forms of corporate power distribution and influence are equal in relation to the facilitation of purposeful companies.

B. The Ecology of Corporate Law

1. The Core Distribution of Power

The most important consideration in relation to the purposive ecology of corporate law in any jurisdiction is the distribution of power among the board and the shareholder body and whether such a distribution is a default distribution that can be altered by the company or whether such distribution, *as a matter of law but also as a matter of practice*, cannot be altered.

The core features of the U.K.'s distribution of corporate power are: (i) that corporate power originates with the shareholders in general meeting and is transferred through the company's articles from the shareholders to the board; (ii) that senior managers of the company are appointed and empowered by the board, and company law provides no inherent managerial power and no removal protection for those managers;[105] (iii) that company law provides for the removal of directors by shareholders in a general meeting at any time, without having to provide a reason for removal, by a simple majority of the votes cast[106] (which in practice often means less than a simple majority of the issued shares); and (iv) that five percent of the shareholder body can requisition an interim meeting to exercise such removal rights (and company law provides some assistance to shareholders in communicating with other

---

[104] On the introduction of "loyalty shares," effectively providing blockholders with additional votes, see, e.g., Marco Ventoruzzo, *The Disappearing Taboo of Multiple Voting Shares: Regulatory Responses to the Migration of Chrysler-Fiat* (ECGI Law Working Paper 288/2015, Mar. 2015), https://ssrn.com/abstract=2574236.

[105] Harald Holdsworth & Co. (Wakefield) Ltd. v. Caddies, [1955] 1 WLR 352.

[106] Companies Act 2006, c. 46, § 168.

shareholders in relation to general meeting resolutions).[107] These elements of corporate power distribution are either elemental to the origins and structure of power in a U.K. company ((i) and (ii))—or they are mandatory (we will discuss below the scope to maneuver around its mandatory nature).

Other company law rules provide for other forms of shareholder control over corporate development, most importantly rules on the issuing of shares and the waiver of preemption rights.[108] These rules provide significant formal and informal power to shareholders, ensuring that their interests are foregrounded in decisions to raise finance to fund projects or to grow the company through acquisitions.[109] The presence of these rights also ensures that senior managers operate within the shadow of the parameters of possible allotment and waiver approvals; that is, the rights necessarily structure operational thinking prior to any request for approval or waiver. Even when shares are issued pursuant to rolling grants of authority and preemption right waivers,[110] decisions are structured by the need to justify ex-post the use of those rolling grants in order to maintain them going forward.

Non-company law rules further enhance shareholder power. These rules include the significant transaction rules for Premium-Listed companies (requiring shareholder approval for greater than 25% value transactions)[111] and the Takeover Code's non-frustration rule. The significant transaction rules, as with the share allotment and preemption-right-shareholder-approval regime, necessarily foreground shareholder interests in relation to major acquisitions. The Takeover Code's non-frustration rule prevents any board action (without contemporaneous shareholder approval) which has a defensive effect once a bid has become imminent (although note that U.K. company law provides similar protections in this regard).[112] In addition, the pro-shareholder balance of power is reflected both in optional rules found in most companies' articles of association and in some of the Corporate Governance Code's recommendations. In these latter regards, note the rarely used but invariably present shareholder instruction rights in company articles,[113] and the U.K. Corporate Governance Code's recommended one-year board term.[114]

Taking these rules at face value, U.K. corporate law provides a pro-shareholder legal ecology that does not enable companies to provide a purposefully tailored zone of insulation. But before considering further whether it is possible in practice to legally engineer a zone of

---

[107] *See id.* §§ 303–305, 314.

[108] *See id.* §§ 549–551, 561–566.

[109] Note the preemption right regime would not apply in relation to the issues of shares for non-cash assets—such as buying the shares or assets of another company, but the share allotment rules would.

[110] *See generally* KERSHAW, *supra* note 32, at 722, 726–27.

[111] FIN. CONDUCT AUTHORITY, HANDBOOK r. 10 (2019).

[112] PANEL ON TAKEOVERS & MERGERS, THE TAKEOVER CODE r. 21 (2016) [hereinafter THE TAKEOVER CODE].

[113] *See* Companies (Model Articles) Regulations 2008, SI 2008/3229, art. 4.

[114] U.K. CORPORATE GOVERNANCE CODE, *supra* note 11, provision 18 at 8 .

insulation, it is important to contextualize the U.K. comparatively in this regard.[115] A majority of advanced economy (non-Commonwealth) jurisdictions provide for either legal ecologies that are in different ways *either* far less pro-shareholder *or* provide the option for the company to provide for a less pro-shareholder ecology.[116] These jurisdictions provide for, or enable the construction of, a zone of insulation and are therefore well adapted for purposeful companies. In a German company, for example, the Stock Corporation Act provides for a two-tier board—a supervisory board and a management board. Corporate power is transferred to the management board directly[117]—that is, in contrast to the United Kingdom, such power is not delegated by shareholders. Moreover, German corporate law provides for variable forms of employee board participation in companies with two-tier boards[118]—in large companies with a specified number of German employees half, and in smaller companies one-third, of the supervisory board.[119] While it is often presumed that codetermination requirements are mandatory rules, in fact a degree of optionality is provided in relation to codetermination even for large publicly traded companies. Where employees do not make use of their right to form a works council, and the company employs fewer than 2,000 German resident employees, no employee representatives will join the supervisory board. This approach is taken by a number of major German companies, although one wonders whether the "loophole" would be closed if it became widely adopted. In relation to shareholder representatives, German corporate law provides for the removal of the supervisory board members by a 75% majority of shareholders[120] and provides for cause-based and indirect removal of management board members (although difficult to enforce) where there is "an important reason" to support removal.[121] Although German companies benefit from preemption rights, they are not subject to significant transaction approval rules.[122] Nor does German takeover law impose on target boards a non-frustration

---

[115] *See, e.g.*, Luca Enriques et al., *The Basic Governance Structure: The Interests of Shareholders as a Class*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 73 (Reinier Kraakman et al. eds., 3d ed. 2017).

[116] *See id*. *See also* Martin Gelter, *Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L.J. 129 (2009); Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM. J. COMP. L. 1 (2011).

[117] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BUNDESGESETZBLATT [BGBL.] I at 1089, *as amended in* BGBL. I at 2586, § 76(1) (July 23, 2013).

[118] *See* Mitbestimmungsgesetz [MitbestG] [Codetermination Act], May 4, 1976, BGBL. I at 1153; Drittelbeteiligungsgesetz [DrittelbG] [One-Third Participation Act], May 18, 2004, BGBL. I at 974.

[119] MitbestG at 1153, § 11; DrittelbG at 974 § 4.

[120] AktG at 1089, § 87(8).

[121] *Id.* § 84(3); note, however, that a no confidence vote by the shareholders is generally considered an important reason (with exceptions based on the shareholders' motivations).

[122] Provided that the transaction value does not exceed approximately 80% of the asset value of the corporation: *see* Bundesgerichtshof [BGH] [Federal Court of Justice], Feb. 25, 1982, ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFES IN ZIVILSACHEN [BGHZ] 83, 122 (1982) (*Holzmüller*).

rule, although German corporate law imposes several obstacles to the construction of U.S. takeover defenses such as poison pills,[123] and also limits the availability of many pre-bid defenses.[124]

If we turn our gaze to the United States, we find corporations, in contrast to the United Kingdom, whose boards are empowered by the corporate statute not by the shareholders, but, similar to the United Kingdom, whose managers are appointed and empowered by the board and who receive no company law protection from removal. With regard to director removal rights and rights to call shareholder meetings, most U.S. states explicitly provide for optionality, allowing companies to adjust the legal ecology within which they operate. Accordingly, U.S. companies can be structured in such a way as to provide for an identical core legal ecology (on virtually all levels) to the United Kingdom, although it is less common that they are. Most U.S. states allow companies to elect to provide for staggered board terms during which time directors can only (unless the company provides otherwise) be removed for cause[125] and prevent shareholders from calling interim meetings.[126] Moreover, as is well known, the poison pill, the most potent of takeover defenses (which is particularly potent when combined with a staggered board),[127] is available to any company at any time. With regard to the other shareholder rights considered above in relation to the United Kingdom: approval rights are required in relation to asset sales but the provision is triggered at (although standard defined)[128] much higher levels than the United Kingdom's 25% rule. It is possible, although of questionable validity, for U.S. companies to provide for instruction rights, and in practice they do not do so; in relation to preemption rights, most corporate statutes provide that they are not available unless they are provided for in the company's constitution[129]—in practice they are uncommon in publicly traded companies.

Relatedly, and importantly for the U.K. debate, the U.S. experience shows us that private equity portfolio companies, many of which are often emerging growth companies, usually IPO with a set of weak shareholder rights (staggered boards and with-cause removal rights). That is, at the IPO stage where the private equity investors seek to maximize the return on part of their shareholding, and where they invariably retain significant ownership-skin in the game, they elect to provide these companies with a carefully crafted set of pro-director governance rules. Moreover, *either* there is no investor discount related to these rules, *or* the

---

[123] Carsten Gerner-Beuerle, David Kershaw & Matteo Solinas, *Is the Board Neutrality Rule Trivial? Amnesia and Corporate in European Takeover Regulation*, EUR. BUS. L. REV. 559 (2011).

[124] *See, e.g.*, Paul L. Davies, Edmund Schuster & Emilie van de Walle de Ghelcke, *The Takeover Directive as a Protectionist Tool?* (ECGI Law Working Paper No. 141/2010, 2010), https://ssrn.com/abstract=1554616.

[125] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141.

[126] *See id.* § 211.

[127] Lucian A. Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy*, 54 STAN. L. REV. 887 (2001).

[128] DEL. CODE ANN. tit. 8, § 271.

[129] *Id.* § 102(a)(3).

discount investors apply does not outweigh, in the views of these sophisticated market actors, the medium- to long-term value benefit of such provisions.

