The Long Road to Reformulating the Understanding of Directors' Duties: Legalizing Team Production Theory?

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I. INTRODUCTION

In this Article, the historical evolution of corporate governance is considered, highlighting the different eras of governance, the dominant theoretical and practical paradigms, and the reformulation of paradigms and counter paradigms. Two alternative and sharply contrasting theorizations, one collective and collaborative (the work of Berle and Means), the other individualistic and contractual (agency theory and shareholder value) are focused upon. The explanatory potential of Blair and Stout's team production theory is elaborated, along with its conception of the complexity of business enterprise, with a mediating hierarch (the board of directors) securing a balance between the interests of different stakeholders. The potential for reform of corporate purpose, corporate governance, and directors' duties is examined with reference to the U.K. Modern Company Law Review. The impact of the intensification of the financialization of corporations is analyzed, with the increased emphasis upon short-termism. The origins of the global financial crisis in shareholder value orientations are explored, as well as the continuing reverberations of the crisis. In light of the foregoing discussion, I argue it is imperative to advance sustainable enterprise, and elaborate on the critical changes this will necessitate in corporate purpose and directors' duties.

II. THE EVOLUTION OF CORPORATE GOVERNANCE AND OF DIRECTORS' DUTIES

Corporate governance has evolved through a series of epoch-making paradigmatic challenges. Bob Tricker, who pioneered the con-

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temporary research in corporate governance,[1] has suggested that three distinct eras can be identified:

- Nineteenth century: Entrepreneurship
- Twentieth century: Management
- Twenty-first century: Governance

The nineteenth century was a time of great entrepreneurs advancing technologies and products, building businesses in enterprises they owned and controlled with a personal domination. As business enterprises increased in scale and complexity, the need for more specialized management and for enhanced sources of investment led to the separation of ownership and control, and boards of directors became more firmly established in the twentieth century to pursue the best interests of the company and provide accountability for performance. In the twenty-first century, the need for wider accountability and responsibility of business has become apparent with the realization of the profound environmental and social impact of corporations. In addition, there is the increasing influence of the rise of vast investment institutions, the beneficiaries of whom represent large sections of the community including superannuation, insurance and mutual funds, and the recognition that effective governance is required for the security of investments.

Managers operating in a particular era typically see the world through one overarching paradigm, within which separate frames of reference, metaphors, and perspectives that they use stand in some coherence to each other, but differ radically from those in use in preceding and succeeding eras. Using new frames of reference or seeing through the assumptions of different forms means that the managerial and organizational world not only looks different, it becomes different (sometimes presented as the social construction of reality).[2] In any system that is ecologically interdependent, if you change any paradigmatic part then you change the whole. When there is sufficient change and fluidity in the system then we can speak of a "paradigm shift"—the period when a shift occurs from one paradigm to the next new paradigm. In these circumstances uncertainty and ambiguity will apply.

Paradigm shifts are more challenging today because the pace of social, economic, and technological change is more rapid, and the impact of business on the environment and society is more profound. Multiple technological breakthroughs, shortening product life cycles along global

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1. *See* ROBERT I. TRICKER, CORPORATE GOVERNANCE (1984); Robert I. TRICKER, CORPORATE GOVERNANCE: PRINCIPLES, POLICIES AND PRACTICES (2012).

2. *See* PETER L. BERGMAN & THOMAS LUCKMANN, THE SOCIAL CONSTRUCTION OF REALITY (1966).

value chains, and rapidly changing markets are accelerating the pace of paradigm shifts, while serious questions are being raised concerning the sustainability of business enterprise.[3]

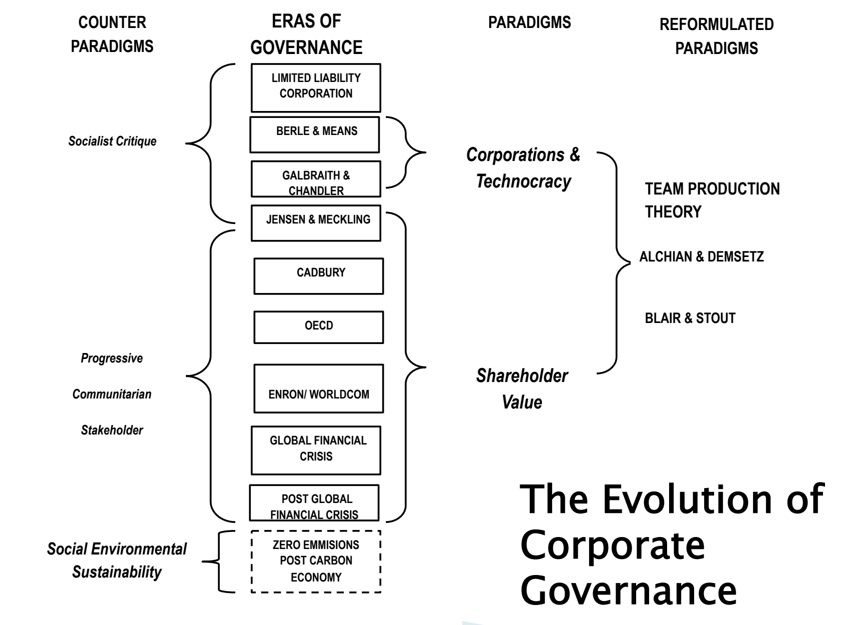

Figure 1: *The Evolution of Corporate Governance*

The evolution of corporate governance is portrayed in Figure 1, which highlights the different eras of governance, the dominant theoretical and practical paradigms, and the reformulation of paradigms and counter-paradigms. The early decades of governance in the nineteenth century were spent wrestling with the implications of the limited liability corporation. In the 1930s, Berle and Means's recognition of the paradigm shift from owner-entrepreneurs to modern corporations with professional managers and dispersed shareholders defined the parameters of debate for the next half century, culminating in the remarkable intellectual contributions of John Kenneth Galbraith and Alfred Chandler on the nature of the new industrial state and the managerial revolution during the expansionary years of the post-war recovery. In the more troubled economic times during the closing decades of the twentieth century, the narrower focus of Jensen and Meckling on the principal–agency problem took hold

3. *See* THOMAS CLARKE & STEWART CLEGG, CHANGING PARADIGMS: THE TRANSFORMATION OF MANAGEMENT KNOWLEDGE FOR THE 21ST CENTURY (2000).

with a vice-like grip on the minds of economists, lawyers, policymakers, and sometimes self-interested business people. More recently a reform movement in corporate governance, initiated in the U.K. Cadbury Report and spread internationally by the Organisation for Economic Co-operation and Development (OECD), has continued, though defied by the spectacular corporate failures of Enron and WorldCom, and almost imploded in the recklessness of the global financial crisis.

Throughout the last century there were always radical voices that offered a different critique: in different eras, socialist, progressive, communitarian, and stakeholder ideas possessed resonance and an appeal to an alternative economic and political system. However the strongest intellectual legacy of this rich historical development is undoubtedly a particularly lethal, stripped down interpretation of agency theory and shareholder value. How the crudest of conceptions could capture such a hegemonic hold is a subject worthy of deep study in the sociology of knowledge.

Another tributary of ideas has offered a more thoughtful interpretation of the corporate governance dilemma. Team production theory, initiated by Alchian and Demsetz, comprehends something of the collaborative basis of business endeavor that was fundamental to earlier theorists. The reformulation of team production theory by Margaret Blair and Lynn Stout presents a recognizable and meaningful explanation of the purpose of the corporation and the duties of directors. However, it is likely that to meet the imminent challenge of social and environmental sustainability in a post-carbon economy, further rethinking of corporate purpose, corporate governance, and directors' duties will be essential.

The search for coherent new paradigms is a vital task in corporate governance because it is a discipline

- that has become identified almost solely with endless templates for compliance and regulation;
- overwhelmed by the constrictions of agency theory;[4]
- neglectful of diversity, creativity, and innovation;
- unaware of the impact of corporate governance upon the intensification of inequality;[5]
- with a narrow focus on empirical studies of abstracted variables and bereft of attempts at holistic explanations of integrated and interrelated social and economic institutions and systems; and

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4. *See* Olivier Weinstein, *Firm, Property and Governance: From Berle and Means to the Agency Theory, and Beyond*, ACCT., ECON. & L.: A CONVIVIUM, June 2012, at 1.

5. *See* Paddy Ireland, *Shareholder Primacy and the Distribution of Wealth*, 68 MOD. L. REV. 49, 77 (2005).

- ill-equipped to deal with the urgent imperative for corporate governance to deliver sustainable enterprise.[6]

III. BERLE AND MEANS AND THE COLLECTIVE NATURE OF THE CORPORATION

Since the origins of contemporary capitalism, the wider purposes and interests of the corporation were recognized and valued. Berle and Means were the first to fully explore the structural and strategic implications of the separation of ownership and control.[7] Berle wrote in the preface to *The Modern Corporation and Private Property* that "it was apparent to any thoughtful observer that the American corporation had ceased to be a private business device and had become an institution."[8] In their monumental work, Berle and Means searched for a new conception of the corporation that embraced the wide constituency of corporate interests and responsibilities (a concern tragically abandoned by most contemporary financial economists):

> Neither the claims of ownership nor those of control can stand against the paramount interest of the community. . . . It remains only for the claims of the community to be put forward with clarity and force. Rigid enforcement of property rights as a temporary protection against plundering by control would not stand in the way of the modification of these rights in the interests of other groups. When a convincing system for community obligations is worked out and is generally accepted, in that moment the passive property right of today must yield before the larger interests of society. Should corporate leaders, for example, set forth a program comprising fair wages, security to employees, reasonable service to their public and stabilization of business, all of which would divert a portion of the profits from the owners of passive property and would the community generally accept such a scheme as a logical and human solution of industrial difficulties, the interests of passive property owners would have to give way. Courts would almost of necessity be forced to recognize the result, justifying it by whatever of the many legal theories they might choose. It is conceivable, indeed it is almost essential if the corporate system is to survive, that the "control" of the great corporations should develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community

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6. *See* THOMAS CLARKE, INTERNATIONAL CORPORATE GOVERNANCE (2d ed. forthcoming 2015).

7. *See* Weinstein, *supra* note 4.

8. ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY, at v (1932).

> and assigning to each a portion of the income streams on the basis of public policy rather than private cupidity.[9]

As Olivier Weinstein authoritatively sets out, the clear features of the new form of corporate enterprise advanced by Berle and Means, "underlying its capacity to serve as a support to the accumulation of capital and to an unprecedented concentration of material, human and financial resources,"[10] included three essential dimensions:

- The separation between investors and the enterprise, the status of the corporation making the corporation an autonomous entity, involving the strict separation between the assets of the enterprise and the assets of the investors;[11]
- Incorporation required governance rules legally separating business decisionmaking from the contribution of finance capital, and giving discretionary powers to directors and officers, recognizing their managerial rights to allocate corporate resources;[12]
- The freedom in a public corporation for shareholders to sell their stock with the development of capital markets. This signified a radical change in the relationship of the investors and the enterprise.[13]

These dimensions are integral to the investment, operation, and development of corporations, the workings of capital markets, and are the foundation on which Berle and Means built their theory of the implications of the separation of ownership and control. Integral to this theorization is a realization that there is a distinction between the corporation as a legal entity and the firm as a real organization. The corporation is both a legal entity and a collective, economic set of activities that cannot be simply reduced to a series of contracts. It is this latter existence that gives the corporation an existence independent from the changing shareholders.[14] This gives rise to the enduring question: In whose interests should the corporation be managed?

Berle and Means could never have imagined that eighty years later corporations, managers, shareholders, and lawyers would remain mired

9. *Id*. at 312.

10. *See* Weinstein, *supra* note 4, at 5.

11. *Id.*

12. *Id.* at 6.

13. *Id.*

14. *See* Margaret M. Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); *see also* Richard Mitchell, Anthony O'Donnell & Ian Ramsay, *Shareholder Value and Employee Interests: Intersections of Corporate Governance, Corporate Law and Labor Law*, 23 WISC. INT'L L.J. 417 (2005).

in the controversial issues raised by their ideals. And however undermined and marginalized the idealism of Berle and Means became in the work of financial economists in the later twentieth century (who reasserted shareholder primacy with a purity and intensity not witnessed since the early nineteenth century origins of industrial capitalism), the resonances of good sense of the original Berle and Means statement continued in the minds and actions of practical managers and corporations.

An emerging collective conception of the corporation is conveyed in the early work of Berle and Means, who identified the collective nature of the corporate entity, the importance of managing multidimensional relationships, and the increasing accountability of the corporate entity with profound obligations to the wider community.[15] Paradoxically, Berle and Means left an ambiguous legacy[16] that was subsequently interpreted in two alternative and sharply contrasting theorizations: one collective and collaborative, the other individualistic and contractual.[17]

Throughout much of the twentieth century, the large modern enterprise was represented as a social institution, an organization formed through collective action and technological advance.[18] Chandler is identified with the conception of the large corporation as an integrated, unified, collective entity that could not possibly be reduced to the sum of individuals it comprises.[19] Then, in the later decades of the twentieth century, the view of the enterprise as a simple contractual arrangement—a nexus of contracts—and a mode of interaction between individuals became ascendant, providing the theoretical framework for the ultimately hegemonic agency theory and its insistence on shareholder primacy and shareholder value.[20]

The modern corporation, as typified by Berle and Means, manifested the separation of ownership and control, where professional managers were able to determine the direction of the enterprise and shareholders had "surrendered a set of definite rights for a set of indefinite expecta-

15. *See* BERLE & MEANS, *supra* note 8.

16. *See* John W. Cioffi, *Fiduciaries, Federalization, and Finance Capitalism: Berle's Ambiguous Legacy and the Collapse of Countervailing Power*, 34 SEATTLE U. L. REV. 1081 (2011).

17. *See* Weinstein, *supra* note 4.

18. *See* ALFRED D. CHANDLER, THE VISIBLE HAND, MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977); JOHN KENNETH GALBRAITH, AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER (1952); JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE (1967).

19. *See Weinstein*, *supra* note 4.

20. *See* MICHEL AGLIETTA & ANTOINE REBERIOUX, CORPORATE GOVERNANCE ADRIFT: A CRITIQUE OF SHAREHOLDER VALUE (2005); Armen A. Alchian & Harold Demsetz, *The Property Right Paradigm*, 33 J. ECON. HIST. 16 (1973); Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Capital Structure*, 3 J. FIN. ECON. 305 (1976); Weinstein, *supra* note 4.

tions."[21] After the New Deal and the end of the Second World War, managers seized the opportunities newly open to them, and many U.S. corporations grew massively in scale and market domination, achieving a preeminent position in the world economy. A new managerial mode of coordination of enterprise, technology, and planning had arrived transcending the market.[22] As Lynn Stout recounts:

> History suggests that Berle and Means's 1932 prediction proved largely correct. For the next half-century, boards and executives of public corporations embraced a philosophy that has been called "managerial capitalism" or "managerialism." Rather than seeing themselves as mere agents of shareholders, corporate directors and professional executives—who usually worked for fixed fees and owned relatively little stock in the company—viewed themselves as stewards or trustees charged with guiding a vital social and economic institution in the interests of a wide range of beneficiaries. Certainly they looked out for investors' interests, but they looked out for the interests of employees, customers, and the nation as well . . . . Judged by that standard, managerial capitalism seemed to generate good results. American corporations dominated the global economy, producing innovative products for their consumers, secure jobs for their employees, and corporate tax revenues for their government. And—especially notable—they produced outstanding investment results for public shareholders. Between 1933 and 1976 (a period that includes the infamous bear market of 1973–1974), shareholders who invested in the S&P 500 enjoyed inflation-adjusted compound average annual returns of 7.5%. This compares very favorably indeed with the sorts of returns shareholders have received more recently.[23]

This was the era of Galbraith's *New Industrial State*, in which corporate growth and brand prestige appeared to displace profit maximization as the goal of technocratic managers (who, in his view, often possessed excessively concentrated power).[24] In a technocratic milieu, the shareholder was rendered "passive and functionless, remarkable only in

21. BERLE & MEANS, *supra* note 8, at 244.

22. *See* CHANDLER, *supra* note 18.

