



The challenge of effective ‘corporate purpose law’ reform

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ABSTRACT

Company law commentary is again considering the company’s purpose. Mayer has argued that corporate purpose law in the United Kingdom (UK) should change with an ‘embarrassingly simple policy’ – requiring companies to state their purposes. The aim of this article is to demonstrate how difficult it would be to enact such a change to UK company law. The UK has no overt corporate purpose law: the most direct provision is hidden in the content of duties owed by directors. Yet, if the reason for corporate purpose law reform is that companies are run too much in the interests of their shareholders, then additional changes to company law are needed to remove the ability for shareholder pressure to be applied following corporate purpose law reform. The result is that changing corporate purpose law requires a number of further incidental changes to company law (indirect corporate purpose law), which necessitates a fundamental rewrite of UK company law. Partial reform is undesirable as it will allow the same dynamics to funnel through alternative routes, will present a veneer of change and will use up legislative bandwidth. Changing corporate purpose law in the UK is hard and involves a fundamental rewrite of company law. Alternative methods of regulation, to achieve the same ends, are more readily available.

Keywords: company law; corporate purpose; corporate law; shareholder rights.

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INTRODUCTION

Anglo-American company law discourse is again¹ examining 'corporate purpose',² namely what companies exist to do. The options range between the company operating purely for the benefit of shareholders,³ to it having a wider societal purpose.⁴ This debate 'has become one of the hottest public policy issues'.⁵ Different jurisdictions take different approaches.⁶

The United Kingdom (UK) has no direct corporate purpose law regime. There is no provision that overtly states what a company's purpose is or should be. For the UK, corporate purpose only appears in law as a duty for directors of companies to act in what they consider to be the best interests of the company for the benefit of its members.⁷ In the Anglo-American sphere, any lacuna in overt corporate purpose tends to be filled by the interests of shareholders.⁸ Overall, the UK is

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- 1 Eg B R Cheffins, 'The past, present and future of corporate purpose' (2025) 48 *Delaware Journal of Corporate Law* 387–454; J E Fisch and S D Solomon, 'Should corporations have a purpose?' (2021) 99 *Texas Law Review* 1309–1346; L M Fairfax, 'Stakeholderism, corporate purpose, and credible commitment' (2022) 108 *Virginia Law Review* 1163–1241; K J Hopt, 'Corporate purpose and stakeholder value' (2024) ECGI Working Paper Series in Law 690/2023.
 - 2 Eg C Mayer, *Prosperity: Better Business Makes the Greater Good* (Oxford University Press 2018) 22, 24; C Mayer, 'What is wrong with corporate law? The purpose of law and the law of purpose' (2022) ECGI Working Paper Series in Law 649/2022.
 - 3 Discussed in (amongst other places) S Bhagat and G Hubbard, 'Should the modern corporation maximize shareholder value?' (2020) AEI *Economic Perspectives* 1–14; M J Roe, 'The shareholder wealth maximization norm and industrial organization' (2001) 149 *University of Pennsylvania Law Review* 2063–2081; A Key and R Adamopoulou, 'Shareholder value and UK companies: a positivist inquiry' (2012) 13 *European Business Organization Law Review* 1–29.
 - 4 Discussed in (amongst other places) C M Bruner, 'Corporate governance reform and the sustainability imperative' (2022) 131(4) *Yale Law Journal* 1062–1384; R E Freeman and D L Reed, 'Stockholders and stakeholders: a new perspective on corporate governance' (1983) 25 *California Management Review* 88–106; W W Bratton, 'Enron and the dark side of shareholder value' (2002) 76 *Tulane Law Review* 1275–1361; L A Stout, *The Shareholder Value Myth* (Berrett-Koehler 2012).
 - 5 E B Rock, 'For whom is the corporation managed in 2020? The debate over corporate purpose' (2021) 76 *Business Lawyer* 363–396, 363.
 - 6 B Sjøfjell, A Johnston, L Anker-Sørensen and D Millon, 'Shareholder primacy: the main barrier to sustainable companies' in B Sjøfjell and B J Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press 2015); E Elhauge, 'Sacrificing corporate profits in the public interest' (2005) 80 *New York University Law Review* 733–869, 738.
 - 7 Companies Act 2006, s 172.
 - 8 See J E Fisch, 'Measuring efficiency in corporate law: the role of shareholder primacy' (2006) 31 *Journal of Corporation Law* 637–674; R J Rhee, 'A legal theory of shareholder primacy' (2018) 102 *Minnesota Law Review* 1951–2017.

seen as a particularly pro-shareholder corporate purpose regime.⁹ As we are situated at one end of this spectrum, any proposal to reform UK corporate purpose law is therefore a proposal to make companies focus less on shareholders and more on other constituencies, who may currently be harmed by our approach.¹⁰ Arguments that have been presented for doing so include to improve sustainability,¹¹ wider social changes sweeping into corporate law,¹² Covid-19 having fundamentally changed corporate governance,¹³ a need to pre-empt future macroeconomic issues,¹⁴ and merely that academic treatment of corporate purpose is cyclical.¹⁵ Overall, Anglo-American corporate law attention has returned¹⁶ to exploring whether company law needs to make a company's purpose be less about shareholders.

Mayer has argued that corporate purpose law should change with an 'embarrassingly simple policy'¹⁷ – making companies state their purposes in their articles of association and disclose how they meet those purposes.¹⁸ Davies argues that Mayer's approach misses the point – shareholders who are interested in prioritising social interests can use existing company law structures and rules to achieve such ends anyway, and those who wanted to retain profit maximisation would

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- 9 Eg see A Johnston, 'Market-led sustainability through information disclosure' in B Sjäfjell and C M Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press 2019).
- 10 Eg from within law, see P Ireland, 'Shareholder primacy and the distribution of wealth' (2005) 68 *Modern Law Review* 49–81; L A Stout, 'The toxic side effects of shareholder primacy' (2013) 161 *University of Pennsylvania Law Review* 2003–2023. From other fields, see A Rebérioux, 'Does shareholder primacy lead to a decline in managerial accountability?' (2007) 31 *Cambridge Journal of Economics* 507–524; F Dobbin and J Jung, 'The misapplication of Mr Michael Jensen: how agency theory brought down the economy and why it might happen again' (2010) e30B *Markets on Trial: The Economic Sociology of the US Financial Crisis* 29–64.
- 11 Eg Bruner (n 4 above).
- 12 See L M Fairfax, 'Racial rhetoric or reality? Cautious optimism on the link between corporate #BLM speech and behaviour' [2022] *Columbia Business Law Review* 118–205.
- 13 M Gelter and J M Puaschunder, 'Covid-19 and comparative corporate governance' (2021) 46 *Journal of Corporation Law* 557–629.
- 14 A Kovvali, 'Countercyclical corporate governance' (2022) 101 *North Carolina Law Review* 141–205.
- 15 H Wells, 'The cycles of corporate social responsibility: an historical retrospective for the twenty-first century' (2002) 51 *Kansas Law Review* 77–140.
- 16 Eg L L Dallas, 'Is there hope for change? The evolution of conceptions of good corporate governance' (2017) 54 *San Diego Law Review* 491–564.
- 17 Mayer (n 2 above) 22.
- 18 *Ibid* 23.

find ways around the new regime.¹⁹ Spamann and Fischer have argued that, given the broad discretion already enjoyed by managers, there is no need to amend corporate purpose law, and doing so will achieve nothing.²⁰

However, external challenges to corporate purpose reforms do not negate the value of examining how effective corporate purpose law reform would need to work in the UK. This article analyses some implications of the *how* of UK corporate purpose law reform. The article's claim is that reforming corporate purpose law in the UK is actually quite difficult and requires a number of consequential amendments. The overt UK focus means that this article's analysis may not be applicable in other legal cultures.²¹

The reasons proposed for corporate purpose law reform tend to involve concerns that a shareholder-focus of companies harms third parties, in particular challenging sustainability.²² This focus is thought to arise because either shareholders directly require it by exercising their rights, or directors act in a way calculated to appease shareholders, in order to pre-empt direct shareholder action.²³ The problem of any reform of UK corporate purpose law, though, is that underlying shareholder control of companies is hard-baked into UK corporate law. Whilst we may have limited direct corporate purpose law in the UK, we have numerous factors that indirectly cause the same pressures within a company. From being the beneficiary of duties and ratifying breaches of them, to appointment and removal rights starting and ending companies, to setting the terms of the constitution and relying on it, shareholders have a high degree of control over the company. Cutting them out to the degree necessary to reduce these pressures sufficiently to properly change corporate purpose requires a dramatic rewrite of UK corporate law.