In a survey of thirty-eight PE IPOs of U.S. companies by Kirkland & Ellis in 2016 (half of which were "emerging growth companies"),[130] in which the PE company retained a significant, often controlling, interest, the company at IPO had a staggered board in 95% of the cases.[131] Similarly, in a sample of fifty "controlled"[132] U.S. companies by Davis Polk in 2018 (25% of which were emerging growth companies), 78% had a staggered board.[133] Moreover, in 80% of the sample, the companies provided for a with-cause-only removal right,[134] and in many instances for a combined with-cause and super-majority removal right.[135] Nor are these staggered boards, in contrast to many other controlled company governance provisions, subject to automatic removal clauses in the event that PE/controller ownership falls below a certain threshold. Interestingly, the reverse is the case in relation to staggered boards where a few companies provide for a "springing staggered board"[136] and, more commonly (in 65% of the sample), provide a "springing" with-cause removal right,[137] which comes into effect in the event that PE/controller ownership or voting power falls below a particular threshold.

It is also noteworthy in relation to these companies that they adopt a range of other provisions weakening shareholder power, including: plurality voting;[138] a prohibition on voting by written consent;[139] a prohibition on calling interim shareholder meetings;[140] and super-majority (of the outstanding shares) for charter and bylaw amendments.[141] These reports do not consider the pricing effects of adopting these rules. However, in an earlier 2003 report on PE IPO governance provisions, Debevoise & Plimpton observed that

---

[130] Carol Anne Huff, *Recent Trends in IPOs of Private Equity Sponsor-Backed US Companies*, PRAC. LAW. 51, 52 (Sept. 2016).

[131] *Id.* at 53.

[132] Which in this case refers to companies where one person (real or legal) holds 50% or more of the equity.

[133] DAVIS POLK, CORPORATE GOVERNANCE PRACTICES IN U.S. INITIAL PUBLIC OFFERINGS 14 (2018), www.davispolk.com/files/2018_controlled_ipo_survey.7.9.2018.pdf.

[134] *Id.* at 15.

[135] See, e.g., the companies listed in *infra* note 137.

[136] *See* DAVIS POLK, *supra* note 133, at 14 (5% of the sample).

[137] *Id.* at 15. The ownership/voting threshold in the "springing with-cause" provisions is typically at or close to de jure control: for example, in the sample, American Renal Associates Holdings Inc., Emerald Exposition Events Inc., Evoqua Water Technologies Corp., and Foundations Buildings Materials Inc. have with-cause plus supermajority removal rights which "spring up" when the controlling shareholders interest falls below a specified ownership or voting threshold (40%, 50%, 50%, <50% voting rights, respectively).

[138] *Id.*, at 2 (88%).

[139] *Id.* (86%).

[140] *Id.* (84%).

[141] *Id.* (86%).

"underwriters have frequently observed that including a normal set of shark repellents . . . will not harm the marketability of the IPO shares." Debevoise & Plimpton observed further that institutional investors "just don't seem bothered by them."[142] Although, since 2003, momentum has gathered in U.S. corporate governance circles against staggered boards, it is worth noting that even as of 2003 institutional shareholders firmly opposed the adoption by an existing public company of staggered boards—a paradox Debevoise & Plimpton describes as "odd." We return later to a broader consideration of the efficiency of such provisions.

2. Challenging the Mandatory Presumption

As noted above, the core power distribution rules relating to board removal and shareholder meetings in the U.K. are mandatory rules as are, for listed companies, the preemption right rules (subject to shareholder waiver)[143] and the Takeover Code's non-frustration rule and, for premium-listed companies, the significant transaction rules. If one treats these rules as unavoidable, then it is clear that it is not possible to create a legal zone of insulation in a widely held U.K. company. In such companies, in the absence of rarities such as purposeful blockholders or multiple voting rights, a company purpose which requires a rebalancing of constituency interests will struggle to become more than window dressing.

Given this, a question of considerable importance is whether it is possible in practice to devise mechanisms for a U.K. company which, consistently with these mandatory rules, enable a legal ecology that can support a purposive company. Put differently, Can creative legal engineering provide a purposive ecology in spite of the mandatory nature of these rules? In short, the answer is formally "yes," but in practice "no." There is considerable optionality available within U.K. corporate law but it is neither readily visible nor in practice is it deployed. To enable companies to provide for a supportive and tailored purposive legal ecology would therefore require state intervention to render market participants aware of the existing optionality and to render its adoption legitimate. To see this latent optionality, consider first two theoretical ways in which mandatory pro-shareholder orientation of U.K. corporate law can be tamed.

> *Board Removal*—Consider a provision in the articles of a publicly traded company that provides that (i) the directors shall be appointed for five-year terms; and (ii) in the event a shareholder resolution is moved to remove any director of the company, that the shares held by the directors will have the number of votes determined by a majority of the directors, with no limit on the number of votes. If enforceable, this would provide the directors with insulation from shareholder pressure as good as that available in any U.S. company. But is it enforceable? In *Bushell v. Faith*,[144] the House of Lords approved of a lesser version of this provision where, in a three

[142] 3 DEBEVOISE & PLIMPTON PRIVATE EQUITY REPORT 3 (2003) ("Questions to Ask Before You Join a Club"). The term "shark repellent" is used in the report to include a staggered board.

[143] The preemption rules are mandatory rules for public companies.

[144] Bushell v. Faith [1970] AC 1099 (Eng.).

shareholder (equal shareholding) company, a director received three votes per share on the moving of a removal resolution against him or her. Their Lordships held that the arrangement was not invalidated by the mandatory removal right. The reasoning of the majority of their Lordships, with Lords Upjohn and Donavan providing the most comprehensive judgments, was that the mandatory removal provision provided only for a simple majority of the votes to remove a director and the Companies Act clearly delegated the authority to determine the voting rights attached to the shares to the articles. Lord Donovan also emphasized that at the time of the drafting of the provision the legislature would have been fully aware of the practice of using weighted voting rights but nevertheless did not address it in the Act. He observed: "Parliament followed its practice of leaving to companies and their shareholders liberty to allocate voting rights as they pleased."[145] The judgment, however, has been heavily criticized. Indeed, Lord Morris of Borth-y-Gest in dissent followed the first instance judge in describing the arrangement as making a "mockery" of the mandatory removal right.[146] *Gower's Principles of Modern Company Law* describes the judgment as "apparently indefensible" unless it is construed narrowly as authorizing such arrangements only in small partnership-like companies.[147] In support of this reading, Lord Donavan did observe that in many small companies such provisions are necessary to "safeguard against family quarrels." However, this in-passing observation does not affect the legal principle which both Lords Donavan and Upjohn expound: the power of all companies to determine the rights attached to shares is unaffected by the removal provision. However, even if such contingent weighted voting rights are compliant with company law, the Listing Rules create other barriers to adoption. As noted above, for a Premium-Listed company, as of 2014 Listing Principle 7 prohibits disproportionate voting arrangements. Nevertheless, this prohibition does not apply to a Standard Listing and, therefore, such a weighted voted provision remains formally available to all companies.

The Non-frustration Rule (NFR)[148]—Let us first assume shareholder buy-in for a poison pill, which, given the U.S. PE governance data outlined above, is clearly plausible in early stage IPO companies.[149] In such circumstances, is it possible to legally engineer a way around the non-frustration rule? Consider a poison pill put in place prior to any bid becoming imminent (the NFR is only triggered when a bid is imminent).[150] A typical pill involves an option to buy shares in the target company

---

[145] Bushell v. Faith [1970] 1 All ER (HL) 53, 58 (Lord Donovan) (Eng.).

[146] Bushell v. Faith [1970] 1 All ER (HL) 53, 54 (Lord Borth-y-Gest) (Eng.).

[147] PAUL DAVIES & SARAH WORTHINGTON, GOWER'S PRINCIPLES OF MODERN COMPANY LAW 14–51 (10th ed. 2016).

[148] Here we ignore the NFR triviality debate: *see* David Kershaw, *The Illusion of Importance: Reconsidering the U.K.'s Takeover Prohibition*, 56 INT'L & COMP. L.Q. 267 (2007).

[149] *See supra* text accompanying notes 122–35.

[150] THE TAKEOVER CODE, *supra* note 112, r. 21.

(a "flip-in" plan), the terms of which, including strike-price triggers, are set forth in a "shareholder rights plan." A pill provides for value dilution for the bidder ("the pill is triggered") on the crossing a share ownership threshold, as upon crossing that threshold without target board approval the options provide that all shareholders *apart from the bidder* may purchase newly issued shares at a heavy (typically 50%) discount. An ordinary pill which gives the board an election to approve a bidder crossing a threshold is not NFR compliant, as any decision not to approve the bidder crossing the threshold would amount to action interfering with the shareholders' ability to decide on the merits of the bid. However, if the triggering or non-triggering of the pill was connected to the board's separate and, pursuant to rule 25 of the U.K. Takeover Code, required recommendation to shareholders as to whether to accept or reject the bid,[151] then this would not involve the board directly making a decision that interfered with the bid—that is, the interference would arise as a result of a separate, required, and formally unconnected board action. In theory, this would enable an effective poison pill. Such an approach has, however, never been tested and there is good reason to think that the Takeover Panel would not look kindly on it. Clearly, it generates scope for boards to intentionally, under the cover of their recommendation, interfere with the merits of the bid. And, as with the board removal provision considered above, it might appear to the Panel to make a mockery of the rule because it interferes with the spirit of the non-frustration rule as well as with the "grund" principles on which the Code is based, which include non-interference with shareholder choice.[152] Accordingly, although formally available, there is some uncertainty that it could be relied upon in practice.

If such provisions in any company are theoretically available, then why have we not seen them in practice? One explanation is that the absence of such engineered provisions reflects the market's reasoned and evidence-based rejection of what it views as suboptimal governance provisions. We return to this issue in Part IV when we consider the evidence on whether alternative arrangements that provide for a zone of insulation are suboptimal. However, it is also plausible that the absence of such provisions is connected to several drivers of investor and advisor inertia in this regard.

