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Shareholder Voice and Corporate Purpose: The Purposelessness of Mandatory Corporate Purpose Statements

Law Working Paper N° 666/2022

May 2023

Paul L. Davies

University of Oxford and ECGI

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Abstract

In his 2018 book, Prosperity, Professor Colin Mayer puts forward the proposition that a single, "embarrassingly simple" change to corporate law would transform "at a stroke" the conduct of large companies. After this reform, it is argued, boards would no longer follow the maxim of Milton Friedman that their goal is to maximise profits. Instead, once companies were required to include in their constitutions a commitment to a purpose which contained a social or communal goal, as well as a profit-making one, they would operate so as to find "profitable solutions to the problems of people and the planet." This paper argues that this result is unlikely to follow without either a substantial re-set of the shareholder-centric features of corporate law or a fundamental change in how investors conceive of their goals when acquiring equity positions in companies. The paper proceeds by analysing two hypothetical cases. In the first, shareholders are committed to the Friedmanite maxim. Here, it is argued that they will not adopt, or permit directors to adopt on their behalf, a purpose statement which is effectively constraining of the board's commitment to profit-making, even if the adoption of a purpose statement is mandatory. The initial stages of this analysis rely on the French experience with voluntary, but officially encouraged, corporate raison d'être statements; on shareholder reactions in the US to proposals that their companies should convert to Public Benefit Corporation status; and on the responses of UK companies to the mandatory requirement in the early companies legislation that companies state their commercial purposes and to the attachment of significant legal consequence to actions falling outside those stated purposes. The paper proceeds to consider ways of overcoming the problems revealed in this analysis. These are an extensive reduction of the shareholders' powers to hold the board accountable or the specification by a court or regulator of the purpose the company must adopt. It is concluded that neither strategy is likely to be feasible or desirable. The second hypothetical case is where investors no longer define their goals in purely financial terms but wish to achieve, through their investments, social or communal goals. It is concluded that, although ESG investing may have the potential to move companies in the direction desired by Prosperity, the current manifestations of ESG investing fall short of the transformative goal the book envisages. Moreover, it is unclear whether that potential will be realised in the future. If it is, it is argued that the current structure of corporate law will allow the investors' desires effectively to flow through into the board's management of the company, even in the absence of a mandatory purpose requirement in legislation. In short, the paper concludes that the mandatory purpose requirement will either be largely ineffective by itself (the first hypothetical case) or largely unnecessary (the second case).

Keywords: Corporate purposes, shareholder perceptions, directors' duties, ESG investing

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Shareholder Voice and Corporate Purpose:

The Purposelessness of Mandatory Corporate Purpose Statements

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Forthcoming in *Board-Shareholder Dialogue: Policy Debate, Legal Constraints and Best Practices* (Luca Enriques & Giovanni Strampelli eds., 2023, Cambridge University Press).

Abstract

In his 2018 book, *Prosperity*, Professor Colin Mayer puts forward the proposition that a single, "embarrassingly simple" change to corporate law would transform "at a stroke" the conduct of large companies. After this reform, it is argued, boards would no longer follow the maxim of Milton Friedman that their goal is to maximise profits. Instead, once companies were required to include in their constitutions a commitment to a purpose which contained a social or communal goal, as well as a profit-making one, they would operate so as to find "profitable solutions to the problems of people and the planet." This paper argues that this result is unlikely to follow without either a substantial re-set of the shareholder-centric features of corporate law or a fundamental change in how investors conceive of their goals when acquiring equity positions in companies.

The paper proceeds by analysing two hypothetical cases. In the first, shareholders are committed to the Friedmanite maxim. Here, it is argued that they will not adopt, or permit directors to adopt on their behalf, a purpose statement which is effectively constraining of the board's commitment to profit-making, even if the adoption of a purpose statement is mandatory. The initial stages of this analysis rely on the French experience with voluntary, but officially encouraged, corporate *raison d'être* statements; on shareholder reactions in the US to proposals that their companies should convert to Public Benefit Corporation status; and on the responses of UK companies to the mandatory requirement in the early companies legislation that companies state their commercial purposes and to the attachment of significant legal consequence to actions falling outside those stated purposes. The paper proceeds to consider ways of overcoming the problems revealed in this analysis. These are an extensive reduction of the shareholders' powers to hold the board accountable or the specification by a court or regulator of the purpose the company must adopt. It is concluded that neither strategy is likely to be feasible or desirable.

The second hypothetical case is where investors no longer define their goals in purely financial terms but wish to achieve, through their investments, social or communal goals. It is concluded that, although ESG investing may have the potential to move companies in the direction desired by *Prosperity*, the current manifestations of ESG investing fall short of the transformative goal the book envisages. Moreover, it is unclear whether that potential will be realised in the future. If it is, it is argued that the current structure of corporate law will allow the investors' desires effectively to flow through into the board's management of the company, even in the absence of a mandatory purpose requirement in legislation.

In short, the paper concludes that the mandatory purpose requirement will either be largely ineffective by itself (the first hypothetical case) or largely unnecessary (the second case).

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I. *Prosperity* and Corporate Purpose

In 2018 Colin Mayer, then Professor of Management Studies at the Saïd Business School of the University of Oxford, published a short book entitled *Prosperity*.[1] It has proved to be highly influential in business and broader policy circles and has been much debated around the world. It is a highly ambitious book, which seeks to reset the goals of the management of large companies in all jurisdictions.[2] Mayer was reacting in particular against a dictum of Milton Friedmann from 1970 that "there is one and only one social responsibility of business" which was "to increase [the company's] profits so long as it stays within the rules of the game."[3] There can be debate about what Friedman meant by "the rules of the game". In the sentence

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[1] OUP 2018.

[2] The book is not clear on the exact range of companies to which it applies, but its prescription is most apposite for companies with multiple shareholders whose shares are traded on public markets. These will be the focus of this piece.

[3] *Prosperity* p 2.

just quoted Friedman seems to have had in mind only competition and anti-fraud rules, but Mayer also quotes a sentence from elsewhere in the same article where Friedman refers more broadly to "the basic rules of the society, both those embodied in law and those embodied in ethical custom".[4] This latter formulation opens up a wider set of possible constraints on the profit-directed activities of companies.

However, as for Friedman, so for Mayer the precise definition of the rules of the game is not central to the argument. Mayer's point is that a blunt version of Friedman's argument – that the purpose of business is to maximise (via profits) shareholder value without more than a passing reference to the rules of the game – has "defined business practice and government policies around the world" and has been "the basis of business education that has moulded generations of business leaders. Indeed, virtually every MBA course begins from the premise that the purpose of business is to maximise shareholder value . . ."[5] Mayer is highly critical of this approach. In his view, it undermines the democratic legitimacy of private enterprise and deprives society of a powerful engine – the corporation - which has the potential to secure transformational benefits for society as a whole. Removing the Friedman doctrine from the place it currently occupies, in the view of *Prosperity*, is what one might term the negative goal of the book.

However, the ambition of *Prosperity* is demonstrated by its positive goal which is to substitute for profit maximisation the aim of "finding profitable solutions to the problems of people and the planet."[6] Indeed, the bulk of the book is devoted, correctly in my view, to the development of its positive goal. The Friedman doctrine is dealt with in some detail in the "Preface" of the book (really a substantial chapter) but thereafter comes in for only occasional bashing. It is clear that the negative goal of the book is achievable without resort to a mandatory purpose requirement. No corporate law system, to my knowledge, imposes a legal duty on the board to maximise the company's profits. If boards do view their role in the way *Prosperity* describes – and there is, of course, a good deal of evidence that they do – then that result flows from the pressures which shareholders and investors are able to apply to boards to behave in this way. There are various steps which could be taken to reduce those pressures, without removing

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[4] M Friedman, *A Friedman Doctrine – The Social Responsibility of Business is to Increase its Profits*, New York Times Magazine, Sept 13, 1970. Nor, where directors were free of legal and ethical constraints, can Friedman be said to have advocated profit maximisation over any particular time-frame, ie he was not a "short termist".

[5] *Prosperity* p 2. Cf Brian Cheffins, *Stop Blaming Milton Friedman!*, University of Cambridge, Legal Studies Research Paper 9/2020, who argues that the influence of Friedman's words was due, not to their novelty or innate persuasiveness, but to the adoption in the 1980s of high-powered executive pay arrangements in the US.

[6] Ibid p 12.

shareholders from their position of ultimate control of the company. Looking at the UK Professors Kershaw and Schuster have advocated such a suite of reforms, which, they suggest, would operate to create a more neutral stance on the part of the law towards shareholder rights, compared with its currently strongly pro-shareholder orientation, and which would create a "zone of insulation" for the board from immediate shareholder pressure.[7]

The main focus of *Prosperity* is, then, on securing its positive and ambitious goal, ie the adoption and implementation by companies of purposes which are both profitable and problem-solving for "people and planet". In Chapter 7 purposes, and their coterminous commitments, are categorised into three types: self-regarding (the company is a main beneficiary of the commitment), communal (where the commitment relates to those who deal with the company but the company does not capture all the benefits of its commitment) and social (where benefits are conferred on those not in a contractual or analogous relationship with the company).[8] It is the communal and social purposes which are at the centre of the mandatory purpose rule.

As a corporate lawyer, my interest is in the implications of this shift for the configuration of corporate law. General corporate law changes are dealt with in chapter 7, entitled simply "Law".[9] This contains a surprisingly light treatment of corporate law, surprising for one might think that a fundamental shift in the goals of large companies would require quite a lot in terms of supporting corporate law or corporate governance reform. After all, a large part of corporate law and governance is about setting the incentives of those who control the central management of large companies and holding them accountable (and sometimes also liable) for their actions.

The answer to this initial puzzle is to be found in the book's central proposition that "the transformation of the corporation can be translated from a visionary ideal to a practical reality through an embarrassingly simple policy."[10] This policy is that "corporate law should prioritize purpose." More precisely, "corporate law is the means to achieving purposeful company ends. . .It should require companies to articulate their purposes, incorporate them in their articles of association, and above all demonstrate how they credibly commit to the delivery of purpose."[11]

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[7] D Kershaw and E Schuster, "The Purposive Transformation of Company Law" (2021) 69 *American Journal of Comparative Law* 478. In the US this set of policies is most strongly associated in academia with the work of Professor Stephen Bainbridge. See, for example, his "Preserving Director Primacy by Managing Shareholder Interventions", in *Research Handbook on Shareholder Power*, 231 (edited by Jennifer G. Hill & Randall S. Thomas, 2015)

[8] *Prosperity* p 152.

[9] Of the other implementation chapters, chapters 9 and 10 deal with finance and investment and chapter 8 deals mainly with the regulation of banks and capital markets.

[10] *Prosperity* p 22.

[11] Ibid p 23.

Once adopted, the chapter suggests, the purpose would control the contours of the directors' fiduciary duties, which is correct, and the configuration of the governance structure of the company, which is a more debatable claim. Beyond this, the book envisages that investors, suppliers and corporate (but not other) clients of the company would be required to commit to the purpose the company had adopted. This radical extension of the impact of companies' articles of association outside the company itself is mentioned briefly at the beginning to book[12] but thereafter disappears from sight. The myriad legal questions it raises will be ignored by this article as well.

