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CLIENT BRIEFING

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A BRIDGE TO BETTER BUSINESS:

THE POSITIVE CASE FOR UPDATING DIRECTORS' DUTIES

The rising cost of living along with the energy, climate change, water, pollution and other crises bear down on people and the communities they live in. As the pressure increases, it brings to the surface urgent questions about real sustainability leadership and how best to have regard to stakeholder interests. Decisions taken, and being taken, by boards are more and more being assessed through the demanding lens of what they mean for all stakeholders. This in turns asks what balance must be struck between the interests of shareholders and others affected by or reliant on that business, including (in the language of directors' duties) "the interests of the company's employees … [and] the impact of the company's operations on the community and the environment".

There can be no doubt that some boards have faced and will continue to face some very difficult decisions concerning investment and capital allocation, shareholder returns and the interests of consumers. Given the vital role business must play, Jeff Twentyman and George Murray ask whether directors' duties give the proper foundation needed to allow companies to respond in the way society increasingly expects and the climate and other emergencies demand.

We suggest that it would in fact be useful to look again at the way in which directors' duties are formulated. A change could better align the written legal requirements with reality, better serve stakeholders, give useful direction and, importantly, protection to directors.

The issues this raises are complex and not all the arguments included below will achieve universal appeal. Now is nevertheless the right time to examine the positive case for how directors' duties could strike a different balance between shareholder and stakeholder interests fit for our times.

Significant change is needed to the way business interacts with and addresses the greatest challenges facing people and planet. The Better Business Act and other initiatives discussed below are not a complete answer, but a proposition for a necessary refocus. Is it too much to think that the legal community engages positively, alongside a large number of businesses, with the proposition to come up with something better than what we have now?

Developing Directors' Duties

Directors' fiduciary duties are continuing to change in light of increasing focus on the concerns of wider stakeholders - not just shareholders - and there is a positive case for legislative change to reflect this. Initiatives like the Better Business Act amongst others offer potential routes to do this, despite some practical issues, and could bring significant benefits - including greater clarity for directors and a "safe harbour" in which to better balance shareholder and stakeholder interests.

Whilst the wording in s172 of the Companies Act 2006, which details directors' duties in respect of promoting the success of a company, remains the same, the way it is being interpreted and applied is evolving. Businesses that approach decision making as being purely profit-driven, with stakeholders' interests being something to be minimised, risk increased legal, fiduciary and reputational risks. As Lord Sales told the Anglo-Australasian Law Society: "it is clear that the very traditional view of the undemanding nature of directors' duties is now outmoded."[1]

At the extremes, this shift can manifest as litigation relating, for example, to a failure to address the risks of climate change; increased regulatory attention; shareholder activism increasingly reflecting stakeholders' concerns especially towards energy companies, miners and banks[2]; and reputational risks. All of these are expanding, with some notable successes, and in part come

[1] *"Directors' duties and climate change: Keeping pace with environmental challenges"* Anglo-Australasian Law Society, Sydney, Lord Sales, Justice of the Supreme Court, 27 August 2019, page 10.

[2] The amount of climate change-related litigation worldwide has more than doubled since 2015, with over 1,000 cases having been brought in the last six years, compared to just over 800 cases between 1986 and 2014, according to the Grantham Institute.

from the belief that directors are not striking the right balance between shareholder and stakeholder interests.

Energy companies, for instance, are attracting criticism for making super-profits and engaging in substantial share buybacks at a time of widespread energy poverty and underinvestment in the energy transition. The currently proposed windfall tax could represent a hard-edged manifestation of public and government sentiment that perhaps the wrong shareholder/stakeholder balance has been struck. An Ofgem board director even quit recently over a rule change to the energy price cap that "gave too much benefit to companies at the expense of consumers"[3].

The water and sewerage industry is also in the firing line for an apparent over-focus on shareholder returns at the expense of good environmental performance, better water management and the broader consumer interest, which has **prompted the Environment Agency to warn of tougher action against directors**.

One way to address these kinds of imbalances, and offer additional protection to directors, could be to amend s172 to provide for greater clarity of corporate purpose. This in turn could provide more flexibility and a safe harbour for making decisions that better account for wider stakeholders, as many directors are already doing.