23. Lynn Stout, *On the Rise and Shareholder Primacy, Signs of its Fall, and the Return of Managerialism (in the Closet)*, 36 SEATTLE U. L. REV. 1169, 1171 (2013); *see also* GERALD F. DAVIS, MANAGED BY THE MARKETS: HOW FINANCE RE-SHAPED AMERICA 63 (2009); ROBIN MARRIS, THE ECONOMIC THEORY OF MANAGERIAL CAPITALISM (1964); ROGER L. MARTIN, FIXING THE GAME: BUBBLES, CRASHES, AND WHAT CAPITALISM CAN LEARN FROM THE NFL 63 (2011); Alfred D. Chandler, *The Emergence of Managerial Capitalism*, 58 BUS. HIST. REV. 473 (1984); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

24. *See* GALBRAITH, *supra* note 18; *see also* DOUG HENWOOD, WALL STREET: HOW IT WORKS AND FOR WHOM 259 (1998).

his capacity to share without effort or appreciable risk, the gains from growth by which the technostructure measures its success."[25] This Galbraithian idyll was disintegrating by the time of the severe recession of the early 1970s, with the inability of U.S. corporations to compete effectively with Japanese and European products in important consumer market sectors, accompanied by a push from Wall Street towards conglomerate formation in the interests of managing multiple businesses by financial performance. "Over time purely financial interests have increasingly asserted their influence over hybridised giant corporations."[26]

IV. The Grim Hegemony of Agency Theory and Shareholder Value

While the nexus of contracts theory preceded agency theory, and was the intellectual foundation upon which it was based, it was the cruder aspects of agency theory that became the dominant paradigm in business and law. The insistence on the collective and public nature of the new corporations which Berle and Means convincingly made, and others including Galbraith and Chandler developed, invited a response from economists and lawyers who retained a belief in private property, free markets, and shareholder rights. This was a determined and successful effort to impose "the reprivatisation of the corporation."[27]

A fertile scene was set for Michael Jensen, his colleagues in the business and law schools at Harvard, and the Chicago school of economics—as enthusiastic advocates of the financialization sweeping through corporate America—to develop a finance-based theory of corporate governance that was to envelop Anglo-American policy and practice. While agency theory and shareholder value were the most enduring principles of the Jensen legacy, they were preceded and accompanied by other financial innovations that disrupted the stability and often damaged the substance of corporate America. The series of wrecking balls of leveraged buyouts (LBOs), junk bonds, and free cash flow directed at U.S. corporations were impelled by the frequent enthusiastic exhortations of Jensen.[28]

Jensen was an early convert to the LBO, in which a group of investors and incumbent senior management would take a company private by going deeply into debt: "The discipline of debt and the potential vast re-

25. GALBRAITH, *supra* note 18, at 356.

26. HENWOOD, *supra* note 24, at 262.

27. *See* Ireland, *supra* note 5; Weinstein, *supra* note 4.

28. *See* HENWOOD, *supra* note 24; William Lazonick, *Controlling the Market for Corporate Control: The Historical Significance of Managerial Capitalism*, 3 J. INDUST. & CORP. CHANGE 445 (1992) [hereinafter Lazonick, *Controlling*].

wards from holding the stock would inspire managers to heroic feats of accumulation."[29] In this new market for corporate control, alternative managerial teams compete for the rights to manage corporate resources.[30] However, it is clear that the resources the new management teams were particularly focused upon were the cash flows of the corporations concerned. Jensen neatly translated this investor avariciousness into "disgorging free cash flow," which he defined as:

> [C]ash flow in excess of that required to fund all projects that have net present values when discounted at the relevant cost of capital. Conflicts of interest between shareholders and managers over payout policies are especially severe when the organization generates substantial cash flow. The problem is how to motivate managers to disgorge the cash rather than investing at below the cost of capital or wasting it on organization inefficiencies.[31]

Yet, as Henwood persuasively argues:

> Jensen's definition sounds more precise than it really is, while cash flow and cost of capital are possible to figure out, though different analysts will come up with different measures for each, it is judging future projects that is difficult. It assumes firms know how much money a project can earn. Of course they never can. In practice, one can do little more than extrapolate from the past, but that's not really the same thing.[32]

For Jensen, "the stock market is always axiomatically the ultimate arbiter of social good."[33] However, the result of eliminating the free cash flow of companies in LBOs (which disappeared in fees to investment banks and lawyers, and in huge incentives paid to management and former shareholders), and in loading up companies with debt, while facing increasing interest rates in the inflationary times of the 1970s and 1980s, was to leave U.S. companies without capital to invest in research and development at a time of increasing competition from overseas companies engaged in continuous product development.[34] Meanwhile, Jensen was more impressed by the financial innovation of boutique LBO firms such as Kohlberg Kravis Roberts (KKR), and the inventor of the low rat-

29. Michael C. Jensen, *Eclipse of the Public Corporation*, HARV. BUS. REV., Sept–Oct. 1989, at 61, *available at* https://hbr.org/1989/09/eclipse-of-the-public-corporation/ar/1.

30. *See* Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control*, 11 J. FIN. ECON. 5 (1983).

31. Jensen, *supra* note 29, at __.

32. HENWOOD, *supra* note 24, at 260.

33. HENWOOD, *supra* note 24, at 269.

34. *See* MARGARET M. BLAIR, THE DEAL DECADE: WHAT TAKEOVERS AND LEVERAGED BUYOUTS MEAN FOR CORPORATE GOVERNANCE (1993); MICHAEL USEEM, INVESTOR CAPITALISM: HOW MONEY MANAGERS ARE CHANGING THE FACE OF CORPORATE AMERICA (1996).

ed/high-risk/high-return junk bonds, Drexel Burnham Lambert, suggesting these financial engineers could readily replace corporate entrepreneurs:

> With all its vast increase in data, talent and technology, Wall Street can allocate capital among competing businesses and monitor and discipline management more effectively than the CEO and headquarters staff of the typical diversified company. KKR's New York offices and Irwin Jacobs' Minneapolis base are direct substitutes for corporate headquarters.[35]

This amounted to the eclipse of the public corporation to Jensen, which he announced in a celebrated *Harvard Business Review* article, which received a robust response.[36] Peter Róna, head of Schroder Bank in New York, maintained that by exclusively privileging shareholder interests Jensen preempted "thoughtful analysis of the very question that is at the heart of the issue—what should be the rights and privileges of shareholders?"[37] Róna questioned Jensen's assumption that shareholders are better judges of capital projects than managers and corporate boards as "an ideologically inspired assertion that lacks empirical support."[38]

Extensive evidence assembled by Henwood suggests that Jensen's confidence, that "all-knowing financial markets will guide real investment decisions towards their optimum, and with the proper set of incentives, owner-managers will follow this guidance without reservation,"[39] was unfounded. The impact of the restructuring of assets in the increasingly aggressive market for corporate control in the 1970s and 1980s was not primarily efficiency enhancing as Jensen maintained, and there is little support for the "inefficient management displacement hypothesis."[40] While acquisitions may benefit some private interests, there is little productivity gain and frequent losses from mergers.[41] Any returns from hostile acquisitions came from other sources, including reductions in employment, tax savings, cuts in investment, and possibly, with mergers within industries, increasing their market power to control prices. Moreover, management buyouts and hostile takeovers were not a new permanent organizational form, but a temporary reallocation of assets

35. Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986).

36. *See* Jensen, *supra* note 29.

37. Peter Róna, *Letter in Response to Jensen*, HARV. BUS. REV., Nov.–Dec. 1989, at 6.

38. *Id.*

39. HENWOOD, *supra* note 24, at 276.

40. *See* David J. Ravenscraft & Frederic M. Scherer, *The Profitability of Mergers*, 7 INT'L J. INDUS. ORG. 101, 116 (1989).

41. *See* Richard E. Caves, *Mergers, Takeovers, and Economic Efficiency: Foresight vs. Hindsight*, 7 INT'L J. INDUS. ORG. 151 (1989).

before they were transferred back to large public corporations.[42] In this process the large U.S. corporation was not eclipsed, but was usually badly bruised and often left eviscerated.

The 1980s ended with disillusionment in the role of LBO firms to serve any interest other than their own,[43] with an extensive series of defaults by overleveraged firms amounting to the largest insolvency boom since the 1930s, and with the imprisonment of Michael Milken of Drexel Burnham for fraud. Those who wished to discipline corporations needed to find a more pliable tool than the market for corporate control in order to do so. The organization of shareholder activism provided a new form of investor assertiveness. Ironically, among the most influential of the new shareholder activists was T. Boone Pickens, an oil industry corporate raider. He organized the United Shareholders Association (USA):

> From its 1986 founding to its 1993 dissolution, USA tracked the performance of large public corporations and compiled a Target 50 list of losers. The USA would try to negotiate with the underperformers, urging them to slim down, undo anti-takeover provisions, and just deliver their shareholders more "value." If satisfaction wasn't forthcoming, USA would ask its 65,000 members to sponsor shareholder resolutions to change governance structures. USA-inspired resolutions were often co-sponsored by groups like the California Public Employees Retirement System (Calpers), the College Retirement Equities Fund (CREF), and the New York City Employees Retirement System (Nycers).[44]

In 1995, a new organization, Relational Investors, was founded to invest and act as a "catalyst for change" with similar backing from a number of large institutional investors. These were pension funds of public sector workers, adopting an antimanagement rhetoric aimed at big business, though focusing on governance reforms, such as more independent directors and linking executive pay to stock performance.[45] Unfortunately, these performance improvements would often be achieved by downsizing and investment cutbacks, and heralded an increasing short-termism in the obsession with quarterly results. The rationale for these interventions was that higher share prices benefited society at large; however, the loss of growth and employment through reduced invest-

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42. *See* Sanjai Bhagat, Andrei Shleifer & Robert Vishny, *Hostile Takeovers in the 1980s: The Return to Corporate Specialization*, *in* BROOKINGS PAPERS ON ECONOMIC ACTIVITY: MICROECONOMICS 1 (Martin N. Baily & Clifford Winston eds., 1990).

43. *See* SARAH BARTLETT, THE MONEY MACHINE: HOW KKR MANUFACTURED POWER & PROFITS (1991).

44. HENWOOD, *supra* note 24, at 289.

45. *See* MICHAEL USEEM, INVESTOR CAPITALISM: HOW MONEY MANAGERS ARE CHANGING THE FACE OF CORPORATE AMERICA (1996).

ment involved considerable social costs, and the benefits in share price gains were distributed to a much narrower section of the community, with the extreme concentration of all forms of shareholdings, including pension funds investing in equities, since all forms of superannuation are themselves highly unequally distributed.[46]

Management theory and practice for some decades has been overwhelmed by this narrow and constricted view of the modern corporation distilled into agency theory. Agency theory is often assumed to be eternal, universal, and unquestionable in its explanation of the essence of the nature of the corporation. In fact agency theory is of quite recent construction, heavily focused on the Anglo-American business world, and is profoundly questionable. All of the sophistication, rich diversity, nuances and insights of management scholars, and the experience and wisdom of management practitioners have been displaced by the rigid simplicity of the assumptions of agency theory in recent decades.[47] This one-dimensional management, with its self-validating hypotheses, as Marcuse warned, has populated the management journals and infused management discourse.[48]

Jensen and Meckling's *Theory of the Firm: Managerial Behaviour, Agency Costs and Capital Structure*[49] remains one of the most cited economic articles of the last four decades. It sets out a new theory of the firm firmly triangulated between: (1) property rights, (2) agency, and (3) finance. The singular concern for agency theory is that the "agents" (managers) represent the interests of the "principals" (shareholders). The new theory of the firm aims to go beyond standard neoclassical theory's distancing treatment of the firm as a "black box," and offers a stringent alternative to the managerial theories of Galbraith, Chandler, and others, in which the objective of the managerial firm was determined to be maximization of growth or size, and fulfillment of a wide spectrum of economic, technological, social, and political goals.[50]

Agency theory has become "a cornerstone of . . . corporate governance."[51] While agency theory is often regarded not only as the dominant current interpretation, but also as an eternal and universal explanation, it is very much a product of the Anglo-American corporation and capital market. Rooted in finance and economics, it has somehow managed to

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46. HENWOOD, *supra* note 24, at 291.

47. *See* Sumantra Ghoshal, *Bad Management Theories Are Destroying Good Management Practices*, 4 LEARNING & EDUC. 75 (2005).

48. *See* HERBERT MARCUSE, ONE-DIMENSIONAL MAN (1964).

49. Jensen & Meckling, *supra* note 20.

50. *See* Weinstein, *supra* note 4.

51. *See* Luh Luh Lan & Loizos Heracleous, *Rethinking Agency Theory: The View from Law*, 35 ACAD. OF MGMT. REV. 294 (2010).

penetrate not only policy and practice, but also the essential understanding of corporate law regarding directors' duties. Not only does agency theory dangerously oversimplify the complexities of business relationships and decisions, it damagingly demands a focus on a single objective. Agency theory asserts shareholder value as the ultimate corporate objective that managers are incentivized and impelled to pursue: "The crisis has shown that managers are often incapable of resisting pressure from shareholders. In their management decisions, the short-term market value counts more than the long-term health of the firm."[52]

The mythology of shareholder value has proved one of the most debilitating ideologies of modern times. The pursuit of shareholder value has damaged and shrunk corporations, distracted and weakened managers, diverted and undermined economies, and, most paradoxically, neglected the long-term interests of shareholders.[53] An unfortunate lacuna in corporate law was filled by the simplistic tenets of agency theory, which has promulgated enduring myths of shareholder primacy that have been misconstrued as authentic legal interpretations of directors' duties, and often guided directors with increasingly narrow and damaging corporate objectives. The tenets of shareholder value are portrayed as eternal, universal, and unarguable when they are of recent origin, exclusive to Anglo-American regimes, and profoundly contentious.[54]

Among the central defects of agency theory as presently interpreted are:

- Agency theory focuses on an oversimplification of complex financial and business reality.
- Agency theory damagingly insists upon the single corporate objective of shareholder value.
- Agency theory misconceives the motivations of managers.
- Agency theory ignores the diversity of investment institutions and interests.
- Agency theory debilitates managers and corporations, and ultimately weakens economies.

52. *See* Blanche Segrestin & Armand Hatchuel, *Beyond Agency Theory, a Post-Crisis View of Corporate Law*, 22 BRIT. J. MGMT. 484 (2011).

53. LYNN STOUT, THE SHAREHOLDER VALUE MYTH (2012) [hereinafter STOUT, VALUE]; William Lazonick, *Profits Without Prosperity*, HARV. BUS. REV., Sept. 2014, at 46 [hereinafter Lazonick, *Profits*].