Prosperity was followed by a research/publicity/consultation exercise run by Colin Mayer under the auspices of the British Academy. Its conclusions were published as *Policy and Practice for Purposeful Business* in September 2021.[13] This added a little to the company law implications of the book, but not a great deal. In the space of a single page the BA Report put forward three different methods of implementing the purpose requirement, without elaborating on any of them and without prioritising or ranking them.[14] The one closest to the implementation mechanism identified in *Prosperity* was put as follows: "Changing Section 172 of the Companies Act to require companies to state their purpose in their articles of association." An illustration was given of this reform: "Legislation would require companies to adopt purposes that aim to benefit people and planet as well as shareholders, and report on their success in so doing." This proposal reflects the suggestion in *Prosperity* that "if companies do not address communal and social commitments adequately" then "there may be obligations to enhance human, intellectual, natural and social capital beyond the levels that organisation would voluntarily choose."[15] This proposal is technically inept, since section 172 of the British Companies Act 2006 concerns the duties of directors rather than the obligations of companies. This may appear to be a pedantic point, since the corporate obligation could clearly be placed elsewhere in the Act. However, the failure to observe the conceptual distinction between directors' duties and corporate obligations has consequences for other steps in the argument,

[12] Ibid p 23.
[13] British Academy, *Policy and Practice for Purposeful Business*, 2021
[14] At p 22.
[15] *Prosperity* pp 158-9. This positive obligation appears as a separate requirement from the negative obligation to refrain from actions which "could be detrimental to the maintenance of these forms of capital" (p 159). In more recent writing Mayer has place more emphasis of the refraining element of his proposals than on the positive obligations. See C Mayer, "*What is Wrong with Corporate Law? The Purpose of Law and the Law of Purpose*" ECGI Law Working Paper 649/2022. The implementation of the negative obligation raises different issues from that raised by the positive obligation, upon which this paper will concentrate.

as we see below.[16] A second proposal seemed explicitly to shift the duty to adopt the approved purpose away from the company and into the hands of the directors: “Company law emphasises duties of directors to *determine* and implement company purposes.” (emphasis added). Finally, there was a proposal for governmental nudging which appeared not to have a mandatory element.

This article focusses primarily, not on the implementation of the chosen purpose, but on the first step in the process, which is the adoption by the company of a transformative purpose, either by the shareholders by amendment of the company’s articles of association or by a directors’ resolution. It will be suggested that shareholders or directors accountable to shareholders will not adopt purposes of the type envisaged by *Prosperity* without either substantial changes in corporate law beyond the mere adoption of a requirement to state a corporate purpose or a substantial alteration in the goals of investors from those the Friedman doctrine assumes (or some combination of the two). The purpose statement requirement envisaged in Chapter 7 is not, it will be argued, “embarrassingly simple” but in fact complicated, perhaps even “embarrassingly” complicated if the goal is its quick implementation. A one-section addition to the Companies Act requiring companies to state a purpose of the required type in their articles of association will not by itself “transform business at a stroke.”[17] Instead, it will be argued, it will either be a failure or be rescued by some non-simple changes in corporate law or by a transformation of investors’ goals.

II. The Structure of this Paper

This thesis will be explored in this paper in relation to two contrasting shareholder worlds (which are taken in order to sharpen the analysis and not in order to argue that other worlds might not be conceivable or actually exist). In the first world, which was Friedman’s starting point, shareholders wish to “make as much money as possible while conforming to the basic rules of the society”. My argument here is that, in the current state of company law, any purpose statements which emerge in this world are not likely to constrain significantly the company’s established modes of conducting its profit-making business. Profit-oriented shareholders will not favour purposes which impede their Friedmanite goal, whether those purposes are to be

[16] See text attached to notes 108-112.

[17] *Prosperity* pp 22-23.

adopted by the shareholders (the normal rule for changes to the company's internal constitution) or by directors accountable to shareholders.

The paper then explores two possible ways of securing transformative corporate purpose commitments, even in the face of shareholder opposition. Neither, it will be argued, is likely to be achievable or even desirable. The first strategy is to place the purpose-adopting duty on the board but then to re-configure company law so as to shield the directors from any adverse reaction from the shareholders to the board's decision. It will be suggested that this strategy, if implemented, would be unlikely to be wholly effective in achieving its goals, would come with considerable costs and, in any case, would be unlikely to obtain legislative endorsement. The second is to provide a counterweight to shareholder reluctance to adopt sufficiently transforming purposes by requiring regulatory or court approval of the shareholders' choice of corporate purpose, ie corporate purpose ceases to be a matter of private ordering. This strategy blurs the boundary between the private and public sectors of the economy. It will be argued that this step would also be undesirable and, in any event, appears to run counter to the philosophy behind *Prosperity*.

The paper then moves to the second corporate world, which is one where Friedman's description of shareholders' goals is no longer accurate. In short I posit a change in the orientation of shareholders towards their investments. We are now in a world of ESG investing. Investors might change their views about what constitutes the best way of "making money" (a relatively limited shift) or, more boldly, they might come to share *Prosperity's* views about the importance of communal and social goals for their investment strategies. In this world, investors evaluate the company's achievements along communal and social dimensions as well as along the financial one. The management of the company is not to be condemned even if it could be shown that a greater financial return would have resulted over a certain time period through the abandonment of the other goals. In practice, it might be difficult to disentangle the separate operation of these two developments. Either way, what might emerge in such a situation are some significant departures from current corporate behaviour, because shareholders themselves supported the adoption of corporate purposes which were communal or social. The core question here is not, however, about the rise of ESG investing as a general phenomenon, but about its potential to push companies in the direction of adopting corporate purposes of the type envisaged in *Prosperity*. Unlike the approaches, discussed above, which are essentially top-down, rule-driven strategies, the third is a bottom-up investor-driven approach. In this world the driver of change is not the adoption of a broad corporate purpose,

but the transformation of investors' goals, which then expresses itself in the purpose statement or in some functionally equivalent way.

Of course, it does not follow that in this second world there is no space for corporate law to aid the social change, for example, by making more credible the commitments that companies under shareholder pressure choose to make[18] or for the state to nudge companies in the direction of broad corporate purposes, as in the latest version of the UK Corporate Governance Code. However, the implications for the reform of corporate law in this second world are very different from those in the first. Far aiming at shielding the board from the shareholders or subjecting their choices to review, the third strategy suggests that shareholder influence should be given full reign. Shareholders should be free to shape the broad contours of corporate strategy and behaviour and to remove directors who will not listen to shareholders' views on these matters.

Before proceeding with this analysis, it is worth making two additional points about *Prosperity*. The first is that it does not adopt the familiar shareholder/stakeholder frame of analysis. It is likely that stakeholders (however defined) would do better in the world envisaged by the book as compared with a Friedmanite world, but this result would appear to flow from the company's commitment to its stated purpose, not from a stakeholder framework of accountability. Both approaches are stated in *Prosperity* to be "misconceived". "There should be no presumption in company law of either shareholder primacy or stakeholder pluralism. One or other may sometimes be appropriate but never consistently so."[19] This underlines the novelty of the purpose proposal and it is a refreshing change.

Second, there is some ambiguity about how *Prosperity* conceives of the company and its governance. At places the book comes close to an entity theory of the company. Thus, one sentence reads: "The separation of the mind of the corporation from those of any individuals who comprise it confers an ability on it to demonstrate a quite different level of integrity from the individuals who comprise it."[20] However, this can be interpreted as meaning that, once a company has adopted a binding corporate purpose of the type the book envisages, those involved it will be required to implement that purpose, irrespective of their individual interests and goals – or else cease their association with it. In fact, the dominant conception of the

[18] Colin Meyer's previous book, *Firm Commitment* (2013), is enlightening on this matter.
[19] *Prosperity* p 23. And see also Mayer, C. (2022), "Shareholderism Versus Stakeholderism–a Misconceived Contradiction" (2022) 106 *Cornell Law Review* 1859.
[20] Ibid p 14.

company which the book adopts appears to be a managerialist one. As it is put early in the book, the company "is a vehicle for committing to the fulfilment of its stated purposes and once freed from the shackles of particular interest groups, be they shareholders, employees or governments, the corporation is capable of delivering substantial benefits to its customers and communities."[21] The inclusion of employees among the groups from whose shackles the company must be freed would be surprising from a stakeholder advocate, whilst the omission of managers from the list of "particular interest groups" fits with the idea that the managers are somehow above the fray and are there disinterestedly to discharge the responsibility of implementing the purposes the company has adopted – or perhaps even to adopt it in the first place.

III. Purpose statements in a Friedmanite world

In this section I proceed on the basis that shareholders' goals are purely financial and that they regard purpose statements, at least of the communal or social types, as inimical to the maximisation of the financial return on their investments. Although profit is still an essential part of corporate purposes under the *Prosperity* proposals, it is no longer the sole goal of the company. Where the adoption of a purpose statement is contrary to the perceived financial interests of the shareholders, one would expect either the statement not to be adopted or to take a form which does not in fact significantly constrain the company's capacity for pursuing profits. Following the current fashion, one might characterise weak purpose statements as "purpose-washing".

The reasons for making this prediction are very straightforward. Given the posited goals of the shareholders, the analysis follows almost as a matter of definition where the purpose decision is in the hands of the shareholders, as in most jurisdictions it will be if the purpose is proposed to be embodied in the company's constitutional documents. Where the decision is in the hands of the board via a board resolution, then directors fearful of removal, whether by shareholder vote or a takeover, will be similarly unadventurous. It is useful to divide the analysis into two parts: first, where the adoption of purpose is formally voluntary for the company (even if subject to official encouragement) and where it is required by the law.

[21] Ibid p 4.

A. Voluntary adoption of purpose statements

In this sub-section I examine two pieces of evidence which support the proposition that, where purpose statements are not mandatory, they will either not emerge or will be formulated in a non-constraining way, even if companies are officially encouraged to adopt them. Those two pieces of evidence relate to practice in France and the United States, the French practice being particularly interesting. Since there is no reason to suppose that the shareholders in French and US companies are exclusively of the Friedmanite type, the conclusion I argue for would apply *a fortiori* in a Friedmanite world. It might be argued that this evidence is beside the point, since the proposal in *Prosperity* is that broad purposes should be mandatory, not voluntary. However, my argument is that the evidence of the antipathy of shareholders to constraining voluntary purpose statements and their accompanying commitments indicates that they would seek to minimise the impact of any mandatory obligation placed upon their company or its directors. Sub-section (B) gives an historical example of how easy such evasion will be, unless, to repeat the theme, the purpose requirement is accompanied by substantial additional changes in corporate law.

Under reforms of 2019 the French legislature created two optional ways for companies to commit to broad purpose objectives, one being stronger and one weaker than the other.[22] Under the stronger form a company may choose to become a *société à mission* (which I shall refer to as a "committed company").[23] To achieve this status, the company must incorporate in its statutes one or more social or environmental purposes. The statutes must contain a statement of the methods (including resources) to be used to attain the stated purposes. A "purpose committee" must be created, containing at least one employee, whose role is to monitor the implementation by the company of the stated purposes. This committee reports annually to the shareholders, at the same meeting as that to which the company's financial statement are presented. It has unconstrained access to the company's records and full investigatory powers to discharge its supervisory function. In addition, the committee's report must have attached to it an independent third-party certificate verifying the company's progress. Finally, the company's status as a committed company is published in a public register. Apart from its voluntary characteristic, this appears to be a scheme which fleshes out what *Prosperity* advocates.

[22] I am grateful to Alain Pietrancosta for discussion of aspects of these rules. The responsibility for what is said about them below is, of course, my own.
[23] Article L210-10 of the *Code Commercial*.

The weaker form of the purpose statement consists of the permission for companies to include in their statutes a statement of their *raison d'être*, consisting of a statement of the principles to which the company is committed and of its willingness to make expenditures to achieve these principles.[24] Quite apart from the absence of required internal and external monitoring mechanisms in the weaker mechanism, the types of principle the company must adopt in its *raison d'être* are not specified. Moreover, the better view is that inclusion requires directors only to take the principles into account; they are not obliged to prioritise them.[25] The *raison d'être* permission is, therefore, a significantly weaker approach to purpose statements than that which applies if the choice is made to become a committed company.