A range of initiatives are looking to amend s172 or at least to develop the conversation around it, such as the Better Business Act campaign ("**BBA**"). This wants to change the law to embed purpose and stakeholders' concerns into all businesses. In the meantime, there are a number of voluntary efforts companies can and are already taking, which do not require a change in legislation.

Despite some potential practical difficulties, there are good arguments for why the law around duties to stakeholders should be updated. The written law has come to be interpreted as requiring shareholder primacy, but practice and social expectations are in an altogether different place.

This produces a tension that creates unhelpful risks for directors looking to balance the two. Since many businesses already make significant efforts to account for stakeholders' interests in the real world, it is arguably time for the law to catch up. This could in turn offer much needed clarity on how to square a shareholder-first view of the role of directors with the increasing expectations of 'stakeholderism'.

This briefing looks at the existing legal landscape; what solutions the BBA and other proposals offer as well as the risks they present; how any such changes might be enforced; and what some of the alternatives are. This will help directors better understand how social and legal expecations around their fiduciary duties are changing to reflect stakeholder concerns, and with what changes they may look to engage.

Stakeholder capitalism on the rise

In 2016, the UK Government's Mission-led Business Review[4] recognised that there was growing evidence that mission-led businesses (those that are both profit-driven and look to contribute to society) can have a competitive advantage when it comes to business performance, employee retention, and customer loyalty. The ReGenerate project, backed by the Department for Digital, Culture, Media and Sport, also made a strong case for purpose-driven business in 2020[5], arguing that the public want businesses to take greater responsibility for social and environmental issues; businesses can positively transform society; and that being purpose-driven is increasingly shown to empower businesses to become more successful and sustainable.

Last year, the British Academy's Future of the Corporation project released its insightful final report on the "Policy & Practice for Purposeful Business"[6], which looks in detail at how businesses and public policy can change to help create a fairer, more resilient future.

The report argues for a coherent package of changes to policy and practice that together support the implementation of corporate purpose and hold decision-makers to account. It concludes that the UK already has the permissive legal, regulatory, governance and reporting framework needed for "purposeful business", but that there is insufficient accountability and implementation.

It goes on to say that few companies take up the options that exist in the law to adopt purposes beyond promoting shareholder interests (with some notable exceptions, such as certified B Corps[7]), and there is insufficient

[3] *Ofgem board director Christine Farnish quits over energy price cap*, The Guardian, 17 August 2022, available **here**.

[4] *On a Mission in the UK Economy: Current state of play, vision and recommendations from the advisory panel to the Mission-led Business Review 2016*, available **here**.

[5] *The case for purpose driven business*, ReGenerate, available **here**.

[6] *Policy & Practice for Purposeful Business: The final report of the Future of the Corporation programme*, The British Academy, available **here**.

[7] To become a certified B Corp, a business must score highly enough on the "B Impact Assessment" and then change its articles of

appreciation and enforcement of directors' duties under the law. Internationally, there are initiatives to ensure that companies and investors report their environmental and social impacts, as well as some purpose-built corporate structures like France's *Entreprise à Mission*, but still insufficient focus on measuring, valuing and incentivising corporate purpose.

To strengthen accountability for corporate purpose, the report recommends:

1. governments should put purpose at the heart of company law and the fiduciary responsibility of directors;
2. regulators should be given new powers to hold directors and controlling owners to account for their corporate purpose;
3. companies place purpose at the heart of their annual reporting and demonstrate to their stakeholders how their ownership, governance, strategy, values, culture, engagement, measurement, incentives, financing and resource allocation deliver it; and
4. investors engage with companies about the nature and implementation of their purposes, and evaluate their performance and future prospects against them.

Some of these recommendations are not far removed from initiatives now in place or in contemplation in the UK:

- the UK Corporate Governance Code 2018, against which all premium listed companies are required to report, places emphasis on relationships between companies, shareholders and stakeholders, and promotes establishing a corporate culture aligned with company purpose, business strategy, integrity and diversity (Principles A and B);

- the UK Government, following the outcome of its review of corporate governance, reporting and audit, will metamorphose the Financial Reporting Council into the more powerful Audit, Reporting and Governance Authority and give it **new powers to hold directors and controlling owners to account for their corporate purpose amongst other things**, which will presumably also solidify adherence to Principles A and B of the Governance Code.