54. *See* AGLIETTA & REBERIOUX, *supra* note 20; William Lazonick, *In the Name of Shareholder Value: How Executive Pay and Stock Buy-Backs Are Damaging the US Economy*, *in* THE SAGE HANDBOOK OF CORPORATE GOVERNANCE 476 (Thomas Clarke & Douglas Branson eds., 2012) [hereinafter Lazonick, *Shareolder Value*]; STOUT, VALUE, *supra* note 53; Blair & Stout, *supra* note 14; Lazonick, *Profits*, *supra* note 53; Weinstein, *supra* note 4.

- Agency achieves the opposite of its intended effect.[55]

As Didlier Cossin, Professor of Finance at the International Institute for Management Development, Switzerland, has recently observed:

> Most financial models taught today rely on false mathematical assumptions that create a sense of security even as failure approaches. . . . The list of flawed theories (including agency theory) . . . are all finance models based on over-simplifying complex choices. This pretence that mathematical models are the solution for human problems is dangerous and is not only at the core of finance theory but is also in the heads of many corporate and financial managers. Given the tremendous changes in financial systems, these theories must be scrutinised and then abandoned as models for the future.[56]

Not only does agency theory dangerously oversimplify the complexities of business relationships and decisions, but it also damagingly demands a focus on a single objective. Agency theory asserts shareholder value as the ultimate corporate objective that managers are incentivized and impelled to pursue: "The crisis has shown that managers are often incapable of resisting pressure from shareholders. In their management decisions, the short-term market value counts more than the long-term health of the firm."[57]

Agency theory, while claiming an interest in how companies are controlled, dares not to enter the "black box" of the firm itself and, from a distance, hopelessly misconceives the motivations of managers, reducing their complex existence to a dehumanized stimulus/response mechanism:

> The idea that all managers are self-interested agents who do not bear the full financial effects of their decisions[58] has provided an extraordinary edifice around which three decades of agency research has been built, even though these assumptions are simplistic and lead to a reductionist view of business, that is, comprising two participants—managers (agents) and shareholders (principals).[59]

Agency theory tends to ignore the diversity of investment institutions and interests, and their variety of objectives and beneficiaries. As Lazonick has argued, institutional investors are not monolithic, and dif-

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55. *See* AGLIETTA & REBERIOUX, *supra* note 20; Lazonick, *Shareholder Value*, *supra* note 54, at 476; STOUT, VALUE, *supra* note 53; Lazonick, *Profits, supra* note 53.

56. Didlier Cossin, *Financial Models Create a False Sense of Security*, FIN. TIMES (Sept. 5, 2011, 12:45AM), http://www.ft.com/cms/s/2/af6d86de-d57a-11e0-9133-00144feab49a.html

57. *See* Segrestin & Hatchuel, *supra* note 52.

58. *See* Jensen & Meckling *supra* note 20.

59. Annie Pye & Andrew Pettigrew, *Studying Board Context, Process and Dynamics: Some Challenges for the Future*, 16 BRIT. J. MGMT. 527 (2005).

ferent types of institutional investors have different investment strategies and time horizons.[60] Corporate governance becomes less of a concern if shareholding is a very transitory price-based transaction, and much share trading today is computer generated, with rapid activity generated by abstract formulas. While life insurance and pension funds do have longer term horizons, and often look to equity investments to offer durable and stable returns, the behavior of other market participants is often focused on the shorter term, and more interested in immediate fluctuations in stock prices than in the implications of corporate governance for the future prospects of a company:

> Pension fund managers can generally take a longer-term perspective on the returns to their portfolios than can the mutual-fund managers. Nevertheless even the pension funds (or insurance companies) are loath to pass up the gains that, in a speculative financial era, can be made by taking quick capital gains, and their managers may feel under personal pressure to match the performance of more speculative institutional investors. The more the institutional investors focus on the high returns to their financial portfolios needed to attract household savings and on the constant restructuring of their portfolios to maximize yields, the more their goals represent the antithesis of financial commitment. Driven by the need to compete for the public's savings by showing superior returns, portfolio managers who invest for the long term may find themselves looking for new jobs in the short term.[61]

Lazonick asks: why did senior executives willingly diminish the financial strength and resilience of major corporations in this reckless way? The answer:

> The ideology of maximizing shareholder value is an ideology through which corporate executives have been able to enrich themselves. The economists' and corporate executives' mantra from 1980 until the 2007–2008 meltdown of shareholder value and the need to "disgorge . . . free cash flow"[62] translated into executive option grants and stock buybacks, and resulted in increasing dramatically those executive options' value.[63]

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60. *See* WILLIAM LAZONICK, BUSINESS ORGANISATION AND THE MYTH OF THE MARKET ECONOMY (1991) [hereinafter LAZONICK, ORGANISATION]; Lazonick, *Controlling*, *supra* note 28.

61. *See* LAZONICK, ORGANISATION, *supra* note 60.

62. Jensen, *supra* note 35, at 323.

63. *See* Lazonick, S*hareholder Value*, *supra* note 54; WILLIAM LAZONICK, SUSTAINABLE PROSPERITY IN THE NEW ECONOMY?: BUSINESS ORGANISATION AND HIGH-TECH EMPLOYMENT IN THE UNITED STATES (2009) [hereinafter LAZONICK, SUSTAINABLE]; Lazonick, *Profits*, *supra* note 53; *Venture Capital and Public Research: Where Are the Googles?*, FINNOV Final Conference

The power of the shareholder value model "has been amplified through its acceptance by a worldwide network of corporate intermediaries, including international law firms, the big accounting firms, and the principal investment banks and consulting firms—a network whose rapidly expanding scale give it exceptional influence in diffusing the . . . model of shareholder-centered corporate governance."[64]

V. The Strengths of Blair and Stout's Team Production Theory

The concept of shareholder primacy, and the concomitant insistence that the only real purpose of the corporation is to deliver shareholder value, has become an almost universal principal of corporate governance and often goes unchallenged. This self-interested, tenacious, and simplistic belief is corrosive of any effort to realize the deeper values companies are built upon, the wider purposes they serve, and the broader set of relationships they depend upon for their success.[65] The obsessive emphasis on shareholder value is an ideology that is constricting and misleading in business enterprise, is intended to crowd out other relevant and viable strategies for business success, and serves narrow sectional interests. As Margaret Blair and Lynn Stout argue:

> The idea that shareholders alone are the raison d'être of the corporation has come to dominate contemporary discussion of corporate governance, both outside and (in many cases) inside the boardroom. Yet the "shareholder primacy" claim seems at odds with a variety of important characteristics of US corporate law. Despite the emphasis legal theorists have given shareholder primacy in recent years, corporate law itself does not obligate directors to do what the shareholders tell them to do. Nor does it compel the board to maximize share value. To the contrary, directors of public corporations enjoy a remarkable degree of freedom from shareholder command and control. Similarly, the law grants them wide discretion to consider the interests of other corporate participants in their decision-making—even when this adversely affects the value of the stockholders' shares.[66]

Since the mid-1980s, a majority of states in the United States (but not in Delaware, the seat of incorporation of many major U.S. corpora-

(Feb. 1–5, 2012), A. Mina, M. Montalban & P. Nightingale, *available at* https://www.youtube.com/watch?v=vsg70sEDKtI.

64. *See* Ireland, *supra* note 5, at 49.

65. *See* CLARKE, *supra* note 6.

66. *See* Margaret M. Blair & Lynn Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH U. L.Q. 403, 405–06 (2001).

tions) amended their corporate law statutes to permit (but typically not to require) directors to take into account in decisionmaking the interests of other stakeholder constituencies and community interests beyond shareholders. Approximately half of these constituency statutes (as they are called), grant the license only in the context of a hostile takeover or other corporate control transaction;[67] indeed, the license has principally been invoked by directors in response to an unsolicited takeover bid. Generally, the statutes do not give nonshareholder stakeholders standing to take enforcement action against directors, and they make no provision for representation in governance of nonshareholder interests.[68]

Lynn Stout explains how the Chicago economists strongly influenced the debate over shareholder primacy to the point where, in the 1990s, most scholars and regulators accepted shareholder wealth maximization as the proper goal of corporate governance.[69] Hansmann and Kraakman's 2001 paper, *The End of History for Corporate Law*, marked the peak of this theory.[70] Stout's view is that this was the zenith of the shareholder primacy view, which is now "poised for decline."[71] She explains very clearly that furthering shareholder value is only one interpretation of directors' duties: "American law does not actually mandate shareholder primacy."[72]

Despite these developments, the primacy traditionally accorded to shareholder interests is most often justified on the basis that it is the means by which corporate law can most effectively secure aggregate social welfare. This view was perhaps most clearly and familiarly expressed by the economist Milton Friedman when he wrote: "[T]he social responsibility of business is to increase its profits."[73] Vogel discusses the continuing market constraints on managerial exercise of responsibility,[74] and Robe mounts a sustained challenge to Friedman's polemic.[75] How-

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67. *Id.* at 406 n.5.

68. *See* CORPS. & MKTS. ADVISORY COMM., THE SOCIAL RESPONSIBILITY OF CORPORATIONS (2006), *available at* http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2006/$file/CSR_Report.pdf; Kathleen Hale, *Corporate Law and Stakeholders*, 45 ARIZ. L. REV 823 (2003).

69. *See* STOUT, VALUE, *supra* note 53; Lynn Stout, *New Thinking on Shareholder Primacy,* 2 ACCT., ECON. & L.: A CONVIVIUM 1 (2012) [hereinafter Stout, *Primacy*].

70. *See* Henry Hansmann & Reiner Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

71. STOUT, VALUE, *supra* note 53, at 23.

72. *Id.* at 35.

73. *See* Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES MAG., Sep. 13, 1970, at 32–33, 122–126.

74. *See* DAVID VOGEL, THE MARKET FOR VIRTUE: THE POTENTIAL AND LIMITS OF CSR (2005).

75. *See* Jean-Philippe Robe, *Being Done With Milton Friedman*, 2 ACCT., ECON. & L.: A CONVIVIUM 1 (2012).

ever, the question of whose interests should shape corporate operations and strategy has become contested under the corporate social responsibility movement. Is it, and should it be, the collective interest of shareholders exclusively or should it also include other interests and wider social claims in their own right?

Lynn Stout argues that the debate is not a simple contest between shareholders and stakeholders, but that the idea of shareholder value as a stand-alone concept does not make any sense. Indeed, she comments that "a relentless focus on raising the share price of individual firms may be not only misguided but harmful to investors."[76] Further:

> If we stop to examine the reality of who "the shareholder" really is—not an abstract creature obsessed with the single goal of raising the share price of a single firm today, but real human beings with the capacity to think for the future and to make binding commitments, with a wide range of investments and interests beyond the shares they happen to hold in any single firm, and with consciences that make most of them concerned, at least a bit, about the fates of others, future generations, and the planet.[77]

She argues convincingly that each of the basic assumptions behind shareholder primacy are false, and that shareholders do not own the company: "Corporations own themselves, and enter contracts with shareholders exactly as they contract with debt holders, employees, and suppliers."[78] Once it is conceded that directors are allowed to pursue the success of the company in meeting all of its contractual relationships—and that they are not required to simply maximize the value of the corporation's shares—the question then becomes: What ultimate objectives should they pursue?[79] If the answer to this question is the corporate objective is to pursue a long-run goal to satisfy wider corporate interests, it is difficult to implement this prescription without adopting a more explicitly stakeholder orientation in practice, as even Michael Jensen, the arch-priest of agency theory, has conceded:

> In order to maximize value, corporate managers must not only satisfy, but enlist the support of, all corporate stakeholders—customers, employees, managers, suppliers, and local communities. Top management plays a critical role in this function through its leadership and effectiveness in creating, projecting, and sustaining the company's strategic vision. . . . Enlightened value maximization uses

76. STOUT, VALUE, *supra* note 53, at 7.

77. *Id.*

78. *Id.*; *see also* Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century,* 51 UCLA L. REV 387 (2004).

79. *See* Blair, *supra* note 78.

> much of the structure of stakeholder theory but accepts maximization of the long-run value of the firm as the criterion for making the requisite tradeoffs among its stakeholders.[80]

In recent decades, many theories of corporate governance have developed that have attempted to complement or displace agency theory, including institutional theory, resource dependence theory, stewardship theory, and stakeholder theory. Each has enjoyed varying degrees of support at different times. However, one theorization of corporate governance that, due to its origin in the nexus of contracts literature, has received more attention from legal scholars but deserves more attention in the business schools, is the adaption of team production theory by Margaret Blair and Lynn Stout.[81] In this director primacy model, the firm is viewed as a team production, defined as a complex productive activity involving multiple parties where the resulting output is neither separable nor individually attributable.

In adapting the nexus of contracts theory, Blair and Stout consider shareholders as only one of the parties that make a contribution to the firm, and effectively are not the only residual claimants of the firm.[82] Other groups, including employees, creditors, managers, and government, make contributions to ensure the enterprise will succeed.[83] The assets created are generally firm specific and, once committed to team production, cannot be withdrawn and sold elsewhere for their full value. Blair and Stout provide an expansive adaption of the original theoretical framework of Alchian and Demsetz (who themselves did not use the concept of "nexus of contract," though it is closely associated with their work). For Blair and Stout, team production theory with the board of directors serving as a "mediating hierarchy" between the different interests provides a sound foundation for conceiving of the corporation in both law and practice:

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80. Michael C. Jensen, *Value Maximization and the Corporate Objective Function*, *in* UNFOLDING STAKEHOLDER THINKING: THEORY RESPONSIBILITY AND ENGAGEMENT 65 (J. Andriof et al. eds., 2002). *See also* Michael Jensen, *Value Maximisation, Stakeholder Theory, and the Corporate Objective Function*, 7 EUR. FIN. MGMT. 297 (2001). For a different view of value creation and distribution, see Shyam Sunder, *Extensive Income and Value of the Firm: Who Gets What?* (Comparative Research in Law & Political Econ., Research Paper No. 20/2009, 2009), *available at* http://ssrn.com/abstract=1440886. *See also* Yuri Biondi, *The Problem of Social Income*: *The Entity View of the Cathedral,* 34 SEATTLE U. L. REV. 1025 (2011).

81. *See* Blair & Stout, *supra* note 14.

82. *See* Blair & Stout, *supra* note 66.

83. *See* Allen Kaufman & Ernie Englander, *A Team Production Model of Corporate Governance*, 19 ACAD. OF MGMT. EXEC. 9 (2005). *See also* Thomas Clarke, *The Stakeholder Corporation: A Business Philosophy for the Information Age*, 31 INT'L J. OF STRATEGIC MGMT.: LONG RANGE PLANNING 182 (1998) [hereinafter Clarke, *Stakeholder*]; Lynn Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002).