It is submitted that the evidence to date of the use of both mechanism by companies in the SBF Index – the 120 most actively traded companies listed in Paris – supports the view that shareholders in publicly traded companies regard these mechanisms with extreme caution.[26] As of October 2021 only one had chosen to become a committed company.[27] This was Danone, which adopted the status in 2020, having pursued since 2014 a social and environmental business model. However, in 2021 activist shareholders forced out the person who had been CEO during this period on the grounds that shareholder financial interests had suffered during his tenure.[28]

With official encouragement,[29] much greater use has been made of the weaker form of the purpose commitment, but nevertheless the data provide evidence of companies not wishing to bind themselves to anything significantly constraining. A majority of SBF companies (68 or 57%) had adopted a *raison d'être*, but only 14 (12%) had taken advantage of the option provided by the law to place the purpose statement in their statutes (and 5 of those 14 had placed the purpose statement in the preamble to the statutes rather than in their main body). The remaining 54 (or nearly 80% of the adopting companies) had placed the *raison d'être*

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[24] Art 1835 of the *Code Civil* (as amended). Since *raison d'être* appears in my English dictionary, I intend to leave that term as it is.

[25] A Pietrancosta, *Codification in Company Law of General CSR Requirements: Pioneering Recent French Reforms and EU Perspectives*, ECGI Law Working Paper No. 639/2022, para 43 (available at ssrn.com/abstract=4083398).

[26] The figures below are taken from Étude WEMEAN, *Raison d'être et société à mission : Où en est le SBF120 ?* (October 2021).

[27] Some further 5 large companies, not in the SBF 120 and some with strong state participation, have gone down the *société à mission* route, as have some 300 smaller companies, of which 70% have fewer than 50 employees (Pietrancosta, above n 25, para 61).

[28] "The fall from favour of Danone's purpose-driven chief", *Financial Times*, March 17, 2021. At the time of its adoption of committed status, this step was hailed as a toppling of the statue of Milton Friedman.

[29] For an account of the political steps leading up to this reform see A Pietrancosta, "Intérêt social et raison d'être" *Annales des Mines: Réalités industrielles*, 2019/4, p. 55.

outside the statutes. Arguably, this was something they were at liberty to do even without the legal reforms of 2019, though it seems overwhelmingly likely that these extra-statutory purpose statements were motived in fact by the governmental policy of facilitating statutory purpose statements. Not placing the commitment in the statutes means it is not formally binding on the company and its directors. Thus, the directors cannot be sued on the ground alone that they have fallen short of what the purpose statement requires.[30] Where the statement is in the preamble to the statutes, it operate as an interpretative aid in relation to what is said in the body of the statutes. Finally, 51 of the SBF (42.5%) had not adopted a *raison d'être*.

As important is the substantive content of the *raison d'être* statements actually adopted. Taking the ones embodied in the statutes, and which therefore had been approved by the shareholders, one can see that they in fact demonstrate little in the way of firm commitment to communal or social goals. Some are no more than short publicity glosses on the company's business model with no reference to specific communal or social policies.[31] Other statements do make some reference to such policies but only at such a high level of generality that departure from the policy would be capable of being demonstrated only in egregious cases.[32] The same analysis may be made about the non-statutory purpose declarations.[33] It is not clear what decision-

[30] See Pietrancosta, above n 25, para 59 for an analysis of the duties placed on both directors and the companies when the purpose statement is incorporated in the statutes. However, even a *raison d'être* statement placed outside the articles might have indirect legal implications: since it is a public statement, it could provide or support an action by investors against the company based on misstatement to the market.

[31] Orange: *Orange est l'acteur de confiance qui donne à chacune et à chacun les clés d'un monde numérique responsable.*

ADP (Aéroports de Paris) : *Accueillir les passagers, exploiter et imaginer des aéroports, de manière responsable et à travers le monde.*

Nexity : *La vie ensemble.*

Soitec : *Nous sommes le terreau innovant de technologies intelligentes et économes en énergie, qui transforment durablement nos vies quotidiennes*

[32] ENGIE (25% owned by the French state): *Agir pour accélérer la transition vers une économie neutre en carbone, par des solutions plus sobres en énergie et plus respectueuses de l'environnement. Cette raison d'être rassemble l'entreprise, ses salariés, ses clients et ses actionnaires et concilie performance économique et impact positif sur les personnes et la planète. L'action d'ENGIE s'apprécie dans sa globalité et dans la durée.*

Worldline : *Nous concevons et exploitons des services de paiement et de transactions numériques pour contribuer à une croissance économique durable, renforcer la confiance et la sécurité dans nos sociétés. Nous les rendons respectueux de l'environnement, accessibles au plus grand nombre, tout en accompagnant les transformations sociétales.*

EDF (then majority state-owned, now fully) : *Construire un avenir énergétique neutre en CO2 conciliant préservation de la planète, bien-être et développement grâce à l'électricité et à des solutions et services innovants.*

[33] The closest to a firm commitment that I found among these extra-statutory statements was part of a long declaration by Suez: *SUEZ s'investit pour la préservation et la restauration du capital naturel et ainsi l'avenir de la biodiversité sur mer comme sur terre. Partenaire engagé auprès des collectivités, des industriels et des citoyens, SUEZ mobilise les parties-prenantes pour réussir la transition environnementale, en développant des modèles d'économie circulaire et en innovant pour anticiper les exigences du futur. Fières de leurs métiers et fortes de leurs valeurs, les équipes de SUEZ ancrées sur tous les territoires façonnent un environnement durable,*

making mechanism within the company was used to adopt the extra-statutory purpose statements. Some may have had no shareholder input and have been the result of a board resolution. Their striking feature is that they are not more constraining in the round that statutory purpose statements.

It would be wrong to ignore the reputational risks created for companies by even general and non-binding purpose statements. Even if of little use in legal proceedings, civil society groups, employees and official bodies may be able to use them effectively to put pressure on companies over particular issues. However, it is suggested that none of the purpose statements put out by French companies is robust enough to carry by itself the weight of translating the *Propserity's* proposals "from a visionary ideal to a practical reality."

The second piece of evidence comes from the United States and relates to proposals that companies convert to, or adopt goals analogous to those of, a public benefit corporation (PBC). The PBC has some affinities with the French *société à mission*. It aims to balance shareholder and stakeholder interests, and the non-shareholder interests it proposes to promote must normally be stated in the company's certificate of incorporation. These could include communal and social goals of the type envisaged in *Prosperity*. The delivery of the non-shareholder benefits is subject to reporting to the shareholders' meeting and may be required to be accompanied by third-party certification.[34] Jill Fisch analysed shareholder proposals in the period 2019-2021 that companies convert to a PBC or take analogous steps. She found that none of the proposals secured the level of shareholder support necessary for adoption and indeed secured significantly less support than other types of shareholder proposal.[35] While Fisch sees these proposals as a potentially useful way of raising the purpose issue within companies, it is submitted that her data also indicate shareholder scepticism about robust forms of purpose adoption.

dès maintenant. Even without legislative encouragement, purpose statements are widely adopted by publicly traded-companies, but, not surprisingly, they too are more promotional than constraining. One author characterises the purpose statements of the DAX 30 companies in Germany as "increasingly crisp and catchy": H Fleischer, "Corporate Purpose: A Managerial Concept and its Implications for Company Law" (2021) 18 *European Company and Financial Law Review* 161, 170.

[34] See, for example, Delaware General Corporation Law, §§361-368.

[35] Jill Fisch, *Purpose Proposals*, ECGI Law Working Paper 638/2022, especially Section IV and Tables 1 and 2.

B. Mandatory purpose statements

The obvious way forward from this limited, but not encouraging, experience with voluntary purpose statements might seem to be to make them mandatory. Indeed, *Prosperity*[36] clearly contemplates that the purpose statement would be mandatory and so it is arguable that the above experience with voluntary purpose mechanisms does not undermine what the book envisages. However, merely to require a purpose statement, whilst leaving its formulation to the board or the shareholders, is not likely to produce different statements from the ones emerging under a formally voluntary regime. Indeed, the overall quality of the purpose statements is likely to decline. This is because companies which, under the voluntary regime, choose not to adopt a purpose statement are, presumably, those which attach the least value to such statements. If required to make a statement, those companies now unwillingly within the net can be expected to adopt the least constraining formula they can devise. As *Prosperity* itself admonishes us: "stop believing that [laws and regulations] can constrain anything or anyone who is given a sufficiently strong incentive to violate them."[37] In the case of a requirement merely to state a corporate purpose, it would not even be necessary to violate the law, simply to discharge the legal obligation in a particular way.

The ease of circumvention of required purpose statements whose formulation is left to the company is surely the lesson from the history of required purpose statements as they appeared in the early UK Companies Acts. These required limited companies to specify in their founding documents "the objects for which the proposed company is to be established".[38] Of course, the aim of the nineteenth century legislature was not the transformative goal envisaged by current advocates of purpose statements. On the contrary, fearing what this new-fangled, limited-liability company might get up to, the nineteenth century legislature wished to constrain its areas of activity by requiring it to specify in its "objects clause" the scope of its commercial or other business. Nevertheless, the technique was the same in both then and in the current proposals: the use of purpose clauses to shape the way in which the company conducts its business.

On the basis of this statutory provision, the courts built a fearsome set of restrictions, known as the *ultra vires* doctrine. Transactions outside the scope of the objects clause were of no legal effect (were void), while the directors' fiduciary duties required them to conduct the business

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[36] *Prosperity* p 23.
[37] Ibid p 9.
[38] This is the formula used in s 8 of the Companies Act 1862, but it was a routine part of statutory company law until the Act 1989.

of the company in accordance with its objects clause and directors were potentially liable to the company for the harm caused to it as a result of not so doing. No one within or dealing with the company liked the system, even if the legislature and the courts thought it performed a public purpose. Directors wished to be rid of risk of personal liability; third parties contracting with the company wished to be rid of the risk of an ineffective transaction – or the ex ante cost of employing lawyers to crawl over the company's constitutional documents; and even existing shareholders did not like it because it hindered the organic growth of the company.[39]

In this situation, companies set their lawyers to work on drafting a way out of the problems. Objects clauses became longer and longer as drafters tried to anticipate all the areas where the company might wish to operate in the future. Eventually, bold drafters began to add at the end of the list of objects sweeping up clauses such as the following: anything "incidental or conducive" to the achievement of the specified activities or even "any other trade or business whatever which in the opinion of the board of directors can be advantageously carried on by the company" in connection with the specified objects. When the courts accepted these formulations,[40] the ultra vires doctrine was effectively dead – except for the unprepared – though it took a couple more decades before the legislature removed from the Act the requirement to state objects and to override the *ultra vires* doctrine.[41]

What does this history tell us? First, as with the *raison d'être* statements, it shows that companies will use their lawyers' drafting skills to navigate around required statements which they regard as inconvenient, especially if significant sanctions are attached to non-compliance with the statement. *Prosperity* does not deal in any detail with the legal consequences of failure to abide by the purpose clause, though it is clear that significant consequences are envisaged (which may, however, stop short of transactional invalidity).[42] Second, it shows that, if the formulation of the purpose statement is left by the rules wholly to the company, the courts and regulators will be ill-equipped to respond effectively to limit the corporate drafters' efforts.

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[39] Initially, the objects clause could not be altered and so a new business outside the objects require a new company and a new capital; later the objects clause became alterable but only by supermajority vote of the shareholders.

[40] *Bell Houses Ltd v City Wall Properties Ltd* [1966] 2 QB 656 (Court of Appeal of England and Wales).

[41] For a brief history of the objects clause requirement and the *ultra vires* doctrine see *Gower's Principles of Modern Company Law* (6th ed, 1997; P L Davies ed.) pp 202-206.

[42] *Prosperity* floats two enforcement mechanisms (p 159). These would restrain the company from acting in breach of its purpose statement (ex ante injunctions) and require it to restore "detriments where damage has been done" (ex post damages). However, it is not clear whose "detriments" would be covered, who would be liable (only the company or company and directors and large shareholders?) or the range of parties who would be empowered to sue (all those who suffer a detriment?).

IV. Reviewing the company's choice of purpose

One possible reaction by the law-maker to the above analysis situation would be to subject the company's decision to a review, either by a court or a regulator. The initial formulation of the corporate purpose would be left with the company, but that choice would be open to review by an external tribunal. Apart from the delicate question of who would be empowered to trigger the review, it is suggested that there is an unresolvable tension here between effective review and the company's commercial freedom: it is possible to have one or the other, but probably not both to any significant extent.