19 P L Davies, 'Shareholder voice and corporate purpose: the purposeless of mandatory corporate purpose statements' (2022) ECGI Working Paper Series in Law 666/2022.

20 H Spamann and J Fischer, 'Corporate purpose: theoretical and empirical foundations/confusions' (2022) ECGI Working Paper Series in Law 664/2022. See also M Gatti and C Ondersmam, 'Can a broader corporate purpose redress inequality? The stakeholder approach chimera' (2020) 46 *Journal of Corporation Law* 1–72.

21 D W Puchniak, 'No need for Asia to be woke: contextualising Anglo-America's "discovery" of corporate purpose' (2022) 4 *RED* 14–21.

22 Eg Sjøfjell et al (n 6 above); Bruner (n 4 above).

23 G S Crespi, 'Maximising the wealth of fictional shareholders: which fiction should directors embrace?' (2007) 32 *Journal of Corporation Law* 381–427; D J H Greenwood, 'Fictional shareholders: for whom are corporate managers trustees, revisited' (1996) 69 *Southern California Law Review* 1021–1104.

This is not to undermine the drive to change corporate purpose. Instead, its aim is to demonstrate how difficult Mayer's policy²⁴ is to implement. Fail to take all doctrinal steps sufficiently, and you still allow shareholder pressure to force management to act for the benefit of shareholders, so you do not resolve the problem. Worse, you may exacerbate it by providing the *appearance* of resolving it whilst not actually doing so. This will make future reform less likely and remove attention from the problem.²⁵ Take all necessary steps, and you need to fundamentally rewrite UK company law in a way which may cause downsides. After all, each feature of corporate law that we need to disable to effectively reform corporate purpose law exists for a reason, often to provide a disciplinary restraint on managerial excess. Removing these therefore will remove disciplinary functions of corporate law designed to prevent managers focusing on themselves to the detriment of the company.

Given the complexities of effective corporate purpose law reform, and the potential downsides in doing so, it may be better to explore alternative ways to achieve the same ends. In particular, rather than making companies act in a way that is less focused on shareholders, we may want to re-examine the legal features that incentivise shareholders to act in a way that is perceived to cause such ills.

The rest of this article adopts this argumentation structure, and proceeds as follows. Part 1 ('A UK zone of shareholder exclusion') analyses the core of UK direct corporate purpose law reform. Part 2 ('Indirect corporate purpose law') explores the indirect aspects of corporate purpose law; the myriad of ancillary steps needed to create a UK zone of insulation for directors from shareholder pressure. Part 3 ('The perils of partial reform') argues that partial reforms of corporate purpose law will fail to achieve its policy ends. Part 4 ('Risks of reform and conclusions') argues that there are downsides to taking the various steps required to properly reform corporate purpose law – hinting that we may not want to reform corporate purpose law at all – and that there are alternative ways to achieve the ends desired by those seeking corporate purpose law reform.

24 Mayer (n 2 above) 22.

25 This arguably occurred when the UK adopted its current framework – see A Keay, 'Tackling the issue of the corporate objective' (2007) 29 Sydney Law Review 577–612.

A UK ZONE OF SHAREHOLDER EXCLUSION

Zones of insulation and exclusion

We start, then, with exploring how we would achieve corporate purpose law reform in the UK. Mayer proposes mandating that a company must articulate a purpose in its articles of association and then requiring disclosure as to the extent such a purpose is achieved.²⁶ There are two main reasons to suggest that more is required. First, as discussed in Part 2, articles of association are selected by the shareholders, who are likely to select pro-shareholder purposes.

Second, such purpose clauses are likely to be drafted in a broad and vague way. Companies used to have to state their objects in their memoranda of association.²⁷ Matters outside these objects were *ultra vires*, so unenforceable against the company.²⁸ Increasingly clever legal drafting was approved by the courts, steadily reducing the effect of this prohibition. In 1880, the House of Lords upheld the validity of a clause authorising matters incidental to primary objects.²⁹ In 1918, they upheld the validity of an objects clause that contained a list of alternative objects for directors to choose between.³⁰ In 1966, the English Court of Appeal approved an objects clause which empowered the directors to do, subjectively, what they thought may further other objects.³¹ There are obvious differences between Mayer's proposal and historic objects clauses. The point though is that, however carefully purpose requirements are drafted, if left to the same insiders who currently choose matters, such requirements will be pushed towards greater discretion and greater freedom for those insiders. This will undermine Mayer's reform without some further exclusion of shareholders from selecting corporate purpose.

As such, UK commentators have argued that Mayer's aims will not be met by his solution. Davies argues that any such purpose statements will be used by those shareholders who would be trying to achieve these ends anyway, and ignored by those who would not.³² Kershaw and Schuster argue that corporate law helps market participants achieve their purposeful ends, and is only one part of the corporate ecology

26 Mayer (n 2 above) 23.

27 P J Omar, 'Powers, purposes and objects: the protracted demise of the ultra vires rule' (2004) 16 *Bond Law Review* 93–116.

28 *Ashbury Railway Carriage & Iron Co Ltd v Riche* [1875] 6 WLUK 39.

29 *Attorney General v Great Eastern Railway Co* (1880) 5 App Cas 473.

30 *Cotman v Brougham* [1918] AC 514.

31 *Bell Houses Ltd v City Wall Properties Ltd (No 1)* [1966] 2 QB 656.

32 Davies (n 19 above).

which does so.³³ Both refer to the same problem: if shareholders of UK companies truly wished for their financial interests to be subordinated to those of other constituencies, companies they influence through existing shareholder rights would already be doing so, and forcing a purpose to be articulated will not make shareholders do so. Both therefore argue that, to effectively change corporate purpose law, shareholders must be removed from decision-making. Davies argues that effectively achieving any change would require 'an extensive reduction of the shareholders' powers to hold the board accountable'.³⁴ Kershaw and Schuster state that managers would require a 'zone of insulation' from shareholders to avoid shareholder pressures deviating from a wider social purpose.³⁵ Insulating managers in this respect is ultimately the same as excluding shareholders.

On how this can be achieved, both sets of commentators are less specific. Davies focuses less on the details of shareholder exclusion, stating that '[t]he myriad legal questions it raises will be ignored by this article as well'.³⁶ Both Davies and Kershaw and Schuster argue that part of achieving such will be by removing from shareholders two particular disciplinary functions³⁷ – their ability to remove directors, and the obligations on directors to remain neutral in the presence of a takeover offer.³⁸ Kershaw and Schuster also point out – as part of the ecology of the corporate landscape – needing to change director power originating from shareholders, that shareholders holding at least 5 per cent of shares can requisition a meeting, and shareholder control over issuing shares.³⁹ They generally focus, though, on the idea that a zone of insulation is required to allow for mission-purpose if shareholders themselves are not in favour of such purpose.⁴⁰ This article explores the implications of these insights – and other ancillary changes required to achieve an effective 'zone of insulation' for directors.

The rest of this part and the next part focus on how to achieve such a zone of exclusion in the UK. It explores the current aspects of direct corporate purpose law in the UK and moves on to indirect aspects of corporate purpose law, including the company's constitution, and the way a company starts and ends. In each case, to create a zone of

33 D Kershaw and E Schuster, 'The purposive transformation of corporate law' (2021) 69 *American Journal of Comparative Law* 478–538, 538.

34 Davies (n 19 above), 1.

35 Kershaw and Schuster (n 33 above) 499–506.

36 Davies (n 19 above) 6.

37 *Ibid* 21–24; Kershaw and Schuster (n 33 above) 512–514.

38 See D Kershaw, *Principles of Takeover Regulation* (Oxford University Press 2016) ch 11.

39 Kershaw and Schuster (n 33 above) 507.

40 *Ibid* 537.

exclusion, a fundamental and holistic rewrite of UK company law is required.