We believe, however, that our mediating hierarchy approach, which views public corporation law as a mechanism for filling in the gaps where team members have found explicit contracting difficult or impossible, is consistent with the "nexus of contracts" approach to understanding corporate law. The "nexus of contracts" view of the firm holds that relationships in the firm should be understood as an intertwined set of relationships between parties who agree to work with each other in pursuit of mutual benefit, even though not all the relationships that comprise a firm are necessarily spelled out in complete "contracts." It might perhaps be more informative to think of corporations, and hierarchical governance structures within corporations, as institutional substitutes for contracts, just as property rights are an institutional substitute and necessary precondition for contracts. Nevertheless, we locate the mediating hierarchy model of the public corporation within the nexus of contracts tradition because in the model, team members voluntarily choose to submit themselves to the hierarchy as an efficient arrangement that furthers their own self-interests.[84]

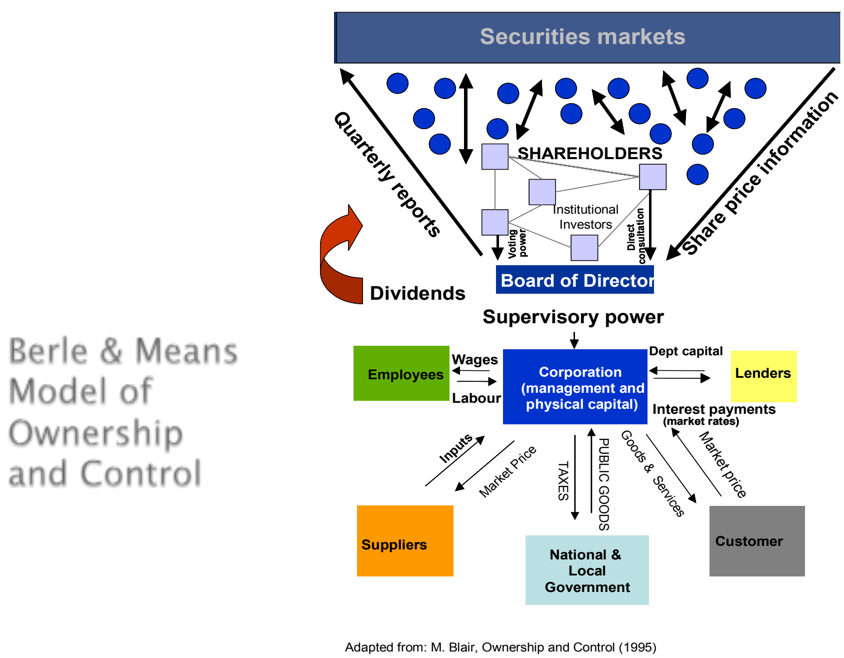

Figure 2: *Berle and Means Model of Ownership and Control*

84. Blair & Stout, *supra* note 14, at 254.

As Figure 2 demonstrates, Blair and Stout have reformulated the Alchian and Demsetz approach to a nexus of contracts around the wider stakeholder relationships that exist in the business enterprise. While agency theory and shareholder primacy focus simply on the nexus between shareholders (principals) and directors (agents), the Blair and Stout conception of team production theory recognizes the significance and contribution of all with an interest in the success of the company, including employees, customers, suppliers, creditors, and government.[85] At the center of this constellation of relationships and interests is the mediating hierarch—the board of directors—who negotiate effective outcomes in pursuit of the business's success. Compared to the stark and binary assumptions of agency theory, Blair and Stout's team production theory conceives of much of the complexity of contemporary business activity, the expansiveness of corporate purpose, and the demands upon boards of directors and managers in securing performance:

> The team production approach, however, offers another and in many ways more intriguing explanation for the anomaly of open-ended corporate purpose. In brief, it suggests that the appropriate normative goal for a board of directors is to build and protect the wealth-creating potential of the entire corporate team—"wealth" that is reflected not only in dividends and share appreciation for shareholders, but also in reduced risk for creditors, better health benefits for employees, promotional opportunities and perks for executives, better product support for customers, and good "corporate citizenship" in the community.[86]

Blair and Stout have portrayed a convincing alternative view of the essentially collaborative basis of corporate wealth generation across an array of involved and skilled stakeholders.[87] This understanding of the business enterprise resonates closely with the approach of European, and Asian business.[88] Lester Thurow, the former Dean of MIT School of Management, placed these differences in the fundamental conception of business purpose at the heart of his analysis of the relative competitive performance of Anglo-American, European and Asian enterprise:

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85. *See* Margaret M. Blair, *Closing the Theory Gap: How the Economic Theory of Property Rights Can Help to Bring "Stakeholders" Back into Theories of the Firm*, 9 J. MGMT. & GOV. 33 (2005) [hereinafter Blair, *Theory*].

86. *See* Margaret Blair & Lynn Stout, *Specific Investment and Corporate Law*, 7 EUR. BUS. ORG. L. REV 473 (2006).

87. Blair & Stout, *supra* note 14, at 247. *See also* Richard Mitchell, Anthony O'Donnell & Ian Ramsay, *Shareholder Value and Employee Interests: Intersections of Corporate Governance Corporate Law and Labor Law*, 23 WISC. INT'L L. J. 417 (2005).

88. *See* THOMAS CLARKE, INTERNATIONAL CORPORATE GOVERNANCE (2007) [hereinafter CLARKE, CORPORATE]; Clarke, *Stakeholder*, *supra* note 83.

> If the executives of profit maximizing firms are asked to state the order in which they serve various constituents, shareholders come first with customers and employees a distant second and third. Most managers will argue that the sole purpose of the company is to maximize shareholder wealth. If Japanese firms are asked the same question, the order of duty is reversed: employees first, customers second, and shareholders third. . . . In the United States, private research and development falls in recession and rises in booms. In Europe and Japan, it does not. To an American firm, cutting R & D is a technique for manufacturing profits during a period of declining sales. The same spending patterns exist in investment and training. These different patterns are reflected in the respective accounting systems. In US accounting conventions, since R & D is expensed, cutting R & D leads to higher bottom-line profits immediately. In Japan, where R & D is capitalized, it does not. Thus the Japanese accounting system discourages short-term behavior, and the American system encourages it.[89]

While in need of further elaboration, the idea of a participative engagement of all stakeholders in a common productive effort is far closer to the perceived reality of business activity than the abstracted and rarefied academic speculation of the agency theorists. Indeed, the arrival of the new knowledge-based economy added a powerful boost to the early conceptions of the essentially social basis of industry. As Charles Handy highlighted:

> The old language of property and ownership no longer serves us in the modern world because it no longer describes what a company really is. The old language suggests the wrong priorities, lead to inappropriate policies and screens out new possibilities. The idea of a corporation as the property of the current holders of shares is confusing because it does not make clear where power lies. As such, the notion is an affront to natural justice because it gives inadequate recognition to the people who work in the corporation, and who are, increasingly, its principal assets.[90]

Ironically, during the 1990s explosion of the knowledge economy, the Anglo-Saxon shareholder-value-based approach to corporate governance became reinvigorated in the United States, United Kingdom, Australia, New Zealand, and other countries that adopted this model (though the original high tech companies of Silicon Valley would never have gotten started without venture capitalists and employee stock options that

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89. *See* LESTER THUROW, HEAD TO HEAD: THE COMING ECONOMIC BATTLE AMONG JAPAN, EUROPE, AND AMERICA (1992); Lester Thurow, *Who Owns the Twenty-First Century?*, 5 SLOAN MGMT. REV. 9 (1992).

90. Charles Handy, *The Citizen Corporation*, HARV. BUS. REV., Sept.–Oct. 1997, at 26.

often maintained majority ownership until the companies were well established and ultimately became the servants of equity markets).[91] The shareholder value model also began to have a strong influence in European and Asian economies, which formerly sustained more stakeholder or collective conceptions of corporate governance. In the context of global competition, international investment patterns, and the aggressive growth of international mergers and acquisitions, assuming the primary objective of releasing shareholder value often seemed the only sure way, not only for international business success, but, for corporate survival itself.

However, the practical realities of running a business are far more complex than the exponents of the single metric of shareholder value could possibly imagine. To maintain the viability and innovation of businesses, managers are required to focus not only on their profit model (the entire focus of agency theory), but also upon developing the configuration of their business network, structure, and processes; creating their products and production systems; and enhancing their services, channels, brands, and customer engagement.[92] Peter Drucker banged on about the many challenges and performance measures of management, and was widely read and understood by practicing managers:

> Neither the quantity of output nor the "bottom line" is by itself an adequate measure of management and enterprise. Market standing, innovation, productivity, development of people, quality, financial results—are all crucial to an organisation's performance and indeed to its survival. Non-profit institutions too need measurements in a number of areas specific to their mission. Just as a human being needs a diversity of measures to assess its health and performance, an organization needs a diversity of measures to assess its health and performance. Performance has to be built into the enterprise and its management; it has to be measured—or at least judged—and it has to be continuously improved.[93]

Managers are used to having their performance measured across this array of complex activities by hundreds of performance indicators and are required to maintain continuous improvement in almost all of these indicators simultaneously if they are to compete effectively in the market. For agency theorists to reduce this complex and demanding existence of

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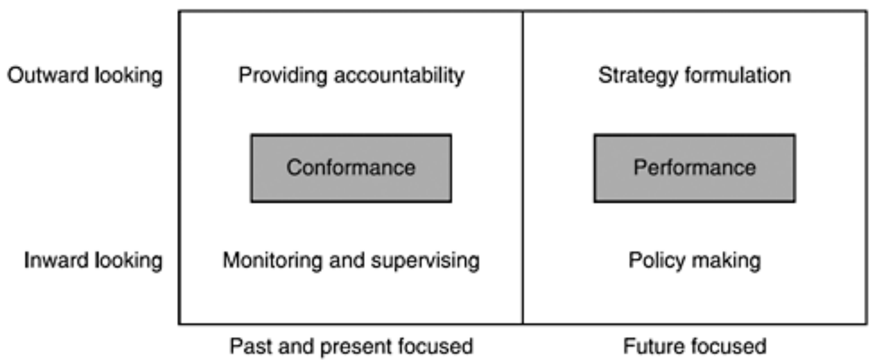
91. *See* Paul Oyer, *Stock Options—Its Not Just About Motivation* (Policy Brief, Stanford Inst. for Econ. Pol'y Research, Oct. 2002). Though some of the gilt has chipped off Silicon Valley social media IPOs. *See* Shira Ovide & Scott Thurm, *Silicon Valley's Stock Funk*, WALL ST. J. (Oct. 5, 2012), http://online.wsj.com/news/articles/SB10000872396390443493304578038763698056392.

92. *See* LARRY KEELEY, HELEN WALTERS, RYAN PIKKEL & BRIAN QUINN, TEN TYPES OF INNOVATION: THE DISCIPLINE OF BUILDING BREAKTHROUGHS (2013).

93. *See* PETER F. DRUCKER, THE NEW REALITIES (1990).

professional managers to the single metric of shareholder value is at best naïve, and at worst distorting and destabilizing in the interpretation of business reality and orientation.

As the mediating hierarch in Blair and Stout's team production theory, the board of directors has to negotiate not only the conformance functions of monitoring and accountability that the agency theorists are focused upon, but also the performance functions of providing strategic direction and a policy framework if the business is to succeed (Figure 3). If boards neglect the commitment and investment in strategic development of the company, then paralysis and decline can quickly set in; though if aggressive strategy is pursued without a framework of monitoring and accountability, then recklessness may take hold. In their insistent emphasis on the delivery of shareholder value, agency theorists' emphatic attention is upon value extraction, and they routinely neglect the processes of value creation.



Source: Hilmer, F. and Tricker, R.I. (1991)

Figure 3: *Framework for Board Duties and Activities*

VI. THE REFORM OF DIRECTORS' DUTIES IN THE UNITED KINGDOM

The shareholder value view upholds a property conception of the company.[94] In its most extreme form, as developed by the Chicago school of law and economics, this theory claims the assets of the company are the property of the shareholders, and managers and boards of directors are viewed as the agents of the shareholders with all of the difficulties of enforcement associated with agency relationships. Though the shareholder value orientation is assumed to be an eternal belief, firmly

94. *See* Yuri Biondi, *What Do Shareholders Do? Accounting, Ownership and the Theory of the Firm: Implications for Corporate Governance and Reporting*, 2 ACCT., ECON. & L.: A CONVIVIUM 1 (2012); Sunder, *supra* note 80.

rooted in law with strong historical foundations, little of this is anything more than a recent ideological convenience. Shareholder value in its current manifestation was a construct of financial economists in the 1980s, meant to deal with the lack of shareholder value orientation widely apparent in U.S. industry at the time.

Historically, American corporations have demonstrated a broad conception of the committed orientation towards a wide constituency of stakeholders necessary in order to build the enterprise. Over time, and with the increasing market power of large corporations, managements' sense of accountability might have become overwhelmed by complacency and self-interest. However, to attempt to replace self-interested managers with managers keenly focused entirely upon delivering value to shareholders is to replace one form of self-interest with another. Any broadening of the social obligations of the company was dangerous according to the shareholder value school of thought: "Few trends could so thoroughly undermine the foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."[95]

The difficulty is whether, in trying to represent the interests of all stakeholders, company directors simply slip the leash of the one truly effective restraint that regulates their behavior—their relationship with shareholders. These views were expressed with vigor by liberal economists, and enjoyed the support of leading business leaders and senior politicians. More practically, such views reflected how U.S. and U.K. companies were driven from the 1980s–2000s, with an emphasis upon sustaining share price and dividend payments at all costs, and freely using merger and takeover activity to discipline managers who failed in their responsibility to enhance shareholder value. It was the economic instability and insecurity created by this approach that was criticised in the report by Porter.[96]

Meanwhile, efforts were made to clarify the law on directors' duties. In 1979 the U.K. company legislation was amended to provide that the matters to which directors "are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members."[97] The duty is owed to "the company (and the company alone) and enforceable in the same way as

95. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962).

96. *See* Michael Porter, *Capital Disadvantage: America's Failing Capital Investment System*, HARV. BUS. REV., Sept.–Oct. 1992, at 65.

97. This was later restated in the Companies Act 1985, c. 6, § 309 (Eng.). *See* DAVID KERSHAW, COMPANY LAW IN CONTEXT 339 (2009).

any other fiduciary duty owed to a company by its directors."[98] There was a widespread sense that U.K. company law was in need of reform: "[T]he state of directors' duties at common law are often regarded as leading to directors having an undue focus on the short term and the narrow interests of members at the expense of what is in a broader and a longer term sense the best interests of the enterprise . . . ."[99]

In the Anglo-American world, many have argued for clarification of the legal duties of company directors, and these issues were extensively considered for several years in the deliberations of the United Kingdom.[100] Traditionally, commercial law in many European countries has supported a sense of the wider social and environmental obligations of companies, which continues despite a recent enthusiasm for the principle of shareholder value, as some large European companies for the first time seek the support of international investors. The United Kingdom has stood apart from Europe as an influential exponent of the Anglo-American market-based approach to corporate governance with a focus on shareholder value. However, this ingrained orientation in British business has not been unchallenged. In the 1930s, John Maynard Keynes railed against the irresponsibility of transient stockholders:

> The divorce between ownership and the real responsibility of management is serious within a country when, as a result of joint-stock enterprise, ownership is broken up between innumerable individuals who buy their interest today and sell it tomorrow and lack altogether both knowledge and responsibility towards what they momentarily own.[101]

George Goyder cites a remarkable passage highlighting the blindness of narrow interpretations of existing company law in Lord Justice Percy's *Riddell Lectures* in 1944:

> Here is the most urgent challenge to political invention ever offered to the jurist and the statesman. The human association which in fact produces and distributes wealth, the association of workmen, managers, technicians and directors, is not an association recognised by the law. The association which the law does recognise—the associa-

98. Companies Act 1985, c. 6, § 309(2) (Eng.).

99. COMPANY LAW REVIEW STEERING GRP., U.K. DEP'T OF TRADE & INDUS., MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: THE STRATEGIC FRAMEWORK ¶ 5.1.17 (1999) [hereinafter STEERING GROUP, STRATEGIC FRAMEWORK], *available at* http://webarchive.nationalarchives.gov.uk/20090609003228/http://www.berr.gov.uk/files/file23279.pdf.

