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ARTICLE

Sustainable Directors' Duties and Reasonable Shareholders

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Abstract

This paper will examine the sustainability of directors' duties from two perspectives, namely that the duties are stable in their own right and that they cover enough ground for them to help achieve sustainable goals. First, we will examine how directors' duties to act in a company's best interest operate well when shareholder interests are aligned. These duties, when breached, can be ratified by shareholders given the traditional understanding that they are the company. This may, in turn, have been associated with the growing acceptance of shareholder primacy over the past 40 years, seen most recently in the UK Supreme Court decision in *BTI v Sequana* (2022). The Supreme Court, however, also discussed the limitations of shareholder ratification, and its interaction with the rules protecting creditors, particularly as regards capital maintenance. Those rules have, however, been weakened, and private law has had to step in to address the abuse those rules were aimed at. Where the substantive content of directors' duties is concerned, the focus everywhere is on how to make directors take account of external constraints such as environmental, social and governance (ESG) concerns and corporate purposes that may contradict enhancing shareholder value (as well as existing shareholder protection) as an established paradigm of company law. We will also analyse the difficulties in accommodating the interests of other internal constituents, like creditors (some of whom may have been externalised). This paper will build on earlier suggestions that the proper purpose rule has a part to play in balancing the interests of corporate constituents both *inter* and *intra se* and even in considering the position of future shareholders. The test of what is in the best interest of the company may not provide enough balance in this regard, as seen perhaps from the recent failed derivative action sought by some shareholders of Shell against its directors, and directors should take account of the interest of the reasonable shareholder in capturing the gist of what ESG should aim at.

Keywords Directors' duties · Interests of creditors · *BTI v Sequana* · ESG · *ClientEarth v Shell* · Proper purpose rule · Future shareholders · Reasonable investors

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1 Shareholder Primacy

There was a time when the company was seen as a strong separate entity with an inviolable ‘trust fund’.[1] Capital was locked in, but has now been coded[2] in such a way that it is sometimes more for shareholders to extract rather than for the corporation to grow. Many company directors and managers today focus on that right side of the balance sheet and not on their underlying business. Some firms behave more like funds than the business that they are in. Perhaps the worst example was the decline of ICI from a leading chemical and pharmaceutical company to one which sold off this core business and focused on its short-term share price to the ultimate detriment of the shareholders.[3] As Van der Zwan stated:

> What sets the financialized corporation apart from its industrial-age predecessor is that the financial gains from these operations are not reinvested in the firm’s productive facilities, but rather are distributed to shareholders through dividend payouts and share buybacks (Lazonick and O’Sullivan, 2000). It is for these reasons, that Blackburn has dubbed the financialized firm ‘the disposable corporation’ (2006, p 42).[4]

Much of this has been driven by relaxed capital maintenance rules, but such increased autonomy has meant a reallocation of risks without participants in a business venture fully realising its implications. Governments have been somewhat complicit as they strived to create growth after the Global Financial Crisis, particularly of small and medium-sized enterprises. Lawyers have helped to code things like digital assets and derivatives, which have been accepted as property much more quickly than shares and debts were in the past.[5]

While some of the cleverest arguments have been appropriated in favour of only the virtues of profit maximisation, there is a cognitive dissonance when this rush to paper wealth amidst shareholder primacy in the past 40 years or so (the Dow Jones Index has risen more than thirty times since 1982 whilst the US GDP is only about 7 times higher, and the rate of return on capital is greater than income growth[6]) is said to be perfectly consonant with sustainability goals. We may have overly focused on the agency costs problem between management and shareholders, and kept on trying to enhance minority shareholder protection and to keep aligning directors’ duties and incentives with shareholder interests when that was no longer the problem. This

[1] *Wood v Dummer* 30 Fed Cas 435 (no 17944) (CC DMe1824), discussed by Manning (1981), p 28.

[2] Pistor (2019).

[3] Kay (2012).

[4] van der Zwan (2014), pp 108-129.

[5] Pistor (2019). In fact, shares were more slowly reified as property compared to debts, possibly because they carried obligations such as unpaid contributions and even unlimited liability. In *Colonial Bank v Whinney*, the House of Lords (11 App Cas. 426) reversed the Court of Appeal (30 Ch D 261) and found that the share was a thing in action. The Judicature Act 1873 (36 & 37 Vict c 66) s 25(6) referred to ‘all debts and other legal choses in action’ and the House of Lords was of the opinion that shares were akin to debt securities, which are more proprietary in nature: UK Jurisdiction Taskforce, Legal statement on cryptoassets and smart contracts (November 2019), para. 68.

[6] Piketty (2014). See, now, LoPucki (2023).

was understandable in the 1970s as the labour share of national income peaked in 1975. Compare the first statement from the 1973 World Economic Forum (WEF) calling for more unqualified shareholder return:

> 2. The management has to serve its investors by providing a return on its investments, higher than the return on government bonds. This higher return is necessary to integrate a risk premium into capital costs. The management is the *shareholders' trustee.* [emphasis added][7]

with the second statement from the WEF Annual Meeting 2020 some 47 years later:

> v. A company provides its shareholders with a return on investment that takes into account the incurred entrepreneurial risks and the need for continuous innovation and sustained investments. It responsibly manages near-term, medium-term and long-term value creation in pursuit of sustainable shareholders returns that *do not sacrifice the future for the present.* [emphasis added][8]

These statements are aspirational and aimed to counter the then existing position. As with the famous New York Times headline of Friedman in 1970 that the 'social responsibility of business is to increase its profits',[9] the WEF recognised that labour unions were overly strong at that time. In contrast, its 2020 statement acknowledges that things have swung too much in favour of immediate shareholder-as-owner primacy.[10] This article will try to combine the two statements to suggest that directors owe a duty to their company to maintain the balance between the present and future by focusing on the reasonable shareholder. This will be discussed in the context of the important recent UK Supreme Court decision in *BTI 2014 LLC v Sequana SA*,[11] where it was held that the traditional duty of directors to act in a company's best interest still maintained an unqualified shareholder focus until insolvency was imminent, whereupon creditor interests were to be considered. But this may come too late, not just for creditors, but also for employees and the environment. Some shareholders may want these other constituencies to be considered at an earlier stage, and so shareholders are not a monolithic whole with the same risk appetite even within a particular company and their profiles differ across companies as well.

Since 'Black Monday' in 1987, we have witnessed one financial crisis leading to an economic one every 10 years or so as leverage benefits shareholders, or a certain generation of them. But that first financial crisis had relatively small real economic effects. The warning signs of over-financialisation came perhaps first with the Asian Financial Crisis that began in 1997 in Thailand. We subsequently saw the toll wrought by the Global Financial Crisis in 2008. The advent of digital assets then put more pressure on shareholder returns. Covid-19 has made it worse, with

[7] WEF Davos Manifesto 1973, A Code of Ethics for Business Leaders, para. 2.

[8] WEF Annual Meeting 2020, A Company's Purpose in the Fourth Industrial Revolution, para. A.v.

[9] Friedman (1970). Cheffins (2020) argued that this statement did not lead to modern shareholder primacy, which was caused by the hostile takeover wave of the 1980s.

[10] See also EY (2020), which is an action plan to counter corporate and shareholder short-termism.

[11] [2022] UKSC 25.

the removal of wrongful trading rules[12] on top of the guilt governments felt after the Global Financial Crisis in bailing out the banks, which are now also protected by bail-in rules. Non-adjusting creditors are the ones that have been left behind.