Traditional fund managers, who populate the share registers of most U.K. companies, have poor incentives to closely engage with the governance arrangements of their individual portfolio companies.[153] Among the factors driving such passivity are the structure of traditional fund-management fee arrangements[154] and, as importantly, the staffing of traditional fund-management teams, which mean that the fund managers have limited time to dedicate to the analysis of unusual governance arrangements in their portfolio companies.

---

[151] *Id.* r. 25. Our thanks to Richard Godden for our conversations about this idea and for alerting us to the fact that many practitioners are of the view that such a structure is Takeover Code compliant.

[152] *See* KERSHAW, *supra* note 87, at 138.

[153] Lucian Bebchuk et al., *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89 (2017).

[154] *Id.*

The significant recent fund flows into explicitly passive forms of investments such as index trackers,[155] in addition to the harder to quantify "closet trackers,"[156] are likely to further dilute the few incentives that exist for funds to engage with and understand more tailored governance arrangements.[157] More active hedge funds which do have strong incentives to engage, do not have the time horizons necessary to incentivize them to think about governance purposefully, which involves a time horizon significantly longer than the average hedge fund holding period of two to three years.[158]

When governance is outsourced to "governance experts,"[159] the capacity and incentive (proxy advisors are not shareholders) constraints of such experts results in them necessarily adopting governance "best practice" lenses which provide limited scope for engaging with tailored individual corporate legal ecologies. Such constraints, even in relation to simpler governance conversations than the ones we outline above—such as the separation of Chair and CEO roles—result in "governance experts" providing for hard-fixed, or strong-presumption recommendations. International Shareholders Services (ISS) U.K. proxy voting guidelines require, for example, a "strong justification" to overcome a "vote against" recommendation on a joint CEO and Chair or a former CEO becoming Chairman.[160] In the United States, they also provide a hard-voting recommendation against staggered boards and in favor of the de-staggering of a board.[161] Accordingly, the poor information incentives

---

[155] *See, e.g.*, Vladyslav Sushko & Grant Turner, *The Implications of Passive Investing for Securities Markets*, BIS Q. REV. (2018), https://www.bis.org/publ/qtrpdf/r_qt1803j.htm; Jan Fichtner, Eelke M. Heemskerk & Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-concentration of Corporate Ownership, and New Financial Risk*, 19 BUS. & POL. 298 (2017).

[156] *See further Closet Trackers*, FIN. CONDUCT AUTHORITY (2019), www.fca.org.uk/firms/authorised-and-recognised-funds/closet-trackers.

[157] Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493 (2018). *But see* Edward Rock & Marcel Kahan, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, 100 B.U. L. REV. 1771 (2021) (arguing that advisers to the largest passive funds are in a strong position to influence company-specific governance, but not performance-related, issues).

[158] William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1420 (2007) (reporting a mean holding period of twenty-one months). *See also* Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. L. & BUS. REV. 459, 480 (2013), reporting from a sample of 379 events holding periods of 100 less than one year, 131 one to two years, and 148 three years and more.

[159] The evidence suggests that somewhere between 10% and 20% of voting follows proxy advisor recommendations. *See* Jennifer E. Bethel & Stuart L. Gillan, *The Impact of the Institutional and Regulatory Environment on Shareholder Voting*, 31 FIN. MGMT. 29 (2002); Stephen Choi et al., *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649 (2009). Some companies, for example IBM, submit to the Securities and Exchange Commission (SEC) that this generates a de facto controlling interest: *see generally* Bryce C. Tingle, *Bad Company! The Assumptions Behind Proxy Advisors' Voting Recommendations*, 37 DALHOUSIE L.J. 710, 719 (2014).

[160] INST'L SHAREHOLDERS SERVS., UNITED KINGDOM AND IRELAND PROXY VOTING GUIDELINES 13 (2020).

[161] INST'L SHAREHOLDERS SERVS., UNITED STATES PROXY VOTING GUIDELINES 18 (2020).

of traditional fund managers, the time horizons of hedge funds, and the partial outsourcing of governance to "experts" who also have poor incentives to pay attention to individual company circumstances, creates a fertile landscape for a constraining governance normality—a normality that will have little truck with unusual governance arrangements which tack against the prevailing view. Accordingly, investor inertia on purposive governance is hardwired into the contemporary equity investment landscape. Moreover, as managers will only reap a small proportion of any potential gains from a commitment to purpose, they are only weakly incentivized to pushback against this inertia. A lack of market experimentation around the concept of purpose is, therefore, neither surprising nor indicative of an informed market view as to its value.

Nevertheless, the resistance to these structures is not simply a function of investor inertia. Such explanations underestimate the importance of the formal legal position to inhibiting doing things differently. There are three related reasons for this. First, even where rules are explicitly default rules, the default position is sticky; the substantive position they take is, although optional, anointed by rule makers as legitimate and "more desirable."[162] Where rules appear to be mandatory but can be cleverly structured around, the stickiness effect is accentuated: the regulator has made a clear election so there needs to be a really good reason to structure around it. Second, connected to this, in the face of apparent clear mandatory rules clever structuring "smells bad." It is very difficult to persuade all corporate participants including nonexecutive directors, corporate lawyers, and shareholders/fund managers to do something that, even if legally valid, looks like it makes "mockery" of a legal provision or contravenes the spirit of the regulatory consensus. This is especially so where the resulting position can be interpreted as providing insulation and reducing accountability of the executives proposing it.[163] Lawyers in particular may also be hesitant to provide formal opinions on their validity given the resulting reputational risk that flows from deploying them. For companies that operate permanently in the calcium light of media and public scrutiny there is no scope at all to generate any such "smell," especially when they know that they are unlikely to be afforded the opportunity to justify non-standard arrangements to informed and open-minded investors. Third, these types of arrangement always contain some legal risk. Although, a strong case can be made for their legality, there is not-insignificant risk that a judge or regulator could elevate substance over form and strike down the arrangement as a scheme to evade a mandatory rule. Given this risk, for most companies, it is not worth the candle of overcoming the above barriers. Of course, the extent to which these effects limit experimentation varies depending on the rule in question. These effects are likely to be particularly strong in relation to core rules such as removal rights and the non-frustration rule.

[162] Korobkin, *supra* note 68, at 611–12. *See also* Luca Enriques, Ronald J. Gilson & Alessio M. Pacces, *The Case for An Unbiased Takeover Law (With an Application to the European Union)*, 86 HARV. BUS. L. REV. 85 (2014) (considering sticky defaults in the context of European takeover regulation).

[163] *See infra* Part IV.A.

Accordingly, to enable the creation of a purposeful zone of insulation it is not enough to appeal to the latent, constructible optionality contained within U.K. corporate law. To enable purposeful companies to construct a legal ecology that supports the implementation and diffusion of that purpose, state action is required to: (i) remove legal noncompliance risk, (ii) take away the impression of undermining the spirit of the rule, and (iii) remove default-rule stickiness. Removing such biases would allow purposive directors and managers to operate on a level playing field when they try to persuade their shareholders/fund managers of the merits of a purposeful legal ecology.

One approach to this would be to introduce clearer ecology optionality in U.K. corporate law, which would enable companies to select from a menu of options to determine the nature and extent of their zone of insulation. These options could include, for example: opt-ins to staggered boards with weaker removal rights, such as higher voting thresholds (e.g., a simple majority of the outstanding shares, or a supermajority resolution) or with-cause removal rights; and opt-outs from the non-frustration rule, the preemption-rights regime, and the Listing Rule's prohibitions on proportionate voting arrangements and its significant transactions approval regime. This optionality could also extend to board structure and provide an option between two-tier and one-tier boards, and where the former is selected offer an option of employee board representation. Similarly, it could provide for other stakeholder representation options, such as a customer director. It could also provide for a default election structure where the company elects to have such non-shareholder supervisory board members.

Optionality could be organized into a variable rule-menu providing greater legitimacy to the selection of these options, thereby overcoming the sticky default problem. These choices could be organized, for ease of use, into sets of rules suitable for certain types of purposes. But as choice and optionality and crafting rules apposite to individual companies mission-purposes are the real drivers of reform, then alongside these rule-menus there should be a "pick and mix" option. What matters is that the options are structured in a way that assists companies and their advisors in managing the process of selecting a coherent set of options but at the same time nudges companies to think about and to make a considered choice about the appropriate set of options.

In important work, Luca Enriques, Ronald Gilson, and Alessio Pacces[164] explore a similar solution to addressing conflict over the efficient form of takeover regulation, particularly in relation to the mandatory bid rule.[165] Taking what they frame as an "unbiased" approach they provide for a menu of default options from which companies can choose. However, they do retain a pro-shareholder bias for newly formed companies, and a status-quo bias for existing companies. In our approach to enhanced optionality, status-quo bias for existing companies flows automatically as a purposeful governance regime would not actively impose governance options from the range of options. However, in relation to newly formed companies, or for companies that actively consider changing their governance

---

[164] *See* Enriques, Gilson & Pacces, *supra* note 162.

[165] On the efficiency debate surrounding the mandatory bid rule, see, e.g., Edmund Schuster*, The Mandatory Bid Rule: Efficient, After All*, 76 MOD. L. REV. 529 (2013).

arrangements, the U.K. experience shows us that any default preference generates stickiness and that the menu of options should therefore strive to be truly unbiased.

As the corporation evolves, governance changes may be required to adapt to its new circumstance; but if the power to alter such arrangements is left in the hands of shareholders alone, through a low-threshold vote, then such purposeful governance arrangements can always be dismantled by shareholders and will be ineffective. In the United Kingdom, constitutional changes can be implemented by shareholders acting alone through a special resolution requiring 75% of the votes cast, which in practice is significantly lower than 75% of the outstanding shares. Accordingly, any such menu of options needs also to provide for stronger means of entrenching the selected governance provisions. The most effective form of such entrenchment is found in the corporate laws of most U.S. states which provide for *board* as well as shareholder approval to change the core constitutional document.[166] Since a determined shareholder body can *eventually* gain control over the board, albeit at significant cost and necessitating considerable patience, such board-centered entrenchment is not irreversible. However, the implicit cost for shareholders of reversing course can act as a powerful bonding mechanism, as it ensures that the firm's commitment to its purpose will only be reneged on once its costs for shareholders become significant.