As Roger Urwin, co-founder of the Thinking Ahead Institute, a non-profit that "aims to mobilize capital for a sustainable future", argues (with a focus on asset owners):

> *"Fiduciary duty should be adjusted to provide better guardrails within which asset owners can operate. It seems that fiduciary duty, with its current high bar in financial primacy and poor air-cover for trustees, is fast becoming an anachronism in a world now focused on sustainability and wider responsibility".*[8]

This sentiment is starting, slowly, to be played out in the courts. The recent charities case *Butler-Sloss v Charity Commission*[9], for example, found that charities in particular may decide to make ethical investments (in this case, aligned with the Paris Agreement amongst other things) even if it means a lower rate of return, where consistent with the charity's purpose, and where it can be justified. Whilst not directly applicable to corporates, it does offer a key example of how returns and purpose can be balanced, and might offer directors looking to embrace purpose a glimpse of how the wheel might turn in the future.

The combination of commentary, initiatives and court cases show that there is a rising tide of expectation around purpose and embedding stakeholder-focussed approaches into businesses. In practice, however, it remains piecemeal. Greater clarity, and consistency, around how to account for stakeholders could help achieve more positive outcomes for people, planet and profit, and there are a range of ways to do this.

The current legal landscape - having regard for s172

Legislation in the UK allows but does not require businesses to define a specific corporate purpose in their articles of association. In the absence of a bespoke purpose clause, s172(1) of the Companies Act sets out the default position.

Under the Companies Act, the purpose of the company, and the fiduciary duty of the company's directors, is the promotion of the success of the company for the benefit of its members as a whole. In so doing, directors must *have regard to* certain other stakeholders, including (but not limited to) employees, suppliers, customers, the

association to "reflect a commitment to creating a material positive impact on society and the environment, and to consider

the impact of your decision on all of your stakeholders, including shareholders, employees, suppliers, society and the environment."

[8] *The Beta Steward Proxy Review 2021: Progressing Toward Authentic Value Creation*, The Shareholder Commons, August 2021, available here.

[9] https://www.bailii.org/ew/cases/EWHC/Ch/2022/974.html

community and the environment, bearing in mind also the company's reputation.

This obligation is procedural only. It is open to directors to have regard to, but ultimately set aside, these stakeholders' interests if judged to be in members' interests overall - and is generally interpreted as affording primacy to the interests of shareholders. This approach carries some risk however, where the balance struck is too one-sided[10].

Many practising lawyers, amongst others, seem wedded to a belief that this model of directors' duties is the only viable model, and must be interpreted as requiring shareholder primacy. This view forgets that s172 was, even when drafted over 15 years ago, a compromise or "fudge"[11] reflecting political necessity to include reference to stakeholders, without fettering directors' discretion. This led to the broadly worded, if slippery, requirement to "have regard" to stakeholders, without the "sting" of any realistic prospect of facing sanction for non-observance. It also meant that stakeholders were not given standing to sue in the event their interests were not properly accounted for, instead having to rely on altruistic shareholders[12].

It is open to us then to see s172 as a flawed artefact that was a product of its time, and contemplate ways it could be improved – for which Margaret Hodge MP, who helped usher in the Companies Act, is now advocating, along with co-author Jonathan Djanogly MP[13]. Any amendment to improve s172 might reflect how society has changed and expectations relating to businesses have evolved in the meantime, as well as looking at some of the deeply negative outcomes that have arisen under the current model.

This could go some way to readjusting the balance to address things like the P&O staff layoffs scandal earlier this year; criticism directed at supermarkets for benefitting from business rates relief as sales boomed during the pandemic; and the payment of super-sized dividends and share buybacks by consumer-facing energy and utility companies during a cost of living crisis and seemingly negative environmental performance.

For corporates looking to put purpose and stakeholders at the heart of their business right now, there is relatively little formal guidance, but what there is can be impactful if integrated fully into a business' approach:

- the UK Corporate Governance Code 2018, in particular Principles A and B of the Code, asks the boards of certain listed companies to ensure their role is to promote the long-term sustainable success of the company, generating value for shareholders *and* contributing to wider society, as well as to establish the company's purpose, values and strategy. This is consistent with, but also more than, what s.172 already asks when read with a stakeholder focus, and better reflects practice in reality irrespective of the language in the Companies Act.

  The Code also asks those boards to understand key stakeholder views and describe in the annual report how their interests and the matters in the s172 statement have been factored into board discussions and decision making.