100. *See generally id.*

101. John Maynard Keynes, *National Self-Sufficiency*, *in* THE COLLECTED WRITINGS OF JOHN MAYNARD KEYNES 233 (Donald Moggeridge ed., 1992).

> tion of shareholders, creditors and directors—is incapable of production and is not expected by the law to perform these functions.[102]

An initiative to develop a more expansive view of corporate purpose and directors' duties in the United Kingdom was launched by the Royal Society of Arts (RSA) in the *Tomorrows' Company* Inquiry in 1992 into the sources of sustainable business success. This involved twenty-five major international corporations headquartered in London, and determined that the essential basis of business performance was the measurement and management of relationships with all stakeholders in the *inclusive* company:

> The conventional wisdom in the UK is to define the purpose of business in terms that stress the importance of immediate financial performance and returns to shareholders and treat other participants merely as means to this end. Of course, a Board must continually attend to its company's financial performance and level of shareholder return, but an exclusive concentration on any one stakeholder will not lead to sustainable competitive performance. It is therefore not necessarily in the best interests of shareholders themselves to be singled out in this way. We believe that sustainable success is available from the inclusive approach in which the company includes all its relationships in its definitions and measures of success.[103]

In an effort to jettison the company law rhetoric formed in the nineteenth century, and to make the law more accessible, a U.K. Company Law Review (CLR) steering group was established in 1998 after the RSA Inquiry. The ensuing consultative document proposed for the first time that there should be a statutory statement of directors' duties (presently the core components of those duties is found in case law), and made a significant step in the direction of endorsing fuller corporate social and environmental reporting:

> [C]urrent accounting and reporting fails to provide adequate transparency of qualitative and forward looking information which is of vital importance in assessing performance and potential for shareholders, investors, creditors and others. This is particularly so in the modern environment of technical change, and with the growing im-

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102. EUSTACE PERCY, THE UNKNOWN STATE: 16TH RIDDELL MEMORIAL LECTURES 57 (1944). *See also* GEORGE GOYDER, THE RESPONSIBLE COMPANY (1961); David Ellerman, *Rethinking Common vs. Private Property*, ELLERMAN.ORG (Aug. 14, 2012), http://www.ellerman.org/rethinking-common-vs-private-property/.

103. *See* ROYAL SOCIETY OF ARTS, TOMORROW'S COMPANY INTERIM REPORT 2 (1994). *See also* THOMAS CLARKE & STEWART CLEGG, CHANGING PARADIGMS (2000); THOMAS CLARKE & ELAINE MONKHOUSE, RE-THINKING THE COMPANY (1995); ROYAL SOCIETY OF ARTS, TOMORROW'S COMPANY FINAL REPORT (1995).

> portance of "soft," or intangible assets, brands, know-how and business relationships. The full annual report must be effective in covering these, both as a stewardship report and as a medium of communication to wider markets and the public. . . . [W]e believe that the time has come to require larger companies . . . to provide an OFR [operating and financial review], which will cover the qualitative, or "soft", or intangible, and forward looking information which the modern market and modern business decision making requires, converting the practice of the best run companies into a requirement for all.[104]

In this more expansive context and interpretation of corporate purpose, two approaches were considered to revising directors' duties:

- A pluralist approach under which directors' duties would be reformulated to permit directors to further the interests of other stakeholders even if they were to the detriment of shareholders; and
- An enlightened shareholder value approach allowing directors greater flexibility to take into account longer-term considerations and interests of various stakeholders in advancing shareholder value.

In considering these approaches, the essential questions of what is the corporation, and what interests it should represent, are exposed to light. As Davies argues:

> The crucial question is what the statutory statement says about the interests which the directors should promote when exercising their discretionary powers. The common law mantra that the duties of directors are owed to the company has long obscured the answer to this question. Although that is a statement of the utmost importance when it comes to the enforcement of duties and their associated remedies, it tells one nothing about the answer to our question, whose interests should the directors promote? This is because the company, as an artificial person, can have no interests separate from the interests of those who are associated with it, whether as shareholders, creditors, employers, suppliers, customers or in some other way. So, the crucial question is, when we refer to the company, to

104. COMPANY LAW REVIEW STEERING GRP., U.K. DEP'T OF TRADE & INDUS., MODERN COMPANY LAW FOR A COMPETITIVE ECONOMY: DEVELOPING THE FRAMEWORK ¶¶ 5.75, 5.77 (2000) [hereinafter STEERING GROUP, DEVELOPING].

> the interests of which of those sets of natural persons are we referring?[105]

The U.K. Modern Company Law Review asked: "What should be the legal rule with respect to directors' duties?"[106] Should company law:

- Require directors and senior managers to act by reference to the interests of all stakeholders in the corporate enterprise, according primacy to no particular interests including those of shareholders (mandatory pluralism)?
- Permit (but not require) directors and senior managers to act by reference to the interests of all stakeholders, according primacy to no particular interests including those of shareholders (discretionary pluralism)?

The most radical of these models is the mandatory pluralist model, creating a multi-fiduciary duty requiring directors and managers to run the company in the interest of all those with a stake in its success; balancing the claims of shareholders, employees, suppliers, the community, and other stakeholders. The claims of each stakeholder are recognized as valuable in their own right and no priority is accorded shareholders in this adjustment; their interest may be sacrificed to that of other stakeholders.[107] The discretionary pluralist model would permit, but not require, directors to sacrifice shareholder interests to those of other stakeholders. Either of these models would formalize earlier managerialist practice that has been displaced by the current shareholder value culture. As a member of the Corporate Law Review Steering Group, Davies defended the enlightened shareholder value view suggesting the pluralist approach produces a formula that is unenforceable, and paradoxically gives management more freedom of action than they previously enjoyed:

> As far as directors' duties are concerned, this is the heart of the enlightened shareholder value approach. The aim is to make it clear that although shareholder interests are predominant (promotion of the success of the company for the benefit of its members), the promotion of shareholder interests does not require riding rough-

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105. Paul Davies, Enlightened Shareholder Value and the New Responsibilities, W.E. Hearn Lecture at the University of Melbourne Law School (Oct. 4, 2005) [hereinafter Davies, Enlightened], *available at* http://www.law.unimelb.edu.au/files/dmfile/Enlightened_Shareholder_Value_and_the_New_Responsibilities_of_Directors1.pdf. In contrast, according to Biondi, this problem occurs only because Davies considers the company as a subject of law (i.e., a legal person), not an object. If the company is an institution and an object of law, it can be considered as a collective agency, and be organized consequently as other institutions are (in a Republican order). *See* Yuri Biondi, *The Governance and Disclosure of the Firm as an Enterprise Entity*, 36 SEATTLE U. L. REV. 391 (2013).

106. *See generally* STEERING GROUP, DEVELOPING, *supra* note 104.

107. Stakeholders are variously defined as those with an interest in, or dependence relationship with, the company or, alternatively, as those upon whom it depends for its survival.

> shod over the interests of other groups upon whose activities the business of the company is dependent for its success. In fact, the promotion of the interests of the shareholders will normally require the interests of other groups of people to be fostered. The interests of non-shareholder groups thus need to be considered by the directors, but, of course, in this shareholder-centred approach, only to the extent that the protection of those other interests promotes the interests of the shareholders. The statutory 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.[108]

An Australian legal expert, Paul Redmond, offers a more nuanced critique of widening the scope of directors' duties too greatly without first developing adequate measures of their performance:

> The pluralist or multifiduciary model rests on a social, not a property, view of the corporation. It identifies the corporate purpose with maximising total constituency utility. This is an indeterminate outcome measure which poses particular difficulties is translation into a legally enforceable duty. The indeterminacy of the criteria for decision and performance measurement also points to a probable loss of accountability for directors since it offers broad scope to justify most decisions. It is difficult to resist the conclusion of the UK review that either it confers a broad unpoliceable policy discretion on managers themselves or must give a broad jurisdiction to the courts. The model needs either practical rehabilitation or a superior performance metric. It is not clear where either might be found.[109]

However, John Parkinson, another member of the Corporate Law Review Steering Group, argued strongly for the viability of a pluralist conception that maintained a broader sense of corporate purpose, but sadly Parkinson died during the period the steering group was meeting.[110] The Review process and the subsequent Company Law Reform Bill attempted to tread a fine legal line between a sense of "enlightened shareholder value," which was becoming best practice in many leading U.K.

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108. *See* Davies, Enlightened*, supra* note 105.

109. PAUL P. REDMOND, CANBERRA COMMONWEALTH OF AUSTL., SUBMISSION NO. 84 TO PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES: INQUIRY INTO CORPORATE RESPONSIBILITY (2005).

110. *See* THOMAS CLARKE, THEORIES OF CORPORATE GOVERNANCE: THE PHILOSOPHICAL FOUNDATIONS OF CORPORATE GOVERNANCE (2004); JOHN PARKINSON, CORPORATE POWER AND RESPONSIBILITY: ISSUES IN THE THEORY OF COMPANY LAW (1993); Thomas Clarke, *The Evolution Of Directors Duties: Bridging The Divide Between Corporate Governance and Corporate Social Responsibility*, 32 J. GEN. MGMT., 1, 1–27, (2007); Canals L. Jordi, *Rethinking the Firm's Mission and Purpose*, 7 EUR. MGMT. REV. 195 (2010).

and international companies, and more radical claims for company law to adopt a more "pluralist" sense of the ultimate objectives of the enterprise and the interests to be served. The reform attempted to manage this balancing act by suggesting that the pluralist objectives of maximizing company performance to the benefit of all stakeholders can best be served by professional directors pursuing commercial opportunities within a framework of standards and accountability:

> The overall *objective* should be pluralist in the sense that companies should be run in a way which maximises overall competitiveness and wealth and welfare for all. But the means which company law deploys for achieving this objective must be to take account of the realities and dynamics which operate in practice in the running of commercial enterprise. It should not be done at the expense of turning company directors from business decisions makers into moral, political or economic arbiters, but by harnessing focused, comprehensive, competitive decision making within robust, objective professional standards and flexible, but pertinent, accountability.[111]

Yet it was clear there were profound inconsistencies and tensions in this practical inclusiveness in terms of the division of powers, which might lead to serious cracks when significant corporate decisions were made. The reform supports the ultimate power of shareholders to appoint or dismiss directors for whatever reasons they choose, and to intervene in management to the extent the constitution permits, and confesses:

> There is clearly an inconsistency between leaving these powers of shareholders intact and enabling or requiring directors to have regard to wider interests. . . . The effect will be to make smaller transactions within the powers of directors subject to the broad pluralist approach, but larger ones which are for shareholders subject only to the minimal constraints which apply to them."[112]

After much debate it was the discretionary pluralism model that emerged clearly in the U.K. Company Law Review Steering Group following its comprehensive review of company law, which recommended a recasting of directors' duties to give effect to its notion of "enlightened shareholder value" ultimately contained in the Companies Bill 2006, which received Royal Assent on November 8, 2006.

Section 172(1) of the UK Companies Act 2006 establishes a duty to pursue broadly the success of the company:

> 172 Duty to promote the success of the company

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111. STEERING GROUP, DEVELOPING, *supra* note 104, ¶ 2.21.
112. *Id.* ¶ 3.29.

> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
>
> (a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
>
> (f) the need to act fairly as between members of the company.[113]

Effectively, § 172 replaces the *discretion* of directors to attend to these issues, with a "*duty . . . to . . . have regard (amongst other matters) to . . . .*"[114] For the conservative British business establishment this might have been a significant step, but to many business people in other parts of the world, this might represent little more than a statement of common sense. Yet, not only in the United Kingdom, but also in the United States, this controversial new clause was trumpeted as a remarkable innovation in company law, the U.K. government claiming the provision "marks a radical departure in articulating the connection between what is good for a company and what is good for society at large."[115] How the government interpreted the new clause was elaborated in the 2005 White Paper:

> The basic goal for directors should be the success of the company for the benefit of its members as a whole; but that, to reach this goal, directors would need to take a properly balanced view of the implications of decisions over time and foster effective relationships with employees, customers and suppliers, and in the community more widely. The Government strongly agrees that this approach, which [is] called "enlightened shareholder value," is most likely to

113. Companies Act, 2006, c. 46, § 172 (U.K.).

114. *Id.* (emphasis added).

115. Rt. Hon. Margaret Hodge, *Introduction* to COMPANIES ACT OF 2006: DUTIES OF COMPANY DIRECTORS, MINISTERIAL STATEMENTS (U.K. Dep't of Trade and Indus. June 2007), *available at* http://www.remus.uk.com/_files_/auto_files/2b4dc4f6775ce4473f5a9cb409937f13.pdf.

> drive long-term company performance and maximise overall competitiveness and wealth and welfare for all.[116]

In light of the U.K. debate, other Anglo-American countries began considering reformulating directors' duties. In Australia, the potential of changing corporate law and directors' duties was considered at this time in two parliamentary inquiries by the Corporations and Markets Advisory Committee (CAMAC) and Parliamentary Joint Committee on Corporations and Financial Services (PJC). In Australia, the Corporations Act 2001 does not provide an explicit legal duty that is owed by corporations and their directors to society, creditors, employees, company groups, and individual shareholders. In practice, however, it is accepted that the duty to act in the interests of the company may not be distinct from the interests of other stakeholders. This appreciation is leading to the development of an "Environment, Social, and Governance" (ESG) theme in board management.

In this context, both inquiries rejected the need to change company law and insisted that existing law permitted a wide definition of directors' duties:

> [A] well-managed company will generally see it as being in *its own commercial interests*, in terms of enhancing corporate value or opportunity, or managing risks to its business, to asses and, where appropriate, *respond to the impact of its activities* on the environmental and social context in which it operates. Companies that fail to do so appropriately may jeopardise their commercial future.[117]

And:

> Companies that embrace the concept of corporate responsibility are realizing that the long-term financial interests of a company are not "*mutually exclusive*" with acting fairly in the interests of stakeholders (other than shareholders).[118]

While both reports concluded that corporate social responsibility, in addition to the social and environmental benefits, can be an important means for companies to manage nonfinancial risks and maximize their long-term financial value, they recommended the expansion of corporate voluntary initiatives rather than looking to any change in the law. Many in Australia regarded this refusal to change the law as a missed oppor-

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116. U.K. DEP'T OF TRADE AND INDUS., COMPANY LAW REFORM § 3.3 (2005) [hereinafter DEP'T OF TRADE, COMPANY LAW].

117. CORPS. & MKTS. ADVISORY COMM., THE SOCIAL RESPONSIBILITY OF CORPORATIONS 78 (2006) (emphasis added).

118. PARLIAMENTARY JOINT COMM. ON CORPS. AND FIN. SERVS., CORPORATE RESPONSIBILITY: MANAGING RISK AND CREATING VALUE ¶ 3.10 (2006) (emphasis added).

tunity, both to clarify the law and to propel the growing movement towards greater corporate social and environmental responsibility.

