CORE
Metadata, citation and similar papers at core.ac.uk
Provided by Brunel University Research Archive

THE SUCCESS OF THE COMPANY IN S. 172(1) OF THE UK COMPANIES ACT 2006: TOWARDS AN 'ENLIGTHENED DIRECTORS'PRIMACY' ?

LUCA CERIONI (*)

This paper argues that S. 172(1) of the UK Companies Act 2006, which, by incorporating the concept of enlightened shareholders value, requires a director of a company to have regard to several non-shareholders groups, can be read from a particular managerial perspective, and that directors could end up having a personal interest 'to internalise' exactly this perspective in their approach to S. 172(1). The article submits that, when this occurs, this managerial perspective can offer an input to the legal reasoning and to the model of companies underpinning UK company law, by turning the enlightened shareholders value into an approach that may be defined 'enlightened directors' primacy' and that would benefit the long-term survival and development of the business activity. This outcome would be fully in line with the OECD Principles on Corporate Governance, and with the 'interest of the company' as identified in some continental Europe jurisdictions.

INTRODUCTION

A fair body of literature has already been dealing with s. 172(1) of the UK Companies Act 2006, which incorporates the 'enlightened shareholders value' approach to corporate governance in the UK. The various contributions appear to have mainly dealt with the issues regarding the effectiveness of this provision and its enforcement: e.g., whether shareholders value could still be enlightened after the withdrawn of the would-be requirement on listed companies to produce an operating and financial review (OFR)[1]; whether s. 172(1) may really determine a change in corporate behaviour, in particular whether the non-shareholder constituencies listed in the provision would find any remedy in the event that directors have no regard to their interests, issue which has attracted a firmly negative response[2]; in what way the advice of legal practitioners may affect directors' and shareholders' response to this new provision[3].

However, directors' general duty of promoting 'the success of the company' and the fact that, according to s. 172(1), 'in doing so' directors need to have regard to the non-exhaustive list of factors indicated in that provision, give rise to two questions, which are consequent to each others: 1) could s. 172(1) be regarded, from a managerial perspective, as an indication about the concept of 'success',

---

[1](*) Lecturer in Commercial Law at Brunel University (Uxbridge, West London), Law School; LLM. Ph.D in Law; e-mail: luca.cerioni@brunel.ac.uk (institutional) or lcerio@yahoo.it (private).
I'm thankful to my former Ph.D. supervisor, Prof. Janet Dine at the Centre for Commercial Law Studies (CCLS), Queen Mary, University of London, for her useful comments on this piece.
Andrew .Johnston, 'After the OFR: Can UK Shareholder Value Still be Enlightened ?' (2006) 7 *European Business Organisation Law Review* 817.

[2] Demetra Arsalidou, 'Shareholder primacy in cl. 173 of the Company Law Bill 2006' (2007) 28 *Company Lawyer* 67, submits that, in this case, the position of stakeholders in general, and employees in particular, would be even worse than under s. 309 of Companies Act 2006.

[3] Joan Loughery, Andrew Keay and Luca Cerioni, 'Legal Practitioners, The Corporate Objective and The Shaping of Corporate Governance', forthcoming in (2008) 1 *Journal of Corporate Law Studies*.

and, 2) if so, could this perspective offer an original 'input' to the legal reasoning and to the model of companies underpinning UK company law ?

This work attempts at offering a response to both questions. For this purpose, in part 1 it argues that each of the factors listed in s. 172(1) can be examined from a strategic managerial perspective, and that, from this perspective, all these factor taken together suggest a concept of 'success of the company'. Subsequently, in part 2, the paper aims at demonstrating that it would be in the interest of directors, despite the short-term approach that seemed to prevail in recent years, to adopt this strategic managerial perspective as the most 'strategic consultancy' that they could draw from s. 172(1), in order for them to become more invulnerable to the risk of liability for breach of duty than they would otherwise be. Subsequently, part 3 submits that this 'consultancy', if accepted by directors, has the potential not only to allow them to be the only agents controlling the companies, but also to offer a perhaps unforeseen input to the legal reasoning and to the development of the model of companies underpinning UK company law. Part 4 mainly argues that such development – for which the definition of 'enlightened directors' primacy' is proposed - would, ultimately, deprive of any practical meaning, at least for some companies, the classic distinction between the shareholder-centred model and the stakeholders model. Ultimately, this contribution is, therefore, aimed at offering an additional perspective to the discussions that are probably bound to continue, on s. 172(1), for some years after the entry into force of this provision on 1 October 2007.

I. A MANAGERIAL VIEW ON S. 172(1)

A. *A Strategic Managerial Perspective as a Framework for Analysis and a Consequent Key Question*

Despite the absence in s. 172 (1) of an indication about the meaning of the expression 'success of the company', it was stated that 'success means what the members collectively want the company to achieve. For a commercial company, success will usually mean long-term increase in value'[4]. It was also indicated, during the reform process, that this expression ties all elements currently listed by s. 172(1) together[5]. Given the perception by a significant number of directors that they had to give priority to the immediate returns of shareholders irrespective of longer term returns, the Company Law Review Steering Group (CLRSG) believed that it was necessary to encourage a change in directors' behaviour. For this purpose, it believed that a new formulation intended to clarify the law on directors' duties and make it more accessible could bring about this behavioural change[6]. This would occur by recognising that the ultimate objective of benefiting the shareholders 'is achieved by building a successful business, which in turn depends on the adoption of an appropriate timescale and paying proper attention to relationships, impacts and reputation'[7]. This perceived importance of

[4] Definition by Lord Goldsmith, Lords Grand Committee, 6 February 2006, column 255, quoted in the recently published guidance Companies Act 2006, Duties of company directors, Ministerial Statements, DTI June 2007, at p. 7 (hereinafter: Ministerial Statements).

[5] John Parkinson, 'Inclusive Company Law' in J. de Lacy (ed), *The Reform of United Kingdom Company Law* (2002), 54.

[6] See Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework* (2000), 31, 36 and 37; on the diffuse 'short-terminist' approach by directors, Institute of Directors Good Boardroom Practice (1999).

[7] Parkinson above n 5, 54.

relationships, impact and reputation is consistent with the recommendations formulated by the 1998 Hampel Report, according to which directors can meet their legal duties to shareholders, and can pursue the objective of long-term shareholder value successfully, only by developing and sustaining stakeholder relationships[8].

The reasons for the importance of relationships, impacts and reputation in building the success of the business can be suggested by a strategic managerial perspective, which latter can also clarify the notion itself of 'success of the company' as a long-term increase in value that cannot be found in s. 172(1). This strategic managerial perspective would be, basically, concerned with the question how to get the most out of the firm's assets[9] and would regard, as assets, all factors listed in s. 172(1) simply because all of them contribute, either directly or indirectly, to the very existence of the business activity.

The immediate and obvious observation from the strategic management perspective is that, if the promotion of the long-term health of the company were sacrificed to the maximisation of share prices, there would risk to be no longer the company whose shares must (under that view) have their price maximised. The negative effects caused by the pressure on the maximisation of share prices, *if this maximisation is pursued as a goal on its own*, have already been highlighted by the literature as part of the history of the corporate collapses which marked the start of the new century[10]. Unsurprisingly, the OECD Principles of Corporate Governance[11], which are non-binding recommendations addressed to all member countries and intended to offer a point of reference for lawmakers, refers to the *long-term success* of the corporation[12]. This suggests that the increase in share price, which, by its nature as a price movement, is visible to a greater extent the shorter the period of time in which it is observed, cannot be the objective, but can only be significant, over time, as one of the *signals* of the company's long-term increase in values, together with other signals such as the business' growing share in the market, volume of sales etc..

The CLRSC, while choosing the shareholders primacy approach, realised the importance of building long-term relationships[13] and allowed directors to take into considerations constituencies other than shareholders, but *only to the extent that* the protection of the interests of these constituencies promotes the interest of shareholders[14]. However, it was said that leading businesses already regard the factors that are now listed in s. 172(1) as elements to be taken into account in promoting the long-term, sustainable success of the company, i.e. as elements to

[8] Christine Mallin, *Corporate Governance* (2004), 22.

[9] Garth Saloner, Andrea Shepard, Joel Podolny, *Strategic Management* (2001), 1

[10] E.g., Margaret Blair, 'Post-Enron Reflections on Comparative Corporate Governance', Georgetown University Law Center, 2002 *Working Paper Series in Business, Economics and Regulatory Law*, Working Paper No. 316663; Janet Dine, 'Using companies to oppress the poor' in Janet Dine, Andrew Fagan (ed) *Human Rights and Capitalism* (2006), 66.

[11] First issued in 1999 and subsequently published in a revised version in 2004, after the corporate collapses (hereinafter: OECD Principles).

[12] OECD Principles (2004), 12.

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

[14] See Paul Davies, 'Enlightened Shareholder Value and the New Responsibilities of Directors', Lecture given at the University of Melbourne Law School (the inaugural WE Hearn Lecture), 4 October 2005, 5.

be considered in running the corporation according to 'current best practice'[15]. If this view is accepted, the conception whereby the interests of other constituencies are to be considered *only to the extent that* the protection of the interests of these constituencies promotes the interest of shareholders gives rise to this key question: can there be a *general criteria* to ascertain the extent to which the protection of these other interests does not promote the interest of shareholder ?
A managerial strategy of getting the most out of each factor contributing to the existence of the business activity[16] could suggest, as regards each of the elements that are listed by s. 172(1), the assessment that follows, and could lead to an overall response to the question.

B. *A Strategic Managerial Assessment on Each Factor listed in s. 172(1)*
S. 172(1) lists, as non-exhaustive elements to which directors should have regard: the likely consequence of any decision in the long-term; the interests of the company's employees; the need to foster the company's business relationships with suppliers, customers and others; the impact of the company's operations on the community and the environment; the desirability of the company maintaining a reputation for high standards of business conduct; the need to act fairly as between shareholders. The reasons for the importance of these elements, and a strategy of getting the most out of each of them, could be explained as follows.

1 *The Likely Consequence of any Decision in the Long Term*

It was properly emphasized that shares are, in essence, 'rights to future incomes'[17], so that, without the continuation in the future of the dividends flows that shares can allow their owners to get, there would be no benefit for shareholders. In turn, to preserve the company's capacity to continue in its business over time, and thus to generate future dividends flows, any decision going beyond routine day-to-day operations – or, in other words, any *strategic* decision - must necessarily consider, by using the available information, the consequences in the long-run of the intended course of action. These consequences need to be considered *in economic terms*, i.e., on the business' ability to generate profits according to accountancy measures; *in financial terms*, i.e., on these profits' ability to generate timely inflows of financial resources; *in broader social terms*, i.e. in terms of reactions and responses by all those groups, commonly named as 'stakeholders', upon whom the company's ability to carry on business (and to get economic and financial returns) ultimately depends. Leading management literature has come to the conclusion that 'The corporation's most important asset – and the only one that it cannot create or replace on its own – is its acceptance within society as a legitimate institution'[18] , where acceptance implicitly means *continuous* acceptance over time, without which the shareholders' rights to future income are put at risk. It follows that, from the strategic managerial viewpoint, the first element listed by s. 172(1) can be taken to mean: 'the likely consequences of any decision on the continuous acceptance,

[15] Alistair Darling, 'Reforms in pursuit of enlightened shareholders value', *Financial Times*, 4 June 2006.
[16] And thus of considering, as noted above, the factors listed in s. 172(1) as part of the company's assets.
[17] Paddy Ireland, 'Property and contract in contemporary corporate theory' (2003) 23 *Legal Studies* 453, 493.
[18] Jim Post, Lisa Preston and Sybille Sachs, *Redefining The Corporation, Stakeholders Management and Organizational Wealth* (2002), 256.

over time, of the company's activity within society'; accordingly, a strategic view would conclude that consideration of this element is *always* necessary.

