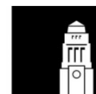

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BOARD ACCOUNTABILITY AND THE ENTITY MAXIMIZATION AND SUSTAINABILITY APPROACH

Andrew Keay

I. Introduction

Undoubtedly the accountability of boards is regarded as a critical issue in corporate governance. The OECD has stated that '[t]he corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.'[1] In the report of the Cadbury Committee on the Financial Aspects of Corporate Governance[2] (commonly referred to as 'the Cadbury Report'), delivered in 1992, the central issue for corporate governance was said to be: how to strengthen the accountability of boards of directors to shareholders.[3] It has been said that good corporate governance is able to be best achieved by holding directors accountable for their behaviour and decisions.[4] It has been argued that accountability of directors is at the heart of corporate governance[5] and a cornerstone of good corporate governance.[6] Good corporate governance is able to be best achieved by focusing on the accountability of directors, and it can be argued that accountability of directors is the basis for the success of all other principles of corporate governance.[7]

The issue of accountability has been raised as a major issue at very important points of time over the years and particularly following scandals like Enron and Worldcom in the early days of this century. Certainly the Cadbury Committee was established shortly after scandals involving UK companies, such as Polly Peck and Maxwell Communications. According to the Cadbury Report its purpose was 'to review those aspects of corporate governance specifically related to financial reporting and accountability.'[8] It also stated that while boards have to be free to take their companies forward, in doing so they must operate within a framework of effective accountability, and this is the essence of any system of good corporate governance.[9] One of the leading problems in corporate governance is the fact that

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[1] Organisation for Economic Co-Operation and Development, 'OECD Principles of Corporate Governance' (2004), available at http://www.oecd.org/dataoecd/32/18/31557724.pdf, at 24.
[2] Cadbury Committee on the Financial Aspects of Corporate Governance, Report of the Committee on the Financial Aspects of Corporate Governance (London: Gee, 1992).
[3] Ibid., at para. 6.1.
[4] J. Solomon and A. Solomon, Corporate Governance and Accountability (Chichester: John Wiley & Sons, 2004), p. 14; E. Makuta, 'Towards Good Corporate Governance in State-Owned Industries: The Accountability of Directors' (2009) 3 Malawi Law Journal 55 at 56.
[5] A. Belcher, *Directors' Decisions and the Law* (Abingdon: Routledge, 2014), p. 183.
[6] A. Young, 'Frameworks in Regulating Company Directors: Rethinking the Philosophical Foundations to Enhance Accountability' (2009) 30 Company Lawyer 355 at 356.
[7] Makuta, above n 4. While the commentator was writing about the corporate governance of State Owned Enterprises, it is argued that the comment is as applicable to the normal commercial public company.
[8] Cadbury Report, above n 2 at para. 1.2. However, the Report's definition of 'corporate governance' did not include an express reference to 'accountability' (para. 2.5).
[9] Ibid., at para. 1.1.

what accountability involves and how it is worked out in practice has not been identified and thought through properly.

The fact that the accountability of boards is essential to corporate governance means that the nature of corporate governance is an important matter. There are various theories of corporate governance and these are tied to theories devised to identify and articulate what is to be the objective of a company. A recent approach that does this is the entity maximization and sustainability theory ('EMS'). This holds essentially that the directors are to endeavour to maximize the wealth of the corporate entity by increasing the overall long-run market value of the company as a whole and at the same time to ensure that the life of the company is sustained, that is, it survives. It provides an alternative to other theories such as the shareholder value and stakeholder theories. The chapter focuses on EMS in relation to board accountability, and because of space limitations its aim is to explore perhaps the primary issue as far as board accountability is concerned:[10] to whom is the board accountable?

The chapter develops in the following way. First, there is a brief explanation of what board accountability involves. Next there is a short discussion of the essence of the EMS theory. In the third, and main part of the chapter, there is an examination of the question to whom the board should be accountable in an EMS framework. Finally, there are some concluding remarks.

II. Board Accountability[11]

As noted at the beginning of this chapter, accountability has been mentioned frequently in the corporate governance literature and relied on as a critical factor in corporate governance. It has also been used in definitions of corporate governance. Nevertheless, there have been few attempts to explain what it actually means, certainly in the context of corporate governance. This is not the case in other areas of law and society, such as in public administration, politics and even administrative law, where there have been several helpful contributions.[12] A recent study[13] has argued that accountability in relation to boards is concerned with a number of elements and is a process that involves several stages. These stages must be preceded by boards

[10] This is the same for accountability in any areas of society: J. Lerner and P. Tetlock, 'Accounting for the Effects of Accountability' (1999) 125 Psychology Bulletin 255 at 259.
[11] For a detailed discussion of the issue, see A. Keay, Board Accountability in Corporate Governance (Abingdon: Routledge, 2015).
[12] For instance, see A. Sinclair, 'The Chameleon of Accountability: Forms and Discourses' (1995) 20 Accounting, Organizations and Society 219; R. Mulgan, '"Accountability": An Ever Expanding Concept?' (2000) 78 Public Administration 555; M. Dubnick, 'Accountability and Ethics: Reconsidering the Relationships' (2005) 6 International Journal of Organization Theory and Behavior 405; J. Koppell, 'Pathologies of Accountability: ICANN and the Challenge of "Multiple Accountabilities Disorder"' (2005) 65 Public Administration Review 94; M. Bovens 'Two Concepts of Accountability' (2010) 33 West European Politics 946; M. Dubnick and K. Yang, 'The Pursuit of Accountability: Promise, Problems and Prospects' (2010), available at: http://chapters.ssrn.com/abstract=1548922, at 3.
[13] A. Keay and J. Loughrey, 'The Framework for Board Accountability in Corporate Governance' (2015) 35 Legal Studies 252.

accepting responsibility for what they do and the need to be answerable.[14] Unless boards realize and acknowledge that accountability constitutes an essential part of corporate governance then there cannot be worthwhile and effective accountability. Boards could always take action to stymie many of the accountability mechanisms that are in place if they wished to do so. This element does not, of itself, require any action, necessarily, but involves a mindset that should exist within a board.