Direct corporate purpose laws in the UK

So, how would we actually effect a change in UK corporate purpose law? Our doctrinal understanding of corporate purpose comes from the duties that directors owe to the company.⁴¹ Section 172(1) of the Companies Act 2006 provides that directors must act in a way that they think (subjectively) is in the best interest of the company, for the benefit of its members as a whole, taking into account various non-shareholder constituencies.⁴² This tries⁴³ to find a middle ground between the two binary approaches to corporate purpose, by adopting 'enlightened shareholder value'.⁴⁴ However, the requirement to include non-shareholders in these considerations is weak – directors must 'have regard' to such interests. Having regard is a very low threshold – it is difficult to do deliberate harm to someone without having regard to them. The requirement of section 172, then, is to act in good faith in the way that they consider to be in the best interests of shareholders, whilst being merely cognisant of the harms caused to others in doing so.

Nevertheless, the UK Corporate Governance Code, which applies to listed companies,⁴⁵ states that the 'board should establish the company's purpose'⁴⁶ and monitor culture to align to that purpose,⁴⁷ as should remuneration policies and practices.⁴⁸ Kershaw and Shuster have argued that this appears to be in conflict with section 172,⁴⁹ and it has been argued that a fundamental flaw with the code is its attempt to push non-shareholders' interests that clash with the basic tenets of UK company law.⁵⁰ There is a limit to how far a non-shareholder sheen can be cast on section 172 without reform. Even if the UK Corporate Governance Code could work to reform purpose in the UK,

41 For comparative approaches, see H Fleischer, 'Corporate purpose: a management concept and its implications for company law' [2021] *European Company and Financial Law Review* 161–189.

42 Companies Act 2006, s 172(1). See discussion in A Key and T Iqbal, 'The impact of enlightened shareholder value' [2019] *Journal of Business Law* 304–327.

43 Key (n 25 above).

44 Key and Iqbal (n 42 above).

45 Listing Rules, rule 9.2.6.

46 UK Corporate Governance Code 2024, principle B.

47 *Ibid* provision 2.

48 *Ibid* principle P.

49 Kershaw and Schuster (n 33 above) 488–490.

50 B R Cheffins and B V Reddy, 'Thirty years and done – time to abolish the UK Corporate Governance Code' (2022) 22(2) *Journal of Corporate Law Studies* 709–748.

we should not rely on it. This code only applies to listed companies, whereas private companies also cause the harms resulting in proposals to reform corporate purpose law in the UK.⁵¹ Not only will reforming matters for listed companies then only solve half the problem, it is likely to result in more socially harmful business activities moving to private companies, a form of 'sustainability arbitrage'.⁵²

Section 172(2) leaves open the possibility that a company's purpose may be something other than shareholder-focused – stating 'where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members', then the replacement wording supersedes the benefit of members.⁵³ A Mayer-esque corporate purpose statement could therefore dovetail with this, perhaps with a simple mechanism to displace section 172(1) with an alternative, selected purpose.

However, this would not be sufficient on its own as this duty is owed to the company.⁵⁴ Shareholder resolution is the only way by which a breach of this, or any UK director duty, can be forgiven, known in company law parlance as the breach being 'ratified'.⁵⁵ A breach of duty can only be enforced by the company, but as directors are unlikely to sue one of their lot for a breach, mechanisms exist for shareholders to enforce a breach on behalf of the company.⁵⁶ Such mechanisms mean that whatever a company's corporate purpose statement, directors will be incentivised to ignore non-shareholders, and keep shareholders happy.⁵⁷

Should directors ignore a socially optimal purpose to purely divert money to shareholders, the only party able to forgive them will be the shareholders. In such circumstances, they are likely to be lenient. The only parties able to discipline them are their other directors or shareholders on behalf of the company – neither of whom are likely to do so. In other words, merely reforming direct corporate purpose law in the UK will not be sufficient to effectively change

51 A A Gözlügöl and W G Ringe, 'Private companies: the missing link of the path to net zero' (2022) 22 *Journal of Corporate Law Studies* 887–929.

52 C Veziroğlu and A Kayıklık, 'The climate crisis and private companies: how to address the sustainability arbitrage problem' (2023) 24 *European Business Organization Law Review* 585–621.

53 Companies Act 2006, s 172(2).

54 *Ibid* s 170(1). See R Goddard, 'Directors' Duties' (2008) 12 *Edinburgh Law Review* 468–472.

55 Companies Act 2006, s 239.

56 See discussion in J Armour, 'Derivative actions: a framework for decisions' (2019) 135 *Law Quarterly Review* 412–436; J Hardman, 'An institutional analysis of UK ostensible minority shareholder protection mechanisms' (2023) 23 *Journal of Corporate Law Studies* 397–436.

57 J Hardman, 'The plight of the UK private company minority shareholder' (2022) 33 *European Business Law Review* 87–124.

any corporate behaviour in the way desired by those in favour of corporate purpose law reform. Any corporate purpose requirement baked in law would need to ensure that this purpose could not be enforced by shareholders. It would also need to ensure that it *could* be enforced by the targeted beneficiaries, something not currently facilitated under UK company law.

Overall, then, even if we manage to bake corporate purpose into the UK existing scheme, the basics of our directors' duties will need to change. The way in which breaches are ratified and wrongdoing punished would need to be reworked to avoid any purpose being ignored and the *status quo* perpetuated. To ensure a zone of insulation, we would need to stop shareholders having the dominant voice through any of these mechanisms. We could achieve this either by allowing others rights of enforcement and ratification,⁵⁸ or removing these rights from shareholders. Either option is a major rewrite of UK company law. Neither will be sufficient, either. Even if we manage to insulate directors' duties from shareholders, the latter have a statutory ability to remove the former by ordinary resolution.⁵⁹ Shareholders do not have to justify their votes for doing so, so would be free to trigger this right if, say, directors focused more on the company's wider purpose and less on maximising the dividend stream to shareholders.

As such, in addition to removing shareholder power to launch derivative claims, a proper zone of insulation for management would need to remove shareholder power to remove them. It would not be sufficient to purely carve out breaches of purpose from this right. Longer forms of notice need to be given to remove a director,⁶⁰ and directors are entitled to have written statements circulated on any such resolution,⁶¹ and to attend and make representations at the meeting.⁶² However, shareholders do not need to provide a reason *why* they wish to remove a director, and are able to vote their shares as they see fit.⁶³ As such, it would be possible for shareholders to circumvent such a carve-out for only 'purpose breaches' by removing a director and simply being silent as to why. To make such a carve-out work, rationales for removal would need to be provided, but it would be very difficult to

58 Eg N Safari and M Gelter, 'British Home Stores collapse: the case for an employee derivative claim' (2019) 19 *Journal of Corporate Law Studies* 43–68.

59 Companies Act 2006, s 168. See D D Prentice, 'Removal of directors from office' (1969) 32 *Modern Law Review* 693–696.

60 Companies Act 2006, s 168(2).

61 *Ibid* s 169(3).

62 *Ibid* s 169(2).

63 *North-West Transportation Company Limited and Other v Beatty and Others* (1887) 12 App Cas 589 (PC). See E Lim and J Lowry, 'Reconsidering the rule on shareholders' exercise of voting powers' [2020] *Journal of Business Law* 645–667.

ascertain their veracity. As such, to ensure a proper zone of insulation for management, shareholder abilities to remove directors – whether contained in statute or in the company's constitution – would need to be removed.

Accordingly, even if we manage to embed broader corporate purposes in UK corporate law, further changes are required to ensure that it is done so meaningfully. These changes involve fundamental rethinking of the basics of how we enforce and ratify breaches of directors' duties, and disapplications of shareholder abilities to remove directors. Immediately, then, there are three knock-on effects that need to change in UK company law to ensure that a direct corporate purpose enactment is meaningfully protected from shareholder pressure. We need to also change rules which appear to have nothing to do with corporate purpose, but would allow the same *ex ante* pressures to be applied by shareholders on management: indirect parts of corporate purpose law. Ensuring that corporate purpose law is changed in the UK is therefore already not simple. However, as we shall see, there are a raft of other parts of UK corporate law that need to be amended in order to ensure that corporate purpose law reform would be effective, a number of other indirect areas of corporate purpose law that would need to be modified in order to meaningfully alter corporate purpose law in the UK. Indeed, the more you start looking at these matters, the greater the domino effect is in respect of the need to fundamentally rewrite UK corporate law to effectively achieve corporate purpose ends.

