Controlling the Environmental Impacts of UK Fast Fashion Companies: Do B Corps provide a way forward?

REIMANN, JOHANNA,MARIA

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By Johanna Maria Reimann

Supervised by Chris Riley

Abstract

This thesis is looking at the problem of the environmental harm caused by the fast fashion sector, and how the law might seek to regulate this harm. It focuses specifically on regulation that targets companies involved in the production and sale of fast fashion, so in this sense, it looks at how 'corporate law' might address the environmental harm. However, it does not look at all that corporate law might have to say. Instead, its focus is again narrower. It's asking, specifically, how far corporate law can go by merely enforcing the commitments which companies themselves make to acting in an environmentally responsible way. Many companies often - for a variety of reasons - choose to make commitments to behave well. In this sense, some companies 'self-select' to be more environmentally responsible. This thesis focuses on how effectively corporate law can enforce these self-imposed commitments.

The main area in which it analyses the law's ability to enforce these self-imposed constraints is through its analysis of so-called 'B Corps' – a private label certifying a company's commitment to ESG – an institutionalised form of self-imposed constraints.

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By Johanna Maria Reimann

Master of Jurisprudence

Durham University

Submitted November 2022

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Statement of Copyright

Acknowledgements

I would like to send my sincerest thanks to Chris Riley. Without his year long guidance and support, this thesis would not have been possible.

I would also like to thank my family and friends who never failed to boost my mood and push me to finishing this thesis. Without our countless coffee breaks from the Billy B, endless zoom calls home and facetimes to those friends now living in London, I would have struggled a lot more than I did throughout this last year.

Introduction

This thesis has been written during a tumultuous time where the decisions of companies are being assessed in terms both of their profitability and, increasingly, their environmental and societal sustainability. It was written in the aftermath of the 2021 United Nations Climate Change Conference (COP 26) where billions were pledged from the public sector and trillions from the private sector to fund climate change mitigation efforts.[1] There is increasing recognition that for climate mitigation efforts to be successful, states cannot be the only entities taking proactive effort or solely held responsible for inadequate responses. As such, corporations are coming to the forefront of climate action as they, as entities, are the main contributors to, for example, greenhouse gas ('GHG') emissions, deforestation and are responsible for other business ventures that negatively affect the environment.

This thesis looks at these issues in the context of just one sector – namely 'fast fashion' – and one mechanism for improving the environmental behaviour of companies in that sector – namely their adopting the status of 'B Corps'. Put bluntly, its aim is to examine how much difference 'the B Corps movement' is likely to make in ensuring that fast-fashion companies act in a more socially responsible (stakeholder friendly) way.

Although fast fashion is an international phenomenon, and the problems it causes are global in nature, this thesis' focus is on UK companies' contribution to that problem. Especially, how far the B Corp movement is likely to make a difference to, *specifically,* these *UK companies.* Of course, as it will be shown, the B Corp movement is itself a global movement. It is not only UK companies that can become B Corps. Nevertheless, the effect of becoming so, including the impact that doing so has on the behaviour of the company,

[1] UN Climate Change Conference, *COP 26: The Glasgow Climate Pact* (2021), 19 <https://ukcop26.org/the-conference/cop26-outcomes/> accessed 21 September 2022.

depends on the national laws, and especially the corporate law, in the country where the company is incorporated. The 'regulatory impact' of being a B Corp varies, therefore, from country to country and must be worked out for each country individually. Given that, this thesis focuses on exploring the regulatory impact of becoming a B Corp in just the UK.

To highlight the problems caused by fast fashion companies, chapter 1 will outline the adverse effects of the business practices of these corporations on the environment.

Chapter 2 turns from describing the problems to understanding their causes. The corporate behaviour that causes these impacts is determined by the choices of the companies' senior executives and directors. Those choices are a consequence of the various 'forces' or 'pressures' to which executives/directors are subject. Chapter 2 develops a model for understanding these forces, and shows how they impel directors to favour shareholders, and so to maximise profits, behaviour which in turn impacts adversely on other stakeholders, including the environment.

Regulation can change that state of affairs. But in designing regulation, a fundamental choice has to be made. That choice is between targeting the entity (the company) itself or, targeting individuals within the company. Chapter 3 explains this choice and, most importantly, evaluates its consequences – evaluating the comparative effectiveness of 'corporate liability' versus 'personal liability'. Chapter 3 will also explain the substantial rise in the number of climate litigation cases being brought increasingly against corporations and sometimes their directors.

So, to recap: Chapters 1 to 3 provide the necessary building blocks or foundations to measure the likely impact of the B Corp: chapter 1 describes the problem, chapter 2 explains its causes and chapter 3 evaluates two different regulatory responses.

Chapters 4 and 5 build on these foundations to examine the likely impact of the B Corp movement. Chapter 4 is descriptive and explains the basics of B Corps – what they are, and the additional regulation they impose on those companies (and their directors) that choose to gain B Corp certification.

Chapter 5 then evaluates the overall impact of this additional regulation. To do so, it (a) explicitly builds on the framework developed in chapter 2 (what determines directors' choices); and (b) incorporates the lessons of chapter 3 (the comparative effectiveness of corporate versus personal liability). More specifically, as to (a), I apply the model I developed in chapter 2 and ask how differently the underlying forces, which determine directorial behaviour, operate in a B Corp (compared to how those forces were shown, in chapter 2, to work in a non-B Corp company). More specifically as to (b), I consider whether the additional regulation that arises through being a B Corp should be categorised as imposing 'corporate' or 'personal' liabilities, and what this means in terms of the likely effectiveness of such additional regulation.

Ultimately, it will be argued that although self-selecting to become a B Corp – changing a company's constitution – could be desirable, in the fast fashion sector it is impossible for incorporation. It will also be argued that very little *actually* changes in *practice* by becoming a B Corp as the UK's corporate landscape is ill-fitting for this corporate model to flourish and fulfil its objective of making a more stakeholder-friendly for-profit business environment

Interestingly, I started this research with the expectation that the position would be different. Namely, that B Corps would be a good way of improving the sector. However, my research led me, unfortunately, to the opposite conclusion. If B Corps are unlikely to be the solution I had initially hoped, this begs the question of what will work better. My thesis provides some foundation stones for thinking more about this question. But it must be noted that offering solutions that will work, where B Corps do not, is not part of my thesis.

Chapter 1 Sector Overview

This chapter will provide an insight into the environmental problems with the fast fashion industry to explain why this thesis contextualises its findings, and plants its hypotheses, within this sector.

To do so, it will begin by defining what 'fast fashion' *per se* incorporates. It will then go on to provide some statistics illustrating the problems with the fast fashion industry, comparing it to other sectors so that the sheer scale of this industry can be conceptualised.

This chapter is a necessary predecessor to the remainder of my thesis because, without knowing about the extent of the environmental issues that derive from fast fashion, questions about why this sector, rather than say, the oil industry, was chosen, would arise.

As an industry pushed forwards by the interrelation between corporations and consumers, fast fashion provides a perfect example where over-consumption, profit maximising business ventures and insufficient sectorial regulation, lead to environmental damage.

1.1 "Fast Fashion" – What is it?

Fast fashion differs from "fashion" in the sense that its business model is based on 'offering consumers frequent novelty in the form of low-priced, trend-led products.'[2]

[2] K Niinimaki, G Peters, H Dahlbo, P Perry, T Rissanen and A Gwilt, 'The environmental price of fast fashion' (April 2020) 1 *Nature Reviews Earth & Environment* 189, 189.

Mega-corporations dominate this field, with companies such as H&M[3] and Inditex[4] in the EU, ASOS[5] in the UK, and UNIQUOL[6] in Asia being some of the largest. The revenue produced by such corporations is in the billions and their production of garments is showing no signs of slowing down. Consequently, there is now a 'throwaway consumer culture,' a concept which will be further explained in 1.2.[7]

The EU Parliament has attributed the existence, and exponential growth, of fast fashion as a phenomenon deriving from 'rapid changes in trends, continuous availability of new products and a huge drop in prices.'[8] Such a trend is confirmed by the statistic that 'clothing production doubled between 2000 and 2015' while consumer utilisation of these products decreased by 36%.[9] For example, in 2012, compared to 1996, it was found that consumers wore their clothing for half the duration.[10]

1.2 The Environmental Consequences of "Fast Fashion"

As the second largest exporter of clothing, after China, in 2019 the European Apparel and Textile Confederation reported that the EU exported 128 billion euros of clothing.[11] Surprisingly, although the population of the UK is smaller than several EU member states,[12] UK consumers accounted for the largest proportion of these exports. As such, it

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[3] "H & M Hennes & Maurtiz GBC AB" registered address: Mäster Samuelsgatan 46 A, 106 38 Stockholm (Corporate registry number: 556070-1715).
[4] Inditex headquarters: Edificio Inditex, Avda. De la Diputación s/n, 15143 – Arteixo, A Coruña – Spain
[5] ASOS plc registered address: Greater London House, Hampstead Road, London, NW1 7FB, UK (incorporated in the UK, company number: 4006623).
[6] Wholly owned subsidiary of Fast Retailing Co Ltd which is incorporated in Japan (Company Number: 2500-01-000684).
[7] L Woensel and S Lipp, 'What if fashion were good for the planet?' (September 2020) *European Parliamentary Research Service* PE 656.296, 1.
[8] *ibid.*
[9] Ellen MacArthur Foundation, *Circular business models: redefining growth for a thriving fashion industry* (2021), 5.
[10] Woensel and Lipp, 'What if fashion were good', 2.
[11] EURATEX, Economic and Statistics, 'Facts and Key Figures of the European Textile and Clothing Industry' (EURATEX, June 2020) www.euratex.eu/facts-and-key-figures/ accessed 28 November 2021, 22.
[12] As of 2022, the UK was 4th largest, behind Russia, Turkey and Germany (D Clark, 'Population of Europe in 2022, by country' (*Statista,* August 2022) <www.statista.com/statistics/685846/population-of-selected-european-countries/> accessed 28th September 2022).

is apparent that consumption in the UK is disproportionately large for its size. Figures 1 and 2, below, provide a visual representation of export and import statistics: figure 1 depicts the countries with the largest global supply of clothing and textiles while figure 2 depicts the main importing countries of EU clothing and textile products.

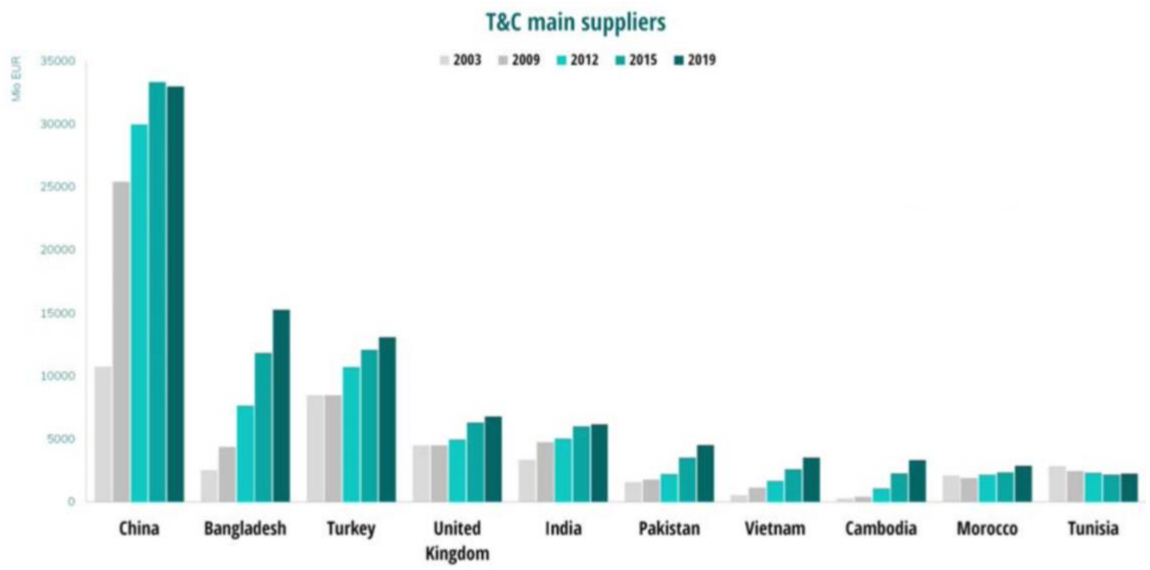

Figure 1 source: EURATEX, Economic and Statistics, 'Facts and Key Figures of the European Textile and Clothing Industry' (EURATEX, June 2020).

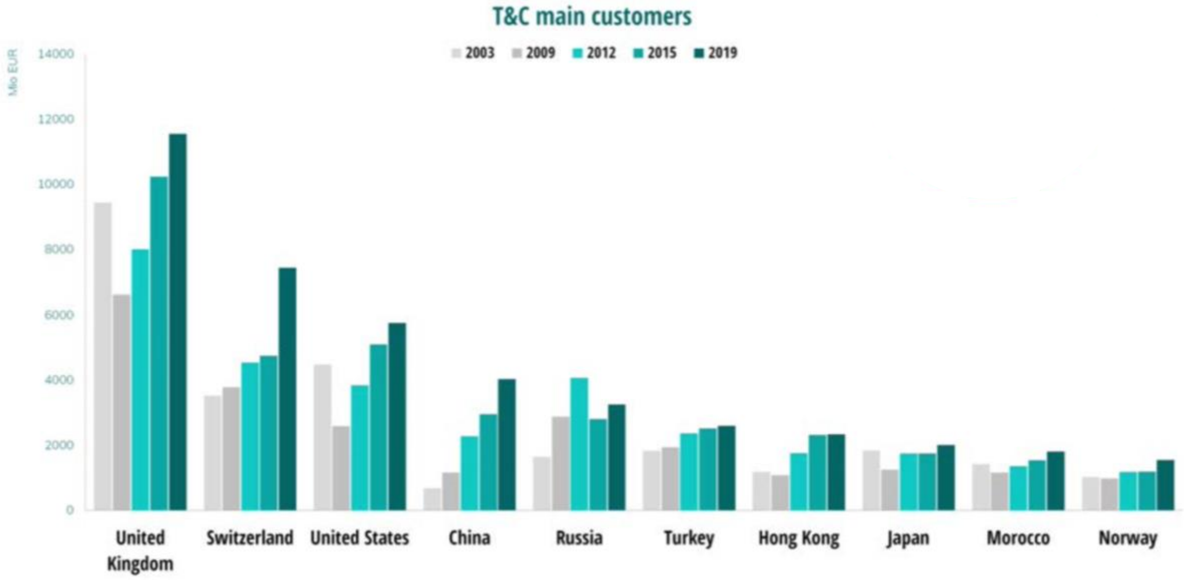

Figure 2 source: EURATEX, Economic and Statistics, 'Facts and Key Figures of the European Textile and Clothing Industry' (EURATEX, June 2020).