III. The Case Against Adaptive Legal Ecologies

A. Theories of Accountability and Authority

The idea that corporate law should facilitate, where required, the creation of adapted purposive legal ecologies which provide the board and managers with a zone of insulation from shareholders is clearly at odds with dominant political narratives, as well as with a substantial body of academic theory, which both emphasize the increasing importance of holding the board and managers accountable to shareholders and the centrality to such accountability of strong shareholder rights and of shareholders who are willing to exercise such rights. A "zone of insulation" through a less optimistic lens could be presented as "the zone of the unaccountable" or the "zone of managerial abuse." Lucian Bebchuk and Roberto Tallarita, for instance, have recently argued that existing managerial incentive systems render a deprioritization of shareholder interests unlikely, irrespective of a corporation's stated purpose, and highlight both the practical difficulties of redesigning these incentives as well as the perils of reduced managerial accountability.[167]

The concern that the board and managers are unlikely to be held to account by apathetic and inattentive shareholders has a long heritage in corporate law. U.K. company law has often responded to this narrative by imposing mandatory restrictions on governance flexibility.

[166] *See, e.g.*, DEL. CODE ANN. tit. 8, § 242(b).

[167] *See* Bebchuk and Tallarita, *supra* note 2. See also the accompanying empirical work, Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *For Whom Corporate Leaders Bargain*, 93 Southern Cal. L. Rev. (forthcoming 2021), finding that managers did not use discretion afforded to them by US constituency statutes to negotiate for non-shareholder constituencies. *See also* Rock, *supra* note **Error! Bookmark not defined.**, 394.

Indeed, the history of U.K. company law in the twentieth century can largely be told through this lens, including, *inter alia*, the Companies Act 1929, rendering liability waivers for directors' breach of duty void; the Companies Act 1947, providing for the mandatory removal right discussed above; and the Companies Act 1980, requiring mandatory shareholder approval for self-dealing transactions. More recently we have seen this trajectory in the United Kingdom most clearly in the context of executive pay where the state required first an advisory shareholder vote on remuneration[168] and, as of 2013, both advisory and mandatory votes.[169] More recent regulatory initiatives have also focused on enabling shareholder engagement with management. We have seen in this regard the introduction of the Financial Reporting Council's Stewardship Code for institutional investors and the Investors Forum,[170] both of which are organized around the idea that the remedy for governance and managerial failings is to enable and cajole shareholders to behave as real owners: to make the board and management aware of their presence and to deploy effectively the rights which law and regulation provides them with. Here then is a deep contradiction contained within the idea that the board establish the company's purpose and seek to ensure that firm culture embeds and embraces that purpose. Such an idea portends, indeed requires, flexible governance arrangements that in some instances (not all, depending on the nature of the company) will tack against these longstanding and dominant ideas both about accountability and what matters in corporate governance.

The purposive ideas about corporate law and governance also face serious academic headwinds. Corporate law and financial theory over the past thirty to forty years has, in different guises, focused on the problem of managerial agency costs: the costs incurred by the company when managers act in their own, not the company's, interests. The discipline has been largely accountability driven, with a strong focus on the legal tools and strategies available to contain agency costs.[171] Scholarship that has focused on the accountability and discipline of boards has, however, always been tempered with multiple countervailing theories, mostly from U.S. and continental European commentators, which focus on the benefits arising from corporate legal arrangements that enhance board authority and limit shareholder rights, particularly the importance of board authority for both a long-term investment horizon and enabling boards and management to balance constituency interests, thereby incentivizing firm-specific human capital investments and the productivity benefits they generate. These theories closely support and overlap with the ideas about purposive governance set forth in this Article. There are several different—both pro-shareholder and pro-stakeholder—instantiations of this theory. For example, it comes in the guise of Merrick

---

[168] *See* Companies Act 2006, c. 46, § 439(5).

[169] *See id.* § 439A.

[170] *See generally UK Stewardship Code*, FIN. REPORTING COUNCIL, www.frc.org.uk/investors/uk-stewardship-code (last visited Aug. 30, 2019); *About Investor Forum*, INVESTOR F., www.investorforum.org.uk/about/ (last visited Aug. 30, 2019).

[171] *See* JOHN ARMOUR ET AL., THE ANATOMY OF CORPORATE LAW (3d ed. 2016).

Dodd's theory of trusteeship,[172] Stephen Bainbridge's lens of director primacy,[173] Margaret Blair and Lynn Stout's team production theory,[174] Martin Lipton's "for sale" sign,[175] or William Bratton and Michael Wachter's "case against shareholder empowerment."[176]

This rich and theoretically innovative conversation which traverses the U.S. academy and legal practice, contrasts starkly with the limited parameters of the U.K.'s policy and regulatory debate in this regard; a U.K. debate that has largely remained firmly in the gravitational orbit of the accountability lens and the idea that strong shareholder rights provide for optimal governance arrangements. A U.K. position that may be explained by, *inter alia*, different academic cultures, a longstanding (if now waning) sense of British corporate regulatory exceptionalism, but also, perhaps most importantly, by the fact that, in contrast to the United States—where the optionality contained within late-twentieth-century corporate law provided the foundations for the debate—in the United Kingdom the legal position during this period was fixed and inflexible. However, although this U.S. debate provides us with theoretically informed conflicting camps, it has provided no resolution as to which camp we should join. Disagreements at the level of theory can only be settled by reliable empirical evidence, and it is to this evidence that we now turn.

B. Corporate Law's Empirical Turn

1. Whose Value?

At the end of the last millennium scholarship turned to empirical methods to provide a clearer answer to the question: What is the optimal form of corporate governance? But before we evaluate this evidence, it is of importance to note that the idea of optimal governance arrangements in this empirical literature is measured by the financial value of the corporation and by shareholder wealth. That is, the optimality or suboptimality of governance arrangements is understood to be a function of the wealth generation effects of such arrangements as measured by share price returns over variable time intervals, accounting returns, or Tobin's Qs.[177] These measures necessarily, therefore, do not capture some components of the social welfare effects that some purposeful companies *may* generate. Accordingly, to the extent that a particular legal and regulatory ecology facilitates

---

[172] E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1931).

[173] Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006).

[174] Lynn A. Stout & Margaret M. Blair, *Team Production in Business Organizations: An Introduction*, 24 J. CORP. L. 743 (1999).

[175] Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. CHI. L. REV. 1037 (2002); Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979).

[176] William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653 (2010).

[177] Tobin's Qs are the ratio of a company's market value to book value.

the development of a purposeful company, financial measures focusing on shareholder welfare do not necessarily capture all the welfare effects of such corporate legal rules.

For employees, these nonfinancial welfare effects *could* include, *inter alia*, an enhanced sense of personal purpose and direction generated by feeling connected to and being part of a corporate mission-purpose—at least if, as we think is likely, such benefits will not in practice be fully reflected in a firm's labor costs. If a person's sense of purpose "limits chaos and makes intelligible sense"[178] of our lives, and is a core component of a person's psychological well-being,[179] then even a small corporate contribution to that personal purpose provides subjects with a more meaningful life. This contribution may have multiple psychological, corporate, and societal spill overs from an increased probability of happier, less resentful individuals, to the enhanced legitimacy of both corporate life and capitalism. Psychological research supports the view that employee-regarding corporations generate positive psychological benefits for their employees. Susana Leal, Arménio Rego, and Miguel Cunha, for example, show that employee perceptions of corporate social responsibility are positively correlated with "psychological capital measures" which aggregate measures of employee self-efficacy, optimism, resilience, and hope.[180]

It follows that legal ecologies that support employee-regarding purposeful companies may have positive psychological effects that could spill over into that employee/person's personal, corporate, and political lives. The firm-specific value effects can plausibly be captured through value measures as well as proxies for firm productivity and innovation.[181] But what is the welfare effect of more fulfilled, happier, confident, less resentful citizens? What is the societal value of purposive psychological spillovers on the nature and quality of political voting decisions that may impact on such purposeful corporate citizens' lives? Measuring the relation of such effects to micro-corporate rules with any confidence will likely remain firmly outside the reach of empirical social science. But our inability to measure such effects reliably *does not* mean that we should not have regard to such possible effects when making an evidence-based judgment about the optimal nature and form of law and governance to support purposeful companies.

---

[178] JORDAN PETERSON, TWELVE RULES FOR LIFE: AN ANTIDOTE TO CHAOS (2017).

[179] See Carol Ryff's work on psychological well-being providing a six component model of psychological well-being, one component of which is "the belief that one's life is purposeful and meaningful (Purpose in life)." See Carol Ryff & Corey Lee M. Keys, *The Structure of Psychological Well-Being Revisited*, 69 J. PERSONALITY & SOC. PSYCH. 719, 720 (1995) (also observing that "comprehensive accounts of psychological well-being need also to probe people's sense of whether their lives have purpose", *id.* at 725); Carol Ryff, *Psychological Well-Being in Adult Life*, 4 CURRENT DIRECTIONS PSYCH. SCI. 95 (1995).

[180] Susana Leal et al., *How Employees' Perceptions of Corporate Social Responsibility Make Them Happier and Psychologically Stronger*, 8 OIDA INT'L J. SUSTAINABLE DEV., no. 9, 2015, at 113, 114.

[181] *See* Gartenberg et al., *supra* note 53.

2. Removal Rights and Staggered Boards

A comprehensive assessment and summary of all empirical literature on the relationship between shareholder rights and shareholder value is beyond the scope of this Article. Here we focus on the most important aspects of this literature, namely its consideration of the value effects of director tenure and removal rights and the effect of takeover defenses. A fuller consideration of this literature would also consider the value effects of control enhancing structures, in particular dual class shares with variable voting rights.[182]

A significant body of literature considers the short- and long-term wealth effects in U.S. companies of having or not having a staggered board. In much of the literature the presence or absence of a staggered board is a standalone factor in the empirical models, but sometimes an index of shareholder rights and governance provisions which include, as one component of such index, the presence or absence of a staggered board is used to measure corporate governance arrangements. The most developed, and widely used, of such indices are the G-Index, developed by Gompers, Ishii and Metric,[183] and the Entrenchment Index (E-Index) developed by Lucian Bebchuk, Alma Cohen, and Allen Ferrell.[184] Even leaving the obvious endogeneity problem aside, the results of these empirical investigations are mixed. Although an increasingly close call, the weight by number of such papers on balance supports the view that staggered boards destroy value; although, again on balance, there is an increasing weight of support in favor of legal insulation for innovative, early stage publicly traded companies.