INDIRECT CORPORATE PURPOSE LAW

The company's constitution

Mayer's proposal is to ensure that a purpose be included in the articles of association, the company's main constitutional document.⁶⁴ The articles of association are set by its shareholders and contain the internal rules which govern the operation of the company. The UK Government creates a default set of rules for the company's constitution,⁶⁵ which apply unless other articles are selected upon incorporation.⁶⁶ Once selected, articles can only be amended by shareholder vote of at least 75 per cent.⁶⁷ It is possible to 'entrench' articles of association, so that an even higher percentage of shareholder vote is required to change them in the future.⁶⁸ As entrenchment of articles is undertaken by

64 Companies Act 2006, s 17(a).

65 Ibid s 19; Companies (Model Articles) Regulations 2008, SI 2008/3229.

66 Companies Act 2006, s 20.

67 Ibid s 21.

68 Ibid s 22.

shareholder unanimity, it has obvious limitations for protecting other parties.⁶⁹ A change of articles of association can be proposed by either directors or shareholders. Articles can be changed at shareholder meetings (for public and private companies) or by written resolution (for private companies only).⁷⁰ Directors can summon meetings,⁷¹ or circulate written resolutions.⁷² Shareholders can do either if they represent 5 per cent of shares (or lower if stipulated in the company's articles) on their own, or with others in favour of proposing the motion.⁷³ As such, directors can propose changes to articles of association, and shareholders can not only propose such changes but also are the only parties entitled to vote on such changes. No other constituency has the power under UK law to propose, or vote on, changes to articles of association. Shareholders thus control what the articles are: by deciding on any changes, and with power to propose changes. Purpose statements included in the articles of association are therefore subject to shareholder capture – to ensure a purpose statement that transcends pure shareholder interests, this will need to be enforceable, and only changeable, by parties other than shareholders. It will need to be outside the company's articles of association.

Purely pulling corporate purpose statements out of the company's articles of association will not mitigate the importance of the articles of association in respect of the influence shareholders have over the company's activities. A lot of the UK internal dynamics of the company are provided for in the articles of association. They contain the powers that directors have in their capacity as directors, and the reasons such powers are given.⁷⁴ These have an important role in setting the content of the duties that directors owe: directors must act within their powers, and use those powers for proper purposes.⁷⁵ Shareholder ability to set this balance means that the boundaries of director power are set by shareholders: they always have the ability to change it should directors act in a way that they do not like. This, in turn, makes directors more likely to act in a way that they consider shareholders will want in

69 For the same point in respect of minority shareholder protection and entrenchment, see R Cheung, 'The use of statutory unanimous shareholder agreements and entrenched rights in reserving minority shareholders' rights: a comparative analysis' (2008) 29 *Company Lawyer* 234–241.

70 Companies Act 2006, s 288.

71 *Ibid* s 302.

72 *Ibid* s 291.

73 *Ibid* s 292 in respect of written resolutions and s 303 in respect of company meetings.

74 S M Watson, 'The significance of the source of the powers of boards of directors in UK company law' [2011] *Journal of Business Law* 597–613.

75 Companies Act 2006, s 171. See discussion in S Worthington, 'Directors' duties and improper purposes' (2016) 75 *Cambridge Law Journal* 213–216.

order to protect their powers.⁷⁶ This shareholder ability is stated to have occurred by accident,⁷⁷ and has been highly criticised: the New Zealand Law Commission called it 'entirely unsatisfactory' and 'an anachronism which is misleading'.⁷⁸ Nevertheless, even if you pull a purpose statement out of the articles of association, to make purpose reforms work effectively you must also remove shareholder ability to set director powers. Otherwise, directors are likely to – perhaps just out of sheer appeasement to retain their powers – act in a way that benefits shareholders.

The articles of association also control the process for declaring dividends,⁷⁹ the process for appointing directors,⁸⁰ how directors undertake their meetings,⁸¹ whether directors can obtain insurance in respect of personal liability,⁸² and many other features. The articles of association are thus an important part of the framework of any company and of company law. They are directly controlled by shareholders. If corporate purpose law reform needs to insulate managers by excluding shareholders, then the articles of association wholesale must be part of this zone. There are two ways by which this could be achieved. Another constituency – such as directors – could select and amend the articles of association. Given that the articles currently delimit director power, this may well be sub-par. Alternatively, a lot of features that are left to the articles of association could be brought into the mandatory rules of the company regime. Certainly none of those points listed above for the articles of association need to be default rules rather than mandatory rules. Making these, and others, part of the mandatory UK framework rather than default rules to be established by the articles would be a major rewrite of UK company law, which would be needed to effectively ensure a zone of insulation.

76 Hardman (n 57 above).

77 Watson (n 74 above); L A Walcott, 'The conundrum: resolving the statutory contract in the Commonwealth Caribbean' (2017) 38 *Company Lawyer* 248–252.

78 New Zealand Law Commission, *Company Law: Reform and Restatement* (NZLC R9, 1989) paras 155–156.

79 For private companies, see Companies (Model Articles) Regulations 2008, sch 1, paras 30–35. See discussion in J Rickford, 'Legal approaches to restricting distributions to shareholders: balance sheet tests and solvency tests' (2006) 7 *European Business Organization Law Review* 135–179.

80 For private companies, see Companies (Model Articles) Regulations 2008, sch 1, para 17. See discussion in P Watts, 'Why as a matter of English-law principle directors do not owe a duty of loyalty to creditors upon insolvency' [2021] *Journal of Business Law* 103–121, predicated upon the power of directors' appointers.

81 For private companies, see Companies (Model Articles) Regulations 2008, sch 1, paras 7–16.

82 For private companies, see Companies (Model Articles) Regulations 2008, sch 1, para 53.

In addition to choosing what the articles are, shareholders are one of the few parties who are able to enforce them. The company's articles bind the company and its members:⁸³ each shareholder in respect of each other shareholder, each shareholder in respect of the company, and the company in respect of each shareholder. The articles bind no one else. No other party can (a) be sued in respect of a breach of a UK company's constitution (other than a director through a breach of their duties), or (b) sue in respect of a breach of these duties. For example, when articles of association provided that an individual had a right to be a company's solicitor for life, the Court of Appeal held that this person could not enforce the articles when sacked.⁸⁴ Thus even if the articles of association clearly stated that the purpose of the company was to maximise the number of employees, and it then clearly breached this by, say, making all employees redundant, the only party able to sue to enforce this provision under the corporate contract would be shareholders. Should shareholders benefit from this decision, then they are unlikely to enforce the breach against the company.

To create a zone of insulation for management, we would need to remove sole shareholder ability to enforce the contract, and increase it for those other constituencies who may be beneficiaries of a wider corporate purpose. The point stands even if purpose is moved out of the articles of association – then shareholder exclusion would still be required from enforcing articles to avoid the threat of attempted enforcement creating tacit pressure on managers, in addition to exclusion from the purpose mechanics themselves. Such exclusion would, once again, necessitate a dramatic rewrite of UK company law.

Corporate life and death

Shareholder control goes beyond merely the constitution. Shareholders are needed to set up UK companies.⁸⁵ All initial proposed shareholders need to sign the company's memorandum of association.⁸⁶ As such, if you set up a company limited by shares in the UK (the most popular type of company)⁸⁷ you need the proposed shareholders to sign

83 Companies Act 2006, s 33.

84 *Eley v Positive Government Security Life Assurance* (1876) 1 Ex D 88 CA. See discussion in K W Wedderburn, 'Shareholders' rights and the rule in *Foss v Harbottle*' (1957) 15 Cambridge Law Journal 194–215.

85 In practice, most UK companies are set up by promoters and then sold on to end users: see J Hardman, 'Articles of association in UK private companies: an empirical leximetric study' (2021) 22 European Business Organization Law Review 517–557.

86 Companies Act 2006, s 8.

87 J Hardman and G Ramírez Santos, 'Empirical evidence for the continuing need to "think small first" in UK company law' (2023) 24 European Business Organization Law Review 117–165.

documentation and confirm the number of shares that they will take in the company upon its establishment.⁸⁸ Proposed initial shareholders also sign the incorporation form, a form IN01, as do proposed initial directors.⁸⁹ It is therefore those who will become its directors and shareholders who decide whether or not to set a company up. They will only do so if they consider it to be in their interests to do so.⁹⁰ This is particularly pertinent in relation to corporate groups, where shareholders are able, through their disciplinary control noted above, to push for companies to be created which isolate liability in places away from corporate assets.⁹¹ This transcends the theoretical: group structures tend to have a higher debt to equity ratio than equivalent activity taking place within a unified corporate form.⁹²

Proposed initial shareholders and managers are the only entities who provide such direct control over the start of the company's life. Proposed shareholders will only be willing to start a company (or acquire shares if it is already started) if they obtain comfort that management will run the company in a way which furthers their interests. Thus in addition to the risk that shareholders push for the proliferation of companies where it benefits them to do so, they may only be interested in helping to create a company if it is run according to their interests. This creates a risk that shareholders *only* establish companies when they perceive that it is advantageous to them to do so. To counter such risk and create an effective zone of insulation for management, then, we need to explore how to remove shareholders from the decision to incorporate a company.