Review, whether by a court or a regulator, could be cast in more than one form. The least constraining would be a review standard analogous to the business judgement rule: the reviewer would check only that the company had acted in good faith and, perhaps, on the basis of adequate investigation. It would be possible to build a role for non-shareholder groups into the process of purpose formulation through either an ex ante consultation requirement or an ex post complaints procedure (either to the company itself or the court/regulator). However, the formulation of the purpose would remain principally in the hands of the company, with no legislative specification of the types of purpose which would be regarded as appropriate. How far this type of review would move the purpose statements beyond those generated by the voluntary mechanism is open to debate. The risk of having to demonstrate good faith and, possibly, adequate investigation might deter companies from adopting wholly vacuous statements of purpose. However, if the tribunal remains loyal to its remit, the fact that it or indeed most businesses or outsider observers would regard the statement as inadequate would not lead it to overturn the company's choice.

Moving beyond the business judgement standard would be some form of a "range of reasonable responses" standard. Here, the law would specify or the court/regulator would develop a substantive standard for determining whether the purposes adopted by the company met the legislative requirement for a purpose statement. Purely self-serving or vacuous statements would no longer cross the bar for acceptability. However, the company's initial choice would still benefit from a level of protection against adverse review: the company would not have to produce a statement which the court/regulator thought was the most appropriate or "best" for its business. Provided the company had adopted a purpose the court/regulator thought suited its circumstances, this review standard would be met, even if the court/regulator would have

formulated a different purpose statement, had it been permitted to impose it on the company. On this review standard the company makes a constrained choice from among a number of possible purposes assessed as reasonable by the law or its agents.

The third possible approach is one where the reviewer is given full power to revise the company's purpose statement. The company's choice would pass review only if the court/regulator agreed that it was the best fit for the company's circumstances. The reviewer would revise it if the company's choice did not accord with the court/regulator's view of what was appropriate for the company. Depending on how the reviewer sought to exercise its powers, the company on this standard might be left with limited choice as to the purposes it should adopt.

The second and third forms of review identified above have the potential to shift corporate behaviour away from the patterns disclosed by voluntary purpose statements. The law in conjunction with the reviewing agency would have a substantial role in setting corporate purposes. Since the goals that *Prosperity* seeks to promote are public (communal or social), a public role in specifying those goals might be welcomed by many. However, there are obvious downsides. Regulators (and governments acting through them) are not always more long-sighted than the business people or the markets.[43] Even if regulators do a good job, concentrating decisions centrally may well reduce the rate at which solutions to problems emerge, because competitive experimentation is removed. Courts are often more decentralised decision-makers than regulators but are less expert and so less able to deal effectively with the more demanding review standards. They are likely to be either non-interventionist, if they recognise their lack of expertise, or arbitrary in their interventions, if they do not – or possibly both at different times or in different parts of the judicial system. In effect, rigorous review by state organs to determine the acceptability of corporate non-social goals would mean overturning the principle that underlay the first modern UK Companies Act, the Joint Stock Companies Act 1844, that incorporation of the purpose of carrying on business should not require the approval by the state of those business goals.

In any event, it appears that government/court control of the setting and implementation of corporate purposes would run against the philosophy underlying *Prosperity*. This is a book which leaves companies firmly in the private sector of the economy. It is not a book which promotes the pursuit of public purposes through state ownership or control – the traditional, if

[43] Is there anybody more short-termist than a politician seeking election?

now somewhat tarnished, formula in the UK for safeguarding the public interest. As the book says: "This [purpose] is not a theory of socialism or mutualism or stakeholder capitalism. . . It is about . . . the purpose of business as producing profitable solutions to problems of people and planet." [44] This is not a prescription for state control of private sector companies via the backdoor of setting corporate purposes. Therefore, it is suggested that the book's underlying approach is inconsistent with anything other light review of the company's choice of purpose.

Outside *Prosperity* Professor Mayer has argued, with others, for a mandatory rule which would require large US corporations to incorporate as Public Benefit Corporations.[45] This could be regarded as another mechanism for reviewing the company's choice of purpose, since the law will not recognise a company as a PBC unless its purposes meet the specified statutory standards. However, at least under the Delaware version of the PBC, the constraints on the shareholders' choice of purpose (or public benefit) via provisions in the company's charter are light. Although a Delaware PBC could choose a demanding set of public purposes, it is required to have only a single one and that purpose may promote "effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature."[46] The purpose, therefore, need not meet the transformative standard set out in *Prosperity*: established donations policies such as support for the local orchestra or university would apparently qualify.[47] The Delaware PBC provisions are drafted more along the lines of encouraging Corporate Social Responsibility than necessarily a transformative corporate purpose (though the latter would count as an example of the former). Nor is any particular level of commitment to the public benefit specified in the statute. Rather, the duty of the directors is to conduct the affairs of the company in a way which "balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation."[48] Moreover, the directors' balancing decision is not open to easy scrutiny. The public benefit statement does not create a duty on the directors to non-stockholders in respect of its implementation and the duty owed to the stockholders requires the directors' balancing

[44] *Prosperity* pp 11-12.
[45] Colin Mayer, Leo Strine and Jaap Winter, "50 years later, Milton Friedman's shareholder doctrine is dead", *Fortune*, September 13, 2020.
[46] DGCL §362(b).
[47] For example, a commitment to devote a small proportion (1%) of its annual profits to an identified worthy cause.
[48] DGCL §365(a) – this duty thus puts a much emphasis on a stakeholder approach as on the promotion of the purpose.

decisions only to be informed and to be free of conflicts of interest, ie the statute applies a rationality rather than reasonableness standard.[49] To discourage non-shareholders from shifting easily into the shareholder category in order to initiate a derivative action, obstacles are put in the way of derivative actions to enforce the balancing obligation, in addition to those normally applicable to a derivative action. The claimants must hold the lesser 2% of the company's outstanding stock or shares with a market value of $2 million dollars.[50] Finally, monitoring is required only via a two-yearly report to the shareholders; there is no requirement for more demanding mechanisms, for example, by including a third-party verification requirement, unless the company chooses to include them in its certificate of incorporation or bylaws.

While a duty to operate as a PBC would deprive the shareholders of the choice not to become a PBC or to end that status, it is far from clear that the shift would produce a meaningful change in companies which are not adopting PBC voluntarily but only under compulsion, and whose shareholders regarded the status as a drag on the achievement of their goals. One can predict that the shareholders' choice of public benefit in such cases would be unconstraining and that directors would readily understand how shareholders wished them to strike the balance among the corporate objectives, their understanding possibly aided by the formulation of the criteria for pay-outs under their performance-related pay schemes. Given the width of the purposes which are permitted to count as public and the limited enforcement mechanisms for the public duty (essentially disclosure),[51] it appears that mandatory incorporation as PBC is not a rule which escapes the above analysis.

To sum up the argument so far. In a Friedmanite world (as defined above) a requirement to state the corporate purposes does little or nothing to address the shareholder "shackles" on companies. So long as these are in place, the purpose requirement will not come anywhere near achieving the goals set for it in *Prosperity*. The assumption underlying the purpose proposal appears to be that a requirement to state a purpose will unshackle the company from the shareholders, because it will in some undefined way override the governance rights of the shareholders. As we have shown above, this is not the case, unless the purpose requirement is implemented together with a level of state control over the company's choice of purposes which is at odds with the vision set out in *Prosperity.* This is not the end of the discussion,

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[49] DGCL §365(b).
[50] DGCL §367.
[51] There are more constraining versions of PBC in some other states, but presumably unwilling corporations will choose the least constraining.

however. One possible way forward, discussed in the next section is to complicate the corporate law reforms beyond the introduction of a purpose requirement, so as to reduce the influence of the shareholders on the board.

V. Shielding the board from the shareholders

Let us remain in the Friedmanite world for the time being, but complicate the proposed purpose reform with bolder corporate law changes. Here, the aim would be to shield the directors from adverse shareholder reaction if, in response to a duty laid upon them, they chose to adopt a set of purposes with which the shareholders disagreed. Where there is a controlling shareholder in place (or a controlling small group of large shareholders),[52] there is no point in embarking on this exercise. The views of the controllers will ultimately prevail and, if they are Friedmanites, they will not countenance the adoption of purpose statements by their companies. Formally, it would be possible no doubt to strip shareholders of all their levers of control and influence over the company. This might be an effective way of destroying controlling shareholders as a class of investor: neither financial nor non-financial private benefits of control would be likely to survive the reform. However, the economic dislocation caused by this reform to an economy built on financing corporate activity through controlling shareholders is likely to be huge. And controlling shareholders may be well-placed politically to resist the move.

However, it will be no easier to implement this reform today in dispersed shareholding jurisdictions, such as the US and the UK. The main targets of such reforms would be to reduce the impact of at least four powers which shareholders normally possess: (a) to appoint and remove directors; (b) to instruct the board how to act; (c) to convene meetings of the company; and (d) to transfer their shares when a tender offer is made to them; (e) to set profit-related pay. The aim would have to be to go beyond the "zone of isolation" envisaged by Professors Kershaw and Schuster.[53] Their goal might be said to be to preserve the capacity for directors to take actions which will pay off for the shareholders in due course but which the shareholders are not well placed to evaluate accurately, ie to reduce what are sometimes termed "principal costs".[54] Here, by contrast, the directors would have to be shielded from shareholder reaction

[52] Which is, world-wide, the dominant form of shareholding: A De La Cruz, A Medina, & Yun Tang, *Owners of the World's Listed Companies*, OECD Capital Market Series (2019).
[53] Above n 7.
[54] Z Goshen and R Squires, "Principal Costs: A New Theory for Corporate Law and Governance" (2017) 117 *Columbia Law Review* 767.

when, on the hypothesis we are considering, the directors aim to run the company on a continuing basis in a way which hinders the achievement of the shareholders' goals in relation to their investment. This is a tall order indeed.

It might be said that a shielding strategy would need to aim to do no more than reproduce today a system of corporate governance which was not wholly unlike the one which in fact prevailed in the UK in the 1950s or until more recently in the US. But that is to indicate the nub of the difficulty. The move from dispersed and rationally apathetic investors to semi-concentrated shareholdings in the hands of institutional shareholders has created a politically influential set of incumbents with a strong interest in maintaining the present level of shareholder governance rights. Their opposition to the shielding strategy can be assumed but not their failure to defend it. Let us look briefly at the US and the UK in turn.

Until the end of the last century, the shareholders' position in the US was not totally removed from the position the shielding policy would put them in. This was the result mainly of private ordering via the company's constitution, in which the shareholders had acquiesced, though in the case of instructions to the board the SEC's proxy rules protected the board's managerial functions from intrusive shareholder intervention. For the rest, it was a largely a matter of constitutional provisions on staggered boards, plurality voting and director control of the proxy machinery; confining the power of convening shareholder meetings other than the annual meeting to board; and the board's power to adopt a poison pill in the face of an undesirable takeover.[55]

Although some may regret it,[56] this is not a division of powers between board and shareholders which any longer obtains. More than a decade ago Professors Kahan and Rock charted the

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[55] Delaware corporate law deals with most of these issues via default rules, some of which are set in favour of the board and others in favour of the shareholders, but even the shareholder friendly defaults may be changed if the shareholders acquiesce. Thus, §216(3) DGCL sets plurality voting as the default, but that is alterable by the certificate of incorporation or the bylaws; the same is true of the power to convene an extraordinary meeting of the shareholders which §211(a)(2)(d) confines as a default to the board. On the other hand, annual election of directors is the default under §211(b) but §141(d) provides for a shareholder choice of a staggered board. §141(k) provides an apparently mandatory rule that a simple majority of the shareholder may remove directors at any time, but the certificate of incorporation may require a supermajority for this action and until the clarification given in *Frechter v Zier* 2017 WL 345142 (Del. Ch. Jan. 24, 2017), it was thought the supermajority rule could be placed in the bylaws. The point here is that the company's certification of incorporate may, and usually does, give the board the power to amend bylaws without reference to the shareholders (§109(a)). The poison pill may be adopted unilaterally by the board under §157 unless, as is unusual, its powers over the issuance of options is restricted in the certificate of incorporation.