The sheer volume of clothing and textiles imported to and exported by the EU and UK highlights that there is a problem. There is no indication that consumption and production levels are slowing down, the European Parliament noted 'the amount of clothes bought in the EU per person has increased by 40% in just a few decades.'[13] In the UK alone, 'in 2020, people…spent £54 billion on clothes. According to stats, the market is close to recovery, as it's approaching its 2019 size of £61 billion in 2022.'[14] Provided growth continues as predicted, the Ellen MacArthur Foundation has forecast that 'total clothing sales could reach 175 million tonnes in 2050 – more than three times today's amount.'[15]

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[13] N Šajn, 'Environmental impact of the textile and clothing industry: What consumers need to know' (January 2019) *European Parliamentary Research Service* PE 633.143, 1.
[14] D Radonic, '27 Revealing Fast Fashion Statistics You Need to Know in 2022' (Fashion Discounts, 3 March 2022) <https://fashiondiscounts.uk/fast-fashion-statistics/> accessed 21 October 2022, [20].
[15] Ellen MacArthur Foundation, *A new textiles economy: Redesigning fashion's future* (2017) www.ellenmacarthurfoundation.org/publications, 39.

In order to impede this sobering forecast, consumers, companies and/or governments clearly need to do something. Already, 'the global fashion industry produc[ed] around 2.1 billion tonnes of greenhouse gas…emissions in 2018' which accounted for '4% of the global total' of emissions.[16] As a 2020 McKinsey report expostulated, this was 'an emissions' share larger than that of France, Germany and the UK combined.'[17] In an insight report by the World Economic Forum, it was reported that the fashion industry, including its supply chain, is the third largest contributor to global greenhouse gas emissions, exceeded only by food and construction.[18] Figure 3, below, encapsulates these findings that 'eight supply chains are responsible for more than 50% of global emissions.'[19]

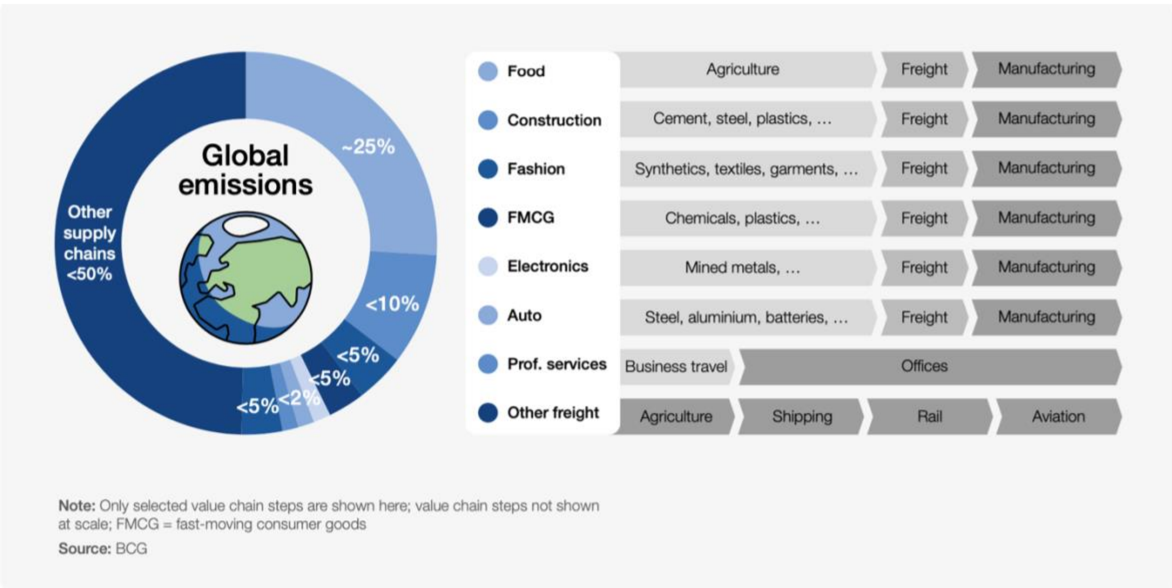

Figure 3 source: World Economic Forum, INSIGHT REPORT - Net-Zero Challenge (January 2021).

[16] Ellen MacArthur Foundation, *Circular business models: redefining growth for a thriving fashion industry* (2021), 5.
[17] McKinsey & Company and Global Fashion Agenda, *Fashion on Climate: How the Fashion Industry Can Urgently Act to Reduce its Greenhouse Gas Emissions* (2020), 3.
[18] World Economic Forum, *INSIGHT REPORT - Net-Zero Challenge: The supply chain opportunity* (January 2021), 12.
[19] *ibid.*

Catalysing the effect of garment overproduction, it is estimated that in excess of $500 billion is 'lost every year due to lack of recycling and clothing utilisation.'[20] While fast fashion companies and their supply chains continue to create new "on-trend" garments, around '92 million tonnes of clothes-related waste' is discarded annually.[21] Figure 4, below, provides a useful diagram to illustrate the sheer volume this quantity of waste correlates to.[22]

Figure 4 source: Mulhern, 'The 10 Essential Fast Fashion Statistics' (Earth.Org, July 2022).

These shocking statistics are why this thesis is focusing on the fast fashion industry and exploring one of the practical solutions that could be introduced in the UK to precipitate improved environmental behaviour – namely, through more of its constituent companies becoming B Corps.

1.3 Brief overview of the key corporate players

Here it is useful to briefly provide an overview of the key corporate players in the fast fashion sector.

The majority of these megacorporations are parent companies whose portfolio brands within their group represent the largest producers of fast fashion globally. A prevalent

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[20] O Mulhern, 'The 10 Essential Fast Fashion Statistics' (*Earth.Org* July 24 2022) <https://earth.org/fast-fashion-statistics/> accessed 13 September 2022.
[21] *ibid.*
[22] *ibid.*

example of such a parent is Inditex. In the first half of 2022, Inditex reported sales that 'reached €14.8bn ($14.79bn), up by 24.5% in constant currencies from a year earlier.'[23]

The brands of this parent include Zara, Bershka, Pull&Bear and Stradivarius. Each of these are well known fast fashion brands whose sales are global. Another example, whose main place of operation is in the UK is Boohoo Group Plc.[24] Brands within this group include Boohoo, Prettylittlething and Nastygal. Each of these brands - those part of Inditex and Boohoo Plc - boast low prices and fast turnarounds. They epitomise the fast fashion paradox and provide perfect examples of companies being responsible for environmental damage in the pursuance of profit.

As a consequence of this thesis' focus being on the regulatory significance of UK companies becoming B Corps, which depends largely on how UK company law deals with that status, and because UK company law applies to *UK registered companies,* my concern is really with fast fashion companies that are *registered* in the UK. So, for the purposes of this thesis, 'UK companies' means companies registered in the UK, rather than say, companies that happen to be manufacturing in the UK, or retailing to the UK.

In the UK, a distinction must be made when identifying the major UK registered fast fashion companies: between listed and private companies.

Those with the largest revenue[25] belong to the listed category and include companies such as Next[26] and ASOS. However, a couple of other UK registered fast fashion companies

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[23] Retail Insight Network, 'Zara's owner Inditex registers €14.8bn in sales for H1 2022' (14 September 2022) <www.retail-insight-network.com/news/zara-inditex-h1-2022/> accessed 3rd October 2022.
[24] Boohoo Group plc, a company registered in Jersey (company number: JE114397).
[25] J Warner, 'Top 100 fashion and clothing stocks to watch' (IG, 18 December 2019) <www.ig.com/uk/news-and-trade-ideas/top-100-fashion-and-clothing-stocks-to-watch-191217> accessed 5th November 2021.
[26] NEXT plc, registered address: Desford Road, Enderby, Leicester, LE19 4AT, UK (incorporated in the UK, company number: 04412362).

are private companies, with popular high street names such as New Look falling into this category.[27]

Next and ASOS fall into the retailer category, both of whose products are shipped globally. If pressure were placed on their suppliers to behave well and, for example, conform to e.g., their transformation into a B Corp (the impacts of which will be analysed throughout chapters 4 and 5), a change in their behaviour would have beneficial impacts on the global climate crisis.

Although some would argue that the UK 'exports far less in clothing than it imports—£8.2 billion in exports compared to £30.6 billion in imports,' this is still a substantial amount being exported and illustrates that the UK is contributing to the problem.[28] Moreover, this statistic takes into consideration the sources of leading UK retailers. By looking at the graph below, it is clear that companies such as ASOS import the larger portion of their products from abroad, before selling them.

[27] New Look Retail Holdings Limited, a company registered in Jersey (No. 128640) is the holding company of New Look Retailers Limited (incorporated in the UK, company number: 01618428).
[28] Radonic, '27 Revealing Fast Fashion Statistics You Need to Know in 2022', [19].

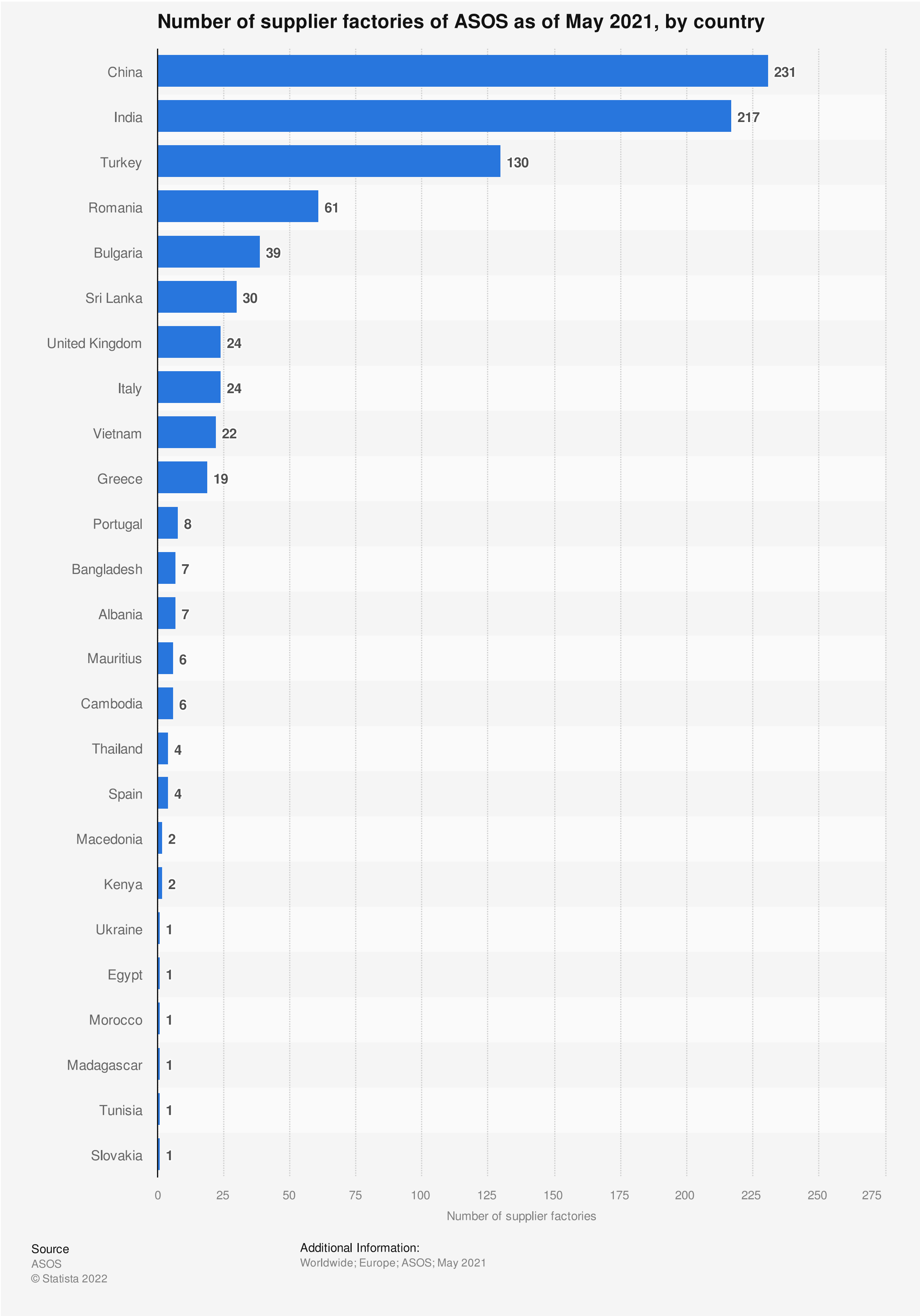

Figure 5 source: S Chevalier, 'ASOS: number of manufacturing factories 2021, by country' (Statista, 13 October 2021) <www.statista.com/statistics/1100017/number-of-suppliers-of-asos-by-region/> accessed 21 October 2022.

This importing trend can also be seen in the business behaviour of the private company New Look: see figure 6 below.