It has been argued that there are four stages to accountability.[15]

- The first stage entails the board providing accurate information concerning its decisions and actions, so that the ones to whom the account is being given are informed as to what has been done. This part constitutes disclosing and reporting, and certainly candid reporting is an essential element of it.[16] Inter alia, this addresses the problem of information asymmetry.
- The second stage involves a board explaining and justifying its actions, omissions, risks, and dependencies for which it is responsible.[17] Often this is seen as the primary aspect of accountability and is the stage that is focused on in much of the accountability literature. It has been referred to as constituting explanatory accountability[18] and it includes the notion of being answerable, a key element of accountability.[19] This explanatory stage, together with the disclosure stage, produce transparency, as they lay bare what has occurred; it provides truthful information about the board's actions. The element of justification provides a check on the decision-making of the board, and acts in such a way as to move the balance between director accountability and director power somewhat towards the former.
- The third stage is constituted by the questioning and evaluating of the reasons provided by the board for what it has done. This allows for analysis of the actions of boards.
- Fourth, the final stage is that there is the possibility, but not the requirement, of the imposition of consequences. This might simply constitute feedback and may not necessarily entail negative consequences being imposed, but on many occasions it is likely that it will.[20]

[14] Canadian Democracy and Corporate Accountability Commission, 'Canadian Democracy and Corporate Accountability: An Overview of Issues' (2001) at iii.
[15] Keay and Loughrey, above n 13.
[16] A. Licht 'Accountability and Corporate Governance' (2002), available at http://ssrn.com/abstract=328401, at 29.
[17] AccountAbility, 'AA1000 Framework Standards for Social and Ethical Accounting, Auditing and Reporting' (1999), available at http://www.accountability.org/images/content/0/7/076/AA1000%20Overview.pdf, at 8
[18] J. Uhr, 'Redesigning Accountability: From Muddles to Maps' (1993) 65 Australian Quarterly 1 at 4.
[19] A. Quinn and B. Schlenker, 'Can Accountability Produce Independence? Goals as Determinants of the Impact of Accountability on Conformity' (2002) 28 Personality and Social Psychology Bulletin 472 at 472; Mulgan, above n 12 at 569.
[20] This could involve censure or, in the most extreme case, removal of directors.

III. Entity Maximization and Sustainability Theory (EMS)[21]

Jonathan Macey has said, in relation to the two leading governance theories, that no company can sustain the abstract goal of shareholder wealth maximization or the broad stakeholder model.[22] Thus, EMS was constructed to offer another alternative when addressing the issue of the ultimate objective of the company, and the basis for corporate governance development. It has two elements to it. First, putting it simply, there is a commitment to maximize the wealth of the entity. Management should seek to develop the total wealth-creating potential of the enterprise that they oversee.[23] The second part is to sustain the company as a going concern, that is, to ensure its survival;[24] it will remain as a going concern.

A critical aspect of the model is that there is a focus on the company as an entity or enterprise, that is, 'an institution in its own right.'[25] The model assumes that the company has interests that are independent of any stakeholder, including shareholders, or group of stakeholders who affect the company or are affected by it. This model is company focused, and while the company owes something to each of its investors, it is owned by nobody[26] and it is not a composite of all of the individual products of each co-operating resource;[27] it is an end in itself, and it is not an instrument of anyone but a living and developing enterprise[28] that is autonomous[29] and has a life of its own. As Margaret Blair and Lynn Stout have said, once the shareholders have formed a company and selected a board, they have 'created a new and separate entity that takes on a life of its own and could, potentially, act against their interests.'[30] The theory means that the directors are not under the direct control of the shareholders or any other stakeholder group. This allows the directors to make decisions which are best for the entity and not any shareholder or stakeholder. So, in making any decisions the directors must ask: what will benefit the company? Under EMS the company is not run for the benefit of the shareholders or any other

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[21] For a full discussion of the theory, see A. Keay, The Corporate Objective (Cheltenham: Edward Elgar Publishing, 2011).

[22] L.A. Cunningham 'Convergence in Corporate Governance' (1999) 84 Cornell Law Review 1166 at 1172.

[23] See M. Blair, Ownership and Control (Washington, DC: The Brookings Institute, 1995), p. 239.

[24] The French Viènot Report in 1995 stated something that is similar: Viènot I Report, 'The Boards of Directors of Listed Companies in France' (1995) at 8, and referred to in E. Pichet, 'Enlightened Shareholder Value: Whose Interests Should be Served by the Supports of Corporate Governance' (2008), available at http://ssrn.com/abstract=1262879, at 16.

[25] W. Suojanen, 'Accounting Theory and the Large Corporation' (1954) 29 The Accounting Review 391 at 392.

[26] C. Handy, 'What is a Company for?' (1993) 1 Corporate Governance: An International Review 14 at 16.

[27] This was acknowledged as far back as 1972 and mentioned in the classic work on team production: A. Alchian and H. Demsetz, 'Production, Information Costs and Economic Organizations' (1972) 62 American Economic Review 777 at 781-783. It would be impossible to find a single way of aggregating the interests of all stakeholders over time: S. Marshall and I. Ramsay, 'Stakeholders and Directors' Duties: Law, Theory and Evidence' (2012) 35 University of New South Wales Law Journal 291.

[28] Handy, above n 26 at 17.

[29] This is the vision of the company in France : M. Viènot, 'Rapport sur le Conseil d'Administration des Societes Cotees' (1995) 8 Revue de Droit des Affaires Internationales 935 and referred to in A. Alcouffe and C. Alcouffe, 'Control and Executive Compensation in Large French Companies' (1997) 24 Journal of Law and Society 85 at 91.

[30] M. Blair and L. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 Virginia Law Review 247 at 277.

stakeholders, but for itself. This is akin to sole traders who own and run a business, and they do so for their own benefit. As with a sole trader's operations the company's operations will usually benefit others.