[56] For example, S Bainbridge, above n 7.

decline of the system which protected the "imperial CEO" from shareholder influence.[57] As these authors put it, for the staggered board "the day is not far off when staggered boards will be the rare exception"[58] among the largest companies, with a consequential reduction in the effectiveness of the poison pill.[59] There had been a "meteoric rise" in the replacement of plurality voting by majority voting among S&P companies.[60] Finally, precatory resolutions adopted by shareholders, long thought to be ineffective, were increasingly implemented by companies.[61] Kahan and Rock put these changes down to the substantial re-concentration of shareholdings in the largest US companies from a multitude of individuals into the hands of a smaller number of institutional shareholders, notably public pension funds, mutual funds and hedge funds.[62] All have incentives, varying in strength and character from one type of institution to another, to exercise their governance powers so as to reverse the exclusionary constitutional rules in which they had previously acquiesced. These efforts were aided by some modest reforms by the SEC of the proxy rules, notably the one removing the need to file an (expensive) proxy statement where a shareholder wished to solicit votes on a resolution proposed by the company, an important step in a world of annual, majority voting on directors.[63]

There is little or nothing in subsequent developments which undermines Kahan and Rock's conclusion that "it is much more likely that CEOs, in the intermediate term (over the next ten years or so), will lose more power than that they will regain some of the power they have

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[57] M Kahan and E Rock, "The Embattled CEO" (2009-10) 88 *Texas Law Review* 987. This article also charts the greater control exercised over CEOs by boards, but I leave this part of their analysis on one side. On the issue of whether the poison pill is undergoing a revival as a tool against activist hedge funds, see J Gordon, "The Rejected Threat of Corporate Vote Suppression: the Rise and Fall of the Anti-Activist Pill" [2022] *Columbia Business Law Review* 206 and O Eldar, T Kirmsc and M Wittry, *The Rise of Anti-Activist Poison Pills*, available at https://ssrn.com/abstract=4198367.

[58] Ibid p 1008.

[59] In addition, it has been argued that incentive-based remuneration systems for directors and managers have been re-designed so as to give them an inventive not to block takeovers that are value maximising from the shareholders' point of view. The poison pill might thus have some impact on the distribution of gains from takeovers as between officers and shareholders, but not the incidence of takeovers. See M Kahan and E Rock, "How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law" (2002) 69 *University of Chicago Law Review* 871; J Gordon, "An American Perspective on Anti-takeover Laws in the EU" in G Ferrarini et al (eds), *Reforming Company and Takeover Law in Europe*, 2004, ch 9C.

[60] Above 57 p 1010.

[61] Ibid p 1012.

[62] Ibid §III.

[63] Ibid §V. This helped shareholders seeking to deny re-election to an incumbent director – though not course shareholders seeking to put their own nominees on the board, unless they could get their nominee onto the company's proxy statement. The shareholder friendliness of the SEC proxy rules tends to vary with the political composition of the US government. Although Kahan and Rock do not make this claim, it is likely that the SEC itself was responding to the desire of institutional shareholders to be increasingly influential in the world of corporate governance.

lost."[64] Of course, it would be possible formally to embody in corporate law or securities regulation rules which aimed to restore the protections US directors and officers had towards the end of the last century. However, given that these matters have been regarded by the public authorities in the US as ones appropriate for ordering primarily via the company's constitution, it would take considerable political pressure from directors and managers both to alter that commitment to private ordering and to introduce in its place corporate law rules that mandated the constitutional provisions which resulted from private ordering before the rise of the institutions. Above all, there would be fierce counter-lobbying from those institutions which perceived themselves as having benefitted from the new arrangements. Even Professor Bainbridge accepts that "in the near term, rolling back the gains made by shareholder activists and their academic proponents may not be politically viable"[65] and he confines himself to arguing against any further relaxations in favour of such shareholders.

The story in the UK is similar: from the (rational) apathy of dispersed shareholders to partial re-concentration of shareholdings in hands of institutions, initially pension funds and insurance companies, more recently mutual funds. There are two contrasts with the US experience. First, the process of re-concentration got under way some two to three decades earlier in UK, probably because the incentives among moderately well-off people to save for retirement through institutional intermediaries, rather than through direct holdings, became strong somewhat earlier in the UK than the US.[66] Second, the story of dispersed shareholder apathy played out in the UK against, not a background of managerial-inspired restrictions in the company's constitution on shareholder activism, but a background of strong positive shareholder governance rights in the companies legislation. Notable was the right, introduced in the Companies Act 1948, of a simple majority of the shareholders to remove at any time and for any reason any director of the company "notwithstanding anything in [the company's] articles or in any agreement between it and him."[67] In addition, since the theory of UK company

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[64] The principal example might be thought to be the rise of dual-class shares, but these are a mechanism for investing control, positive or negative, in a subset of shareholders, typically a visionary entrepreneur, rather than a mechanism for protecting corporate management against the shareholders as a whole. If the holder of the majority of the votes inhabits a Friedmanite world, as is assumed at this stage, then the analysis in section II is undisturbed.

[65] Above n 7, p 247.

[66] Paul Davies "Institutional Investors in the United Kingdom" in Baums, Buxbaum and Hopt (eds), *Institutional Investors and Corporate Governance*, 1994, ch 9.

[67] This provision was introduced into the Companies Act as a result of a recommendation made by a governmental committee at the end of the Second World War (*Report of the Committee on Company Law Amendment*, Cmd 6659, 1945). Surprisingly, the Committee put forward no rationale for its proposal other than that "it seems to us desirable to give shareholders greater powers to remove directors with whom they are dissatisfied than they have at present" (para 130). However, it seems likely they were reacting to a change in

law was, and still is, that the board's management powers derive from the articles of association, not the law, UK company law never had any doctrinal difficulty with shareholder resolutions which gave the board binding instructions about how to act within their managerial realm, provided the resolution had supermajority shareholder support.[68] Finally, the law has long provided that 10% (today reduced to 5%) of the shareholders may convene a meeting, whether the board wishes one or not, and 5% may add a resolution to a meeting convened by the company.

The strategy of shielding management in the UK thus could not rely on changes to the company's articles, for these would normally be ineffective to override the shareholders' statutory rights. Instead, in the past management had to rely principally on the high coordination costs which faced dispersed shareholders seeking to exercise those rights. Even 5% was a high barrier for dispersed shareholders of a publicly traded company to cross. However, with the rise of the institutions these coordination costs were substantially reduced (though not eliminated). Relatively small coalitions of institutional shareholders could now access these long-standing governance rights and increasingly sought to do so.[69] Moreover, institutional shareholders now had sufficient influence to change both corporate practices and regulatory rules in their favour. The primary example of the former is the institutional investors' long-standing opposition to non-voting or weighted-voting shares, which have never been prohibited by the companies legislation and, until recently, not by the listing rules either, but which disappeared from corporate practice when it became clear that the institutions would not buy such shares. The primary example of the latter is the presence of the mandatory "no frustration" rule at the heart of the UK takeover rules.[70]

As in the US, a rolling back of shareholder rights to the extent necessary to implement a shielding strategy is probably politically infeasible in the UK, which is not to say that some re-

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the judicial interpretation of the articles which occurred earlier in the century. Under this change, where the articles conferred management powers on the board, as would normally be the case, a shareholders' resolution could give the board instructions as to how to exercise those powers only if it was supported by a majority equivalent to that needed to change the articles, ie three quarters of those present and voting. In the nineteenth century a simple majority was considered to be enough.

[68] See previous note. However, the threat of the exercise of the removal power, requiring only a simple majority, reduced the need for shareholders to rely on the instruction power.

[69] G Stapledon, *Institutional Shareholders and Corporate Governance*, 1996, Part II.

[70] On both these examples see Paul Davies, "Shareholders in the UK" in Hill and Thomas (eds), above n 7, ch 11; on the latter see Paul Davies, "Defensive Measures: The Regulation of Defensive Measures in the United Kingdom and the United States" in Hopt and Wymeersch (eds), *European Takeovers: Law and Practice*, 1992, ch 7 and J Armour and D Skeel, "Who Writes the Rules for Hostile Takeovers and Why?" (2007) 95 *Georgetown Law Journal* 1727.

balancing of relations between shareholders and the board is not within the realm of practical contemplation.[71] A comprehensive rolling-back would entail a fundamental re-think of long-standing elements of UK company law which would generate strong opposition from those, in particular the institutional shareholders, who promoted them. Despite the limited set-back for the domestic institutional shareholders entailed in the recent reform of the Listing Rules so as to implement a cautious acceptance of dual-class shares,[72] it is difficult to see them failing successfully to oppose a full-scale roll-back of their rights. In addition, the shielding strategy is inconsistent with the policy of "engagement" for institutional shareholders with their investee companies which has been heavily promoted by official bodies over the past decade.[73] The "stewardship" idea, however that term is defined, relies upon shareholders possessing significant governance rights over the company, though not necessarily the full suite which they currently possess in the UK.

Thus, neither in the US nor the UK is a comprehensive shielding strategy likely to be politically feasible. Nor is it obviously economically desirable. Shielded management may also be slack management. True, the shielding strategy is to be part of a larger set of reforms requiring company boards to adopt purpose statements. A tightly formulated and rigorously enforced purpose statement would reduce managerial slack in all probability, but corporate management is not likely to be any more favourable to such constraining statements than corporate shareholders. This would put the legislature back in the difficulty we analysed at the end of Part III: either the legislature accepts weak, board-designed purpose statements or it engages in court or regulatory review and enforcement of those statements with the consequent reduction in the scope for private sector initiatives.

VI. Shareholders in a non-Friedmanite world

In this section, we relax the assumption that shareholders are stuck in a Friedmanite world or, perhaps better, in what convention understands to be the characteristics of that world. We analyse two forms of relaxation. The first, the more modest, is one in which investors hold to

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[71] See the proposals of Kershaw and Schuster, above n 7.

[72] E Lidman and R Skog, *London allowing dual class Premium Listings: A Swedish commentary*, ECGI Law Working Paper 580/2021 (available at ssrn.com/abstract_id=3826174. All the recent reform did was put the institutions back in the position they had been before 2014, ie reliant on their market power to regulate public companies' use of dual-class shares.

[73] Paul Davies, *The UK Stewardship Code 2010-2020: From Saving the Company to Saving the Planet?* ECGI Law Working Paper 506/2020, also available in D Katelouzou and D Puchniak (eds) *Global Shareholder Stewardship* (2022).

profit maximisation but take a more sophisticated and long-term view of the mechanisms through which profit is likely to be maximised. For example, they do not regard the quarterly earnings statement as the sole indicator of how well the company is doing to maximise the financial returns to the shareholders. The second relaxation is where shareholders are prepared to trade-off financial and non-financial goals, ie profit maximisation no longer constitutes a full specification of the returns investors seek.

A. Sophisticated profit maximisation

Whether this form of shareholder action constitutes a significant shift from how Friedman contemplated shareholders would behave can certainly be debated. In the very article from which his famous quotation is drawn, he stated: "it may well be in the long-run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government. That may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects".[74] This is sophisticated profit maximisation at the firm level, sometimes referred to as "doing well by doing good". However, in terms of the goals of *Prosperity* it probably does not need much analysis. The focus of the shareholders is still on the maximisation of their financial returns, even if they no longer adhere to a Gradgrind approach as how best to achieve their goal. Social and communal goals still have no place in their own right. And one might also think that existing corporate governance mechanisms should ensure, at least over time, that sophisticated profit maximisation is adopted at the firm level, if it is in fact an effective method of increasing profitability.

In terms of ESG investing, discussed further below, there is some evidence that sophisticated profit maximisation does drive institutional shareholder interventions at firm level and that such interventions have some degree of success. A recent study by Professor Bauer and colleagues focussed on non-public ESG-focussed engagements with investee companies carried out by an asset manager, both on behalf of itself and other funds, over the period 2007-2020.[75] Some of these engagements were on matters financially relevant to the company and

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[74] Above n 4.