Shareholder primacy was the right strategy in a world with plentiful resources and new 'general purpose technologies'[13] or 'disruptive technologies'.[14] But the world has changed. Some shareholders may want to take on too much risk[15] and we are in the wrong part of the real, as opposed to financial, innovation cycle for that. Management, especially in financial institutions, ended up working against their own constituents, starting with customers, creditors, employees, and now possibly the environment. They must be given a chance to take a different path without fear of being said to have failed their shareholders.

2 Directors' Duties to the Company

While there are many facets to sustainability, this paper will explore how we can use private law, in particular directors' fiduciary duties, to bring us back to the position where directors focus on maintaining the company's existence as well as its place within the broader community. Their duty is to the company, and consequently it is difficult to make directors liable in negligence through some form of assumption of responsibility to third parties or outside causes.[16] The main duty is the one that requires directors to act in what they, in good faith, believe to be in the interest of the company. In fact, this is broken into separate requirements to be met before an archetypal statutory derivative action under, for example, s 216A Singapore Companies Act 1967 can be brought by a company against a director (as in the UK under s 263(3) Companies Act 2006, with the latter having been replaced by the duty to promote the success of the company under s 172(1)). Good faith has to be seen on the part of the shareholder seeking derivative standing, and the court must also believe that the action will *prima facie* be in the interest of the company. The latter test is viewed from a notional directors' perspective given that a derivative action is one which the directors do not wish to bring but some shareholders do.[17] While the company's best interest can be measured here in terms of how the shareholders *as a whole* will benefit from the bringing of a derivative action as disputes should be resolved (which should ideally be the view of shareholders independent of the

[12] See the suspension of wrongful trading in various jurisdictions due to Covid-19 discussed by van Zwieten and Licht (2020). Davies (2020), p 236, stated that 'continued trading in the vicinity of insolvency might be absolutely the right decision'.

[13] Gordon (2012).

[14] Giem (2013).

[15] Blair (2012).

[16] *William v Natural Life Health Foods Ltd* [1998] UKHL 17.

[17] The best interest of the company here to be seen from the 'prudent director' viewpoint (*Zavahir v Shankleman* [2016] EWHC 2772) or that of some directors (*Iesini v Westrip Ltd* [2009] EWHC 2526). Even a *prima facie* case was not made out in *ClientEarth v Shell Plc* [2023] EWHC 1137 (Ch).

wrongdoing director in accordance with the decision in *Smith v Croft (No 2)*[18]), we will see that it is harder to visualise what even unconflicted and independent shareholders would want when it comes to taking a decision which may not benefit the company but which is meant to comply with an external ESG requirement, particularly if non-binding, imposed on that company. There is no reason to assume that shareholders share the same interests when it comes to relationships the corporate entity has with the outside world as they did in the past with a company's external relations, and when fairness was only a concern where a company's internal constitutional balance was implicated, as in the case of a rights issue.

As regards rights issues, in *The Wellness Group v OSIM*,[19] Chua LM JC stated:

> In my judgment, a rights issue would be unfair within the meaning of s 216 if (a) there is no commercial reason to raise capital through a rights issue, or (b) the dominant purpose of the rights issue is to dilute non-subscribing shareholders.

While the Singapore judge rightly did not comment on whether the dominant purpose test should be the causative one suggested for the proper purpose rule applicable to directors by the UK Supreme Court in *Eclairs v JKX Oil*,[20] as not all the judges in the Wellness Group case agreed with it,[21] the judgment is significant in its linkage of shareholder oppression (based, in Singapore, on a test of 'commercial unfairness' that requires a buyout of the oppressed minority) to some of the language that would have been used in a director's improper purpose case. A rights issue is one of the situations where what directors do for the company in fundraising also impacts on shareholders and the balance of control between them. In the US, Fried[22] also suggests that rights issues should be subject to a 'substantive fairness' test due to the risk of expropriation. Later in this article, it is suggested that directors' duties will need further development in this regard in order to create a mechanism in which sustainability goals and corporate purposes translate into something that directors have to take into account. This is particularly so if the cost to the company results not from breach (which can be the case with binding requirements) but from compliance (which is often the case with voluntary requirements). The test of whether directors have acted in the best interests of the company finds it difficult to accommodate this as shareholders have different interests when it comes not just to rights issues but also to matters concerning ESG. While the European Commission has lamented the 'lack of a clear definition of "company interest" in company law frameworks',[23] the problem may be that that interest has to change with the context.

18 [1988] Ch 114.

19 [2016] SGHC 64, at [183]. The decision was upheld by the Court of Appeal on 31 October 2016.

20 [2015] UKSC 7, at [1].

21 See, especially, Lord Mance, ibid., [52]-[53]; Tjio (2016), pp 183-4.

22 Fried (2021).

23 EY (2020), section 3.2.1.

3 Shareholder Ratification and Capital Maintenance

When it comes to a narrow and less multifaceted decision where directors are only expected to act in the company's best interest and not to be conflicted themselves, shareholder approval or ratification can waive or cure any breach. Here, shareholder primacy is rightly the starting point and a recent Singapore decision has clarified, somewhat against previous authority, that approval for a director to enter into a conflicted transaction still has to be given by the shareholders in a general meeting, and not by the board.[24] This is the general principle, although because there is no absolute bar to a conflicted transaction, it should be possible to modify it by permitting board approval (via provisions to such effect in the corporate constitution) without there being a breach since director decision-making is the default position.[25] With ratification, which is an even more serious act by the company that extinguishes any possible action against a wrongdoing director, however, it is right that only shareholders can approve a breach as they are in effect the company at that time. There are no duties on them when it comes to how they vote, unless to alter the articles of association. Even s 239(4) of the UK Companies Act 2006, which requires independent shareholder ratification, is only concerned with ruling out shareholders linked to the director from the vote, and not with broader concerns regarding other constituencies. But it does signify that there are at the least intra-shareholder conflicts in ratification.[26]

In an important recent decision, however, the UK Supreme Court in *BTI 2014 LLC v Sequana NA*[27] (*Sequana*) examined the nature and limits of shareholder ratification of breaches of directors' duties in the shadow of other constituencies, such as creditors. Counsel argued that shareholders, being the corporators, would not be able to ratify a breach of directors' duties only when it amounted to an actual fraud on creditors. This, therefore, negated any possible duty on directors to take account of creditor interests when they sought to promote the success of the company, as creditors were expected to protect themselves contractually.[28] The majority rejected this argument and held that there was a limit to ratification when the company was insolvent, or near enough to it, for a special duty[29] to arise on directors to take creditor interests into account (which conversely meant that it was not enough for there to be a 'real risk of insolvency'[30] to trigger this *West Mercia* duty, as the two were inter-related). In an important dissent on the law but not the outcome of the case, Lady Arden thought that ratification was not based on the *West Mercia* rule creating a special duty to take account of creditor interests when a company was near

[24] *Traxiar Drilling Partners II Pte Ltd v Dvergsten, Dag Oivind* [2018] SGHC 14.

[25] *Dayco Products v Ong Cheng Aik* [2004] SGHC 192, at [14]. Shareholder primacy does not mean shareholder decision-making.

[26] This was recognised in *ClientEarth v Shell Plc* [2023] EWHC 1897, at [95]-[98].

[27] [2022] UKSC 25.

[28] Ibid., [26], Lord Reed.

[29] Based on the case of *West Mercia Safetywear Ltd (in liq) v Dodd* [1988] BCLC 250.

