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INTERNATIONAL SHAREHOLDERS AS STEWARDS: TOWARD A NEW CONCEPTION OF CORPORATE GOVERNANCE

Iris H-Y Chiu[*]

INTRODUCTION

In the wake of the United Kingdom (U.K.) banking crisis 2008–2009, institutional shareholders have been accused of having been "asleep."[1] The critique is that institutional shareholders have been uncritical of risky business practices in their investee banks and should have monitored board risk management.[2] Although institutional shareholder apathy is not regarded as the key cause of the U.K. banking crisis, the Walker Review, Sir David Walker's report on corporate governance in banks and financial institutions, is of the view that such institutional shareholder apathy has provided a tolerant context for misjudgments of risk made at the Board level of the failed U.K. banks.[3] A number of corporate governance reforms have since been made in the U.K., including reforms to Board composition and Board-level practices.[4] The focus of this Article is the "Stewardship Code,"[5] a set of best practices for institutional shareholders, encouraging them to move away from apathy and to engage with investee companies.

The notion of "stewardship," in relation to institutional shareholders, may be "defined as the process through which [institutional] shareholders, directors and others seek to influence companies in the direction of long-term, sustainable performance that derives from contributing to human progress and the wellbeing of the environment and society."[6] The key

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1. Jennifer Hughes, *FSA Chief Lambasts Uncritical Investors*, FIN. TIMES, March 11, 2009, at 1; Kate Burgess, *Myners Lashes Out at Landlord Shareholders*, FIN. TIMES, Apr. 21, 2009, http://www.ft.com/cms/s/0/c0217c20-2eaf-11de-b7d3-00144feabdc0.html; *see also* Helia Ebrahimi, *Institutional shareholders Admit Oversight Failure on Banks*, THE DAILY TELEGRAPH, Jan. 27, 2009, at 1.

2. DAVID WALKER, A REVIEW OF CORPORATE GOVERNANCE IN BANKS AND FINANCIAL INSTITUTIONS: FINAL RECOMMENDATIONS ¶¶ 5.10–.11 (Nov. 2009) [hereinafter WALKER REVIEW], *available at* http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf.

3. *Id.* ¶ 5.10.

4. *See* FIN. REPORTING COUNCIL, THE UK CORPORATE GOVERNANCE CODE 2–3 (June 2010), *available at* http://www.frc.org.uk/corporate/ukcgcode.cfm.

5. FIN. REPORTING COUNCIL, THE UK STEWARDSHIP CODE (July 2010) [hereinafter UK STEWARDSHIP CODE], *available at* http://www.frc.org.uk/corporate/investorgovernance.cfm.

6. Arad Reisberg, *The Notion of Stewardship from a Company Law Perspective: Re-Defined and Re-Assessed in Light of the Recent Financial Crisis?*, 18 J. FIN. CRIME 126, 126 (2011)

notions in "stewardship" seem to be long-termism, and taking a more holistic view of the well-being and performance of the company. This Article will argue that "stewardship" embodies an ideological shift in corporate governance theory away from the dominant shareholder-centered contractarian paradigm. Hence, the role that is expected of shareholder stewardship is a form of governance that also serves the interests of stakeholders and the public, and not merely a call to rejuvenate shareholder power.

Part I argues that the dominant theoretical framework for corporate governance in the U.K. is very much a shareholder-centered contractarian paradigm. Although the contractarian theory has been most developed in U.S. corporate governance theory, company law in the U.K. and the reforms leading up to the Companies Act 2006 (the Companies Act) show that policy-makers endorse the dominant contractarian paradigm and the key position of shareholders in corporate governance.

Part II then discusses the U.K. Stewardship Code, a body of soft law for the governance role of institutional shareholders. The contextual background to the Stewardship Code is also important as "stewardship" is articulated as a complementary force for governance in the financial regulation landscape post-global-financial-crisis. This Part will argue that "stewardship" is a notion that enrolls institutional shareholders into a governance role beyond that of corporate governance. This, however, entails an ideological paradox. On the one hand, the Stewardship Code seems to emphasize the importance of institutional shareholders' corporate governance role, very much in line with the shareholder-centered contractarian paradigm dominant in corporate governance theory. This Article, however, argues that the principles in the Stewardship Code could bring about a gradual move away from shareholder-centered contractarianism. This Part will argue that the key features of "stewardship" limit shareholders' contractarian freedom in monitoring, particularly in short-termist tendencies. Further, when examined against the backdrop of the "enlightened shareholder value" rhetoric supporting the reforms leading up to the Companies Act, it will be argued that "stewardship" has the potential to introduce an ideological shift that moves away from the tenets of shareholder-centered contractarianism.

Yet, the Stewardship Code is still nested within the broader context of the importance of equity finance and securities markets in the U.K. Part III suggests that although "stewardship" has the potential to introduce an ideological shift in corporate governance theory, such a shift is not in the

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(citing MARK GOYDER & ARTHUR PROBERT, TOMORROW'S COMPANY, TOMORROW'S OWNERS—DEFINING, DIFFERENTIATING AND REWARDING STEWARDSHIP 3 (Pat Cleverly ed., 2009), *available at* http://www.forceforgood.com/Uploaded_Content/tool/2311200915392335.pdf.

direction of "communitarianizing" corporate governance theory. This Part examines the main strands of "communitarian" theories and argues that the "stewardship" notion does not go that far. Nevertheless, this Article critically analyzes the principles in the Stewardship Code and argues that elements of stakeholder theory may be discerned. This Part argues that "stewardship" elevates the importance of "key stakeholders" and contextualizes the objective of shareholding so that the nature of shareholder-centered contractarianism could be significantly affected.

It may nevertheless be argued that the form of stakeholder theory that is supported by the Stewardship Code is a somewhat weak and confused version of stakeholder theory that attempts an uneasy marriage with the dominant shareholder-centered contractarian paradigm. Part IV fleshes out the theoretical weaknesses of the Stewardship Code. Nonetheless, this Article argues that the Stewardship Code represents a first step toward modifying the shareholder-centered contractarian nature of the corporation. In particular, for financial institutions, the Stewardship Code embodies an elevation of the state or relevant regulator into a key stakeholder position.[7] The notion of "key stakeholders" has evolutionary potential in corporate governance theory and it is hoped that such ideological possibilities can be further developed in corporate governance theory.

I. SHAREHOLDER-CENTERD CONTRACTARIANISM AS DOMINANT IN CORPORATE GOVERNANCE THEORY

Much of the theoretical literature in corporate law may be placed broadly in two camps of thought. The first is that the company is a nexus of contracts, and hence, the nature of corporate law deals with transactional, relational, and private order issues. The second views the corporation as a "real entity" whose activities and exercise of power may entail social impact and externalities, and so, posits that corporate law should relate to the entity nature of the corporation and its acts. As Worthington argues, both strands of thought are evident in the development of corporate law in the U.K.,[8] although the contractarian model supporting the agency paradigm that characterizes the Board-shareholder relationship is arguably the

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7. This is not an entirely new idea. An earlier piece by Kern Alexander points out that the state has an interest in regulating corporate governance aspects of financial institutions where this has bearing on the micro-prudential soundness of financial institutions, such as the fitness and soundness of senior management. *See* Kern Alexander, *UK Corporate Governance and Banking Regulation: The Regulator's Role as Stakeholder*, 33 STETSON L. REV. 991, 1033–34 (2004). This Article takes this idea further and argues that while the state's "stake" after the global financial crisis may need to become more open-ended, this may be difficult to accommodate within existing corporate governance ideology. The Article will thus evaluate what the Stewardship Code has achieved from the ideological point of view.

8. Sarah Worthington, *Shares and Shareholders: Property, Power and Entitlement*, 22 COMPANY LAW. 258, 307, at 263–66, 308–10 (2001) (pts. 1 & 2).

dominant theoretical paradigm for corporate theory and law.[9] The contractarian model of corporate governance and law, and the finance perspective that characterizes the Board-shareholder relationship as one of agency, allow institutional shareholders to be placed in the key role of monitoring management. Such is the optimal hypothetical bargain that shareholders would have made.

A. THE DOMINANCE OF THE CONTRACTARIAN PARADIGM IN CORPORATE THEORY AND LAW

In 1937, Coase's seminal work *The Nature of the Firm*[10] provided the foundation upon which the contractarian conception of the corporation became a dominant intellectual paradigm.[11] The firm as a nexus of transactions that are off market because of transaction cost efficiency has become a powerful and lasting conception of the corporation.

The contractarian approach focuses on the microscopic constituents of the firm as a nexus of contracts entered into by volition; hence, the role of corporate law, boosted by the rise of the law and economics movement, deals with making such contractual relations efficacious. Staunch contractual theorists in corporate law support the role of corporate law as an enabling or facilitative framework so that contracting parties may decide how their relations may be governed.[12] The pure contractual framework is oblivious to the effects of the corporate entity as a whole. Bebchuk has nevertheless pointed out that it is a myth that constituents in a corporation actively engage in contractual bilateralism to determine the substantive governance of their relations.[13]

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9. John Armour & Michael Whincop, *The Proprietary Foundations of Corporate Law*, 32 O.J.L.S. 429, 429 (2007) (Eng.). *See generally* BRIAN R. CHEFFINS, COMPANY LAW: THEORY, STRUCTURE AND OPERATION (1997) (providing contractarian analyses of the company; pages 31–46 examines the contractarian theory itself).

10. Ronald Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

11. Steven M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 547 (2003).

12. *See, e.g.*, William A. Klein, *The Modern Business Organization: Bargaining Under Constraints*, 91 YALE L.J. 1521 (1982) (suggesting that the firm may be understood as a series of bargains, negotiated under constraints, and made in view of a long-term relationship); Fred McChesney, *Contractarianism Without Contracts? Yet Another Critique of Eisenberg*, 90 COLUM. L. REV. 1332 (1990) (arguing that Eisenberg's view that a corporation is essentially a nexus of rules, rather than contracts, is foolish because such rules are quintessentially contractual rules); Manuel A. Utset, *Towards a Bargaining Theory of the Firm*, 80 CORNELL L. REV. 540 (1995) (positing that the manager-shareholder relationship may best be conceptualized as a game-theory based bargain).

13. *See* Lucian Ayre Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1827–29 (1989); Lucian Ayre Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395, 1400–01 (1989).

Easterbrook and Fischel's influential thesis is that the role of corporate law is to provide a default set of rules that represents a hypothetical bargain between institutional shareholders and management.[14] This overcomes the problem of the myth of active contracting, but nevertheless upholds the enabling character of corporate law to support the conception of the corporation as a nexus of contracts. These hypothetical bargains would reasonably reflect contracting parties' expectations as well as minimize transaction costs amongst them.[15] The "defaultization" thesis goes as far as to support shareholder rights such as voting and the imposition of fiduciary duties on directors in order to protect the open-ended residual risks that institutional shareholders bear.[16]

The contractarian model has evolved to focus on the Board-shareholder relationship following the financial economics perspective that characterizes the main corporate governance "problem" as the agency problem. The Board-shareholder relationship is defined as an agency relationship, where institutional shareholders bear agency costs as part of the risk of delegating to management the primary role of generating and using corporate wealth.[17] Such delegation is open-ended, and shareholders bear the residual risks that management would be serving their own interests instead of maximizing shareholder wealth.[18] The agency paradigm is a dominant ideological paradigm influencing the legal characterization of shareholders' roles and powers and directors' fiduciary duties. Mandatory law in the U.K. treats shareholders as the monitors of the Board, and provides for certain decisions to be reserved for the general meeting. Provisions dealing with the appointment and removal of directors are examples of the former.[19] Further, directors or their connected persons are not allowed to enter into substantial property transactions with the company,[20] or to benefit from a company loan or quasi-loan[21] or other credit

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14. Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, *in* The Economic Structure of Corporate Law 1, 34 (1991).

15. David Charny, Hypothetical *Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815, 1819–21 (1991).

16. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *The Fiduciary Principle, the Business Judgment Rule, and the Derivative Suit*, *in* THE ECONOMIC STRUCTURE OF CORPORATE LAW, *supra* note 14, at 90, 90–91.

17. *See* MICHAEL C. JENSEN & WILLIAM H. MECKLING, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, *in* FOUNDATIONS OF ORGANIZATIONAL STRATEGY 51, 53–54, 95–96 (Michael C. Jensen ed., 1998).

18. *See id.* at 54.

19. Companies Act, 2006, c. 46, §§ 160, 168–169, 188 (U.K.) (in respect of long-service contracts exceeding two years with the company). Appointments may, however, be made just by the Board under the Model Articles, although this may be modified by companies. The Companies (Model Articles) Regulations, 2008, S.I. 2008/3229, sched. 1, § 17, sched. 2, § 17, sched. 3, § 20 (U.K.).

20. Companies Act §§ 190–196 (U.K.).

21. *Id.* §§ 197–200, 213–214.

transaction,[22] without the approval of shareholders by an ordinary resolution. These provisions co-opt shareholders into monitoring the prospects of self-dealing by management, and in turn allow the exercise of a form of proprietary control for shareholders. Further, directors acting in conflicts of interest and duty may seek shareholder approval for the transactions. Shareholder approval thus takes on a gate-keeping function to ensure that directors are allowed to proceed without running the risk of a breach of fiduciary duties.[23] Mandatory law has also provided for shareholders to have the right of ratification or otherwise of breaches, negligence, or omissions committed by directors.[24] The right of shareholder ratification seems particularly based on the perspective of shareholders as residual risk bearers and hence the exclusive right to act as assessors of whether or not it is appropriate to accept irregularities committed by management.

Although the contractarian theory has been most ideologically developed in the writings of American commentators, it has perhaps found easy acceptance in English corporate law, which has been evolved from partnership law. English corporate law arguably has a natural emphasis and concern for the private order and internal relationships that subsist beneath the corporate structure. Hence, English corporate law is largely dominated by the intellectual framework of the contractarian theory which entails two consequences for corporate governance: one, that corporate governance is essentially a framework for private order; and two, that mandatory regulation in this area should be limited unless market failures persist.

Much of corporate governance in the U.K., in terms of Board composition and shareholder engagement, is therefore seen as an exercise of best practice in order to motivate institutional shareholders to protect their relatively weaker position as principals and residual risk-bearers in the open-ended contract into which they have entered. The U.K. Corporate Governance Code enshrines a set of best practices for companies to comply with or explain, so as to allow institutional shareholders to intelligently monitor and consider the effects of corporate governance upon their interests.[25] This approach is a shareholder-centered contractarian perspective of the corporation, viewing institutional shareholders as ultimate monitors of Board practices and accountability. The development

22. *Id.* §§ 201–214.