It may be argued that no other stakeholders are needed to start a company's life. Should an unincorporated business transfer to a company, then all existing voluntary stakeholders (eg trade creditors, employees, suppliers, customers) need to consider whether to continue to interact with the new legal vehicle (and can refuse to do so if they dislike the change in legal form). All future voluntary stakeholders must agree to the business being a company in order to contract with it,⁹³ and should they consider it to be a more risky form, can

88 Companies Act 2006, s 10.

89 Registrar's Rules 2009, vol 2, sch 2 issued under Companies Act 2006, s 117.

90 J Hardman, 'The nexus of contracts revisited: delineating the business, the firm, and the legal entity' (2022) 34 *Bond Law Review* 1–33.

91 Either directly or through shareholder pressure: R Squire, 'Strategic liability in the corporate group' (2011) 78 *University of Chicago Law Review* 605–669.

92 T Paligorova and Z Xu, 'Complex ownership and capital structure' (2012) 18 *Journal of Corporate Finance* 701–716.

93 In the context of limited liability, see S E Woodward, 'Limited liability in the theory of the firm' (1985) 141 *Journal of Institutional and Theoretical Economics* 601–611; F H Easterbrook and D R R Fischel, 'Limited liability and the corporation' (1985) 52 *University of Chicago Law Review* 89–117.

charge a premium for such risk.⁹⁴ Thus their ongoing engagement with a business after it has transferred to a company is evidence of tacit agreement to its establishment, but until it is established, there is nothing to tacitly agree to. Involuntary creditors do not choose to interact with the company in the first place, so cannot provide *ex ante* approval to its establishment. As such, there is no evident category of stakeholders to *replace* proposed shareholders in the formation of companies. There are, though, two options to create a zone of exclusion of shareholders in the incorporation decision. First, it is possible to follow the UK partnership model, which holds that partnerships are automatically created should the incidents of partnership (carrying on business together for a profit) be met.⁹⁵ Similar incidents of being a company could be found and allow for objective ascertainment of the boundaries of the corporate form.⁹⁶ Doing so would remove the risk that companies are only established when it is in the interests of shareholders to do so, and thus be a way to create an effective zone of insulation for the initial decision to establish a company.

Second, proposed directors alone could decide when to establish a new company. This appears to be the easiest to achieve, as it merely involves the removal of one party who must sign the incorporation form. Directors would then need to obtain subscriptions from shareholders to the company. There remains a danger, here, that directors may seek to utilise corporate forms as a way to aggrandise their own interests.⁹⁷ As such, it may be that similar issues remain, albeit caused by a different constituency. This would manifest in different ways to current shareholder issues and be a distinct problem. Removing shareholders from the incorporation of companies somehow is needed to adequately establish a full zone of inclusion, to remove them from deciding whether to start the company's life. Of course, even then, shareholders would need to be attracted subsequently. How attractive a new company is for shareholder investment is likely to be a function of predicted financial return for shareholders.⁹⁸ This means that directors will have to establish a form of company that

94 In the context of secured debt, see T H Jackson and A T Kronman, 'Secured financing and priorities among creditors' (1979) 88 *Yale Law Journal* 1143–1182.

95 Partnership Act 1890, ss 1 and 2.

96 J Hardman, 'Fixing the "misalignment" of the concession of corporate legal personality' (2023) 43 *Legal Studies* 443–460, 454–460.

97 Eg W J Baumol, 'On the theory of expansion of the firm' (1962) 52 *American Economic Review* 1078–1087; Y Amihud and B Lev, 'Risk reduction as a managerial motive for conglomerate mergers' (1981) 12 *Bell Journal of Economics* 605–617.

98 J J Park, 'From managers to markets: valuation and shareholder wealth maximisation' (2022) 47 *Journal of Corporation Law* 435–486.

shareholders are interested in investing in – one that presents them with a strong predicted financial return. As such, there are inherent natural limitations to achieving a zone of managerial insulation/shareholder exclusion in the incorporation decision. Nevertheless, let us continue to try to obtain as strong a zone as possible: this involves changing the role of shareholders in the start of the company's life.

Shareholders also enjoy a privileged role at the death of the company. Whilst all creditors can petition to wind up a company on the grounds that it is unable to pay its debts,⁹⁹ shareholders are the only private party automatically able to resolve to wind the company up when it is meeting, and is able to meet, its debts at any time and for any reason.¹⁰⁰ The Secretary of State is able to petition to wind up the company on public interest grounds.¹⁰¹ Shareholders and creditors are also able to petition to wind up the company on just and equitable grounds.¹⁰² Courts are very reticent to utilise this heading generally,¹⁰³ and it is very rare for creditors to use this ground rather than winding up under the heading of inability to pay debts. As a result, shareholders are the only private constituency effectively able to end a company which is not facing financial difficulty.¹⁰⁴ They must utilise a number of ritual steps to do so and utilise a court and an insolvency practitioner.¹⁰⁵ The decision to end a company's life is dramatic, and a nuclear option. However, the threat to do so, or desire to avoid such a threat, could well encourage directors to follow the interests of shareholders over others who do not have such a power. Effecting proper change to the law of corporate purpose will thus require equalising such power with other constituencies. This could involve removing the power from shareholders to resolve to wind up the company, or it could give similar powers to other constituencies. Either would insulate management from pressure to treat shareholders differently to other constituencies. Once more, though, this is a dramatic change to UK company law: either removing a major power that shareholders enjoy, or extending this right to other constituencies makes a fundamental change to UK company law.

99 Insolvency Act 1986, s 122(1)(f).

100 *Ibid* s 122(1)(a).

101 *Ibid* s 124A.

102 *Ibid* s 122(1)(g).

103 See B Clark, 'Just and equitable winding up: wound up?' [2001] *Scots Law Times* 108–111.

104 See also Insolvency Act 1986, s 84.

105 See the discussion of rituals in S Wheeler, 'The corporate way of death' (1996) 7 *Law and Critique* 217–244.

A fundamental rewrite

The foregoing indicates that changing corporate purpose law in the UK involves a fundamental rewrite of UK company law. From the simple list set out above, effective UK corporate purpose law reform needs to amend (in order discussed) the ability to ratify director breaches, the ability to launch derivative claims, the ability to remove directors, the subject matter left to articles of association, who chooses the articles of association of the company, who can enforce the articles of association of the company, who is involved in starting companies, and who can resolve to wind up companies. In each case, to take purpose seriously we need to ensure that shareholders are balanced with other constituencies to avoid the shareholder voice maintaining dominance and so continuing exactly the same pressure as existed before corporate purpose law reform. This can occur either by giving these rights also to other constituencies, or removing them from shareholders. No change on its own is minor, and each needs to be fully worked through. In aggregate, they involve a dramatic change to UK company law. These are merely the company law rules, and so do not include wider changes needed to specific rules applicable as part of stock exchange requirements, or other sub-sets of companies, such as the application of the board neutrality rule in takeovers.¹⁰⁶

This article does not advocate that such changes *should* be made. As discussed below, there are reasons to question each change: excluding shareholders risks leaving directors and managers unaccountable to anyone,¹⁰⁷ exacerbating the risk of managerial opportunism at the expense of the venture.¹⁰⁸ Any insulation from shareholders would therefore need to be coupled with an alternative disciplinary mechanism. However, the foregoing is sufficient to evidence that changing corporate purpose law in the UK is complicated. To ensure that it is done properly, fundamental root-and-branch reform of UK company law is needed. Due to a requirement to insulate managers, each of the foregoing changes ultimately disempowers shareholders, either by removing their rights or watering them down by providing similar rights to other constituencies. Properly reforming corporate purpose law in the UK therefore has the inevitable consequence of disenfranchising shareholders *en masse*. Not only is the core of purpose

106 Takeover Code, general principle 3.

107 Eg L A Bebchuk and R Tallarita, 'The illusory promise of stakeholder governance' (2020) 106 *Cornell Law Review* 91–177; L A Bebchuk, 'The myth that insulating boards services long term value' (2013) 113 *Columbia Law Review* 1637–1694.