2 *The Interests of the Company's Employees*

It was pointed out that the new formulation 'can be said to express the insight that the shareholders are not likely to do well out of a company whose workforce is constantly on strike, whose customers don't like its products and whose suppliers would rather deal with its competitors'[19]. As regards employees, they can of course be expected to be dissatisfied when they perceive that their interests are being disregarded, and their dissatisfaction is inevitably bound to generate unfavourable employees relations and to affect negatively all the organisation due to the interdependences between their work and the final output delivered by the company. It has been recognised that 'Management of interdependences constitutes a major activity of everyday work life'[20] and that 'Favourable employee relations help reduce turnover and encourage long-term and cooperative commitment to the organisation'[21]. Because business runs better when people within a company have close ties and trust one another, but building such positive interdependencies, which have been defined as 'social capital', is difficult in the current volatile times[22], it has been argued that this social capital is even more important and, by investing in it, companies will seize the opportunities in today's volatile, virtual business environment[23]. For this reason, manager can foster cooperation by giving employees a common sense of purpose through good strategic communication and inspirational leadership[24]. In turn, this sense of purpose is bound to induce employees to see the company not merely as a source of income but also and mainly as the *right* organisation within which they can accomplish themselves from the professional viewpoint, i.e. as the organisation to which, thus, they can commit themselves by enhancing it through personal skills development, teamwork and constructive suggestions. In turn, finding the *right* company in which personal aspirations can be realised, and thus the company with whom a long-term relationship can be possible, is certainly the primary interest of each employee[25]. The resulting personal commitment of employees and their voluntary 'willingness to walk the extra mile'[26] would be the strategic 'reward' that the company would get from considering the employees not merely as labour suppliers but as individuals with whom a common sense of purpose needs to be built up. It can thus be argued that, from a strategic management perspective, the requirement of s. 172(1) to have regard to 'the interests of the company' employees' can be interpreted as if it red: 'the interests of the

[19] Davies above n 14, 5-6.

[20] Sze-Sze Wong, Gerardine De Sanctis, Nancy Staudenmayer, 'The Relationship Between Task Interdependency and Role Stress: A Revisit of the Job Demands-Control Model' (2007) 44 *Journal of Management Studies* 284.

[21] Post, Preston, Sachs above n 18, 48

[22] Laurence Prusak, Don Cohen 'How to Invest in Social Capital' (2001) 79 *Harvard Business Review* 86, 87.

[23] Ibid, 93, where the Authors conclude that 'In our organisation, just as in our neighborhoods and nations, our ability to recapture community will determine our progress'

[24] Ibid, 92.

[25] Stephen Walmsley, 'Leadership with a human face' (2004) 77 *CMA Management* 8, 14, notes that today's employees are 'more concerned about having leaders they can identify with. The want to know how and what they are contributing to within an organisation. Above all, they demand to be engaged and see the big picture..'.

[26] Post, Preston, Sachs above n 18, 48

company's employees to consider the company as the right organisation which allows their aspirations to be realised, and with whom a mutually beneficial and thus long-term relationship can be built'. Arguably, the promotion of this interest is one of the preconditions for the promotion of shareholders' interest to benefit from their rights to *future* incomes.

3 *The Need to foster the Company's Business Relationships with Suppliers, Customers and Others*

If a business had only occasional, short-terms relationships with suppliers, customers and others such as financers, the profit, however high, made by that business would signal nothing, ex ante, about the business' ability to continue to generate profits in future accounting years. This because the profit would be calculated ex post, at the end of each accounting year, and the short-term nature of the relationships which have made that profit possible in a specific accounting year would imply a total uncertainty as to whether those relationships will or will not arise again in the future. In turn, this uncertainty would minimise what the management literature considers to be the 'relational assets' available to the company, i.e., it would minimise the benefits created by stakeholder linkages, collaborations, processes and reputation-increasing factors[27]. The relational assets are nevertheless considered to be a key component of the 'organisational wealth' of the company, which is the capacity of the company to create value over the long-term[28] and which needs to rely, inter alia, on *stable* customer and supplier relations[29]. The literature on relationship marketing stressed that customer loyalty to brand and firms reduces marketing costs, and stabilises production and sales volume[30] . It was argued that, in the current global scenario, 'as close and stable stakeholder relationships become rarer, they also become more valuable'[31]. This certainly applies to stable relationships with suppliers and customers, because the reduced marketing costs, together with the possibility of favourable terms granted by suppliers who trust the company and with the stabilisation of production and sales, would generate a twofold benefit. On the one hand, it would result in an increase of the operating profit which would be shown by the profit and loss account of the company, i.e., in an increase of the most important part of the overall profit. This because the stabilisation of sales would enhance the capacity to stabilise the revenues from sales, at the same time as at least one component of the expenses which are necessary to produce these revenues (such as marketing costs) would decrease. On the other hand, the stabilisation would also make it possible to reasonably foresee the amount of the operating profit that the business could reap in the future.

It would thus be possible to argue that the strategic managerial perspective would read 'the need to foster company's business relationships with suppliers, customers and others' as meaning: 'the need to create *stable* business

[27] Post, Preston, Sachs above n 18, 45

[28] Ibid, 45-9, where the Authors accept the concept of 'organisational wealth' elaborated by Karl Erik Sveiby, *The New Organisational Wealth: Managing and Measuring Knowledge-Based Assets* (1997).

[29] Ibid, 254.

[30] Frederik E. Webster, 'The Changing Role of Marketing in the Corporation' (1992) 56 *Journal of Management* 4, 1-17 .

[31] Post, Preston, Sachs above n 18, 254

relationships with suppliers, customers and others in order to maximise, *ex ante*, the company's possibility to continue to generate its operating profit over time'.

4 *The Impact of the Company's Operations on The Community and the Environment*

The wealth-enhancing advantages of good relations with local communities and citizens have been stressed by the strategic management literature, according to which the 'social license to operate' implies that the business activity enjoys the support, or at least does not attract the hostility, of members of the general public[32]. It has been noted that 'A firm that enjoys favourable community relationships can be a regular participant in local community planning and problem solving, and can have a chance to present its own side of the story when problems or opportunities arise'[33]. In effect, the existence of a business activity whose operations have adverse consequences on the community and on the environment, and who attract the hostility of the public, is under continuous threat even if this activity generates profits for some time, because the negative reputation tends to spread from one stakeholders group to another[34] and, ultimately, creates a fertile ground for competitors.

This realisation offers a reply to the view whereby saying that shareholders and other interests overlap is not the same thing as saying that they necessarily coincide, and that maximising long-term profits and acting in an ethically, socially or environmentally responsible way are not always consistent[35] . This view cites, as examples, occasions where it will be clear to management that serving the interests of shareholders, even when their interests are viewed as long-term ones, requires discontinuing an activity and dismissing part of the workforce, and the fact that not all forms of socially undesirable behaviour will result in a reputation-related damage that inflicts costs on the company that exceed the gains deriving from the questionable acts[36].

These observations appear to conceptualise the interests of shareholders as satisfied when they are supposed to win the most in a zero-sum game. Nonetheless, the objection[37] would be that, to the extent that this approach implies sacrificing relationships or compromising the company's ability to broaden its stakeholders base, it risks threatening the most solid foundation for a business activity to prosper in the current international and volatile business environment: a stable, and possibly increasing, base of long-term relationships[38]. The fact that this is the most solid base for businesses to prosper is, implicitly, recognised even by the OECD Principles, which highlight the importance of a 'wealth – creating cooperation' amongst stakeholders, and state that corporations should recognise that the contribution of stakeholders (which contribution would not really be such without long-term relationships) constitute a valuable resource for the long-term success[39]. From this perspective, in the examples above indicated, the dismissed workforce or those who are damaged by socially undesirable behaviour, who can

[32] Ibid, 49-50
[33] Ibid, 50.
[34] Ibid, p. 46.
[35] Parkinson above n 5, 49.
[36] Ibid.
[37] Apart from the (in) opportunity in itself of creating perceptions of zero-sum games: see infra, under C.
[38] Blair above n 10, 6; and Post, Preston, Sachs above n 18, 254.
[39] OECD Principles, Annotations, p. 46.

be expected to be hostile to the company and to contribute to the spread of a negative reputation, deprive the company of part of the resources who are needed for its long-term success.
Arguably, the 'the impact of the company's operations on the community and the environment' can thus be read, from the strategic management perspective, as meaning 'the impact of the company's operation on the general community's willingness to continue to provide the company with resources which are important for its long-term success'.

5 *The Desirability of the Company Maintaining a Reputation for High Standards of Business Conduct*

A growing body of literature has been indicating a business case for "Corporate Social Responsibility" (CSR)[40], which is being defined in several ways[41] but consists, basically, in a business conduct of high (ethical) standards such as to internalise, in the company's decisions–making, social and environmental concerns beyond minimum legal standards. It was noted that CSR 'can be viewed as a form of reputation building or maintenance'[42] The company's reputation for high standards of business conduct is desirable because 'high ethical standards are in the long term interests of the company as a means to make it credible and trustworthy, not only in day-to-day operations but also with respect to longer term commitments'[43]. This reputation is obviously interconnected with the impact of the company's operations on the community and on the environment as considered under point 4), as it can be described as a *reputation for a positive impact of company's operation* on the community and on the environment.
The strategic managerial perspective would thus read the 'desirability of the company maintaining a reputation for high standards of business conduct' as 'the desirability of the company maintaining a reputation for positive effects of its operations on the general community and on the environment, and thus a reputation such as to make it credible and trustworthy'.

6 *The Need to Act Fairly Between the Members of The Company*

If those shareholders who are in a weaker position than others and who have not taken part in the appointment of directors feel that directors, in their choices, tend to disadvantage them (for the benefit of stronger shareholders), these shareholders cannot be expected to commit their investment in the capital of the

[40] Inter alia: T.Donaldson, L.Preston, 'The stakeholder theory of the corporation: concepts, evidence, and implications', (1995) 20 *Academy of Management Review* 986; Jill Solomon and Aris Solomon, *Corporate Governance and Accountability* (2004), 14, 28 and 191-2.