23. *Id.* §§ 175(4), 180.

24. Foss v. Harbottle, (1843) 67 Eng. Rep. 189, 203–04 (Ch.) (now enshrined with modification in Companies Act, 2006, c. 46, § 239).

25. Moore further argues that the Stewardship Code should contain macro principles for greater flexibility in application so that individual companies can explain their considered governance models even if deviating from the Stewardship Code as such. *See* Marc T. Moore, *Whispering Sweet Nothings: The Limitations of Informal Conformance in UK Corporate Governance*, J. CORP. L. STUD. 95, 104 (2009).

of corporate governance codes in the U.K. since 1992[26] is intended to facilitate contractarian discipline within the internal working of the corporation, even if empirical research by MacNeil and Li, and by Faure-Grimaud, show that institutional shareholders are largely agnostic about the governance profile of an investee company, unless the company has under-performed.[27] The capstone of the first 1992 Cadbury Code of Corporate Governance is arguably shareholder monitoring. The Cadbury committee views institutional shareholders as follows:

> [Institutional s]hareholders have delegated many of their responsibilities as owners to the directors who act as their stewards. It is for the [institutional] shareholders to call the directors to book if they appear to be failing in their stewardship and they should use this power. While they cannot be involved in the direction and management of their company, they can insist on a high standard of corporate governance and good governance is an essential test of the directors' stewardship.[28]

Institutional shareholders are also especially admonished:

> [T]he way in which institutional shareholders use their power to influence the standards of corporate governance is of fundamental importance. Their readiness to do this turns on the degree to which they see it as their responsibility as owners, and in the interest of those whose money they are investing, to bring about changes in companies when necessary, rather than selling their shares.[29]

We look to the institutions in particular, with the backing of the Institutional Shareholders' Committee, to use their influence as owners to ensure that the companies in which they have invested comply with the Code. The widespread adoption of our recommendations will turn in large measure on the support which all institutional shareholders give to them. "*The obligation on companies to state how far they comply with the Code provides institutional and individual shareholders with a ready-made*

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26. Corporate governance codes in the U.K. have developed thusly: from the Cadbury Code of 1992, to revisions in 1995 made after the Greenbury Committee's report on executive remuneration; then in 1998 after review by the Hampel Committee, and again in 2003 following the Higgs review of the role of non-executive directors; and then in 2006 and 2008, before the Walker Review findings culminated in the revised and re-named UK Corporate Governance Code of 2010.

27. Sridhar Arcot, Valentina Bruno & Antoine Faure-Grimaud, *Corporate Governance in the UK: Is the Comply or Explain Approach Working?*, 30 INT'L REV. L. & ECON. 193, 193 (2010); Ian MacNeil & Xiao Li, *"Comply or Explain": Market Discipline and Non-Compliance with the Combined Code*, 14 CORP. GOVERNANCE 486, 492, 494 (2006).

28. COMM. ON THE FIN. ASPECTS OF CORPORATE GOVERNANCE, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE ¶ 6.6 (1992) [hereinafter CADBURY REPORT], *available at* http://www.jbs.cam.ac.uk/cadbury/report/index.html.

29. *Id.* ¶ 6.10.

agenda for their representations to boards. It is up to them to put it to good use."[30]

The soft law on corporate governance in the U.K. has developed in order to boost institutional shareholder monitoring as a form of private order beneath the corporate structure. Such monitoring is couched in terms of institutional shareholders' own private investment interests and is not framed with reference to any other external welfare objectives.

II. THE U.K. STEWARDSHIP CODE

In the wake of the U.K. banking crisis 2008–2009, institutional shareholders have been accused of having been "asleep."[31] The critique is that institutional shareholders have been uncritical of risky business practices in their investee banks and should have monitored Board risk management.[32] Although the European Commission Green Paper acknowledges that the lack of critical scrutiny by institutional shareholders in financial institutions may be a "special case" due to the complexity of banking businesses, the Paper nevertheless points out that shareholder apathy is a chronic problem in listed companies with dispersed ownership.[33] If the quality of monitoring by institutional shareholders is, nevertheless, consistent with their private investment objectives, why then are institutional shareholders criticized? Such criticism may arguably be unwarranted as institutional shareholders should have contractarian freedom, within the contractarian paradigm of corporate governance, to determine how and for what purpose their monitoring is carried out. The critique against the perceived laxity of institutional shareholders is based on a different expectation of the purpose of corporate governance. The Walker Review and the Stewardship Code pay tribute to this other expectation; and on this basis, this Article argues that there is potential for the introduction of a theoretical shift from the shareholder-centered contractarian paradigm. The position taken by the Walker Review and the Stewardship Code is nevertheless not entirely groundbreaking. This Article attempts to map out a possible theoretical trajectory going forward in order not to lose the momentum of reform.

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30. *Id.* ¶ 6.16 (emphasis added).

31. Hughes, *supra* note 1; Burgess, *supra* note 1; *see also* Ebrahimi, *supra* note 1.

32. WALKER REVIEW, *supra* note 2, ¶¶ 5.10–.11

33. *Commission Green Paper on the EU Corporate Governance Framework*, ¶ 2, COM (2011) 164 final (Apr. 5, 2011) [hereinafter Commission Green Paper], *available at* http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf.

A. THE WALKER REVIEW AND BEYOND

The Walker Review of corporate governance in U.K. banks and other financial industry entities,[34] in the wake of the global financial crisis, provides the key context for the Stewardship Code. The Review examines the extent to which corporate governance could have contributed to the failure of certain banks in the U.K. and provides many recommendations to strengthen Boards, risk management, and the role of institutional shareholder monitoring.[35] The Report opines that shareholder engagement is important in the public interest, videlicet:

> The potentially highly influential position of significant holders of stock in listed companies is a major ingredient in the market-based capitalist system which needs to earn and to be accorded an at least *implicit social legitimacy*. As counterpart to the obligation of the board to the [institutional] shareholders, this implicit legitimacy can be acquired by at least the larger fund manager through assumption of a reciprocal obligation involving attentiveness to the performance of investee companies over a long as well as a short-term horizon. On this view, those who have significant rights of ownership and enjoy the very material advantage of limited liability should see these as complemented by *a duty of stewardship*. *This is a view that would be shared by the public, as well as those employees and suppliers* who are less well-placed than an institutional shareholder to diversify their exposure to the management and performance risk of a limited liability company.[36]

The references to "social legitimacy" in a market-based capitalist system, and to the "stewardship" of equity providers, show an interesting contrast with the quotations above in the Cadbury Report. These references refer to both private and public interest notions in institutional shareholders' investment role; that is, because investment, particularly by institutions, is backed by social legitimacy, the investment role carries with it stewardship responsibilities.

The contextual reference to the Walker Review, which precedes the Stewardship Code, should be taken together with the Principles in the Code in order to discern if a theoretical shift in corporate governance theory has been encouraged. I argue that, considering stakeholder and social responsibility issues, the key features of the Code on long-termism and holistic notions of stewardship encourage a move away from the shareholder-centered contractarian model in corporate governance theory. On the other hand, one could argue that the Stewardship Code does nothing groundbreaking in terms of corporate governance theory. It affirms the

34. Walker Review, *supra* note 2.
35. *Id.* ¶ 5.9.
36. *Id.* ¶ 5.7 (emphasis added).

monitoring position of institutional shareholders, but more explicitly sets out how monitoring may be made optimal. In this respect, it merely fleshes out more of the facilitative framework to assist in private contractarian monitoring. The following will examine the nature of monitoring, as envisaged in the Stewardship Code, in order to see if the Code still endorses a shareholder-centered contractarian view of institutional shareholders' corporate governance role.

The Walker Review of Corporate Governance in Banks and Financial Institutions in the U.K. advocates that the future of institutional shareholder activism should be an exercise in stewardship. The Review states:

> Experience in the recent crisis phase has forcefully illustrated that while [institutional] shareholders enjoy limited liability in respect of their investee companies, in the case of major banks the taxpayer has been obliged to assume effectively unlimited liability. This further underlines the importance of discharge of the responsibility of [institutional] shareholders as owners, which has been inadequately acknowledged in the past.[37]

The enactment of the Stewardship Code is not confined to investing in financial institutions that may be supported by the lender of the last resort and government bailout. The Stewardship Code extends generally to institutional shareholders investing in the corporate sector. The general application of the Stewardship Code would require that institutional shareholders regard "stewardship" as a tenet of investment, and should require the notion of "stewardship" to characterize the responsibilities accompanying investment generally. But what does "stewardship" mean? Institutional investors are already subject to legal obligations of trusteeship that are imposed on them in the capacity of managing pension funds and insurance savings. Thus, what would "stewardship" encompass that is not already captured in the legal relationship of trusteeship between institutional funds and their beneficiaries?

It is arguable that the characterization of "stewardship" is not merely a reiteration of the status quo, being that investment managers owe duties to funds, and that funds owe trusteeship duties to beneficiaries.[38] "Stewardship" seems to include notions of public interest and accountability—that institutional investors should monitor the corporate sector not only in the interests of the long-term savers who invest in those institutional funds, but also for the long-term well-being of the economy as a whole. This is similar to the "universal ownership" model that Hawley and Williams advocate: institutional monitoring should act as a "bridge

37. *Id.* at 12.

38. *See generally* Iris H-Y Chiu, *Stewardship as Investment Management for Institutional Shareholders*, 32 COMPANY LAW. 65, 65–67 (2011) (setting forth the argument).

between public policy, corporate governance and the well-being of [beneficiaries]."[39] This characterization of institutional shareholder monitoring would go beyond the notion of shareholder monitoring as an outworking of the agency problem[40] in the private order of the corporation. Such monitoring is also intended to be a form of governance that takes into account the wider public interest and social good.

The Stewardship Code requires that, as a matter of stewardship, "[i]nstitutional [shareholders] should *monitor* their investee companies."[41] Such "monitoring" includes seeking to be satisfied that corporate governance arrangements are robust, carrying out meetings with company directors and/or the Chairman of the Board, maintaining records of such meetings, considering the use of voting power, and attending general meetings.[42] "Monitoring" also includes the "escalation" of shareholder engagement where it is appropriate to do so in order to protect and enhance shareholder value, and may include intensifying meetings with Board members, making public statements, and even requisitioning general meetings.[43] The "monitoring" is couched in terms of protecting, and under Principle 4, "enhancing" shareholder value.[44] In this way, it may be argued that the "monitoring" in the Stewardship Code is an outworking of private interest—that institutional shareholders monitor Boards in their private investment interests. If so, the Stewardship Code may be regarded as a standardized bargain between shareholders and the corporation in order to protect shareholders' interests as capital suppliers with a residual claimant status. The Stewardship Code seems not to have broken any new ideological ground.

Nevertheless, there are a few features of the Stewardship Code that seem to indicate a move away from treating shareholder monitoring as an essentially private matter; for example, the reference to "long-term [performance]" of companies in the Preface to the Code—it is curious, however, that this is not further embodied in the Principles.[45]

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39. James P. Hawley & Andrew T. Williams, *The Universal Owner's Role in Sustainable Economic Development*, *in* RESPONSIBLE INVESTMENT 217, 223 (Rory Sullivan & Craig MacKenzie eds., 2006) (quoting Mark Mansley & Andrew Dlugolecki, *Climate Change: A Risk Management Challenge for Institutional Investors* 12 (Universities Superannuation Scheme, Ltd. 2001), *available at* http://www.uss.co.uk/Documents/USS%20Climate%20Change%20-%20A%20RIsk%20Management%20Challenge%20for%20Inst%20Investors%20SUMMARY%202001.pdf).

40. *See generally* JENSEN & MECKLING, *supra* note 17 (discussing the role of monitoring in the agency problem).

41. UK STEWARDSHIP CODE, *supra* note 5, princ. 3 (emphasis added).

42. *Id.*

43. *Id*. princ. 4.

44. *Id.*

45. *See generally* UK STEWARDSHIP CODE, *supra* note 5. Note that the only place where the Stewardship Code mentions the "long-term" is in the preface.

It is not clear if "long-term performance" is couched in financial terms or extends more holistically to the well-being of the company in its contribution to human and economic progress. It is arguable that the Stewardship Code's preference for the "long-term horizon" of institutional shareholders is consistent with the "enlightened shareholder value" rhetoric championed by policy-makers in the reforms leading up to the Companies Act.

The "enlightened shareholder value" model underlies section 172 of the Companies Act dealing with directors' fiduciary duties to promote the long-term success of the company, taking into account matters relating to the interests of stakeholders such as employees and the community, and to responsibility for the environment.[46] Although the "enlightened shareholder value" model pertains to defining the scope of directors' duties,[47] it also paints a picture of what shareholders' interests should be. The "enlightened shareholder" is the benchmark of a hypothetical shareholder who is interested in the long-term well-being and performance of the company, and its social and environmental impact. The "enlightened shareholder value" model arguably provides a normative framework for shareholder behavior, and an investment approach toward long-term performance, with such long-term performance being a holistic rather than a narrowly financial measure. On the whole, the Stewardship Code seems to encourage "patient capital"[48] as key to stewardship.

Principle 4 of the Stewardship Code envisages the possibility of escalated monitoring in view of "risks arising from social and environmental matters."[49] This is arguably consistent with the "enlightened shareholder value" model mentioned above. Principle 4 may be setting out a normative principle that institutional shareholders should be concerned about corporate social responsibility matters, thereby requiring institutional shareholders to move away from narrowly focusing on financial

46. Companies Act, 2006, c. 46, § 172(1) (U.K.).

47. *See* Andrew Keay, *Enlightened Shareholder Value, The Reform of the Duties of Company Directors and the Corporate Objective*, 2006 L.M.C.L.Q. 335, 360–61 (Eng.). *See generally* Andrew Keay, *Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado About Little?*, 22 EUR. BUS. L. REV. 1 (2011) [hereinafter Keay, Moving Towards Stakeholderism] (analyzing section 172 of the 2006 Companies Act).

48. Term used for "long-term capital" during the proceedings of a symposium hosted by the CFA Centre for Financial Integrity Business Roundtable Institute for Corporate Ethics. *See generally* CFA Centre for Fin. Integrity/Bus. Roundtable Inst. for Corporate Ethics, Symposium Report, *Breaking the Short-Term Cycle: Discussion and Recommendations on How Corporate Leaders, Asset Managers, Investors and Analysts Can Refocus on Long-term Value* (2006) [hereinafter *Breaking the Short-Term Cycle*] (summarizing symposium proceedings), *available at* http://www.darden.virginia.edu/corporate-ethics/pdf/Short-termism_Report.pdf.