VII. HOW ENLIGHTENING IS ENLIGHTENED SHAREHOLDER VALUE?

Just as debate continued on the precise intentions of the U.K. Labour government during the long period of the company law review process, and throughout the drafting of the White Paper and subsequent Companies Act 2006, so too were the purpose and intentions of the Act keenly considered by the academic and legal community. One authority stated:

> The purpose behind s.172, within the framework just discussed, was primarily to emphasise the fact that directors should not run a company for short-term gains alone, but to take into account long-term consequences. The policy intention is to encourage decision-making based upon a longer-term perspective and not just immediate returns. Also, the section, together with the Business Review (required by s.417 of the Act), was to make the process of management more enlightened and it did this so as to ensure that directors would consider a much wider range of interests, with the hope that there would be more responsible decision-making.[119]

However, the practical influence of the new legislation has proved modest compared to the ideals that inspired it. A survey of law firms at the time of legislation discovered that most were agnostic concerning whether § 172 might alter the outcomes of directors' decisions in the course of doing business.[120] Directors might have a new and more inclusive duty enshrined in the Act, but they remained entirely immersed in a political economy of financial institutions, relationships, and expectations, which they normally feel impelled to respect. These influences continuously shape and form directors' values and behavior, as Lipton, Mirvis, and Lorsch argue:

> Short-termism is a disease that infects American business and management and boardroom judgment. But it does not originate in the

119. Andrew R. Keay, *The Duty to Promote the Success of the Company? Is it Fit for Purpose?* 10–12 (Univ. of Leeds, Working Paper, 2011) [hereinafter Keay, *Duty*], *available at* http://www.law.leeds.ac.uk/assets/files/research/events/directors-duties/keay-the-duty-to-promote-the-success.pdf. *See also* Andrew R. Keay, *Good Faith and Directors Duty to Promote the Success of the Company*, 32 COMPANY L. 138 (2011); Andrew R. Keay, *Moving Towards to Stakeholderism? Enlightened Shareholder Value, Constituency Statutes and More: Much Ado About Little?*, 22 EUR. BUS. L. REV. 1 (2011); Andrew R. Keay, *Risk, Shareholder Pressure and Short-termism in Financial Institutions: Does Enlightened Shareholder Value Offer a Panacea?*, 5 L. & FIN. MKT. REV. 435 (2011).

120. Joan Loughrey, Andrew Keay & Luca Cerioni, *Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance*, 8 J. CORP. L. STUD. 79, 90 (2008).

> boardroom. It is bred in the trading rooms of the hedge funds and professional institutional investment managers who control more than 75% of the shares of most major corporations.[121]

Indeed it can be argued that the key players in corporate governance, the institutional investors and the executives and directors running the companies, are now so financially committed to the short term that there is little chance of § 172 changing their behavior, as Keay argues:

> While s.172 provides an entreaty, in s.172(1)(a), to manage whilst having regard for the long-term effects of an action, it is questionable whether it will in fact happen across the board. First, it is going to be difficult to enforce the long-term requirement, especially where directors resolutely maintain that they have acted in good faith. Second, managing for the long term is often antithetical to the interests of the company's managers. Managers could favour the short term because they only have a temporary interest in the company, primarily limited to their time in the job. Managers get no or little benefit from planning for the long term as it is likely to be their successors who will receive the plaudits, and benefit from rents that come to the company under that approach. In fact planning for the long term could make the performance of today's managers look decidedly average, as the share price might not increase and higher dividends would not be paid as quickly as if short-term plans were implemented.[122]

In this context (despite the high aspirations of some involved in the early work of revising U.K. company law), it is possible that § 172 and the accompanying business Review in § 417 of the Act, will amount to only a "self-serving and vacuous narrative rather than analytical material which is of genuine use."[123]

Redmond argues "we are at a stage where directors are permitted to take different stakeholder interests into account[,] but only to the point that this can be argued to be good for long-term shareholder wealth."[124] It would be hard for directors to make decisions that treat the well-being of employees or the environment as the primary cause for action (unless based on other legal obligations under employment or environmental

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121. M. Lipton, T. Mirvis & J. Lorsch, *The Proposed "Shareholder Bill of Rights Act of 2009"*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 12, 2009, 4:56 PM), http://blogs.law.harvard.edu/corpgov/2009/05/12/the-proposed-%e2%80%9cshareholder-bill-of-rights-act-of-2009%e2%80%9d.

122. *See* Keay, *Duty*, *supra* note 119, at 23.

123. PAUL L DAVIES, GOWER & DAVIES' PRINCIPLES OF COMPANY LAW 740 (8th ed. 2008) [hereinafter DAVIES, PRINCIPLES].

124. Thomas Clarke, *Deconstructing the Mythology of Shareholder Value: A Comment on Lynn Stout's "The Shareholder Value Myth"*, 3 ACCT., ECON. & L.: A CONVIVIUM 15, 34 (2013).

law).[125] As Marshall and Ramsay state, "the extension of duties of directors has not been attended by the extension of rights for stakeholders."[126]

In fact, the U.K. revisions of directors' duties have achieved little more than rebalancing the interpretation of directors duties back to the common law interpretation, before the shareholder primacy movement had caused a deeply flawed and unbalanced definition of directors' duties to become salient. Meanwhile, the practical exigencies of running a company in highly a financialized market environment made it more difficult than ever to pursue the newly enlightened interpretation of directors duties in the United Kingdom or elsewhere.

VIII. FINANCIALIZED AND DEHUMANIZED CORPORATIONS?

A cruel paradox is that while we have been working back towards a broader and more inclusive definition of director duties, and corporations themselves have been at pains to profess newfound responsibilities, the practical realities of corporate existence and impact have often become starker. Financial imperatives have driven a relentless pursuit of shareholder value, while the very concept has been exposed as narrow and damaging.[127] This process of the cumulative financialization of economies, corporations, and society has been typified as encompassing:

- The ascendancy of shareholder value as a mode of corporate governance;
- The growing dominance of capital market financial systems over bank-based financial systems;
- Significant increases in financial transactions, real interest rates, the profitability of financial firms, and the share of national income accruing to the holders of financial assets;

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125. *Id*. *See also* Bob Baxt, *Future Directions for Corporate Law: Where Are We Now and Where Do We Go From Here? The Dilemmas of the Modern Company Director*, 25 AUSTL. J. CORP. L. 216 (2011); Alice Klettner, Thomas Clarke & Michael Adams, *The Changing Roles of Company Boards and Directors: The Impact of Legal Reform*, 24 AUSTL. J. CORP. L. 148 (2010); Shelley Marshall & Ian Ramsay, *Stakeholders and Directors Duties: Law, Theory and Evidence*, 18 UNSW L. J. 291; Ross W. Parsons, *The Director's Duty of Good Faith*, 5 MELBOURNE U. L. REV. 395 (1967); Paul Redmond, *The Reform of Directors' Duties*, 15 UNSW L. J. 86 (1992); Richard Williams, *Enlightened Shareholder Value in UK Company Law*, 18 UNSW L. J. 360 (2013).

126. Clarke, *supra* note 124, at 34 (quoting Marshall & Ramsay, *supra* note 125).

127. *See* Ronald Dore, *Financialization of the Global Economy*, 17 INDUS. & CORP. CHANGE 1097 (2008). *See also* GERALD F. DAVIS, MANAGED BY THE MARKETS: HOW FINANCE RE-SHAPED AMERICA (2009); G.R. KRIPPNER, CAPITALIZING ON CRISIS: THE POLITICAL ORIGINS OF THE RISE OF FINANCE (2012) [hereinafter KRIPPNER, CRISIS]; G.R. Krippner, *The Financialization of the American Economy*, 3 SOCIO-ECON. REV. 173 (2005) [hereinafter Krippner, *Economy*]; N. van der Zwan, *Making Sense of Financialization*, 12 SOCIO-ECON. REV. 99 (2013).

- The increasing political and economic power of a particular class grouping: the *rentier* class for some;[128]
- The explosion of financial trading with a myriad of new financial instruments;
- A pattern of accumulation in which profit making occurs increasingly through financial channels rather than through trade and commodity production;[129]
- The increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international.[130]

Multiple changes in the structural transformation of finance are occurring at three levels: (1) financial markets and institutions increasingly displacing other sectors of the economy as the source of profitable activity; (2) the insistent financialization of nonfinancial corporations through a regime of maximizing shareholder value and the emphasis on financial metrics; and (3) the penetration of finance into every aspect of life as people are increasingly incorporated into financial activity.[131] For Krippner, the international expansion of financial markets and institutions amounts to a new "pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production."[132] The finance sector has progressively increased its share of GDP, and even for nonfinancial corporations, the pursuit of interest, dividends, and capital gains outweigh any interest in productive investment. As nonfinancial corporations have become increasingly drawn into a financial paradigm, they have less capital available for productive activity, despite increasing profits from financial activity.[133] A combination of the accumulation of debt and the volatility of asset prices has increased systemic risk, leading to the increasing intensity of boom–bust cycles.

These financial pressures are translated into the operations of corporations through the enveloping regime of maximizing shareholder value as the primary objective. Agency theory has provided the rationale for this project, prioritizing shareholders above all other participants in the corporation and focusing corporate managers on the release of share-

128. *See* RUDOLF HILFERDING, FINANCE CAPITAL, A STUDY OF THE LATEST PHASE OF CAPITALIST DEVELOPMENT (T. Bottomore ed., M. Watnick & S. Gordon trans., RKP 1981) (1911).

129. *See* KRIPPNER, CRISIS, *supra* note 127; Krippner, *Economy*, *supra* note 127.

130. *See* G.A. Epstein, FINANCIALIZATION AND THE WORLD ECONOMY (2005); van der Zwan, *supra* note 127.

131. *See* van der Zwan, *supra* note 127.

132. *See* Krippner, *Economy*, *supra* note 127, at 175.

133. Lazonick, S*hareholder Value*, *supra* note 54.

holder value incentivized by their own stock options. In turn, this leads to an obsessive emphasis on financial performance measures, with increasingly short-term business horizons. However, as financial gains are realized they are not reinvested in advancing the corporation's productive activity, but distributed to shareholders in dividend payments and share buybacks.[134] While enriching executives and shareholders, corporations' innovative and productive future is threatened by the increasing impact of financialization.

Finally, the overwhelming embrace of finance is experienced in the increasing dependence of people on financial services and transactions in everyday life. The increasingly universal significance of defined contribution superannuation schemes, property mortgages, credit cards, and mass-marketed financial services has created a world in which the apparent "democratization of finance" has led to a convergence of finance and lifestyles.[135] However, in contrast to the public welfare and savings regimes of the past, which were intended to mitigate life cycle risks, the contemporary immersion in a profoundly financialized personal world acutely exposes individuals to the recurrent risks of the financial markets. This accumulation of an unrelenting international expansion of financial markets, the insistent financialization of corporate objectives and values, and the subordination of whole populations to financial services exploded in the 2008 global financial crisis.[136]

The impact of financialization is greatest among U.S. corporations and was highlighted by Michael Porter in his research for the U.S. Council on Competitiveness.[137] Porter explained that America failed to compete effectively with European and Japanese corporations in the 1970s and 1980s, even in domestic markets, on the highly liquid but unstable U.S. financial markets, compared to the more stable finance and governance of their overseas competitors.[138] Bill Lazonick has completed a series of major research programs on the myths of the market economy and the failure of U.S. capital markets to provide support for innovation in business in any sustainable way.[139] Lazonick provides extensive evidence of four central elements driving the increasing financialization of U.S. corporations: (1) maximizing shareholder value; (2) the continuous pay-

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134. van der Zwan, *supra* note 127, at 108; *see also* Lazonick, S*hareholder Value, supra* note 54.

135. van der Zwan, *supra* note 127, at 111.

136. *See* Klettner, Clarke & Adams, *supra* note 125; R.A. POSNER, THE CRISIS OF CAPITALIST DEMOCRACY (2010); ROBERT R. REICH, SUPERCAPITALISM: THE TRANSFORMATION OF BUSINESS, DEMOCRACY AND EVERYDAY LIFE (2008).

137. *See* Porter, *supra* note 96.

138. *Id.*

139. *See* LAZONICK, ORGANISATION, *supra* note 60; LAZONICK, SUSTAINABLE, *supra* note 63.

ment of high share dividends; (3) regular large scale share buy-backs by corporations; and (4) high executive stock options.[140]

It was through a hollowing-out of the social responsibility of business that the U.S. business corporation emerged as primarily a financial instrument. In this new financialized, dematerialized, and dehumanized corporate world, agency theory could be purveyed as the primary theoretical explanation, and shareholder value as the ultimate objective with impunity. In turn, these new conceptions of the theory and objective of the firm became vital ingredients in the further financialization of corporations, markets, and economies.[141] Lazonick records how financialization had an impact upon the leading sectors of American industry: U.S. information technology companies, which led the world in 1990s innovation (e.g., Microsoft, IBM, Cisco, Intel, Hewlett-Packard), "spent more (and except for Intel much more) on [stock] buybacks than they spent on R&D in 2000–2009."[142]

As nonfinancial corporations have become increasingly drawn into a financial paradigm, they have less capital available for productive activity despite increasing profits from financial activity. A combination of the accumulation of debt and the volatility of asset prices has increased systemic risk, leading to the increasing intensity of boom–bust cycles.[143] These financial pressures are translated into the operations of corporations through the enveloping regime of maximizing shareholder value as the primary objective. Agency theory has provided the rationale for this project, prioritizing shareholders above all other participants in the corporation, and focusing corporate managers on the release of shareholder value, incentivized by their own stock options. In turn, this leads to an obsessive emphasis on financial performance measures, with increasingly short-term business horizons. However, as financial gains are realized, they are not reinvested in advancing the corporation's productive activity, but distributed to shareholders in dividend payments and share buybacks.[144] While enriching executives and shareholders, corporations' innovative and productive future is threatened by the increasing impact of financialization.

More critically, in the 2007–2008 global financial crisis:

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140. *See* Lazonick, S*hareholder Value*, *supra* note 54; Lazonick, *Profits, supra* note 53.

141. *See* Weinstein, *supra* note 5.

142. *See* Lazonick, S*hareholder Value*, *supra* note 54, at 490; William Lazonick, *The Financialization of the U.S. Corporation: What Has Been Lost, and How It Can Be Regained*, 36 SEATTLE U. L. REV. 875 (2013).

143. *See* Joachim Becker et al., *Peripheral Financialization and Vulnerability to Crisis: A Regulationalist Perspective*, 14 COMPETITION & CHANGE 225 (2010).

144. *See* Lazonick, S*hareholder Value*, *supra* note 54.

> The financial firms (Citigroup, Merrill Lynch, Lehman Brothers, Wachovia, Washington Mutual, Fannie Mae, to name a few), many of whom failed, had previously used up precious reserves in order to fund stock buybacks, which in turn made already over-compensated executives even wealthier. Why did senior executives willingly diminish the financial strength and resilience of major corporations in this reckless way?[145]

IX. THE CONTINUING REVERBERATIONS OF THE GLOBAL FINANCIAL CRISIS

The relentless search for returns, regardless of the consequences, embodied in the pursuit of shareholder value was at the heart of the causes of the global financial crisis, and the continuing reverberations that are occurring. The self-interest and irresponsibility inherent in the practice of pursuing shareholder value reached its zenith with the reckless excesses of the global financial crisis. William Bratton and Michael Wachter relate the activities of financial sector firms in the years and months leading to the financial crisis of 2007–2008:

> For a management dedicated to maximizing share-holder value, the instruction manual was clear: get with the program by generating more risky loans and doing so with more leverage. Any bank whose managers failed to implement the [high-risk strategy] got stuck with a low stock price. . . . Unsurprisingly, its managers labored under considerable pressure to follow the strategies of competing banks.[146]

The global financial crisis and its aftermath consisted of multiple and compounding failures in financial markets, institutions, regulation, and governance.[147] The "animal spirits" unleashed in unfettered securities markets, massive incentivization of risk taking and leverage, and the abandonment of effective governance and ethical commitments occurred

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145. Thomas Clarke & Douglas Branson, *Introduction* to THE SAGE HANDBOOK OF CORPORATE GOVERNANCE 25 (Thomas Clarke & Douglas Branson eds., SAGE Publications Ltd. 2012).