[41] E.g., the UK Government states that CSR '.is about how business takes account of its economic, social and environmental impacts in the way it operates – maximising the benefits and minimising the downsides' (www.csr.gov.uk) and '..about companies acting voluntarily to raise performance beyond minimum legal standards'; the World Business Council for Sustainable Development (WBCSD) has defined CSR as, 'the continuing commitment by businesses to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large': see WBCSD Report 'Meeting Expectations. Corporate Social Responsibility', p. 3, available at www.wbcsd.ch, links 'business role' and 'corporate responsibility'.

[42] Abagail McWilliams, Donald S.Siegel and Patrick M.Wright 'Corporate Social Responsibility: Strategic Implications' (2006) 43 *Journal of Management Studies* 1, 4.
[43] OECD Principles, Annotations, p. 60

company with a long-term perspective. Nonetheless, it was noted that the willingness of investors to hold securities of a company determines the ease with which, and lowers the cost at which, additional capital can be raised, so that investors who are willing to hold securities over the long term, without regard to temporary fluctuations in dividends or values, are of key importance for the 'organisational wealth' of the company[44]. This because the presence of these investors, who are often referred to as 'patient capital', contributes on the one hand to stabilise corporate financial structures, and, on the other hand, to give employees and other stakeholders some assurance that their own commitments to the business activity will not be sacrificed for short term financial returns[45]. Consequently, when there are shareholders who perceive directors' choices as detrimental to them to the advantage of other shareholders, the 'patient capital' available to the business activity inevitably risks to decrease, with the negative side effects on the business' ability of generating profits over time.

The strategic managerial perspective thus suggests to read the last element listed in s. 172(1) as 'the need to act fairly between the members of the company, in order to maintain (and, possibly, to increase) the patient capital that the business activity needs'.

C *The Response to the Key Question*

If the indications offered by a strategic managerial perspective regarding each element listed in s. 172(1) are read all together, it is possible to infer that they are complementary to each others, and to identify only one *general criteria* to ascertain the extent to which the protection of other interests does not promote the interest of shareholder: the protection of other interests would not benefit shareholders' interest when *it would conflict with the survival and development of the business activity over time*. The implication of this criteria are not negligible.

It was noted that the difference between the inclusive approach which was adopted under the label of 'enlightened shareholders value' and the 'pluralist' or 'stakeholders' model which was rejected by the CLRSG lies in what should happen in those occasions when there is a clash of interests between the shareholders and other affected groups: the inclusive approach would encourage companies to adopt the necessary long term perspective to recognise that co-operative relationships are important in building competitive strengths, but would not require company's management to be inclusive when there is no economic case for it, so that, when it considers interests as contrasting, this approach would attribute priority to shareholders' interests; by contrast, the pluralist approach would, in these cases, require a balancing of interests[46].

Nevertheless, the strategic perspective above indicated would call into discussion exactly the view that there may be situations when there is no economic case for inclusiveness. This view appears to be rooted in a context in which, in assessing their own interests, the various groups only regard these interests as satisfied when getting the highest immediate returns, so that, at any decision concerning the allocation of an amount of resources, directors and managers would realise that an higher pie to one group implies a lower pie to another group (e.g., an higher amount of salaries to employees, or an higher

[44] M.L. Smith, J.Pfeffer, D.M.Rousseau, 'Patient Capital: How Investors Contribute to (or Undermine) Relational Wealth', in C.Lena and D. M. Rousseau (ed), *Relational Wealth* (2000), 261-76.

[45] Post, Preston, Sachs above n 18, 48.

[46] Parkinson above n 5, 44 -9.

amount of investments in environmental friendly technologies, may risk leading to a lower amount of after tax profits and to a lower amount of dividends for shareholders). In other words, the view that there may be situations when there is no economic case for inclusiveness implicitly assumes that there are situations when the choices by directors face a zero-sum game, in which the gains to one group equal the losses to another group. However, this view appears to derive from a short-term perception because, inevitably, the shorter the duration of the relationship between one group and another the more various situations may be perceived as presenting a zero-sum game. By contrast, in the same situations, a strategic management perspective which considers close and stable relationships as key components of the organisational wealth (and thus of the business' ability, ex ante, to continue to generate profits) would aim at minimising or avoiding the zero sum game, i.e. it would consider the continuous wealth creation for groups involved in the business activity as the best condition for shareholders' possibility of getting continuous incomes from their shares[47]. This conduct would find an exception – if the general criteria above identified to recognise the compatibility of shareholders interests with other interests were applied - only towards any individuals or groups whose interests would conflict with the survival and development of the business activity over time. Nevertheless, it can be easily noted that all constituencies listed in s. 172(1) could only benefit from the survival and development of a company with whom they feel that they could enter into stable and mutually wealth creative relationships.

Globally considered, all elements indicated by s. 172(1) may thus, under the managerial perspective considered here, indicate a precise notion of 'success of the company for the benefit of the members as a whole'. The success would coincide with company's ability to ensure ex ante the optimal conditions in order for shareholders' right to continuing (future) income flows to be safeguarded, where these conditions lie *in the capacity* of finding a common purpose with all groups (listed in s. 172(1)) who affect the possibility for the business activity to continue over time, and consequently they lie *in the ability* of minimising or avoiding the perception of zero-sum game situations and of building long-term, mutually beneficial relationships with all these groups. It is evident that this notion of success specifies in depth the conditions in order for the long-term increase in value (which was indicated, on its own, as the 'success' for a commercial company)[48] to be possible. Consequently, two questions arise, each subsequent to the other. The first question is whether at least some directors could end up having a personal interest to give up the 'short-term' approach

[47] An example of a difference between the two perspectives can be found in the situation where a company decides to undertake a new activity that it considers more promising as the old one. Under the view that there would be no economic case for inclusiveness in this situation, the management may believe that, to pursue shareholders' interests, workforce employed in the old activity has to be dismissed to reduce the costs. There would thus be the perception of a zero-sum game situation (shareholders would gain, employees would loss). Under the *strategic managerial perspective*, the management would find out which 'transferable skills', and which personal talents in terms of creativity, motivation and so on of the workforce employed in the old activity can be used in the new activity too, in order to help safeguarding one of the main stakeholders' contribution to profit making by further enhancing the commitments of these workers to the goals of the company and their process of identification with the organisation (and, thus, in order also to prevent the undesirable effects that would result from workers' dismissals, in terms e.g. of workers and local communities diffusing a negative reputation and from skilled workers being hired by actual or potential competitors). There would thus be the goal of minimising/avoiding (the perception of) a zero-sum game situation (employees would need not to loss, in order for shareholders to continue to gain over time).

[48] Retro, A, the definition by Lord Goldsmith.

reported in recent years and to adopt exactly the strategic management perspective in their understanding of s. 172(1). If so, the second question is whether or not this perspective can end up offering an input to the legal reasoning.

II DIRECTORS' POTENTIAL INTEREST IN ADOPTING THE STRATEGIC MANAGERIAL PERSPECTIVE

A *The Interpretative Uncertainties and the Margins for the potential Directors' Liability*

The Explanatory Notes to the Companies Act 2006 published by the Government[49], suggest what can be the implication, for directors, of a failure to consider the factors listed in s. 172(1). The Notes state that the list, even though not exhaustive, highlights

areas of particular importance which reflect expectations of responsible business behaviour, such as the interests of the company's employees and the impact of the company's operations on the community and the environment…[50].

In addition, they indicate that the decision as to what will promote the success of the company, and what constitutes such success, is one for the director's good faith judgment[51], which ensures that business decisions on, e.g, strategy and tactics are for the directors, and not subject to decision by the court, subject to good faith[52].

Lastly, the Notes go on to explain how the duty to promote the success of the company is to be exercised: in considering the factors listed in s. 172(1), the duty to exercise reasonable care, skill and diligence laid down in s. 174 will apply[53]. The duty to exercise reasonable care, skills and diligence, in turn, is performed by exercising the same standards of care, skills and judgment that would be exercised by a reasonably diligent person with the general knowledge, skills and experience that may be expected for carrying out the same functions as the director in relation to the company at issue (an objective test), and with the general knowledge, skills and experience the director actually has (a subjective test)[54].

The implication as regards the exercise of the duty laid down by s. 172(1) is that it will not be sufficient to pay lip service to the factors and, in many cases, the directors will need to take actions to comply with this aspect of the duty. At the same time, the duty does not require a director to do more than good faith and the duty to exercise reasonable care, skill and diligence would require, nor *would it be possible for a directors acting in good faith to be held liable for a process failure which would not have affected his decision* as to which course of action would best promote the success of the company[55].

---

[49] Companies Act 2006, Explanatory Notes (hereinafter: the Notes in the text, Note number in note) , available at http: www.ops.gov.uk/acts/en2006/ukpgaen20060046_en.pdf

[50] Note 326, p. 50.
[51] Note 327, p. 50
[52] Ibid.
[53] Note 328, p. 51
[54] See s. 174
[55] Note 328, p. 51, emphasis added

These explanations, which echo those that were contained in the Guidance on Key Clauses[56], can be read as suggesting that a person of a reasonable care, skill and diligence would *always* consider the factors listed in s. 172(1) to be relevant exactly because (as the Notes recognise) these factors *highlight areas of particular importance* and – it may be added – they are so for any business. It was noted, while the reform was still in progress, that,

Customers, employees and suppliers are strategic stakeholders because no company can exist or operate without them. They must therefore be considered as an essential component of the "company as a whole" to whom directors owe their common law duties. On this reasoning there is no need to change the law to increase the duties of directors as the statutory law already allows directors to use their powers for "a proper purpose"[57].

If this line of reasoning is followed, the Notes may be intended as explaining that the list of strategic factors – in addition to stakeholders such as customers, employees and suppliers – is to be extended at least to all other elements indicated in s. 172(1), and that this list serves to connect the proper purposes for which directors need to exercise their powers, dealt with in s. 171[58], with the duty to exercise reasonable care, skills and diligence laid down in s. 174. This would be so, in the sense that, in exercising its powers for the proper purpose to be identified in each circumstance, in accordance with s. 171, directors would need in any case to exercise reasonable care, skills and diligence (under s. 174) by having regard at least to the factors listed in s. 172(1), due to these elements indicating (always) areas of particular importance[59].