[75] R Bauer, J Derwall and C Tissen, *Private Shareholder Engagements on Material ESG Issues*, available at ssrn.com/abstract=4171496. See also P Krueger, Z Sautner and L Starks, *The Importance of Climate Risks for Institutional Investors*, ECGI Finance Working Paper 610/2019, showing significant institutional shareholder engagement with portfolio companies on climate change matters where climate change was thought to create risks of direct costs to the companies, of costs of dealing with climate change regulation, and of climate change-inspired technological changes which would undermine existing business models. Equally, climate change might open opportunities for new investments.

some not.[76] This found that three-quarters of the engagements were financially relevant and that material engagements were more likely to be successful (ie produce some appropriate response from the company) than non-material ones (suggesting that companies were more open to engagements which were financially relevant). After engagement, targeted companies' share price outperformed their peers, but this outperformance was particularly noticeable in relation to successful governance engagements. Engagements in the environmental and, especially, in the social categories had less impact of the performance of the stock.[77] Overall, these results suggest that the market attaches a higher value the G element of ESG than to its other two elements and that this is so because they have the greater potential to improve the company's profitability.[78] *Prosperity* is right to conclude that sophisticated profit maximisation has limited potential to move companies towards social or communal purposes.[79]

However, an interesting recent discussion has emerged about the potential for sophisticated profit maximisation to generate at the level of an investment portfolio a trade-off between individual firm performance and overall returns to the portfolio. Professors Gordon and Coffee have developed, separately, a theory under which widely invested funds would have a financial incentive to pursue communal and social objectives at the portfolio level.[80] On this theory, a widely invested fund has succeeded in diversifying away idiosyncratic risk but is still exposed to systemic risk, ie risks which affect the economy as a whole. Gordon focusses on three systemic risk in particular: climate change, financial crises and social disorder, the last possibly arising out of the first two risks but also arising independently out of the unequal distribution of gains and losses from globalisation. His theory is that such funds have an incentive to support actions by portfolio companies to mitigate these risks, even at the cost of reducing the financial

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[76] How this categorisation was made in discussed in §2 of the paper. Reliance on the MSCI materiality framework suggests "financially relevant" equated with the impact of ESG factors on the company, not the impact of the company on the wider community.

[77] For literature supporting the importance of governance initiatives for financial performance see R Kräussl, T Oladiran and D Stefanova, *A Review on ESG Investing: Investors' Expectations, Beliefs and Perceptions* (2022) at 11 (available at ssrn.com/abstract=4123999), but contrast E Pollman, *The Making and Meaning of ESG*, ECGI Law Working Paper 659/2022 on the indeterminacy of the ESG term and, in consequence, the difficulties of measuring the impact of ESG investing accurately.

[78] Even non-G interventions might be financially relevant to a company in particular circumstances. For example, a company might announce a decision no longer to admit into its supply train businesses which made use of child labour, provided that the benefits of a positive consumer reaction to this announcement exceeded the costs of finding alternative suppliers.

[79] *Prosperity* p 6.

[80] J Gordon, *Systematic Stewardship*, ECGI Law Working Paper 566/2021 (available at ssrn.com/abstract_id=3782814); J Coffee, "The Coming Shift in Shareholder Activism: From "Firm-Specific" to "Systematic Risk" Proxy Campaigns (and How to Enable Them)" (2021) 16 *Brooklyn Journal of Corporate, Financial and Commercial Law* 45.

returns to the companies taking this action. This would be the case if the actions reduced the systemic risks to the portfolio as whole so that the risk/return ratio of the fund was improved by these actions, to the financial benefit of those invested in the fund. It would clearly be a matter of (complex) calculation in particular cases whether the costs of actions in terms of reduced returns at the individual company level exceeded their benefits at the portfolio level.

The above analysis suggests a way in which diversified and widely-invested funds should approach the question of supporting or opposing firm-level initiatives aimed at reducing the identified systemic risks. It is not an analysis of how such funds do in fact conduct themselves at the moment, though the authors indicate some evidence pointing in this direction. Roberto Tallarita, however, has argued that, at least in relation to climate change, the incentives for fund managers to act in this way are weaker than these authors Gordon suggests.[81] This is for two principal reasons. First, he argues that the market discounts the future benefits of climate change initiatives at a higher rate than most experts and governmental bodies think appropriate. Consequently, funds following market signals will invest less than is appropriate in climate change mitigation if the risk-reduction objective is to be realised. Second, he points out that many funds, while certainly diversified, do not hold (a proportion of) the whole economy, especially if the economy is defined in global terms. For example, many funds regarded as very widely invested are overweight in the developed world, which is likely to suffer relatively less from climate change than other parts of the world. Again, the consequence is an under-investment in (global) climate change mitigation, although arguably this is an appropriate level of investment for the particular fund.

The thrust of Tallarita's article is that it would be a mistake to rely heavily on market-driven corporate action to address climate change and he advocates instead a central role for external regulation. At the moment, the conclusion must be that the prospects for portfolio-level policies of "doing well by doing good" to address effectively major social issues are uncertain. One indicator of the tensions at play is the recent rowing back by BlackRock from its famous CEO and client letters of 2020.[82] To the extent that these letters called for more than greater non-financial disclosure by investee companies, they can be seen as a call for the implementation

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[81] R Tallarita, "The Limits of Portfolio Primacy" (2023) 76 *Vanderbilt Law Review* (forthcoming); also available at ssrn.com/abstract=3912977. See also R Tallarita, *Fiduciary Deadlock*, available at ssrn.com/abstract=4197225

[82] Available at www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter and www.blackrock.com/corporate/investor-relations/2020-blackrock-client-letter#:~:text=As%20Larry%20Fink%20writes%20in,and%20assets%20around%20the%20world.

of a portfolio level strategy of the type Professor Gordon contemplates. The 2020 CEO letter concluded as follows: "Companies must be deliberate and committed to embracing purpose and serving all stakeholders – your shareholders, customers, employees, and the communities where you operate. In doing so, your company will enjoy greater long-term prosperity, as will investors, workers, and society as a whole." However, it was reported that in the 2022 annual reporting season BlackRock's support for shareholder resolutions on environmental and social topics fell significant. A spokesman for the fund manager explained that "Many climate-related shareholder proposals sought to dictate the pace of companies' energy transition plans with little regard to the disruption caused to their financial performance, given continued demand from consumers. Others failed to recognise the progress made . . ."[83] The trade-off between short-term financial costs at individual company level and long-term portfolio benefits is clearly one which even the largest and most sophisticated fund managers find it difficult to assess consistently.

B. Trading off maximum financial performance for social or communal gains

In this section we consider shareholders and investors who do no hold to the Friedmanite policy of profit maximisation. Certainly, they invest for a financial return – often they are investing for an income in retirement – but they are prepared to forego a portion of that return (unclear exactly how much) in return for the achievement of non-financial objectives (unclear what level of non-financial achievement or which type of achievement they will accept as compensation of the lower financial return). Such investors seem to be ideal candidates to support the purpose objectives which *Prosperity* advocates. But do such investors exist and are their incentives strong enough to bring about the adoption of social and communal goals by companies? If they do, then radical changes to current governance structures are hardly necessary, since these are designed to reflect the shareholders' choices.

The argument that non-Friedmanite investors are already a significant force among investors and are about to become stronger has been put forward by Professor Ringe in terms of both demand and supply.[84] The demand, in his view, comes from the goals of the generation of investors entering or about to enter the investment market. This generation can be seen as

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[83] "BlackRock pulls back support for climate and social resolutions", *Financial Times*, 31 July 2022.

[84] Wolf-Georg Ringe, *Investor-led Sustainability in Corporate Governance*, ECGI Law Working Paper 615/2021. Cf S Haber et al, *ESG Investing: What Shareholders do Fund Managers Represent?* (available at ssrn.com/abstract=4267270) - emphasising the diversity of attitudes towards ESG investing (including opposition) across the investor community.

having built up wealth earlier in their careers and now being poised to invest it for their future well-being. Possibly more important, they can be seen as likely soon to be the beneficiaries of substantial wealth which they have not themselves earned, ie the wealth accumulated by the parents during the Great Financial Moderation.[85] In either case, the argument is that their goals as investors depart from the Friedmanite model precisely because they define their aims in terms of a combination of financial return and social or communal goals.

No strong theory seems to have been advanced to explain the underlying drivers of this broadening of investment goals. It may be that the new generation of investors, used to a life of relative financial ease, are ready to admit non-financial goals into their investment strategies. Or it may be that a younger generation is more impressed by specific threats to their future well-being, such as climate change, than current investors with shorter time-horizons. However that may be, asset managers have a clear incentive to meet this demand by designing funds with the relevant characteristics. ESG funds usually involve an element of selection and thus command higher fees than passive non-ESG funds. Apart from this, asset managers need to keep up with the predicted shift in investor goals for fear of losing out to competitors who do so. Hence, the extensive offerings of ESG funds which are now on the market.

Some scholars are not convinced by the supply and demand analysis based on new investor goals. Professor Schwartz has provided a political explanation for the growth of ESG investing, namely the incentive of funds to ward off regulation by showing commitment to ESG incentives.[86] Whilst it is the case that in some countries there is governmental pressure in this direction on asset managers,[87] the enthusiasm with which the asset management industry has embraced ESG funds is difficult to explain wholly on a political argument.[88] Kasey Wang has provided a more comprehensive historical account of mutual funds' ESG activism, suggesting that funds have always responded to the goals of those important to them.[89] Thus, initially,

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[85] M Barzuza, Q Curtis and D Webber, "Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance" (2020) 93 *Southern California Law Review* 1243.

[86] J Schwartz, "Stewardship Theatre" (2022) 100 *Washington University Law Review* (forthcoming); "'Public' Mutual Finds" in A Laby (ed) *Cambridge Handbook in Investor Protection,* 2022 (also available at papers.ssrn.com/sol3/papers.cfm?abstract_id=3821388).

[87] For example, the UK Stewardship Code (see Davies, above, n 73).

[88] As Professor Schwartz himself acknowledges in the Cambridge Handbook chapter (above n 86 at p 32) some governmental agencies have expressed reservations about funds' commitment to ESG in relation to their fiduciary duties to end investors. See "BlackRock labels Texas 'anti-competitive' over ESG blacklisting', *Financial Times*, August 25, 2022.

[89] K Wang, "Why Institutional Investors Support ESG Issues" (2021) *University of California Davis Business Law Journal* 129. This analysis is not inconsistent with the argument that political factors identified by Professor Schwartz have been important, but it does not attach primary importance to them.

ESG investing was confined to funds whose investors were limited to those with strong ethical concerns (often faith based). Later, ESG concerns spread to funds managed by public or trade union officials who needed to appeal to a public electorate to secure their continuance in office. Finally, ESG investing became important for a least a subset of general investors.

However, for the purposes of this paper it is not enough to identify an increasing flow of funds into ESG vehicles. We need to assess the capacity of ESG investment to move companies in the direction of meaningful purpose statements. This turns, in part, on the methodologies which are used to implement ESG investing. For example, ESG investing which takes the form of excluding certain categories of investment opportunities from a portfolio are likely to be irrelevant to this end.[90] Even positive ESG strategies may not involve engagement with investee companies, especially if they are based on investment in an ESG index, though such funds may influence managerial policy indirectly, for example, through management's desire to maintain or improve the company's position in the index. It is now well established that both passive and active fund managers face disincentives in relation to the supply of engagement services to investors. Passive funds compete on cost, while engagement is expensive. Active funds are better resourced but find it virtually impossible to exclude competitors from the benefits of successful engagement.[91] However, in relation to low-cost forms of engagement, such as voting on propositions put up by others, the costs of engagement are not significant, especially where those costs can be spread over a number of funds.[92] Thus, the crucial question becomes whether there are entities with sufficiently strong incentives to incur the costs of designing and promoting ESG resolutions which other shareholders can then consider whether to support. In the area of non-ESG resolutions, scholarship attributes that role to activist hedge funds,[93] but their concerns focus on traditional operational and financial improvements to investee companies. The issue is whether there exist similar activists in the ESG space.