[30] This 'real risk of insolvency' argument failed at first instance [2016] EWHC 1686, [479], the Court of Appeal [2019] EWCA Civ 112, [191] and the Supreme Court [2022] UKSC 25, [199], [247].

insolvency but on the doctrine of capital maintenance, which also appeared to be the position in Singapore.[31] She pointed out that s 239(7) UK Companies Act 2006 recognised that some breaches of duty remained unratifiable by shareholders, even if independent, or if done unanimously. Put differently, it did not matter what the quality of shareholder ratification[32] was in these cases of unlawful capital return, as, according to Lady Arden, shareholder primacy did not mean that the shareholders owned the company from a proprietary angle. She said:

> It is inherent in shareholder primacy that other interests such as those of creditors will necessarily diminish the interests of shareholders. They are only ever residual claimants.[33]

Lynn Stout has pointed out that, from another viewpoint, it could be said that it is in fact the debt holders that are residual claimants on a company's cash flow who have given a call option to the shareholders.[34] While the rest of the Supreme Court also disavowed any proprietary interest of shareholders and creditors in the company's assets, they were amenable to seeing the financial interests of these constituents in those assets, and some form of co-sharing of economic interests in those assets by shareholders and creditors might not be inaccurate.[35] But much of this analysis is buttressed by capital maintenance rules which were needed to 'accelerate the point at which failing corporations must file for insolvency'.[36] Those rules did so by providing checkpoints at which the company's position had to be examined by the board (solvency statement) or shareholders (resolution) before certain transactions could be carried on. Capital maintenance rules have, however, now been pushed back for more than 40 years in many parts of the world, following the lead of US company law from around the early 20th century.[37]

Previously, Lady Arden, at the English Court of Appeal in *Chaston v SWP Group Plc*, revived another capital maintenance rule, one which prohibits a company from giving financial assistance to a purchaser of its shares.[38] She reversed what appeared to be a trend towards reducing the relevant test on whether the transaction was in the commercial interest of the company. Her decision made it clear that unless the regulators further amended the financial assistance rules, they continued to require directors to follow them faithfully. This clearly suggests that these rules on capital are

31 *Sequana*, at [312]; *Raffles Town Club Pte Ltd v Lim Eng Hock Peter* [2012] SGCA 62.

32 Cf. Payne (1999), who prefers the approach that asks whether the ratification was carried out by the correct decision maker in the best interest of the company.

33 *Sequana*, at [376].

34 Stout (2001), p 1192.

35 Armour and Whincop (2007), Part C (this could be sequential or joint).

36 Allen and Kraakman (2016), section 4.2.3.

37 Manning (1981), p 129, stating that stock purchases were important in allowing closely held corporations to repurchase the shares of deceased members (in order to pay death duties) to assist the other shareholders who could not afford to do so.

38 [2003] 1 BCLC 675, where, according to Arden LJ, at [38], 'it is clear…that the test is one of commercial substance and reality'.

not just about what directors believe to be the best interest of the company. There is something more, even if today the rules themselves have been statutorily weakened.

'Ford's Principles of Corporations Law'[39] has also observed that the financial assistance prohibition is a manifestation of the general rule that a company's resources should be used for proper corporate purposes, as well as for the company's benefit, and not to assist in the purchase of its shares. This doctrine helps mediate situations in which it is necessary to see through the corporate entity to the various constituents behind it, where there may be conflicting interests between them and where recourse to the company's best interest can be a refuge for those seeking to take unfair advantage of its entity status. In this article, an argument will be articulated that the proper purpose rule can serve as a proxy for sustainability. First, we will have to look more closely at *Sequana*, which will confirm that solely relying on the traditional best interest directorial duty may not work when the conflict of interest is not at board level. Instead, a different conflict exists between the constituencies interested in the outcome of the board's decision, there between shareholders and creditors. There are also situations regarding employees and the environment when it is difficult to say what is in the best interests of the company because even shareholder interests are not aligned. While a company is populated by different types of shareholders, directors' duties should be focused on the 'reasonable shareholder' of that particular company.

4 Balancing the Success of the Company for Shareholders and Creditor Protection: *BTI v Sequana*

Despite the UK relaxing capital maintenance rules as of around 1980, s 423 of the Insolvency Act 1986, which, in spite of where it is located, is a rule not dependent on bankruptcy, continues to set aside undervalued transactions made with the purpose of prejudicing persons with claims against the transferor. This was observed by Lord Neuberger in *Prest v Petrodel*[40] as a 'specified and limited' application of the principle that 'fraud unravels everything'. US fraudulent conveyance cases, in practice, identify a necessary purpose to defraud creditors only if this leaves the company 'insolvent or with unreasonably small capital'[41] as that puts assets beyond the reach of creditors.[42] Intent may otherwise be hard to prove, as this is rarely 'susceptible to direct proof'.[43] But that is not the case in the UK, where in *BTI v Sequana*

[39] Austin and Ramsay (2018), para. 24.670.

[40] *Prest v Petrodel Resources Limited* [2013] UKSC 34, at [83].

[41] Kahan (2003), p 147.

[42] Section 548(a)(1), US Bankruptcy Code; *Whyte ex rel. SemGroup Litig. Trust v. Ritchie SG Holdings, LLC*, 526 B.R. 556 (D. Del. 2014).

[43] This is illustrated in *re Kaiser*, 722 F.2d 1574 (2d Cir. 1983).

the judges continued to apply it without the need to prove insolvency,[44] and fraudulent conveyance rules may even be meant to protect *future* creditors.[45]

In *Sequana*, section 423 was used to set aside a lawful dividend paid by a company from distributable reserves to its holding company Sequana whilst having one material contingent liability. This was some ten years before the company, which was set up to meet the liability, became insolvent. However, the estimate of that liability, which involved costs arising from the clean-up of a polluted river, was too low and so the dividend payment was challenged as a conveyance intended to defraud creditors, including British American Tobacco, which was to be indemnified for the clean-up costs. The dividend was ultimately set aside by the court on the basis that it was given for no consideration (clearly a transaction at an undervalue) to Sequana to set off against debts owed by it to the company and to put those assets out of the reach of the company's creditors. Unfortunately, Sequana was also bankrupt and so the appeals which ultimately reached the Supreme Court, which heard the case in May 2021 but only rendered its judgment in October 2022, focused on whether the directors of the company, which had assigned its claims to BTI and had been sold by Sequana, had breached their duties to the company.

This was held not to be so at every level, as directors' duties, while owed to the company (to promote its success for the benefit of its members as a whole) under section 172(1), did not shift their focus to creditors under subsection (3) as insolvency was not likely, which meant 'probable'[46] or 'imminent',[47] when the dividend was paid. This was the view of the majority in the Supreme Court. Lady Arden, however, disagreed that this 'creditor duty' came about only through s 172(3), but believed that s 172(1) itself required directors, when considering the company's success, to also consider creditor interests alongside those specifically mentioned, which included employees and the environment. However, she agreed that the need to consider creditors had not arisen in this case and, along with the majority, also rejected a lesser 'real risk of insolvency' test which the appellant asked for.

To Lady Arden a company is polycentric,[48] as are its best interests, which Lord Reed[49] also agreed have been modified today. But although s 172(1) specifically mentions other constituencies to be considered by directors, such as employees (subsection (b)) and the environment (subsection (d)) and even fairness between shareholders (subsection (f)), it does appear that those interests come to the fore only in egregious circumstances. It seems to remain the case that the s 172(1) duty to

44 In *Sequana*, at [61], Lord Reed seemed to see s 423 as an insolvency rule, but none of the other judges did. Cf. Armour (2003a), section 3.1, stating that, in practice, it is difficult to show that the creditors have been prejudiced without showing the debtor's insolvency.