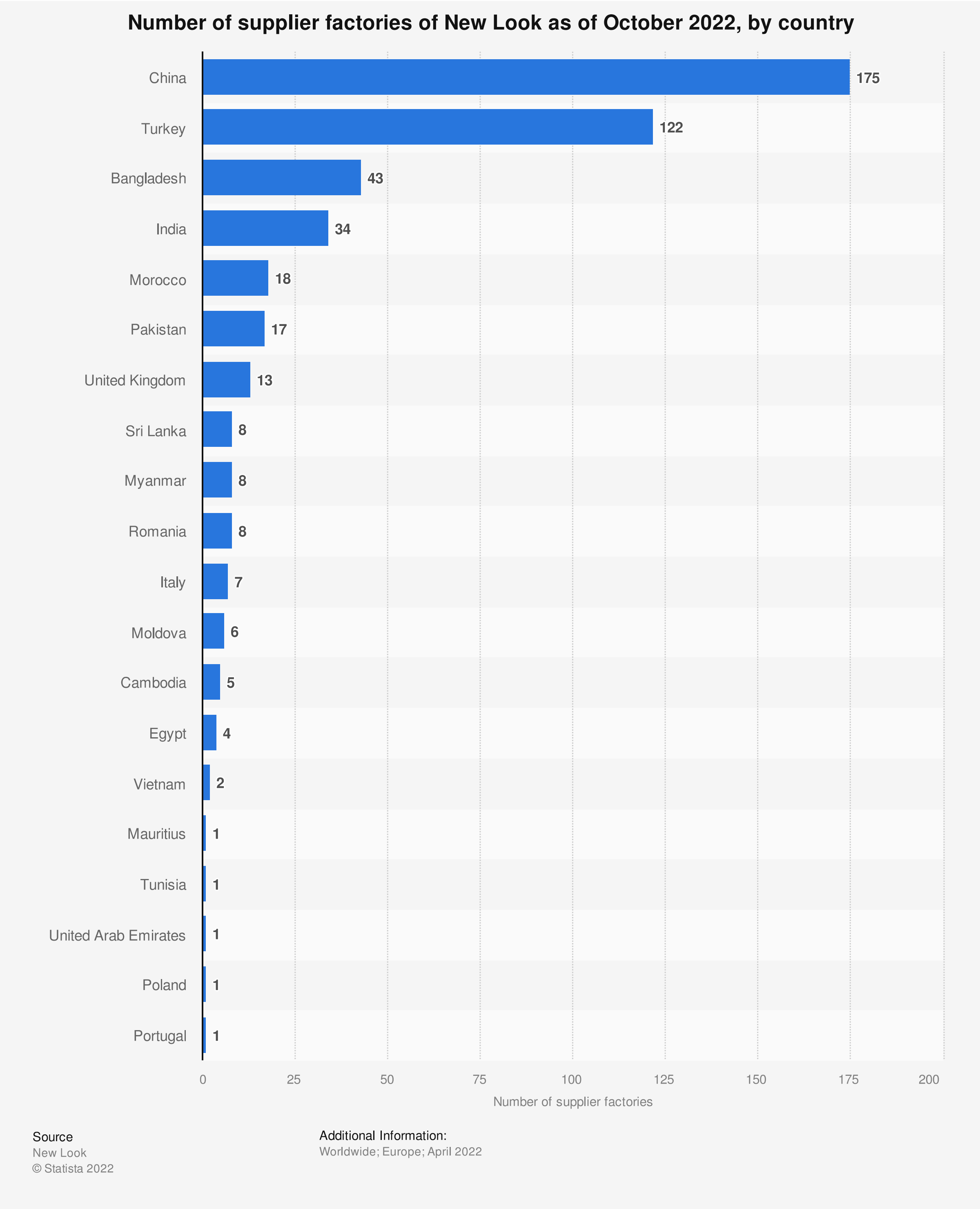

Figure 6 source: P Smith, 'New Look: number of manufacturing factories 2022, by country' (Statista, 1 September 2022) <www.statista.com/statistics/1103836/number-of-suppliers-of-new-look-by-country/> accessed 21 October 2022.

This thesis therefore looks at how *UK* fast fashion companies could change their behaviours to become more environmentally sustainable: a change in business strategy could have long lasting effects, not only on how these particular companies pursue their business ventures with sustainability at their core, but also by becoming leaders in the fast fashion field.

1.4 Conclusion

The purpose of this short chapter was to illustrate how fast fashion damages the environment because of the way its core business concept is orientated. It also illustrated how UK companies are contributing to the environmental problem: largely because of the sheer volume of clothing being imported and exported.

This provides context for why this thesis transposes its findings into the fast fashion industry: it being a crucial example of businesses operating around profit maximisation ventures.

Chapter 2 Shareholder primacy vs. Stakeholderism: explaining the choices companies make

2.1 Introduction

One of the key debates around companies, and their regulation, concerns whose interests companies *ought to* favour. The debate typically focuses on whether companies should prioritise the interests of their shareholders (what is usually called 'shareholder primacy') or should seek instead to balance the interests of all their stakeholders ('stakeholderism').

This chapter is connected to that debate, but its focus is somewhat different. It does not seek to evaluate whose interests companies *ought to* favour. Instead, its focus is on *explaining* whose interests companies (and those who run companies) *do* favour. Its purpose, then, is 'explanatory' rather than 'normative'.

The chapter begins with the conceptual question of defining the two theories mentioned above – shareholder primacy and stakeholderism. Dominating this debate, these two theories postulate conflicting ideologies about the hierarchies given to the diverging interests of stakeholders.

How these two theories deviate will be explained in this chapter before delving into the positive and descriptive question of in whose interests' companies *are* currently run. It will look at the key pressures exerted on British directors and in which direction these pressures push directors along the continuum between shareholder primacy and stakeholderism. This leads into the explanatory question about why companies *are* currently run how they are. In other words, whichever direction directors are pushed, determines how the average UK company pursues and protects different stakeholder interests.

By highlighting the ways directors choose to pursue different business endeavours, and what real-world forces propel them towards shareholder primacy, this chapter lays the foundations for the remaining chapters in which the focus will be on how companies can choose to diverge from traditional corporate formulations and instead self-select to pursue more stakeholder-friendly endeavours. These chapters focus on the strategic question: looking at what various strategies could and should be adopted to change things and make companies, particularly in the fast fashion sector, become more environmentally sustainable.

2.2 Shareholder primacy vs. Stakeholderism

This section addresses the conceptual question, asking what these two concepts – shareholder primacy and stakeholderism – mean.

Consolidated by Friedman, shareholder primacy is a corporate construction under which a director's 'responsibility is to conduct…business in accordance with [shareholder] desires,' namely 'to make as much money as possible.'[29] This concept has historically dominated the US and UK's corporate framework, leading commentators to argue that this has encouraged directors to justify their pursuance of aggressive profit maximisation schemes, due to historic precedent.[30] Conversely, a stakeholderist theory argues for *genuine* consideration of other stakeholder interests – i.e., for directors not to be fundamentally motivated by shareholder desires - even if it becomes necessary to sacrifice some of a company's profitability.

The following subsection explains more fully the meaning of, and the differences between, the concepts of shareholder primacy and stakeholding. It will define and draw

[29] M Friedman, 'The Social Responsibility of Business is to Increase its Profits' (The New York Times Magazine, 13 Sept 1970), 1.
[30] A Balfour and S Fuller, 'Why Business Leaders are Profit Motivated rather than Socially Motivated: The role of Business Education' (2010) 6 *Journal of Global Business Management* 2, 191.

a clearer picture of the key differences between these two concepts before entering a discussion about which dominates in the UK.

2.2.1 Shareholder primacy

Shareholder primacy theory postulates that directors should treat the interests of shareholders as paramount. A second, subsidiary, point that shareholder primacy is orthodoxly also understood as encapsulating is that the directors will best achieve this (prioritisation of shareholder interests) by, in simple terms, maximising profits.[31]

It is worth pausing here to note that this second, subsidiary, point could be challenged by some shareholder primacists. While some may agree with the first point (that shareholders' interests should come first), they may still disagree with the second (that the best way to achieve this is by maximising profits). They might argue, for example, although shareholder interests should be paramount, shareholders themselves are more altruistic, and are thus interested in more than the financial return on their investment. Shareholders accordingly will gain a large degree of happiness, wellbeing and welfare from the knowledge that other stakeholders are well cared for, gains which will more than compensate for reductions in the financial returns they get because their companies forego profit maximisation. Therefore, they would argue shareholder interests are best served, not by maximising profits, but by aiming for another target.

There is much more one might say about the plausibility of this 'heretical' view within shareholder primacy. However, as this is not the dominant or orthodox way of conceptualising shareholder primacy, it will not be considered further in this thesis.

[31] It is also worth noting that, even within the 'orthodox' mainstream view of shareholder primacy, where shareholders just want money, this is sometimes expressed as meaning that companies should maximise 'shareholder value' not 'profits.' As 'profit maximisation' is the term routinely employed, it is accurate enough for this thesis.

The purpose of this chapter is to illustrate that when real-life internal and external pressures are taken into consideration, directors interpret shareholder primacy as being best achieved with the ultimate aim of *wealth creation* for shareholders. Accordingly, even when longer-term profit maximisation schemes - that seem to consider e.g., the environment and social impacts of the company's business endeavours - are undertaken, this is merely done *instrumentally* with the ulterior motive of generating more profit. In our current climate, a company's profitability is intrinsically linked with its reputation and risk management. For present purposes, it is sufficient to recognise how directors are required, according to shareholder primacy, to pursue profit maximisation above all else.[32]

To provide a more coherent understanding of the intrinsic differences between shareholder primacy and stakeholderism, this subsection will now explain how shareholder primacy developed to become the dominating theory of corporate law in the US and UK.

The premise of shareholder primacy arose out of Adam Smith's 'invisible hand' doctrine, whereby individual acts of economic self-interest combine, through the 'invisible hand' of market forces, to further the best interests of society at large.'[33] Sneirson describes how Smith's theory was premised upon an hypothetical entrepreneur who both managed and owned a small private business.[34] This self-interested entrepreneur, motivated by 'accumulating profit' for himself, was subsequently transposed by Neoclassical

[32] Note, in chapters 3 and 4, recent climate litigation and the risks of reputational damage will be discussed.
[33] J Sneirson, 'The History of Shareholder Primacy, from Adam Smith through the Rise of Financialism' in B Sjåfjell and C Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (CUP 2019), 77.
[34] *ibid.*

economists into the corporate scene.[35] By interchanging the entrepreneur with the figure of the shareholder, Ho explains that Smith's classical economic approach was reconciled with 'the structure of the modern corporation.'[36]

Shareholder primacy's dominance is manifested by the historic US case, *Dodge v Ford*[37], where the Michigan Supreme Court articulated that 'the powers of the directors are to be employed' 'primarily for the profit of [shareholders].'[38] Decided just before Berle and Means began articulating their theory, this case supports Berle and Means' contention that owner-shareholders, not directors, 'ought to receive the profits of the corporation because they acquired ownership of the corporate venture and are the rightful benefactors of all corporate economic surplus.'[39] Premised on the idea that directors were becoming too powerful, in the 1960s Manne distilled their theory of rightful shareholder control into the basis of our current shareholder primacy model. Postulating for profit maximisation as a corporation's sole objective, Manne opined that any departures from the objective of 'maximis[ing] profits' would be economically inefficient and result in a company's demise.'[40] Writers such as Friedman[41] and Fischel[42] distilled this approach into the doctrine that dominates US and UK corporate practice today: 'wealth creation for shareholders [is a director's] principal objective.'[43]

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[35] *ibid.*
[36] K Ho, *Liquidated: An Ethnography of Wall Street* (Duke University Press 2009), 174.
[37] [1919] 170 NW 668.
[38] *ibid.,* [684].
[39] A Berle and G Means*, The Modern Corporation* (Transaction Publishers 1932), 220.
[40] H Manne, 'The 'Higher Criticism' of the Modern Corporation' (1962) 62 *Columbia Law Review* 399, 402.
[41] Friedman, 'The Social Responsibility of Business is to Increase its Profits'.
[42] D Fischel, 'Efficient Capital Market Theory, The Market for Corporate Control, and the Regulation of Cash Tender Offers' (1978) 57 *Texas Law Review* 1.
[43] K Johnstone and W Chalk, 'What Sanctions are Necessary?' in K Rushton (ed) *The Business Case for Corporate Governance* (CUP 2008), 174.

2.2.2 Stakeholderism

In stark contrast to the shareholder primacy doctrine, which encourages a merely *instrumentalised* consideration of non-shareholder interests, according to stakeholderism, directors are required to give *genuine* concern to non-shareholder interests, even if this comes at the cost of profitability.[44] As Foss and Klein assert, stakeholderism is the 'act of maximising the welfare of all legitimate stakeholders.'[45] Accordingly, the main interest of shareholders, i.e., profit maximisation, is balanced equally with that of other stakeholders, for example, employees.

Therefore, whereas, under shareholder primacy, directors take other external factors into account, for example their environmental impact, only in order to promote the profitability of their company in the long term, under a stakeholder theory, directors give 'genuine' weight to these other factors. 'Genuine' highlights the underlying difference between the two theories. The shareholder primacy doctrine predicates financial yield, with the instrumentalised consideration of these factors, whereas with stakeholder theory, these factors are contemplated *in order to* address and enhance them, in and of themselves, even if the business endeavour results in a forfeiture of profits.

Having understood clearly what 'shareholder primacy' and 'stakeholding' mean, as concepts, this thesis is now in a position to see which concept best represents the decision-making of directors of UK companies. Do such directors behave as shareholder primacists say they should, or as the stakeholder theory urges them to do? To be clear, the issue here is a 'descriptive' one, not a 'normative' one. This thesis is not trying to ascertain whether shareholder primacy is more 'attractive' than stakeholding, but

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[44] See further, R E Freeman, *Strategic Management: A Stakeholder Approach* (Pitman, Boston 1984).
[45] N Foss and P Klein, 'Stakeholders and Corporate Social Responsibility: An Ownership Perspective' (2018) 38 *Advances in Strategic Management* 17, 19.

whether it is descriptively a more accurate representation of the behaviour of UK directors.

The remainder of this chapter explores this descriptive issue. To do so, it identifies those 'pressures' to which directors are subject, pressures that will determine which model (whether shareholder primacy or stakeholding) they are likely to follow. By ascertaining the direction in which directors are pushed by these various pressures, either towards stakeholderism or shareholder primacy, and the types of forces that are at play, it is possible to provide an explanation for why directors are left with no real choice other than to pursue aggressive profit maximising business endeavours, ones that ultimately negatively impact the environment.

In explaining the forces that operate on directors, I distinguish between 'internal' and 'external' forces. Section 2.3 focuses on the internal forces, comprising, first, the legal duties imposed on directors and, second, the control rights enjoyed by shareholders. External forces (such as the threat of takeovers, NGO campaigns and media influence) will be addressed in section 2.4.

However, throughout these two sections it will be clear that even if some pressure from the various forces at play push directors towards protecting their company's reputation and take non-shareholder interests into consideration, this is ultimately done with long-term profitability at its core. Consequently, shareholder primacy is proven to be the dominating practice in the UK, even if through, for example the s172 duty contained in the Companies Act 2006 ('CA'), 'policy makers have attempted to strike a middle balance' between stakeholderism and shareholder primacy by 'remain[ing] faithful to an orientation toward the interest of the company and its members while encouraging a more inclusive decision-making process that can account for the interest[s] of stakeholders.'[46]

Before turning to identify, and analyse the force exerted by each group of pressures, there is one final issue that must first be addressed.