- the Companies (Miscellaneous Reporting) Regulations 2018 which requires UK companies within scope to include a "s172 statement" in their strategic reports describing how the directors have had regard to the matters set out in the s172(1)(a)-(f) of the Companies Act, as well as statements on the factors relating to employee engagement and business relationships in the directors' report or cross-referenced to the s172 statement in the strategic report.

  However, as the FRC has found[14], there is a risk that s172 statements can tend towards being boilerplate, unconnected to the business model or strategic issues, and shying away from how stakeholder considerations have (or haven't) impacted decisions.

- the range of corporate reporting, which points towards actions they may need to take, for example reporting under the Taskforce on Climate-Related Financial Disclosures framework, which applies in legislation to large corporates and LLPs as of 6 April 2022, and requires companies in scope to make climate disclosures as against four pillars: governance, strategy, risk

[10] As academic Nicholas Grier points out: "Ironically, the effects of the reluctance of directors to engage with the duties outlined in the legislation have been so detrimental to some companies' interests that the only solution is for directors to start engaging with those very duties".

[11] *To prevent another P&O, we must rethink the role of Britain's bosses*, The Times, 20 April 2022, available **here**.

[12] *Enlightened shareholder value: did directors deliver?,* Nicholas Grier, available **here**.

[13] *Ibid.* 11

[14] *Reporting on stakeholders, decisions and Section 172*, Financial Reporting Lab, July 2021, available **here**.

management (including transition risk) and metrics & targets.

There is a space for more to be done, and a degree of political will to do so. As Harvard law professor Lucian Bebchuk argues[15], "those who seriously care about corporations' external effects on stakeholders should not harbor illusory hopes that corporate leaders would protect stakeholder interests on their own". This is because during transactions "corporate leaders generally didn't bargain for any employee protections [and] also didn't negotiate for any protections to customers, suppliers, communities, the environment, or other stakeholders".

Instead, Bebchuk makes the case for concentrating efforts on securing governmental interventions that could truly protect stakeholders. In other words, to achieve real change, legislation needs to be imposed.

The case for the Better Business Act (or similar)

The BBA campaign[16] looks to change the law to better align businesses' social and environmental impacts with their existing duty to shareholders. In effect, this would offer directors more flexibility to take account of non-financial (or perhaps better put as pre-financial) factors in their decision making, by offering a "safe harbour" that would protect directors acting reasonably from disgruntled shareholders who may otherwise feel their primacy has not been sufficiently respected.

The BBA is one leading example, but it's important to remember that it's not the only route that can be taken, and any problems specific to the BBA's draft wording can, mostly likely, be ironed out as needed. The key point is that change is possible, and there are good arguments in favour of it, notwithstanding any technical issues.

The campaign is business-led and supported by over 1,500 UK businesses, as well as the Institute of Directors[17], with some cross-aisle political support, including from Margaret Hodge MP, Jonathan Djanogly MP and Labour's shadow business secretary Ed Miliband who has argued for fundamentally rewriting UK company law[18].

According to the BBA campaign, 72% of voters back their proposals, and the Institute of Directors found a majority of directors surveyed think the Companies Act "focuses too much on shareholders and not enough on wider stakeholders". BBA research also claims to show that companies that are run in line with the principles of the BBA can expect faster turnover and headcount growth, greater levels of employee retention and diversity, and higher levels of innovation.

An illustration of the BBA's draft amendment can be found **here**, current as of August 2022 with future drafts planned to reflect widely sought consultation and feedback. The current draft would, in particular, amend s172 to read as follows (specific substantive changes from the current s172 are underlined):

> ***172 Duty to advance the purpose of the company***
>
> *(1) A director of a company must act in the way the director considers, in good faith, would be most likely to <u>advance the purpose of the company</u>, and in doing so must have regard (amongst other matters) to the following considerations—*
>
> > *(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 <u>well-deserved reputation for trustworthiness and</u> high standards of business conduct, and*
> >
> > *(f) the need to act fairly as between members of the company.*
>
> *(2) <u>The purpose of a company shall be to benefit its members as a whole, whilst operating in a manner that also—</u>*
>
> > *<u>(a) benefits wider society and the environment in a manner commensurate with the size of the company and the nature of its operations; and</u>*

[15] *Stakeholder Capitalism in the Time of COVID*, Lucian A. Bebchuk, Kobi Kastiel, Roberto Tallarita, available **here**.