108 Eg L A Bebchuk, 'The case for increasing shareholder power' (2005) 118 *Harvard Law Review* 833–914. These may be mitigated by certain market forces: see E F Fama, 'Agency problems and the theory of the firm' (1980) 88 *Journal of Political Economy* 288–307.

reform about making companies do things beyond simply maximising shareholder value, but the swathe of ancillary rights (listed above and others) currently enjoyed by shareholders need to be removed or widened to others, too. It is therefore axiomatic that reforming corporate purpose law in the UK makes life considerably worse for shareholders of UK companies: corporate purpose law reform for us needs to amend all methods through which shareholders can apply pressure to directors to maximise their lot.

THE PERILS OF PARTIAL REFORM

The foregoing has outlined some of the more major steps needed to achieve corporate purpose properly, and the scale of the rewrite of UK corporate law necessary to fully effect corporate purpose change. It is tempting to conclude that this makes it worthwhile doing *something* to amend corporate purpose laws, but not the complete raft of changes needed to fully embed such amendment. After all, perhaps doing something that fell short of full reform but did not require a major reconceptualisation of all of UK company law would be better than doing nothing. Perhaps a small reform could be utilised, such as that proposed by Mayer, on its own, without the entire raft of legal changes needed to effectively embed it. Unfortunately, there are three reasons why doing so not only will not achieve the ends of amending corporate purpose law, but will actively hinder them. First, doing so leaves the ability for shareholders to pressure management. Second, doing so presents a veneer of resolution to an issue that would not be resolved. Third, law reform time is limited, and so there is probably only one chance to get this right in the UK.

First, as noted above, the UK's current legal corporate purpose landscape is inherently pro-shareholder. This applies in respect of the basic direct rules of corporate purpose, but also the raft of indirect rules that exist to buttress these direct rules. Shareholder-focused indirect corporate purpose rules allow shareholder pressure to be inflicted upon directors to achieve a pro-shareholder outcome. The rights enjoyed by shareholders have long been in place, including when managerialism was considered to be in the ascendency.¹⁰⁹ These rights are blunt tools, lacking nuance¹¹⁰ and which shareholders were traditionally

109 A Johnston, A Hatchuel and B Segrestin, 'From balanced enterprise to hostile takeover: how the law forgot about management' (2019) 39 *Legal Studies* 75–97.

110 V Brudney, 'Corporate governance, agency costs, and the rhetoric of contract' (1985) 85 *Columbia Law Review* 1403–1444.

passive about.¹¹¹ Yet shareholders are more likely to use them in modern times. These rights are now supported by a vast corporate governance machine to coordinate their deployment.¹¹² This pressure may be direct – such as activist investors pushing voting decisions in certain directions, or otherwise overtly influencing management.¹¹³ It may also be indirect – directors may well rationally act in a way to avoid these ancillary rights being triggered by pre-emptively acting in a way that they think will be what shareholders want.¹¹⁴ Whether commentators argue for additional shareholder rights¹¹⁵ or for protecting the board from shareholder pressure,¹¹⁶ they agree that these ancillary rules providing rights to shareholders influence management behaviour. So much so, that if you leave one part of the edifice in place, the same pressures can still be brought to bear.

Leave but one of those ancillary rights enjoyed by shareholders in place, and it can act as a funnel to bring the same pressures on directors. In the order discussed above: leave shareholder ability to ratify director breaches, and directors will act in a pro-shareholder way to ensure that such ratification occurs if needed. Leave shareholders the ability to launch derivative claims, and they will threaten to do so if they are not appeased. Leave shareholders with the ability to remove directors, and they will remove those who do not act in their interests. Leave shareholders with the ability to choose the articles of association, and they will draft them to most benefit themselves. Leave shareholders with the sole ability to enforce the articles of association, and they will enforce the parts that protect them, and threaten to tie the company up in litigation even if their claim is not particularly strong. Leave shareholders to choose who establishes a company, and they will do so when and where it advantages them. Leave shareholders the sole ability to wind up a solvent company, and they will use this ability

111 D Attenborough, 'The vacuous concept of shareholder voting rights' (2013) 14 *European Business Organization Law Review* 147–173; B S Black, 'Shareholder passivity reexamined' (1990) 89 *Michigan Law Review* 520–608.

112 D S Lund and E Pollman, 'The corporate governance machine' (2021) 121 *Columbia Law Review* 2563–2634.

113 See R J Gilson and J N Gordon, 'The agency costs of agency capitalism: activist investors and the revaluation of governance rights' (2013) 113 *Columbia Law Review* 863–927; I Anabtawi and L S Stout, 'Fiduciary duties for activist shareholders' (2008) 60 *Stanford Law Review* 1255–1308; J C Coffee and D Palia, 'The wolf at the door: the impact of hedge fund activism on corporate governance' (2016) 41 *Journal of Corporation Law* 545–607.

114 For majority/minority dynamics see Hardman (n 57 above).

115 Eg Bebchuk (n 107 above); Bebchuk (n 108 above).

116 Eg W W Bratton and M L Wachter, 'The case against shareholder empowerment' (2010) 158 *University of Pennsylvania Law Review* 653–728; K J M Cremers and S M Sepe, 'The shareholder value of empowered boards' (2016) 68 *Stanford Law Review* 67–148.

to threaten companies with a nuclear option unless appeased. More likely, leave any of these in place, and directors will act in a way to *avoid* shareholders threatening to use such rights. If your reason for advocating for corporate purpose law reform is that corporate managers need to be freed from direct shareholder pressure and the perception of shareholder pressure, then undertake any reform piecemeal and it will not meet your objectives.

It is tempting to dismiss this on the grounds that other jurisdictions provide some limitations on these shareholder rights, whilst allowing others. It therefore seems as if some form of partial reform must be possible without triggering such a funnel of shareholder pressure. For example, Germany is stated to be a jurisdiction which focuses less on shareholders than the UK does, whilst still providing considerable shareholder rights (such as setting the company's constitution).¹¹⁷ Yet looking at Germany rather illustrates the risk of such funnel than undermining it. Germany operates against the backdrop of EU company law, itself stated to be based on the assumption of shareholder primacy.¹¹⁸ The types of problems associated with shareholder focus – short-term push for profits¹¹⁹ – have been evident recently in German companies. The Volkswagen (VW) emissions scandal¹²⁰ has been attributed to shareholder pressure.¹²¹ This is not the only issue within German corporate law – the Wirecard scandal is generally seen as being caused through a failure of regulation of financial reporting.¹²²

117 See K J Hopt, 'Comparative corporate governance: the state of the art and international regulation' (2011) 59 *American Journal of Comparative Law* 1–73, 28–30.

118 Eg M Hossli-Neuman and A Baumgartner, 'Dealing with corporate scandal under European market abuse law: the case of VW' (2019) 16 *European Company and Financial Law Review* 484–534.

119 See discussions in I Anabtawi, 'Some skepticism about increasing shareholder power' (2006) 53 *UCLA Law Review* 561–599; J C Stein, 'Efficient capital markets, inefficient firms: a model of myopic corporate behaviour' (1989) 104 *Quarterly Journal of Economics* 655–669; Bratton and Wachter (n 116 above); A Keay, 'Risk, shareholder pressure and short-termism in financial institutions: does enlightened shareholder value offer a panacea?' (2011) 5 *Law and Financial Markets Review* 435–448.

120 See B W Jacobs and V R Singhal, 'Shareholder value effects of the Volkswagen emissions scandal on the automotive ecosystem' (2020) 29 *Production and Operations Management* 2230–2251.

121 See C M Elson, C Ferrere and N J Goossen, 'The bug at Volkswagen: lessons in co-determination, ownership and board structure' (2015) 27 *Journal of Applied Corporate Finance* 36–43.

122 See S Mock, 'Wirecard and European company and financial law' [2021] *European Company and Financial Law Review* 519–554; C P Buttigieg, L G Witzel and B B Zimmermann, 'Soft regulatory capture and supervisory independence: a case-study on Wirecard' [2023] *European Company and Financial Law Review* 623–659.

Yet the VW example demonstrates the ability for shareholder pressure to funnel into other routes if more direct routes are removed. If any push to reform corporate purpose law arises out of a desire to stop shareholder pressure on the company, the VW and other German examples illustrate that direct corporate purpose law reform on its own will not be effective. With the culture and tradition of shareholder dominance in the UK, such funnelling is even more likely.