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[90] P Brest, R Gilson & M Wolfson, "How Investors Can (and Can't) Create Social Value" (2018) 44 *Journal of Corporation Law* 205. And see G Strampelli, "Can BlackRock Save the Planet? The Institutional Investors' role in Stakeholder Capitalism" (2021) 11 *Harvard Business Law Review* 1 on the costs faced by even negatively focussed index funds.

[91] L Bebchuk and S Hirst, "Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy" (2019) 119 *Columbia L R* 202

[92] E Rock and M Kahan, "Index Funds and Corporate Governance: Let Shareholders be Shareholders" (2020) 100 *Boston University Law Review* 1771; R Gilson and J Gordon, "The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights" (2013) 113 *Columbia Law Review* 863.

[93] R Gilson and J Gordon, previous note.

Much useful information about ESG activism has recently been provided by Roberto Tallarita.[94] Studying 2900 ESG proposals made in the United States between 2010 and 2021, he finds that a mere 25 organisations were responsible for submitting half of them and that a quarter of them were submitted by only 4 organisations.[95] These four were, in declining order of submissions, two public pension schemes (New York City Retirement Schemes and New York State Common Retirement Fund), one conservative think tank (the National Center for Public Policy Research and thus not an asset manager by principal focus[96]) and one a socially responsible asset manager (Trillium Asset Management[97]). Thus, of the four leading submitters, only one was an ESG asset manager, two were public pension funds which have been active traditionally in the submission area,[98] and one was a conservative think-tank which, one may guess, was opposed to ESG measures being taken by companies unless they were likely to improve profitability.

Besides identifying the "matchmakers", ie those who put forward activist resolutions for consideration by ESG shareholders, Tallarita has interesting data on the substantive content of the resolutions and their success rate. Surprisingly for a non-US observer, 31% of the submissions concerned political spending and lobbying and other political issues.[99] On this issue, the US is something of outlier, for corporate political expenditures (not necessarily including lobbying) are often regulated by law in other countries,[100] whereas in the US the already limited legislative constraints on political expenditures have been weakened in recent years by the Supreme Court.[101] By contrast, 11.4% of submissions related to climate change

[94] R Tallarita, "Stockholder Politics" (2022) 73 *Hastings Law Journal* 1617.
[95] Ibid, Table 9.
[96] Its website describes itself in the following terms: "*The National Center for Public Policy Research* is a communications and research foundation supportive of a strong national defense and dedicated to providing free market solutions to today's public policy problems. We believe that the principles of a free market, individual liberty and personal responsibility provide the greatest hope for meeting the challenges facing America in the 21st century." Presumably in buys shares in companies it wishes to influence purely for the purpose of exercising this influence.
[97] Described thus on its website: "*Trillium Asset Management* offers investment strategies and services that advance humankind towards a global sustainable economy, a just society, and a better world."
[98] See Wang, above, n 89.
[99] Tallarita, above n 94, Table 3.
[100] See, for example, the Companies Act 2006 (UK), Part 14, requiring shareholder approval for corporate political donations and expenditure. The impact of requiring shareholder approval has been largely to shut off corporate political contributions (though not, of course, contributions by particular wealthy entrepreneurs or corporate lobbying).
[101] Notably in *Citizens United v Federal Election Commission* 558 US 310 (2010).

issues, 12.5% to "sex, gender and race" – presumably often board composition matters; and 7.6% to human rights. No other specific category of issues exceeded 3% of the total.[102]

These percentages relate to the substantive content of shareholder resolutions over the eleven year period as a whole. It is possible that the substantive composition of the resolutions varied over time. For example, it might be that the political resolutions were over-represented at the beginning of the period (ie shortly after the *Citizens United* decision[103]) while climate change resolutions became more prominent towards the end of the period. There is some evidence of this from the article by Barzuza and colleagues[104] Their focus is not on how resolutions are placed before the shareholders but on the level of support the "Big Three" asset managers give to the resolutions that are advanced by others. They rely on the ESG policy statements put out by and the voting records of these managers towards the end of the previous decade. They identify a strong move by these asset managers from 2017 onwards towards supporting two principal categories of shareholder resolutions, namely, those dealing with board diversity and those dealing with climate change. This may also help to explain Tallarita's finding of an increased success rate for shareholder resolutions over the period he studied. At the beginning of the period only 1% were approved by a majority whereas by 2021 the figure was 19%. If withdrawn proposals are added in, on the bases that withdrawal indicates some level of acceptance of the resolution by the company, then the success rate in 2021 climbs to 40%.[105] Equally, the overall support rate for resolutions voted on increased from 18% at the beginning of the period to 35.4% at the end.

It is clear that, at least in the United States, ESG activism is an established feature of shareholder activity. The question for this paper is whether it has the potential to push companies towards the adoption of broad social and communal purposes, as envisaged in *Prosperity*. To date, the range of issues encompassed by ESG activism in the US has been limited, principally to diversity and climate change issues, with some degree of support for human rights issues. Even on climate change Barzuza and colleagues analyse the concerns of the Big Three as driven by the impact of climate change on the company rather than the

[102] "Other" environmental issues accounted for 5% and "other" social issues for 8%.
[103] Above n 101.
[104] Above n 85. See also M Gatti, G Strampelli and M Tonello, *How Does Board-Shareholder Engagement Really Work?* (available at ssrn.com/abstract=4256925), reporting on non-public engagements to the effect that executive compensation, climate change and board diversity were the most common topics of engagement and that "the category of strategic issues . . . did not gather much attention" (at 20).
[105] Above n 94, Figure 2.

company's contribution to climate change.[106] Outside the Big Three, recent evidence suggests that institutional investors focus disproportionately on the governance element of ESG, to the detriment of the environmental and social elements, perhaps because governance is more closely related to financial returns than the other elements.[107]

The question thus has to be about the *potential* of ESG activism to move companies beyond individual topics in the direction of broad communal and social goals advocated by *Prosperity*. Whilst not amounting to a purpose statement in form, shareholder resolutions on a sufficient range of ESG matters and formulated in a sufficiently constraining manner could operate functionally in a similar way. At this stage of the development of ESG activism, the answer to the question of whether this potential will be realised must remain open.

C. Shareholder commitment without a mandatory purpose requirement

If, however, investors' goals were to develop strongly in the direction of preferring companies which have committed themselves to communal or social goals, then the mechanisms of shareholder voice would operate to the benefit of the incorporation of these goals into the company's strategic choices, with or without an explicit purpose requirement in the law. In this situation, far from freeing the company from the shackles of its shareholders, the appropriate policy would be to maintain shareholder influence over the management of the company and, in particular, over the setting of its purposes. However, outside *Prosperity*, Professor Mayer has argued that a mandatory purpose provisions still has a role to play in this situation, namely, to override a restriction which he finds in the current British companies legislation on the range of purposes a company is permitted to adopt. Referring in particular (again) to section 172 of the Companies Act 2006 (UK) he states: "At present, the law does not permit of commitment to objectives beyond the pursuit of the success of the company for the benefit of its members and it thereby fails to protect companies which seek to create long-term prosperity through committing to the interests of others."[108] This is not correct. In fact, s 172(2) explicitly

[106] Above n 85 at 1275. The impact on the company includes the impact of complying with regulation aimed at reducing the rate of climate change and not just the direct impact of climate change on the company's operations.

[107] F de Silanes, J McCahery and P Pudschedl, *Institutional Investors and ESG Preferences*, ECGI Law Working Paper 631/2022; S Gomtsian, "Different visions of stewardship: understanding interactions between large investment managers and activist shareholders" (2022) 22 *Journal of Corporate Law Studies* 151.

[108] C Mayer, above n 15, Abstract. On p 1 it is stated: "In . . . the UK, the success of the company is specified as being for the benefit of its shareholders (what are termed its 'members')." The relevant part of s 172(1) reads: A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to [a list of non-shareholder matters]"

recognises that the purposes of the company, as adopted by the shareholders, might be or include purposes which are not for the benefit of the members. In such a case, the sub-section provides that "Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes."[109]

It is not surprising that section 172 of the British Act takes a broad view of permissible corporate purposes. The role of this section is to define the directors' core duty of loyalty, not to stipulate the corporate purposes. The scheme of the Act is that the directors have a duty to promote whatever purposes the company has adopted. The specification of those purposes ("objects") is in the hands of the shareholders, in the company's articles on initial incorporation or by subsequent changes to them or possibly by a simple resolution of the shareholders adopted by supermajority vote, though there is a default of unrestricted business objectives.[110] Mayer's statement again displays analytical confusion between the duties of directors and the setting of the corporate purposes, but this time it leads to a wrong reading of the law. Get the purposes right (via provisions in the company's constitution) and the directors' duties (set by the Act) fall into place, not the other way around.[111] In the hypothesis we are discussing, of highly developed ESG strategies on the part of shareholders, the current formulation the core duty of directors will work just fine to secure directors' adherence to the purposes the shareholders choose.

In short, UK corporate law does not prevent companies from adopting other-regarding purposes, but it does place the adoption of those purposes in the hands of the shareholders (through their control of the company's constitution). This is not an idiosyncratic approach of UK company law. Other jurisdictions proceed in the same way. There is no space here for a comparative survey, but we have already noted that the Delaware B-Corp legislation operates by placing the specification of the public benefits in the corporate charter (under the control of the shareholders) and then fashioning the directors' duties around what the charter says.[112]

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[109] CA 2006, s 172(4).
[110] CA 2006, ss 21 and 31.
[111] A point which *Prosperity* at p 23 gets exactly right.
[112] See text attached to fn 47 above. Equally, French law requires the board(s) to "take into consideration" the company's *raison d'être* where one has been adopted in the company's statutes: French Commercial Code art L225-35 (board of directors) and L225-64 (board of management).

A more realistic concern with shareholder-chosen social or communal purposes is the uncertain persistence of shareholders' commitment to those goals. What the shareholders decide to adopt, they can take away (albeit only by supermajority vote). The potential loss of commitment by the shareholders to the company's purposes is recognised in relation to charitable (eleemosynary) companies (where the whole purpose of the company is to benefit persons other than its members). Mandatory rules prevent the distribution of charitable company assets to its members, even in a winding up, and establish a regulator to police adherence to the charitable objectives when the company is a going concern.[113] This might be thought to be a heavy-handed solution in relation to companies which also have a commercial purpose. However, an effective, private-ordering solution is available.[114] The company could make any alteration of its adopted purposes conditional on the consent of the holder of a "golden" share and then allocate that share to some appropriate guardian, while the ongoing faithfulness of the company to the stated objectives could be ensured by a requirement in the articles for periodic validation by an external party, any alteration in the reporting requirements possibly also being subject to the consent of the holder of the golden share.[115] Private ordering gives the company flexibility as to how it organises its purpose arrangements. Nevertheless, for small companies there might be value in providing a separate corporate form, such as some form of public benefit corporation, which takes some of the design burden off the incorporators.[116]

VII Conclusion

Establishing the purpose for which a company exists is clearly important. Without knowing it, it is difficult to see how the board and senior management can set the company's strategy

[113] Charities Act 2011. Equally, the (non-charitable) UK Community Interest Company (CIC), whose assets are also locked in, is overseen by a CIC Regulator. In both cases, the absence of members of the company with an economic interest in its operations means that the members cannot be expected always to monitor the board effectively and the members may even have an interest in subverting the company's public purposes. Neither charitable company nor CIC meets the design requirements promoted by *Prosperity* because of the severe constraints on distributions by these bodies.

[114] Even this would probably require further supplementation, for example, via "green pills". See J Armour, L Enriques and T Wetzer, *Green Pills*, ECGI Law Working Paper 657/2022.