45 *Midland Bank v Wyatt* (1882) 18 Ch D 588, where the father transferred assets to children without intending to benefit them to protect the family business from long-term commercial risk, i.e., future creditors, discussed by Armour (2003a), section 3.45. For an Irish perspective, see *Doherty v Quigley* [2015] IECA 297. Defrauding creditors has to be a purpose and not the sole or dominant purpose of the transaction: *JSC BTA Bank v Ablyazov* [2018] EWCA Civ 1176.

46 *BTI 2014 LLC v Sequana* [2019] EWCA Civ 112 per Richards LJ, at [220].

47 *Sequana* per Lord Reed, at [86], Lord Briggs, at [186], Lord Hodge, at [243].

48 *Sequana*, at [303].

49 *Sequana*, at [12].

promote the success of the company finds it difficult to balance differing interests when it involves a going concern, even if Lady Arden saw a strong form of enlightened shareholder value in s 172(1). In any case, the majority believed that s 172(3) was needed to recognise and further develop the 'creditor duty'.[50] As Lord Reed said, creditors were expected to protect themselves contractually (although some are non-adjusting). Still, we must recognise that there is a shareholder/bondholder conflict in that the residual claimants will have an incentive to shift value to themselves from those ranking above them.[51] Usually, this takes the form of risky decision-making that may reduce the expected return of an investment but increases its volatility so that there is at least a chance of a payoff to the shareholders. Shareholders are willing to take the riskiest course of action when a company is not doing well, given that their claims to the few remaining assets rank last.[52]

While recognising just the interest of creditors does not give rise to an insoluble conflict, the reference, in particular, to *potential creditors*[53] in the context of fraudulent conveyances can dilute the focus of directors' duties. There is a strong argument that it is not the function of directors' duties to encourage companies to adopt socially desirable behaviours; this should be within the purview of upstream regulations, such as those protecting employees or the environment.[54] Easterbrook and Fischel, for example, pointed out that '[a] manager told to serve two masters … has been freed of both and is answerable to neither'.[55] We have seen how, in 1970, Friedman first argued that '[i]f businessmen do have a social responsibility other than making profits for stockholders, how are they to know what it is?',[56] at a time when the power of labour unions was at its apex and non-shareholder interests were prioritised by 'bureaucratic'[57] managers. The pendulum then swung too much in favour of shareholders, and so now it may be that to stave off the regulation, even advocated by Friedman, to control externalities, shareholders and businesses are claiming that

[50] Lady Arden in *Sequana*, at [344], was of the opinion that s 172(3) did not recognise an existing duty but exhorted courts to develop one.

[51] Jensen and Meckling (1976).

[52] This is one of the three agency problems identified as being the focus of corporate law across various jurisdictions by Kraakman et al. (2004).

[53] This was also said to be the case by Lord Templeman in *Winkworth v Edward Baron* [1986] 1 WLR 1512, at 1516, a decision criticised by Sealy (1988). See also Cunningham A (2021a), pp 12-104, discussing Irish fraudulent conveyance laws that are restricted to land transfers. In 2022, Ireland also adopted a statutory duty to consider the interests of creditors near insolvency: s 224A of Ireland's Companies Act 2014.

[54] Cf. McConvill and Joy (2003), who believe that directors' duties to the environment are a logical extension of such upstream regulations. It is arguable that the proper purpose rule comes closest to bridging private law and regulation, which Lord Leggatt JSC recently stated are quite distinct: *Philipp v Barclays Bank UK PLC* [2023] UKSC 25, [22].

[55] Easterbrook and Fischel (1991), p 38.

[56] Friedman (1982), p 133.

[57] Jensen and Murphy (1990) still saw this in management even though matters had improved since the 1970s.

they are socially responsible.[58] Bainbridge has suggested this as a plausible reason for the 2019 change in the US Business Roundtable's[59] Statement on the Purpose of the Corporation, signed by 181 CEOs, to embrace corporate purposes, although he believes that it is more greenwashing that is at play,[60] which seems to be rather a US fund phenomenon.[61] But it does show that the existing best interest duty has difficulties accommodating different goals amongst its constituents given the focus on shareholder value maximisation, which Bainbridge still advocates.[62]

5 Managing Different Interests Within a Class

The position is more subtle if conflicting interests are within the same constituency, particularly between shareholders. We know that in schemes of arrangement involving solvent or insolvent restructuring, differing interests today are not sufficient to require the formation of separate classes of shareholders and/or creditors to vote to approve the scheme. They must have different rights, and even then courts have sometimes favoured informed voting over separate class voting. To stave off challenges and obtain court sanction, any restructuring should also be done in a way that the arrangement is such that an intelligent and honest person, a member of the class concerned and acting in respect of their interest, might *reasonably* approve.[63] In small quasi-partnerships we have also seen that shareholder disputes are resolved through oppression actions involving majority shareholders buying out minorities whose 'legitimate expectations'[64] have been breached. But greater formal protection

58 Rhee (2023) argues that the case of *Dodge v Ford Motors Co* (1919) 204 Mich. 459 (where Ford was made to declare dividends to its shareholders in 1919) had not been influential until neoliberalism came to the fore in the 80s. This is consistent with the point made above that compares the 1973 WEF Davos statement (made when unions and purposes were strong) with the modern 2020 50th Anniversary statement (made against a background of shareholder primacy). This must mean that companies have managed to evolve, even given existing directors duties, which is consistent with the 'reasonable shareholder' story below. Compare Bainbridge's (2023) analysis of *Ford* and how, according to him, the Business Roundtable has only recently changed the focus in its statement from shareholder to stakeholder capitalism. The story could lie somewhere in between, as we have seen that capital maintenance rules in the US were weakened from the 1900s: Manning (1981).

59 Bainbridge (2023), para. 9.4., alongside other non-altruistic reasons.

60 Ibid., section 9.7.

61 Gibson et al. (2022).

62 Bainbridge (2023) may reflect the earlier acceptance in the US position of shareholder primacy. For the rest of the world, the WEF statements of 1973 and 2020 show the earlier stakeholder position and a more recent shareholder primacy one. Flannigan (2022) also argues that, unlike the accepted position in the Commonwealth where directors' duties are owed to the company, US academics saw directors as more accountable to shareholders from the 1930s without clear judicial support for this.

63 *Re National Bank* [1966] 1 WLR 819, at 829A-E, *Re Hellenic & General Trust Ltd* [1976] 1 WLR 123. In the US, liquidation and restructuring plans must be such that they will provide the hypothetical, reasonable and average investor with enough information to make an informed judgment of the plan: Cox & Hazen (2003), pp 1282. In Singapore, the court will only approve a scheme restructuring that has a reasonable prospect of working: *Re Aaquaverse Pte Ltd* [2023] SGHC 29.