In addition to explaining that the duty to exercise reasonable care, skills and diligence, and thus the objective test involved in this duty, will apply in having regard to the factors listed in s. 172(1), the Notes indicate the areas 'where the statutory statement departs from current law', and these areas do not include s. 172(1)[60]. All this appears to confirm the submissions that the case-law developed before the introduction of the new Company Act will not lose its force and that the courts will be able to use objective considerations despite the fact that s. 172(1) refers only to the subjective element of 'good faith'[61]. The continuing relevance of the current case-law can also be inferred from the fact that the new statutory set of directors' duties are based on and replace the existing common law rules and equitable principles[62], and, as it was noted, from the statement in s. 170(4) concerning the interpretation and application of the general duties[63] On the other hand, the objective considerations available for the courts to use could

[56] Guidance on the Key Clauses, para. 63 and 64.
[57] Shann Turnbull (2005) On Line Opinion, 'Enhancing shareholder value with social responsibility', www.onlineopinion.com.au
[58] See s. 171 (b)
[59] It can be said 'at least' because the factors indicated by s. 172(1) are not-exhaustive.
[60] Notes 298 to 302, pp. 45 – 46.
[61] Sarah Worthington, 'Reforming Directors' Duties' (2001) 64 *Modern Law Review* 439, 456; Andrew Keay 'Enlightened shareholders value, the reform of the duties of company directors and the corporate objective' (2006) *Lloyd's Maritime and Commercial Law Quarterly* 335, 359.

[62] Ministerial Statements above n 4, 1, 4.
[63] s. 170(4): 'regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties'; also, Burges Salmon, briefing 'The Companies Act 2006: what does it mean for directors?' (www.burges-salmon.com/publications/contents/The Companies Act 2006_BRM0126_02_07.pdf) and Keay above n 61, 359.

also be found, ultimately, in the areas which are objectively (i.e., for any business) of particular importance and which are listed by the statutory factors indicated by s. 172(1)[64].

However, a question might be raised on the basis of the explanation in the Notes that the duty *does not* require a director to do more than good faith and the duty to exercise reasonable care, skill and diligence would require, *nor* would it be possible for a directors acting in good faith to be held liable for a process failure *which would not have affected his decision* as to which course of action would best promote the success of the company[65]: the question appears to be whether these two implications will be intended as alternative or as cumulative (in the sense that the second implication, i.e. the lack of impact on the decision, serves to explain and thus to complement the first implication, i.e. the good faith and the reasonable care, skills and diligence). Assume that a director exercises the duty set out in s. 172(1) with a care, skill and diligence that he is sure would satisfy the objective and subjective tests ex s. 174, and, in so doing, identifies the important factors in those listed by s. 172(1), but, despite this, omits to *analyse in depth* the consequences of his intended decision on one of these factors, because he believes, ex ante, that anybody would consider it reasonable to foresee that this analysis would not alter the decision but would only be time-consuming. Assume also that, ex post, it is showed that the failure to analyse fully the factor in the decision-making has resulted in the overlooking of elements that would otherwise have been perfectly known ex ante, and that the failure to consider these elements in the decision-making process has caused an alteration of the decision to the detriment of the company, who may, e.g., have suffered a damage to reputation and lost some customers. The question would be whether this director is vulnerable to liability for breach of duty. The response would be in the negative if the two implications indicated by the Notes were alternative, because the director could say that he acted in good faith, and that the care, skills and diligence duty has been performed. By contrast, this response would be positive if the two implications were cumulative, because the failure in the decision-making process has affected the decision on the course of action[66]. The right response would appear to be the second one, in light of explanations offered by commentators who were also involved in the reform process. It was clearly indicated that, in order for a damage to non shareholders interests to determine a breach of directors' duties, a *damage* or *potential damage* to the company would need to be shown[67].

It was also said that the duty, which remains enforceable only by the company or in default by the shareholders if the requirement for bringing a derivative action are satisfied, also distinguishes between the obligation to identify relevant factors, which must be performed with appropriate care, skills and diligence, and the decisions about how to act, which are matters for good faith judgment[68]. In conclusion, it was said that all this does not imply

[64] Davies, above n 14, 7, after arguing that it is extremely difficult to prove breach of a subjectively formulated duty such as the duty to act in what the directors thinks it is in good faith, acknowledges that 'it is true that the new requirement to take into account stakeholders interest in deciding what will promote the company's success is formulated partly in an objective way…In theory, therefore, there is opened up a new avenue of attack on directors'decisions..'. The statutory factors have been regarded, also by a major law firm, as expressing an objective test and importing CSR factors: infra, note 77.

[65] Note 328, p. 51, emphasis added.

[66] And, ex post, a damage to the company has occurred.

[67] Parkinson above n 5, 55.

[68] Ibid.

that the obligation to have regard to wider interests is for practical purposes unenforceable. For example, a company might make a decision that causes serious environmental damage without giving proper prior consideration to its environmental effects. If the decision result in loss to the company (it may incur environmental liabilities or lose sales following injury to its reputation) and it could be shown that the failure to take account of the environmental implications of the decision was negligent, then in principle liability could ensue[69].

Although it may be objected that, in this explanation, the reference to 'taking into account' and to the 'negligence' seems to indicate a case different from the example above indicated, a counter-argument could be pro-offered: the attention that is placed on the ex post consequence would seem to suggest that a negligence in the decision-making may consist of a lack of full analysis, after the factors have been identified. It was further explained that 'directors who *act* in good faith will not be held liable for failing to have regard to one of the factors *if this failure would not have altered their business decision*'[70].
This would appear to confirm that the case of potential liability is one whether the failure to 'have regard to' one of the factors has occurred, (not only during but also) after the identification of the factors, in the subsequent phase of action. In this phase, the failure to 'have regard to' may be intended (no longer as a failure to identify but) as 'failure to pay full attention', and thus 'failure to carry out a complete analysis' which could have shown further elements to be considered at the time of the decision: this reading appears to be further supported by the Ministerial Statement that 'have regard to' means 'give *proper* consideration to..'[71]. Therefore, although one could say that:
the Government's view is that, provided the directors make a decision in good faith and have exercised reasonable care, skills and diligence in reaching that decision, it should not be open to challenge in the court. This would preserve the courts' reluctance to overturn directors' commercial decisions provided they have been made in good faith, commonly called the business judgment rule[72]

and could add that the courts have made it clear in the past that they will not use hindsight in making their decision when assessing directors' actions[73], a doubt would remain. Precisely, the fundamental question appears to be whether any elements that could have been known at the time of the decision and whose importance in the course of events could have been appreciated (if a full analysis had been carried out and had indicated these elements) may be seen by courts no longer as hindsight, but as elements to be used to assess if there have been omissions by directors. In consequence, the question also appears to be whether these elements will be taken to indicate a failure to exercise reasonable care, skills and diligence. An example may be made as regards the cases when the interests of the company and of stakeholders are indicated as contrasting with each others: the Ministerial Statements assert that '..it will sometime be necessary, for example, to lay off staff'[74]. It may be supposed that, ex ante, directors, after considering one

[69] Ibid.
[70] Darling above n 15, emphasis added.
[71] Ministerial Statements above n 4, 9, emphasis added.
[72] http://www.nortonrose.com/knowledge/publications/2007/pub5860.aspx?page=13786&lang=en-gb (last accessed on 8 January 2008), Norton Rose briefing 'Companies act 2006: the impact on directors – update', under 'Directors' duties'.
[73] Keay above n 61, 355.
[74] Ministerial Statements above n 4, 9

by one all factors, identify in the dismissal of staff the appropriate course of action for reducing some costs in a time of uncertainty about the market trends for the company's products, but do so without a deep (and thus, full) analysis of all potential implications for the company, because *they* believe that any reasonable person in their position would have taken the same decision and that such an analysis, while time-consuming, would not have changed the decision. However, assume that, ex post, directors and shareholders realise that such a course of action had negative consequences for the company. Arguably, this course of action would not have been followed if the strategic management approach highlighted in part I had been adopted, because this approach would have suggested an assessment of employees' interests as their interest to consider the company as the organisation with whom a mutually beneficial relationship can be built, and it would have suggested the in-depth analysis of employees' skills and talents that could have still been useful to the company[75]. Assume that the negative consequences consist, e.g., of a decrease in profit that exceeds the reduction of costs and thus results in a loss, and that this has occurred for various reasons which would have known or easy to foresee, ex ante, if the deep analysis had been carried out. The doubt whether – in this example and in other similar cases - directors might no longer enjoy a protection such as the one offered by a business judgment rule, and may thus incur liability, would appear to be well grounded, in light of at least three elements.

The first element can be identified in the fact that the 'Guidance for company directors' contained in the Ministerial Statements, while on the one hand recommends directors to act in the company's best interests, taking everything they think relevant into account, on the other hand also recommends them to 'be diligent, careful and *well informed* about the company's affairs'[76]. Thus, in the above example, it could be wondered whether directors took what they though it was relevant into account *but without being well informed*, because they were not aware of the circumstances that the full analysis would have otherwise made clear ex ante. It could also be wondered whether the fact of not being well informed will be regarded, despite any assertion by the directors concerned that they have exercised reasonable care, skills and diligence, as indication of failure to do so (after all, the objective test for the duty of care is what a *reasonably diligent person* would have done, rather than what *directors believe* that a reasonably diligent person would have done).

The second element lies in the views, expressed by some major law firms in recent client briefings, that the factors listed in s. 172(1) constitute an objective test which imports wider CSR factors into the decision- making, that directors must take care to consider the potential relevance of each of the factors and that, once satisfied of this, courts are unlikely to interfere with the result of the decisions[77]. The 'potential relevance' needs to be intended, apparently, in the

---

[75] Retro, part I, B 2 and note 47.

[76] Emphasis added, quotes from Ministerial Statements above n 4, 2

[77] E.g., Norton Rose, above n. 72, expressly states that the factors listed s. 172(1) constitute an objective test and import wider CSR factors in the issues directors must consider when making decisions, and that it is clear that the Government 'expects to see actions, and not merely words, in the exercise of this new duty'; Travers Smith, in its briefings on the Companies Act 2006 ('The Companies Act 2006 Directors' duties public companies', http://www.traverssmith.com/assets/pdf/Legal_Briefings/TheCompaniesAct2006-Directorsduties-publiccompanies.Nov2007.pdf, and 'The Companies Act 2006 Directors'duties private companies', http://www.traverssmith.com/assets/pdf/Legal_Briefings/TheCompaniesAct2006-Directorsduties- privatecompaniesNov2007.pdf, both lastly accessed on 8 January 2008) also sees in the new duty a reflection of the Government's agenda for CSR; Gary Milner -Moore and

sense of potential impact, because the factors can be said to be relevant due to the fact in itself that they reflect (as stated by the Notes) areas of particular importance. The briefings also suggested that lengthier board minutes may serve as an evidence that the statutory elements have been considered, and that the more active shareholders may challenge decisions, even for the mere purpose of seeking publicity of the decision-making, by means of the new derivative actions that under Part 11 of the Act they are allowed to bring for negligence[78].

The third element is the fact that, although the case-law developed before the introduction of the Companies Act can be expected not lo loose its force, the clarification of the law concerning director's duties, that is being indicated as the goal of the new codification, leaves open *all margins* in the future case-law concerning this 'clarification'[79]. In other words, the relevance that the pre-existing case-law can be expected to maintain does not eliminate the uncertainty created, for the time being, by the lack of judicial precedents on s. 172(1).