49. UK STEWARDSHIP CODE, *supra* note 5, princ. 4.

performance and to take a more holistic view of corporate performance including its impact on wider society.[50]

It could be argued that institutional shareholders' concern for social responsibility and environmental matters could be completely within the realm of their private investment interest, as a corporation's energy savings or avoidance of environmental or tortious liability could affect financial performance. In this way, Principle 4 does not require institutional shareholders to balance their private investment interests against social or environmental impact. It could be argued that Principle 4 may be seeking a convergence of institutional shareholders' private interests with the public interest of communitarian concerns, so that beneficial social or environmental outcomes could *by the way* be attained.[51] This would not amount to a call to social activism. Although an undertone of public interest can be detected in the reference to social and environmental matters in Principle 4, Principle 4 does not advocate the more radical embrace of social activism.

Academic literature has shown that there is still an indeterminate link between corporate social responsibility and financial performance;[52] hence, there may arguably be no natural convergence between institutional shareholders' private investment interests and corporate social responsibility. If so, could Principle 4 then be regarded as providing a normative benchmark for shareholder behavior toward a form of social activism? The enlightened shareholder value rhetoric provides some encouragement toward a normative model of shareholder behavior, so that institutional shareholders engage not only for their "own good," but also in considering the "good of others." Although Principle 4 is not overtly

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50. See Simon Deakin, *Squaring the Circle? Shareholder Value and Corporate Social Responsibility in the U.K.*, 70 GEO. WASH. L. REV. 976, 978, 980, 986 (2002).

51. *See, e.g.*, Steve Waygood, *Measuring the Effectiveness of Investor Engagement: GSK and Developing Country Access to Essential Medicines*, *in* RESPONSIBLE INVESTMENT, *supra* note 39, at 206, 212.

52. Michael L. Barnett & Robert M. Salomon, *Beyond Dichotomy: The Curvilinear Relationship Between Social Responsibility and Financial Performance*, 27 STRATEGIC MGMT. J. 1101, 1105–06 (2006). Some studies generally supporting a positive correlation are as follows: Marc Orlitzky, *Links between Corporate Social Responsibility and Corporate Financial Performance: Theoretical and Empirical Determinants*, *in* 2 CORPORATE SOCIAL RESPONSIBILITY 41 (José Allouche ed., 2006); Laura Poddi & Sergio Vergalli, *Does Corporate Social Responsibility Affect the Performance of Firms?* (FEEM, Working Paper No. 52.2009, 2009), *available at* http://www.feem.it/userfiles/attach/Publication/NDL2009/NDL2009-052.pdf; Jeffrey P. Katz, Eric Higgins, Marsha Dickson & Molly Eckman, *The Impact of External Monitoring and Public Reporting on Business Performance in a Global Manufacturing Industry*, 48 BUS. & SOC'Y 489 (2009). Other studies finding a negative correlation are as follows: Stephen Brammer, Chris Brooks & Stephen Pavelin, *Corporate Social Performance and Stock Returns: UK Evidence from Disaggregate Measures*, 35 FIN. MGMT. 97 (2006); Leonardo Bechetti & Rocco Ciciretti, *Corporate Social Responsibility and Stock Market Performance* (CEIS: Ctr. for Econ. & Int'l Studies, Working Paper No. 79, 2006), *available at* http://papers.ssrn.com/abstract=897499.

endorsing social activism, it is still important to note the encouragement toward a holistic consideration of corporate well-being. Perhaps, short of social activism, Principle 4 could be normativizing a form of institutional shareholder governance that avoids negative externalities.

Principle 5 envisages that institutions may step up engagement in collective terms especially "at times of significant corporate or wider economic stress, or when the risks posed threaten the ability of the company to continue."[53] Collective institutional shareholder engagement may take on a representative type of market governance for wider social concerns, beyond the atomistic concerns of investment purposes. The reference to "wider economic stress" likely refers to concern for the public interest.[54] Principle 5 thus seems to have the effect of framing shareholder engagement within normative expectations that are consistent with public interest objectives.

Principle 5, in this Article's view, indicates that institutional shareholders are being overtly regarded as part of the governance landscape in furtherance of public interest. Regulation theory, in the wake of the decline of the state[55] and central command-and-control type mechanisms in regulatory control, has been advocating theoretical models of de-centralized governance[56] where various actors, public or private, may act in a "regulatory space"[57] to exert governance and discipline on each other. Although different theories present different levels of optimism as to how the private interests of various actors may coincidentally produce beneficial public interest effects, and how the patchwork of governance forces may

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53. UK STEWARDSHIP CODE, *supra* note 5, princ. 5.

54. Part I of the WALKER REVIEW, *supra* note 2, discusses stewardship as a part of the social legitimacy of shareholding.

55. For views on the decline of the nation state, see generally PREM SHANKAR JHA, THE TWILIGHT OF THE NATION STATE: GLOBALISATION AND CONTEMPORARY STUDIES ON THE NATION STATE (Anne Marie Smith & Kate Nash eds., 2006); GOVERNANCE WITHOUT GOVERNMENT (James N. Rosenau & Ernst-Otto Czempiel eds., 1992).

56. Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342, 344 (2004). *See generally* Julia Black, *Critical Reflections on Regulation*, 27 AUSTRALIAN J. LEGAL PHIL. 1 (2002) [hereinafter Black, *Critical Reflections on Regulation*] (exploring the requirements for, and implications of, "decentralized" regulation); Julia Black, *Enrolling Actors in Regulatory Systems: Examples from UK Financial Services Regulation*, 2003 PUB. L. 63 (U.K.) [hereinafter Black, *Enrolling Actors in Regulatory Systems*] (analyzing the role of regulatory capacity and regulatory enrollment in de-centered and fragmented regulation); Julia Black, *Mapping the Contours of Contemporary Financial Services Regulation*, 2 J. CORP. L. STUD. 253 (2002) [hereinafter Black, *Mapping the Contours*] (arguing that financial services regulation is fragmented and examining such regulation through a de-centered analysis of regulation); Scott Burris, Michael Kempa & Clifford Shearing, Changes *in Governance: A Cross-Disciplinary Review of Current Scholarship*, 41 AKRON L. REV. 1 (2008) (providing an overview and analysis of governance theory and reform).

57. *See* Colin Scott, *Analysing Regulatory Space: Fragmented Resources and Institutional Design*, 2001 PUB. L. 329, 331 (U.K.). *See generally id.* at 330–34 (describing the "regulatory space" metaphor).

work together,[58] the direction that is clear is that we are increasingly looking for governance potential in a range of different actors, private or public. Hence, Principle 5 can be seen in this light: institutional shareholders, being proximate to their investee corporations, and given certain proprietary rights of control through voting and management accountability, are in a good position to be enrolled in the governance landscape.

On the whole, the Stewardship Code admonishes institutional shareholders to take on a more explicit governance role, thereby aligning private and public interests and going beyond mere private interest. It may be argued that the Financial Reporting Council applies on a comply-or-explain basis, and the Council has explicitly stated that some asset managers may legitimately choose not to engage if that is not consistent with their investment strategies, as long as an explanation is provided for that purpose.[59] This Article, however, argues that as the Stewardship Code's default position is that of stewardship and engagement, and is likely targeted at large and significant pension funds and asset managers, the exceptions to the Stewardship Code do not undermine the expectations in the Stewardship Code with respect to changing shareholders' governance role. Further, this Article argues that there are two key features in the Stewardship Code that fundamentally challenge the shareholder-centered contractarian paradigm of corporate governance as they are inconsistent with the contractarian freedom that should be enjoyed by institutional shareholders in their corporate governance role. These two features are: the call to monitor for the long-term, and the consideration of wider good in the exercise of monitoring.

1. Long-Termism

Many commentators argue that, left to their own tendencies, institutional shareholders are largely short-termist in nature. Dallas, arguing

58. *Compare* John S.F. Wright & Brian Head, *Reconsidering Regulation and Governance Theory: A Learning Approach*, 31 L. & POL'Y 192, 211 (2009) (finding that the "Responsive Regulation" theory, which "provides a normative frame based on public-interest considerations[,]" may be applied most effectively where "industry interests are very strong and third-party voices are relatively weak"), *with* Liesbet Hooghe & Gary Marks, *Unraveling the Central State, but How? Types of Multi-Level Governance*, 97 AM. POL. SCI. REV. 233, 238 (2003) (concluding that "Type II governance," where "a wide range of public and private actors who collaborate and compete in shifting coalitions," is task-driven and "designed to address a limited set of related problems"). *See also*, Shann Turnbull, Self-Regulation, *Address at the Ninth International Conference on Socio-Economics, University of Montreal*, at 2, 4–5 (July 6, 1997) (arguing that self-regulation cannot work unless power is divided rather than absolute, power is shared by interested parties, and multiple independent and varied inputs of information are supplied to such parties), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=630041.

59. FIN. REPORTING COUNCIL, IMPLEMENTATION OF THE STEWARDSHIP CODE ¶ 27 (July 2010), *available at* http://www.frc.org.uk/corporate/investorgovernance.cfm.

that human behavior, technological advances, and the market structures and legal frameworks are key to supporting a culture where capital constantly accesses opportunities and thus defines performance in shorter and shorter runs, presents a powerful account of how short-termism came to rule both financial markets and the non-financial business sectors.[60] This focus on short-termism also causes non-financial business sectors to assess performance in shorter and shorter runs, further feeding back into capital needs.[61] Short-termism, in other words, has naturally evolved in the financial and non-financial business sectors, and is a combination of both human behavior in managing risk and structural possibilities provided by technology and law. The behavior of institutional shareholders in markets such as the United States and U.K., dominated by equity capitalism, is also heavily characterized by short-termism.[62]

Wong notes, from the practitioner's point of view, that institutions such as pension funds and insurance companies diversify their portfolios by engaging different groups of asset managers to manage investments, and further, that investment managers are assessed quarterly and regular tournaments of asset managers are the norm.[63] Such assessments are generally made with reference to financial performance. A couple of industry reports and surveys also confirm the overwhelming dominance of short-termism in institutions' approaches to investing, and the frequent trading and exit behavior on the part of investment managers.[64] Investment managers, hence, prefer to be able to see their performance measured in hard targets, which are financial in nature, and, therefore, tend to sell rather than monitor a company for indefinite gains and periods.[65]

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60. *See* Lynne Dallas, *Short-Termism, the Financial Crisis and Corporate Governance*, 37 J. CORP. L. 265, 293–322 (2011) (discussing the causes of short-termism in financial and non-financial business sectors).

61. *Id.* at 310–16, 320–22 (discussing the spiraling problem of "myopia" in non-financial business sectors).

62. *See* ASPEN INST., OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT 1–2 (2009) (describing the prevalence of short-termism in the United States), *available at* http://www.aspeninstitute.org/publications/overcoming-short-termism-call-more-responsible-approach-investment-business-management.
Academic research has consistently argued that short-termism persists in the investment management patterns in the U.K. *See, e.g.*, Andrew Jackson, *Towards a Mutual Understanding of Objectives? Attitudes of Institutional Investors and Listed Companies to Corporate Governance Reforms*, 9 CORP. GOVERNANCE 196, 198, 203 (2001); John Hendry, Paul Sanderson, Richard Barker & John Roberts, *Responsible Ownership, Shareholder Value and New Shareholder Activism*, 11 COMPETITION & CHANGE 223, 237 (2007).

63. Simon C.Y. Wong, *Why Stewardship is Proving Elusive for Institutional Shareholders*, 25 BUTTERWORTHS J. INT'L BANKING & FIN. L. 406, 407 (2010). Academics have noted the same. Paul Cox, Stephen Brammer & Andrew Millington, *Pension Fund Manager Tournaments and Attitudes Towards Corporate Characteristics*, 34 J. BUS. FIN. & ACCT. 1307, 1311 (2007).

64. *Breaking the Short-Term Cycle*, *supra* note 48, at 1; ASPEN INST., *supra* note 62, at 1–2.

65. *Breaking the Short-Term Cycle*, *supra* note 48, at 3; ASPEN INST., *supra* note 62, at 2; *cf.* Brian Bushee, *The Influence of Institutional Investors on Myopic Investment Behavior*, 73

Institutional shareholders' "natural" corporate governance behavior is driven by their own investment needs, and short-termist trading and selling out are key features of such behavior.[66] Does this mean that the "monitoring" envisaged under the shareholder-centered contractarian model of corporate governance is a myth? It could be argued that "monitoring" could also refer to such short-termist investment monitoring and selling out, particularly if the market for corporate control could exert a form of discipline on managers. Yet, Gaspar et al.'s research shows that short-termist selling out to takeover bidders is motivated exclusively by institutions' investment perspectives and there is little consideration for the investee company as such.[67] Investee companies which have been bought out by short-termist institutions have tended to fare less well in the long-term.[68] Nevertheless, contractarian freedom is, by its nature, self-centered and not other-centered; hence, short-termist monitoring is still consistent with the private contractarian nature of institutional shareholders' corporate governance role.

The focus on long-termism, developed under the "enlightened shareholder approach" in the U.K. company law reforms in 2006, and now explicitly admonished in the Stewardship Code, is arguably contrary to the natural tendencies and practices in the investment industry. The kind of "monitoring" that would naturally evolve in a shareholder-centered contractarian model of corporate governance would be short-termist in nature: focused on financial performance and looking for opportunities to exit. The contractarian model *would* arguably foster and support these tendencies as a natural outworking of efficient contractual behavior. Hence, compelling institutions to favor "patient capital" introduces a constraint which does not arguably align with institutional shareholders' natural tendencies.[69]

ACCOUNTING. REV. 305, 306, 330 (1998) (finding that while institutional ownership can play a monitoring role to ensure that managers choose to maximize long-run value over short-term earnings targets, where such institutions exhibit "transient ownership characteristics," the probability that such managers will make the inverse choice is significantly increased); Brian Bushee, *Do Institutional Investors Prefer Near-Term Earnings Over Long-Run Values?*, 18 CONTEMP. ACCOUNTING. RES. 207, 212–13, 240 (2004) (finding that high levels of "transient" institutional ownership is associated with overweighting of short-term earning value and underweighting of long-term earning value, and concluding that the finding supports the notion that such ownership provides fund managers incentives for favoring short-term earnings over long-term value).