146. William Bratton & Michael Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 720–21 (2010).

147. *See* GEORGE AKERLOF, & ROBERT J. SHILLER, ANIMAL SPIRITS: HOW HUMAN PSYCHOLOGY DRIVES THE ECONOMY, AND WHY IT MATTERS FOR GLOBAL CAPITALISM (2009); WILLIAM D. COHAN, HOUSE OF CARDS: HOW WALL STREET GAMBLERS BROKE CAPITALISM (2009); SATYAJIT DAS, EXTREME MONEY: THE MASTERS OF THE UNIVERSE AND THE CULT OF RISK (2011); NICHOLAS DUNBAR, THE DEVIL'S DERIVATIVES (2011); SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN (2010); KEVIN PHILLIPS, BAD MONEY: RECKLESS FINANCE, FAILED POLITICS AND THE GLOBAL CRISIS OF AMERICAN CAPITALISM (2009); RAGHURAM G. RAJAN, FAULT LINES: HIDDEN FRACTURES STILL THREATEN THE WORLD ECONOMY (2010); ANDREW ROSS SORKIN, TOO BIG TO FAIL (2009); Becker et al., *supra* note 143; Klettner, Clarke & Adams, *supra* note 125.

in a regulatory vacuum. Governments were convinced that lightening the burden of regulation was the means to promote more dynamic financial markets and business development. The realization of the consequences of unchecked systemic risks has prompted national governments and international agencies into a major series of regulatory reforms and interventions in financial markets and institutions, the effect of which remains to be discerned.

At a conference of corporate lawyers, investors, and regulators at the Columbia University Millstein Center for Corporate Governance in June 2013, there were many indications that traction has not yet been achieved in the reform of the structure, orientations, and behavior of the international financial community.[148] The U.S. investment banks (Strategically Important Financial Institutions or "SIFIs") have grown even larger since the financial crisis due to further consolidation in the industry following the crisis. The enormous wave of regulation from the G20, Basel Bank of International Settlements, and the passage of Dodd–Frank in 2010 have not changed the banks in any substantial and meaningful way. The Wall Street banks are now larger and more remote than before, continue business as usual, and have not fundamentally changed their behavior, leading Elizabeth Warren, the campaigning U.S. Senator, to call for a twenty-first century Glass–Steagall Act to "ensure [the banks] are not too big to fail—or, for that matter, too big to manage, too big to regulate, too big for trial, or too big for jail."[149]

There is a profound paradox that after two decades of corporate governance reform, governments and corporations remain fully engaged in the governance challenges posed by the transformation of markets, operations, and technologies in the finance sector. "We have not yet fully understood the causes of the last financial crisis, and [have] not begun to prepare for the next one."[150] The Dodd–Frank Wall Street Reform Act in the United States is still being implemented (828 pages, 398 rules, running to 14,000 pages, with every page being wrestled over by the lobbyists of the big banks).[151] Though passage of the 882-page Volker Rule—intended to update the 27-page Glass–Steagall Act—was achieved in

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148. Millstein Center for Corporate Governance, *Corporate Governance in the New 'Normal'*, 2013 Millstein Governance Forum, Columbia University Law School (June 24–25, 2013).

149. *See* Elizabeth Warren, *Scaling Back 'Too Big': The 21st Century Glass–Steagall Act Would Reduce the Risk of Another Crash,* BOSTON GLOBE (Sept. 18, 2013), http://www.bostonglobe.com/opinion/2013/09/18/century-glass-steagall-act-will-disable-too-big-fail-bank-risk/cdR0wqqnDIGBBoYAaFFfbO/story.html.

150. Personal correspondence with Douglas Arner, Professor, Univ. of Hong Kong Facutly of Law (2014).

151. Wall Street Reform and Consumer Protection (Dodd–Frank) Act, 28 U.S.C. §§ 5301–5641 (2010).

December 2013, separation of investment banking and retail banking (preventing banks from speculating with depositors funds, knowing the state will bail them out if they fail), remains in doubt. Justin O'Brien commented on this tortured legislative process:

> Ironically, flawed legislative framing, the complexity of Dodd–Frank, and the glacial pace of implementation enable the very defects in the financial sector regulation that legislators seek to remedy. The Volcker Rule, which restricts proprietorial trading, is an obvious example. A clear rule has transmogrified into a complex implementation process, informed by waves of exceptions that undercut legislative intent and undermine regulatory authority.[152]

Any belief that the considerable efforts by government to rescue and reform financial institutions and markets would lead to sustained stability and security in the sector was rudely dispelled in a prolonged sequence of bank scandals and market failures in the years following the financial crisis. The banking crisis segued into a sovereign debt crisis in southern Europe with governments facing challenges in funding their activities. This was quickly followed by seismic eruptions in the mainstream financial institutions with the revelations surrounding the London Interbank Offered Rate (LIBOR) rate fixing. A total of $10 trillion in loans and $350 trillion in derivatives worldwide were indexed to LIBOR.[153] The U.S. Financial Stability Oversight Council (established by the Dodd–Frank Act to identify risks to financial stability, promote market discipline, and respond to emerging threats) highlighted:

> Recent investigations uncovered systemic false reporting and manipulations of reference rate submissions dating back many years. This misconduct was designed to either increase the potential profit of the submitting firms or to convey a misleading picture of the relative health of the submitting banks. These actions were pervasive, occurred in multiple bank locations around the world, involved senior bank officials at several banks, and affected multiple benchmark rates and currencies, including LIBOR, EURIBOR, and the Tokyo Interbank Offered Rate (TIBOR). Each of the banks that faced charges engaged in a multi-year pattern of misconduct that involved collusion with other banks.[154]

This rate manipulation predated the crisis and had continued long after the government support and intervention in the banking sector fol-

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152. Justin O'Brien, *Culture Wars: Rate Manipulation, Institutional Corruption, and the Lost Normative Foundations of Market Conduct Regulation*, 37 SEATTLE U. L. REV. 375, 383 (2014).

153. CITE

154. FINANCIAL STABILITY OVERSIGHT COUNCIL, U.S. FEDERAL TREASURY, 2013 ANNUAL REPORT 137 (2013).

lowing the financial crisis, revealing how constricted any ostensible change in governance and ethics within the banks actually was. After a major inquiry into Barclay's involvement in the LIBOR rate-rigging, subpoenas to JPMorgan, Deutsche Bank, Royal Bank of Scotland Group, HSBC, Citigroup, and UBS, all of the banks settled for fines amounting to billions of dollars with the Department of Justice and Commodities Futures Trading Commission (CFTC) in the United States and the Financial Services Authority (FSA) in the United Kingdom. The Salz Review on Barclay's exposed the "gaps between Barclay's publicly articulated values and its business practices."[155] Antony Jenkins, the new CEO of Barclays, admitted in the 2012 Annual Report: "For the past 30 years, banking has been progressively too aggressive, too focused on the short term, too disconnected from the needs of our customers and clients, and wider society and we lost our way."[156] The U.K. Parliamentary Commission on Banking Standards stated: "Too many bankers, especially at the most senior levels, have operated in an environment with insufficient personal responsibility," and "[r]emuneration has incentivised misconduct and excessive risk-taking, reinforcing a culture where poor standards were often considered normal."[157]

X. VALUE FOR ALL PARTIES?

As Margaret Blair contends, in the United States, directors have both the authority and the responsibility, without any change in corporate law, to consider the interests of all of the participants in the corporate enterprise in order to try to find the outcome that creates value for all parties.[158] However, this responsibility is confounded by the realities of corporate practice. Take, for example, the recent experience of Apple, currently the most successful corporation in the United States in terms of market capitalization, revenues, product design, and brand. In 2013, Apple possessed in excess of $140 billion in cash and liquid assets, probably the greatest hoard of any corporation in history (accumulated on the backs of over 1 million Chinese workers in assembly plants often de-

155. M. SALZ, AN INDEPENDENT REVIEW OF BARCLAY'S BUSINESS PRACTICES 11 (2013).

156. BARCLAY'S BANK, ANNUAL REPORT 9 (2012).

157. PARLIAMENTARY COMMISSION ON BANKING STANDARDS, CHANGING BANKING FOR GOOD, 2013, HL 27-I, HC 175-I, at 8–9 (U.K.).

158. Margaret M. Blair, *In the Best Interests of the Corporation: Directors Duties in the Wake of the Global Financial Crisis*, *in* THE SAGE HANDBOOK OF CORPORATE GOVERNANCE 62 (Thomas Clarke & Douglas Branson eds., 2012) [hereinafter Blair, *Best*].

prived of pay, and frequently deprived of sleep, while Apple maintained up to 40% returns while holding down costs on its supplier Foxconn[159]).

Meanwhile, in response to pressure from the New York-based Greenlight hedge fund, Apple agreed to disburse dividend payments of $100 billion over the following three years, and subsequently, under pressure from the hedge fund raider Carl Icahn, Apple further increased this proposal for a massive disbursement of funds to shareholders (without any further commitment, other than those which had secured only modest improvements, to remedying Apple's appalling record of labor standards in China). When the CEO of Apple, Tim Cook, was hauled before the U.S. Senate Permanent Subcommittee on Investigations to explain the systemic avoidance of corporation tax by Apple and other U.S. corporations by parking tens of billions in overseas tax havens rather than repatriating the funds, his response was to call for a tax holiday to enable corporations to return their profits at a fraction of the standard corporate tax rate.[160] This did not enamor the Senate since there was significant evidence that previous tax holidays for U.S. corporations had not seen the funds utilized for business and employment development, but in paying dividends, share buybacks, executive stock options, and paying down debt.[161] This is the result of pursuing the logic of shareholder primacy and the discipline of shareholder value through global value chains to factories in emerging economies. Even the most successful corporation neglects the labor standards of a million young workers—and avoids paying taxes—while disbursing hundreds of billions of dollars to shareholders, and in the process loses much of the capacity to invest in innovation, and the design and development of new product technologies and new production processes.

Yet, while engaging in a considered way in this consistently irresponsible behavior, boards of directors of U.S. corporations clearly believe they are carrying out their duties as prescribed by corporations law, and are indeed legally constrained to do this. In fact, there is no reference to any duty to deliver shareholder value in U.S. corporate law, or in the corporate law of any other country.[162] Corporate law around the world sensibly states that it is the duty of directors to pursue the best interests

159. *See, e.g.*, Leonid Bershidsky, *Does Your iPhone Exploit Chinese Workers?*, BLOOMBERG VIEW (Dec. 12, 2013, 12:24 PM), http://www.bloombergview.com/articles/2013-12-12/does-your-iphone-exploit-chinese-workers-.

160. *See, e.g.*, Heidi Moore, *Tim Cook's Pitch for a Corporate Tax Holiday Suits Washington Just Fine*, THE GUARDIAN (May 17, 2013), http://www.theguardian.com/commentisfree/2013/may/17/tim-cook-tax-holiday-suits-politicians.

161. *See* DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH SERV., R40178, TAX CUTS ON REPATRIATION EARNINGS AS ECONOMIC STIMULUS: AN ECONOMIC ANALYSIS (2011).

162. *See* Blair, *Best, supra* note 158.

of the company, and it is this interpretation that has been sustained in common law in many significant judgments in the courts.[163] However, though this may refer to the general body of shareholders over time, there is no injunction upon directors to pursue the immediate interests of shareholders, or the interests of particular shareholders. Nor are directors prevented from taking into account the interests of other stakeholders in the company. In fact, the translation of shareholder rights into property rights by the agency theorists is quite bogus, since shareholders do not "possess" any of the assets of the company (which are owned by the company). All shareholders possess are their shares, which give them certain rights, such as attendance at the annual general meeting, voting for directors, and receipt of dividends, but in no other sense allow any form of "control" over the company.[164]

XI. THE IMPACT OF SHORT-TERMISM AND IMPATIENT CAPITAL

In this context of the continuing ascendancy of shareholder value, and aggressive short-termism, the U.K. Kay Review was called to examine the mechanisms of corporate control and accountability provided by U.K. equity markets, and their impact on the long term competitive performance of U.K. businesses, and to make recommendations. Specifically, it was tasked to inquire into whether the timescales considered by boards and senior management in evaluating corporate risks and opportunities, and by institutional shareholders and asset managers in making investment and governance decisions, and match the time horizons of the underlying beneficiaries. Furthermore, it was to consider whether the current functioning of equity markets gives sufficient encouragement to boards to focus on the long-term development of their business. In the Interim Report of the Review, Kay commented:

> We heard many references to the merits of liquidity, transparency, price discovery, and other intermediate objectives. While these objectives may be desirable, they are not achieved without cost, and must find their justification in the contribution they make to the fundamental goals of high performing companies and good risk adjusted returns for savers. Many respondents to this Review thought that equity markets have lost sight of these goals. For example, the Association of Chartered Certified Accountants (ACCA) observed

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163. There is, however, a lingering definitional issue of who or what "the company" is that directors are pursuing the best interests of, and often reference to the "members" of the company.

164. Indeed if they did have such control, chaos would inevitably quickly occur, as professional managers business decisions were continuously overruled. *See* STOUT, VALUE, *supra* note 53; Stout, *Primacy*, supra note 69; Blair, *Best, supra* note 158; Weinstein, *supra* note 4; Blair, *Theory, supra* note 85.

> that "it is sometimes forgotten that equity markets exist not solely to enrich speculators, market makers and intermediaries . . . . It would seem fair to say that equity markets today serve the needs of the players in these markets better than they serve either those who put up the money or the businesses wanting finance to support growth."[165]

Kay analyzed this distinction between short-term trading and long-term investing. High-frequency traders are driven by short-term market trends and turn their portfolios over rapidly. Underlying performance is of less interest than immediate opportunity. In contrast, investors intent on holding assets for the long term will analyze a company's prospects and underlying performance. Kay concludes: "Equity markets work effectively for the corporate sector when they encourage, and do not impede, decision making which enhances the long term competitive capabilities of the business."[166] Yet recent advances in financial, computing, and communications technologies have facilitated the dramatic reduction of the average holding period of equity; on the New York Stock Exchange (NYSE), this has diminished from seven years in the 1950s to six months today.[167] More worryingly, as much as 70% of trading volume on the NYSE is performed by computer driven algorithms and is measured in milliseconds, and other exchanges are similarly overwhelmed.[168] The concern is that the short-term emphasis of equity markets may have further intensified unproductive value extraction at the expense of sustainable value creation.

The more impact short-term traders have in the market, the more volatile prices will be. Andrew Haldane of the Bank of England has documented this phenomenon, citing a Chartered Financial Analyst (CFA) 2006 Symposium, which concluded: "The obsession with short-term results by investors, asset management firms, and corporate managers collectively leads to the unintended consequences of destroying long-term value, decreasing market efficiency, reducing investment returns, and impeding efforts to strengthen corporate governance."[169] Indeed it can be argued that the key players in corporate governance, the institutional investors and the executives and directors running companies, are now so

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165. JOHN KAY, THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING, INTERIM REPORT ¶¶ 2.8–2.9 (2012).