B *The convenient Conduct from Directors' viewpoint*

In light of the situation of uncertainty above described, directors would need to consider that there may be occasions when asserting that they acted in good faith may not be sufficient to prevent litigations brought against them from being successful. In the light of the Notes, of the explanations and of the lawyers' positions above recalled, they would need to consider that the alteration of business decision as a result of their failure to fully analyse ex ante the impact on one of the factors may fall within the occasions when litigation against them risks being successful. This may be expected to be the case when a damage or potential damage to the company can be shown ex post and would have been realistically predictable ex ante in light of circumstances, relating to a factor not fully considered or in other words not fully analysed, that would otherwise have been known at the time of the decision. Nevertheless, it can be remarked again that whether or not the failure to 'have regard to' one of the factors listed by s. 172(1) has altered directors' business decisions, and actually resulted in a damage or potential damage to the company, can be realised *only* ex post, whereas directors can be expected to have the interest, ex ante, to minimise the risk of (successful) actions brought against them and even to discourage such actions.

For those directors who have been adopting a short-term approach (without paying due attention to what are currently the statutory factors) up to the present time, the fact that any implications for the company of a failure to 'have regard to' one of the factors listed in s. 172(1) can be verified only ex post means that continuing with such the short term approach may involve, ex ante, a degree of risk of liability for breach of s. 172(1). This would occur unless they can always be sure that shareholders of the companies they run perceive the 'success of the

Rupert Lewis, Herbert Smith, "In the Line of Fire" -Directors Duties under the Companies Act 2006 (hereafter "In the Line of Fire"), http://www.herbertsmith.com/NR/rdonlyres/B65D78B4-23E8-463E-8D51-9E893A0705E7/3831/IntheLineofFire.pdf, 3 (lastly accessed on 8 January 2008) argue that, once satisfied that directors have taken care to consider the factors, the courts are unlikely the interfere in the decisions made as a result.

[78] Ibid Milner Moore and Lewis p. 4; also ibid Travers Smith p. 5.

[79] About the intended clarification of the law on directors' duties, see retro, part I, A and Note 301, p.45 and 46, which recalls the Company Law Review recommendations of providing 'greater clarity of what is expected of directors and make the law more accessible' and explains that the Government accepted these recommendations.

company' only when getting the highest immediate returns irrespective of the longer term outcomes, since, in this case, directors following a short-term approach can realistically expect no litigation against them. However, as regards listed companies, it may not be easy to know when this is the case. Although the UK listed sector has been described as characterised by a wide dispersal of shareholdings, with many shareholders regarding investment in companies merely as short term financial opportunities and with a resulting environment unsupportive of long-term commitments[80], it has been also noted that the last thirty years have witnessed a drop in individual investors' ownership of shares from 53% in 1963 to 14% in 2002 and a dramatic increase of share ownerships by institutional investors, for many of which a longer term approach is appropriate[81]. On the other hand, as regards non listed and in general closely held companies, the greater the importance of companies' dividends on shareholders' overall personal income, the greater the extent to which shareholders can be expected to wish these dividends to continue and possibly to increase over time, and thus to take a long-term perspective. These circumstances, together with the uncertainties above highlighted as regards potential cases of liability, contribute to a clear conclusion..

The conclusion is that, ex ante, the most effective manner for directors to discourage actions against them and thus to minimise/avoid the risk of liability for breach of s. 172(1) is to read the new provision as *'advising' them that*, in order to effectively insulate themselves from the risk of litigation and liability, *it is always convenient to fully analyse the long term consequences of their decisions and thus to consider all non shareholders interests listed* in the provision. This means to 'internalise' the requirements of s. 172(1) and, from the viewpoint of directors not already following this approach and who wish to discourage ex ante litigations against them, can be translated into three key questions, interconnected to each others: *how* can the requirements of s. 172(1) be properly internalised, i.e. how can the elements listed in s. 172(1) be given 'proper consideration'[82] in the decision-making; which are, in the various situations where decisions under s. 172(1) need to be taken, the *relevant factors* not to be overlooked; what is the *most effective manner* to properly internalise the requirements of s. 172(1) and to act by considering in full all relevant factors. Arguably, if directors found the reply to each of these three questions and managed ex ante to transmit to shareholders the message that they acted accordingly, any scrutiny of the directors' decisions could only come to the assessment that directors have not breached s. 172(1).

As regards the first question, once accepted that the 'strategic consultancy' directors can draw from s. 172(1) is that, for their benefit (to minimise the risk of liability), the long-term consequences of their decisions and the other statutory elements should always be fully analysed, and that lengthier board minutes may be useful as evidence that directors have (so) considered the statutory factors, it follows that the best evidence for this purpose could be given (not by minutes containing a mere box-ticking reference, but) by an analysis of these factors carried out in the *light of all circumstances that relate to any of them and that could have been known by the directors.* This analysis could be expected to be

[80] Parkinson above n 5, 58

[81] Christine Mallin, *Corporate Governance* (2004), 65: the longer term approach appears to be appropriate for many institutional investors, as the option of selling their shares, in case of dissatisfaction with directors' choices, is not viable given their shareholdings' size or a policy of holding a balanced portfolio.

[82] As required by the Ministerial Statements: Ministerial Statements note 4 above, p. 9.

most effective if the requirements of s. 172(1) were internalised as an indication of the way in which a company can be properly run. This may lead the board to decisions where the satisfaction of the interests of shareholders are perceived as not conceivable without the consideration of the wider interests listed in s. 172(1). As a result, this would also make it possible to produce, as evidence that the statutory factors have been considered, board minutes containing an analysis of these factors carried out in the light of all circumstances which could be known at the time of the decision, and demonstrating that the analysis has guided the decisions. Directors could show, in so doing, that they have followed an approach taking into consideration all constituencies which can lead to the success of the company for the benefit of shareholders, and thus to the maximisation of shareholders' interests intended as continuation of the dividends flows over time, which would mean effective protection of shareholders' rights to future incomes.

As regards the relevant factors not to be overlooked in taking into consideration the constituencies listed in s. 172(1), directors would need to consider a key fact: in any business decisions that impact upon one or more of the categories listed in s. 172(1), there is inevitably the risk of negative reactions on their part if these constituencies fell themselves adversely affected. The more the contribution of these categories is important for the performance of the company (importance that can be perceived, e.g., in the need to maintain the trust on the part of suppliers, to keep skilful employees etc..), the more the risk of negative reactions by these categories could result in a withdrawal of the contribution of these categories that results in negative consequences in the long term, i.e. that could prevent the company from continuing a successful performance. Accordingly, it can be argued that the relevant factors not to be overlooked are *those elements that, in each individual situation, can minimise and can possibly avoid the risk of withdrawal of important contributions to the company* in the strategic areas which are of particular importance to any business and which are listed in s. 172(1). These elements could not be identified and fully analysed without an open and inclusive decision making approach with the stakeholders groups indicated in that provision, based on a transparent communication with them, that should make it possible to 'monitor' the degree of satisfaction of all those without whom the company's continuing success for shareholders' benefit would not be possible. It was already demonstrated in the literature[83], before the introduction of the new Companies Act and again more recently[84], that a fundamental component of directors' duty needs to be identified in the assessment of the risk incumbent on their companies and in the creation and supervision of systems for the control of this risk, which could be achieved only by means of extensive consultation with those concerned by the decisions to be taken. This position can be fully supported – and complemented - by recognising that the general risk on the business activity is the risk of withdrawal of the contributions to its continuing existence by the various constituencies, and that whatever system of risk control needs to minimise this general risk. The relevant factors for this purpose, identified through a full analysis based on an open and inclusive decision – making approach (which make it possible to 'internalise' the concerns of the constituencies listed in s. 172(1)), need to be properly reflected, in turn, by the choices made in the organisational and financial management of the company. To

[83] Janet Dine, 'Risks and Systems: A New Approach to Corporate Governance and the European Employee Consultation Structure?' (2001) 3 *International and Comparative Corporate Law Journal* 299

[84] Dine above n 10, 48.

monitor the effectiveness and appropriateness of those choices, the internal control and internal audit function would need to be fully enhanced, given the key role that it plays in so doing[85].

The response to the third question – what is the *most effective manner* to properly internalise the requirements of s. 172(1) and to act by considering all relevant factors – lies exactly in the strategic management perspective described in the previous part[86]. This follows from the responses to the first two questions: in fact, if directors would need to consider the company as properly run when taking into consideration all those constituencies upon whom the protection of shareholders' rights to continuous incomes ultimately depends, and if the relevant factors are those elements that can minimise and avoid the risk of withdrawal of important contributions to the company by these constituencies, there is a most effective and efficient manner to do so (and to allow an open and transparent communication approach to work). This manner consists inevitably of building long-term relationships of mutual trust and benefit with both shareholders and all other constituencies listed in s. 172(1). In fact, the perception, by those stakeholders, of the company concerned as the organisation that they can trust on a long-term basis, and with whom they thus can find a common sense of purpose, can help the stakeholders in assessing their own interest as satisfied not mainly when getting the highest immediate returns, but when getting continuous returns over time from their contributions (whether these consist in the provision of labour, of goods or services, of finance etc..). Ultimately, what can at a first sight be sometime perceived as contrasting interest could thus no longer be regarded as such once a long – term perspective is introduced and internalised by all parties. This can facilitate the task of directors in properly considering all factors listed in s. 172(1). The building of long-term relationships is exactly what follows from adopting the strategic management perspective, and, thus, from 'internalising' the concept of 'success of the company for the benefit of the members as a whole' that can be extrapolated from it. To do this, which would mean to aim to ensure ex ante the optimal conditions in order for shareholders' right to future income flows to be safeguarded, directors would need to identify the manner which can allow them to get the most out of the open and inclusive decision-making approach, or, in other words, *to get the most out of each constituency*. Because this approach inevitably would require a broad view of the expectations of each constituency, arguably this manner can be found in a dual course of action. On the one hand, directors could see the continuation of the business activity over time with the persistent satisfaction of constituencies as the criteria that, when taking the decisions going beyond day-to-day operations, can be used to unify the advice they can take from lawyers with the advice they can take from other professionals most directly related to businesses, such as the accountancy professionals, the marketing consultants, the human resources consultants and, in general, the strategic management consultants. Because each of these professional categories can suggest directors a series of performance's indicators (e.g., the accountancy profession would suggest considering the evolution over time of indicators that complement each others, such as gross margin, operating profits, etc[87] ; human resources consultancy would suggest the factors affecting satisfaction of employees and related indicators concerning their fidelity; marketing consultancy could propose the most effective strategies to acquire and retain customers etc...),

[85] Alex Dunlop (ed), *Corporate Governance and Control* (1998), 13 - 79.
[86] Retro, par. I
[87] See, e.g., Dimitris N. Chorafas, *IFRS, Fair Value and Corporate Governance* (2006), 343.