66. *See* Hendry et al., *supra* note 62, at 237.

67. *See* José-Miguel Gaspar, Massimo Massa & Pedro Matos, *Shareholder Investment Horizons and the Market for Corporate Control*, 76 J. FIN. ECON. 135, 136, 138–39 (2005).

68. *Cf. id.* at 138, 158–59 (finding that buyer firms with short-term investors have had worse underperformance in the long-run).

69. Wong, *supra* note 63, at 406.

Next, it will be argued that the regard that institutions need to have for the wider context or public interest is also contrary to a shareholder-centered contractarian model of corporate governance.

2. Wider Good

The rhetoric in the Walker Review refers to "social legitimacy" in the institutional shareholders' role, based on a "view . . . shared by the public" and by stakeholder groups.[70] Hence, institutional shareholders' governance role is not only based on contractarian speak and the agency problem. Rather, it is now stated that the role *should* be supported by public and stakeholder perception.[71] This view can only be reconciled with the shareholder-centered contractarian ideology if we regard the public and stakeholders as all part of the contractarian fabric. Nonetheless, that would conflate the private nature of the corporation supported by the contractarian theory and the social purpose of the corporation supported by communitarian theories. Hence, how should we interpret the call to "social legitimacy" within the existing theoretical frameworks? Is social legitimacy and public interest to be accommodated within the contractarian ideology or without? If the contractarian theory regards corporate governance as essentially an issue of private order, then "public interest" notions are only accounted for in terms of market failures. But the Walker Review seems to go beyond market failures.

Shareholder-centered contractarian ideology regards market failures to be impediments to shareholder monitoring due to information asymmetry or bargaining failures.[72] To overcome such market failures, the existing legal framework already provides for securities disclosure regulation to empower institutional shareholders with information. Mandatory company law rules on general meetings, voting, and institutional shareholders' approval for specific transactions[73] facilitate shareholder monitoring and provide shareholder rights to overcome such market failures. The rhetoric in the Walker Review pertaining to "stewardship" does not deal with the market failures surrounding institutional shareholders' monitoring role. Rather, it deals with ideas of social welfare—making shareholder monitoring beneficial to the wider community at large, and such wider community not being captured within the private order of the contractarian framework. Further, it will be discussed that shareholder stewardship, under the comply-or-explain regime, is also envisaged to become publicly

70. WALKER REVIEW, *supra* note 2, ¶ 5.7.

71. *Id.*

72. *See* Melvin Aron Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1463–64, 1520, 1524 (1989).

73. Examples include substantial transactions or interested transactions. *See* Companies Act, 2006, c. 46, §§ 190–214 (U.K.).

accountable, thereby explaining the Walker Review's reference to the duty of stewardship as a construct of "social legitimacy" that complements the limited liability enjoyed by institutional shareholders.

In sum, it is argued that the contextual framing of "stewardship" moves away from a shareholder-centered contractarian ideology of corporate governance. This is because "stewardship" does not accept the natural tendency of short-termism as an investment tenet, and thus introduces limitations to the contractarian freedom enjoyed by institutional shareholders in determining how best to deal with their investments. Additionally, the references to wider good in the Walker Review do not cohere with the private nature of shareholder monitoring under the shareholder-centered contractarian model of corporate governance. Further, the Financial Reporting Council now subjects the Stewardship Code to a comply-or-explain regime and encourages institutions' investment managers, proxy voting agencies, and even foreign investors who now own more than 40 percent of the U.K.'s publicly listed equity,[74] to adhere to the Stewardship Code. This Article argues that the comply-or-explain regime would also contradict the private nature of shareholder monitoring. Not only is shareholder monitoring subject to a form of normativization in the Principles of the Code mentioned above, institutional shareholders are themselves accountable under the comply-or-explain regime. Hence, the Stewardship Code does not seem to encourage the view that shareholder monitoring is a private activity framed by the contractarian and agency paradigms.

It could be argued that institutions are accountable to their beneficiaries anyway, but this Article argues that the accountability framed under the comply-or-explain regime is different from that under fund management trusteeship, which is based on private law. The nature of accountability envisaged in the Stewardship Code is more public than private in nature. Principles 1, 2, 5, and 6 require public disclosure by institutions in relation to their stewardship responsibilities and the rendering of such.[75] Such public disclosure would likely be monitored by the Financial Reporting Council and policy-makers, and hence the accountability in the discharge of stewardship is not limited to fund beneficiaries. The comply-or-explain model is likely to facilitate monitoring of institutional engagement, not by beneficiaries, but by policy-makers. Beneficiaries are likely to be too

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74. Statistics as of December 2010. OFFICE FOR NATIONAL STATISTICS, OWNERSHIP OF UK QUOTED SHARES 2010 (Feb. 28, 2012), *available at* http://www.ons.gov.uk/ons/dcp171778_257476.pdf.

75. UK STEWARDSHIP CODE, *supra* note 5, princs. 1, 2, 5, 6. Principle 1 deals with the monitoring policy generally, Principle 2 focuses on how institutions manage conflicts of interest in discharging stewardship responsibilities, Principle 5 requires public disclosure of any policies on collective engagement, and Principle 6 requires voting records to be publicly disclosed or an explanation for their nondisclosure. *Id.*

dispersed and indifferent to relate the engagement activities of their pension funds or insurance companies to the long-term performance of their savings. Hence, the Stewardship Code is intended to steer the modus of monitoring by institutional shareholders, not only for the purposes of protecting their private investment interests, but also as an exercise of governance that may deliver social good. Public disclosure also assists policy-makers and relevant regulators to understand and discern the impact of shareholder engagement on corporations, and possibly also establishes a platform of intelligence for policy-makers to consider options in governance. Principle 7 requires disclosure of details of the discharge of stewardship to beneficiaries, but does not say that such disclosure should be publicly made.[76] Still, the institutions' trade bodies, such as the National Association of Pension Funds and the Investment Management Association, publish almost yearly surveys going into some detail of how institutions engage and what is achieved. Hence, it is argued that institutional engagement will be looked at most closely by policy-makers and regulators, rather than by dispersed individual beneficiaries. Individual beneficiaries are unlikely to make the connections between how institutional stewardship in shareholder engagement translates into investment performance, or the ultimate provision of retirement or long-term savings. On the other hand, policy-makers and regulators would be interested in the quasi-governance role of institutions in the regulatory space.

It can, however, be argued that the Stewardship Code represents a set of hypothetical default bargains that institutions would have struck with their beneficiaries, and that it does not depart from a dominantly private interest paradigm. But this Article argues that the Stewardship Code is unlikely to reflect beneficiaries' preferences. Beneficiaries are likely to prefer that institutions have the freedom to engage as well as to sell, and would not likely place undue emphasis on engagement. As Tsuk-Mitchell explains, the key conceptualization of an "investor" has been one whose primary right is to sell out if unhappy with the investment, and not necessarily to participate in the internal reform of companies.[77] Further, the hypothetical default bargain model breaks down especially in relation to Principle 5. Why would beneficiaries necessarily think that collective engagement by institutions in times of economic stress would be the ideal default bargain? Would not beneficiaries prefer institutions to rationally engage in individual wealth-maximizing behavior in order to address their investment interests? Although the Stewardship Code is soft law, this Article is of the view that the approach of the Stewardship Code to normativizing aspects of shareholder monitoring, in addition to its comply-or-explain nature,

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76. *Id.* princ. 7.

77. Dalia Tsuk Mitchell, *Institutional Shareholders as Proxies: The Contours of Shareholder Democracy*, 63 WASH. & LEE L. REV. 1503, 1514, 1563–64, 1570 (2006).

supports taking the view that the Stewardship Code signals the shifting away from a private contractarian approach to shareholder monitoring. Institutional shareholders are not merely required to align their private interests with wider concerns, but possibly to do more, as engagement, monitoring, public reporting, and collective engagement all require positive effort and cost.

In the next Part, this Article will argue that although the Stewardship Code contains principles that indicate a move away from shareholder-centered contractarianism, the theoretical shift does not swing to a communitarian conception of the corporation. This Part will suggest that the theoretical shift is based on elements of stakeholder theory, in particular elevating the position of the state as "key stakeholder" in the context of the U.K. bank bailout in 2008–2009.

III. THE RISE OF THE "KEY STAKEHOLDERS"

This Part first examines the models of communitarian theories in corporate governance, and argues that the Walker Review and the Stewardship Code, nevertheless, do not encourage a total embrace of communitarian theories of corporate governance. It will also argue, however, that the developments in the Walker Review and the Stewardship Code embody a limited conception of the stakeholder theory, what this Article will refer to as a "key stakeholders" approach.

A. THE COMMUNITARIAN MODELS OF CORPORATE GOVERNANCE THEORY

Although the contractarian theory dominates corporate governance theory and legal frameworks, the corporation has not always been regarded merely as a private order of arrangements. Berle's and Dodd's writings in the 1930s conceive of the corporation as a social entity and institution producing social impact, although they disagree on the channels of accountability for directors.[78]

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78. *Compare* A. A. Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049, 1074 (1931) (arguing that corporate powers must only be used for the ratable benefit of shareholders because, substantively, corporate law should be viewed as a more flexible branch of the law of trusts), *with* E. Merrick Dodd, *For whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1147–48 (1932) (arguing that while Berle's "trustee" theory is generally agreeable, it is disagreeable to view corporations as solely profit-makers for shareholders because corporations have social utility and should therefore bear responsibility for stakeholders), *with* Adolf A. Berle, *For whom Corporate Managers are Trustees: a Note*, 45 HARV. L. REV. 1365, 1367–68, 1370 (1932) (responding to Dodd by arguing that, in practice, the social utility of a corporation exists in the large number of shareholders and through their interconnectedness with other members of society, and that until a "clear and reasonably enforceable scheme" is developed, corporate responsibility should be directed toward making profits for shareholders).

Communitarian models of corporate law grasp the phenomenon that the sum of the corporation and its power are greater than its constituent parts, and therefore view corporate power as a social issue of concern. The concession theory posits that corporations are creatures of statute, and hence, there is not only a sense of public purpose in their existence, but that the state is also placed in an unquestioning position to impose regulation on corporations.[79] This is possibly the earliest conception of a communitarian model of the corporation, derived from the chartered corporation in the eighteenth century. The concession theory is based on the organized collectivity of the corporation as an extension of certain social purposes, such as infrastructural building (railways) or empire building (companies that governed and exploited colonial resources such as the East India Company).[80]

The concession theory has long waned in persuasion but communitarian conceptions of the corporation remain as theorists continue to observe a "semi-public" character in the organized collectivity of the corporation—the "real entity." Dodd observes that the "real entity" of the corporation is regulable and regulated, as its internal processes and its products entail social consequences such as employee relations, products liability, consumer rights, and so on.[81] As corporations become major employers, centers of consumer outputs, and economic engines of growth, Kaysen comments that corporate power becomes social and political power.[82] The investment of corporations into research or innovation may determine the economic growth of specific industries and public investment into education and training: the economic significance of corporations extends beyond efficiency and output to social progressiveness and distribution.[83] Marketing carried out by corporations shape social perceptions and consciousness, and eventually culture.

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79. Mahoney argues that the statutory intervention only followed developments in the mercantile community that had been attempting to achieve the separateness of business activities from personal assets through various other means such as contract and trust, and hence the claims of the concession theory are overrated. *See* Paul G. Mahoney, *Contract or Concession? An Essay on the History of Corporate Law*, 34 GA. L. REV. 873, 884, 887–88, 892–93 (1999); *see also* Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 937–38, 965–66, 971, 992–93 (1984) (noting that even if corporate personality is now enshrined in statute, it does not mean that the corporation is of a public character or that a regulatory fiat over it is warranted).

80. *See, e.g.*, JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA 21, 47–49 (2003). Yet, Mahoney would argue that charters are for more self-interested purposes such as securing a monopoly. Mahoney, *supra* note 79, at 887.

81. *See* Dodd, *supra* note 78, at 1148, 1150–51, 1153, 1161–62.

82. Carl Kaysen, *The Corporation: How Much Power? What Scope?*, *in* THE CORPORATION IN MODERN SOCIETY 85, 99 (Edward Sagendorph Mason ed., 1975).

83. *See id.*, at 93, 94–96, 100, 102–03.

The "semi-public" character of the corporation is arguably minimized in the contractarian approach, which focuses on the "parts" of the corporation rather than its sum,[84] and thus, produces a de-socializing and de-politicizing effect upon the trajectory of corporate law scholarship.[85] Contractual theorists also argue that the transactional actors in the corporation are often assumed to be rational transactors with narrow foci on economic objectives such as resource allocation,[86] asset partitioning,[87] and economic gain.[88] Such a depiction of the transacting actors in the nexus dehumanizes these actors[89] and encourages self-interested atomistic behavior such as "shirking and sharking"[90] to arise. The conception of the corporation in individualistic terms under the contractarian theory is arguably responsible for perpetuating the behavioral problems of managerial power and "sharking"—that is, shareholder power exercised for selfish and short-termist objectives.[91] Yet, the communitarian theorists who look at the sum of the corporation as well as its parts are not quite in agreement as to what the alternative vision might encompass.[92]

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84. *See generally* Paul N. Cox, *The Public, the Private and the Corporation*, 80 MARQ. L. REV. 391 (1997) (examining the contractarian-communitarian debate, and arguing that traditions of contractarian theory have some overlap with communitarian premises and that corporate law may be viewed through a contractarian lens as being reliant on non-legally enforced social norms).

85. Professor Tsuk-Mitchell argues that the economic focus of corporate law steers corporate theory into the safe haven that is strictly opposite to the Marxist/leftist conceptions of corporate law, which are more social in nature, in an age when the cold war still loomed large. Dalia Tsuk, *Corporations Without Labor: The Politics of Progressive Corporate Law*, 151 U. PA. L. REV. 1861, 1864, 1909–11 (2003).

86. KENNETH J. ARROW, THE LIMITS OF ORGANISATION 17–18, 20–22 (1974).

87. Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 Yale L.J. 387, 392–94 (2000).