Second, doing something but not undertaking all the reforms identified above will create the impression of resolving underlying problems, without actually resolving them. A simple and superficial change to the UK's corporate purpose rules will provide a veneer of social probity to companies, whilst leaving problems unchecked. Companies not only exist in a legal context and a profit-generating context, they also exist in a social context. Sometimes this is referred to as companies being subject to the 'court of public opinion',¹²³ and sometimes it is referred to as the company's 'social license to operate'.¹²⁴ Either way, the point is that profit-making and legal forms do not exist in a vacuum, but as a wider part of society. To make profit using your legal form, you need people to trade with, to work for you, etc. Their willingness to do so – and the terms on which they are willing to do so – are partially a function of their attitude to the relevant business. This is sometimes worded in terms of risk – that increased prices will be charged for increased risk.¹²⁵ It is part of a bigger aspect, though, that the better your business is regarded, the better terms it will get.

This contributes to the need for strong branding – and the tendency to use whatever tools (including corporate law) at your disposal to boost that branding.¹²⁶ Complaints have been legitimately raised about greenwashing, where companies highlight eco-friendly policies and ignore their negative policies to present a misleadingly positive picture,¹²⁷ and rainbow-washing, where the same occurs in respect of LGBTQ+-friendly policies.¹²⁸ Each of these is a complaint that companies portray themselves in a way which makes themselves look

123 Eg S Wheeler, 'Global production, CSR and human rights' (2015) 19 *International Journal of Human Rights* 757–778.

124 Eg H A Sale, 'The corporate purpose of social licence' (2021) 94 *Southern California Law Review* 785–842.

125 Jackson and Kronman (n 94 above).

126 See V Fleischer, 'Brand new deal: the branding effect of corporate deal structures' (2006) 104 *Michigan Law Review* 1581–1637; LA Heymann, 'Metabrading and intermediation: a response to Professor Fleischer' (2007) 12 *Harvard Negotiation Law Review* 201–223.

127 See M P Vandenberg, 'Private environmental governance' (2013) 99 *Cornell Law Review* 129–200.

128 J T Rice, 'Rainbow-washing' (2023) 15 *Northeastern University Law Review* 285–357.

best, even if that does not reflect full reality. A partially reformed corporate purpose law will be treated the same way: portrayed as companies acting in a more socially responsible way, even though nothing will change. Indeed, this may in part be caused by dominant investors pushing the company to position itself as socially advantageous without ultimately changing anything.¹²⁹

It has been argued that corporate law discourse tends to follow underlying social attitudes.¹³⁰ So it seems to be with the recent focus on corporate purpose.¹³¹ Purporting to make a change in respect of corporate purpose law which does not actually solve all issues can still be portrayed as doing so by those who benefit from the *status quo*. In other words, not only will nothing be solved, the social pressure to solve problems will likely be minimised. Not only will doing something that falls short of fully reforming corporate purpose not do so, it will make it look like it has done so, reducing pressure for effective change. This will not resolve existing issues driving change, but will hide them below the surface. If your intention is to obscure existing corporate dynamics and portray the impression that they cause no problems, then this may be a success. However, if you actually want to change corporate practice in the UK through corporate purpose law reform, you need to avoid partial reform.

Third, any change – even a minor one such as Mayer's – requires primary legislation to be passed by the UK Parliament. The UK Parliament has been very busy in respect of company law matters, mostly in providing minor tweaks to corporate law processes.¹³² However, its time is finite – and some company law matters that were proposed have still not been enacted.¹³³ A new Government took power in 2024, with its own set of priorities. The last time that the UK company law regime was holistically changed, it took eight years, from 1998 to 2006.¹³⁴ Even then, not all aspects of the 2006 regime have

129 J E Fisch and J Schwartz, 'How did corporations get stuck in politics and can they escape?' (2024) ECGI Working Paper Series in Law 2024/757.

130 See L M Fairfax, 'The rhetoric of corporate law: the impact of stakeholder rhetoric on corporate norms' (2006) 31 *Journal of Corporation Law* 675–718.

131 Eg C Mayer, 'Who's responsible for irresponsible business?' (2017) 33 *Oxford Review of Economic Policy* 157–175.

132 Eg Economic Crime and Corporate Transparency Act 2023.

133 Eg nothing further has happened on corporate re-domiciliation since B Hannigan and J Hardman, 'Corporate re-domiciliation: regulatory policy and technical challenges' (2022) 26 *Edinburgh Law Review* 427–433.

134 See R Goddard, "'Modernising company law': the Government's White Paper" (2003) 66 *Modern Law Review* 402–424; J Loughrey, A Keay and L Cerioni, 'Legal practitioners, enlightened shareholder value and the shaping of corporate governance' (2008) 8 *Journal of Corporate Law Studies* 79–111, 82–87.

been applied to older companies.¹³⁵ Changes have been made since then – such as the introduction of a regime to ensure the recording of each company's 'persons of significant control',¹³⁶ changes to reform corporate transparency¹³⁷ and UK governmental control (for national security reasons) over shareholders in strategically important companies passing certain percentage ownership thresholds.¹³⁸ The overall picture is clear: the basic scheme is set, with political points of particular relevance being added onto that basic scheme. This basic scheme of UK company law is incredibly pro-shareholder, and this is a fundamental feature of the development of UK corporate law.¹³⁹ Corporate purpose law reform is likely to only get just one bite of the cherry – a sub-par reform will prevent, or at least delay, more meaningful law reforms later.

Effective corporate purpose law reform therefore cannot be achieved by a half-reform. Attempts to make a simple change will not act to change existing core pressures which appear to cause dissatisfaction with the company, but will provide a veneer of respectability over corporate activities which will hide this, and will delay or prevent future reforms in this area. Those serious about effectively changing corporate purpose law in the UK need to grasp the nettle and reform indirect corporate purpose law as well as direct corporate purpose law. Any way of doing so will need to require companies to make a credible commitment to wider purposes,¹⁴⁰ and remove the raft of ancillary rules that buttress the current narrow approach to corporate purpose.

RISKS OF REFORM AND CONCLUSIONS

So far, then, it has been argued that changing corporate purpose law in the UK requires a fundamental rewrite of large amounts of company law, and that this cannot be partial to avoid the same dynamics funnelling through other legal routes.

This part advances two arguments. First, all of the mechanisms identified as needing change for effective corporate purpose law reform exist for their own reasons, and removing them may do more harm than

135 Eg J Hardman, 'The Companies Act 2006: it's time to complete the transition' (2020) 41 *Company Lawyer* 93.

136 Introduced by the Register of People with Significant Control Regulations 2016, SI 2016/339.

137 Economic Crime and Corporate Transparency Act 2023.

138 National Security and Investment Act 2021, ch 4.

139 See J Armour, S Deakin and S J Konzelmann, 'Shareholder primacy and the trajectory of UK corporate governance' (2003) 41 *British Journal of Industrial Relations* 531–555.

140 Fairfax (n 1 above).

good. Second, corporate purpose law reform may be targeted in the wrong direction – rather than making companies think about others than shareholders, we should change the structure of shareholder incentives within the company.

First, the legal features reviewed exist for a reason. The 'master problem of research' in company law¹⁴¹ has, for a long time, been how to deal with issues arising in respect of managerial excesses.¹⁴² The ability to remove directors arose as a deliberate disciplinary function.¹⁴³ The concern is that managers act in a way that is in their own interests, and not in the interests of the company.¹⁴⁴ It has been argued that the best party to monitor any group endeavour is the holder of the residual claim in that endeavour,¹⁴⁵ which in the case of a company is the shareholders.¹⁴⁶ Thus the ability to remove directors is stated to have an important disciplinary function to the benefit of the company.¹⁴⁷ In addition to the direct benefits, it causes indirect disciplinary benefits in the case of listed markets: dissatisfied shareholders will sell their shares rather than try to exercise their right to remove directors,¹⁴⁸ pushing down the share price. This opens the company up to opportunistic buyers who can immediately increase value by sacking management.¹⁴⁹ This 'market for corporate control' mechanism disciplines directors who avoid this happening by acting more optimally *ex ante*.¹⁵⁰

141 R Romano, 'Metapolitics and corporate law reform' (1984) 36 *Stanford Law Review* 923–1016, 923.

142 Caused by separation of ownership and control identified by Berle and Means: A A Berle and G M Means, *The Modern Corporation and Private Property* revised edn (Harcourt, Brace & World 1967) 5.