IV. To Whom is the Board Accountable in EMS?

As mentioned at the outset, one of the primary issues with board accountability is ascertaining to whom the board is accountable and it is on that point that the balance of the chapter focuses. In shareholder value theory the board is said to be accountable to the shareholders of the company and this involves the board being accountable for, inter alia, maximising shareholder wealth. A good instance of this approach was provided by the Cadbury Committee when it stated:

> 'Boards of directors are accountable to their shareholders and both have to play their part in making that accountability effective. Boards of directors need to do so through the quality of the information which they provide to shareholders, and the shareholders through their willingness to exercise their responsibilities as owners.'[31]

In another popular theory, stakeholder theory, the board is said to be accountable to all of the company's stakeholders. But, what this means is unclear. In EMS theory, the directors owe their duties to the company entity. Thus it could be argued that it follows the board is accountable to the company. But what does that actually mean? Can it mean that the board is accountable to the board acting as the company? Stephen Bainbridge, as part of his director primacy theory, seems to think so as he says that board members will monitor each other and, presumably, be accountable to each other.[32] Thus the board is accountable to itself. Bainbridge asserts that the board is a small, close-knit group that works together over a significant period of time and this permits them to see how each other behaves. He goes on to say that appropriate norms develop and the board members can monitor whether they are adhering to them.[33] The commentator sees the board as a Platonic guardian.[34] But, it is contended that it is not rational to say that the directors as a board are accountable to the board acting for the company. While the board would be accounting to the company in the larger scheme of things, in reality it is accounting to itself. There must be accountability to some persons or body that is independent of the board, as any accountee (the one accounted to) in the accountability process must be independent of the accountor (the one who does the accounting).[35] So, let's rule out the board being accountable to itself. Therefore, what are the options? There appear to be two clear ones.

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[31] Cadbury Report, above n 2 at paras. 3.2 -3.4.

[32] S. Bainbridge, The New Corporate Governance (New York: Oxford University Press, 2008), pp. 100-104.

[33] Ibid.

[34] S. Bainbridge, 'Director Primacy in Corporate Takeovers: Preliminary Reflections' (2002) 55 Stanford Law Review 791 at 795.

[35] See M. Elliott, 'Ombudsman, Tribunals, Inquiries: Re-Fashioning Accountability beyond the Courts' (2012), available at http://ssrn.com/abstract=2133879, at 2; Bovens, above n 12 at 957.

A. An Accounting Council

The first option is rather novel as far as Anglo-American companies are concerned. Such companies, unlike those in many countries, only have one board as part of their governance structure. One option is to introduce another board or body, to be known as 'the accountability council' ('the council') that acts on behalf of the company and is the body to which the board accounts. The council would bear some general similarity to the supervisory board that is used in two-tier board systems such as in Germany. In Germany the role of the supervisory board (Aufsichtsrat) is to monitor the management of the company and safeguard the company's interests.[36] The German Corporate Governance Code 2012 provides that the supervisory board is to 'advise regularly and supervise the management board in the management of the enterprise. It must be involved in decisions of fundamental importance to the enterprise.'[37] The council that is considered in this chapter would not have such a broad role or as extensive powers as the Aufsichtsrat for its only remit would be to act as the accountee to the board. In this respect it would be acting directly on behalf of the company.

Unlike in the German system where the Vorstand (the management board) is constituted solely by executive type directors, it is suggested that it would be preferable to retain the present constituency of the board in one-tier systems. That is, the board would continue to be comprised of both executive directors and non-executive directors. Monitoring would continue to be undertaken by the non-executive directors, and not, as in the German system, by a supervisory board. The retention of non-executives on the management board would mean that there would not be the same need for the council to monitor or be kept as informed as the supervisory board has to be in a two-tier system. However, the council would have to be empowered to seek information from the board and this is likely to mean that it is better informed and is able to posit more and better-informed questions of the board when compared to the general meeting under the present arrangements in Anglo-American corporate governance. It would be solely a review body. Of course, the council would not be prevented from acquiring information elsewhere than directly from the board and taking independent and external advice on what is presented to it. The members of the council would be subject to a duty to act in the best interests of the company. How this might work is set out below.

In corporate governance systems with dual boards the management board is generally accountable to the supervisory board[38] so the existing system could remain in companies with two-tier boards, to ensure accountability if EMS is practised;[39] the supervisory board would act as accountee (that is, the one to whom an account is given). This board does already act as accountee and usually has the power to dismiss

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[36] Stock Corporation Act 2010 (Aktiengesetz), s.111.

[37] German Corporate Governance Code 2012, available at http://www.ecgi.org/codes/documents/cg_code_germany_15may2012_en.pdf, at para. 5.1.1

[38] A. Belcher and T. Naruisch, 'The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures' (2005) Journal of Business Law 443 at 451; S. Goo and F. Hong, 'The Curious Model of Internal Monitoring Mechanisms of Listed Companies in China: The Sinonisation Process' (2011) 12 European Business Organizations Law Review 469 at 476.

[39] An exception is China as the board of directors is accountable to the shareholders and not the supervisory board. See Company Law 2005, art. 46.

the members of the board of directors.[40] Also, the supervisory board may bring company actions against the members of the board of directors, just as shareholders may, using derivative proceedings.[41] To whom is the supervisory board accountable? This is not stated in legislation or codes, but as this board is selected, in the German framework, by the shareholders and employees one might think that the board is accountable to these two stakeholder groups. These groups have the power to decline to re-elect board members.

If the proposal concerning the creation of the council were able to be implemented in relation to Anglo-American companies then the powers of the council would have to be established. It is not possible, given space limitations, to flesh out all of the powers that should be granted to the council, although I would not envisage there would be a huge number. Here are a few. First, it should be awarded the power to remove directors. Second, it should be required to make a report to the general meeting prior to meetings of that body, and especially before the AGM. Third, the council should be entitled to require at any time a report from the board on the affairs of the company. This should ensure the council has sufficient and detailed information to allow for questioning and evaluation of the board's explanations of what it has done or not done. Fourth, the council should be permitted to inspect and examine the books and records of the company, or appoint special experts to carry out such inspection and examination. Fifth, it should be able to call a shareholders' meeting whenever the interests of the company so require.