2.2.3 Agency Theory vs. Stewardship Theory

This issue relates to two theories about the motivations of directors.

The reason this analysis is included is because my question is framed in terms of the choices that directors make and the 'pressures' that influence those choices. To understand how directors will choose, in the face of such pressures, one has to have some initial 'model' of how individuals make choices. Agency theory and stewardship theory put forward two competing models. Under agency theory, directors are modelled as actors – 'agents' – who choose how to act based on a 'rational' calculation of what will maximise *their own* wealth.[47] As Keay summarises, 'agency theory assumes [that directors] will engage in self-dealing and/or shirking; they will have no incentive to maximise the interests of the shareholders, and have no altruistic motives in anything they do…There will be a conflict between the interests of the directors and those of the shareholders…even though they are engaged in a cooperative venture.'[48]

Conversely, under stewardship theory, directors are modelled as actors – 'stewards' – who make choices more to fulfil their understanding of the role they are performing: stewardship theory maintains that directors act as stewards who are not concerned with their own financial prosperity, but '[are] willing to act in the best interests of their

[46] R Mares, *The Dynamics of Corporate Social Responsibilities* (Martinus Nijhoff Publishers 2008), 188.
[47] Note that 'utility' would be more accurate, but 'wealth' is better fitting with the remainder of my analysis.
[48] A Keay, 'Stewardship Theory : Is Board Accountability Necessary?' (2017) 59 *International Journal of Law and Management* 6, 1297.

company and they will act in a way that leads to collectivist/organisational utility rather than self-serving benefits.'[49]

This distinction does not mean that if directors are acting as 'agents' they will necessarily choose shareholders/profit maximisation/short termism. Nor does it mean that if directors are acting as stewards, they will necessarily choose stakeholders/long termism. What it does mean, is that the different pressures being identified in the remainder of this chapter, will operate differently. For example, the 'force' which any particular pressure, considered below, will exert on directors may vary depending on whether directors are understood as acting in accordance with an 'agency model' of decision making, or a 'stewardship model' of decision making.

To try and make this point clearer, I shall illustrate it by reference to one of the pressures that is discussed later in this chapter. The reader might find it useful to return to this example once they have digested the text in section 2.3.1 below. The pressure which will feature in this illustration is found in s172 CA, namely the duty on directors to 'promote the success of the company for the benefit of its members as a whole.'

For an agency model, pressures that impact on the wealth of directors are the most important. Section 172 is a pressure that really matters, from an agency point of view, if, but only if, it carries a real threat to the wealth of directors; if not, it is significantly less important. Similarly, remuneration practices matter if, but only if, they result in directors' own rewards being significantly affected by the choices they make.

Similarly, on an agency theory view, *social* norms that directors should be loyal to others, trustworthy and put others' interests first, probably have little influence because they

[49] *ibid.,* 1298.

generally do not affect directors' wealth. Note, however, that it would likely be different if these norms, or bad publicity, were effectively enforced through reputational sanctions in a way that made a significant or predictable difference to the wealth of those ignoring the norms or receiving the bad publicity.

By contrast, if one takes a stewardship view of directors, doubt falls on whether directors are choosing what to do by making repeated calculations of what will promote their own wealth. So, pressures which may well operate as incentives or threats to the wealth of directors are less significant, because directors themselves are not so heavily focused on their own wealth when choosing how to act. By contrast, social norms, bad publicity, and so on, even if they add little to the financial incentives on directors, matter if those norms are internalised by directors. Section 172 might matter even if it is never enforced, as it may nevertheless create a 'culture' in which directors understand their role to be the protection of shareholder interests. Therefore, if taking a stewardship view, changing the wording of s172 to make it more genuinely stakeholder friendly, can matter, even if stakeholders cannot enforce it against directors: the change to the wording helps to redefine the role of directors, and that alone will make a difference to 'stewards' (but probably not to 'agents').

In summary, the 'agents or stewards' debate is relevant to my explanation of the pressures on directors because it precipitates the question when the various pressures are discussed in this chapter: are the directors understood as stewards or agents? Each theory argues or assumes that individuals (including directors) *already* either *are* agents or *are* stewards. This assumption is then carried forwarded to explain how directors, understood in that way, react to the pressures exerted on them.

Throughout the remainder of this section, it is useful to keep this distinction in mind. When considering the pressures exerted on directors and the ways in which they react, the force exerted by each pressure depends on whether one thinks it is being applied to directors who already are, and therefore act as, 'agents', or to directors who already are, and therefore act as, 'stewards'.

If one views directors as agents, one could incentivise them to become more stakeholder friendly by altering the pressures affecting their wealth – i.e., to make it worth their while, financially, to change their allegiance. If one views directors as stewards, then redefining their role, social norms, etc., will make a lot of difference.

2.3 The UK's position: The internal pressures on directors

This section focuses on the different internal pressures on directors. This will include an analysis of the directors' duties, the role of other provisions that grant shareholders' powers and a brief explanation of the rising popularity of Employee Share Ownership Plans (ESOP), linking director pay to share value.

2.3.1 Directors' Duties

One very obvious pressure that is exerted on directors arises from the general duties imposed on them by the CA. Therefore, to evaluate whether the average UK director approaches corporate decision making from the perspective of shareholder primacy or stakeholderism, it is useful to begin by considering their statutory duties.

Historically, 'company' interests and 'shareholder' interests were interpreted synonymously. For example, Plowman J in *Parke* [50] observed that ''the benefit of the company' meant the benefit of the shareholders as a general body.'[51] This approach is

[50] *Parke v Daily News Ltd* [1962] Ch 927.
[51] *ibid.,* [963].

manifested in the statement of Lord Evershed in *Greenhalgh,*[52] where he explains that '"interests of the company as a whole", [did] not mean the company as a [distinct] commercial entity,' but instead 'mean[t] the [shareholders] as a general body.'[53]

Now embodied by s172, directors are explicitly required to 'act in a way [they] consider…would be most likely to promote the success of the company for the benefit of its members.'[54] Deriving from historic precedent, Warren J observed in *Cobden Investments,* that the common law duty and s172 'come to the same thing.'[55] As such, the statutory duty builds on Lord Green's assertion in *Re Smith* that directors 'must exercise their discretion bona fide in what they consider – not what a court may consider – is in the interests of the company.'[56]

"Members" per se, has been construed as a direct reference to "shareholders," as they are the financial beneficiaries of the corporation. In *Al Nehayan,* Leggatt J observed that 'fiduciary duties typically arise where one person *undertakes* and *is entrusted with* authority to manage the property or affairs of another and to make discretionary decisions on behalf of that person.'[57] It is of little surprise therefore, that as the individuals and entities investing their property in a company, shareholders generally expect their interests to be prioritised by directors.

Commenting on the 1999 Company Law Review Steering Group (CLRSG) who formulated the notion of ESV, the Trade and Industry Committee defined it as meaning directors had a 'primary duty to maximise value for the company's shareholders.'[58] However, they

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[52] *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286.
[53] *ibid.,* [291].
[54] s. 172(1) CA.
[55] *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810, [52].
[56] *Re Smith and Fawcett* [1942] Ch 304, [306].
[57] *Al Nehayan v Kent* [2018] EWHC 333, [159].
[58] House of Commons, Trade and Industry Committee, 'The White Paper on Modernising Company Law' (Sixth Report of Session 2002–03), [13].

added 'that other relationships were significant in this and therefore needed to be taken into account when judging how to carry out this duty. The interests of employees, customers, suppliers, and local residents, as well as the environmental impact of the company's activities and its good standing in the eyes of the public, all had to be considered when judging what was in the interests of shareholders.'[59] This provides support to Keay's observation that when ESV was formulated, the government 'did not envisage the ultimate objective of the company being changed from shareholder value.'[60] Therefore, if, as he maintains, 'ESV simply ensured that stakeholder interests were to be considered in achieving the ultimate objective' - namely the pursuance of profit maximisation - it would appear that in our current corporate landscape, the inescapable profit maximisation pursued by the average UK board of directors means that many external stakeholder concerns are largely ignored or simply given lip service.[61]

Interestingly, the Parliamentary Joint Committee on Corporations and Financial Services mused that 'the basic legal position is quite straightforward: the duty of directors to act in good faith and in the best interests of the company requires directors to treat *shareholders'* interests as paramount.'[62] In other words, 'the interests of employees, or other stakeholders, can be considered in performing these duties but only where this would be in the company's [shareholders] interests.'[63]

It is worth pausing here to note that, even within shareholder primacy, there is a tension about whether this requires directors to satisfy shareholders' short term, or long term,

[59] *ibid.*
[60] A Keay and T Iqbal, 'The impact of enlightened shareholder value' (2019) 4 *Journal of Business Law,* 307.
[61] *ibid.*
[62]Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing Risk and Creating Value* (2006), 51.
[63] *ibid.*

interests. This tension is illustrated by the US case of *TW Services,* in which it was asserted that 'directors, in managing the business and affairs of [their] corporation, may find it prudent (and are authorised) to make decisions that are expected to promote corporate (and shareholder) long run interests, even if short run share value can be expected to be negatively affected.'[64] This case highlights the different forms of shareholder primacy that exist: one which focuses on myopic profit maximisation, and another which focuses of profit maximisation in the long term.

It must be noted that the more directors are trying to serve the shareholders' long-term interests, the much more likely that this will, albeit still instrumentally, require more attention to be given to the impact of the company's activities on non-shareholders. In a practical sense, therefore, it must be acknowledged that the pursuance of long-term shareholder interests does result in more benign treatment of stakeholder interests. However, although the longer-term approach seems to take more stakeholder interests into account, this is still ultimately done with the motive of profit maximisation. While stakeholder interests may be considered and may often result in a more benign treatment of stakeholders, this is done with an ulterior motive - profit – therefore, this form of shareholder primacy (i.e., ESV) cannot be conflated with stakeholderism.

In other words, when one takes the statutory s172 'have regard to' list,[65] it is not trying to make directors give independent balancing weight to these stakeholder interests (outlined throughout s172(1)(a)-(f)). Rather, it is trying to ensure that the pressure (from

[64] *TW Services Inc v Crown* [1989] WL 20290, [7].
[65] Remember its wording:
'(a)the likely consequences of any decision in the long term,
(b)the interests of the company's employees,
(c)the need to foster the company's business relationships with suppliers, customers and others,
(d)the impact of the company's operations on the community and the environment,
(e)the desirability of the company maintaining a reputation for high standards of business conduct, and
(f)the need to act fairly as between members of the company.'

the duty) is directed towards making directors be 'sophisticated' profit maximisers – pressuring them to take decisions that will *actually* maximise shareholder value, given the full costs and benefits that the company suffers as a result of the impact on stakeholders. As Tate notes, the statutory provision only 'formally obliges directors to consider stakeholder interests during the decision-making process' in as far as it conforms with the traditionally held desire for profit maximisation.[66]

It is worth also considering how regulation to which the company itself is subject – say environmental restrictions on what the company may do – fits in here. Such regulation – imposed upon the company – does not change the profit-maximising obligation imposed on directors by s172. The duty under s172 does not require that directors must always ensure the company complies with all regulations imposed upon it. It merely requires directors to include the costs of non-compliance (or the benefits of compliance) in their calculation of what action will maximise profits. Such regulation, then, is *instrumentally* relevant to the directors' profit-maximising choices (just as impacts on stakeholders are instrumentally relevant).

Of course, if the environmental regulation that is imposed on companies is extensive, and the sanctions for its breach are substantial, then maximising profits will often require environmentally responsible behaviour. The director's duty will still be to maximise profits, but in order to fulfil that duty they will often, given external regulation, need to ensure the company acts in a regulation-compliant, and so environmentally responsible, way.

[66] R Tate, 'Section 172 CA 2006: the ticket to stakeholder value or simply tokenism?' (2012) *Aberdeen Student Law Review,* 3.

Enough has been said here to show how regulation imposed on the company does not change the profit-maximising focus of s172. However, it does raise an interesting 'strategic' issue, which will be returned to in chapter 3. If one wants to make companies behave in a more environmentally responsible way, should this be done by leaving the directors' duty to maximise profits intact, but imposing more environmental regulations on the company itself? Or is it better to change the duty imposed on directors, so that they are no longer required to maximise profits?

2.3.1.1 How great is the pressure exerted by the directors' duties?

It is argued here that the wording of the directors' duties encourage profit maximisation. Specifically, that s172 and s174 impose a strong pressure on directors to favour shareholders/profits.

Firstly, even if directors care only about the costs and benefits *they* will suffer (in other words, even if directors act like 'agents' who choose based on a calculation of costs and benefits to themselves), the costs of breaching s172/174, by reducing profits to be environmentally friendly, could be significant.

It is only 'marginal' decisions where directors could get away with sacrificing profits: where it is clear that the environmental option is less profitable, they will be much less confident that their protestations of 'good faith' and claims they used 'business judgement' and that they cannot condemned with hindsight, will save them. In clear cut cases like these, it is much more likely that one would see shareholders successfully using derivative claims to enforce breaches of duty.

While it is true, that few derivative claims are seen in practice, that is because directors do not often take environmentally friendly, but clearly (not-marginally) unprofitable decisions.

In this view, s172/4 does exert a significant pressure on directors, at least where profitability clearly trumps environmental concerns.

It would therefore be argued this is even more so the case if one takes a more stewardship view of how directors make choices. On this view, the pressure the duties create is to be understood not just in terms of the financial costs and benefits they impose on directors. They should also be understood as 'norms' which directors 'internalise'. They instruct a director about what the role of a director is. Furthermore, under the duties' current wording, they are telling the director that their role is to maximise profits. Even if the likelihood of enforcement is quite low, they exert a pressure on directors to favour profits simply by the part they play in defining what the directors' role is.

This pressure is exacerbated by the powers shareholders have to bring enforcement proceedings against a director that breaches their s172 duty. Stakeholders on the other hand, have no standing to bring any such proceedings and this has led commentators such as Tsagas to conclude that the section merely gives 'the illusion…that something is being done in the sphere of company law in relation to acknowledging stakeholders' interests in corporate decision-making.'[67] If the only individuals able to bring action against directors are the shareholders, it seems clear that the directors would be encouraged to pursue their interests – a consequence of not doing so being the directors' own personal liability (a consequence discussed in greater detail in chapter 3).