88. DOUGLASS NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 107–08 (1990).

89. Lawrence E. Mitchell, *Groundwork of the Metaphysics of Corporate Law*, 50 WASH. & LEE L. REV. 1477, 1479 (1993) [hereinafter Mitchell, *Groundwork of the Metaphysics of Corporate Law*] (citing ELIZABETH WOLGAST, ETHICS OF AN ARTIFICIAL PERSON (1992)); Alan Wolfe, *The Modern Corporation: Private Agent or Public Actor*, 50 WASH. & LEE L. REV. 1673, 1688 (1993); *see* Lawrence E. Mitchell, *Trust, Contract, Process*, *in* PROGRESSIVE CORPORATE LAW 185, 194–97 (Lawrence E. Mitchell ed., 1995).

90. Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL'Y REV. 265, 327 (1998).

91. "Shirking" is characterized as an agent "slacking off" to the detriment of the principal, while "sharking" is characterized as the principal's abuse of power and authority to the detriment of the agent. *Id.* at 278, 280.

92. *See* Joel Seligman, *Foreword* to PROGRESSIVE CORPORATE LAW, *supra* note 89, at ix–x. For a critique of Progressive Corporate Law Scholarship, see generally Stephen Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856 (1997).

B. THE CORPORATION AS SOCIAL CONSTRUCT AND CITIZEN

One communitarian conception of the corporation is that it is an organized collective that is part of the social fabric. This perspective places importance on the external and collective dimension of the corporation as a "real entity" in society and community, and therefore, demands are placed on corporations to have legal and social rights and duties and to participate in social life. Earlier commentators, such as Blumberg, see corporations as having a role to play in mitigating racial inequality in America by promoting equal opportunities in employment, and by being involved in philanthropy and social giving.[93] Parkinson, commenting in the 1990s, also advocates that "social activism" is part-and-parcel of corporate responsibility, involving charitable giving and support for community.[94] This is also consistent with Mitchell's and Ripken's arguments that the corporation should be perceived as a "person," and hence corporate law should play a part in "humanizing" the corporate personality in order to encourage a holistic existence of the corporation within the social fabric.[95] Wheeler, in the U.K., advocates that corporations should participate actively in the social fabric, partnering regional development causes and steering profit-making along virtue ethics in order to become a "social citizen."[96] Solomon, in his contribution to the *Progressive Corporate Law* volume, also advocates the communitarian conception of the corporation as a form of humanomics—that is, a collective entity that may be formed not only for private enterprise, but also for responsible and sustainable use of resources, including labor.[97]

The "socialization" of the corporation, as discussed above, is, however, not the dominant paradigm in the communitarian camp. The concern with adopting this communitarian perspective as the theory of the corporation is that the notions of libertarian rights in property and contract may be undermined.[98] This undermining of libertarian notions of individualist empowerment may give way to regulatory intervention and control, thereby allowing the regulatory state to assume concentrated power over economic

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93. Phillip I. Blumberg, *The Politicalization of the Corporation*, 26 BUS. LAW. 1551, 1551, 1582–84, 1586–87 (1971).

94. JOHN E. PARKINSON, CORPORATE POWER AND RESPONSIBILITY 266–67, 290–92 (1993).

95. Susanna Kim Ripken, *Corporations are People Too: A Multi-Dimensional Approach to the Corporate Personhood Puzzle*, 15 FORDHAM J. CORP. & FIN. L. 97, 105–06, 175–77 (2009); Mitchell, *Groundwork of the Metaphysics of Corporate Law*, supra note 89, 1487–88.

96. SALLY WHEELER, CORPORATIONS AND THE THIRD WAY 38–39, 42–44, 53, 71–72, 79–80 (2002).

97. Lewis D. Solomon, *On the Frontier of Capitalism: Implementation of Humanomics by Modern Publicly Held Corporations—A Critical Assessment*, *in* PROGRESSIVE CORPORATE LAW, *supra* note 89, at 281, 281–82.

98. Some discussion of the undermining of libertarian individual rights conceptions in the rise of the administrative state may be found in Jerry L. Mashaw, *"Rights" in the Federal Administrative State*, 92 YALE L.J. 1129 (1983).

activities. The latter half of the twentieth century has seen the rise of the administrative state in western economies such as the United States and U.K. (developments in the welfare and administrative state in the U.K. were arguably proliferated under the Labour government elected in 1945).[99] Perhaps private contractarian principles underlying corporate theory and law have been serving a countervailing ideological purpose.

C. EXTERNALITIES-BASED PERSPECTIVE OF THE CORPORATION

Another group of commentators advocate the communitarian conception of the corporation based on the social externalities caused by corporate activities. Greenfield, for example, writes extensively on the social costs resulting from corporate activities and calls for corporate law to be treated as "public law" in order to regulate externality-creating behavior.[100] The "socialization" of the corporate entity may be manifest in specific regulation such as health and safety legislation, employment legislation, consumer protection and fair trading, anti-competitive regulation, occupier's liability, products liability, and so on.[101] These laws could intervene in internal corporate processes in order to achieve certain social outcomes. Products liability laws affect internal processes of quality control and checking; laws on equal opportunities demand internal processes to be put in place in order to monitor equal opportunities and create feedback processes. Bruner argues that, where the U.K. is concerned, the wide range of specific regulatory laws in respect of defined social issues such as employment rights, product safety, and so on, means that there is less need for corporate law to deal with such matters in corporate

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99. *See* WILLIAM R. CORNISH & G. DE N. CLARK, LAW AND SOCIETY IN ENGLAND: 1750–1950, at 464–66 (1989).

100. *See generally* KENT GREENFIELD, THE FAILURE OF CORPORATE LAW (2006) [hereinafter GREENFIELD, THE FAILURE OF CORPORATE LAW] (challenging the dominant view of corporate law by showing that changes to the basic assumptions of corporate law and corporations could have positive results, and proposing some changes that may be achievable); Kent Greenfield, *New Principles for Corporate Law*, 1 HASTINGS BUS. L.J. 89 (2005) [hereinafter Greenfield, *New Principles for Corporate Law*] (prescribing five principles for corporate regulation, founded upon the interests of society, that may further the public good).

101. *See generally* William W. Bratton, *Welfare, Dialectic, and Mediation in Corporate Law*, 2 BERKELEY BUS. L.J. 59 (2005) (examining the objectives of corporate law; explaining why such objectives create resistances toward social responsibility and stakeholder empowerment; and explaining how corporate law has actually mediated tensions created in the shareholder-manager agency relationship in an "open-ended" and "piecemeal" manner, notwithstanding the theories posited for managing such tensions); Robert John Schultze, Book Note, *Can This Marriage be Saved? Reconciling Progressivism with Profits in Corporate Governance Laws*, 49 STAN. L. REV. 1607 (1997) (arguing that external regulation targeting specific issues is the right approach to govern issues of a social effect resulting from corporate activity, and that it is wrong to reach into internal governance for the purposes of regulating for social effects).

governance.[102] He argues that the greater presence of the welfare state in the U.K., and a gamut of specific social legislation, make it unnecessary for corporate law to cater to so many stakeholder "constituents" and social issues, hence placing the emphasis in corporate law on the internal private order of corporate governance.[103] Instead of "socializing" the corporate law, public regulatory law may have the effect of trimming the parameters of corporate law so that it is concerned only with an internal core, thus maintaining the contractarian conception of corporate law.

This Article agrees with Bruner's observations that social issues, especially with regard to externalities, are often treated as outside of corporate law. Although the imposition of such regulatory law would undoubtedly change corporate and business practice, such public regulatory law is based on defined third-party externalities and does not purport to govern internal operations and corporate governance directly. This is why, notwithstanding that corporate governance codes have been promulgated as a response to social disquiet following the fall of the Bank of Credit and Commerce International in 1991,[104] perceptions of excessive executive remuneration in 1995,[105] and most recently, the social costs resulting from the global financial crisis of 2008–2009,[106] such codes have remained as soft law in the U.K.

Do the Walker Review and the Stewardship Code support the rise of a communitarian theory of corporate governance, given their seemingly common sympathy for public interest and wider good? This Article argues that they do not embrace the communitarian conception of socializing the corporation.

The Stewardship Code does not seem to subscribe to the communitarian theories that are explicit on social activism. Where the Stewardship Code gets the closest to social activism, namely Principles 4 and 5, it is actually ambivalent about social activism. Principle 4 encourages institutions to monitor and consider the escalation of engagement where there are risks in respect of social and environmental matters. This may come close to a call toward activism for social responsibility. As discussed in Part I, however, the risks in respect of social and environmental matters may also refer to

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102. *See* Christopher M. Bruner, *Power and Purpose in the "Anglo-American" Corporation*, 50 VA. J. INT'L L. 579, 583–86, 603, 622, 634, 637–39, 649–653 (2010).

103. *See id.* In general, Bruner's argument is that, in comparing the U.S. and U.K. climates, the amount of regulation, outside corporate law, protecting the interests of constituents other than shareholders, is inversely proportional to the amount of regulation, inside corporate law, required to safeguard such interests.

104. CADBURY REPORT, *supra* note 28, at 9, 11.

105. STUDY GROUP ON DIRECTORS' REMUNERATION, DIRECTORS' REMUNERATION: REPORT OF A STUDY GROUP CHAIRED BY SIR RICHARD GREENBURY 7, 11–12 (1995) [hereinafter GREENBURY REPORT], *available at* http://www.ecgi.org/codes/code.php?code_id=131.

106. WALKER REVIEW, *supra* note 2, at 9–12.

short-term and long-term financial risks to the company and to investors. As academic literature is still divided on the exact impact of corporate social responsibility on the financial performance of companies, Principle 4 does not rule out financially-focused behavior. Principle 5 calls upon institutions to collectively engage in times of wider economic stress, and this again may seem to be an endorsement for social activism. In light of the context of the global financial crisis, however, Principle 5 may be better read as collective activism in order to safeguard the viability of a corporation so that its failure may not trigger contagion or systemic risk effects to the industry and to other sectors. Principle 5 does not advocate the socialization of any particular corporation to serve social purposes, and is perhaps closer to externality mitigation. On the whole, there does not seem to be a clear antithetical shift away to "communitarianize" or "socialize" the nature of the corporation, as advocated by the first strand of communitarian theorists discussed above.

The theoretical shift that may be represented by the Walker Review and the Stewardship Code is not toward the archetypal opposite of shareholder-centered contractarianism—communitarianizing the corporation. Rather, although not in the way stakeholder theorists advocate in terms of access and participation rights in corporate governance, the theoretical shift is closer to embodying a form of stakeholder theory. Neither the Stewardship Code nor the Corporate Governance Code[107] goes as far as to address participatory rights for stakeholders, which is a key feature in the stakeholder models to be discussed below. Hence, the Stewardship Code cannot be regarded as embracing "stakeholder theory" as such, but possibly only as infusing certain stakeholder elements into an extended form of shareholder-centered contractarianism. This approach will be referred to as the "key stakeholders" approach in this Article.

D. STAKEHOLDER THEORY

Stakeholder theory is not strictly speaking a "communitarian view" as it does not emphasize the social purpose or nature of a corporation. Rather, it is a "processual" perspective, asking for stakeholders to be co-opted into corporate governance either by participation or by disclosure and accountability.[108] Still, there seems to be an almost natural convergence

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107. *See* sources cited *supra* notes 4–5.

108. Although some theorists go for stakeholder duties as well, others argue that activist institutional shareholders should be imposed with a fiduciary duty. Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1262–65, 1307 (2006). The extension of duties in substantive law is not supported though. *See* Richard Saliterman, *Perceptions Bearing on the Public Policy Dynamics of Corporation Law*, 20 HAMLINE L. REV. 261, 288, 331 (1996) (arguing that all constituents in the corporation are in it for self-interested purposes as well, and the needs of individual liberty could be severely compromised by ill-defined legal duties).

between theories sympathetic to the communitarian conception of corporate law and theories supporting increased involvement of stakeholders in corporate governance. This convergence appeals as the widening of the constituency base of the corporation draws more of society or community into the "boundary"[109] of the corporation, arguably giving such "participation" a social or semi-public character. On the other hand, can such participation be open to all? If such participation cannot be open to all, then the selection of which stakeholders matter would create an inclusive-exclusive effect, which may not differ from the wider contractarian conception of the corporation that includes a broad range of constituents beyond the organs of the company. In this respect, communitarian theories which ultimately emphasize processual approaches and stakeholder engagement may arguably not be very different in character from a contract-plus conception of the corporation. Nevertheless, stakeholder theories have the potential of introducing diverse negotiation in the "contractarian" order of the corporation, whereby the basis upon which stakeholders may be enrolled could be framed around alternative concepts such as externalities, justice, and social legitimacy, beyond capital-centered agency concepts.

Early commentators suggest a form of stakeholder participation that is open to the public: that of the public election of directors of significantly large corporations such as General Motors in the United States,[110] or of instituting "public directors" that have public accountability for the social effects of corporate decisions.[111] These rather dated but bold proposals reach into corporate governance in order to regulate corporate decision-making and activity, not merely as a private enterprise, but as a social construct.

More contemporary commentators such as Freeman define stakeholders as "suppliers, customers, employees, [owners], the local community, and [managers]."[112] This definition of "stakeholder" is based on the scope of persons who may be able to enter into a "Fair Contract" with the corporation.[113] Greenfield advocates that stakeholders should be able to

109. There has been interesting research in economic geography on how the boundaries of the firm may be defined, and whether modern technological innovations changing the interface of firm interaction with "outsiders" now makes many "outsiders" part of the "firm" itself. *See generally* UNDERSTANDING THE FIRM: SPATIAL AND ORGANIZATIONAL DIMENSIONS (Michael Taylor & Päivi Oinas eds., 2006) (addressing, from an economic geography perspective, the gaps and fragmented thinking present in certain theories of the firm).

110. Blumberg, *supra* note 93, at 1560.

111. Arthur S. Miller, *A Modest Proposal for Helping to Tame the Corporate Beast*, 8 HOFSTRA L. REV. 79, 91 (1979).

112. R. Edward Freeman, *A Stakeholder Theory of the Modern Corporation*, *in* THE CORPORATION AND ITS STAKEHOLDERS 126 (Max B.E. Clarkson ed., 1998).

113. *See id.* at 126, 129–34.

elect directors and share in the gains of the corporation;[114] but, of particular relevance, his treatise, focusing greatly on the lack of redistributive justice to employees, argues for a fiduciary duty to be owed to employees due to the failures of relational contracting between corporations and employees.[115] Sheehy advocates "stakeholder" participation in holding corporations to account for, and to benefit from, the distribution of gains from corporations.[116] This version of stakeholder theory is based on a "justice" model that regards stakeholders as those who could be negatively affected by corporate activities. The externality connection then justifies Sheehy's view that corporate gains should contribute to stakeholder wealth, and not just to the private wealth of capital providers, in order to compensate for such stakeholders' forbearance of negative externalities.