directors would eventually be equipped with the tools to appreciate how the satisfaction of the requests expressed by shareholders and other stakeholders could favourably impact on these indicators. The significance of these indicators, ultimately, would be to help[88] to monitor the company's continuing success. On the other hand, directors – even in closer or smaller companies – can find it convenient, to better interact with a broader range of practitioners and consultancies specialising in different sectors that are all important for the company's operation and performance, and to unify the advice received from different categories of professionals, to increase their own level of competences. This would allow them to adopt an integrated legal, economic-financial and social view of the implications of their decisions and, in so doing, to form and to exercise their own independent judgment in identifying the actions that will promote the success of the company. They would thus in a better position (than would be the case without this integrated view) to successfully perform the general duty laid down by s. 173 too, i.e. the duty to exercise independent judgment[89]. This latter, in light of the explanations in the Notes about the relationship between the duties, can in fact be seen - just like the other general duties - as normally overlapping with the duty in s. 172(1)[90], and the Ministerial Statements indicate that '..the obtaining of outside advice does not absolve directors from exercise their judgment on the basis of such advice'[91]. The broad and integrated legal, economic-financial and social view and their own competences, in addition to allowing directors to unify the advice from different professional categories and to form their own independent judgment, would also be an important 'assets' in preventing (the perception of) possible downsides in their decisions. They could in fact use a combination of legal, economic-financial and social elements to construct *complete and coherent arguments*, that they could then use for a twofold purpose: to transmit to each stakeholders group listed in s. 172(1) the message that its ultimate concerns are safeguarded by the decision-making process; to give shareholders, ex ante, a demonstration that no negligence incurred in the decision-making process and that the success of the company for shareholders' benefit as a whole was always the goal that motivated the substantive consideration given to factors listed in s. 172(1). In other words, directors could use the arguments that they could draw from a broad legal, economic-financial and social view (and thus, ultimately, from the strategic management perspective that underlies such view), to transmit shareholders the message that the safeguard of other constituency interests is always being regarded as the optimal conditions in order to get the most out of each constituency in terms of its contribution to the protection of shareholders' rights to continuing dividends flows[92].

It may certainly be objected that there may be shareholders who continue to assess their own interests as satisfied when they get the most immediate returns irrespective of the long-term prosperity of the company, and that they may try to take steps to initiate derivative litigation against directors who adopt the long-term

[88] Together with the perception of the satisfaction of stakeholders and thus of their continuing willingness to contribute to the company's business activity.
[89] S. 173(1).
[90] See Note 311 (the relationship between the duties), 48
[91] Ministerial Statements above n 4, 9.
[92] Or, in other words, to trasmit shareholders the message that 'Because the survival and success of the corporation is dependent upon strategic stakeholders it is very much in the interest of shareholders to have them recognised and bonded to the corporation..': S.Turnbull, above n 57.

strategic managerial perspective. Specifically, it might be said that this may occur when these shareholders believe that they could have elements to argue, e.g., that, if directors had taken a short term perspective and given priority to their immediate returns over the other factors listed in s. 172(1), the profit in the last financial year would have been higher. Nevertheless, apart from the fact that lawyers would probably have advised these shareholders, in any case, that the derivative litigation would be unsuccessful[93], this could not but hold even truer in the case at stake, as directors' response to these shareholders could be easy and convincing. This response, in light of the managerial competence that directors could have built, could be articulated at least in three points. First, the directors concerned may assert that the emphasis on the short-term that was reported as prevailing in recent years[94] was probably 'based on a misunderstanding of the current law'[95], which thus had to be understood as requiring the promotion of shareholders' interests on a long-term basis[96]. This – they may explain - would not have been possible if consequences on the future (i.e., long-term) prosperity of the business, and thus on the stakeholders groups affecting it and listed in s. 172(1), had been neglected. Second, they may explain that an economic data such as the profit relating to the last financial year is an ex post measure without meaning if considered in isolation, but can only acquire significance in an examination over time and in comparison with the data concerning the company's competitors. In this regard, this examination can already be expected ex ante to support directors' inclusive long-term approach because it was generally recognised, by the UK Government too, that the CSR, which would lead exactly to the internalisation of the concerns expressed by the stakeholders categories listed in s. 172(1), makes businesses more competitive, and not less[97]. Lastly, directors may argue that they decided to attach importance to the satisfaction of the interests listed in s. 172(1) to avoid being negligent and in the good faith awareness that, the more these constituencies contribute to the business activity, the more the shares are of value to their owners, because shareholders' rights to future income are better protected. Therefore, in the event of shareholders adopting a short-term view and of directors adopting the strategic managerial perspective, it would appear that these directors could be able not only to become virtually invulnerable to 'complaints' and to potential actions, but also to 'invite' these shareholders to 'rethink' the assessment of their own interests.

III. A POTENTIAL INPUT TO THE LEGAL REASONING AND TO THE MODEL OF COMPANIES ?

---

[93] Given that courts have generally been hostile to derivative claims: Lean S. Sealy 'Problems of Standing, Pleading and Proof in Corporate Litigation' in Ben Pettet (ed), *Company Law in Change, Current Legal Problems* (1987), 12. Lawyers could also advise that the derivative litigation has only a tactical purpose of obtaining publicity of decisions: retro, A. The explanations that directors could formulate, which are referred to in the text, apply in this case too.

[94] Retro, part I

[95] John Birds, 'The reform of directors' duties', in John de Lacy (ed), *The reform of United Kingdom company law* (2002), 159. Also, Davies, above n 14, said that '..in my view, common law never required short – terminism..' . The CLRGS had evidence that the law was misunderstood: Company Law Review, Modern Company Law for a Competitive Economy: The Strategic Framework (1999), para. 5.1.1., 39-41.

[96] Ibid Birds.

[97] See Web Site www.csr.gov.uk/pdf/dti_csr_final.pdf, and link businesscasecsr.shtml

In the previous part, it has been argued that, in light of the explanations that have been put forward in terms of consequences in the event of failure to consider one or more of the factors listed, directors who wish to minimise or avoid the risk of (successful) actions against them could well find the adoption of a long-term, strategic managerial perspective to be in their own benefit.

In consequence, could this perspective offer an input to the legal reasoning and to the model of companies underpinning UK company law ? As indicated in part II[98], one may reasonably expect that a director who transmits *ex ante* the message that he has adopted the strategic managerial perspective, and explains the reasons for doing so, will not even be sued as the company and its shareholders could most probably come to the only conclusion that he has not breached s. 172(1). Nonetheless, for the purpose of proposing a response to the question about the input to the legal reasoning, one may either consider a situation, however unlikely, in which this director is sued, or assume a situation in which a director explains *ex post*, i.e. after he finds himself sued before a court, that he has adopted the strategic management perspective, thus that he has regarded the safeguards of the constituencies listed in s. 172(1) as always necessary for promoting the success of the company (according to the conception of success indicated by the strategic managerial perspective). In either cases, one can also assume that this line of argument is convincingly presented by his lawyers. The possibility of a lawyer proposing the strategic management perspective as the most correct interpretation of s. 172(1) is linked to the physiological fact that lawyers' arguments, which can lead to creative and innovative developments in any area of law[99], are designed to present an interpretation of the law that serves their clients' interests. This, in the case at stake, could lead the lawyer – irrespective of what can be his personal view on the fairness of s. 172(1) - to present the interpretation suited to the interest of the director who has adopted that perspective in taking the decisions. An additional reason suggests why this scenario would not appear to be (so) unrealistic: a major law firm has publicly regarded s. 172(1) as no more than a codification of existing good practice developed before the new Company Act[100], and these views may affect other lawyers. The strategic management perspective adopted by the client (the director that, by assumption, is sued before a court) could thus be seen by the lawyer concerned as no more than an accurate specification of how the good practices, already developed *before* the new Company Act, should be described in detail. Accordingly, the lawyer concerned could find an additional reason to affirm that the common law rules developed before the new law to interpret directors' duty to act in good faith continue to apply[101] and that s. 172(1) offers the occasion to better develop or specify these rules. It seems then reasonable that a court hearing these arguments, and the (strategic management) argument that any decision aimed at ensuring the success of the company should have regard to its effect on stakeholders' willingness to continue to offer its contribution to the business

[98] As indicated retro, part II, B.

[99] Michael J. Powell, Professional Innovation: Corporate Lawyers and Private Lawmaking, (1993) 18 *Law and Social Inquiry*, 423, 426 – 9, summarises various examples in the tax area, in the commercial area, in the areas of bankruptcy and takeover.

[100] Herbert Smith has commented, as regards the factors listed by s. 172(1), that 'Most would acknowledge that a responsible director should have regard to these factors and many others besides whenever called upon to form a decision', Milner-Moore and Lewis, Herbert Smith, above n 76, 2

[101] Which position has already been taken by the literature and can be inferred from the Notes: retro, part II, A.

activity, looks at the case-law developed before the introduction of s. 172(1). As regards this case-law, two trends were already demonstrated, long before the passing of the new law.

The first is that UK courts were moving away from the narrow contractual view of companies, as a number of cases involved 'the extension of the "umbrella" of the company to cover interests other than the shareholders' interest'[102]. In this respect, after the introduction of the Act, it was shown again that, before the new law, the shareholders' primacy approach did not emerge unequivocally from the case-law, because, together with cases suggesting that focus should be on shareholders, [103] there are other cases suggesting that directors must run the company by considering the interests of stakeholders, such as the *Dawson International Plc v. Coats Paton Plc (No 1 case)*[104]. As it was noted, in the Court's statement in that case that 'directors are under a fiduciary duty to the company to have regard to inter alia the interests of members and employees' the wording 'inter alia' seemed, implicitly, to indicate that members and others were only two of a number of categories whose interests need to be considered by directors[105].

The second trend was a change in focus, in the judiciary's techniques used in combating improper directorial conduct, from a determination of whether such conduct was in good faith to a determination of whether it was for proper purposes. The latter test allowed courts to rely on objective criteria: it was noted that, as a result of this shift in focus, although directors may have acted honestly in what they believe to be the company's interests, they may nevertheless be liable to the company if they have exercised their powers for a purpose different from that for which powers were conferred upon them[106].

These trends confirm that corporate governance is in 'a state of flux'[107] and that, when dealing with the issue of the meaning of acting in the company's interests, 'the courts have cleverly fudged the answer'[108] up to present. In consequence, there would appear to be no reason why a court who hears a well explained strategic management argument, and who is induced to take a position on it due to the arguments presented by the lawyer concerned, could not (cleverly) find, just in the strategic management perspective, two decisive elements.

One could be a 'proper purpose' of general application, which would be so irrespective of what the proper purposes invoked in the particular circumstances may be. This generally applicable proper purpose that the strategic managerial perspective would 'recommend', and without which the proper purposes at issue in any particular case concerning ongoing businesses could not be achieved, would lie in the survival and development of the business activity over time, and thus in the maintaining of the contributions (at least) of all factors listed in s. 172(1) to the business activity. The maintaining of these contributions – the director and the lawyer concerned may well argue – is the best condition for the 'long-term increase in value' that was regarded as the success of the company in

---

[102] Janet Dine, 'Private Property and Corporate Governance Part II: Content of Directors' Duties and Remedies', in Fiona McMillan Ptfield (ed), '*Perspectives on Company Law*' (1995), 115; Bruce Butcher, 'Directors' Duties in the Twenty-First Century: A New Beginning ?' (2000) 2 *International and Comparative Corporate Law Journal* 197, 202.