64 Which themselves only arise through informal agreement: *O'Neill v Phillips* [1999] UKHL 24, recently again followed by the New Zealand Court of Appeal in *Birchfield v Birchfield Holdings Limited* [2021] NZCA 428, stating that the unfairness is about 'exclusion without a reasonable offer'.

was thought unnecessary in listed companies as the minority can sell out, with the focus being on disclosure of information on secondary markets. There should be no need for minorities to stay in a listed firm and ask for changes. But that is precisely what we are now witnessing in the ESG space. For example, some shareholders of Shell, led by ClientEarth, who bought a small holding in the company (27 shares) for this reason, tried to bring a derivative action to sue Shell's board to get it to adopt a more environmentally friendly strategy when the majority of shareholders had already approved the existing strategy at the AGM. Previous actions have only been aimed at the company itself, largely for negligence, some of which have succeeded in requiring changes in corporate behaviour.[65] The derivative action, the underlying causes of action of which were the s 172 and s 174 UK Companies Act 2006 duties to promote the success of the company and exercise reasonable care and skill respectively, failed on the threshold grounds that it might not have been brought in good faith, nor was it seen as *prima facie* aimed at promoting the success of the company.[66]

The issue with the recent Shell derivative litigation against its directors is that it is about the future, as the company is doing well given high share and oil prices, and many shareholders have different views of how things should be. There is also no present loss as such. Consequently, ClientEarth admits that this is really the first test case in respect of directors' duties and external ESG requirements. But there are indications from *Sequana* that it will not be easy to argue that the directors have failed to act in a way as to promote the success of the company even where it suffered clear damage (i.e., if the case had proceeded to trial after satisfying the procedural threshold for commencing a derivative action, which, in any case, failed as, on the face of it, ClientEarth could not show that Shell's directors had acted unreasonably). In *Sequana*, s 423 expressly prohibited payment of the dividend, which caused the company loss as it was unrecoverable. Yet, Lord Briggs, with whom Lord Kitchin agreed, stated:[67]

> It is, in passing, an irony of the present case that the May dividend has been found to have offended section 423 but no claim that it involved for that reason alone a breach of duty by the respondent directors has ever been pursued.

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[65] E.g., *Milieudefensie et al. v Royal Dutch Shell plc* ECLI:NL:RBDHA:2021:5337, where Shell was ordered to reduce its emissions by 45% by 2030: see Mayer (2022). This led to Shell dropping the 'Royal Dutch' prefix and moving to London, and the derivative action led by ClientEarth against its directors. See also Broccardo et al. (2022), arguing for voice over exit.

[66] *ClientEarth v Shell Plc* [2023] EWHC 1137 (Ch), [64] and [20] respectively. An additional argument, that Shell had a duty to comply with the Dutch order, failed, [20]-[24], but the proper purpose argument based on s 171 discussed below was not raised in this context. ClientEarth announced that it would appeal the decision, after the High Court declined to reconsider its decision on 24 July 2023: *ClientEarth v Shell Plc* [2023] EWHC 1897. In contrast, s 171 was the main cause of action on which the common law derivative action in *McGauhey and Davies v Universities Superannuation Scheme Ltd* [2002] EWHC 1233 was based. That also failed. However, the action there did not link the proper purpose rule to the interests of the reasonable shareholder, which is the premise of this article.

[67] *Sequana*, at [182]. Armour (2003b) believes that directors could be liable for negligence, at section 7.59-60 (although he also says that there may be a breach of terms of the constitution).

Instead, we have seen that an argument had to be framed that creditors' interests had come into the picture only because the company was near insolvency. This failed as the company became insolvent only 10 years later. Any projected insolvency is hard to demonstrate due to the interaction of the balance sheet and cash flow tests which still exist in many jurisdictions. As regards the 'balance sheet' test, the English Court of Appeal held, in *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc*,[68] that a company could not be said to be insolvent simply because its liabilities appeared to exceed its assets, partly due to the difficulties of taking contingent and prospective liabilities into account. In this case, a trustee of longer dated notes issued by a special purpose vehicle (whose Lehman-linked securitised assets had fallen in value during the Global Financial Crisis) was asked to declare a contractual event of default that mirrored the tests of insolvency in section 123 of the Insolvency Act 1986. This would result in the acceleration of the repayment of all the notes, without which the longer dated notes would bear the brunt of losses once payments could no longer be met out of those securitised assets (with those notes that matured earlier paid in full). It was held that there was no default as Eurosail continued to be able to meet its debt obligations. The insolvency provisions were meant to identify companies that could not pay their debts, and this would be so only if there were an incurable deficiency in their assets, where a 'point of no return' had been reached.[69] The Supreme Court rejected the need for the last point, but believed that the 'cash flow' test worked for the reasonably near future only.[70] A 'balance sheet' test was more sensible when looking forward, but the Court believed this was an imprecise test, which the party asserting that the company was insolvent had to prove. On the facts, given that the final redemption of the notes would only be in 2045, the Court felt it had to proceed with caution. Eurosail could pay its debts presently and the Court could not be sure that it would eventually be unable to do so until a time closer to 2045.

6 Future Shareholders

This shows that, even with discounted cash-flow valuations, the duty to promote the success of the company cannot cover occurrences or matters that are too far into the future, including environmental issues. But can the interests of future shareholders not be considered? In the UK at least, s 172(1)(f) UK Companies Act 2006 will then require the directors to have regard to the 'need to act fairly as between the members of the company'. If this includes future members, it will require directors to ensure

[68] *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2011] 1 WLR 2524 (CA). Cf. Walton (2013), pointing out that the meaning in s 123 went beyond winding up and affected other ancillary areas.

[69] *BNY Corporate Trustee* [2013] UKSC 28, at [52] (Lord Neuberger MR), and [114] (Toulson LJ), referring to Goode (2011), para. 4-06.

[70] Ibid., at [37], [42] (Lord Walker).

the company's long-term viability[71] and may counteract the short-termism that may seep into their thinking.[72] At the same time, it addresses the problem that the best interest duty does not adequately deal with differing interests amongst its various constituencies, as it focuses on just one constituency, albeit then including future shareholders.

There are Commonwealth cases, such as *Provident Corp v International Leasing Corp Ltd*,[73] in which the courts seemed to have recognised that directors owe duties to both present and future shareholders. 'Ford's Corporations Law',[74] however, explains this decision on the same basis as that on which interests of employees are taken into account, i.e., that directors may have regard to future interests when deciding to act in the company's interest but there is no separate duty to speak of.[75] It is no different from the balancing of the interests of shareholders and creditors with which we are still struggling when we look at the best interest duty where the conflict is still resolved in favour of shareholder primacy. As Bainbridge notes:

> Merely allowing directors to consider stakeholder interests thus guarantees nothing, because management can – and likely will – exercise its discretion to favour shareholders in true zero-sum settings. After all, the idea that the same managers who have driven private sector unionism virtually to the point of extinction will suddenly become workers' protectors is risible, at best.[76]

Put differently, a future shareholder is just another stakeholder. Directors' duties are still concentrated on present shareholders given 'cognitive biases'[77] and so they need to be crafted accordingly. In *Sequana*, Lord Briggs discerned the general need for some director impartiality as follows:[78]

> There is nothing inconsistent with the fiduciary nature of the directors' duty that it calls for a balancing of potentially competing interests. Much of the development of fiduciary duty arose in connection with family settlements, where trustees charged with investment powers faced the constant challenge

[71] This can also indirectly accommodate environmental concerns: McConvill and Joy (2003), p 130, who in fact propose a new statutory duty for directors to ensure that the 'corporation interacts with the environment in a sustainable manner'.

[72] It is not always clear what this means: Roe (2022). Compare EY (2020), section 3.1.1.1 (Indicators to assess short-termism).

[73] [1969] 1 NSWR 424.

[74] Austin and Ramsay (2018), para. 8.095.

[75] See Schwarcz (2005), dismissing various Commonwealth claims of duties to future shareholders. US cases to the same effect include, e.g., *A P Smith Manufacturing Co v Barlow* (1953) 98 A 2d 581: see Bainbridge (2023), ch. 2.5. In chapter 3, he points out the syllogistic mistake some managers make, which is that while you can take these other interests into account, you cannot then say that you only take these interests into account, which was the mistake made by Henry Ford in *Dodge v Ford*.

[76] Bainbridge (2023), p 18.

[77] Lifshitz et al. (2023).

[78] *Sequana*, at [177]. In Singapore, it was stated that fiduciaries needed to have 'even-handedness': *Ng Eng Ghee v Mamata Kapildev Dave* [2009] 3 SLR(R) 109, at 124 (CA). In the UK, the duty to promote the company's success is buttressed by the need to consider fairness to shareholders, under s 172(1)(f) Companies Act 2006.