[16] **https://betterbusinessact.org/**

[17] See eg *Amending UK Company Law for a Regenerative Economy*, Regenerative Business Working Group led by Nina Boeger, available **here**.

[18] *Shadow business secretary says companies should be accountable to society and climate as well as shareholders*, The FT, 20 June 2021, available **here**.

(b) reduces harms the company creates or costs it imposes on wider society or the environment, with the goal of eliminating any such harm or costs.

(3) A company may specify in its Articles a purpose that is more beneficial to wider society and the environment than the purpose set out in subsection (2).

(4) The duty imposed upon directors by this section—

(a) has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company; and

(b) is owed solely to the company and not to any other interested parties.

Changes and dangers with the BBA

The key changes the BBA would introduce are:

1. rather than a director being required to act in the way the director considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, they must act in the way most likely to advance the purpose of the company. The effect is that shareholder benefits would derive from successful pursuit of corporate purpose;
2. the purpose of a company is then defined in the amended s172(2) as being a balance between the need to benefit its members as a whole (as s172 currently requires), and also benefit wider society and the environment in a way commensurate with the company's size and the nature of its operations, whilst looking to reduce or eliminate wider social and environmental harms or costs (as the UK Corporate Governance Code already in effect asks);
3. this purpose must be specified in the company's Articles of Association; and
4. the directors owe duties to the company but not any other interested parties.

The BBA's changes are in some ways relatively modest. The existing framework of companies law is retained, with shareholder interests remaining paramount, even if derivative of a purpose.

Sidestepping success, advancing purpose

The BBA's proposal that a director must act in the way most likely to advance the "purpose" of the company, rather than simply "to promote [its] success", expands the boundaries of what it means for a business to do well, to include not just itself, but also those on whom it impacts.

This goes someway to sidestepping the issue that author and academic Colin Mayer[19] has identified around the fact that corporate "success" can include outcomes that are detrimental to stakeholders as long as they are beneficial to shareholders. This idea of "success" is capable of multiple interpretations, "be it restricted to benefits of shareholders in terms of their wealth or welfare or more broadly construed to include those of, for example, employees". So for example, is a company that pays massive returns to its shareholders a success, when its workers survive on unsustainable incomes and welfare and consumers cannot afford its essential products?

A modest proposal

The two limbs of the proposed Act's purpose clause (what would be s172(2)(a) and (b)), in context, are not that radical either.

The requirement in the first limb - to benefit wider society and the environment – is in many ways similar to what the UK Corporate Governance Code's Principles A and B ask in respect of contributing to wider society and promoting long-term sustainable success, and not so different as to create any especially worrying implementation issues.

The proposed second limb - to mitigate social and environmental harms - is also not so radically different when compared to what's happening in Europe. A failure to embrace such a change may in fact leave the UK lagging behind in terms of company law innovation. France's *Loi de Vigilance* already imposes a civil duty (and liability) to be vigilant against abuses of fundamental rights, health & safety, and the environment in connection with business activities.[20] Germany is to follow suit from 1 January 2023. The EU, apparently taking inspiration from Member States' existing laws, is considering a proposal for a Corporate Sustainability Due Diligence Directive ("**CSDD**")[21], which is likely to impose requirements to prevent, mitigate and remediate adverse human rights and environmental

[19] *The Role of Corporate Law Reconsidered: A Brief Response to Paul Davies' Blog*, Colin Mayer, available **here**.

[20] *The French Loi de Vigilance: Prospects and Limitations of a Pioneer Mandatory Corporate Due Diligence*, Verfassungsblog, available **here**.

[21] *Just and sustainable economy: Commission lays down rules for companies to respect human rights and environment in global value chains*, European Commission, available **here**.

impacts all along the value chain of EU and non-EU businesses within scope (likely from around 2025/26).

If the BBA's purpose clause is intrinsically in keeping with objectives that have been adopted or proposed elsewhere, then is the problem here simply that the objectives are badged as "legal" and "default" in nature? If so, such objections may be more an issue of form than substance.

Even if you do not agree with this view, is it objectionable that companies should have an obligation to minimise the harms they cause? If the mitigation obligation principle is accepted, then the words can surely be found.

Defaulting on purpose?

The BBA's inclusion of a default purpose (s172(2) as amended in the BBA's proposal) may make getting behind the campaign unpalatable for some businesses, since it would prevent directors from exercising complete discretion as to how they articulate their business' purpose and thereby differentiate themselves from competitors.