The council itself will also need to be accountable. It is probably appropriate that it is accountable to the general meeting. The problem with this is that it might be thought that the shareholders will take action according to their own interests and this would not appeal to other stakeholders of the company. Although it could be said that the shareholders might not be as influential in the proposed system as they would in the present system, it is still a matter of concern. More is to be said about this issue later, but suffice it to say that the shareholders should be under a duty to act in the best interests of the company when dealing with the accounting of the council.

The safeguard in this option for non-shareholders is that it has been proposed that in an EMS approach a broader range of people could institute derivative actions against defaulting directors and others.[42] This would include being able to initiate a derivative action against the council if it fails to act in the best interests of the company or contravenes any other mandate imposed on it. Ordinarily in most systems, such as the UK, derivative actions are only available to shareholders. But it has been argued that the range of persons who would be entitled to institute these proceedings could be widened.[43] There are jurisdictions where the right to bring

[40] Stock Corporation Act 2010, s. 84(3). See, R. Ghezzi and C. Malberti, 'The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law' (2008) 5 European Company and Financial Law Review 1 at 13; J. Warchol, 'The Balance of Power in Polish Company Code Regulations' (2011) 8 European Company and Financial Law Review 174 at 191.

[41] K. Hopt and P. Leyens, 'Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in German, the United Kingdom, France and Italy' (2004) 1 European Company and Financial Law Review 135 at 142.

[42] A. Keay, 'The Ultimate Objective of the Public Company and the Enforcement of the Entity Maximization and Sustainability Model' (2010) 10 Journal of Corporate Law Studies 35.

[43] Ibid.

derivative actions is granted to persons other than shareholders.[44] It might make sense to limit derivative actions to shareholders if a shareholder value approach is implemented, but if an EMS approach is taken it makes sense to give the right to anyone who has an interest in the company to bring proceedings.[45] In articulating their team production approach to corporate law, Margaret Blair and Lynn Stout argue that the shareholders in bringing derivative actions act as proxies for all those with claims on the company.[46] But, while such proceedings are designed to obtain some relief for the company, it might be argued that shareholders do not take proceedings in relation to action of the board unless they are convinced that either they will benefit from the proceedings, at least indirectly, or that the action of the board is likely to harm them in the short term or even in the long term. It is probable that whether or not shareholders would be prepared to institute derivative proceedings will very much depend on what the directors have done. Some actions that the directors take, in contravention of EMS, might well lead shareholders to reason that the action taken would end up, indirectly, adversely affecting the shareholders, so they will consider proceeding. But other board actions that might not be said to fulfil the EMS demand will not adversely affect shareholders, and might even benefit them, and in such cases no shareholder is likely to take proceedings to ensure that the wrong is corrected.

It is implicit in the EMS model that all those who have effectively invested in the company should be entitled to take action to safeguard the wealth of the company entity, in which they have a potential distinct interest, albeit one that is not vested or able to be calculated. As a consequence there needs to be an enforcement mechanism that is more encompassing. If what is proposed above were to be put into effect then the fact that one is broadening the range of those who can bring proceedings could mean that there is an increase in the chances of a company's interests being protected, because it both leads to the knowledge of more people being brought to consider the company's position and some stakeholders might well have greater knowledge than the shareholders. It is envisaged that the present situation that exists in many countries where a person who wishes to institute a derivative action is required first to seek court approval to proceed would remain and it would enable a court to determine if the applicant is a person who is entitled to bring such an action and has a substantial and good faith claim.

It has also been argued that besides private persons being able to instigate derivative actions power should be given to an appropriately staffed and funded public authority to be able to file derivative proceedings where this power does not presently exist, as is the case in the US and the UK.[47] The argument is based, inter alia, on the following grounds. It could foster greater accountability of directors, deter improper activity, enhance the public interest, and protect all kinds of

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[44] Examples are Canada, South Africa and Singapore.

[45] One commentator accepts the need for it in relation to creditors: R.B. Campbell, Jr., 'Corporate Fiduciary Principles for the Post-Contractarian Era' (1996) 23 Florida State University Law Review 561 at 606.

[46] Blair and Stout, above n 30 at 293. David Millon doubts this, see D. Millon,'New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law' (2000) 86 Virginia Law Review 1001 at 1013.

[47] A. Keay, 'The Public Enforcement of Directors' Duties: A Normative Inquiry' (2014) 43 Common Law World Review 89.

investors.[48] Such a power could bolster the confidence of all stakeholders in the system.

Perhaps the leading benefit of the introduction of the council is that it is likely that it could be a more effective body as far as requiring an account to be given and taking the role away from the general meeting might avoid the problem of individual, or groups of, shareholders only being concerned about their own interests. Thus, the council might have greater credibility as an accountee body than the general meeting in the eyes of stakeholders, the government and the public. What would be important to ensure is that the role of the council would not overlap significantly with that of the non-executive directors, so that confusion as to who does what is avoided as is the incurring of unnecessary cost.[49]

Perhaps one of the major issues with this option relates to the constitution of the council. The establishment of the council might provide an opportunity to widen the involvement of stakeholders in the governance process, something argued for many years by pluralists. The argument has been put that a board of directors should be representative of all of the stakeholders in a company.[50] The problem with this has been that it is difficult to see how it would work. It would also be difficult to find a way of having all stakeholders involved in the appointment of the council,[51] and all stakeholders being represented. To be realistic it is likely that it would not be acceptable to many in government and even less so to those engaged in commercial life. Nevertheless it might well be possible to have the councils in public companies appointed in accordance with the approach adopted in Germany in relation to large public companies where half of the members of the Aufsichtsrat are appointed by the shareholders and the other half by the employees with the Chair being appointed by the shareholders. The Chair has a casting vote in the event of a tie.

While there have been many criticisms aimed at the governance process in the German system, overall it seems to have worked reasonably well. Also, employees are a major group in a company's performance and contribute firm specific capital.[52] In fact having representation of workers on a board is seen by many as something that is desperately needed.[53] Admittedly in many, if not most, countries that practice the Anglo-American system of corporate governance, and particularly the US and the UK, the idea of workers sitting on a council would not be well received by all and

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[48] Ibid.