On the whole, although stakeholder theory again internalizes the conception of the corporation into a web of relationships, and does not communitarianize the corporation,[117] stakeholder theory is more "progressive" in nature, as it allows the boundaries of accountability to be widened and allows for the enrollment of stakeholders based on concepts such as externalities, social legitimacy, and justice. With the dominance of the law and economics movement, and of libertarian political ideologies, the contractarian conception of corporate law as essentially private[118] is an enduring one. Hence, it is not surprising that stakeholder theories do not advocate a completely public form of accountability.

The Stewardship Code does not embrace stakeholder theory in terms of direct access to, and participation in, corporate governance. The real ideological shift in the Stewardship Code and the role of shareholder governance, in general, is a more nuanced one. The following will argue that the Walker Review and the Stewardship Code move toward embracing a key stakeholder, but not stakeholders generally. In the context of the global banking crisis which has given rise to the Walker Review and the Stewardship Code, the key stakeholder is the state or the relevant regulator. It will be argued that the Stewardship Code embraces a form of nuanced participation for the state or relevant regulator as "key stakeholder," in the form of shareholder stewardship as accountability. The indirect nature of

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114. Greenfield, *New Principles for Corporate Law*, *supra* note 100, at 108–09, 115.

115. *See* GREENFIELD, THE FAILURE OF CORPORATE LAW, *supra* note 100, at 63, 154, 159–70 (arguing that extending a fiduciary duty to employees would increase "fairness," which, in turn, would build the "trust and cooperation" required for "relational" contracting).

116. Benedict Sheehy, *Scrooge—The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate*, 14 U. MIAMI BUS. L. REV. 193, 235, 239–40 (2005).

117. *See generally* David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, *in* PROGRESSIVE CORPORATE LAW, *supra* note 89, at 1 (discussing and evaluating non-contractarian approaches to corporate law).

118. The dominance of the contractarian conception of corporate law is discussed in BRIAN R. CHEFFINS, THE TRAJECTORY OF (CORPORATE LAW) SCHOLARSHIP: INAUGURAL LECTURE AT THE UNIVERSITY OF CAMBRIDGE, OCTOBER 2003, at 43–57, 62–66 (2004).

the state's role in the Stewardship Code attempts to introduce some balance to the shareholder-centered contractarian model of corporate governance without appearing to reintroduce concession type theories to reregulate economic activity by the back door. Yet, it may also be said that such a narrow and limited ideological move achieves little in introducing greater public interest rhetoric in corporate governance theory which has, for too long, been dominated by a private and insular contractarian paradigm. Part IV addresses this debate.

E. THE KEY STAKEHOLDER APPROACH

The context of the Stewardship Code is represented by the Walker Review of shortcomings in the corporate governance of banks and financial institutions, and how such sub-optimal governance has affected the U.K. banking crisis 2008–2009. For banks and systemically important financial institutions,[119] the potential for state bailout, in times of crisis or failure, exists in order to prevent cascading devastating effects upon the financial sector and the general economy.[120] Thus, where a failure of a systemically important bank or financial institution looms, it is not merely the shareholders and creditors of the institution that stand to bear residual risks and loss, the state may also be placed in a similar position. Such bailout would, however, benefit and protect shareholders and creditors at the expense of public money.[121] In this context, an institutional shareholders' "residual claimant" role in the contractarian paradigm may be mitigated by ultimate state support; hence, it could be argued that their monitoring role is no longer entirely "free" in the private contractarian sense, and that the state's potential liability is to be regarded as a "stake." Such a stake could either be supported by direct access and participation as per stakeholder theory, or by shareholder accountability, so that shareholder monitoring gives cognizance to, and is accountable for, the state's "stake."

The state's "stake" provides countervailing pressures to shareholders' private contractarian pursuits which would naturally be self-centered and short-termist. The state as a stakeholder, however, is not framed in the terms that stakeholder theorists would expect in terms of direct participation and/or accountability. In this Article's view, the state's "stake" is expressed

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119. Systemically important financial institutions means financial institutions whose collapse may trigger a series of devastating effects upon other institutions and the market generally, thereby affecting general economic well-being. *See* Rosa Lastra, *Systemic Risk, SIFIs and Financial Stability*, 6 CAP. MARKETS L. J. 197, 198–200, 209 (2011).

120. *See id.*

121. It has been argued that the position of the government is in need of recognition in bank and financial institution corporate governance. *See, e.g.*, Peter O. Mülbert, *Corporate Governance of Banks after the Financial Crisis: Theory, Evidence, Reforms* §§ 2, 4.3.2.1 (European Corp. Governance Inst., Working Paper No. 151/2010, 2010), *available at* http://ssrn.com/abstract =1448118.

indirectly through the accountability, or "stewardship," of institutions. Hence, the accountability inherent in the stewardship concept applies, in the particular case of financial institutions, to the accountability of shareholders to the state as a "key stakeholder" that mitigates shareholders' residual risk. Nevertheless, in order to prevent open-ended policy interference by the state, "stewardship" has seven defined features and principles in the Stewardship Code.[122] Thus, the ideological shift introduced by the Stewardship Code is an indirect recognition of a "key stakeholder" based on shareholder accountability.

Yet, can this be said to be an ideological shift in corporate governance generally? The state's "stake" in systemically important financial institutions may be argued to be unique to the financial sector. A number of commentators[123] have argued that banks are special enterprises because they rely much more on deposits and other loans as a source of finance than on equity, and that, therefore, since losses would be shared with a large base of creditors, equity holders would prefer higher risk-taking in order to maximize returns. The corporate governance incentives in banks are thus likely to be in favor of risk-taking that exceeds what may be socially optimal. In this light, regulatory intervention such as micro-prudential regulation is warranted, and the role of the state as some form of a stakeholder is arguably more acceptable as a force mitigating market failure and potential social cost.

Even if we accept that the state may be in a unique position of being a "key stakeholder" in the financial sector, it is not inconceivable that the state could be a "key stakeholder" in other sectors. State bailout has already occurred in another industry in the United States—the automotive industry. Policy-makers can determine that, besides banks, other industries have become socially or systemically important, although this does not necessarily mean that the state is always a "key stakeholder" in such industries. Indeed, this Article also suggests that besides the state as a potential "key stakeholder" in some sectors, the "key stakeholder" concept can be extended to encompass other stakeholders besides the state.

The context of the banking crisis and unique corporate governance incentives in banks may be distinguished from corporate governance in other sectors. The Stewardship Code, however, has chosen to apply more broadly to the corporate sector. This Article argues that the extension of the Stewardship Code to other corporate sectors can be ideologically based on a new "key stakeholder" approach that can be extrapolated from the position of the state in relation to financial institutions and such other systemically

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122. For the specific principles of "stewardship," refer to UK STEWARDSHIP CODE, *supra* note 5.

123. *See* Lucian Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247, 253, 258–61, 275–76 (2010); Mülbert, *supra* note 121, §§ 4.1, 4.2.1–2.2, 6.

important corporations as policy-makers may determine. Such a "key stakeholder" approach is capable of being coherent and can bring about ideological changes to corporate governance theory.

The "key stakeholder" position of the state, in relation to financial and other possibly systemically significant institutions, is based on the potential that the state may "bail out" or mitigate shareholders' residual risk. The state could be a "key stakeholder" in sectors where there may be high levels of economic output or employment so that the social and economic significance of certain corporations may entail a characterization as "systemically or socially significant."[124] Further, other stakeholders in relation to other industries may also be placed in a similar position: that is, having the liability to absorb or mitigate residual risk without participatory rights in corporate governance. For example, the author of this Article has heard informally that some companies in the U.K. have implemented salary sacrifice schemes in order to report favorable finances during the economic downturn of 2008–2009 and to support the paying of dividends to shareholders. The role of employees in such a case could arguably amount to one of providing mitigation to shareholders' residual risk. Such employees could be elevated to a "key stakeholder" position so that shareholder monitoring should take into account of, and be accountable to, them.

A "key stakeholder" may be identified as one that mitigates shareholders' residual risk, taking on a role of loss absorption or sharing. One is reminded of the Coasean bargain with respect to social cost[125]: that constituents affected by the cost of corporate activity may weigh the costs and benefits of such activity and come to actions that proportionately balance their private benefit derived from such activity against the private and social cost incurred. Hence, any "loss absorption" by stakeholders must be balanced against the private benefit that they obtain from the result of corporate activity; for example, manufacturing socially desirable goods.[126] In Coasean terms, "loss absorption" is framed within a private give-and-

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124. Currently, the term "systemically important" is used only in relation to financial institutions. *See, e.g.*, FIN. STABILITY BD., POLICY MEASURES TO ADDRESS SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS (Nov. 2011), *available at* http://www.financialstabilityboard.org/publications/r_111104bb.pdf.

125. *See generally* Ronald Coase, *The Problem of Social Cost* 3, J.L. & Econ. 1, 2, 9–10 (1960) (examining the relationship between the Coasean bargain and social costs, and arguing that because a benefit somewhere is accompanied with a detriment elsewhere, and because a corrective measure to cure that detriment is accompanied by yet another detriment, the total net effect of all benefits and detriments should be regarded).

126. Such balancing is evident in the manufacture of paper products by plants that emit sulfurous odors. Paper products are socially desirable but odors are not, and where the community surrounding the plant is also employed by the plant, one can see the tensions that arise between the private benefit and the private and social costs.

take paradigm between stakeholders and the corporation, and is not socialized into a public interest issue.

The "key stakeholder" approach may be accommodated within the contractarian paradigm of the corporation; and where the "key stakeholder" is the state, the contractarian web is widened to include the state and the constituents it represents. Such an approach has the potential of introducing wider social interest elements into a contractarian paradigm due to the private and public nature of "key stakeholders."

This Article argues that the "key stakeholder" approach is not inherently contradictory. Such an approach does not threaten to subvert the nature of the corporation or reintroduce communitarian concepts by the back door. As the Coasean corporation has taken on new dimensions in present times, from the local company to global multinational enterprises, it is arguably apt to extend the essentially private paradigm of Coasean social cost to embrace a mixture of private and wider social interest. This is because the scale of externalities that may entail from global corporate activity may become sufficiently significant.

It may rightly be said that identifying "key stakeholders" of global and complex operations would likely be a diverse and complex exercise. There may be diverse groups of conflicting interests and an array of social and political driving forces supporting different groups to allow them to be heard. Still, this does not mean that "everyone" should become a "key stakeholder" and that the contractarian boundaries should collapse in favor of a communitarian conception. The key quality of "key stakeholders" is that they are in the position of mitigating shareholders' residual risk in their loss absorption capacity. This may include a group of involuntary tort victims who have suffered from the cost-cutting measures of a corporation compromising on health and safety, but may not include an occasional tort victim of negligence. This Article acknowledges that there may be complexity in ascertaining "key stakeholders," and contests between different groups of stakeholders, and between stakeholders and corporations, are likely to exist. Nonetheless, the next Part will suggest that the complex and negotiative landscape for stakeholders is not necessarily a drawback.

In sum, there are two key ideological changes to the dominant shareholder-centered contractarian theory that are offered by the "key stakeholder" approach. First, the recognition of the key stakeholder's indirect stake in the corporation that calls shareholders to stewardship mitigates shareholder-centric perspectives in corporate governance. Second, the notion of social or public interest can be infused into corporate governance theory either through the identity of the key stakeholder (for example, the state) whose objective may lie in social or public interest, or through the nature of the "stake" which may lie in preventing or mitigating private and social costs as a result of corporate activity.

This Article also regards the Stewardship Code as filling in where the "enlightened shareholder value" approach is lacking. The "enlightened shareholder value" approach recognizes the business case for asking shareholders and directors to integrate stakeholder welfare into corporate performance. Such an approach is instrumental[127] in nature—that is to say, that stakeholders are not given cognizance *as such,* but only because stakeholder welfare may be related to the business case. The enlightened shareholder value approach views stakeholders from a self-centered perspective and is short of being really "enlightened"! The Stewardship Code, however, uses shareholder stewardship to express and account for another's "stake." This is an improvement from the instrumental view taken by the "enlightened shareholder value" approach, as the "stake" is given recognition as being other-centered, and not just perceived from the perspective of the corporation or the shareholder. Although the expression of the "stake" is not independent, and relies on shareholder stewardship, the accountability notion inherent in stewardship is one step toward indicating the other-centered nature of stewardship and away from the self-centeredness of shareholder-centered contractarianism.

One critique against the "enlightened shareholder value" approach is that it is unlikely to be effective in addressing stakeholder concerns without accountability to, and participation by, stakeholders.[128] This Article argues that there is potential in the "stewardship" notion to make the indirectly expressed "stake" count, and thereby edge toward ideologically transforming corporate governance theory. The next Part will argue that much of this ideological potential lies in how stewardship is called to account, as the accountability of stewardship will show the extent to which the indirect stake of "key stakeholders" can be expressed in corporate governance.

IV. THE IDEOLOGICAL SIGNIFICANCE OF STEWARDSHIP

Although the Stewardship Code does not move very far from the shareholder-centered contractarian paradigm, this Article argues that it is mistaken to treat the "key stakeholder" approach, as embodied in the Stewardship Code, as insubstantially consequential. This Part will explore the possibilities in calling stewardship to account so that the "indirect stake" of "key stakeholders" can be made to count. This Part will also explore the

127. *See* T. Donaldson & L.E. Preston, *The Stakeholder Theory of the Corporation*, 20 ACAD. MGMT. REV. 65, 71, 77–78 (1995) (describing the instrumental theory as one that posits a positive correlation between emphasizing stakeholder interests with positive business performance).

128. *See generally* Keay, *Moving Towards Stakeholderism*, *supra* note 47 (concluding that section 172 of the 2006 Companies Act provides only an appearance of focus on stakeholder interests).

weaknesses in the "key stakeholder" approach that may undermine the ideological developments suggested.

As mentioned earlier, the accountability of stewardship is subject to a "comply or explain" regime, and such disclosure is likely to be scrutinized to a greater extent by regulators and policy-makers than by diverse beneficiaries in the institutions. What implications does this have for the accountability of stewardship, the means by which the indirect stake of "key stakeholders" is expressed?

As much of the disclosure that institutional shareholders have to make in relation to stewardship is public disclosure,[129] institutional shareholders could be scrutinized in their stewardship role by regulators and policy-makers as well as stakeholder groups.