It must be acknowledged that the duties' wording allows directors to use their own discretion in exercising them. This could allow them to choose business ventures that prioritise the environment over profitability. As Keay notes, the 'protection of the

[67] G Tsagas, 'Section 172 of the UK Companies Act 2006: Desperate Times Call for Soft Law Measures' (Oxford Business Law Blog, 1 Sept 2017) www.law.ox.ac.uk/business-law-blog/blog/2017/09/section-172-uk-companies-act-2006-desperate-times-call-soft-law accessed 2 March 2021.

interests of stakeholders is left not to any specific rights…but wholly to the discretion of directors.'[68]

However, the same issue arises that the shareholders have extensive powers over the directors. These powers, for example, concern directorial remuneration, tenure and the ability to bring regulatory proceedings against them. The following section will discuss these powers in greater detail, so for now it is simply worth acknowledging their existence.

Milman advocates that the phrase 'have regard to' is extremely 'elastic' and 'sets the barrier at a very low-level requiring reflection on the part of the directors rather than compliance with stakeholder needs.'[69] By being given the discretion to choose which interests the company prioritises, it will be explained throughout this chapter why this tends to result in profit maximising schemes. In other words, due to the various pressures exerted on directors, they are able, and subsequently do, prioritise shareholder interests.

This conclusion is further amplified by the historic interpretation of 'company interest' by the courts as a direct reference to shareholder interests.

Fundamentally, s170(1) makes it explicitly clear that 'the general duties specified in sections 171 to 177 are owed by a director of a company *to the company*.'[70] This is reflected in the common law, for example, the case *Peskin v Anderson*[71] confirmed the ratio of *Platt v Platt*[72] that 'as a general proposition, a director's primary fiduciary duty is

[68] A Keay, 'Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado About Little?' (2011) 22 *European Business Law Review* 1, 35.
[69] D Milman, 'Stakeholders in modern UK company law' (2017) *Company Law Newsletter* 397, 4.
[70] s. 170(1) CA, italics added.
[71] [2000] BCC 1110.
[72] [1999] 2 BCLC 745.

to the company.'[73] This is lent further support by the Model Articles of Association which outline how directors are 'responsible for the management of the company's business' through collective exercises of power.[74] Kershaw notes how this responsibility is 'fulfilled by participating in the collective exercise of power on matters brought before the board and taking responsibility for the exercise of that power.'[75]

As Attenborough maintains, 'section 172 subordinates the company's commercial interests to the interests of shareholders as a constituency.'[76] He goes on to explain how this is catalysed by s33 CA. This provision grants shareholders ultimate power, in the general meeting, over the contents of the company's constitution. Therefore, shareholders 'unilaterally determine the specific activities for which the company has been formed [as well as] substantially grant[ing] corporate power to the directors.'[77] They thereby play a crucial role in choosing how the company prioritises the pursuance of different stakeholder interests and what the corporate *purpose* will be.

It is useful to acknowledge here that chapter 3 will discuss how shareholders can bring legal action against directors personally for breaching their ss171-7 duties. This will be analysed by contrasting it with corporate liability, discussing how effective personal liability mechanisms can be. In the context of this current chapter, it is simply worth noting how this could exert pressure on directors to make decisions that do not breach their duties to the company and therefore, if shareholders can bring action against them personally for breaching their duties, they are more likely to respect them; not wanting

[73] D Arsalidou, 'Directors' fiduciary duties to shareholders: the Platt and Peskin cases' (2002) 23 *Company Lawyer* 2, 63.
[74] Articles 3 and 7 Model Articles for Public Companies.
[75] D Kershaw, 'Corporate Law's Fiduciary Personas' 7.
[76] D Attenborough, 'Misreading the directors' fiduciary duty of good faith' (2020) 21 *Journal of Corporate Law Studies* 1, 28.
[77] *ibid.,* 25.

to damage their reputation. It is also interesting to note that chapter 4, will discuss s172(2). This clause allows deviation from the traditional s172 approach to stakeholder interests – namely the prioritisation of shareholder interests – and creates the possibility for activist shareholders to amend their articles: perhaps inserting an explicit clause about balancing shareholder interests with other stakeholder interests, such as environmental impact.

For present purposes, however, the combination of historic judicial interpretation of 'company interests', s172 and s33 have resulted in directors being pushed towards the pursuance of profit maximisation schemes as shareholders sit at the top of the corporate hierarchy. Through the language of, e.g., s172, shareholders are informed that directors should pursue their interests and are subsequently emboldened to use their powers to enforce this right.

2.3.2 Shareholder Powers

Before analysing the various shareholder powers, it is useful here to briefly distinguish between them and the directors' duties.

Directors' duties are a fairly 'passive' constraint on directors, that rely, for their pressure, largely on 'ex post' enforcement (at least on an agency model of how directors make choices). But in addition to those rather passive, and 'only enforced ex post', duties, shareholders enjoy a number of more assertive powers to impose their will on directors and ensure that directors will serve their interests above those of stakeholders. These powers often have a more 'ex ante' quality to them: they allow shareholders to intervene and influence the future behaviour of directors before directors make choices - rather than just punishing them afterwards as directors' duties aim to do.

A number of statutory provisions exist that grant shareholders extensive powers over directors. For example, both s168 CA, detailing the 'resolution to remove a director,' and decisions regarding director remuneration are controlled by the shareholders of a company. Therefore, though Lord Davey highlighted in *Burland v Earle*[78], that shareholders can 'only use the powers and rights contained in the company's constitution to hold managers to account,' it is apparent that shareholders have powers that result in their interests remaining prioritised.[79]

It will be argued that as directorial job security and income are directly accountable to and controlled by shareholders, it is unsurprising that this has resulted in directors making business decisions in the interests of shareholders - historically revolving around profit maximisation – rather than in accordance with other stakeholder interests.

2.3.2.1 Process to remove a director

A key strategic power for shareholders is contained under s168 and grants them the authority to pass an ordinary resolution to remove a director from their position. Although some CA provisions can be contracted out of through a clause to that effect in the company's constitution, the House of Lords made it explicitly clear in *Russell,*[80] that 'any provision in a company's articles to exclude this [s168] provision would be an 'unlawful fetter' on the company's statutory rights and thus unenforceable.'[81] Even 'a resolution [seeking] the removal of all of the directors at one swoop,' is technically permissible under this statute.[82] Furthermore, under s168(5)(b), any less-strenuous way

[78] [1902] AC 83 (Canada).
[79] V Barnes, 'Shareholder primacy and managerial control in Anglo-American corporate governance' (2020) 41 *Company Lawyer* 2, 45.
[80] *Russell v Northern Bank Development Corp Ltd* [1992] 1 WLR 588.
[81] D Prentis, 'A company's statutory right to remove a director' (Goodman Derrick LLP, 26 March 2018) www.gdlaw.co.uk/site/blog/sectors-blog/a-companys-statutory-right-to-remove-a-director accessed 17 February 2021.
[82] A Keay, 'Company directors behaving poorly: disciplinary options for shareholders' (2007) *Journal of Business Law* 656, 671.

to remove a director from office is permitted, the provision simply sets one mechanism (an ordinary resolution) that must be sufficient. But companies could adopt other mechanisms alongside removal by ordinary resolution. Consequently, as a matter of law, a director's job security can be minimal.

However, it is worth acknowledging that cases such as *Bushell v Faith*[83] highlight how s168 can be circumvented by the insertion of a provision in the articles which, as was the case in *Bushell,* changes the voting weight of the director's shares who is being removed. In this case the House of Lords accepted the validity of a provision that changed the targeted director's voting share to carry 3x the weight. However, as Keay acknowledges, 'it is going to be a rare case where such an article is present in today's world, and it is likely to be present only in the articles of private companies.'[84] For the purposes of this thesis, focusing on publicly listed companies, though the full force of s168 can be circumvented, it can be concluded it has little effect in undermining shareholder primacy's dominance.

Consequently, the mandatory provision of s168 granting ultimate power to shareholders for the removal of their company's director(s) who disappoint them through, for example their choosing not to pursue profit maximising endeavours, encourages the prioritisation of shareholder desires.

2.3.2.2 Director tenure and remuneration

According to s188, through an ordinary resolution, shareholders have the authority to approve director contracts lasting over 2-years. In addition, The Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019, reaffirms

[83] [1970] AC 1099.
[84] Keay, 'Company directors behaving poorly,' 672.

under s226B(2), that policies on directors' remuneration must have been 'approved by a resolution passed by the members of the company in the general meeting.' The explanatory memorandum accompanying these 2019 Regulations, explains that 'the impact of the instrument will be to give shareholders new information with which to assess the performance of directors and to form a view on the effectiveness…of the company's approach to directors' remuneration and performance incentives.'[85]

One way in which shareholders are able to incentivise directors to prioritise share price is through an ESOP. The idea behind these sorts of schemes is that a portion of the directors, and employees, incomes are tied to the company's share price. As such, pressure is placed on them personally to try to increase the corporation's share price so that they, as individuals, will benefit, while also benefitting the shareholders. If the share price is increasing, the employees who are part of an ESOP will gain financial rewards. As Ganti observed, 'these plans…encourage participants to do what's best for shareholders, since the participants themselves are shareholders.'[86] A similar scheme is the focus of Bowdren, who muses that Long Term Incentive Plans, where directorial remuneration is tied to equity, results in 'directors' decisions…tak[ing] account of expected impact on share price.'[87] The impact of this was assessed by Roe, who found that 'management will tend to replicate the time horizons of the market' when their pay is linked to equity.[88]

[85] Department for Business, Energy and Industrial Strategy, 'Explanatory Memorandum to The Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019' (2019) No 970 DExEU/EM/7-2018.2 [7.7].
[86] A Ganti, 'Employee Stock Ownership Plan (ESOP)' (*Investopedia* 20th July 2022) <www.investopedia.com/terms/e/esop.asp> accessed 8 August 2022.
[87] A Bowdren, 'Contextualising short-termism: does the corporate legal landscape facilitate managerial myopia?' (2016) 5 *UCL Journal of Law and Jurisprudence* 2, 302.
[88] M Roe, 'Corporate Short-Termism: In the Boardroom and in the Courtroom' (2013) 68 *Business Lawyer* 977, 985.

By being in control of director tenure and remuneration, shareholders wield power of directors' pay and job security – two things that are vital for directors to receive. Hence, if directors' job-security relies on positive shareholder sentiment, this adds a factor that pushes directors away from dissatisfying shareholders and towards the choice of sacrificing the company's impact on the environment in preference for the pursuance of profit maximisation. Furthermore, when it is decided that directorial remuneration will be linked directly to share price, pressure is directly exerted on them to ensure share value stays high.

2.3.2.3 Impact of shareholder powers

Once shareholder 'approach[es] to voting on the annual remuneration report and the remuneration policy' of company directors are placed in tandem with the shareholder prerogative to pass ordinary resolutions that remove directors, it becomes apparent that directors are, in regard to their financial welfare, reliant on positive shareholder sentiment.[89] When this is placed in tandem with the dominance of agency theory, it is evident directors are often orientated around improving the company's share price. As Armour conclusively asserts, these provisions were 'ostensibly designed to increase the accountability of [directors] to shareholders.'[90]

The following section will take this further, discussing the various external pressures on directors that push them towards prioritising shareholder interests. This will begin with an explanation of how the internal pressure for shareholder primacy is exacerbated by the idea that the market reflects poor directorial decision making, as 'firms are measured by their position on the stock exchange,' with share prices being 'linked to corporate

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89 Department for Business, Energy and Industrial Strategy, 'Explanatory Memorandum' [7.7].
90 J Armour, S Deakin and S Konzelmann, 'Shareholder Primacy and the Trajectory of UK Corporate Governance' (2003) 266 *Centre for Business Research*, 9.

performance'.[91] If potential, and existing, investors regard share valuation as indicative of good corporate performance, directors will undoubtedly focus on their company's share value and as such, will likely pursue short-term business endeavours that result in increased profit maximisation and lead to better stock performance.

2.4 The UK's position: The external pressures on company directors

As established in the previous section, the internal pressures steer directors towards prioritising shareholder interests, namely profit maximisation. This section will therefore analyse the various external pressures influencing directors: those deriving from the market, regulation, consumers, NGOs, charities and the media. Jacometti observes that 'the pressure from consumers and especially of [NGOs] and the media has acted and continues to act as a stimulus for the adoption of sustainable behaviour in the fashion sector.'[92] The accuracy of this assertion and whether such pressure is sufficient to actually influence directors will be examined throughout this section. Ultimately, it will be argued that these pressures have been unable to actually change the average director's approach to decision making, and as such general corporate behaviour, which are predisposed to prioritising profit over environmental sustainability. Though they may be inclined to promote an image of sustainability, to introduce actual, real change to their corporation's practices is highly unlikely, particularly in the fast fashion sector; it will be argued that this is largely because of consumer desire for cheaper products.

2.4.1 Market Forces

As the House of Commons observed during discussion about the introduction of the CA, 'shareholders have two sorts of influence in relation to companies: they can seek to

[91] Barnes, 'Shareholder primacy and managerial control', 47.
[92] V Jacometti, 'Circular Economy and Waste in the Fashion Industry' (2019) 8 *Laws* 27, 2.

change the way the company is run by argument and voting ('voice'), or they can simply sever their connection with the company by selling their shares ('exit').'[93]

The first tactic (voice), unique to shareholders, is what makes their governance rights distinctive within the company. The second tactic (exit) is not unique to shareholders. Shareholders can disinvest; but employees can switch jobs; suppliers can stop doing business with the company; consumers can switch to other companies, etc. However, this is not to say whether these market/exit pressures are more, or less, powerful, for non-shareholders than they are for shareholders – it is just important to note that they do exist. It is the combination of both voice and exit that provide shareholders with a unique opportunity to manifest the 'market for corporate influence' and are crucial to an analysis of the pressures exerted on directors.[94]

Some, such as Ringe argue that the market, especially institutional investors, are capable of encouraging environmentally sustainable business decisions.[95] However, throughout this sub-section, it will be argued that due to shareholders', and potential investors' ability to exit a company that is performing badly, or not in accordance with their desires, the disciplinary powers of the market further solidify the fact that the average director will pursue profit maximisation to satiate dissatisfied shareholders.