Consider in this regard work by Bebchuk and Cohen in 2005,[185] Olubunmi Falaye in 2007,[186] and Martijn Cremers and Allen Ferrell in 2014,[187] which all find that companies with staggered boards had lower valuations as measured by Tobin Qs. Cremers and Ferrell's work, for example, covers the period between 1985 and 2006, and finds an 8.2% lower

---

[182] However, note that that the literature on multiple voting rights provides no clear instruction on whether multiple voting rights are value accretive or destructive. See Renée Adams and Daniel Ferreira's review of the empirical literature, the balance of findings and the empirical problems associated with the findings in *Report on the Proportionality Principle in the European Union*: INST. SHAREHOLDERS SERVS., WITH SHERMAN & STERLING LLP & EUR. CORP. GOVERNANCE INST., REPORT ON THE PROPORTIONALITY PRINCIPLE IN THE EUROPEAN UNION 12–13 (2007). For a more recent consideration of the valuation effects of dual class shares, see Paul A. Gomper et al., *Extreme Governance: An Analysis of Dual-Class Companies in the United States*, 23 REV. FIN. STUD. 1051 (2010) (showing that firm value decreases are correlated with an increase in insider voting rights and Cremers et al. which find a valuation premium for dual class shares at the IPO stage which dissipates during the life cycle of the firm: Martijn Cremers et al., *The Life Cycle of Dual Class Firms* (EGCI Finance Working Paper No. 550/2018, 2018), https://ssrn.com/abstract=3062895).

[183] Paul A. Gompers et al., *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107 (2003).

[184] Lucian A. Bebchuk et al., *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783 (2008).

[185] Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409 (2005).

[186] Olubunmi Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, 83 J. FIN. ECON. 501 (2007).

[187] Martijn Cremers & Allen Ferrell, *Thirty Years of Shareholder Rights and Firm Value*, 69 J. FIN. 1167 (2014).

valuation for companies with staggered boards. A significant body of scholarship using governance indices also reaches similar conclusions as to the value effects of staggered boards.[188] Gompers and co-authors, using the G-Index in which the presence or absence of a staggered board is one of twenty-four coded shareholder rights, found that "an investment strategy that bought shares in the lowest decile of the index (strongest shareholder rights) and sold the firm in the highest decile of the index (weakest shareholder rights) would have earned abnormal returns of 8.5% per year during the sample period."[189] Bebchuk and co-authors' Entrenchment Index has a more limited set of provisions which includes the staggered board as one of only six components, an index developed by analyzing which governance provisions matter to institutional shareholders identified by looking at their voting patterns on non-binding/precatory resolutions. Applying this E-Index, they find that more entrenched boards (weaker shareholder rights) are "associated with economically significant reductions in firm valuation as well as large negative abnormal returns."[190] Other work, instead of focusing on measures of long-term value creation, uses event study methodology to measure the market short term (announcement) reaction to an event that affects the power of staggered boards. Alma Cohen and Charles Wang, for example,[191] look at the market reaction to two Delaware judgments—the first of which undermined the power of staggered boards and the second of which overruled the first judgment. They find announcement two-day returns consistent with the view that the market takes a negative view of the value effects of staggered boards. Although this evidence only goes to the views of the market a short time after the event and not to the actual longer term value effects, it should not be dismissed lightly. If the event study effectively captures the markets' views of this event, it represents the aggregate expectation of multiple sophisticated and informed market players, and one should not invoke mispricing and inefficient markets without supporting evidence. In light of the above evidence, a literature survey article in 2010 concluded that "all in all, it appears that firms with staggered boards do worse than firms with annual board elections."[192]

A set of recent papers, however, challenges this view of the value effects of staggered boards and weaker shareholder rights. William Johnson, Jonathan Karpoff, and Sangho Yi, in a 2015 article,[193] using the G-Index and the E-Indices, found that at IPO insulation mechanisms

---

[188] *Id.*.

[189] Gompers, *supra* n 183, 107.

[190] Measured by Tobin Qs; see Bebchuk, *supra* n 184, 783.

[191] Alma Cohen & Charles C.Y. Wang, *How Do Staggered Boards Effect Firm Value? Evidence from a Natural Experiment*, 110 J. FIN. ECON. 627 (2013).

[192] Renée B. Adams et al., *The Role of the Board of Directors in Corporate Governance: A Conceptual Framework and Survey*, 48 J. ECON. LITERATURE 58, 83 (2010).

[193] William C. Johnson et al., *The Bonding Hypothesis of Takeover Defences: Evidence from IPO Firms*, 117 J. FIN. ECON. 307 (2015). Note the paper's title uses the term "takeover defences" but focuses on shareholder rights indices and staggered boards as independent variables.

covered by these indices are, *inter alia*, positively correlated with IPO firm value[194] when the company has large customers and dependent suppliers and that the longevity of the firm's relationship with major customers is positively correlated with such insulation mechanisms. A finding that both supports the view that insulation can facilitate long term bonding with stakeholders and offers an explanation for the PE IPO governance evidence considered in Part IV above. However, in a later, as yet unpublished paper, while confirming these findings they also find, using the staggered board and the G- and E-Indices as independent variables, that defenses are sticky (with 90% of firms retaining insulating governance arrangements),[195] and as the firms age, and become less dependent on large customers and suppliers, the value effects turn negative.[196] In a 2018 paper, Martijn Cremers, Lubomir Litov and Simone Sepe, using a sample period from 1978–2015, find "no evidence that staggered boards have a strong or persistently negative association with firm value."[197] Interestingly, and of potential relevance for claims made about the effects of purposive bonding, they also find that in firms where stakeholder investments are important[198] and in firms which require long-term investments that are difficult to value, such as innovative and intangibles-focused firms, staggered boards are positively correlated with value. They observe that the findings suggest that it is "difficult to draw any one-size-fits-all inference about the relation between staggered boards and firm value."[199] Supporting these findings on the relationship between innovation and insulation, in a 2018 paper, Thomas Chemmanur and Xuan Tian find that insulation as measured by the G-Index is positively correlated with innovation as measured by patent citations.[200] And in a more recent working paper, using a natural experiment based upon the mandatory imposition of a staggered board on all Massachusetts companies in 1990, Robert Daines, Shelley Li, and Charles Wang find evidence to support the hypothesis that staggered boards benefit early-life cycle firms. They observe that "[a]t such firms, staggered boards encourage valuable investments and innovation and reduce earnings management."[201] They note, however, that their findings do not suggest that staggered boards benefit all firms.

---

[194] Measured by the ratio of firm value (market capitalization plus debt value) to EBITDA (i.e. Earnings before interest, taxes, depreciation and amortization); value divided by sales; and earnings per share divided by share price (*id.* at 320).

[195] From a sample of 2283 companies that went public between 1997 and 2011.

[196] William C. Johnson et al., *The Lifecycle Effects of Firm Takeover Defences*, REV. FIN. STUD. (forthcoming 2021), https://ssrn.com/abstract=2808208.

[197] K.J. Martijn Cremers et al., *Staggered Boards and Long-Term Value Revisited*, 126 J. FIN. ECON. 422, 423 (2017).

[198] Stakeholder investments for Cremers et al. are: customers, as measured by the existence of large customers; strategic partners, as measured by long term business relations; and labor, as measured by labor productivity.

[199] *Id.* at 423.

[200] Thomas J. Chemmanur & Xuan Tian, *Do Antitakeover Provisions Spur Corporate Innovation? A Regression Discontinuity Analysis*, 53 J. FIN. & QUANTITATIVE ANALYSIS 1163 (2018).

[201] Robert Daines et al., *Can Staggered Boards Improve Value? Evidence from the Massachusetts Natural Experiment* 31 (Harvard Business School Working Paper No. 16-105, 2018).

3. Takeover Defenses

If we turn to the value effects of takeovers, we find a body of papers from the past three decades which again on balance *just about* suggest that there are negative value effects of takeover insulation. Early work on the value implications of defenses focused on event studies assessing the market's reaction to pill adoption.[202] A body of evidence developed that yielded no clear evidence about whether the market viewed pill adoptions as either value positive or negative, although, as John Coates has observed, some of these foundational studies were regularly cited as proof "that defences reduce shareholder wealth." Summarizing these studies as of 2000, Coates concluded that "[i]f results from full samples in all studies using two- or three-day-event intervals are pooled, the weighted average price reaction is +0.02%. In other words, the net price impact of pill adoptions has been positive, albeit close to zero."[203]

Another body of work focused on the effects of "shark repellents" contained in companies' constitutional documents or the largely equivalent mechanisms provided in the anti-takeover defenses provided by corporate statutes. These repellents included, for example, fair price provisions, which structure takeover pricing, or business combination provisions, which impose restrictions on the use of the target assets for a period after the completion of a hostile deal. Event studies on shark repellent defenses are similarly inconclusive. Coates's summary of the several studies in the 1980s and 1990s concludes that "event studies of shark repellents do not support strong policy positions one way or the other."[204] More recent work looks to actual firm effects rather than aggregate market opinion revealed by event studies. A 2018 working paper by Cremers et al. finds that in U.S. states that adopted poison pill validation statutes—which addressed uncertainty about the validity of pills in light of the ostensibly discriminatory effect of flip-in pills—there is a positive correlation with firm-value as measured by Tobin Qs, particularly in relation to innovative firms and firms with strong stakeholder relationships (large customers, business partners, and labor).[205] On the other hand, Marianne Bertrand and Sendhil Mullanathan in a 2003 paper find that adoption of anti-takeover statutes results in additional insulation which is used to pay workers more but

---

[202] See the foundational study by Gregg Jarrell & Michael Ryngaert, *The Effects of Poison Pills on the Wealth of Target Shareholders*, 16 BUS. ASS'N PAMPHLETS (1986); Gregg A. Jarrell & Annette B. Poulsen, *Shark Repellents and Poison Pills: Stockholder Protection from the Good Guys or the Bad Guys*, 4 MIDLAND CORP. FIN. 39 (1986); Robert Comment & G. William Schwert, *Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Anti-Takeover Measures*, 3 J. FIN. ECON. 18 (1995); Sudip Datta & Mai Iskandar Datta, *Takeover Defences and Wealth Effects of Security Holders: The Case of Poison Pill Adoptions*, 20 J. BANKING & FIN. 1231 (1996).