A. THE GOVERNANCE ROLE OF INSTITUTIONAL SHAREHOLDERS

Institutional shareholders may be scrutinized in their stewardship role by regulators and policy-makers who consider institutions as a force for governance. Contemporary scholarship in regulation theory has sought to maximize the governance potential of diverse actors in the regulatory space, as the state increasingly faces limitations in capacity, resources, and reach in exercising governance and control.[130] As institutional shareholders have the proximity and resources to monitor investee corporations and actually do monitor such corporations, there is potential for the monitoring role to work as a force for governance. Regulators' and policy-makers' interest in institutions' governance role will likely shape the pressures surrounding institutional accountability for stewardship.

For example, the European Commission has overtly suggested that more effective "governance" of the corporate sector is needed. Its Green Paper has recommended that "better monitoring" of the comply-or-explain regimes of corporate governance codes in European Union (EU) Member States needs to be in place. Extensive harmonization of corporate governance codes in the EU has not yet taken place and Member States have adopted different approaches to the degree of legalizing corporate governance practices.[131] Many EU Member States, however, have adopted the U.K.'s flagship approach of treating the Corporate Governance Code as soft law applying to listed companies and subjecting the listed companies to

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129. *See supra* Part II.

130. *See* Black, *Enrolling Actors in Regulatory Systems*, *supra* note 56, at 64, 84; Lobel, *supra* note 56, at 344, 466; Scott, *supra* note 57, at 330, 347–52. *See generally* Black, *Critical Reflections on Regulation*, *supra* note 56 (arguing that conceptualizing regulation as "decentralized" will widen policy potential); Black, *Mapping the Contours*, *supra* note 56 (arguing that analyzing financial services regulation from a decentered perspective, supplemented by "enrollment" analysis, may lead to improvements in the financial services regulatory system and its accountability).

131. *See* Commission Green Paper, *supra* note 33, ¶ 3.2.

a comply-or-explain approach.[132] This comply-or-explain approach is intended to enroll institutional shareholders into meaningful consideration both of the corporate governance practices of their investee companies and of any deviations from the best practices found in the respective codes. In this respect, the comply-or-explain nature of corporate governance codes supports the private nature of institutional shareholders' monitoring role, allowing them to decide on whether they are satisfied with the corporate governance practices of their investee companies.

The Green Paper, however, observes that shareholder monitoring, especially in respect of deviations from the corporate governance codes, is lacking.[133] This is because companies can get away with either not providing explanations for deviations from the Stewardship Code, or providing boilerplate and brief explanations that institutional shareholders do not pursue further.[134] The Commission is of the view that companies' corporate governance disclosures and practices need to be better monitored.[135] Although it is not explicit what the perceived need for "better monitoring" is based on, the Green Paper goes on to suggest that "securities regulators, stock exchanges, or other authorities" could play a part in contributing to the monitoring of corporate governance disclosures and practices.[136] This suggests that the Commission perceives a public interest element in monitoring the corporate governance of listed companies.

Such a perception is not unfounded. Unchecked management may perpetuate fraud or risky decisions that could result in corporate failure. Corporate losses may not merely be regarded as a private matter of shareholder and creditor loss, but may sometimes become a matter of social loss affecting employees, stakeholders, and the community.[137] Kay also

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132. Examples of most EU Member State Codes may be found on the European Corporate Governance Institute's website. *Index of All Codes*, EUROPEAN CORP. GOVERNANCE INST., http://www.ecgi.org/codes/all_codes.php (last visited Mar. 12, 2012).

133. Commission Green Paper, *supra* note 33, ¶ 3.1.

134. Arcot et al., *supra* note 27, at 193–94; *see also* Commission Green Paper, *supra* note 33, at 196–97 (examples of good and bad codes).

135. Commission Green Paper, *supra* note 33, ¶ 3.2.

136. *Id.* ¶ 3.2.

137. An example is the consequent social losses following major corporate failures such as Royal Ahold and Enron. Commentators have attributed these corporate failures largely to governance failures. Abe De Jong, Douglas V. De Jong, Peter Roosenboom & Gerard Mertens, *Royal Ahold: A Failure of Corporate Governance* 2, 24 (European Corp. Governance Inst., Working Paper No. 67/2005, 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=663504; Robert Rosen, *Risk Management and Corporate Governance: The Case of Enron*, 35 U. CONN. L. REV. 1157, 1157–58 (2003). There is a much more tenuous link between corporate governance and generating positive social benefits through corporate social responsibility. *See* Ron Baukol, Address at Caux Round Table, Tokyo, Japan: Corporate Governance and Social Responsibility (Apr. 19, 2002), at 5–6, *available at* http://www.cauxroundtable.org/view_file.cfm?fileid=30; Laura Starks, Corporate Governance and Corporate Social Responsibility: What Do Investors Care About? What Should Investors Care About? (2009), EFA Keynote Speech at the University of Texas at Austin, *in* 44 FIN. REV. 461, 467.

writes of the failure of certain corporations as having more social and stakeholder implications than others, and of possibly a need to move away from the resistance against interfering with market-based forces when corporations fail. In this sense, shareholder monitoring may be expected not only to meet institutional shareholders' private interests, but may function as a form of "market-based governance" for public interest objectives.[138]

Market-based governance may be described as "the motivation of private interests to further the public good."[139] This is consistent with contemporary scholarship in regulation theory that posits seeking private actors to contribute to the regulatory space as discussed earlier. The European Commission is arguably affirming this perspective of shareholder monitoring in its Green Paper, in considering how the weaknesses of shareholder monitoring may be compensated for by enrolling, perhaps, securities regulators to monitor listed companies' corporate governance disclosures and practices.[140] Nevertheless, the implication of this is that corporate governance codes may be closer to becoming practically hard or regulatory law, as there is policy interest in scrutinizing adherence to the codes and reasons for deviations. The Stewardship Code may thus, in light of the Green Paper, be seen as a template for the governance role of institutional shareholders, which is increasingly being overtly articulated and could even be regulated in due course. In this light, there may be effective regulatory scrutiny of how institutional shareholders carry out stewardship and account for the wider purpose of corporate well-being and performance.

B. SHAREHOLDER-STAKEHOLDER-COMPANY RELATIONS

Next, shareholder stewardship may be used to frame arguments supporting shareholder activism and also arguments to check shareholder activism. The "other-centered" nature of stewardship is a platform which invites discourse. The company-shareholder-stakeholder relational paradigm is taken beyond "bargaining" as the contractarian theory posits. Rather, the discourse extends from "bargaining" to argument. Shareholders, management, and stakeholders can advance a discourse of different arguments. This new "negotiative" landscape of "argument" facilitates greater critical scrutiny into and debate about corporate behavior.

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138. *See* John Kay, *New Rules to Protect the Many from the Few*, FIN. TIMES (June 7, 2011), http://www.ft.com/cms/s/0/6fb99fa4-914c-11e0-b1ea-00144feab49a.html (arguing for special insolvency regimes to deal with corporations whose social significance may be higher than others upon failure, such as utilities companies, banks, and care homes).

139. Rahul Dhumale, *An Incentive-Based Regulatory System: A Bridge Too Far* 13 (ESRC Centre for Bus. Research, Univ. of Cambridge, Working Paper No. 170, Jun. 2000), *available at* http://www.cbr.cam.ac.uk/pdf/wp170.pdf.

140. *See* Commission Green Paper, *supra* note 33, ¶ 3.2.

Shareholder engagement in a company may wax or wane in influence depending on a concept of "stakeholder salience."[141] The thesis is that stakeholders (including shareholders) with salient demands may more likely influence management, and hence, exert greater governance pressures in their corporate governance roles. Salient demands are those that are backed by power, legitimacy, or urgency. Power can only be exercised by shareholders as the legal framework provides for voting, exit, and engagement rights. Yet, legitimacy pressures could come from stakeholder reports, social and media reports, and publicity. Legitimacy pressures could also impact perceived urgency.

Shareholder engagement could thus be based on legitimacy and urgency pressures that are exerted by stakeholder groups, even if the latter do not have direct participation rights in corporate governance. Often, such societal legitimacy is viewed by institutional shareholders as a useful springboard for engagement.[142] Companies can, however, also use societal legitimacy or urgency pressures to countervail institutional engagement; and such use may provide a useful check on selfish use of engagement powers by institutional shareholders.[143]

As legitimacy and urgency can be derived from stakeholder concerns, stakeholders, albeit with an indirect stake through shareholder stewardship, could be practically important in exerting corporate governance influence. Stewardship could be used to advance legitimate stakeholder concerns and could also provide a check against institutions advancing selfish or atomistic agenda that may not be welfare-inducing. A negotiative landscape in corporate governance can thus arise where the company, institutional shareholders, and the indirect representation of stakeholders' legitimate or urgent pressures interact. Although stakeholders do not have a direct voice, and the dynamics of influence are shaped by institutional engagement and corporate manipulation, stakeholders could use public media to manipulate their arguments for legitimacy and/or urgency in order to shape the negotiations and discourse in corporate governance.

The indirect power of stakeholders has been increasingly witnessed in the exertion of social responsibility pressures on corporations. The

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141. E. James M. Gifford, *Effective Shareholder Engagement: The Factors that Contribute to Shareholder Salience*, 92 J. BUS. ETHICS 79, 96–97 (2010).

142. *See id.* at 81–82, 92–93.

143. For example, Rock has written extensively on his reservations on the benefits of institutional shareholder activism. *See, e.g.*, Edward B. Rock, *The Logic and Uncertain Significance of Institutional Shareholder Activism*, 79 GEO. L. J. 445, 452–53, 505–06 (1991) (arguing that managers of such institutional-investor-institutions have substantial disincentives, but few incentives, to actively discipline corporate management and will, at best, be a "disinterested champion"); *cf.* Edward B. Rock, *Controlling the Dark Side of Relational Investing*, 15 CARDOZO L. REV. 987, 988–90, 1030–31 (1994) (arguing that the risks of "relational" investing are great and difficult to minimize and control).

Corporate Responsibility movement has produced a loop of discourse, accountability in reporting, and perhaps also substantive change.[144] The template of stewardship more overtly supports the role of stakeholder-based arguments in legitimacy and urgency and further invites possible scrutiny from regulators and policy-makers, as discussed above. Hence, the indirect stake of "key stakeholders" can be a powerful reflexive force for shaping the governance role of institutional shareholders.

C. THE RELATIONSHIP BETWEEN LONG-TERMISM AND STAKEHOLDER WELFARE

This Article also argues that business management research supporting the correlation between long-termism and greater stakeholder welfare would provide further impetus to support stakeholder arguments and their influence in the stewardship accountability regime under the Stewardship Code. Michael Porter advocates that contemporary businesses should turn to a "shared value" model so that shared value redefines what value creation means for business.[145] "Shared value" incorporates long-term corporate success with societal and general economic well-being, and sees the two as mutually dependent and not contradictory.[146] Porter's strategic recommendations include enhancing long-term stakeholder welfare, such as being concerned for consumers and local communities, in tandem with the development of business strategy for long-term profitability and success.[147] This model endorses the correlation between the long-term well-being of a company and the welfare of its stakeholders. White argues that business strategic thinking needs to be attuned to "long term wealth" creation, a concept that balances patient capital with sustainability and wider social and economic welfare.[148]

These contemporary arguments move away from the shareholder-centric perspective that corporations are purposed to maximize shareholder

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144. Corporate social responsibility reporting is perhaps seen as one of the greater achievements in reflexive accountability undertaken by corporations to the wider public. *See* David Hess, *Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness*, 25 J. CORP. L. 41, 82 (1999) (arguing that social reports, as reflexive law, provide enhanced information through all levels of a corporation, thereby allowing the corporation to understand their stakeholders and vice versa, and to respond appropriately). *But see* John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 37–38 (2005) (empirical research suggesting that the corporate social responsibility movement might not be succeeding and that even if it does succeed, such success may not be desirable).

145. Michael E. Porter & Mark R. Kramer, *Creating Shared Value: Redefining Capitalism and the Role of the Corporation in Society*, 89 HARV. BUS. REV. 62, 64 (2011).

146. *Id.* at 64, 66, 68, 76.

147. *Id.* at 66, 68, 72–73, 76.

148. ALLEN L. WHITE, BUS. FOR SOC. RESPONSIBILITY, WHAT IS LONG TERM WEALTH? 4–6, 8–9 (2007), *available at* http://www.bsr.org/reports/BSR_AWhite_Long-Term-Wealth.pdf.

wealth and proposes to rewrite the hypothetical default bargain of all contractarian constituents as that of the long-term well-being and success of the company for all. The shared value concept would also be able to support a wider "contractarian" paradigm of the company, in order to incorporate different locations of value generation and receipt related to corporate activity. As argued earlier, this ideological shift in fact changes the nature of the contractarian paradigm to one that is not merely insular, shareholder-centric, and private, but may accommodate a range of broader stakeholder interests which could be founded on social and communitarian concerns. Hence, against the backdrop of both such ideological movements in business management and the governance expectations of stewardship, stewardship is not likely to merely be rhetoric for institutions to report as they see fit. Stewardship may be a slow and evolutionary step away from shareholder-centered contractarianism in corporate governance. It arguably has the potential to change business strategic thinking in terms of long-termism and shared value and corporate governance practice and theory in terms of stakeholder influence, and social and communitarian stakes.

Nonetheless, this Article will also point out that the stewardship concept still suffers from some weaknesses that could undermine its ideological ramifications. In particular, the stewardship concept does not move away from giving shareholders a central governance role, and its ideological stance may, hence, be weak and confused. Further, the governance expectations of institutional shareholder stewardship may also be over-estimated.

D. THE WEAKNESS OF THE STEWARDSHIP CONCEPT

It may be argued that the stewardship concept is ideologically weak as it is still unclear as to whom shareholders are accountable as stewards. If the accountability lies with beneficiaries, then beneficiaries are possibly too indifferent and dispersed to hold institutions to account, and such accountability does not add anything above the legal trusteeship duties already owed. Yet, if "accountability" is something more, then the Stewardship Code arguably does not clearly articulate to whom institutions are accountable.