An alternative could be to require directors to set a purpose (with accompanying disclosures) instead of providing a default purpose. However, the drafting in the BBA is fairly broad, so the limitations it would impose would be limited to a baseline which business could choose to exceed.

The default purpose requirement could be seen as the most ideological element of the BBA. It supposes that all companies should have a purpose, and one which benefits wider society. The need to "benefit" wider society is more positive and more demanding than simply to "promote" the success of the company or "contribute" to wider society - but what is beneficial and what is detrimental is still context-specific, dynamic, and not always easy to establish. It is also not stated to be an objective requirement, allowing for subjectively in determining what is beneficial.

For those who argue that a default purpose is too demanding, the question is presumably this: what is the alternative? Should we permit commercial activity that cannot be said to benefit wider society? It may be that the BBA campaign knows that the default purpose proposal is challenging, but nevertheless sees it as a principled and provocative proposition for campaigning purposes. It certainly asks some tough questions of those who would argue against it.

This baseline could drive some business to have to change or go out of business. This of course may not be entirely a bad thing. More practically, a default purpose would force businesses to make a positive case for their existence, over and above simply making money.

This then begs the question of how to best benefit wider society and the environment as a business, especially where they are carrying out a range of different activities in different sectors. Does undertaking a "good" line of business in one sector absolve one or more "bad" undertakings in another? How should directors weigh up the relative merits and assess the weight society attaches to each? Would a business be encouraged to act defensively instead of entrepreneurially as a result? Where would this leave a business which generates cash flow from, say, environmentally harmful activities but applies that capital towards investing in harm-reducing alternatives?

On a practical level, whilst the BBA campaign had previously been pushing for inclusion in the Queen's Speech in May, getting on the legislative agenda in the short term seems unlikely given the government's failure to advance much of its already existing legislative ambitions. But that is not to say momentum has slowed.

A chance for change

Whatever the answer, it would require directors to carefully weigh up decisions, apply sector-specific criteria and make use of the best evidence available to them when exercising their judgement. We do not consider that the BBA would make board decision-making of this sort more complex than it is today. It is not changing the standard required of directors, who would still be required to act in good faith in making judgements about what is in the best interests of company, and within the subjective/objective test in section 174 of the Companies Act, but with a slightly adjusted field of reference to look at when making decisions.

In fact, it is arguable that a legal change to better align the law with real world practice could be pro-director, offering greater protection and a safe harbour against shareholders who backlash when they consider a business is leaning too much towards stakeholder interests. It may give directors the confidence to do the right thing.

Enforcement of stakeholder interests

Even if the BBA were to become law, the directors would continue to owe their duties to the company and not to any particular stakeholder or category of stakeholders directly. As a result, stakeholders would continue to face considerable difficulties trying to challenge in court decisions of directors on the grounds that they have failed, or would fail, to take the interests of stakeholders properly into account. Under the current law, the main route for such a challenge is a statutory derivative action,

which comes with a number of legal, financial and practical obstacles[22].

Very few derivative actions have been brought to date, especially relating to listed companies. It is conceivable that some shareholders - particularly long-term investors committed to driving ESG improvements - may become more willing to use derivative actions, or the threat of them, to force directors to take the interests of stakeholders (or perhaps certain categories of stakeholder) properly into account. However, the obstacles and deterrents mean that a dramatic increase in derivative actions is unlikely to occur.

Of course, relying on shareholders to hold directors to account for failures to protect stakeholder interests in probably not as effective as a more radical change imposing that obligation directly on directors[23]. Nevertheless, a shareholder that has invested because it likes the company's "purpose" might still have leverage to do so.

The BBA explicitly states that the duties imposed are owed solely to the company and not to any other interested parties, which narrows concerns about "opening the floodgates" to endless litigation claims. The floodgates argument is in any event weak: it is perverse to refuse parties rights based on the integrity or suitability of decision making, just in case they exercise those rights when the decision making process goes wrong. The opposite - ensuring good decision making - is more reflective of where we need to be, and companies can and already do put processes in place to ensure they have the evidence needed to defend their decision making against legal challenge.

The wider debate on shareholder primacy

It's important to remember that the BBA's proposed wording is just that – a proposal. Irrespective of concerns over the specific form or wording, the campaign helps open up and put a spotlight on the wider debate and the importance of purpose, people and planet alongside profit.