[103] Keay, above n 61, 343-4.

[104] Ibid; 1988 SLT 854; [1989] BCLC 233.

[105] Keay above n 61, 344

[106] Butcher above n 102, 207-8.

[107] John Armour, Simon Deakin and Suzanne J. Konzelmann, 'Shareholder Primacy and the Trajectory of UK Corporate Governance', (2003) *British Journal of Industrial Relations* 531.

[108] John Lowry, Alan Dignam, *Company Law* (2nd ed, 2003), 292.

the Ministerial Statements[109]. Once satisfied, by the explanations obtained, that the actions by the director concerned satisfy the generally applicable proper purpose, the court could thus be in a better position to assess the proper purposes at issue in the particular case.

Another element could be what was recently perceived as lacking in the statement whereby '.business decisions on, for example, strategy and tactics are for directors, and not subject to decision by the court, subject to good faith'[110]: a definite standards against which the actions of directors alleging that they acted in good faith can be assessed or, in other words, an objective standpoint to for any directors' claim that they acted in good faith[111]. Specifically, this objective standpoint would lie – consistently with the strategic management perspective, and with the generally applicable proper purpose above indicated – on the foreseeable effect of the action concerned on the possibility of the business activity's survival and development over time and, thus, at least on those factors, listed in s. 172(1), that contribute to this survival and development and that are affected by the various decisions. The director concerned and his lawyer could well argue that these interests were internalised in the decision-making (which was fully informed about the company's affairs due to the approach that it adopted) in order to do all what was possible, ex ante, to preserve these stakeholders' contributions and thus to avoid a potential damage to the company . Thus, one could say that the strategic managerial perspective would offer exactly a generally valid objective standpoint, and that only this perspective can offer an objective input not only to affirm that no negligence occurred in the decision-making, but also to test even any assertion that directors may make that they acted in good faith. In other words, this perspective, if adopted and well explained, appears to be able to interconnect a generally applicable 'proper purpose' and the 'good faith'. This would be so despite the fact that the 'proper purposes' test, before the new Act, was reported to have application where directors' good faith was not challenged[112]. However, such a development would be consistent with the Notes when, in explaining the normally cumulative effects of the general duties, they state that '..where more than one duty applies, the director must comply with each applicable duty, and the duty must be read in this context. So, for example, the duty to promote the success of the company will not authorise the director to breach his duty to act within powers, even if he considers that it would be most likely to promote the success of the company'[113]. It could be argued that the duty to act in good faith to do what the directors believe will promote the success of the company, if the success is intended according to the concept suggested by the strategic managerial perspective[114], would never lead directors to breach the duty to act within powers and for the proper purposes which could characterise the specific situations of an ongoing business. This simply because these powers relating to a going concern business would be purposeless in the situations where, without the concern for the survival and development of the business recommended by the strategic managerial perspective, the existence of the business activity came to an end.

[109] Retro, Ministerial Statements above n 4, 7
[110] This statement is contained in the Notes (retro, part II, Note 327, p. 50), which echo the Guidance on the Key Clauses previously published (clause 64).
[111] Keay above n 61, 358.
[112] Butcher above n 102, 208.
[113] Note 313, p. 48.
[114] Retro, part I, C.

For all these reasons, it seems that directors become virtually 'invulnerable' once they can explain that *they acted in good faith because*, by adopting an open and inclusive approach to decision-making aimed at building long-term relationships with the groups listed in s. 172(1) (consistently with the generally applicable proper purpose) and at transmitting to those constituencies the message that their interests be safeguarded by the action at stake, *they had acquired all elements that could be known, ex ante, to believe that the action would promote the (long-term) success of the company for the benefit of the members as a whole* (where this success relates to the optimal conditions for protecting shareholders' rights to future income). Ultimately, the strategic management perspective would, thus, fit well with the Notes' statement that 'it will not be sufficient to pay lip service to the factors'[115]: it would, in fact, suggest that, only if the consideration of the statutory factors listed there always goes much beyond a lip service, it becomes possible to minimise the future risk on the business activity and thus to minimise, a priori, the risk of damage or potential damage to the company and to shareholders' benefits (and, from directors' viewpoint, to become 'invulnerable' to the risk of liability for breach of duty).

Shortly, it can thus be submitted that, in light of the trends in the case-law already developed and on what appears to be the current uncertainties about s. 172(1), the strategic management perspective, and the notion of success of the company that can be extrapolated from this perspective, has the potential of offering an input to legal reasoning in the English legal system more than it would have in a civil law system. In fact, as the courts incorporate the arguments presented by lawyers into a binding precedent, those arguments ultimately have a decisive role in leading to creative and even unforeseen developments[116]. Consequently, such developments could include the strategic management viewpoint and the notion of success of the company that this viewpoint would suggest[117], if these lines of reasoning were in the arguments presented. Of course, whether this input will be actually offered would seem to depend on directors' ability to 'internalise' this perspective, and thus to go beyond the short-term perceptions that have been indicated in recent years. In turn, this ability can be expected to depend on the personal cultural background, on the social context in which each director finds himself to operate and on the quality of its communication with lawyers and with other business professionals with whom the company normally interacts.

The literature has argued that, particularly in common law jurisdictions, 'legal boxes' have been construed and have caused, e.g., 'company law' to be seen as a separate discipline from 'labour law', 'ignoring the fact...that the huge majority of employees work for companies and that companies cannot work without employees' and thus 'resulting in a closure of a legal system which prevents relevant social data from playing its proper part'[118]: if 'legal boxes' have been construed amongst areas of law, it appears unsurprising that 'cultural boxes' may have (even unwittingly) been construed between law and other disciplines, e.g. between law and management. Accordingly, it appears unsurprising that the connection between two perspectives of analysis of s. 172(1), such as the legal perspective and the managerial one, may not appear immediate to directors and to

[115] Retro, part 2, Note 328, p. 51.
[116] Powell above n 99, 426 - 8.
[117] Retro, part I.
[118] Dine, above n 10, 66.

their professional advisers[119]. In this context, as regards the quality and the effects of the communication between lawyers and its clients, the US literature on the operation of social norms in the field of corporate law has argued that corporate law affects directors by changing their belief-systems, as well as by clarifying and by reinforcing social norms governing their behaviour[120]; it has also stressed the role of lawyers in communicating corporate law and standards of conduct to directors[121]. Whereas this may suggest that lawyers' message about s. 172(1) may be the first 'input' in affecting directors' perceptions about this new provision (so that a strategic managerial perspective would not be internalised by directors to the extent that it were not transmitted to them by their lawyers), the opposite case may also occur because directors ultimately have the primary interest in internalising this perspective[122]. Various factors may determine the start of the process from directors, i.e. their internalisation of the strategic managerial perspective, and make it possible the transmission of this input to lawyers: as argued in the previous part, directors' attention to the messages that are being publicly issued about s. 172(1), their own competence and their experience and skills in getting the most out of the dialogue with various categories of professionals can be the decisive factors[123]. Another element that may play a role in allowing a director, who has not been paying attention or proper attention, in his decisions, to the factors listed in s. 172(1), to change his approach, and to internalise the strategic management perspective, can be the increasing awareness that the leading businesses have already regarded the statutory factors as deserving necessary consideration for achieving a sustainable success[124]. In fact, this awareness can induce this director to assume these businesses – more successful than the one he runs - as models, in order to consolidate his role and to increase the general perception of his contribution to the company.

Whatever the factors that can lead directors to 'internalise' the strategic management perspective as the 'consultancy' to be drawn from s. 172(1), when this occurs there would be benefits: for the directors themselves, who would be in a position to make their choices undisputable even on an objective basis, and thus be in a substantially greater position of control of companies than they would otherwise be; for their corporate lawyers, who could find an opportunity to further enhance their role as 'business partners' by means of a more extensive dialogue, in the mutual interest, with other categories of professionals in assisting the long-term development of the businesses which are or may become common customers; for the courts, who could find, from any cases of directors successfully rejecting actions against them by using the strategic management perspective, the

[119] It has, in fact, been suggested that UK lawyers may not wish to be involved in business advice, or at least not to the same extent as US lawyers: John Flood, 'Megalawyering in the Global Legal Order' (1996) 3 *International Journal of the Legal Profession* 169, 192; E. Norman Veasey, Christine T. Di Guglielmo, 'The Tensions, Stresses and Professional Responsibilities of the Lawyer for the Corporation' (2006) 62 *Business Lawyer* 1, 25-27; Mary C. Daly, 'The Cultural, Ethical and Legal Challenges in Lawyering for a Global Organization: The Role of the General Counsel' (1997) 46 *Emory Law Journal* 1057, 1062 and 1077

[120] Melvin Eisenberg, 'Corporate Law and Social Norms' (1999) 99 *Columbia Law Review* 1253, 1255, 1269-71 and 1276, where 'social norms' are intended by the Author as all rules and regularities covering human conduct, other than legal rules and organizational rules, i.e. as standards of conduct.

[121] Edward B. Rock, 'Saints and Sinners: How Does Delaware Corporate Law Work?' (1997) 44 *University of California at Los Angeles Law Review* 1009, 1017-18.

[122] Retro, part II B.

[123] Ibid.

[124] Darling above n 15.

kind of objective considerations to be used to assess directors' conduct in the cases where this perspective is not adopted; for the shareholders, who would get a *priori* an 'insurance' that the optimal conditions for continuing dividends are being sought and maintained. The fact that the co-operative, long – term relationships 'recommended' by the strategic management perspective would offer what can be considered such an 'insurance' seems to be confirmed by two major reports issued over the years preceding the company law reform, which reports attributed the poor performance of many UK companies relative to their overseas competitors not only to underinvestment in physical capital and research and development, but also to a failure to cultivate long-term, co-operative relationships with employees and, in general, co-operative relationships in the 'supply chain'[125].

Lastly, a consequence deriving from the potential of the strategic management perspective to offer an input to legal reasoning would be that, when this input is actually offered, the model of companies underpinning UK company law could also gradually complete what was regarded as a shift from a contractual model into a constituency model[126]. Notably, the contractual model regards a company as primarily the property of and co-extensive with the founders, and results in the interests of shareholders being equated with the interest of the company; the constituency model in a first variant considers the company run in the interest of shareholders when the interests of other groups are also taken into account (on the ground that to ignore them would damage shareholders' interests), and, in a second variant, it accepts that the concerns of other groups must be taken into consideration because such an approach benefits the company directly[127]. The gradual shift towards a constituency model or at least towards a contractual/constituency model - i.e. to a model that would be a contractual one, acknowledging only the interests of the founders, as regards the foundation stage, but would be a constituency one, accepting the concerns of other constituencies, when the company is operational - appears to be potentially possible because the strategic managerial perspective would offer a reply exactly to what was regarded as the difficulty with the constituency model. The difficulty was identified on how to balance the competing interests, an issue which has attracted significant criticism[128]. The reply would be that this can be done by those actions that would transmit to each groups the awareness of mutual wealth-creation over time and, in so doing, that would best ensure the continuity of the business activity over time by fostering co–operative and lasting relationships. As a result of this, the task to be accomplished could not even be seen any longer as a balancing of interests. This because – according to the general criteria suggested by the strategic managerial perspective to identify the case when the interests of shareholders and of other groups coincide[129] - any interests of the groups who would not oppose the survival and development of the business activity could no longer be properly considered as contrasting with each others.