> of balancing the interests of life tenants and remaindermen, the former being interested in maximising income, and the latter in preserving and enhancing capital.

Lord Reed was also of the opinion that the content of the duty to promote the company's success here is to have a fair balance between shareholders and creditors.[79] It is not unlike a trustee's duty of impartiality to balance the interests of those beneficiaries that are interested in income generated by the assets of the trust and those interested in the final distribution of those assets.[80] However, it would appear in any event that the duty of impartiality still focuses mainly on existing beneficiaries, although there is some flexibility, particularly in the case of family trusts, in considering the claims of future beneficiaries that are as yet unborn.[81] But directors are not trustees, and we have seen that shareholder primacy has some path dependence attached to it.[82] It needs to be modified so that directors are more comfortable adopting these balancing exercises when they make decisions which divide their shareholders, who, even if dominated by institutional shareholders that are more centrist in ideology than the general voter,[83] will be found on the left and right of the political spectrum. Is impartiality better captured by a directorial duty to exercise powers for proper purposes in that directors have to act in accordance with the corporate constitution and also fairly between all shareholders and even other corporate constituents?

7 Proper Purposes

In *Eclairs*, in what Lord Sumption saw as a 'formidable dissent' in the Court of Appeal,[84] Briggs LJ saw a difference between the best interest duty and proper purposes, which the majority did not when it found that the board had acted properly in suspending the votes of two shareholders that it suspected wanted to take over the company, both of whom had failed to disclose that they might have been acting in concert:

> I consider it important that the court should uphold the proper purpose principle in relation to the exercise of fiduciary powers by directors, all the more so where the power is capable of affecting, or interfering with, the constitutional balance between shareholders and directors, and between particular groups of shareholders.[85]

[79] *Sequana*, at [81].

[80] *Howe v Earl of Dartmouth* [1802] 7 Ves Jun 137, 32 ER 56.

[81] Hayton (2001), p 103. This is the case even if there are no beneficiaries to hold the trustees to account for the time being: Duckworth (2001), p 16.

[82] EY (2020), p vi.

[83] Bolton et al. (2020).

[84] *Eclairs*, *supra* n. 20, at [29].

[85] [2014] EWCA Civ 640, [122].

While Rachel Leow has said that for subordinate agents like directors, the best interest of the company encompasses the duty to act for proper purposes,[86] it will be argued in this article that the two should be allowed to develop more independently, as is the case with organs of the company, or the entity itself.[87] For one, many Commonwealth companies' laws have them as separate duties, see e.g., s 171 and 172 of the UK Companies Act. It may be that a breach of the proper purpose duty should not be ratifiable, particularly if it is linked to capital maintenance, although it is presently thought that such a breach is ratifiable, as is the case with breaches of the best interest duty. We have seen that in *Sequana*, it was thought that the latter was unratifiable by shareholders if the company was insolvent (majority) or if it involved an unlawful capital return (Lady Arden). That may have been because the directors crossed the line into improper use of power.

Maintaining a fair balance could be the additional understanding illuminating s 171(b), which states that directors have to 'only exercise powers for the purposes for which they are conferred'. Boadle has pointed out that the proper purpose rule is flexible and different for trustees, directors and shareholders[88] and so it is still not fully stable. However, there is enough there to accommodate external codes given that it is about constitutionality (expressed in s 171(a),[89] stating that directors must 'act in accordance with the company's constitution'), fairness and faithfulness to the powers that are given to the power holder. And enforcing the duty is less about obtaining damages but more about seeing the power exercised properly. Thus, in *Eclairs*, for example, an action was successfully brought by the shareholders to enjoin the company from suspending their votes in a general meeting, as the board had done so not to compel disclosure for which the relevant power was intended to but to improperly prevent a hostile takeover.[90] That is really what ClientEarth wants of the Shell directors. Although framed as a derivative action, it has, in substance, more the nature of a class action brought against the company by a group of similarly interested shareholders than a corporate claim by the company against its directors, and was accordingly seen as inappropriate and not brought in good faith.[91]

86 Leow (2022), pp 72-81. In *Sequana,* Lord Hodge was of the opinion that s 171(b) had to be read in light of s 172(1) of the UK Companies Act 2006.

87 Cf. Murray and Langford (2021), stating that the director's duty to act in a corporation's best interest and to act for proper purposes may be the same for incorporated charities.

88 Boadle (2016), p 541, states that 'what is improper for a director exercising a fiduciary power is very different from what is improper for a shareholder exercising a non-fiduciary power'. For trustee powers, *Grand View PTC v Wong* [2022] UKPC 47, at [63], approved the use of extrinsic materials like letters of wishes in determining the purpose of the power.

89 While there are suggestions that purposes be included in the corporate constitution: Langford (2020). Davies (2023) has pointed out that it will end up as with previous wide objects clauses used to circumvent the *ultra vires* rule, or the failure of French voluntary codes. This is illustrated in recent amendments to Article 1835 of the French Civil Code which merely '*allows*' rather than mandates a corporation to specify its '*raison d'être*' in its articles of association. Bainbridge (2023), para. 4.8., says that the constituency statutes of the 30-odd US states that have adopted them are permissive and not mandatory.

90 The other thing to note was that the shareholders could bring the actions personally and not derivatively through the company.

91 *ClientEarth v Shell Plc* [2023] EWHC 1137 (Ch), [64]; *ClientEarth v Shell Plc* [2023] EWHC 1897, [92]. In a sense, courts may also see this kind of derivative action and securities class action litigation as being wrongly brought in each other's place: Booth (2009).

What also helps the use of the proper purpose rule is that the duty on directors to act properly is arguably directly owed to shareholders[92] when the decision does not regard the company's external relations but involves the internal structure of the company and the constitutional balance of power, such as its legal capital. The need for directors to exercise their powers for proper purposes has to be extended to some of a company's external activities.

Schwarcz, who brings a US perspective to the issue of temporal conflicts caused by mandatory corporate disclosure, however, sees the proper purpose rule in company law as balancing the interests between present investors, and not one between such investors and potential bidders or future shareholders, as was pointed out to him by some Commonwealth academics.[93] It is therefore unlikely that the proper purpose rule in its present form or the focus on the interests of long-term investors can be seen, by themselves, to directly involve or resolve a temporal conflict. But the rule does recognise that there are different interests within the constituency of shareholders that fall within the conception of a company which directors have to bear in mind in making their decisions, even if shareholder primacy remains the goal. In contrast, company law has traditionally assumed that shareholders have similar interests, compared to the adverse interests of trust beneficiaries.[94] Below, an argument will be made for the proper purpose rule to focus on the interests of reasonable shareholders, particularly given the present disclosure rules applicable to listed entities which, while they contain elements preserving fairness between existing shareholders (particularly insiders versus outsiders), are equally intended to protect future shareholders indirectly through a 'reasonable investor' test. This creates a variation of the single owner test of sorts and reduces any conflict.[95]

8 Reasonable Shareholders

Hu has highlighted the intergenerational problems involved in the context of US periodic disclosure:[96]

> The timing and nature of such disclosures could help those who are shareholders at one point in time and hurt those who are shareholders at another. To the extent that securities laws allow some discretion in the timing of disclosures, managers have a basic fiduciary problem in terms of which 'generation' of shareholders to favour.

[92] See Birds et al. (2019), p 568. *Sequana*, at [234], suggests that a breach of proper purposes can be ratified by shareholders, which is consistent with cases like *Bamford v Bamford* [1968] 3 WLR 317 (UKCA).