[49] Clearly there is confusion in China where companies have both a supervisory board and non-executive directors on the management board.

[50] For example, K. Greenfield, 'Saving the World with Corporate Law' (2008) 57 Emory Law Journal 947 at 978; F. Post, 'A Response to 'The Social Responsibility of Corporate Management: A Classical Critique'' (2003) 18 Mid-American Journal of Business 25 at 32.

[51] This was also the opinion of the Viènot Report in France. It said that if board members were appointed to represent certain interest groups it would not be desirable. The result could well be to make the board a focus for conflicts between such groups instead of collectively representing the interests of all shareholders as it is supposed to. See Viènot I Report, above n 24, available at http://www.ecgi.org/codes/documents/vienot1_en.pdf, at 13-14.

[52] M. O'Connor, 'The Human Capital Era' (1993) 78 Cornell Law Review 899; Blair, above n 24; L. Zingales, 'In Search of New Foundations' (2000) 55 Journal of Finance 1623.

[53] Aspen Institute Business and Society Program, 'Unpacking Corporate Purpose: A Report on the Beliefs of Executives, Investors and Scholars' (2014), available at http://www.aspeninstitute.org/sites/default/files/content/upload/Unpacking%20Corporate%20Purpose%20May%202014.pdf, at 47.

would probably be given a cool reception by many. Shareholder groups are likely to be against it. The proposal is not going to be an attractive proposition to many shareholders as they are not going to be the direct accountees of the board and they might be concerned about the fact that the council is constituted by some who are nominated by employees, and whose interests might diverge from those of some shareholders. In 1997, Sally Wheeler observed that the notion of employee representation at board level in the UK, and other countries, was not likely to happen given the then capitalist agenda,[54] and the same can probably be said today. There continues to be resistance to worker participation in a number of circles. It was evident recently when proposals to have worker representatives on the remuneration committee of UK boards[55] were speedily dismissed. There have been several arguments against employee involvement in the UK, such that it would circumscribe open discussion. But while that argument might have, to some degree, application to the council, it is not likely that free discussion would be hampered as much as it might at the board level where ideas receive their genesis and where arguments are likely to be more vigorous and extensive, especially on issues of policy and strategy. The council is a review body and, while it might see its fair share of arguments, there is probably less room for debate about policy and strategy.

The council does not need to be large, although it must be of sufficient size to ensure that it is reasonably wide in representation. Given the fact that gender has been an issue in the management of companies it might be appropriate to set some sort of minimum level for female members.[56] This, together with the inclusion of employee representatives, should go some way to addressing the criticism often directed at boards in the US and the UK that they are made-up, on the whole, by middle-aged, well-connected white males with similar socio-economic and educational backgrounds.

It is emphasized that what is proposed is not a ‘carbon copy’ of the German system, and really there are few changes needed to the present set-up that exists in one-tier board systems. The constitution of the board would be the same, and the shareholders still appoint the directors and retain some monitoring roles.

A disadvantage of the changes proposed would be some increase in costs, as the council members would have to be paid a fee and expenses and there would need to

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[54] S. Wheeler, ‘Works Councils: Towards Stakeholding?’ (1997) 24 Journal of Law and Society 44 at 46.

[55] Trades Union Congress, ‘Worker Representatives Can Curb Excess Pay at the Top’ (2012), available at http://www.tuc.org.uk/economic-issues/economic-analysis/worker-representatives-can-curb-excess-pay-top; Executive and Remuneration Bill, Bill No.105, presented by Thomas Docherty (House of Commons, 2013-2014), available at http://www.publications.parliament.uk/pa/bills/cbill/2013-2014/0105/14105.pdf; Department of Business, Innovation and Skills, 'Executive Remuneration Discussion Chapter: Summary of Responses’ (January 2012), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31381/12-564-executive-remuneration-discussion-chapter-summary-responses.pdf. The Trades Union Congress has been calling for employee representation on remuneration committees since the 1990s. See M. Carley, ‘Discussions about whether workers should help set executive pay’ (2011) EIROnline available at http://www.eurofound.europa.eu/eiro/2011/10/articles/uk1110029i.htm.

[56] See, e.g., the practice in Germany: Act on Equal Participation of Women and Men regarding Leadership Positions within the Sectors of Private Economy and Public Service (Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst") (2015).

be some administrative support provided to the council. The council would only need to meet infrequently, say twice yearly, as the non-executives on the board should be able to monitor the managers and they will be attending regular board meetings, so it is not likely that the overall cost would be substantial, given the fact that that the proposal only covers public companies. Nevertheless, smaller public companies could find the cost onerous, so it might be appropriate to limit the proposal to public companies of a particular size by establishing some minimum criteria that must exist in relation to a company before a council must be established.

B. The General Meeting

The second option is that the board is accountable to the general meeting, which obviously is a similar situation to that which applies in many jurisdictions already. But it must be emphasized that in this role as accountee, as in all of its roles, the general meeting is acting as and for the company.[57] Like the board, the general meeting is entitled in this capacity to define the will of the company.[58] In no way does the board or the general meeting express the will of the shareholders,[59] nor do they act for the shareholders; they act for the company itself. Generally speaking, the shareholders cannot interfere in the exercise of the powers that are given to the board under the articles of association (by-laws) except in very limited circumstances.[60] But that does not impede the general meeting from acting as the accountee of the board. In this capacity it would not be interfering in the exercise of the powers of the board directly as it would only be acting as a review body and only able to do those things permitted by the relevant companies legislation, the articles of association, and possibly any code that operates. Stephen Bottomley states that accountability is in fact one reason for the dual division and separation of the decision-making powers in the company, between the board and the general meeting.[61]

Under this second option when the shareholders are acting in the general meeting they are acting for the company and carrying out an accountability role. This option, where the shareholders alone are placed in a position to scrutinize what the board has done will not appeal to many, and certainly those attracted to EMS, on the basis that it is not reasonable and fair. At the general meeting the shareholders might well be biased and there might well be a tendency to be concerned only about how their own interests individually, or as a member of a group of shareholders, will be served and these interests might well not be consistent with those of the company, and contrary to EMS, and are certainly not likely to be consistent with all or even some of the wider interests that contribute to the enhancement of the company's wealth. Given past performance, shareholders might be overly concerned with favouring what gives them short-term gains. Furthermore, shareholders can have serious conflicts of interest with

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[57] L. Sealy and S. Worthington, *Sealy and Worthington's Cases and Materials in Company Law* (Oxford University Press, 2013), p. 179. Certain powers may be reserved for the general meeting to be exercised on behalf of the company: John Shaw & Sons Ltd. v. Shaw [1935] 2 KB 113 at 134.