[203] John C. Coates, *Takeover Defences in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV. 273, 283 (2000) (citation omitted).

[204] *Id.* at 319.

[205] Martijn Cremers et al., *Shadow Pills and Long Term Value* (2018), https://ssrn.com/abstract=3074658. *See also* Bill B. Francis et al., *The Effect of State Antitakeover Laws on the Firm's Bondholders*, 96 J. FIN. ECON. 127 (2010) (supporting the bonding hypothesis by finding a correlation between the adoption of anti-takeover statutes and reduced bond yields, concluding that the insulation provided by the defenses reduces the agency cost of debt).

does not result in increased productivity or operating efficiency; that is, it "does not pay for itself."[206] And Julian Atanassov, in a 2013 article, finds that firms incorporated in states that adopt anti-takeover statutes experience a decline in their innovative capability as measured by the number of patent filings and patent citations.[207] These results are, however, in part contradicted by the bonding-IPO evidence provided by Johnson et al., and by Chemmanur and Tian, which is detailed above, which finds positive-value bonding and innovation evidence associated with the G-Index, which, along with staggered boards, includes in the index, inter alia, six takeover laws.[208]

4. Methodological Flaws

We cannot provide a definitive account of the empirical literature relating to the shareholder wealth effects of legal insulation mechanisms. However, what is clear from the above survey is that the empirical evidence, taken on its own methodological terms, does not provide us with evidence to conclude confidently that legal ecologies which provide or do not provide for insulation are optimal—particularly if one seeks an answer with validity for all types of firms. However, the clarity provided by the empirical evidence is much more problematic than the near equivalence in number of papers pro and contra. The methodological problems afflicting papers *both* pro and contra are considerable, many of which have been acknowledged in the literature.

These methodological challenges include a range of technical problems and disputes relating to the nature of the data set and the empirical methods deployed. For example, Yakov Amihud and Stoyan Stoyanov argue in a recent paper that Cohen and Wangs's negative findings (on the market's reaction to the Delaware court cases that affected the insulation effect of a staggered board) disappear on excluding a few penny stocks;[209] a criticism which Cohen and Wang dispute.[210] The methodological challenges also include more elemental legal problems about the reliability of the proxies deployed for insulation. The G-Index, for example, contains twenty-four coded provisions and does not distinguish between the insulation effect of each of these provisions, which varies considerably. Similar coding scores for companies, therefore, may not accurately reflect the extent to which the boards of these companies are in fact insulated. Furthermore, several of the coded provisions in the G-Index appear to have no tenable relationship to insulation—for example, director indemnification

---

[206] Marianne Bertrand & Sendhil Mullainathan, *Enjoying the Quiet Life? Corporate Governance and Managerial Preferences*, 111 J. POL. ECON. 1043, 1072 (2003).

[207] Julian Atanassov, *Do Hostile Takeovers Stifle Innovation? Evidence From Antitakeover Legislation and Corporate Patenting*, 68 J. FIN. 1097 (2013).

[208] Including anti-green mail, business combination, control share price acquisition, fair price and other constituency, and redemption statutes.

[209] Yakov Amihud & Stoyan Stoyanov, *Do Staggered Boards Harm Shareholders*, 123 J. FIN. ECON. 432 (2017).

[210] Alma Cohen & Charles C.Y. Wang, *Staggered Board and Shareholder Value: A Reply to Amihud and Stoyanov* (Harvard Business School Working Paper No. 16-097, Feb. 2016), https://dash.harvard.edu/handle/1/25680333.

provisions or supermajority shareholder merger requirements[211]—or are invariably immaterial for insulation—for example, golden parachutes.[212] The E-Index, constructed by Bebchuk, Cohen, and Ferrell, was built to address such defects in the G-Index. The E-Index then is more tailored and precise from an insulation perspective, although it also suffers from these same flaws (although to a lesser extent).[213]

More problematically, a staggered board, which is often taken as a standalone proxy for insulation and which is included in the G- and E-Indices, is also an unreliable indicator of insulation. The presumption made in the literature is that a staggered board always provides directors with with-cause removal protection, thereby requiring active shareholders to wait for two annual general meetings before they can obtain control of the board. However, as Lucian Bebchuk, Guhan Subramanian, and John Coates showed in a 2002 article,[214] staggered boards may appear to provide insulation but be wholly ineffective in so doing. Staggered boards may not be an effective insulation device where, for example, the company provides for a staggered board with a without-cause removal right; or where a staggered board with a with-cause removal right may be packed[215] by shareholders acting independently. Daniel Ferriera and colleagues[216] have built on this insight by constructing a management insulation index (MI-Index) which captures whether boards of U.S. companies are really insulated. In their study of a panel of 317 banks they found that although 77% of banks had staggered boards, only 38% of banks with staggered boards were in fact insulated with the balance only "seemingly insulated."[217] Using this MI-Index data for these banks generated statistically and economically significant results in relation to proxies for bank failure, while the E-Index did not do so. This insight is of considerable importance to *both* the above pro- and contra-insulation studies as those studies are generating their results with a proxy for insulation that may be seriously flawed by including in its sample a significant number of seemingly insulated but in fact non-insulated companies. From an econometric perspective this identification error is not so problematic unless there is a reason why those seemingly insulated firms would systematically perform worse than the average firm in the

---

[211] Mergers cannot take place without board approval in any event, see, e.g., DEL. CODE ANN. tit. 8, § 251.

[212] Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1328, 1368 n.169 (2013).

[213] For example, it continues to include supermajority merger provisions: *see id.* at 1365.

[214] Lucian A. Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy*, 54 STAN. L. REV. 887 (2002).

[215] That is increased in size and new directors appointed to create a majority on the board supportive of the shareholders/bidders preferred position—see, e.g., the facts of *Blasius v. Atlas Industries*, 564 A.2d 651 (Del. Ch. 1988).

[216] *See* Ferreira et al., *supra* note 77.

[217] *Id.* at 14.

sample.[218] However, such plausible reasons exist: most importantly such mistaken insulation could proxy for incompetent management—as managers have failed to pay attention to complex governance arrangements required to perfect insulation and to discipline ineffective lawyers.[219]

When we turn to the takeover value evidence, the methodological flaws are more extensive and well documented in the legal literature.[220] Coates in 2000 demonstrated that the event study evidence on poison pill adoption was based on a legally flawed insulation premise, namely that the adoption of a pill was an insulation-relevant event. As every J.D. student of U.S. corporate law knows, a pill can be adopted by almost any company, at any time, provided its adoption and use is consistent with the directors' fiduciary duties.[221] Accordingly, nearly every company effectively has a poison pill, *whether they have formally adopted one or not*. Adoption, therefore, may contain signaling information about managers' expectations about a bid, but it tells us nothing about the value effects of adoption. Event study results built around adoption could not therefore tell us anything about the value effects of the pill *itself*. In relation to findings connected to the adoption of state anti-takeover statutes, U.S. corporate lawyers are adamant that these are highly problematic as they

[218] The relevant question is whether the (even occasional) misinterpretation of insulation arrangements only results in a less precise, noisier proxy for actual insulation, or whether there is a correlation between the likely misclassification on the one hand, and the relevant outcome on the other. In the former case, the misclassification only affects econometric *precision*, which may necessitate larger sample sizes (a surmountable problem), but does not invalidate the findings. In the latter case, the problem is more severe: the misclassified sub-sample can "taint" the combined sample. For example, we may be interested in the effect of reading books on exam performance in students, and may proxy for reading by looking at the time students spend in the library building. This is, of course, a noisy proxy—some students will read at home, and some students will chat with friends in the library; nevertheless, we could conclude that the correlation between spending time in the library and reading will enable us to draw inferences as to the effect of reading on performance. If, however, the only late-night bar in a university town (somewhat unreasonably) happens to also be located in the same building as the library, we no longer get a reliable estimate: there is now reason to believe that presence in the library by the "seemingly preparing" students does not just add average, less prepared students to our sub-sample or "readers." Instead, we will now have students who are systematically *less* hard-working than the average student in our sub-sample of students spending their nights in the library. Since the sign of the two behaviors (reading and drinking) on exam performance are (arguably) opposite, no reliable estimate can be derived if only using the lumped-together group of library-going students as comparator.

[219] Similarly, in recent work, Jens Frankenreiter, Cathy Hwang, Yaron Nili and Eric Talley have recently examined the accuracy of the G-Index by hand-coding the governance documents of S&P 1500 companies. They identify an error rate in excess of 80% and find that correcting these errors substantially weakens the link between "good" governance and firm performance—*See* Jens Frankenreiter, Cathy Hwang, Yaron Nili and Eric L.Talley, *Cleaning Corporate Governance* U. PA. L. REV.(forthcoming 2021).

[220] *See* Coates, *supra* note 203; Klausner, *supra* note 212; Emiliano M. Catan & Marcel Kahan, *The Law and Finance of Antitakeover Statutes*, 68 STAN. L. REV. 629 (2016).