166. *Id.* ¶ 2.3.

167. CITE

168. CITE

169. Andrew Haldane, Executive Director, Financial Stability & Richard Davies, *The Short Long*, Speech at the 29th Société Universitaire Européene de Recherches Financiéres Colloquium 'New Paradigms in Money and Finance?', Brussels (May 2011), *available at* http://www.bankofengland.co.uk/publications/Documents/speeches/2011/speech495.pdf.

financially committed to the short term that there is little chance § 172 of the U.K. Corporation Act, or any similar legislation in other countries, changing their behavior.

In this context, despite the high aspirations of some involved in the early work of revising U.K. company law, it is possible that § 172 and the accompanying business review in § 417 of the Act will simply amount to a directors' commentary that is a "self-serving and vacuous narrative rather than analytical material which is of genuine use."[170] Yet long-term innovation and investment performance requires attention to more than short-term financial metrics, and there are other critical and pressing reasons why corporations are now required to become more long-sighted and expansive in their purpose.

XII. IN SEARCH OF SUSTAINABILITY AND PATIENT CAPITAL

In their analysis of team production, Blair and Stout (unlike agency theorists) explicitly acknowledge the significance of external political influences upon the direction of corporations to which they must respond:

> A second lesson to draw from team production theory concerns the fundamentally political nature of the corporation. Scholarly and popular debates about corporate governance need to recognize that corporations mediate among the competing interests of various groups and individuals that risk firm-specific investments in a joint enterprise. . . . Thus, future scholarship should explore in greater detail the internal and external political and economic pressures that affect the decision making process in firms.[171]

The greatest and most imminent pressure upon businesses of this era is the demand for corporate social and environmental responsibility (CSR) in a severely resource constrained planet. The business imperative for sustainability is becoming increasingly unavoidable. However challenging the prospects, there are growing indications of large corporations taking their social and environmental responsibilities more seriously. Furthermore, these issues becoming more critical in the business agenda and are being taken up as part of the duties of company directors.[172] This is a consequence of several factors: technological advances such as social media make it much easier to find out about companies and broadcast any misdemeanors; maintaining a good reputation is a vital asset for

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170. DAVIES, PRINCIPLES, *supra* note 123, at 740.

171. Blair & Stout, *supra* note 14, at 323.

172. *See* THE NEW CORPORATE ACCOUNTABILITY: CORPORATE SOCIAL RESPONSIBILITY AND THE LAW (Doreen McBarnet, Aurora Voiculescu & Tom Campbell eds., 2007).

many companies; civil society groups have become more vocal regarding companies' public responsibilities; and some of the protections formerly offered by law have been eroded. The substance of company reports is changing, from purely environmental reporting up until the late 1990s, to sustainability reporting (social, environmental, and economic), which has become the mainstream approach of global companies. [173]

At the confluence of these multiple emerging initiatives and trends towards greater corporate social and environmental responsibility, there is emerging a dynamic stakeholder model for driving what is still often referred to as "enlightened shareholder value" (or more expansively, stakeholder values).[174] This enlightened shareholder value approach posits that there can be a win-win situation whereby a company will benefit financially in the long term if it behaves responsibly towards its employees, the environment, customers, suppliers, and other stakeholders. The obvious manifestations of this are reputational benefits, reduced costs from more efficient use of natural resources, and the support of local communities ("the *license to operate*"). Critics of this view maintain that there will be circumstances where the win-win scenario is simply not possible or is too costly; not all companies are concerned with reputation, and the benefits from bad behavior can be all too tempting. A business case for corporate responsibility may exist for some companies but not for all. Indeed, Vogel, in discussing the limits of CSR, comments that it should be understood as "a niche rather than a generic strategy."[175]

Many advances in international CSR policy and practice have occurred in recent years. For example: the further development of the United Nations Environment Programme Financial Initiative ("UNEP FI"), linking environmental, social, and governance issues to company value, has persuasively argued the relationship between sustainability and valuation;[176] the UNEP FI Principles of Responsible Investment has recruited 1,287 investment institutions as signatories of the principles, with assets

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173. *See* KPMG, INTERNATIONAL SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2011 (2012).

174. SHAUN MAYS, CORPORATE SUSTAINABILITY: AN INVESTOR PERSPECTIVE (CANBERRA: DEP'T OF THE ENV'T & HERITAGE) (2003); SUSTAINABILITY, THE CHANGING LANDSCAPE OF LIABILITY: A DIRECTOR'S GUIDE TO TRENDS IN CORPORATE ENVIRONMENTAL, SOCIAL AND ECONOMIC LIABILITY (2005), *available at* http://www.sustainability.com/library.

175. DAVID VOGEL, THE MARKET FOR VIRTUE: THE POTENTIAL AND LIMITS OF CSR (2005) (though this may represent the approach of U.S. corporations rather than the more engaged approach of European or Japanese corporations in corporate responsibility).

176. *See* UNEP FI, SHOW ME THE MONEY: LINING ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES TO COMPANY VALUE (2006), *available at* http://www.unepfi.org/fileadmin/documents/show_me_the_money.pdf.

under management of approximately US$45 trillion;[177] the Global Reporting Initiative (GRI) has been adopted worldwide by major corporations as a means of integrated reporting;[178] and the London Stock Exchange (LSE) has recently joined a U.N.-coordinated Sustainable Stock Exchanges (SSE) initiative aimed at exploring how exchanges can work together with investors, regulators, and companies to enhance corporate transparency and ultimately performance on ESG (environmental, social, and corporate governance) issues.[179]

Together with many other international, national, and private sector initiatives, the knowledge about sustainability and sophisticated policies of corporate sustainability and social responsibility have gained global significance. However, significant questions remain—to what degree have these policies, however refined, become embedded in the governance processes of corporations? Have these policies had an impact on fundamental business models? How effectively have the policies been implemented in practice? One extensive survey offers sobering answers to these questions:

> Corporations that have grasped the importance of sustainability in the value creation process and the necessity for innovation in products, processes, and business models have made the first important step towards a sustainable strategy. However, realization on its own is not enough if it is not followed by implementation. To enable innovation and make sustainability considerations core to a company's strategy and operations, a company needs to have a governance structure and process that is supportive of developing and executing a sustainable strategy. . . . Corporate governance has a key role in the implementation of a sustainable strategy as the board of a firm is responsible for setting the overall direction and creating the appropriate systems that will facilitate it . . . . By examining archival data on how many firms embrace this approach today, we have found that the governance of sustainability is still at an embryonic stage.[180]

177. *See* UNEP FI, PRINCIPLES OF RESPONSIBLE INVESTMENT ANNUAL REPORT 2014 (2014), *available at* http://d2m27378y09r06.cloudfront.net/viewer/?file=wp-content/uploads/PRIAnnualReport2014.pdf.

178. *See* GLOBAL REPORTING INITIATIVE, SUSTAINABILITY REPORT 2012/2013 (2013), *available at* https://www.globalreporting.org/resourcelibrary/2012-2013-Sustainability-Report.pdf.

179. *See* JAIDEEP SINGH PANWAR & JENNY BLINCH, SUSTAINABLE STOCK EXCHANGES: A REPORT ON PROGRESS, *available at* https://www.unglobalcompact.org/docs/issues_doc/Financial_markets/Sustainable_Stock_Exchanges.pdf; UNCTAD, BEST PRACTICE GUIDANCE FOR POLICYMAKERS AND STOCK EXCHANGES ON SUSTAINABILITY REPORTING INITIATIVES (2014), *available at* http://unctad.org/en/PublicationsLibrary/diaeed2013d6_en.pdf.

180. UNEP FI, INTEGRATED GOVERNANCE—A NEW MODEL FOR SUSTAINABILITY (2014), *available at* http://www.unepfi.org/fileadmin/documents/UNEPFI_IntegratedGovernance.pdf.

Recent research offers a different view, revealing that many large Australian companies have a board subcommittee dedicated to considering issues of corporate responsibility and sustainability. Of the ASX 50 companies surveyed, twenty-two disclosed that they had a board committee dedicated to sustainability, six had a dedicated senior executive committee, and three reported they had a dedicated network of managers.[181] They have formal processes for engaging with their stakeholders, and systems for ensuring that stakeholder interests are taken into account at the highest levels of decisionmaking. Formal governance structures are being put in place to ensure that sustainability initiatives are integrated into core business strategy. Moreover, tentative steps are being made by a significant number of large international corporations towards integrated reporting. The prototype integrated reporting framework encourages companies to report in relation to a broad range of "capitals" or resources used and created by the organization. These include the traditional focus: financial capital, but also manufactured capital, human capital, intellectual capital, natural capital, and relationship (or social) capital.[182] In their 2008 survey, KPMG found that only 4% of the 250 largest global companies had experimented with some form of integrated reporting, whereas in 2011, the percentage had risen to 26%.[183] Although companies are attempting to integrate their reporting, in the majority of cases this involves a dedicated section in the annual report rather than truly combined performance reporting, suggesting that integrated reporting is still in an experimental stage.[184]

However, both the operating and reporting environment for corporations is about to change radically as the implications of the sustainability imperative become fully apparent:

> Over the next 20 years there is likely to be increasing pressure for the price of resources, products and services to reflect the full cost of their production including the cost of environmental impacts. Such pressure is likely to grow as governments address the effects of sustainability mega-forces. Possible futures include the removal of subsidies on input commodities (such as fossil fuels and water) and the wider introduction of mechanisms to increase the cost of

181. Alice Klettner, Thomas Clarke & Martijn Boersma, *The Governance of Corporate Sustainability: Empirical Insights into the Development, Leadership and Implementation of Responsible Business Strategy*, 22 J. BUS. ETHICS 145 (2014).

182. INT'L INTEGRATED REPORTING COMM., INTEGRATED REPORTING (2012).

183. CITE

184. KPMG, INTERNATIONAL SURVEY OF CORPORATE RESPONSIBILITY REPORTING 2011 (2011), *available at* http://www.kpmg.com/GR/en/IssuesAndInsights/ArticlesPublications/Sustainability/Documents/ss-KPMG-International-Survey-of-CR-Reporting-2011-Nov-2011-web.pdf.

> environmentally damaging outputs. It is therefore prudent for companies to expect to pay in the future a rising proportion of their external environmental costs which today are often not shown on financial statements.[185]

Coming to terms with the real cost of the natural capital of the earth they have freely exploited will induce a profound transformation upon business thinking and practice. Trucost is a research body established by several U.K. financial institutions to estimate in monetary terms

> the financial risk from unpriced natural capital inputs to production, across business sectors at a regional level. By using an environmentally extended input-output model (EEIO), it also estimates, at a high level, how these may flow through global supply chains to producers of consumer goods. It demonstrates that some business activities do not generate sufficient profit to cover their natural resource use and pollution costs. However, businesses and investors can take account of natural capital costs in decision making to manage risk and gain competitive advantage. Natural capital assets fall into two categories: those which are non-renewable and traded, such as fossil fuel and mineral "commodities"; and those which provide finite renewable goods and services for which no price typically exists, such as clean air, groundwater and biodiversity.[186]

Business is now faced with the greatest political and social challenge ever: how to stop the continuous and cumulative environmental despoliation of the planet before we reach the point of ecological disaster. Since the time of the industrial revolution, industry has been deeply implicated in the emissions that have contributed to global warming, and now must be central to the achievement of zero carbon emissions and sustainable business enterprise. Tackling this challenge will necessitate a fundamental revision of corporate purpose, corporate governance, and directors' duties. How can we have confidence that this will be accomplished when so little has been achieved in the reformulation and enlightenment of directors' duties after decades of effort up to this point? The answer is that we are now in the position of:

- Confronting an environmental and social challenge that is a universal problem unprecedented in human civilization;
- This is an urgent challenge and cannot be deferred or delayed;

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185. KPMG, EXPECT THE UNEXPECTED: BUILDING BUSINESS VALUE IN A CHANGING WORLD 8 (2012), *available at* http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/building-business-value.pdf.

186. TRUCOST, NATURAL CAPITAL AT RISK: THE TOP 100 EXTERNALITIES OF BUSINESS 7 (2013).

- Corporations are a vital means to the solution of sustainability, but every other level of the economy and society will be involved including intergovernmental agencies, national governments, civil society, and people.

No less a person than Henry Paulson, Secretary of the Treasury under George W. Bush, and the architect of the vast U.S. rescue package during the global financial crisis, recently has called upon fellow Republicans to face up to their environmental responsibilities:

> I was Secretary of the US Treasury when the credit bubble burst, so I think it is fair to say that I know a little bit about risk, assessing outcomes and problem-solving. Looking back at the dark days of the financial crisis in 2008, it is easy to see the similarities between the financial crisis and the climate challenge we now face. We are building up excesses (debt in 2008, greenhouse gas emissions that are trapping heat now). Our government policies are flawed (incentives for us to borrow too to finance homes then and encouraging the overuse of carbon-based fuels now) . . . . And the outsize risks have the potential to be tremendously damaging (to a globalized economy then and the global climate now). Back then we narrowly avoided an economic catastrophe at the last minute by rescuing a collapsing financial system through government action. But climate change is a more intractable problem. The carbon dioxide we're sending into the atmosphere remains there for centuries heating the planet.[187]

In response to conservative critics who highlight the high price of intervention, Paulson argues:

> Our failure to act on the underlying problem is deeply misguided, financially and logically. In a future with more severe storms, longer fire seasons, and rising seas that imperil coastal cities, public funding to pay for adaptations or disaster relief will add significantly to our fiscal deficit and threaten our long-term economic security. . . . A tax on carbon emissions will unleash a wave of innovation to develop technologies, lower the costs of clean energy and create jobs as we and other nations develop new energy products and infrastructure.[188]

Over the next twenty years businesses will be exposed to hundreds of environmental and social changes that will bring both risks and opportunities in the search for sustainable growth:

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187. Henry M. Paulson Jr., *The Coming Climate Crash: Lessons for Climate Change in the 2008 Recession*, N.Y. TIMES (June 21, 2014), http://www.nytimes.com/2014/06/22/opinion/sunday/lessons-for-climate-change-in-the-2008-recession.html?_r=0.

188. *Id.*

- Climate Change
- Volatile Fossil Fuel Markets
- Material Resource Scarcity
- Water Scarcity
- Population Growth
- Impact on Resources of Growing Global Middle Class
- Growing Urbanisation
- Food Security
- Ecosystem Decline
- Deforestation[189]

This is all a long way from the simplistic tenets of shareholder value, and the narrow objective it focused upon, often to the detriment of corporations, shareholders, stakeholders, and the wider economy and environment. Hopefully we can now spend more time addressing the possibilities and limitations of corporate social and environmental responsibility, free of the dead weight of the mythology of shareholder primacy. To tackle these compounding problems, corporations will be required to engage in a sustainable revolution just as profound as the industrial revolution in which we will move from a nineteenth century focus on production, and a twentieth century focus on marketing and consumption, to a twenty-first century focus on sustainability. But the integration of corporate governance and sustainability is still to be achieved: while corporate policy has become more sophisticated, implementation remains in its infancy. The reformulation of corporate purpose, corporate governance and directors' duties in the direction of greater environmental and social responsibility is now a matter of survival.

189. *See* KPMG, EXPECT THE UNEXPECTED, *supra* note 185.