[58] R. Flannigan, 'Shareholder Fiduciary Duties' (2014) Journal of Business Law 1 at 9.

[59] Ibid., at 5.

[60] John Shaw & Sons, above n 57 at 134; NRMA v. Parker (1986) 4 ACLC 609 at 613-614; Auer v. Dressel, 118 NE 2d 590 at 594 (1954). Also, see, Automatic Self-Cleansing Filter Syndicate Co. Ltd. v. Cunninghame [1906] 2 Ch. 34 at 44; Ashburton Oil NL v. Alpha Minerals NL (1971) 123 CLR 614.

[61] S. Bottomley, The Constitutional Corporation (Aldershot: Ashgate, 2007), p. 73.

other shareholders arising from their other relationships with the company, from their investments in derivatives or securities issued by other companies, from their investments in other parts of the company's capital structure, and from their short-term investment focus.[62] If the general meeting has to be the body that effectively acts as accountee is there not a danger in some companies of it only being concerned to benefit some of the members or to produce short-term benefits? So, for instance, if the directors did act in such a way as to benefit shareholder interests alone, and did not consider the interests of the company, then it is unlikely that the shareholders will, in an accounting role, question what the directors have done. If the members in general meeting are said to be acting on behalf of the company (the accountee), cannot it be said that they should be putting aside their own selfish interests and acting in what are the best interests of the company?

To address this issue are we able to say that the shareholders owe a duty to act in the best interests of the company? It must be noted at the outset that what is being mooted here is a duty imposed on the shareholders in general meeting and not a duty on shareholders across the board and in everything that they do. Arguably, the concern about shareholder bias would not be as strong if the shareholders, like the directors, were subject to fiduciary duties[63] and had to act in the best interests of the company, with this meaning the company entity and not the shareholders as a whole. But the problem with this is that the general position that is usually posited as being taken around the world is that, unlike directors, shareholders may use the rights in their shares, such as the power to vote, as they wish and they do not owe duties. Most commentators in the US, as opposed to those in other jurisdictions such as the UK, generally accept that controlling shareholders are regarded as owing a fiduciary duty.[64] But where there is no control exerted by a majority shareholder, as the case is with most public companies (a majority is only usually obtained by organizing a broad coalition of shareholders), the shareholders are entitled to vote in general meetings in a selfish manner.[65] In this respect it has been said, as far as US companies are concerned, that, 'American public shareholders are uniquely blessed by the freedom to do what they will... [S]hareholders owe the corporation no legal duties'.[66]

This is generally accurate in the US save where controlling shareholders are

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[62] I. Anabtawi and L. Stout, 'Fiduciary Duties for Activist Shareholders' (2008) 60 Stanford Law Review 1255 at 1261.

[63] The roots of fiduciary duties are explained in the old English case of Bishop of Woodhouse v. Meredith (1820) 1 Jac & W 204 at 213.

[64] See, e.g., Kahn v. Lynch Communications Systems Inc., 638 A 2d 1110 (1994); Ivanhoe Partners v. Newmont Mining Corp., 535 A 2d 1334 at 1344 (1989); Linge v. Ralston Purina Co., 293 NW 2d 191 (Iowa Sup. Ct. 1980); Donahue v. Rodd Electrotype Co. of New England, 367 Mass. 578, 328 NE 2d 505 (1975); Z. Cohen, 'Fiduciary Duties of Controlling Shareholders: A Comparative View' (1991) 12 University of Pennsylvania Journal of International Business Law 379. R. Karmel, 'Should a Duty Be Imposed on Institutional Shareholders?' (2004) 60 Business Lawyer 1 at 2; D. Donald, 'Shareholder Voice and Its Opponents' (2005) 5 Journal of Corporate Law Studies 305 at 320 and following. Note the robust rejection of a duty existing by P. Dalley, 'The Misguided Doctrine of Stockholder Fiduciary Duties' (2004) 33 Hofstra Law Review 175; P. Dalley, 'Shareholder and (Director) Fiduciary Duties and Shareholder Activism' (2008) 8 Houston Business and Tax Law Journal 301.

[65] R. Gilson and J. Gordon, 'Controlling Shareholders' (2005) 152 University of Pennsylvania Law Review 785 at 786. Also, see, M. de Jongh, 'Shareholders' Duties to the Company and Fellow Shareholders' (2012) 9 European Company Law 185, discussing the Dutch approach.

[66] D. Hoffman, 'The "Duty" to Be a Rational Shareholder' (2006) 90 Minnesota Law Review 537 at 537.

concerned.[67] Moreover, it is generally said to be the position in the UK in relation to any company. The comment of Jessel MR exemplifies this approach when he said that 'those who have the rights of property are entitled to exercise them, whatever their motives may be for such exercise – that is as regards a court of law as distinguished from a court of morality or conscience, if such a court exists.'[68]

But is this in fact the position at law. Are shareholders in general meeting subject to fiduciary duties? If not, should they be? It is not intended to discuss in any depth what fiduciary duties are as it is a complex subject that has been considered on many occasions,[69] and the concept is rather elusive. The original notion of fiduciary duty is a product of equity concerning the duty of a person in a discretionary position of trust to serve the interests of another person.[70] What the courts have said about those subject to fiduciary duties is that loyalty is the distinguishing obligation of such persons.[71] The fundamental aspect of loyalty is that a fiduciary acts for proper purposes and without self-interest and in another person's interests.[72] According to Millett LJ in the English Court of Appeal in Bristol and West Building Society v Mothew:[73] '[t]he principal is entitled to the single-minded loyalty of his fiduciary … he may not act … for the benefit of a third person without the informed consent of his principal.'[74] Millett LJ said, in this case, that fiduciary duty is restricted to duties that are peculiar to fiduciaries and if they are breached it leads to different consequences from the breach of other duties.[75] Certain relationships have been identified as being fiduciary in nature, such as solicitors/attorneys (in relation to their clients), partners, trustees, agents (but not always) and company directors.