[221] Unitrin Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995).

overstate the insulation effect of these statutes, especially after the late 1980s–1990s.[222] The reason for this is the insulation power of the poison pill, particularly when combined with a staggered board, renders trivial the defensive effect of state takeover statutes; that is, the pill crowds out any defensive impact of the statutes, in which case this empirical evidence must be measuring something else other than the insulation effect of the takeover statute. Similarly, in a 2016 paper, Emiliano Catan and Marcel Kahan demonstrate methodological flaws and misidentification problems in a number of frequently cited studies regarding the value effects of state antitakeover statutes, which from a legal perspective should not significantly alter a company's available responses to a hostile takeover bid.[223]

IV. Towards Neutrality in Corporate Law

A. The Logic of Legal and Regulatory Neutrality

What is clear from this assessment of the balance of evidence on removal rights and takeover defenses, and from the consideration of some of the literature's key methodological flaws (shared by both pro- and contra-insulation camps), is that from an empirical perspective nothing is, at present, clear. The state of empirical play does not settle the theoretical conflict. Any assertion that this literature provides clear support for a shareholder rights or board insulation position are likely, therefore, to reflect the prior value and ideological preferences of the person making such a claim; such assertions are unsupported leaps of theoretical and policy faith.

The question then becomes what to do when theory and empirical evidence do not offer a clear regulatory road map? Do we find ourselves frozen in the headlights of conflicting positions; unable to contemplate change; wedded to the status quo and taking refuge in a "if it ain't broke don't fix it" mantra. The submission of this Article is that such a response is illogical, because—given the nature of U.K. corporate law and practice today—it takes sides in a debate that offers no theoretical or empirical support for taking sides. Moreover, as we have argued above, structural factors also result in a situation where experimentation within the narrow field left open by U.K. corporate law is costly for companies, meaning that the lack of variation in governance arrangements within the United Kingdom should not be interpreted as meaning that there is no demand for exploring different concepts of corporate law and purpose. The logical, evidence-based, response is that our legal and regulatory position should track this lack of clear direction.

---

[222] Factors solidifying the defensive power of poison pills include the adoption of poison pill validation statutes (*see* Cremers et al., *supra* note 197) in several states (not including Delaware) and the pro-managerial position taken by the Delaware Supreme Court in *Paramount Communications v. Time Inc.*, 571 A.2d 1140 (Del. 1989).

[223] Catan & Kahan, *supra* note 211.

It seems probable that the theoretical and empirical uncertainty we find reflects the fact that different corporate legal ecologies are suitable for different companies; that one legal ecology never fits all and that, therefore, any binary attempt to empirically prove that one legal ecology is better than another is destined to fail.[224] Without clear and compelling evidence showing which types of companies a specific corporate legal ecology supports, and which it deters, prescribing any one single model is an unadvisable form of blindfolded economic policymaking. The real lesson of the rich and inconclusive theoretical and empirical investigation should thus be that corporate legal systems should enable optionality and that the pool of corporations subject to inflexible regimes is, in aggregate, likely to underperform. An openness to optionality is reflected in important recent academic and think-tank work. In this vein, Eilis Ferran has argued a "promising strategy is to recall the essentially facilitative character of company law: more choice in company law could make a valuable difference."[225] Also in this vein, *The Purposeful Company Project's Policy Report* argued recently that "unless there are compelling arguments to the contrary, regulation and law should be neutral in not biasing the ownership and governance of firms."[226]

That is, corporate law and regulation should take a neutral position in relation to the shareholder rights/board insulation debate, a neutral position that naturally maps onto the different needs of different companies, with different mission-purposes, in different industries, at different times in their, and their industries', life cycle. Such legal and regulatory neutrality should both offer rule optionality and be structured so as to avoid sticky defaults. The menu of options suggested in Part II of this Article is one way of providing such optionality.

Importantly, such optionality is not anathema to U.K. corporate law. On the contrary, such flexibility was, as Ferran alludes to, encoded within the DNA of U.K. company on the inception of incorporation by registration which provided—consistently with its partnership law precursors in deed of settlement companies—for the contractibility of corporate governance.[227] As we noted above, the legislature and the other regulators have over time removed this contractibility. A purposive menu of corporate law options would involve its modernized reinstatement.

B. Reconsidering the Case Against Optionality

This case for the reinstatement of optionality does, however, run up against one of the primary drivers of its twentieth-century removal. If we are to allow companies to fashion governance arrangements to suit their purposive needs, then we need to be confident that

---

[224] BIG INNOVATION CTR., THE PURPOSEFUL COMPANY INTERIM REPORT 53 (2016) (making a similar point about firm-based variation).

[225] Eilis Ferran, *Corporate Mobility and Company Law*, 79 MOD. L. REV. 813, 834 (2016).

[226] BIG INNOVATION CTR., THE PURPOSEFUL COMPANY POLICY REPORT 32 (2017). On regulatory neutrality, see also COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD 202–05 (2018).

[227] Ferran, *supra* note 216; KERSHAW, *supra* note 58, at 289–97.

any approved arrangements are selected with the intention of serving those purposes. Most important in this regard is that we need to be sure that shareholders who approve of the tailored governance arrangements understand and consent to those arrangements.

At the heart of the U.K.'s twentieth-century shift to mandatory rules is the idea that any such shareholder consent in a widely held company is unlikely to amount to informed and considered consent. If shareholders do not exercise control, then on the one side of the governance equation you have directors and managers who may be acting in their own interests when they propose governance changes, and on the other side, rationally apathetic and ineffectual, widely held shareholders (or their fund managers). Pursuant to this lens, this practical power dynamic allows directors and managers to craft governance arrangements that are in their own interests but not in the interests of the company and long-term wealth generation. This contracting failure is thought to justify state intervention to protect both shareholders and the public interest in the effective functioning of wealth generating corporations.[228]

Today, the control exercised by shareholders in widely held companies is attenuated, although for more complicated reasons than simply the dispersion of ownership and the costs of collective action. To understand contemporary shareholders' rational apathy we must look primarily to the incentives and practicalities associated with fund management.[229] Nevertheless, we need to be careful with the presumption that the nature of modern shareholder control, or the lack thereof, requires intervention in the form of mandatory rules which remove optionality. In modern markets, with highly structured information about companies and their governance, and widespread outsourcing of voting decisions to for-profit proxy advisors, shareholder rational apathy arguably creates stronger incentives for standardized, one-size-fits-all governance than it opens space for self-serving managerialism.

In considering the extent to which purposive governance arrangements could be adopted without informed and considered shareholder consent we need to distinguish between different investment entry points. Clearly, there is no concern about early-stage equity investment in private companies. High risk, venture, angel, or private equity investors are highly attentive to governance arrangements and capable, with their lawyers, of understanding and building governance structures that reflect the company's and their interests;[230] and equally they are capable of walking away from an investment if, in their view, the proposed governance structures are inapposite. There is, of course, variation in the quality of legal advice and variation in the governance-competence of market actors; but nevertheless there is no plausible reason for thinking that the state can do a better of job of identifying apposite governance arrangements for such companies or, as the consideration

[228] *See* COMMITTEE ON COMPANY LAW AMENDMENT, REPORT, 1945, Cm. 6659, at 130.

[229] *See* Ronald Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013); KERSHAW, *supra* note 82.

[230] *See* SIMON WITNEY, RESPONSIBLE INVESTORS? CORPORATE GOVERNANCE PRACTICES IN THE PRIVATE EQUITY SECTOR (2020) (documenting governance contracting in U.K. private equity companies).

of the empirical evidence considered above shows, any basis for being confident that imposing particular governance arrangements on all companies enhances social welfare.

When we move from the initial stages of investment to the sale of shares to public investors in an IPO, the question again becomes whether such shareholders are capable of assessing (and whether they do assess) the nature of the selected corporate governance arrangements and any price effect associated with such arrangements. And again, there appears to be no plausible ground for removing optionality in these circumstances. The governance arrangements are publicly available, as is a significant body of literature about the purported pros and cons of such arrangements. Moreover, it appears from the law firm studies outlined in Part III above, that when investors buy shares in the IPOs of private equity portfolio companies that they are fully aware of the governance arrangements and, as we noted above, anecdotal evidence suggests that they do not impose a discount when the governance arrangements provide for weak shareholder rights.[231]

The situation becomes more complicated, however, with regard to the established publicly traded company. There are two concerns here. First, that the shareholders' rational apathy in such companies could be exploited by directors and managers to change the governance arrangements of the company in a way that furthers the directors' and managers', not the company's, interests. Second, that although shareholders may have given informed and considered consent to governance arrangements in the early stages of the company's life, as the company matures such governance arrangements may become inapposite for the evolving company and shareholder apathy makes changing those arrangements very difficult. As a result, mature purposive companies could end up with inapposite, value-destroying legacy arrangements.

The first concern is at the center of the critique of the separation of ownership and control and the effects of shareholder apathy. If insulation optionality in a particular company operates in the managers' personal interests, but not in the company's, yet shareholder apathy means that shareholders rubber stamp managers' insulation preferences, then optionality may be exploited to the detriment of the shareholders. Today, however, this concern exists only in the historical imagination of corporate commentators and regulators. It is correct that modern shareholders acting through their fund managers have poor incentives to actively engage and monitor the company, but that does not mean that they have no opinion on appropriate governance arrangements or that they rubber stamp management proposals. On the contrary, as we have seen, it is clear that today fund managers and their proxy advisors have firmly held and largely inflexible, if sometimes uninformed,[232] views about optimal governance arrangements that make it very difficult in the United

[231] *See supra* text accompanying note 137.

[232] See, e.g., the Glass Lewis Voting Guidelines for the U.K.: GLASS LEWIS, GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE (2018), www.glasslewis.com/wp-content/uploads/2017/12/2018-Guidelines-UNITED-KINGDOM.pdf (recommending, until 2017, voting against shortened notice periods for general meetings, apparently based on an interpretation that these could constitute takeover defenses). *See further* Suren Gomtsian, *Shareholder Engagement by Large Institutional Investors*, 45 J. CORP. L. 686-87 (2020).

States, and would make it very difficult in the United Kingdom, to persuade such shareholders in an existing publicly traded company to deploy any available optionality to provide for insulating governance arrangements.