One of the reasons for this perceived weakness in articulating the accountability channels may be that too much deference is still paid to the shareholder-centric corporate governance framework. Policy-makers may be too keen to avoid overtly introducing communitarian or stakeholder theory models into corporate governance, as the introduction of such models could cause both the theoretical and legal landscape to change dramatically. Hence, shareholders remain central corporate governance actors except that they are now required to be less atomistic, short-termist, selfish, and should act as "stewards." But if we cannot pinpoint for whom institutions should act as stewards, then it becomes difficult to judge the

exercise of stewardship and institutions can then dominate the definition of stewardship. In other words, can the stake of the state or other stakeholders be adequately expressed if shareholders are in control of developing stewardship, engagement, and voting policies?[149]

One possible development in stewardship is that stewardship can be seen as narrowly extending the criteria of assessment that institutions use in evaluating their asset managers. Commentators have written extensively on how asset managers are evaluated for short-term financial performance by institutions,[150] and although long-termism and the wider good are attributes in the Stewardship Code that could pose challenges in reworking the evaluation matrix,[151] institutions could still develop narrowly-extended evaluation matrices and confine the exercise of stewardship to a form of monitoring over asset managers. Further, evaluation matrices for long-termism and the wider good could also become proceduralized and subjective; that is, that institutions may look for the existence of corporate policies dealing with social responsibility and stakeholder engagement instead of critically considering the corporation's substantive business vision and strategy. Narrow-minded constructions of stewardship, constructed in policies that institutions are responsible for developing, could undermine the wider ideological developments toward stakeholder accountability and "shared value." Institutions may be tempted toward a narrow-minded construction in order to simplify their "comply or explain" obligation.

It may also be argued that the stewardship concept is doomed to be ideologically weak as it is ideologically confused. It is an unhappy patchwork: seeking to infuse some stakeholder and communitarian concerns into the dominant shareholder-centered contractarian framework, but unwilling to be bold enough to embark on the progressive changes. Just because shareholders have the capacity and proximity to monitor corporations does not mean that they should or would take up the expression of other stakes that stakeholders have. The investment role of institutions defines their objectives in monitoring. If we pass other interests and stakes onto institutions and expect such institutions to be able to internally mediate that which we have passed on, can we realistically expect them to arrive at a proportionate and balanced "stewardship" stance with ease? And are we, by "passing the buck" to institutions, actually avoiding the more difficult task of ideologically reconciling private interests, such as

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149. *See* UK STEWARDSHIP CODE, *supra* note 5, princ. 1, 6.

150. Amit Goyal & Sunil Wahal, *The Selection and Termination of Investment Management Firms by Plan Sponsors*, 63 J. FIN. 1805, 1813 (2008); *Breaking the Short-Term Cycle*, *supra* note 48, at 1–2; *see* ASPEN INST., *supra* note 62, at 2.

151. Wong, *supra* note 63, 406.

business and investment, with the more social and communitarian expectations of corporate citizenship?

E. FAILING TO CHALLENGE THE AGENCY PARADIGM

A number of commentators have argued that the conventional agency paradigm that defines shareholders as residual claimants and principals, and management as agents, is too simplistic when applied to the banking and finance sector.[152] Ciancanelli et al. argue that the agency paradigm is much more complex in the banking sector.[153] As banks are highly leveraged—depending on deposits and wholesale funding to form a large part of their working capital—depositors and creditors share a substantial amount of residual risk. Further, the potential of state bailout, as mentioned above, puts the state into the position of a key stakeholder mitigating shareholder and creditor risk. Hence, the agency paradigm in the banking sector is not a simple binary shareholder-management model, but should comprise of key stakeholders such as the state, depositors, and wholesale and repo market creditors.

The Stewardship Code, by putting shareholders into the central monitoring role, may be endorsing the simple agency paradigm in corporate governance, which may arguably be retrograde in considering corporate governance reform in the banking sector. It may be argued that by shackling stewardship to a shareholder-centered premise, an opportunity has been missed to distinguish corporate governance in banks from other industries. If we distinguish corporate governance in banks from other industries to begin with, this may open the way for new dialogic movements to take place in respect of the corporate governance of banks and financial institutions, and a broader range of stakeholders could be enrolled into the governance landscape monitoring banking trends and impact.

It could be argued that the Stewardship Code mistakenly concentrates monitoring in the hands of shareholders, where other stakeholders may have greater incentive to monitor, thereby unnecessarily relegating the importance of other stakeholders. Yet, depositor apathy is well documented,[154] and the state is able to monitor through micro- and macro-prudential regulatory supervision. So, can it be said that because other stakeholders do not amount to much anyway, re-emphasizing shareholders' role is the appropriate step to take in corporate governance? This Article is

152. Alexander, *supra* note 7, at 991–92, 1006–07; Christopher M. Bruner, *Corporate Governance Reform in a Time of Crisis*, 36 J. CORP. L. 309, 323 (2011).

153. Penny Ciancanelli & Jose Antonio Reyes Gonzalez, *Corporate Governance in Banking: A Conceptual Framework* 6–7 (Paper Submitted for Presentation at the European Financial Management Conference, Athens, June, 2000), *available at* http://papers.ssrn.com/paper.taf?abstract_id=253714.

154. *See, e.g.*, Mülbert, *supra* note 121, § 4.2.3.2.

inclined toward the view that the emphasis placed on shareholders in the Stewardship Code reflects a reluctance to take a more progressive position in corporate governance. This is a curious stance given that policy-makers view corporate governance as an important driver in the general governance landscape for the financial sector. As the crisis provides an apt opportunity for reform, it is curious why there is such reluctance to introduce bolder shifts in the corporate governance paradigm in the banking sector. Bruner also argues that the re-emphasis placed on shareholders in the Stewardship Code is path-dependent rather than imaginative.[155]

F. OVER-ESTIMATING THE GOVERNANCE POTENTIAL OF INSTITUTIONAL SHAREHOLDERS

Further, it may be argued that the governance potential of institutional shareholders may be over-estimated in "stewardship." It can be said that sufficiently important issues would not likely be left to shareholder governance anyway. In other words, if an issue becomes an important one of social concern, reliance would not be placed on institutions as stewards to mediate the various stakes it is asked to represent, or to decide on a course of engagement to change corporate behavior. The state would directly regulate or intervene. Stewardship is not, therefore, intended to be a channel for strong policy or regulatory representation. Rather, this is the case of bankers' remuneration regulation.

Executive remuneration, and now bankers' remuneration, has often been subject to academic discussion as to what extent remuneration arrangements are actually efficient and reflect optimal market prices, given supply and demand conditions and the worth of the executive's performance.[156] Nevertheless, regulators have not hitherto taken intrusive approaches even if market failure is suspected. In the U.K., much reliance is placed on independent remuneration committees to make the decisions for

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155. Bruner, *supra* note 102, at 329–32.

156. *See generally* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004) (detailing how boards and executives negotiate at less than arms length in respect to executive compensation, thereby diminishing shareholder gains and executive incentive to perform) (for a critical review of Bebchuk and Fried's book, see Stephen M. Bainbridge, *Book Review Essay: Executive Compensation: Who Decides?*, 83 TEX. L. REV. 1615 (2005)); Linda J. Barris, *The Overcompensation Problem: A Collective Approach to Controlling Executive Pay*, 68 IND. L.J. 59 (1992) (discussing the harmful effects of excessive executive compensation and the theories for controlling such compensation, and arguing that the most effective means of control will be through institutional investors supported by active shareholder participation and by the court system); Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 SMU L. REV. 299 (2009) (arguing that executive compensation reform is largely driven by lawmaker motivations); Carl T. Bogus, *Excessive Executive Compensation and the Failure of Corporate Democracy*, 41 BUFF. L. REV. 1 (1993) (examining excessive executive compensation and its consequences, and arguing that such compensation must ultimately be kept in check by judicial remedies).

their respective companies and on shareholders' scrutiny of the disclosure made. Post-global financial crisis, features of bank/financial institution remuneration that give massive bonuses and take a short-termist view of performance are argued to have contributed to weak risk management[157] in financial firms. Where the same flaw appears in many financial institutions, systemic risk effects will result.[158] The connection between remuneration policies and risk management is now recognized and legalized in the EU Directive of November 2010 amending the Capital Requirements Directives 2006/48/EC and 2006/49/EC.[159] The Financial Services Authority (FSA) has enacted the Remuneration Code in the FSA Handbook SYSC 19A in order to transpose the Directive. The overriding principle in remuneration control is that remuneration should be aligned with sound risk management; hence, risk management input is mandatory in the design of remuneration packages.[160] The regulatory intervention into remuneration at financial institutions is not imposed due to market failure, but is rather framed around the rhetoric of systemic risk and public interest. As external considerations of systemic risk and social cost cannot, by their nature, be satisfactorily undertaken at the level of private/internal governance by remuneration committees,[161] the way is paved for regulatory intervention to provide governance. Hence, policy-makers would not likely address issues of

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157. Commission Green Paper on the Corporate Governance in Financial Institutions and Remuneration Policies, ¶ 3.1, COM (2010) 284 final (June 2, 2011), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0284:FIN:EN:PDF.

158. *See* M. BRUNNERMEIER, A. CROCKETT, C. GOODHART, A.D. PERSAUD, HYUN SHIN, THE FUNDAMENTAL PRINCIPLES OF FINANCIAL REGULATION 3–5 (11 Geneva Reports on the World Economy) (International Center for Monetary and Banking Studies 2009).

159. Directive 2010/76, of the European Parliament and of the Council of 24 November 2010 Amending Directives 2006/48/EC and 2006/49/EC as Regards Capital Requirements for the Trading Book and for Re-Securitizations, and the Supervisory Review of Remuneration Policies, arts. 1, 2, 2010 O.J. (L 329) 3, 9, 13 (amending Art 22 of the Capital Requirements Directive, section 11 of Annex V), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:329:0003:0035:en:PDF.

160. FIN. SERVS. AUTH., FSA HANDBOOK: REMUNERATION CODE (SYSC 19A) ¶¶ 19A.1.6, 19A.3.15, *available at* http://fsahandbook.info/FSA/html/handbook/SYSC/19A.

161. Schwarz and Acharya have both argued that systemic risk effects are often not addressed by self-monitoring or internal governance as individual institutions do not see the collective big picture. The collective action problem makes it more likely than not that mitigating systemic risk is a public good that should be provided by regulators. *See generally* Viral V. Acharya, *A Theory of Systemic Risk and Design of Prudential Bank Regulation*, 5 J. FIN. STABILITY 224 (2009) (defining systemic risk as "joint failure risk arising from the correlation of returns on asset-side of bank balance-sheets," concluding that regulatory schemes focusing on an individual bank's risk may be undesirable because they may accentuate the bank's risk, and positing a theory of "optimal regulation" that takes into account both the joint risks and individual risks of banks); Steven Schwarz, *Systemic Risk*, 97 GEO. L.J. 193 (2008) (widening the definition of systematic risk to include financial markets arguing that systemic risk regulation targeted at financial institutions but not markets are insufficient, and positing that a the optimal approach is a "multi-tiered regulatory approach" where a liquidity-provider of last resort is available and market providers are regulated to exercise diligence to enable market efficiency).

regulatory concern through a relatively indirect and weak mechanism such as shareholder stewardship.

Shareholder stewardship is a reflexive expression of the indirect stakes of "key stakeholders"; however, such "stakes" do not amount to that which may warrant immediate regulatory attention and control. Even if the state is a "key stakeholder" in a particular sector, it is likely that "key stakeholders," such as the state, would only bring pressure to bear on institutions in challenging times rather than in good times. In good times, stewardship could likely become cosmetic, as many would be indifferent as to how and why institutions engage their investee corporations, and the state may not wish to preemptively influence shareholder governance where there are no fires to fight. More demands on institutions to express social stakes may only be made in more difficult times. But if an issue attains enough social importance, regulatory control may, nevertheless, be imposed. Therefore, the likely trajectory of the institution's governance role could be an ebbing of governance in good times and total irrelevance in times of crises when regulatory control takes over. This could leave the governance role of stewardship practically meaningless. Hence, shareholder stewardship could ultimately become a lightweight and a mere rhetoric, not actually expressing the indirect stakes and social concerns as a consistent force for governance.

Despite the abovementioned weaknesses, this Article sees potential in the ideologically transforming possibilities in stewardship: as a crank in a window through which stakeholder interests and communitarian values could be let in. It remains to be seen whether regulators would actively influence the governance role of institutions and whether stakeholders would actively seize opportunities to influence the discourse and trajectory in corporate governance. This Article hopes that by framing stewardship in terms of a form of indirect representation of "key stakeholders'" stakes, the evolutionary potential in transforming corporate governance can be seized. It is now appropriate to seek a balanced reconciliation between the private contractarian and capital-centered view of the corporation, and its actual social and public significance.

CONCLUSION

This Article argues that the Stewardship Code, introduced in response to the global financial crisis 2008–2009, may be regarded as having introduced an ideological shift in corporate governance theory in the U.K. Although the Stewardship Code affirms the key governance role of shareholders, institutional shareholders are especially asked to behave as "stewards," and thus, to focus on long-termism and take into account the wider public interest and social good. This Article also argues that while the Stewardship Code cannot be regarded as supporting the shareholder-centered contractarian model of corporate governance, which is dominant in

both theory and law in the U.K., as the implications of the private nature of shareholder-centered corporate governance are not fully supported by the Stewardship Code, this does not mean that the Stewardship Code embraces communitarian theories of corporate governance as an archetypal opposite. This Article further argues that the Stewardship Code, read together with the Walker Review—which provides a contextual backdrop to the Stewardship Code—has affirmed the "governance" capacity of institutional shareholders as a form of "market-based" governance that is capable of monitoring systemically significant financial institutions. Such monitoring is not only undertaken to further institutions' private investment interests, but also to represent the interests of stakeholders, such as the state, who may incur the liability of financial bailout. For this reason, stewardship is an expression of representing "key stakeholder" interests, such as the state's, which mitigate shareholders' own residual risk in firms. This Article therefore argues that the representative capacity of stewardship, governed by normative standards for engagement in the Stewardship Code—such as long-termism and consideration for wider good—has the potential to introduce changes to the dominant shareholder-centered corporate governance theory and frameworks.

This Article suggests that stewardship brings about an evolutionary step toward mitigating the central role of shareholders in corporate governance, and although it does not go as far as to endorse stakeholder theory, the expression of stakeholder interests through stewardship can still be powerful depending on how stewardship is called to account. There are, however, ideological and practical challenges to transforming the dominant shareholder-centered contractarian framework in corporate governance theory. This Article, having hopefully provided a balanced evaluation, remains optimistic about the evolutionary possibilities of stewardship as a first step toward ideological change and development.