The efficient capital markets hypothesis maintains that the market responds immediately and in its entirety to any corporate misdemeanours.

[93] House of Commons, Trade and Industry Committee, 'The White Paper on Modernising Company Law', [108].
[94] B Cheffins and J Armour, 'The Past, Present and Future of Shareholder Activism by Hedge Funds' (2011) 37 *Journal of Corporation Law* 51, 58.
[95] W-G Ringe, 'Investor-led Sustainability in Corporate Governance' (2021) European Corporate Governance Institute - Law Working Paper No. 615/2021, Available at SSRN: https://ssrn.com/abstract=3958960.

This concept links into my chapter 3 analysis, where regulatory measures against corporations and directors are considered. For the current chapter's context, directors are required to consider regulations imposed on companies, as if, for example, the government introduced an environmental based tax for a particular sector/industry, companies would respond and would likely lead to investors decreasing their investments in the affected sectors as they would not want to be involved in heavily regulated markets. As such, the regulatory pressure from capital markets on a company can accentuate the pressures on a company's directors already deriving from stock valuation discussed throughout this section.

When the efficient capital markets hypothesis is put in tandem with the market for corporate control theory, economic theorists maintain that good and bad directorial behaviour is reflected through the value attributed to that company's share value. This sub-section will begin with an analysis of whether share prices do in fact accurately reflect management's success in maximising shareholder value, before going on to query the extent to which this has any disciplinary pressure on directors. In particular, it will examine if this supposed governing effect forces directors to focus on shareholder wealth maximisation, threatening them with consequences if they fail to do so. For example, the role of hostile takeovers in reinforcing directorial accountability to shareholders will be analysed. As Nyombi maintains, shareholders are effectively made 'the prima donnas of the company' during such a process.[96] Ultimately, it will be argued that market forces have the effect of pushing directors further along the path of shareholder primacy due to their reliance on positive market feedback.

[96] C Nyombi and T Mortimer, 'Takeover regulation in the UK and shareholder primacy: what, why and how to reform?' (2018) 24 *International Trade Law & Regulation* 2, 66.

2.4.1.1 Short-termism deriving from stock valuation

Many economic theorists maintain that share values directly and accurately reflect the success of a company.

The possibility of giving the impression a company is performing well means that short-term investment strategies have historically dominated Anglo-American corporate strategy. Essentially, 'short-termism means focusing on short time horizons by both the corporate managers and the financial markets and prioritizing near-time shareholder interest over the long-term growth of the companies.'[97] As a consequence, 'managers regularly make short-term focused choices, no doubt as a result of the immediate benefits available.'[98] Interestingly, Levinthal and March acknowledge that 'there is no guarantee that short-run and long-run survival are consistent. It is easy to imagine situations in which the only strategies that permit survival in the short run assure failure in the long run and vice versa.'[99]

Short-termism can be 'observed in the shortening of investment horizons over the last two decades,'[100] as the 'average holding period in professionally managed funds is less than a year.'[101] In a study conducted for the EU Commission, EY found 'evidence collected over the 1992-2018 period shows that there is a trend for publicly listed companies within the EU [and UK] to focus on short-term benefits of shareholders rather than on the long-term interests of the company. Data indicates an upward trend in shareholder pay-outs, which increased fourfold, from less than 1% of revenues in 1992 to almost 4% in

[97] G Reilly, D Souder and R Renucci, 'Time horizon of investments in the resource allocation process: Review and framework for next steps' (2016) 42 *Journal of Management* 5, 1169-94.
[98] *ibid.,* 1185.
[99] D Levinthal and J March 'The myopia of learning' (1993) 14 *Strategic Management Journal* 2, 101.
[100] P Woolley, 'Why are Financial Markets So Inefficient and Exploitative - and a Suggested Remedy' in A Turner et al. (eds) *The Future of Finance: The LSE Report* (London School of Economics and Political Science, 2010) 133.
[101] A Rappaport, 'The Economics of Short-Term Performance Obsession' (2005) 61 *Financial Analyst Journal* 3, 66.

2018.'[102] Interestingly, their findings highlight the problems associated with the clothing industry as 'the Food industry appears to be the most short-term oriented sector, by allocating the largest share of earnings to pay-outs, followed by the Oil and Gas sector and the Garment sector.'[103] The report goes on to emphasise how 'the Garment sector presented the highest growth of this indicator during the last decades.'[104] As such, it is clear that short-termism dominates many of the corporate decisions of directors within this sector, lending support to my argument that this industry is largely motivated by the pursuance of short-term, profit maximising initiatives.

Ringe maintains that due to market efficiencies, it is capable of regulating itself, without any need for further legislation or governmental intervention, even in regard to the ambitions for net zero and greater levels of environmental sustainability. In a recent paper he argues that institutional investors should act as the overriding arbiters of sustainability, using their financial and global dominance for good through collaboration. To support this contention, Ringe cites how 'a broad coalition of institutional investors (including Amundi, Legal & General, and others) recently urged large banks to stop financing carbon-intensive projects, to scale-up their green lending, and to ensure that executive pay is linked to net zero targets.'[105] Conversely, Mathiopoulos argues that although 'there is evidence that corporations are adopting CSR policy…this is more likely to be a token gesture and a smoke screen for the corporation that wants to look as if it is of good character.'[106]

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[102] EY, for the EU Commission, *FINAL REPORT: Study on Directors' Duties and Sustainable Corporate Governance* (July 2020), vi.
[103] *ibid.,* 12.
[104] *ibid.*
[105] Ringe, 'Investor-led Sustainability', 6.
[106] J Mathiopoulos, 'The purpose of for-profit corporations in light of modern perceptions and wider corporate responsibilities (part 2)' (2017) 38 *Company Lawyer* 10, 309.

2.4.1.2 Pressure from stock valuation

Even if short-term focused decisions dominate directorial decisions, it must be analysed whether market pressures act as a disciplinary force on director decision making, pushing them towards shareholder wealth maximisation.

If one accepts that the market does accurately reflect directorial success, it acts as a stark *signal* of their competence, making it much more likely they will be removed by the shareholders in a general meeting for continually low share prices. As Mayer contends, 'the stock market provides a quick guide to shareholders' views about the reputations of corporations.'[107] Moreover, having a low stock valuation prevents a company growing as it will be more of a struggle to raise capital with a depressed share price. This encourages short-termism as these types of business endeavours often have immediate financial yield. As Rappaport observes, '[t]he shorter the holding period, the more the beliefs of others rather than long-term fundamentals become central to investment decisions [and subsequently,] high turnover…sets the stage for short-term earnings-based decision making or momentum-motivated trading.'[108]

Going hand in hand with this, the feasibility of the directors' company acquiring or merging with another depreciates, instead leaving their own company vulnerable to being taken over through a hostile takeover. For present purposes, it is sufficient to acknowledge the likelihood of this occurring, however, the following subsection goes into more detail on hostile takeovers as the UK has a unique regime that, it will be argued, pushes directors further towards prioritising shareholder primacy. By being taken over, the directors of the original company become exposed to removal. This very real threat

[107] C Mayer, *Firm Commitment: Why the corporation is failing us and how to restore trust in it* (OUP 2013), 45.
[108] Rappaport, 'The Economics of Short-Term Performance', 65-66.

means that many directors will focus on ensuring their company's stock price remains high, protecting their own positions through reducing the likelihood of a bid.

This position is refuted by Bowdren who maintains that 'the managerialist analysis of short-termism posits that shareholders harbour short-termist tendencies due to their financial self-interest, whereas managers are more naturally aligned with sustainable company growth and long-term value creation.'[109] However, this ignores the prevalence of agency theory. Although the pressures of the market are subject to debate, it cannot be denied that short-termism is a very real problem.

A final way in which the market pressurises directors towards prioritising shareholder primacy, is through the ways directorial pay can be based on share price movements. As discussed earlier in this chapter, there are a number of schemes, such as ESOP, whereby the market acts as a clear metric to reward or punish executive performance. As Bowdren muses, 'executive remuneration could be seen as a transmission mechanism as pay is conditioned on, and often delivered as, equity. Therefore, one can expect directors' decisions will take account of expected impact on share price.'[110]

Although Kay argues 'shareholder engagement is neither good nor bad in itself: it is the character and quality of that engagement that matters,' it has been established throughout this subsection that a large number of investors, and as a result, directors, choose to indulge in short-termism.[111] The following subsection will explain how the existence of the hostile takeover regime in the UK focuses the average director's mind on company share price, encouraging the pursuance of short-term endeavours that result in

109 Bowdren, 'Contextualising short-termism', 306.
110 *ibid.,* 302.
111 J Kay, *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (BIS 2012), 20.

immediate financial success. As Schwartz observes, 'a corporation's purpose is to serve shareholders, in particular, to maximize their wealth' because failure to do so leads to the possibility of a new hostile company, enticing shareholders to renege on their original company through the promise of financial gain and higher share price.[112]

2.4.1.3 Hostile Takeovers

Catalysing the effects of the market, one pervasive practice, unique to the UK, is the British hostile takeover regime. Commentators such as Schwartz observe how 'the fear of activist intervention creates a world of de facto shareholder primacy, where companies are overwhelmingly incentivized to maximize stock prices at the expense of all else.'[113] The lack of control directors wield over the takeover process and the powers shareholders enjoy in relation to, specifically, takeovers, encourage boards to pursue aggressive profit maximisation regimes to ensure their company's share price remains elevated and out of the takeover arena. Throughout this subsection it will be argued that the British hostile takeover regime consolidates the internal pressures exerted on directors, uniting them into a driver for shareholder primacy. It is important to keep in mind that hostile takeovers rarely occur. [114] However, it is maintained that the *threat* of one being possible, in tandem with the other market pressures on directors, are sufficient to pressurise directors to continue prioritising shareholder interests.

The disciplinary effect of takeovers derives from a company's poor market valuation which 'is generally perceived as a signal by the bidder that the target's assets are not being maximised for the benefit of shareholders.'[115] As the financial investors in the

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[112] J Schwartz, 'De facto shareholder primacy' (2020) 79 *Maryland Law Review* 3, 660.
[113] *ibid.,* 656.
[114] For further detail on the UK takeover regime, see: J Mukwiri, *Takeovers and the European Legal Framework: A British Perspective* (Routledge-Cavendish, 2009).
[115] N O'Sullivan and P Wong, 'The Governance Role of Takeovers' in Keasey, Thompson and Wright, *Corporate Governance: Accountability, Enterprise and International Comparisons* (Wiley, 2005), 155.

company, shareholders of UK companies are granted authority over the acceptance or rejection of a takeover bid. If the board disapprove, the bid becomes hostile and as a result of rule 21 of the Takeover Code 2016 which reinforces General Principle 7 of the Takeover Code that a bid by a rival company must be approved by shareholders in a general meeting, it is ensured that 'directors are prohibited from mounting any defences to any takeovers irrespective of how antithetical it may be to the health and the continuous operation of the business activity of the company.'[116][117] Thus, for UK companies, rule 21 is understood as 'the core of hostile takeovers' because it 'prohibits the board [from] blocking any bids without the consultation of the shareholders.'[118] Armour et al. therefore argue that 'what can be said with some confidence is that the [Takeover Code] sets up a system that focuses director attention…on the immediate question of whether it is in shareholders' best interest to accept a tender offer.'[119] In other words, the UK takeover regime reinforces the pre-eminence of shareholder primacy as it 'effectively makes shareholders the prima donnas of the company during takeovers.'[120]

If a bid is successful, it will almost definitely lead to the replacement of incumbent management as they were the ones mismanaging the company – in the sense of generating lower profits than the predator believes its choice of managers could generate. O'Sullivan and Wong therefore maintain that 'takeovers represent an important *external governance mechanism* whereby shareholders can replace underperforming or opportunistic managers.'[121] If directors make business decisions that fail to enhance a

[116] Nyombi and Mortimer, 'Takeover regulation in the UK and shareholder primacy', 66.
[117] Interestingly, this is apposite to the US where directors are able to incorporate 'the poison pill strategy' to 'make itself less attractive to the potential acquirer,' thereby deterring potentially hostile predatory companies (A Hayes, 'Guide to Mergers and Acquisitions: Poison Pill' (*Investopedia,* 19 September 2021) **Error! Hyperlink reference not valid.**> accessed 10 February 2022).
[118] Nyombi and Mortimer, 'Takeover regulation in the UK'*.,* 78.
[119] Armour, Deakin and Konzelmann, 'Shareholder Primacy', 6.
[120] Nyombi and Mortimer, 'Takeover regulation in the UK', 66.
[121] O'Sullivan and Wong, 'The Governance Role of Takeovers', 155.

company's valuation, resulting in a drop in stock price, they open up both their company to the possibility of a hostile bid and themselves to replacement.

Shareholders who understand existing directors as pursuing endeavours that fail to guarantee financial yield, undermining their key interest in the company, may be more inclined to give genuine consideration to external hostile bids that guarantee them profit. As Nyombi observers, the Takeover Code was 'designed principally to ensure that shareholders are treated fairly and are not denied an opportunity to decide on the merits of a takeover.'[122] If UK directors attempt to use the tactics available to US directors, such as a poison pill, they 'may be found to [be in breach of] their fiduciary duties by exercising their powers for an improper purpose, namely the protection of their own position, as opposed to the furtherance of the company's business.'[123]

It can therefore be observed that the *threat* of takeover intensifies 'market forces [which already] largely reinforce the shareholder primacy norm.'[124] If, as this section has outlined, a 'company's stock price is a common metric for assessing [director] performance,' directors must 'pay considerable attention to it.'[125]

The remainder of this chapter looks at the role of other external factors pressurising directors. These are the pressures deriving from third parties; pressures that rely on directors placing importance on corporate reputation being necessary for their company's continuing profitability and increasing share price.

[122] Nyombi and Mortimer, 'Takeover regulation in the UK', 65.
[123] Armour, Deakin and Konzelmann, 'Shareholder Primacy', 4.
[124] Sneirson, 'The History of Shareholder Primacy', 76.
[125] *ibid*.

2.4.2 Regulatory pressure

Throughout every decision-making process, directors are required to take the possibility of regulatory action into consideration. If subjected to regulatory action, this could result in both corporate liability and the personal liability of the directors. Chapter 3 will explore the dichotomy between these two forms of liability and how they are being manifested in current climate litigation.