[115] For the importance of third party verification in relation to B-Corps, see D S Lucas, *Third Party Standards and Sustainability Reporting: The Case Of Minnesota Benefit Corporations* (available at ssrn.com/abstract=4232285); and for the potential of general mandatory reporting requirements A Pacces, *Sustainable Corporate Governance: the Role of the Law*, ECGI Law Working Paper 550/2020 and V Knapp, "Sustainable Corporate Governance: A Way Forward" (2021) 18 *European Company and Financial Law Review* 216, esp §3.

[116] Cf S Shackelford, J Hillier and X Ma, "Unpacking the Rise of Benefit Corporations A Transatlantic Comparative Case Study" (2020) 60 *Virginia Journal of International Law* 698, reporting that, as of the end of 2015, there were 460 B-Corps incorporated in Delaware, of which 404 were newly formed entities.

optimally, investors decide whether to invest in it, shareholders work out how well it is doing, stakeholders decide whether to contract with it or society in general evaluate its worth. Nothing in this piece seeks to gainsay these points. Rather it is aimed at evaluating a further proposition, which is that the adoption of a stated purpose should be mandatory for (at least large) companies and that the chosen purpose should be required to contain a social or communal element (as these are defined in *Prosperity*). This step, it is argued in *Prosperity*, would "transform business at a stroke." This piece has sought to argue, by contrast, that such a requirement, by itself, would bring about no such result. Rather, it has been argued that the mandatory, broad purpose requirement will be either (largely) ineffective or (largely) unnecessary. To be effective, it would need to be accompanied by either substantial changes in corporate law which would downgrade the governance rights of shareholders, almost to the point of elimination, or a substantial change in the investment goals of shareholders, coupled with some less far-reaching legal reforms. The former is undesirable on a variety of grounds; the latter a possibility, but not a strong one, and in any event the transformation of corporate behaviour would then be driven, not by the mandatory purpose requirement, but the transformed behaviour of investors.

The defect, it is suggested, in the analysis of the purpose requirement in *Prosperity* is the characterisation of the reform as "simple". In formulation it is certainly simple, but in implementation it is not. *Prosperity* proceeds as if the purpose requirement were self-executing, but it is not. To require a company to do anything via an obligation contained in its internal rule-book, whether a purpose statement or anything else, requires a body within the organisation, which has the authority to bind it, to incorporate the required provision therein. Typically, this will be the shareholders in general meeting, but could be the board of directors in some cases. *Prosperity* mainly favours the board for the role of determining corporate purpose. "[T]he board is the custodian of corporate purpose. In contrast to a shareholder primacy view of the firm, corporate purpose does not reside with financial institutions or the market for corporate control."[117] But, this sentence contains a misleading contrast. Within the organisational structure of the company, it is the board or the shareholders in general meeting who are can bind the company. Financial institutions (unless they are shareholders) or the market for corporate control (whoever that is) have no authority to take decisions binding on the company, no matter how much they may influence the decisions of those bodies which do.

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[117] *Prosperity* p 121.

The weakness of *Prosperity*, it is suggested, is that it does not engage in the relevant way with the organisational structure of the company. To state for the last time the proposition this paper advances: shareholders who do not like broad purpose requirements and directors accountable to them will not implement them in a meaningful way and those shareholders who do favour them are not dependent on the presence of a purpose requirement (though that requirement could perform a role in encouraging discussion of the issue within the company).[118] There are many ways in which the law reformer could seek to escape from this conundrum: state determination of corporate purposes or a reconstitution of the board along stakeholder lines are only the most obvious. But *Prosperity* does not engage with these implementation strategies and at times seems averse to some manifestations of them. This leaves us only with the uncertain potential of ESG investing, which again is not discussed in the book and at times is commented on unfavourably.

My goal in advancing the above analysis is not to suggest that the adoption of other-regarding corporate strategies might not be a social welfare enhancing reform – that is a much bigger issue. Rather, it is to assert that the mandatory purpose requirement as envisaged in *Prosperity* launches, but does not to conclude, a debate on the delineation and implementation of corporate purposes. The purpose proposal may constitute a principle (probably only one of a number) around which reforms could be assessed, but it is not a transformative reform in itself. As it stands, the arguments presented by *Prosperity*, even as developed in the British Academy report, do not constitute a watertight set of interrelated policy proposals for legal reform. Perhaps *Prosperity* can be thought to be a bit like the Coase theorem.[119] Coase did not suppose that in the real world there were no transaction costs, but starting from a position of no transaction costs allows one to analyse the real-world frictions which prevent bargaining over the allocation of damage. So, here, the assumption of no legal/organisational implementation problems allows one to examine why broad purpose statements are so rarely adopted in profit-seeking businesses in present circumstances and to analyse the conditions which might have to be met before there could be a significant change from the prevailing practice.

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[118] Fisch, above, text following n 35. Taking this point further, Edmans has argued for a mandatory "say-on-purpose" vote for the shareholders: A Edmans, *Grow the Pie* (2020) at 206.

[119] R Coase, "The Problem of Social Cost" (1960) 3 *Journal of Law and Economics* 1.

POSTSCRIPTUM

This is a short rejoinder to Colin Mayer's response to my arguments, which appears as ECGI Law Working Paper 694/2023. The most salient point which he seeks to make is that my starting point, that *Prosperity* contemplates a legal obligation on companies to adopt social or communal purposes (as well as commercial ones), is incorrect. Readers of the Preface to and Chapter 7 of *Prosperity* are probably well placed to reach a conclusion about what a fair reading of those chapters can be taken to state or imply, without any further argument from me, beyond what I say in the body of this paper.

In any event, Colin now asserts that the purpose of *Prosperity* says should be understood in the following way:

> "While Davies is focused on the front end of determination and adoption of purpose, that is not something of concern to *Prosperity*, which instead concentrates on the back end of commitment to and implementation of purpose. It is not concerned about the front end because it is not seeking to determine and adopt anything other than purposes which are supported by shareholders, namely *profitable* solutions for the problems of people and planet." (p 1).

In the face of the considerable evidence of shareholder reluctance to supplement the financial goals of the company with social or communal ones, this view of what *Prosperity* is about does substantially reduce the value of the book. Since the adoption of expanded corporate purposes is presented as a major reform, one would expect its advocate to devote attention to the mechanisms and incentives, within and without the law, for companies to adopt such purposes. After all, the principal problem with utopias is not imagining them, but working out how to bring them about – or some approximation of them.

In any event, Colin does accept that the British Academy Report,[120] the outcome of a study group which he chaired as a follow up to the book and of which he was the driving force, does contemplate the imposition of a legal obligation to adopt broader purposes via the company's articles. So, at a minimum, a legal obligation on companies to adopt broader purposes has been placed on the menu of policy choices as a result of Colin's activities, and it calls out for critical examination, which is what I have aimed to give it in my paper. Colin identifies certain alleged defects in my arguments, but, again, I leave it to readers to judge whether these defects exist and, to the extent that they do, how important they are.

Colin seeks to explain what he regards as the "significant difference" (p 9) between what *Prosperity* and the British Academy Report say about mandatory, broad corporate purposes on the grounds that the Academy Report was addressing the additional topic of the "negative detriments" of corporate behaviour, not just the positive benefits of broader corporate purposes. As he puts it: 'In contrast the British Academy introduces a second element to corporate

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[120] Above n 13. In the acknowledgements in the BA Report Colin is fulsomely thanked: "The report and the programme as a whole have benefited hugely from the insight and expertise of Professor Colin Mayer CBE FBA. Without his leadership and support, the programme would not have been possible."

purposes alongside "producing profitable solutions to the problems of people and planet" and that is "not profiting from producing problems for either" (p 9).

This seems to me a post hoc rationalisation since, on the one hand, mandatory purposes are an incomplete legal response to corporate externalities. They do very little to provide redress to those outside the company who suffer from the company's behaviour in breach of the purposes.[121] That is the realm of tort law and regulation, not corporate law. On the other hand, broader purposes, whether voluntary or mandatory, cannot be said to lack all mitigating impact on corporate harms. For example, a company which has adopted voluntarily a purpose of reducing income inequality in society is less likely to lobby government against increasing the national minimum wage than one which has not. So, if Colin's argument is correct, *Prosperity* missed a trick by not examining the potential for corporate purposes to mitigate externalities.

However, in my reading, *Prosperity* did set out to deal with the negative elements of corporate behaviour as well as promoting the production of profitable solutions to the problems of people and the planet. This then explains the limitations of the British Academy's report. It was not setting out a general prospectus for dealing with corporate externalities, but was rather taking further an issue already raised in *Prosperity*: how to deploy corporate law to promote the adoption of broad purposes on a mandatory basis where companies were unwilling to adopt them voluntarily. This is, after all, the only proposal to emerge from the "Law" chapter of the Academy's report (see its Table 1). Liability rules in favour of outsiders, whether directed at the company or its directors, are absent.

Prosperity in fact states that it does seek to address externalities. In its first pages it lists among the problems the book seeks to fix that the company "is the source of inequality, deprivation and environmental degradation" and among the questions it seeks to answer is: "How can we ensure that we harness business as a source of societal benefits *and avoid its detriments*" (emphasis added).[122] Maybe, the answer to the first part of this question is more fully developed in the book than the answer to the second, but it is clearly put on the agenda of the issues to book sees to address.

As to the Academy Report, the adoption of broad purposes, whether voluntarily or in the shadow of the law, may be a way of formally binding directors to the company to pursue those purposes, but its practical efficacy in that regard is subject to limits, as a number of legal colleagues have argued.[123] The adoption of a purpose by the company in its articles or by board

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[121] We know, sadly, that even non-profit organisations with the most elevated goals may find that their operations involve the infliction of negative externalities, if only because of the limitations of hierarchical control. Companies operating for profit are perhaps even more likely to be at risk of inflicting such harms, no matter how high the social value of their objects. Social and communal values at the top are clearly not a guarantee of the absence of harmful behaviour at all times and in all aspects of the organisation's activities. See BBC, *Oxfam: UK halts funding over new sexual exploitation claims*, 7 April, 2021 (available at www.bbc.co.uk/news/health-56670162) and S Wheeler, *UN Peacekeeping has a Sexual Abuse Problem*, 2020 (available at www.hrw.org/news/2020/01/11/un-peacekeeping-has-sexual-abuse-problem)

[122] *Prosperity*, pp 1-2.

[123] See Marco Ventoruzzo, 'Brief Remarks on "Prosperity" by Colin Mayer and the often Misunderstood Notion of Corporate Purpose' (2020) *Rivista delle società* 65, and Klaus Hopt, *Corporate Purpose and Stakeholder Value*

resolution increases directors' incentives to promote it but it is not guaranteed to ensure the directors' commitment to it in all circumstances or to remove from them all discretion in the interpretation of those purposes. The mandatory "purpose adoption" technique will probably need supplementation, for example, through "green pills".[124] I do not explore this issue in this Working Paper, because, as Colin would put it, I am writing about the front end. But it is undoubtedly an important consideration for those writing about the back end.

In short, the front end/back end distinction does not undermine my view that a reasonable reader of *Prosperity* would conclude that it had put on the agenda the issue of using corporate law to require the adoption of broad purposes – even if Colin now asserts that he did not intend this. So perhaps the aims of the book and of the report on this point are not so different after all.

The reader who has waded through my paper, Colin's response and the above postscript may be a little impatient. After all, Colin does accept that the British Academy working party which he chaired did propose consideration of mandatory, broad corporate purposes. *Sub specie aeternitatis* does it matter all that much whether this proposal was contained in Colin's book, his British Academy project or both? This gives rise to an intriguing question: where does Colin now stand – and where logically ought he to stand - on mandatory broad objects for companies? Has he abandoned this aspect of the British Academy's Report? Since his next book, which he trails, focusses on the topic of externalities, presumably we shall find out in due course. I look forward to reading it.

- *Historical, Economic and Comparative Law Remarks on the Current Debate, Legislative Options and Enforcement Problems*, ECGI Law Working Paper 690/2023, especially the reasoning supporting Conclusion 6.

[124] See n 114 above.

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