As foreshadowed above, traditionally shareholders are not recognised as being under fiduciary duties.[76] But people other than those who fall into traditional relationships can be subject to fiduciary duties. Paul Finn stated, in a comment that was adopted by the English Court of Appeal, that a person 'is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a

[67] D. Block, N. Barton and S. Radin, The Business Judgment Rule (New York: Aspen Law and Business, 1996), pp. 368-369.
[68] Cohen, above n 64 at 381.
[69] For instance, A. Scott 'The Fiduciary Principle' (1949) 37 California Law Review 539; P. Finn, Fiduciary Obligations (Sydney: Law Book Co, 1977); D. DeMott, 'Beyond Metaphor: An Analysis of Fiduciary Obligation' (1988) Duke Law Journal 879; R. Cooter and B. Freedman, 'The Fiduciary Relationship: Its Economic Character and Legal Consequences' (1991) 66 New York University Law Review 1045; P. Finn, 'Fiduciary Law and the Modern Commercial World', in E. McKendrick (ed.), Commercial Aspects of Trusts and Fiduciary Obligations (Oxford: Clarendon Press, 1992); M. Conaglen 'The Nature and Function of Fiduciary Loyalty' (2005) 121 Law Quarterly Review 452; J. Edelman, 'When Do Fiduciary Duties Arise?' (2010) 126 Law Quarterly Review 302; A. Stafford and S. Ritchie, Fiduciary Duties (Bristol: Jordans, 2014).
[70] See Re Smith & Fawcett Ltd. [1942] Ch. 304 at 306, 308; Hospital Products Ltd v. United States Surgical Corp. (1984) 156 CLR 41.
[71] Bristol and West Building Society v. Mothew [1998] 1 Ch. 1 at 18.
[72] A. Scott, 'The Fiduciary Principle' (1949) 37 California Law Review 539 at 540.
[73] Bristol and West Building Society, above n 71.
[74] Ibid., at 18.
[75] Ibid., at 16.
[76] Most of the discussion in recent times has been concerning making intermediaries who invest on behalf of pension funds etc. in companies subject to fiduciary duties. See Law Commission of England and Wales, Fiduciary Duties of Investment Intermediaries, Consultation Chapter No. 215 (October 2013), available at http://lawcommission.justice.gov.uk/docs/cp215_fiduciary_duties.pdf.

fiduciary.'[77] A person is, therefore, a 'fiduciary' when it is determined that particular duties are owed.

It only seems proper that when shareholders are, like directors on the board, acting for the company, they should be required to focus on the company's best interests and have a duty to the company. And often, of course, their interests will coincide with the company's, although perhaps not always.

It is my view that there are some reasonably weighty arguments from case law in favour of the contention that shareholders do owe a duty to their company to act in the interests of the company when they are congregating as the general meeting of the company. These arguments follow from an analysis of the case law in the UK and other Commonwealth jurisdictions,[78] the thrust of which is often seen as providing that only two limitations are placed on shareholders in how they vote. First, they must act in good faith for the benefit of the company in voting on a motion to alter the company's constitution,[79] and second they must not commit a fraud on the minority in exercising their votes. The concept of a fraud on the minority is one that has been developed over the years by the courts. It is not easily subject to clear exposition and there is no obvious principle that can be extrapolated from the cases,[80] but it does cover the situation where the majority expropriates either the assets of the company or the interest of the minority in the company for the use of the majority. In such cases this action is not able to be ratified by the general meeting.

So, while the case law has not developed clearly and logically, it is possible to see a line of UK and Commonwealth cases that indicate that a middle way has been adopted, one that does not involve the embracing of a duty to the company but one that does not allow shareholders to act completely freely in all situations. Why shareholders are only required to rein in their selfishness in the situations mentioned above and not more broadly is unclear. It is contended that it is correct to say that there is a lack of uniformity in the English and Commonwealth jurisprudence on the obligations of shareholders.[81] However, due to space limitations, I am not able to pursue those arguments or elaborate on them in this chapter. I will accept for present purposes that there is law that says that shareholders can always please themselves when exercising their votes in general meetings save in the circumstances mentioned above.

What I want to suggest is that whatever is the state of the law there is a solid normative argument that supports the fact that a duty should exist when shareholders are in a general meeting and acting as the company. The recognition of a duty would, quite rightly, acknowledge the legal status of the company entity and the fact that the general meeting must act on its behalf and for its independent interests. The following reasons are given in support of this normative argument.

[77] Bristol and West Building Society, above n 71 at 18.
[78] For an examination of some of the pertinent issues, see Flannigan, above n 59; Keay, above n 11 at ch. 4.
[79] The leading case in the UK and much of the Commonwealth is usually regarded as: Allen v. Gold Reefs of West Africa Ltd. [1900] 1 Ch. 656 (CA).
[80] See Clemens v. Clemens Bros. Ltd [1976] 2 All ER 268 at 282.
[81] Cohen, above n 64 at 384.