By watching how this initiative develops, directors may gain insight into the changing expecations around their fiduciary duties and their companies' social license to operate in the face of climate change and other sustainability risks over the coming years. Whether or not the words in the statute change, businesses will want to consider what changes may still be necessary in practice.

The issues the BBA raises are also part of a broader debate on shareholder primacy being advanced by a range of organisations. These include the British Academy's Future of the Corporation project mentioned above, and also:

1. the Institute of Directors' Regenerative Business Working Group report[24] on amending UK company law for a 'Regenerative Economy', which pushes for an economy that stays within a safe and just operating space for humanity, and looks at economic structures "through the lens of ecology as if both people and planet mattered equally" (so-called "doughnut economics" as coined by academic Kate Raworth).

2. the Shareholder Commons project, which seeks "to create paths for sustainable business"[25] by engaging with the "dangerous fantasy" that pursuit of profit and purpose do not come into potential conflict and looking to find a way to deploy private capital in a manner that prioritizes environmental and social systems over individual company profits, while preserving the critical pricing function of free markets.

   In its Beta Steward Proxy Review 2021[26], it argues that responsible investors must also go beyond asking companies to "do well by doing good" and insist they stop doing bad, even when bad creates the greatest internal financial return for the company over the short or long term. Without this, the Commons argues, there is no way to realistically address climate change, mass extinction, growing inequality, or pandemics.

3. The Trades Unions Congress (TUC), in its response to the government White Paper on Audit and Corporate Governance Reform, proposed to change the directors' objective from "success for the benefit of shareholders" to the rather well articulated "long-term success of the company" having regard to sustainable returns, the workforce, business relationships and human rights and environmental impact. This is in order to remove the emphasis on shareholder primacy which the TUC argues has encouraged an over-focus on investor returns at the expense of financial prudence and investment in R&D.[27]

[22] Including the need to seek the court's permission to bring a claim and to convince it of the claim's merit, the fact that any damages paid go to the company and not the shareholder, and that litigation of this type may damage share price, at least in the short term.

[23] *The Nature of Stakeholder Capitalism and the Role of Corporate Law: A Brief Response to Colin Mayer's Blog*, John Gaffney, available **here**.

[24] *Amending UK Company Law for a Regenerative Economy,* IoD Regenerative Business Working Group, available **here**.

[25] **https://theshareholdercommons.com/about/#our-story**

[26] *Ibid 8.*

[27] In full: *"A director of a company must act in the way s/he considers, in good faith, would be most likely to promote the*

Alternatives to the BBA

Of course, the BBA is not the only game in town, and there is already a lot that business can and are doing to embed purpose within their existing legal structures.

Certified B Corporations, or 'B Corps' (which inspired the BBA), are companies verified by B Lab (a non-profit network focused on responsible business) to meet comparatively high standards of social and environmental performance, transparency and accountability. There are around 4,200 B Corps, of which over 700 are in the UK, mostly made up of private companies. Companies looking to certify as a B Corp must score highly enough on an assessment of their governance and impact on workers, the community, customers, and the environment. They must also adopt a stakeholder governance model by focusing on the effect of their corporate activity on all stakeholders. This requires amending the company's articles of association to incorporate an objects clause focused on creating a material positive impact on society and the environment in addition to promoting the success of the business (making use of wording very similar to the BBA's proposals).

Aside from the certified B Corp approach, a number of businesses have embedded purposes specific to them, such as Anglian Water, who as one of the first major utility companies in the UK to enshrine ESG considerations, qualified the pursuit of profit for shareholders with a requirement to also seek "positive outcomes for the environment and society"; and Danone Waters UK, which adopted a slight variation on the B Corp precedent wording when changing their articles of association.

Interestingly, the retailer John Lewis, which was supportive of the B Corp movement, has since moved away from it. Whilst B Corps encourage businesses to lay claim to having a social mission, John Lewis' chair Dame Sharon White argues for a narrower conception, saying there must be "a recognition that companies are set up to make money [and] only when they have done this can those profits be invested in doing good"[28], which for the retailer means investing in their staff, referred to as Partners, who own the business, and other initiatives[29]. Dame White goes on to say that she thinks a "change in law is unnecessary [as] companies are already responding to the demands of their shareholders and customers to be more socially aware."