[93] Schwarcz (2005), p 1067, brings a US perspective to Commonwealth cases like *Howard Smith v Ampol Petroleum* (1974) AC 821, *Teck Corp v Millar* (1972) 33 DLR (3d) 288, and *Hogg v Cramphorn Ltd* (1967) Ch 254.

[94] Sitkoff (2004), pp 650-2.

[95] Farnsworth (2007), ch. 4.

[96] Hu (1991), p 1300, points out that the problem really exists because financial innovation and trading turnover have dramatically increased over the previous generation (pp 1302-3).

Here, present and future shareholders clearly have different interests in that the former (who would otherwise have sold) prefer the disclosure of positive information that results in increases in the share price, and the latter (who would otherwise have bought) are very much dependent on the prompt disclosure of negative news. Existing shareholders may not even care that the company performs poorly, or that disclosure of such performance is made, so long as the trading price goes up and stays that way until they sell their shares.[97] It is partly for such reasons that Hu has argued against the strong-form conception of 'maximising shareholder value'.[98] The law deals with this by requiring continuous disclosure to reach a 'reasonable investor' standard. So, for example, Australia's s 674 of the Corporations Act 2001 states that the listed entity must disclose confidential information required of it by an exchange's listing rules if 'a reasonable person would expect the information, if it were generally available, to have a material effect on the price or value of ED securities of the entity'. In Singapore, s 203 of the Securities and Futures Act 2001 states that a listed entity must disclose what the listing rules require, and accompanying listing rules go on to state, at rule 203, that the entity can only not do so 'where a reasonable person would not expect the information to be disclosed'. The reasonable investor standard helps disclosure committees on boards decide what to disclose to the market and is both a requirement and a form of protection as they try to balance what different shareholders may want said at various times. In Singapore, the courts have held that the materiality threshold for s 203 is based on price sensitivity, and this is a more difficult test to satisfy than the trade-sensitivity test for insider trading.[99] The US SEC has also published a statement that they should focus on the reasonable investor when assessing materiality of financial disclosures.[100]

While the reasonable investor standard in prospectus disclosure is not about balancing the interests of shareholders, as their interests are aligned in an IPO, we have seen this standard itself evolve over time. In *Exeter Group Limited v ASC*,[101] there was found to be insufficient disclosure for there to be a public offering in Australia, a

[97] Although they may care that insiders could have sold their shares before the inevitable and eventual disclosure of the negative information – discrimination of existing shareholders to that extent can, however, be controlled by the existing proper purpose rule.

[98] Hu (1991), p 1284. However, he also believes that neither the focus on the entity itself, nor the recognition of 'blissful shareholder wealth maximisation' (which focuses on long-term shareholders) solves the conflict between present and future shareholders (pp 1287-88).

[99] *Madhavan Peter v PP* [2012] 4 SLR 613 (Chief Justice Chan). But Booth (2013) has argued that information that would cause a reasonable investor to trade would also be information that would convince a sufficient number of investors to do so, and this would naturally have an effect on the market price.

[100] SEC Statement, Assessing materiality: focusing on the reasonable investor when evaluating errors, 9 March 2022.

[101] [1998] 16 ACLC 1,382. It is unlikely that the common law imposed a duty to disclose; although some cases supported the position that if anything is said it cannot be misleading: *New Brunswick and Canada Railway and Land Co v Muggeridge* (1860) 1 DR & SM 363. There have also been judicial statements that refer to the duty of 'utmost candour and honesty' on the part of promoters who invite members of the public to invest in a company: *Central Railway of Venezuela v Kisch* (1867) LR 2 HL 99, at 113, per Lord Chelmsford. This could be seen as the 'golden rule' that did not create a firm foothold: see Anon (1932).

country on which Singapore modelled its 'reasonable investor' prospectus disclosure standard as from 1999. It was not enough for there to be full disclosure regarding the absence of any detailed plans on the part of the management of an investment fund which sought to raise funds from the public (in AUD 2000 tranches) as to the types of companies it would invest in. There was nothing misleading in, or omitted from, the prospectus. Despite this, the Australian Securities Commission refused registration on the basis that a higher, not lower, standard of disclosure applied where a prospectus was targeted at small or retail investors.[102] Today, however, Special Acquisition Purpose Vehicles (SPACs) are structured in precisely that way, taking the form of funds raising money from public investors in order to invest in target companies that have not yet been identified (but will be within 2 to 3 years).[103] Industry norms, relevance and reliability guide the courts in determining what a reasonable investor expects to be disclosed, and this changes over time.[104] In the slightly different context of whether a bank could reasonably rely on the appearance of authority on the part of an agent of a customer providing instructions with respect to the customer's bank account, Lord Leggatt, in the recent UK Supreme Court decision in *Philipp v Barclays Bank Plc*,[105] said:

> The standard of reasonableness provides the necessary flexibility to adapt the principle to different types of commercial transaction and accommodate practices and expectations particular to a field of commerce.

While this was also not about directors' duties but about shareholder obligations in the context of alteration of articles, there might be something instructive in how things played out there. A test which only said that shareholders had to vote in what they considered was the best interest of the company was always insufficient in cases where the constitutional balance of the company was affected by the vote (as opposed to the company's external relations). In *Gambotto v WCP Limited*,[106] the Australian High Court decided on a proper purpose test where the vote resulted in some form of expropriation of membership rights. While that case has not been followed, not even in Australia, it may have led courts to re-examine this best interest test more generally (at least outside expropriation, which may involve property rights and not just different interests). In *Citco Banking v Prusser*, the Privy Council said that the shareholders had to vote to alter the corporate constitution in a way that the 'reasonable shareholder' would see was for the company's benefit.[107] It stated:

[102] The court rejected the argument that disclosure only had to satisfy the more sophisticated investors and that retail investors could rely on them. See also Lin (2015), arguing that the problem in financial regulation has been to only consider a particular kind of reasonable investor, the perfectly reasonable one, and not the actual diverse body of investors.

[103] Varottil (2023); Wan (2023).

[104] *Pancontinental Mining v Goldfields Ltd* (1995) 16 ACSR 463 (profit forecasts).

[105] [2023] UKSC 25, at [94].

[106] (1995) 182 CLR 432. Austin and Ramsay (2018), at para. 11.070, discussing the limits on the application of *Gambotto*, at [11.110]. *Cf Re Southern Cross Airlines Holdings Ltd* [2000] 2 Qd R 216.

[107] *Citco Banking Corp NV v Pusser's Ltd* [2007] UKPC 13 (also holding that the burden of proof rested on the person seeking to challenge the validity of an amendment). See now *Arbuthnott v Bonnyman* [2015] EWCA Civ 536, at [90]-[97].

> [P]rovided there are grounds on which reasonable men could come to the same decision, it does not matter whether the Court would or would not come to the same decision or a different decision.

And we saw earlier that non-insolvent restructurings had to be approved by shareholders in a way reasonably done by an honest and intelligent person.[108] Where directors are concerned, their duty to balance different shareholder interests directs them to ask what the reasonable shareholder would want. This removes any dilemma directors may have in pursuing what may be contradictory action, for example, in satisfying majority versus minority shareholders. While that is needed most when it comes to the internal constitutional balance of power, such as in a rights issue, ESG matters straddle the external relations of the company with very different shareholder views about their importance.