First, it makes sense that if the members of the board are subject to duties the members of the general meeting, when acting for the company, are also subject to duties. For just as the board acts for the company when making decisions within its authority, so the general meeting acts for the company when involved in the making of decisions within its authority. Shareholders can use their votes in meetings to indulge in opportunism, just as directors can, and this could involve voting for the company to take a particular course of action that could produce some personal gain for shareholders, but to the detriment of the company. Shareholder opportunism could also lead, inter alia, to externalising the cost of providing benefits to shareholders. As Iman Anabtawi and Lynn Stout have said: 'there is no reason to assume that activist shareholders are somehow impervious to the same temptations of greed and self-interest that are widely understood to face corporate officers and directors.'[82]

There will be occasions where shareholders can vote for their own interests, such as where there is debate over the power to compulsorily dispose of, or expropriate, shareholders' shares,[83] and where the corporate entity has no interest in what is decided. This is something that was recognized by the Privy Council in Citco Banking Corp NV *v Prusser's Ltd*.[84] But clearly it has been accepted in several decisions that the company is a distinct entity that is separate from the shareholders,[85] so consideration must be for its interests and not those of the shareholders when the general meeting is acting as the company.

Second, in the establishment of the company the expectation is that the shareholders, when part of the general meeting, will seek to enhance the wealth of the company and only seek to benefit reflectively[86] because that is why they have become involved in the company.

Third, if the shareholders were under a duty to the company to act in its best interests that would go some way to assuaging the concerns of many non-shareholders who are connected with the company, for they might feel that the shareholders do get too much out of the company enterprise and have too much influence over it.

Fourth, the case law in the UK and the Commonwealth has essentially focused on the actions and voting of majority shareholders, but it is becoming clear that minority shareholders can play a part in destabilizing a company.[87] There appears to be more minority shareholder opportunism occurring in public companies as shareholders become more powerful and more diverse.[88] This can lead to corporate loss. So, these shareholders, as well as majority shareholders who are the ones whose role has been circumscribed to some degree, should also be required to act in the best interests of their company when voting at a general meeting.

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[82] Anabtawi and Stout, above n 62 at 1262.
[83] See Peters American Delicacy Co. Ltd. v. Heath (1939) 61 CLR 457 at 481. An exception might be in the type of case where shareholders are using their shares to allow themselves to assist a competitor as this potentially would be damaging the company.
[84] Citco Banking Corp NV v. Prusser's Ltd. [2007] UKPC 13; [2007] BCC 205 at para. 18.
[85] John Shaw & Sons, above n 57.
[86] Flannigan, above n 58 at 23.
[87] This is particularly applicable to hedge funds.
[88] Anabtawi and Stout, above n 62 at 1294.

Fifth, the proposal would not lead to a major change in practical application of the law. As mentioned above, imposing a duty to the company on shareholders in a general meeting would not be that radical as the substance of the law would remain largely intact.[89] It is submitted that more than the foundations have been laid for the duty in the extant law. The approach is a natural extension of corporate law principles,[90] and it acknowledges that on incorporation a new entity enters the stage and it is independent of the shareholders' existence. Finally, if shareholders are subject to a duty, they might be encouraged to be engaged in the life of the company and more diligent in seeking information and monitoring, so that they can make informed decisions.[91]

Naturally if a duty owed by shareholders existed then any breach would need to be enforced and this causes one to ask: who will do the enforcing? The shareholders in breach could be subject to an action by the company, and this would be brought by the board, acting for the company. It all might seem rather incestuous in that the board is accountable to the shareholders (acting as the company) and if the shareholders do not exercise their duties properly, in the eyes of the board, the board can then bring an action. A danger with this scenario is that a board might not like what the general meeting has done and will seek to engage in litigation to hamper or deny the effect of what the general meeting has decided. For instance, if the general meeting decided to remove director X and X had sufficient support at board level an action could be commenced by the board, on behalf of the company, against certain shareholders who carried the vote for removal on the basis that the shareholders have not acted in the best interests of the company. Naturally in this type of situation it would be a matter for the courts to decide whether the shareholders had fulfilled their duties or not.

But what would happen if a member or, more likely, a group of members were to act other than in the interests of the company? The company would have an action against them for breach of duty. The board could take the action, but if the miscreant shareholders controlled the board or were able to influence the board and no action were brought, then a shareholder who believed that the shareholders in general meeting were not acting in the best interests of the company could seek to continue a derivative action on behalf of the company, as could other parties interested in the company, along the lines discussed earlier when considering the option of creating a council as a second board. The concern that some might emit is that shareholders could seek to use the right to enforce an alleged breach of duty by other shareholders, if the board does nothing, to fight again, in a different forum, battles that they lost in the general meeting. Certainly this is something that a court would have to be careful to police, and it could do that at the hearing that will decide whether permission should be given for the continuation of the derivative action. Particularly, the court would have to consider the bona fides of the shareholder who is bringing the action. That problem could exist if a large number of shareholders, or even all of them, voted to do something that was not in the best interests of the company. Theoretically a stakeholder could seek to take derivative proceedings against all of the shareholders as a group, but this is not likely to be possible. Perhaps the way to proceed would be for a group of leading shareholders to be sued.

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[89] Flannigan, above n 58 at 30.

[90] Anabtawi and Stout, above n 62 at 1296.

[91] It is acknowledged that the imposition of a duty could cause some shareholders to steer clear of meetings to avoid the application of the duty to them.

So in sum if we say that the general meeting is to act as accountee to the board, the board is still accountable to the company. The general meeting is acting as and for the company just as the board is when it acts as accountee to the managers who must account to the company. As an accountee body the general meeting is given the task of reviewing what the board has done or not done.

V. Conclusion

Clearly the accountability of boards is a critical issue in corporate governance. Thus any approach to corporate governance must engage with it seriously. In this chapter I have sought to consider one of the primary issues when it comes to board accountability, namely to whom are boards accountable, and I have done so in relation to EMS theory, which constitutes a particular approach to corporate governance.

I have argued that the board must be accountable to the company entity and there are two options that could be implemented to ensure that this takes place. The board is accountable either to an accountability council or to the general meeting of shareholders. Both have certain allure. The former has many attractions, the least not being that it takes direct accountability away from the shareholders, and this is likely to sit well with non-shareholder stakeholders and the public, and it provides for greater inclusion in corporate governance. But it is likely to encounter stiff opposition in many jurisdictions.

Accountability of the board to the general meeting also has attractions. However, it is probably only going to work if the shareholders are, in the general meeting, subject to a fiduciary duty to act in the best interests of the company in order to ensure that the shareholders do not act opportunistically and against the company's interests.