Indeed, approval for pro-insulation changes are today so difficult for existing U.S. publicly traded companies to obtain, they have long stopped asking for them.[233] Similarly, there are multiple examples of institutional shareholders acting to require or pressurize (through non-binding resolutions) boards of U.S. companies to adopt what is viewed as best practice governance, including the de-staggering of boards,[234] the abolition of plurality voting,[235] and the removal of poison pills.[236] Evidence from the United Kingdom about governance activism among inactive shareholders is more sparse as the mandatory structure of corporate law reduces the scope for this sort of activism. Nevertheless, we see such active engagement in relation to consensus best practice governance in the context of noncompliance with the U.K. Corporate Governance Code and irregular pay arrangements.[237] And, as noted above, this idea of enforced institutional governance normality is bolstered by the outsourcing of voting governance to experts such as ISS and Glass Lewis.[238] Given such constraining governance "normality," there is then no plausible concern that self-interested boards and managers could hoodwink inattentive shareholders into approving governance arrangements that they would not consciously consent to.

The second concern should be taken more seriously, although again it is overstated. Modern governance activism is a real and significant phenomenon. The declassification and plurality voting movements in the United States have had real successes in major companies. The anti-poison pill movement has also successfully forced companies to withdraw pills even though, in the absence of amendments to the core constitutional documents, such withdrawal makes no difference to the future availability of a pill. It appears, therefore, that

---

[233] *See* Michael Klausner, *Institutional Investors, Private Equity and Anti-takeover Protection at the IPO Stage*, 152 U. PA. L. REV. 755, 760 (2003).

[234] GLASS LEWIS, GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE 23 (2019) (observing in this regard: "[I]n 2014 shareholder proposals requesting that companies declassify their boards received average support of 84%, whereas in 1987 only 16.4% favoured declassification").

[235] *See, e.g.*, April Demboski & Dan McCrum, *Calpers Wins Apple Shareholder Vote*, FIN. TIMES (Feb. 23, 2011), https://www.ft.com/content/cc2fa2f8-3f88-11e0-a1ba-00144feabdc0 (last visited Nov. 7, 2021).

[236] *See* Marcel Kahan & Ed Rock, *How I Learned to Stop Worrying About the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 885–86 (2002).

[237] *See, e.g.*, Stefan Stern, *Why M&S Shareholders Should Think Before They Speak*, FIN. TIMES (Apr. 8, 2008), https://www.ft.com/content/689aaf38-04aa-11dd-a2f0-000077b07658 (last visited Nov. 7, 2021).

[238] Consider, for example, GLASS LEWIS, *supra* note 225, at 23 ("Glass Lewis favours the repeal of staggered boards and the annual election of directors. We believe staggered boards are less accountable to shareholders than boards that are elected annually. Furthermore, we feel the annual election of directors encourages board members to focus on shareholder interests.") See also the partial reading of the empirical evidence, citing only Bebchuk's work (*id.*).

in many companies the cost of midstream, shareholder-driven governance changes is not prohibitive. Nevertheless, although we see some such governance activism, the associated costs, if substantial, do create a real risk of legacy inapposite governance arrangements in mature purposive companies and thought needs to be given to addressing this problem.

The question then becomes what is the correct and proportionate response to that risk? Prohibiting optionality is disproportionate and prevents early years tailored governance arrangements. One option is to take a leaf out of the U.S. private equity governance playbook. Private equity IPOs typically involve a retained controlling PE investor position that is unwound over time. To reflect the governance implications of the gradual exit, and changing role, of the PE investor, governance arrangements are often contingent on PE ownership thresholds and disappear or "spring up"[239] when PE ownership falls below those thresholds. Generally applicable legal rules addressing legacy governance cannot be as finely calibrated and must, accordingly, deploy more rougher time-triggered adjustments than those provided by PE firms. Most obviously, governance provisions can also be combined with sunset dates, after which there is either reversion to a different set of arrangements or the shareholders are given an opportunity to reaffirm or reject the prevailing governance arrangements. Such sunset dates could be mandatory or, preferably, given the advantages of optionality and the lack of concern about shareholder consent at the IPO stage, would offer a menu of options—five, ten, fifteen years—and require the IPO-ing firm to justify the election in the prospectus. Of course, the potential reversion to an inapposite legal ecology threatens the effective establishment of purpose. Accordingly, longer sunsets, certainly beyond five years, would need to be available. As the flip side of this sunset optionality, companies should also be able to elect to entrench the governance arrangements—requiring board and special resolution shareholder approval for any amendment—during the selected timeframe.

V. Conclusion

The question of what should be a company's purpose has long been a staple part of our academic diet. But company purpose is a protean idea and during the history of corporate law it has had several incarnations. To a nineteenth century Anglo-American or Anglo-Commonwealth corporate lawyer, corporate purpose referred to the objects and capacity of the company; for a twentieth-century lawyer, and for many still today, a company's purpose referred to the ultimate beneficiaries of corporate activity: whose interests should be considered, and whose should take priority when corporate power is exercised. Indeed, the recent and controversial *Statement on the Purpose of a Corporation* by the U.S. Business Roundtable operates within this understanding of corporate purpose. But in the current managerial and business milieu, supported by think-tanks and nascent regulator buy-in, company purpose is taking on a new sense, a sense that we predict will become of increasing importance regardless of where the company is incorporated. In this contemporary sense, purpose is about what the company does, but it is an animated, inspirational sense of how

[239] *See supra* text accompanying notes 130–31.

what it does contributes to and potentially transforms the world in which live. It is the reason for a corporation's existence; why it matters for society that it exists. This is what we refer to in this Article as mission-purpose. In a purposeful company the traditional notion of company purpose as referring to the ultimate beneficiaries of corporate activity is a second-order consideration, the determination of which follows from the identified mission purpose. The configuration, balance and priority of such interests must be designed to support and activate purpose; mission-purpose comes first.

There is a risk of course that such mission purposes become an operationally irrelevant, superficial marketing device layered over the company's activities. We agree that mission-purpose could operate in this way if the company does not, or is unable to, prioritize such purpose. But when taken seriously as a way of structuring corporate decision making and the company's relationships with internal and external stakeholders, this modern notion of company purpose has transformational potential. It offers pathways to value generation not available to non-purposeful companies, pathways engendered by its bonding effects with customers, suppliers, and employees. And, depending on the nature of the mission-purpose, it typically offers these value pathways through a reconfiguration of the stakeholder interests to be furthered by the corporation, often involving a demotion of shareholder interests. In this way it has the potential to transform not only relationships with, but also the experience of, the corporation. In this way, such purposeful companies portend a more inclusive and interconnected form of capitalism.

Such purposeful companies will only flourish, however, where directors and managers commit to identifying, prioritizing, and operationalizing such a purpose and where the company operates in a purposeful ecology that insulates directors and managers from value pressures to compromise purpose. Any regulatory instruction to take purpose seriously will founder in the absence of such an ecology. As we have argued in this Article, where such an ecology does not benefit from purposeful controlling shareholders or founders who hold dual-class shares with weighted voting rights, corporate law must allow companies to construct a zone of insulation, a zone which allows managers and directors to resist value pressures in the short to immediate term in order to give them time to demonstrate the value benefits of being an effective purposeful company.

The United Kingdom is a first mover in the regulatory recognition of this idea of mission-purpose. As such it offers a platform to explore the preconditions to the realization of such purposeful companies and allows us to see that corporate law regimes that inflexibly promote shareholder's interests do not allow for such a zone of insulation. Moreover, the U.K. also shows us that although legal engineering can often offer purposeful alternatives which structure around ostensible mandatory inflexibility, it is unlikely to be deployed in practice. The poor incentives of market participants to invest resources in exploring purpose-specific governance arrangements combined with the fact that such structuring often "smells bad"—risking reputational risk for the company and its advisors—means that in practice such engineering will not be deployed.

To enable purposeful corporate law, corporate law must be "unbiased."[240] It must neither be mandatory nor create sticky defaults that preference one approach to corporate law, thereby supporting one idea of what corporate law and governance should look like. Paradoxically, the United Kingdom's call for boards to engage with mission purpose is found in a Code whose "comply or explain" approach has had global traction because it celebrates the idea that in governance one size does not fit all.[241] Yet, in relation to corporate law we have seen that the United Kingdom only offers one, inflexible size. Without creating more sizes and design flexibility the call to purpose will, therefore, fail in the United Kingdom and the social and economic potential of purposeful companies will remain dormant.

For comparative corporate law there is then some irony in the United Kingdom being the first mover in its regulatory recognition of mission-purpose. However, for comparative corporate lawyers it the best place for it to start, precisely because it foregrounds quite clearly that there is more to a purposeful company than simply having a mission purpose. This Article's inquiry into the purposeful limitations of U.K. corporate law, as compared to those of other jurisdictions, such as Germany and the United States, shows us that the fundamental value of corporate law is not that it provides managers with authority to generate value or that it holds managers to account for their actions, but rather that it allows market participants to build governance arrangements which support their objectives, and if those objectives are purposeful which support their purposeful objectives. Through the lens of mission-purpose, we see that there is no, nor is it in our interests for there to be any, end of corporate legal history that privileges a particular legal structure or corporate constituency. Corporate life is far too multifaceted, complex and innovative for such a constraining idea.

---

[240] *See* Enriques, Gilson & Pacces, *supra* note 162.

[241] *See* U.K. CORPORATE GOVERNANCE CODE, *supra* note 11.

about ECGI

The European Corporate Governance Institute has been established to improve *corporate governance through fostering independent scientific research and related activities.*

The ECGI will produce and disseminate high quality research while remaining close to the concerns and interests of corporate, financial and public policy makers. It will draw on the expertise of scholars from numerous countries and bring together a critical mass of expertise and interest to bear on this important subject.

The views expressed in this working paper are those of the authors, not those of the ECGI or its members.

Electronic Access to the Working Paper Series

The full set of ECGI working papers can be accessed through the Institute's Web-site (https://ecgi.global/content/working-papers) or SSRN:

Finance Paper Series	http://www.ssrn.com/link/ECGI-Fin.html
Law Paper Series	http://www.ssrn.com/link/ECGI-Law.html