If such a regulatory action is successful, the company may face monetary fines and subsequent reputational damage. This may discourage potential investors from investing in the company or push existing shareholders to exit the company if they believe their investment will reap minimal financial reward or expose them to potential future liability. As such, directors will want to avoid the possibility of this occurring.

As the following chapter explores this pressure in detail, this subsection has simply outlined that this pressure exists and notes how it can have extreme consequences, in the form of financial penalties or court proceedings against the company/its directors. Consequently, there is a pressure on directors to not upset their shareholders or stakeholders who may wish to bring such proceedings against them or their company.

However, in the context of the present chapter, it is rather a neutral pressure – in regard to pushing directors towards or away from shareholder primacy maximisation – as both stakeholders and shareholders can bring actions against them or their company; for example through tort law, company law or competition law mechanisms.

2.4.3 The role of consumer pressure

Whether it be through offering cheaper prices or 'on trend', ever-changing stock, fast fashion corporations are reliant on continuing consumer desire to purchase their products.[126] Lying in the reality that a large segment of consumers prioritise lower prices over, for example, more expensive "sustainable" alternatives, consumption habits in the fashion industry encourage companies to entice consumers with cheaper, unsustainable products. This is the nodus of consumer pressure – namely that price is an unavoidable factor that permeates consumer decision making when buying clothes and subsequently, this results in the fast fashion paradox.

Throughout this subsection the average behaviour of consumers will be analysed. This involves observing the recent burgeoning 'ethical consumer' and the effects this has had, if any, on corporate behaviour. Whether it is sufficient to encourage more sustainable behaviour by fashion companies will be discussed. It will be argued that although this trend is increasingly dominant in certain generations such as Gen Z, the average consumer still prioritises price when considering two otherwise identical garments.

To remain competitive, directors are encouraged to choose less environmentally sustainable resources and situate production factories in countries with less stringent environmental protection regimes.[127] Riding on the premise of shareholder primacy, profitability appears to trump sustainability – if a company were to lose a large proportion of its consumer base due to rising garment costs, arising from their opting for more sustainable resources, it seems unlikely in our present climate, that the board of directors would make such a business decision.

The question of whether companies are capable of nudging and manipulating consumers, through for example, marketing regimes, is also relevant to this section. If companies are merely required to don the façade of "sustainability" to induce continuing consumption

[126] Note: 'consumer' here means the final purchaser of a product.
[127] It must also be noted here that many of these countries also have less stringent labour laws, and therefore many clothes are produced cheaper because of the lesser human costs.

of their products by this new paragon of ethical consumption, issues associated with strategic uses of CSR and greenwashing become extremely prominent.[128] In chapter 4 of this thesis, the idea that a company can self-select not to prioritise traditional shareholder interests, instead choosing to pursue, for example, environmental endeavours, will be discussed. For present purposes, however, this chapter will look at greenwashing - outlining a further reason for why company law reform may be necessary.

2.4.3.1 Types of consumers and their influence on fast fashion

Traditionally, the average consumer of the 1990s was motivated by their desire for low prices. Embodied by movements such as 'Geiz ist Geil' in Germany, this mentality of the 1990s and 2000s became increasingly popular. This movement promoted bargain seeking, enticing consumers to adopt a 'throwaway mentality' which now permeates the fast fashion industry.[129] Clothing therefore began to be understood as a short-term commodity, which was equivalent to other 'perishable goods' that were 'disposable' and culturally accepted as okay to 'throw away after only seven or eight wears.' [130] In response to, and arguably exacerbating and catalysing, this consumer mentality, corporate behaviour within the fashion industry has increasingly indulged in the fast fashion paradox. For example, this is seen through the growing average number of annual collections released by European retail companies: Zara and H&M offer 24 and 16 new clothing collections each year respectively.[131] Though not a unique phenomenon to the UK, 'clothing consumption is higher in the UK than any other European country. UK consumers buy on average 26.7 kg of clothing per capita each year —where the next

[128] J Utgård, 'Retail Chains' Corporate Social Responsibility Communication' (2014) 147 *J Bus Ethics* 385.
[129] T Tijang, 'Ist Geiz noch geil?' (Wim Archiv, May 2005) translation by Google www.ihk-nuernberg.de/de/IHK-Magazin-WiM/WiM-Archiv/WIM-Daten/2005-05/Berichte-und-Analysen/Ist-Geiz-noch-geil-.jsp accessed 6 November 2020.
[130] N Šajn, 'Environmental impact of the textile and clothing industry: What consumers need to know' (January 2019) *European Parliamentary Research Service* PE 633.143, 2.
[131] *ibid.*

highest consumption rate is Germany [at] 16.7 kg.'[132] Between 1998-2018, the 'amount consumers [have spent] on clothing has quadrupled…from £15 billion to £60 billion.'[133]

It is therefore understandable why McKinsey maintain that 'consumers are vital to realising [the climate] abatement potential.'[134] They predict that an improvement in consumer consumption habits could 'deliver as much as an 11% abatement in [GHG] emissions.'[135] As we currently stand, '336,000 tonnes of clothing are going to UK landfill or incineration each year,' as a result of over consumption and subsequent overproduction by fashion companies trying to satiate consumer demand.[136] This trend has led the Ellen MacArthur Foundation to assert that if consumer behaviour continues along its current trajectory, 'global apparel production is projected to rise by 63% by 2030, from 62 million tonnes today to 102 million tonnes — equivalent to more than 500 billion additional T-shirts.'[137] As such, 'if this happens, the industry's GHG emissions will rise to around 2.7 billion tonnes a year by 2030.'[138] It is maintained that this behaviour exerts pressure on directors to continue pursuing business operations that produce cheap garments.

As a caveat to this trend, there has been an increasing number of consumers who class themselves as 'ethical consumers.' Hunt provides some clarity on the scope of this category 'ethical consumer,' explaining that this refers to individuals who practice 'ethical consumption.'[139] This movement advocates its intent to 'help [the consumer] see behind

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132 Fashion Revolution, *Fashion Transparency Index 2021* (2021), 12.
133 *ibid.*
134 McKinsey, *Fashion on Climate*, 14.
135 *ibid.*, 24.
136 Textiles 2030: UK Sustainable Textiles Action Plan, *WRAP 2030: Six-month progress report* (October 2021), 2.
137 Ellen MacArthur Foundation, *Circular Business Models: Redefining growth for a thriving fashion industry* (2021), 8.
138 *ibid.*
139 T Hunt, 'What is Ethical Consumerism?' (ethical consumer, 8 July 2020) www.ethicalconsumer.org/what-ethical-consumerism accessed 1 February 2021.

the scenes of the economic system and the corporations and brands that profit from it,' hence 'help[ing] consumers…assess the true cost of what they buy.'[140] In conjunction with this trend, the Slow Fashion movement has begun to take a hold and its rise can be attributed to this incremental change in consumer sentiment as it 'attempt[s] to convince consumers to buy fewer clothes of better quality and to keep them for longer.'[141] As Niinimäki acknowledges, 'one of the most difficult challenges going forward will be to change consumer behaviour and the meaning of fashion,' as the conviction that fashion is mere 'entertainment' must be redefined into recognition that clothing is 'a functional product' with detrimental environmental impacts when mass produced and overconsumed.[142]

Such a proliferation of consumers who particularly concerned with CSR performance,' 'reward or punish firms accordingly, through purchases, boycotts or activism,' has encouraged certain corporations to extensively publicise their green credentials.[143] A survey by Fashion Revolution in December 2020 found that in comparison to their 2018 survey, 'concerns about social and environmental issues in the fashion industry have grown among consumers.'[144] Of the 5000 consumers surveyed, 78% wanted information about the products' environmental impact, implying there has been a shift in consumer sentiment.[145] This trend was reflected in a McKinsey survey conducted during the Covid-19 pandemic, which uncovered that 'some 65% of consumers….said they plan to purchase more long-lasting items.'[146]

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[140] *ibid.*
[141] Šajn, 'Environmental impact of the textile and clothing industry', 5.
[142] Niinimäki et al., 'The Environmental Price of Fast Fashion', 198.
[143] Utgård, 'Retail Chains' Corporate Social Responsibility', 387.
[144] S Ditty, *Consumer Survey Report December 2020* (2020, Fashion Revolution CIC 2020) 3.
[145] *ibid.,* 13.
[146] The Business of Fashion and McKinsey & Company*, The State of Fashion 2021* (2020, https://www.mckinsey.com/industries/retail/our-insights/state-of-fashion), 61.

However, as the following subsection will discuss, 'recent research by Changing Markets and the Clean Clothes Campaign reveals a mere 18% of consumers would trust sustainability information provided directly by brands themselves.'[147] This mistrust stems from the extensive number of exposés about greenwashing, i.e., misrepresentations made by corporations in regard to their sustainability efforts. It is therefore sometimes nigh-on impossible for the average consumer to establish whether a certain fashion corporation is genuinely sustainable or whether they have a skilled marketing team. This is where the role of NGOs, charities, and the media steps in. As the following subsection will explain, these larger entities with many more resources than the average consumer are able to use their resources to influence consumer behaviour and hold corporations to account for any misrepresentations.

Although there has been a proliferation in the number of consumers who prioritise sustainability, the following evidence is indicative that this shift has largely not been translated into practice. As Fashion Revolution's survey uncovered, only '21% of people have [actually] tried to buy clothing made in an environmentally responsible way.'[148] Moreover, consumption levels are continuing to increase: 'in 2018, households in the [EU] spent almost €264 bn on clothing articles, an increase of 10% over the decade.'[149] The allure of low costs, especially in our current recession, seems to be overriding the attraction of 'ethical fashion'. Directors are thereby pressurised - in order to keep their corporation profitable and their share price high/increasing - to satisfy consumer desires: i.e., cheaper products. This is because, in the fast fashion sector, companies are directly reliant on consumers purchasing their products to make a profit margin.

[147] Fashion Revolution, *Fashion Transparency Index*, 13.
[148] Ditty, *Consumer Survey Report December 2020*, 24.
[149] EURATEX, 'Facts and Key Figures of the European Textile and Clothing Industry', 17.

Consequently, corporations have increased their production levels and therefore 'some 40% of garments are currently sold at a markdown.'[150] 'On top of this, due to ever lower prices and lost revenues – from overstock, stockouts, and returns – profit margins of the world's leading apparel retailers decreased by an average of 40% from 2016 to 2019.'[151] This disjuncture between consumption and production exacerbates the fashion industry's negative environmental footprint and should, in an ideal world, be solvable.

As it is clear that there is still an overriding trend for the prioritisation of low price, and consumption levels are continuing to rise exponentially, the following subsection will seek to establish whether the role of the media, charities or NGOs are capable of encouraging both more sustainable corporate behaviour and a change in consumer behaviour. This will involve a discussion of the power of social media and the issues around greenwashing. It is clear 'consumers must play their part in driving industry decarbonisation efforts through their purchasing decisions,' it is just working out how this can be manifested that is the ultimate problem.[152]

2.4.4 The role of NGO, charity and media pressure

The extent to which other external entities may be able to pressurise directors into adopting more environmentally sustainable business endeavours, requires analysis. This sub-section will explain the role of NGOs, charities and the media in disseminating information about corporate behaviour to consumers and potential investors about the actual environmental sustainability of corporations in an attempt to alter perceptions on any exaggerated online statements issued by companies. This will also involve a discussion of greenwashing – 'used to signify misleading claims as they applied to the

[150] McKinsey, *Fashion on Climate,* 12.
[151] Ellen MacArthur Foundation, *Circular Business Models,* 5.
[152] McKinsey, *Fashion on Climate,* 24.

environment' - and how the existence of this phenomena threatens the development of truly sustainable businesses, as their competitiveness is undermined by the false claims of other companies.[153] The pressure these entities are able to place on directors is due to the importance of corporate reputation; though consumers are clearly interested in cheaper prices, there is a growing trend for ethical consumption. In the fast fashion's competitive market, if one corporation is badged as unsustainable and provides similar products to the other fast fashion houses, consumers will almost definitely switch to a competitor.

2.4.4.1 The role of NGOs and charities in pressurising directorial choice

Companies, particularly in the fast fashion industry, rely on high levels of consumption by consumers and therefore, how the company is perceived by both consumers and investors is of crucial importance to their profitability. As such, information which is collated and disseminated by NGOs and charities about their environmental footprint, especially in campaigns that receive large levels of external interest, will likely play a role in director decision making. If their corporate reputation is being threatened by external entities publicising the 'truth' about their sustainability efforts, it becomes apparent that directors should, and most likely do, take this mitigating factor into consideration before pursuing unsustainable endeavours.