There is the advantage of keeping the focus of directors' duty on an identifiable constituency, viz. shareholders, but recognising that the law already requires the interests of future constituents to be borne in mind by using a reasonable shareholder standard. While this stretches our current conception of the company, and the proper purpose rule, it does close the loop on directors' duties, where the best interest duty or the duty to promote the success of the company is too bound to stronger notions of shareholder-as-owner primacy without seeing the different interests that shareholders have in some situations. Just as the existing proper purpose rule surfaces in share issues and takeovers, where the internal balance of power is affected, an extended rule that incorporates the interests of reasonable shareholders could be recognised in situations of disclosure and perhaps ESG requirements. Indeed, many ESG issues today are dealt with by continuous disclosure rather than harder sanctions.

If this evolves with directors' duties, then reasonable directors have to do what they believe reasonable shareholders want when they act in the company's best interest, which can accommodate external constraints. This may be more realistic than expecting actual shareholders themselves to change, which is the main thrust of many of the corporate purpose arguments today.[109] Ernest Lim has said that the best interest duty has worked well in Singapore as Temasek, the state investment fund, is concerned with long-term sustainability. He contrasts this with the position in Hong Kong, where that duty on directors has not worked as well due to the proliferation of long/short hedge funds. Activist hedge funds can improve internal corporate governance, although they may force a company to drop external ESG requirements if it damages profits.[110] A further argument Lim makes is that institutional shareholders should then be fiduciaries, as should controlling shareholders,[111] who may also

[108] See also *Re Dee Valley Group plc* [2017] EWHC 184 (Ch) – share splitting to block scheme of arrangement (by making it harder to get the required majority in number) failed as the vote was not for the benefit of the class.

[109] E.g., Lim (2020). Davies (2023) also suggests that shareholders need to change their goals.

[110] Bainbridge (2023), para. 10.8.

[111] Lim (2019).

otherwise oppose any ESG requirements.[112] Expecting shareholders to change their goals, as Paul L. Davies also advocates,[113] may not be realistic in the short term without that further step. Evidently, that is the aspiration, and we should continue to pressure them with stewardship codes and the like. And it may be that promoting ESG will eventually be consonant with share performance. But the jury is still out on this,[114] and in the meantime directors need to be able to act without too many masters, and to be judged accordingly.

There are leading advocates for sustainability, like Davies, who believe that existing director duties suffice, and the judges in *Sequana* were of the opinion that there was also enough in the various provisions of the UK Companies Act 2006 to deal with constituency conflicts. However, it has been pointed out that even with the duty to consider creditors in insolvency under s 172(3), the Supreme Court did not provide enough guidance on the content of that duty which may call for slightly contradictory action.[115] Certainly, where the UK is concerned, the s 172(1) duty to promote the success of the company has to have regard to fairness between the shareholders. This may be true, but as we saw with how private law developed with shareholder duties when voting to alter the corporate constitution, the best interest duty could do with a nudge from the proper purpose rule as that could then lead to a focus on the interest of the reasonable shareholder. That allows us to accept that shareholders have differing interests but start pushing company directors, as ClientEarth hopes, towards adopting sustainable strategies by requiring them to do what a reasonable shareholder of the company would expect. With disclosure, however, we have seen that reasonableness is both a standard and a constraint, and it may be that at the moment Shell directors are acting properly. Reasonableness works both ways. But a reasonable shareholder in an ESG fund would certainly expect it, as an investor company,[116] to do more than what investee companies are generally required to do since there is clearly less path dependence in rebalancing the portfolio of its current assets.[117] Investors, in turn, can pressure an investee company like Shell, as some ESG funds that are with ClientEarth are doing, but the law must provide a way for directors to balance this against the interests of other shareholders. Companies and shareholders are not monoliths and the danger with an overly strong entity approach (as with shareholder primacy at the other extreme[118]) is that we do not see their diversity. There are conflicts given the type of company involved, the

[112] Gözlügöl (2021).

[113] Davies (2023).

[114] Bainbridge (2023), ch. 8.

[115] Watts (2023).

[116] Which is likely to be part of the 'complex, opaque chains of intermediation that characterise the western banking system' (The Guardian, 24 August 2022).

[117] Gadinis and Miazad (2020), pp 1451-52, estimated that by 2018, ESG funds controlled about 25% of total assets under management worldwide. BlackRock, with its ESG funds today, started out as a hedge fund in 1984, which shows the multiverse nature of investors. The same argument holds with trustees of investment funds where some beneficiaries may favour ESG while others may not, such as those that have sued their investment fiduciaries for their fossil fuel divestment strategies as in, e.g., *Wong v NYCERS, et al.*, Index No 652297/2023 (NY Sup Ct Filed May 11, 2023).

[118] Hill (2020) states that it should be balanced between public and private dimensions.

interests of the shareholder, and the decision that is under consideration.[119] And corporate purposes work better where there is less competition.[120]

9 Conclusion

Traditional directors' duties of care[121] and loyalty have been around for a long time and they have struggled to cope with external requirements[122] imposed on a company (that may well be liable in negligence for non-compliance with ESG requirements that impose a cost on the company for breach) given that those duties are owed by directors to the company (providing them with some shield from being sued by third parties) and, by extension, the undifferentiated shareholders as a whole (when those external requirements are viewed differently by them). The situation is even more difficult, as borne out in the failed derivative action against Shell's directors, if any cost to the company comes not with breach but with compliance, especially with voluntary requirements. In the US, the duty of good faith has ebbed and flowed, although it has helped with oversight liability and may require ESG compliance as not complying is seen as disloyalty on the part of directors. However, Andrew Gold goes on to ask 'if the Delaware courts haven't stretched fiduciary loyalty concepts to the breaking point, even in corporate contexts where charters are a component of the parties' relation.'[123]

Hill and Conaglen argue that only the US takes a more stringent 'entire fairness'[124] approach towards the duty of loyalty, but as we saw with s 172(1)(f) of the UK Companies Act 2006, ESG issues are less about fairness between shareholders and their rights and more about balancing their different interests. While there is an argument that we should identify quality investors and provide them with more votes,[125] as the EU considered in the case of long-term shareholders,[126] this is an approach that requires identification of actual shareholders in that category. The test proposed here, which has drawn from the experience in restructuring, disclosure and alteration of articles, is that courts can ask if directors have acted properly and in the

[119] This is even more so for benefit corporations, regarding which Bainbridge (2023), para. 6.2, states that 'the widespread availability of PBCs as an alternative to the traditional business corporation could alleviate growing pressure on the latter to pursue ESG'.

[120] Roe (2021). See also Pursiainen et al. (2023).

[121] In *Sequana*, Lord Hodge, at [243], disagreed with Lady Arden that the duty of care in s 174 would stop a company from taking a risky decision when doing badly, as it would benefit present and future shareholders and even creditors, although losses would only be borne by the latter. Such actions would still be consistent with s 172(1) without the special duty in subsection (3). Lord Reed, at [74], observed that the duty of care, unlike in the US, is not a fiduciary duty. See also EY (2020), at para. 5.7.1: 'If EU were not to act, current enforcement levels of directors' duty of care in Member States can be expected to remain low, in line with the existing trend'.

[122] EY (2020), at para. 5.1 'Director's duties and company's interest are interpreted narrowly and tend to favour the short-term maximisation of shareholder value'.

[123] Gold (2020), p 72, asks if this has not distorted the meaning of disloyalty.

[124] Hill and Conaglen (2018), p 308.

[125] Cunningham LA (2021b).

[126] But the Shareholder Rights Directive (Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies) was not amended in this regard by Directive 2017/828.

best interest of the hypothetical reasonable shareholder, who is the best embodiment of the company when shareholders as a class have too many varied interests within that class. This requires impartiality and is linked to industry norms. The company can then be the intergenerational machine envisaged by Lynn Stout[127] and one that itself can evolve with the times.

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