---

[125] Parkinson, above n. 5, 46.

[126] Janet Dine, *The Governance of Corporate Groups* (2000), 33-36

[127] Janet Dine, 'Model of companies and the regulation of groups', in Barry A.K.Rider (ed), *The corporate dimension: an exploration of developing areas of company law* (1998), 287.

[128] Inter alia: Mathias M. Siems, 'Shareholders, Stakeholders and the "Ordoliberalism"' (2002) 13 *European Business Law Review* 147; Elaine Sternberg, *Corporate Governance, Accountability in the Marketplace* (2nd ed., 2004) 135.

[129] Retro, part I, C.

IV. A PROPOSED DEFINITION FOR THE INTERNALISATION OF THE STRATEGIC MANAGERIAL PERSPECTIVE: AN 'ENLIGHTENED DIRECTORS' PRIMACY'

In light of all previous arguments, it may be inferred that if/ when directors in the UK consider s. 172(1) not as a complication in their decision making and a box ticking exercise, but as a strategic advise on how to make their choices undisputable and catch this opportunity by taking the strategic management perspective, the enlightened shareholder value may lead to an outcome perhaps beyond the expectations of the CLRSG. Although the enlightened shareholder value was conceived in such a hierarchical way that the duty to foster the success of the company for the benefit of the members takes priority over the duty to take into account other interests[130], it might result in some companies whose directors may identify the elements listed in s. 172(1) as 'ingredients' *always* necessary for business competitiveness and growth, thus for company's long-term success, in order to be able to always justify their choice with complete and consistent arguments and thus to insulate themselves from legal actions or in any case to prevent ex ante these actions from being successful. As these directors may find, for their own interest, that the strategic management perspective turns out being the most convenient one, the result of the enlightened shareholders value *in the companies run by these directors* may be something that the CLRSG perhaps did not envisage. This possible result may be explaining by 'borrowing' a conceptual framework developed in the USA: the 'directors' primacy approach'[131] . In this framework, which expressly aims at providing responses to the two questions concerning who controls corporations ('means of corporate governance') and whose interests should prevail when decision-making is presented with a zero-sum game ('ends of corporate governance'), the firm has a nexus of contracts with agents which are hired by a central decision-making body, the board of directors. The proponents of the framework explain that, unlike what is conceptualised in the shareholder primacy approach, the board of directors would not generally be hired by shareholders, but would hire factors of productions, amongst which investors and thus shareholders; however, in order to successfully hire shareholders, the boards of directors need to commit themselves to maximise shareholders wealth, as shareholders would be the most vulnerable corporate constituency and the interests of other stakeholders would be protected either by contract or by the law. Thus, this framework submits that the 'means of corporate governance' is the control of corporation by directors, and that the 'ends of corporate governance' is the maximisation of shareholders wealth. If applying the conceptual distinction between 'means of corporate governance' and 'ends of corporate governance' to those UK companies where directors, for their own benefit, may identify the internalisation of the wider concerns listed in s. 172(1) as always necessary for business success (for shareholders' own benefit) and thus adopt the strategic managerial perspective, an observation can be made. It may be said that, in those companies, the 'means of corporate governance' would be the control by directors, but the 'end of corporate governance' would be 'enlightened' because it would *always* lie in the maximisation of the possibilities of business survival and development over time, as a result of which the interest of both shareholders and other constituencies in getting continuous returns could all be

[130] Arsalidou above n 2, 69; Keay above n 61, 350

[131] Stephen M. Bainbridge 'Director primacy: the Means and Ends of Corporate governance' (2003) 97 *Northwestern University Law Review* 581.

satisfied. The consequent choices would be oriented by means of two ultimate, objective yardsticks: a) the maintaining, over time, of the contribution of each of these constituencies to the business' survival and development, and thus the continuity of the business activity; b) the need to minimise or avoid the risk that directorial decisions be seen as creating a zero-sum game between shareholders and other stakeholders group, which need could be met by building long-term relationships based on trust, and by transmitting to each constituency the message that these are the most solid foundation for ensuring, ex ante, the continuation of the business activity to the benefit of everybody. Taking into account that a US literature defined, in terms of 'enlightened stakeholders theory', a stakeholders model where the consideration of the interests of various constituencies is oriented by an objective yardstick such as the maximisation of long-term firm's market value[132], what may happen in those UK companies under consideration here may well be indicated in terms of 'enlightened directors' primacy'[133]. In other words, the ultimate outcome may be, *in some companies,* that of introducing exactly the approach that would fit in with also with the enlightened stakeholders theory, despite the fact that the CLRSG rejected the stakeholder model and embraced a shareholders centred paradigm. The result may seem paradoxical in light of this choice by the CLRSG, because the 'enlightened directors primacy' resulting in the companies under consideration would ultimately cause the classic distinction between shareholders primacy and stakeholders models to become purposeless *for those companies.* This would be so due to the fact that – as noted above - the broader concerns indicated in s. 172(1) would, in the companies considered, always be seen as necessary to achieve the success of the company for the benefits of its members as a whole, as the continuity of the enterprise over time and its development would be seen as the key component of this success. In turn, this would bring the corporate governance approach of these UK companies to coincide, in essence, with the approach which has been accepted in some continental Europe jurisdictions which accept, expressly or implicitly, the pluralist approach: e.g., in the Netherlands, the Corporate Governance Code is based on the conception of the company as a 'long-term form of collaboration between the various parts involved' and identifies the general, ultimate task of the management *in ensuring the continuity of the enterprise*[134]; in both Germany and Austria, the Corporate Governance Codes accept, in different words, the same conception when they state that the management board undertakes 'to increase the *sustainable* value of the enterprise'[135] or set the aim of creating a system of management and control that is 'geared to creating sustainable, long-term value'[136] ; in France, the 'Vienot I' Code, which identifies the task of the board of directors in the promotion of the interest of the company, states even more expressly that the interest of the company lies 'in the overriding claim of the company considered as a separate economic agent, pursuing its own objectives which are distinct from those of shareholders, employees, creditors including the internal

[132] Michael C. Jensen, 'Value Maximisation, Stakeholders Theory and the Corporate Objective Function' (2001) 7 *European Financial Management* 297, 309

[133] Alan Dignam, 'Lamenting reform ? The changing nature of common law corporate governance Regulation' (2007) 5 *Company and Security Law Journal* 283, 293, in commenting s. 172(1), refers to "enlightened" directors considering the interests of stakeholders in their decision-making.

[134] See 'The Dutch Code of Corporate Governance. Principles of good corporate governance and best practice provisions', 9 December 2003, Preamble, point 3, emphasis added.

[135] See the German Corporate Governance Code (Cromme Code), 2002, 6, emphasis added.

[136] See the Austrian Code of Corporate Governance, 2006 version, 9

revenue authorities, suppliers and customers. It nonetheless represents the *common interest* of all these persons, which is for *the company to remain in business and to prosper*'[137] . It is evident that the concern for the maintaining over time of the resources that the various constituencies offer to the business activity, that would characterise the 'enlightened directors' primacy', would also reflect the same objective recognised in these continental Europe jurisdictions.

Lastly, the 'enlightened directors' primacy' would also imply that, for the companies concerned, the 'enlightened shareholders value' would fully satisfy the recommendations formulated in the OECD Principles with regard to the relationships between the different constituencies. The OECD Principles state, in fact, that the corporate governance framework should, inter alia, '…encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises' [138], and thus recognise '..that the interests of the corporation are served by recognising the interests of stakeholders and their contribution to the long-term success of the corporation'[139]. Therefore, in accordance with the Principles, while acting 'on a fully informed basis, with due diligence and care, and in the best interest of the company and the shareholders', the board should 'take due regard of, and deal fairly with, other stakeholders' interests including those of employees, creditors, customers, suppliers and local communities' and observe (high) environmental and social standards[140]. In turn, the assessment as to whether these principles are being observed should, in addition to applying strictly legal criteria, verify whether there is an environment favourable to the respect of mutual agreements[141] and whether there is widespread disclosure about how stakeholders issue are being handled[142]. It can be easily realised that the internalisation of the strategic managerial perspective to s. 172(1) [143] (and, thus, the perception of the factors listed there as elements that always need to be safeguarded, in the decision-making, by means of long term relationships based on trust and of an inclusive and fully transparent communication approach) presupposes, on its own, the conduct recommended by the OECD Principles (unlike a 'lip service' to these factors or a 'box-ticking' exercise).

CONCLUSIVE REMARK

In conclusion, it may be said that the strategic managerial perspective described in part. I, which gives a specific content to a notion of 'success' as 'long-term increase in value', allows directors who accept this perspective to regard s. 172(1) as a 'strategic advise' to them on how to make their choices even more undisputable than they would otherwise be. The company law review process which led to the reform had the intention to achieve a behavioural change in directorial decisions after the short-term perceptions that appeared to prevail in recent years[144]. This article has ultimately argued that, when directors perceive

[137] See 'Le conseil d'administration des sociétés cotees', Rapport du group du travail Association Française des Entreprises Privées Conseil National du Patronat Français (Vienot 1 Code), 1995, 8, emphasis added.
[138] OECD Principles, Charter IV, 21.
[139] OECD Principles, Annotations, 46.
[140] OECD Principles, Charter VI, p. 24 Annotations, 58-60.
[141] Methodology for assessing the implementation of the OECD Principles on corporate governance (Paris: OECD 2006), p. 45 (hereinafter: Methodology).
[142] Methodology, 69
[143] Retro, part I
[144] Retro, par. I, A.

the benefit they could get from 'internalising' the strategic managerial perspective, and adopt the inclusive and fully transparent decision-making approach resulting from it, two decisive consequences can be expected. First, the behavioural change in directors' decisions that the CLRSG hoped to achieve can find the best conditions to take place. Secondly, the strategic managerial perspective could actually offer an input to the legal reasoning and thus to the model of companies underpinning UK company law. Its ultimate result for the companies concerned, that this article proposes to define as 'enlightened directors' primacy', would be fully in line with the internationally recognised standards of behaviour for a successful company (which standards may be inferred from the OECD Principles). Ultimately, it may thus be concluded that the drafters of s. 172(1) introduced a provision where law and strategic management meet each other, which provision, as a result, would have been applicable to whatever business–friendly jurisdiction.