In any event, there is no bar on businesses considering non-shareholder issues, like the impact of their operations on the environment, when making decisions, as long as the right balance is struck across different interests. It is also not necessary for businesses to change their legal form in order to take account of stakeholders, and in fact they should be looking to do so even without such a legal structural change.

Other legal forms with embedded purpose

There are, in addition, a range of legal forms already in existence for business to adopt in order to embed purpose (or recreate as a 'synthetic' version within their domestic legal structure).

In France, for example, the *Entreprise à Mission* is a company whose objectives in the social and environmental fields are aligned with its purpose and set out in its by-laws, which requires them to define a purpose, include social and environmental objectives aligned with that purpose in its by-laws, create a "Mission Committee" made up of external advisors to monitor progress, and appoint an independent third party to verity that the mission is carried out.

In the US, 36 states have the 'benefit corporation' or 'public-benefit corporation' as a specific corporate entity that is for-profit and required to create a material positive impact on society.

In 2016, Italy introduced the *Società Benefit* in the Stability Act, which very closely follows the US benefit corporation model, and combines the goal of profit with the purpose of creating a positive impact for society and the environment and which operates in a transparent, responsible and sustainable way.

In the UK, the Community Interest Company (**"CIC"**) is a limited liability company designed for social enterprises which has the specific aim of providing a social benefit to a community and uses its income, assets and profits for the community it is formed to serve (so called "asset lock"). The primary purpose of a CIC is to benefit the community and not its shareholders, directors or

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long-term success of the company, and in so doing, should have regard to the need to:

i. deliver fair and sustainable returns to investors

ii. promote the interests of the company's workforce

iii. foster the company's relationships with suppliers, customers, local communities and others, and

iv. take a responsible approach to the impact of the company's operations on human rights and on the environment..."

[28] *John Lewis Partnership chair SHARON WHITE: Companies must not allow social and environmental goals to distract them from making profits*, This is Money, 6 March 2022, available **here**.

[29] John Lewis Partnership constitutions May 2022, available **here**.

employees, and cannot have as it purpose profit maximisation.

The EU is also looking to improve the EU company law and corporate governance regulatory framework. In 2020, it launched its sustainable corporate governance initiative[30] which looked at enabling companies to focus on long-term sustainable value creation rather than short-term benefits. At the time, it attracted substantial public support, with almost 90% of respondents saying that directors must take account of stakeholder interests.

Two years later, the EU belatedly followed up with its Corporate Sustainability Due Diligence proposal. In terms of directors' duties, however, the proposal does little beyond looking to "clarify" - explicitly without requiring any changes to existing national corporate structures - directors' general duty to act in the best interest of the company, by taking into account the sustainability matters referred to in the Accounting Directive. These include, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term horizons. Overall, this seems to be more of a consolidation exercise than a revolutionary one, that does little to acknowledge the embedded insufficiency of the current standard expected of directors when it comes to stakeholders.

Finally, other levers can be used at government level to provide an eco-system in which purpose-driven companies can thrive (as opposed to imposing purpose on all businesses). Many of these were discussed in the Government's mission-led business review, including: making a specific legal form that promotes purpose available, configuring public procurement rules and the tax system to encourage positive activities and discourage negative ones (or at least collect tax revenue that can be put towards mitigating negative externalities), developing financial vehicles to promote positive impacts and offering soft governance and guidance. Together, these may go some way to addressing the aims of the BBA and the rest without the need for legislative change, and maintain the British tradition of having a light touch on business whilst promoting consistency across the corporate landscape.

No better time to act

There are plenty of arguments that can be made that the existing arrangement is not delivering broadly across stakeholders and that might become more evident as a recessionary environment takes over. Society will need ever greater care to be taken of all its stakeholders, and there is of course a hugely pressing need for investment in R&D and innovation - not least for climate and environmental mitigation and adaptation. But shareholders will still want their return. Is the existing settlement unarguably fit for this purpose? In our view, a broader discussion is needed, and a lot of businesses, representatives of civil society, and some politicians appear to agree.

The easy option would be to say that there is no need for change when so much needs fixing, citing obstacles and other difficulties, not now, let's carry on with the status quo. But in the face of massive and pressing social and environmental challenges, positive action is needed, so the question has to be - if not now, when?

[30] See *Sustainable corporate governance initiative: Summary report - public consultation*, European Commission, available **here**.

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