143 See discussion in A Keay, 'Company directors behaving poorly: disciplinary options for shareholders' [2007] *Journal of Business Law* 656–682.

144 E F Fama and M C Jensen, 'Separation of ownership and control' (1983) 26 *Journal of Law and Economics* 301–325; E F Fama and M C Jensen, 'Agency problems and residual claims' (1983) 26 *Journal of Law and Economics* 327–349.

145 A Alchian and H Demsetz, 'Production, information costs, and economic organisation' (1972) 62 *American Economic Review* 777–795.

146 N Wolfson, 'A critique of corporate law' (1980) 34 *University of Miami Law Review* 959–994.

147 Prentice (n 59 above).

148 A R Admati and P Pfleiderer, 'The "Wall Street walk" and shareholder activism: exit as a form of voice' (2009) 22 *Review of Financial Studies* 2645–2685.

149 H G Manne, 'Some theoretical aspects of shareholder voting: an essay in honor of Adolfe A Berle' (1964) 64 *Columbia Law Review* 1427–1445.

150 H G Manne, 'Mergers and the market for corporate control' (1965) 73 *Journal of Political Economy* 110–120; F S McChesney, 'Manne, mergers, and the market for corporate control' (1999) 50 *Case Western Reserve Law Review* 245–252.

Similar issues arise in respect of derivative claims – which exist because directors are notoriously reticent to enforce breaches of duty against other directors.¹⁵¹ The derivative claim is thus a disciplinary function to allow shareholders to hold directors to account.¹⁵² The raft of changes needed to effectively reform UK corporate purpose law by creating a zone of insulation around managers also insulates them from being held accountable for their own wrongdoing. This disarming of disciplinary functions will have the effect, at least at the margins, of encouraging worse behaviour from management.

All of which is to say that the corporate law features that we need to disable for corporate purpose law reform all exist for specific purposes. Not only is a dramatic rewrite of UK company law required to effect corporate purpose law seriously, each step should only be taken after its own cost–benefit analysis to see whether the benefits of corporate purpose law reform outweigh the harms.

Second, it is time to stop hoping that corporate purpose law reform will be a quick fix to the corporate system. If we are unwilling to undertake the major rewrite of UK company law necessary to effectively reform corporate purpose law, then we are unwilling to reform corporate purpose law. That does not mean that we have no option to regulate. Here, we have two options. First, we can regulate the company from the outside. Milton Friedman is often blamed for the current pro-shareholder landscape, somewhat unfairly.¹⁵³ He stated that business had a social responsibility to make as much money as possible ‘while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom’.¹⁵⁴ If we are unwilling to change the player, we could change the game. If we identify corporate behaviour that is sub-optimal, and we are unwilling to change internal company law rules to amend it, then we could provide additional external regulation.¹⁵⁵

Second, we can look at the underlying causes that drive the need for corporate purpose law reform. These all ultimately relate to allegations

151 D D Prentice, ‘The theory of the firm: minority shareholder oppression: sections 459–461 of the Companies Act 1985’ (1988) 8 *Oxford Journal of Legal Studies* 55–91.

152 A Reisberg, ‘Shareholders’ remedies: the choice of objectives and social meaning of derivative actions’ (2005) 6 *European Business Organization Law Review* 227–268; C Riley, ‘Derivative claims and ratification: time to ditch some baggage’ (2014) 34 *Legal Studies* 582–608.

153 B R Cheffins, ‘Stop blaming Milton Friedman!’ (2021) 98 *Washington University Law Review* 1607–1644.

154 M Friedman, ‘The social responsibility of business is to increase its profits’ *New York Times Magazine* (New York 13 September 1970) 32, 33.

155 A K Sundaram and A C Inkpen, ‘The corporate objective revisited’ (2004) 15 *Organization Science* 350–363.

of shareholder short-termism driving the maximisation of corporate profits, and pushing for all profit to leave the company, in both cases at the expense of others.¹⁵⁶ Whether this is the case or not has been debated,¹⁵⁷ as has whether we can produce a simple, universal answer to the question of whether shareholders are forces for 'good' or 'bad'.¹⁵⁸ Yet, if we assume that the reason we need to change corporate purpose law is because shareholder dominance somehow causes wider harms, corporate purpose law reform still tacitly accepts shareholders setting alternative corporate purposes, whilst hoping that the company so heavily shaped by them can ultimately prioritise other interests over theirs. Most of the individuals involved in companies tend to be relatively normal, and not fundamentally evil.¹⁵⁹ Perhaps, then, engaging with a company 'refracts' your incentives to allow companies to undertake activity that individuals themselves find egregious.¹⁶⁰

This argument has been put in a number of ways, but at the heart of it is that the current corporate law rules can encourage activity by the corporate form which is seen as socially sub-optimal. For example, limited liability has been argued to push shareholders to invest in riskier businesses and riskier ways of undertaking business, causing 'externalisation of risk'¹⁶¹ or 'moral hazard'.¹⁶² Everyone enjoys limited liability in respect of each other person's interactions,¹⁶³ so limited liability on its own cannot be the only reason for causing

156 Eg Sjøfjell et al (n 6 above).

157 Eg M J Roe, *Missing the Target: Why Stock-Market Short-Termism is Not the Problem* (Oxford University Press 2022).

158 J G Hill, 'Good activist/bad activist: the rise of international stewardship codes' (2018) 41 *Seattle University Law Review* 497–524.

159 Y Feldman, A Libson and G Parchomovsky, 'Corporate law for good people' (2021) 115 *Northwestern University Law Review* 1125–1186.

160 J Hardman, *The Limits and Logic of Agency Theory in Company Law* (Routledge 2024) ch 5. There are a series of expectations as to how individuals should fulfil their allotted roles in the company. This has been likened to an 'iron cage' that sets expectations as to how everyone should behave – eg P J DiMaggio and WW Powell, 'The iron cage revisited: institutional isomorphism and collective rationality in organizational fields' (1983) 48 *American Sociological Review* 147–160. The result is often that individuals can experience surprisingly little personal agency when engaging with the company: see PPMAR Heugens and MW Lander, 'Structure! Agency! (And other quarrels): a meta-analysis of institutional theories of organization' (2009) 52 *Academy of Management Journal* 61–85. For example, directors often act in ways that they *expect* shareholders would want them to act, based on certain expectations as to shareholder priorities (see sources cited at n 23 above).

161 H Hansmann and R Kraakman, 'Towards unlimited shareholder liability for corporate torts' (1991) 100 *Yale Law Journal* 1879–1934.

162 CAE Goodhart and RM Lastra, 'Equity finance: matching liability to power' (2020) 6 *Journal of Financial Regulation* 1–40.

163 Easterbrook and Fischel (n 93 above).

the corporate form to appear to provide greater risk to third parties compared to organisational alternatives. Instead, this arises because limited liability is coupled with a variable return¹⁶⁴ and voting powers to effect major changes in the company.¹⁶⁵ Together these cause an incentive to utilise the company to push risk onto a third party. Remove any part and the incentive is neutered: no limited liability will not encourage above-equilibrium risk (as shareholders will have to pay for corporate failure); no variable return means shareholder return would not increase with riskier activity; and no voting rights mean that nothing could be done about it. It is the confluence of these three features that, if it happens at all, push shareholders to push the company into riskier activities. Corporate purpose reform does not tackle any of these core features that create such an incentive. If corporate purpose reform is a major undertaking and has downsides, then perhaps re-examining the corporate law features that combine to create this incentive may be an easier, and less dangerous, way to achieve meaningful change.

The purpose of this article is to identify that changing corporate purpose law in the UK is complicated rather than 'embarrassingly simple'.¹⁶⁶ It involves a dramatic rewriting of UK company law. This rewriting will involve removing important disciplinary restrictions on management. The medicine of effectively changing corporate purpose law in the UK is bitter and its side effects strong. It may be that we are unable or unwilling to take it, especially when more palatable remedies could achieve the same ends, potentially more easily and with fewer risks. But unless we are willing to holistically rewrite UK company law to effectively reform direct and indirect corporate purpose law, we should stop discussing reform of UK corporate purpose law and explore other mechanisms for changing the incentives faced by shareholders.

164 Called the 'residual claim': T S Ulen, 'The Coasean firm in law and economics' (1993) 18 *Journal of Corporation Law* 301–332.

165 Hardman (n 160 above) ch 5.

166 Mayer (n 2 above) 22.