A prevalent example of a charity researching and spreading information directly to consumers about corporate sustainability in the fashion industry is Fashion Revolution.[154] Through the creation of a Fashion Transparency Index, in 2020 this organisation reviewed and ranked '250 of the world's largest fashion brands and retailers

[153] M Cherry, 'The Law and Economics of Corporate Social Responsibility and Greenwashing' (2013) 14 *UC Davis Business Law Journal* 2, 284.
[154] Registered UK Charity No. 1173421.

according to how much they disclose[d] about their social and environmental policies, practices and impacts.'[155] Consumers were thereby given a concise document comparing companies directly to one another, emphasising those that are doing particularly well or badly. The Global Fashion Agenda also concluded in their research of recent trends within this industry that 'fashion companies are not implementing sustainable solutions fast enough to counterbalance negative environmental…impacts'[156] because 'even the most advanced brands face limits to what they can achieve in isolation.'[157] Both these organisations call for intervention by NGOs, who are able to educate consumers 'via tools such as the Fashion Transparency Index or Good on You,' but also emphasise the necessity for greater transparency regulation via, for example, collaboration with governments and policy makers.'[158] A similar sentiment was advanced in Adeyeye's concluding remarks that 'non-state actors such as civil society need to be accountable and responsible, working in the best interest of society, not merely advancing their own agendas.'[159]

A number of other NGOs and charities directly target the directors of companies. For example, in a recent study, Grappi et al. analyse the effectiveness of the Detox campaign conducted since 2011 by Greenpeace.[160] Entitled 'Detox my Fashion,' this campaign propounds that companies should stop 'blaming consumers for overconsumption and

[155] S Ditty, *Fashion Revolution: Fashion Transparency Index 2020* (21 April 2020, Fashion Revolution CIC 2020) 4.
[156] Global Fashion Agenda, Boston Consulting Group and Sustainable Apparel Coalition, 'Pulse on the Fashion Industry: 2019 Update' (2019) www.globalfashionagenda.com/publications-and-policy/pulse-of-the-industry/ accessed 10 November 2020, 1.
[157] *ibid.,* 16.
[158] *ibid.,* 17.
[159] A Adeyeye, 'The Role of Global Governance in CSR' (2011) *Santa Clara Journal of International Law* 9, 168.
[160] S Grappi, S Romani and C Barbarossa, 'Fashion without pollution: How consumers evaluate brands after an NGO campaign aimed at reducing toxic chemicals in the fashion industry' (2017) 149 *Journal of Cleaner Production* 1164.

take responsibility for a radical transformation of the fashion industry.'[161] Being the first NGO-led campaign to unequivocally 'challenge big clothing brands…to take responsibility for the environmental impacts' of their businesses,[162] Greenpeace has successfully 'secured…commitments to Detox from eighty international brands, retailers and suppliers.'[163] The successes experienced by this NGO-led regime to catalyse change in the companies they work with, alludes to the potential for such organisations to influence corporate behaviour. Such positive results were achieved through 'denunciatory tactics'[164] and their capacity to 'expose the direct causal links between fashion brand manufacturing and toxic water pollution around the world.'[165] These tactics of 'accusing brands of misconduct,' 'demanding remedial actions' and 'inviting consumers to make a "green, ethical, and/or conscious choice" when making buying decision by evaluating [a company's] behaviour' seem to play a crucial role in NGO- and charity-led campaigns.[166]

Another example of a successful initiative was launched by the Waste and Resources Action Programme (WRAP) in 2012, for a Sustainable Clothing Action Plan.[167] The 2020 commitment aimed for 15% reduction in the industry's carbon and water footprints, a 15% reduction in the waste of clothes to landfill and 3.5% reduction in the amount of waste across the entire lifecycle of a garment. In light of this target, there is evidence of companies responding, as there has been a 13.4% reduction in the industries carbon footprint, 18.1% reduction in water use, 4% reduction of waste to landfill and 1.4%

[161] M Cobbing and Y Vicaire, *Destination Zero - Seven Years of Detoxing the Clothing Industry* (12 July 2018, Greenpeace) www.greenpeace.org/international/publication/17612/destination-zero accessed 13 January 2021, 51.
[162] *ibid.,* 4.
[163] *ibid.,* 17.
[164] Grappi et al., 'Fashion without pollution', 8.
[165] *ibid.,* 9.
[166] *ibid.,* 8.
[167] Registered UK Charity No. 1159512.

reduction in waste across the entire lifecycle.[168] Though it is apparent that a number of the targets remain unmet, these numbers are indicative of the beginnings of changing corporate behaviour.

However, whether these sorts of regimes are actually able to counteract overconsumption, which exacerbates overproduction is questionable. Fast fashion companies are still 'changing collections about every three weeks,' and thereby 'induce consumers to act with [a] "see now-buy now" [mentality].'[169] These pervasive practices of consumers seem to undermine the growing popularity of NGO-led sustainability regimes. Though pressures are being placed on directors through threats to their company's reputation, it seems that while consumers continue to buy the products, they will continue providing them.

It is therefore necessary to consider the role played by the media in aiding these external entities, if it does so at all, to create greater pressure on directors through, for example, threats to brand reputation. The following sub-section will also include a discussion of greenwashing and the facilitative role played by social media in the paradox of fast fashion.

2.4.4.2 The role of the media in pressuring directorial choice

How companies convey themselves online and how they are subsequently perceived by consumers is fundamental to the continuing consumption levels of their products. Throughout this subsection it will be argued that although the media play a fundamental role in boosting the popularity of the various NGO-led regimes against unsustainable

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[168] The SCAP 2020 Commitment, www.wrap.org.uk/sustainable-textiles/SCAP accessed 11 February 2021.

[169] P Gazzola, E Pavione, R Pezzetti and D Grechi, 'Trends in the Fashion Industry. The Perception of Sustainability and Circular Economy: A Gender/Generation Quantitative Approach' (2020) 12 *MDPI: Sustainability* 2809, 3.

corporate practices, it fails to ultimately push directors towards choosing a more sustainable route as social media has become a key component to the continuing allure of fast fashion.

In our current digital era, information can be disseminated instantaneously to a whole host of consumers and entities. As such companies have employed this to foster and encourage the throw away attitude dominating fast fashion. Brewer observes how 'the prevalence of social media fuels the virtually instantaneous movement of trends…across the world,' and is partially responsible for maintaining the fast fashion paradox.[170] The Environmental Audit Committee mirrored this contention, observing that 'desire for fast fashion [is] fuelled by advertising, social media and a supply of cheap garments.'[171] For example, research by the Hubbub Foundation found that '17% of young people [admitted] they wouldn't wear an outfit again if it had been on Instagram.'[172] Such a consumer attitude cannot be reconciled with any claim of 'ethical consumption' and in light of the fact that consumption levels are continuing to increase globally, TRAID has articulated the concern that 'over-consumption of clothes in the UK plays its part in deepening the main environmental challenges [faced] at national and global levels.'[173]

Though it is clear consumption levels are rising, for an increasing percentage of consumers, surveys indicate that many do, to some extent, take the environmental footprint of products into account when choosing between two equally priced garments. Subsequently, directors (as the decision makers of companies) are recognising the need for their company to appear environmentally sustainable to retain these consumers and

[170] M Brewer, 'Slow Fashion in a Fast Fashion World: Promoting Sustainability and Responsibility' (2019) 8 *Laws* 24, 1.
[171] House of Commons, Environmental Audit Committee, *Fixing Fashion: Clothing Consumption and Sustainability* (19th February 2019) HC 1952, 48.
[172] *ibid.,* 7.
[173] *ibid.,* 10.

remain profitable. Chapters 4 and 5 of this thesis examine the effectiveness of the B Corp label which is supposed to provide some certainty to this area. However, for present purposes, it is sufficient to look at the prevalence of greenwashing and the threat it poses.

Proponents of regulated CSR reporting argue this new wave of advertising corporate 'sustainability' has become 'ubiquitous' with marketing strategy.[174] As Ikejiaku observes, 'CSR [has become] a kind of corporate PR or make-believe rather than a genuine attempt or practical move to change the way [companies] intermingle with society.'[175] He emphasises that CSR reporting has become a 'camouflage,'[176] exploiting consumers through a 'faux-CSR' façade, drawing attention away from corporate misdemeanours.[177] This premise also underlies Utgård's study which uncovered that companies manipulate consumers through signalling theory, finding that directors only 'communicate about their [companies'] CSR efforts when this is profitable for them.'[178] Although a certain level of CSR reporting is a legal requirement, embodied within, e.g., The Companies (Miscellaneous Reporting) Regulations 2018/260 in the UK, 'retail chains are voluntarily communicating more than they are obliged to about their policies and practices' in an attempt, Utgård concludes, to nurture an exaggerated image of sustainability.[179] Similarly, Ikejiaku proposes that companies engage in a 'box ticking mentality' which he defines as a 'fake willingness or pretence…to be ethical and legally responsible.'[180] Both studies conducted into CSR reporting found, on average, it is a marketing tool used to

[174] L Indvik, 'Sustainable fashion? There's no such thing' (Financial Times, 13 Nov 2020) www.ft.com/content/d174e7d7-97c4-43fc-8765-95075e5fcce7?fbclid=IwAR08ONxh9yrGdrcwsQ4HpzYxQfncGyV1kNpsVqO2ELR1uU8wDME89qpCc2s#comments-anchor accessed 13 Nov 2020.
[175] B Ikejiaku, 'Consideration of Ethical and Legal Aspects of Corporate Social Responsibility: The Issue of Multi-National Corporations and Sustainable Development' (2012) 1 *Nordic Journal of Commercial Law* iii, footnote 7.
[176] *ibid.*
[177] Cherry, 'The Law and Economics of [CSR]', 290.
[178] Utgård, 'Retail Chains' Corporate Social Responsibility', 385.
[179] *ibid.*
[180] Ikejiaku, 'Consideration of Ethical and Legal Aspects of [CSR]', 6.

manipulate the modern consumer into consuming their “more sustainable” product over a direct competitors’.

This is further exacerbated by the lack of ‘any objective measure or a legal definition’ for the words ‘sustainable’, ‘ethical’ or ‘green’.[181] Confusion is illustrated by an annual survey conducted by asset management Schroders ‘assess[ing] the views of institutional investors managing $25.9 trillion across 26 countries.’[182] It found that approximately 60% ‘of investors felt greenwashing – “a lack of clear, agreed sustainable investment definitions" - was the most significant obstacle to delivering on their sustainable investment goals.’[183] The ability to exploit these undefined terms is thereby enabled through the ambiguities surrounding “sustainability” jargon. As Bédat, founder of the New Standard Institute researching the relationship between fashion and climate change, explains, unlike ‘organic’ or ‘free range’ labels, ‘sustainable’ ‘is not a regulated term, leaving brands free to attach it to almost anything’ with few fears of fines or legal action for misappropriating it.[184] Boards of directors are thereby able to manipulate and nudge consumers into opting for their product over their competitors’ through labelling garments with a range of sustainability-linked terms.[185][186]

With ‘pure…internet retailers such as Farfetch, Zalando, Asos and Revolve…consistently [outperforming other retailers] in 2020 as locked-down customers turned to their digital

[181] S Mestroni, ‘How Can Fashion Brands Respond to Consumers' Prioritization of Social Values?’ (The Fashion Law, 2 Nov 2020) www.thefashionlaw.com/how-can-fashion-brands-respond-to-consumers-prioritization-of-social-values accessed 7 November 2020.
[182] M Holder, ‘Investor survey signals growing frustration over corporate greenwash’ (GreenBiz, 2 Nov 2020) www.greenbiz.com/article/investor-survey-signals-growing-frustration-over-corporate-greenwash accessed 7 November 2020.
[183] *ibid.*
[184] Indvik, ‘Sustainable fashion?’.
[185] R Baldwin, ‘From Regulation to Behaviour Change: Giving Nudge the Third Degree’ (2014) 77 *Modern Law Review* 6.
[186] Note: chapter 4 will discuss the B Corp label, which some argue, provides a solution to these ambiguities.

devices to shop,' trends for overconsumption are evidently ongoing.[187] For example, between January-October 2020, 'internet retailers on average traded 42 percent higher than other fashion companies.'[188] It therefore appears that even with the growing popularity of ethical-consumption, this has simply prompted retailers to promote their sustainability even when it is entirely faux.

Even if the media and NGO-led campaigns were able to expose each and every one of these misleading regimes, it seems that price is still a dominating factor for consumers and there does not seem to be any deceleration in consumption levels.

Regardless, even if 'ethical consumption' became the predominating norm, until confusions arising from 'sustainability' meaning '10 different things to 10 different people' are addressed, companies are able to mislead the 'ethical consumer' into purchasing their products.[189] If directors maintain their company's profitability merely through advertising regimes, without having to instigate corporate change, it is implied their 'primary motivating factor [is] to cheat…the business world [for] financial gain.'[190] Hence, it is argued, that media pressure is currently unable to override the pressure from the majority of consumers for cheap products.

2.4.5 Conclusion on the pressures exerted by external forces

Echoing the sentiment that companies who indulge in greenwashing undermine the real efforts of companies attempting to improve their environmental impact, the Environmental Audit Committee observed that 'innovators are faced with competition from businesses who are focused on reducing costs and maximising profits regardless of

[187] Business of Fashion and McKinsey, *The State of Fashion 2021,* 117.
[188] *ibid.*
[189] Indvik, 'Sustainable fashion?'.
[190] Ikejiaku, 'Consideration of Ethical and Legal Aspects of [CSR]', 1.

the environmental or social costs.'[191] Such a premise lends support for the overall argument of this section that external entities are unable to actually instigate change in the approach of the average director: the pressures from the average consumer and the market currently trump other pressures.

2.5 Conclusion

This chapter has shown how directors are, under the current mix of internal and external pressures to which they are subject, much more likely to favour profit maximisation over, say, environmental responsibility. The average director chooses to pursue business endeavours that result in financial benefits for both themselves and the shareholders of their company. This means that environmental considerations are often left to the wayside, as other unsustainable initiatives that result in high financial yield are prioritised.

Both illustrating the theoretical and practical issues permeating the UK's corporate landscape, this chapter has been included in this thesis because it lays the foundation for the remainder of the discussions. In particular, it provides an explanation for why companies continue to pursue unsustainable, high-yield, short term endeavours – a problem particularly pervasive to the fast fashion industry.

Chapter 3 will take this discussion further, providing an overview of current climate litigation trends before going into an explanation for why this chapter has focused on directors rather than the corporate entity as a whole. This is largely because of their active role in choosing a corporation's business direction: after all, a corporation is ultimately an unconscious entity.

[191] House of Commons, *Fixing Fashion,* 50.

Chapter 3 Enterprise Liability vs. Personal Liability and Climate Litigation Trends

3.1 Introduction

This chapter explores the choice between regulation that targets the enterprise itself, and regulation that targets individuals (especially directors). Throughout, it will prove that whilst regulation that targets the enterprise itself will often be effective in achieving the law's goals, it will not alone be sufficient. This, it will be argued, is because of the failures of a number of internal mechanisms utilised by *companies themselves* to reprimand the responsible director(s); the board are able to spread any costs imposed upon the company away from themselves and onto other stakeholders - such as employees and consumers. It must therefore be supplemented with what I am terming external personal liability – that is, regulation that (1) target individuals within the enterprise and (2) is enforceable by 'external' actors other than the corporation itself. It will be illustrated that because environmental considerations are within the scope of the directors' duties and activities, the threat of personal liability and being found individually culpable for a corporation's environmental misdemeanours would be a stimulus to guarantee *actual* and *real* change in company behaviour.

The purpose of this chapter is to complete the foundational material that's necessary to evaluate the effectiveness of B Corps. By understanding more clearly the distinction between personal and corporate liability, and by understanding the need for externally enforced personal liability, a much more accurate and meaningful criteria is created that can then be used, in the later chapters, to judge whether the changes that arise through self-selecting to become a B Corp will be effective in moving such companies away from profit maximisation, towards greater environmental responsibility.

3.2 Recent climate litigation trends

Before focusing on the fundamental choice between personal and corporate liability, it is useful to say a little about the climate litigation cases that have been brought, especially against companies or their directors. In fact, a whole range of climate litigation exists.[192] Historically, many of these cases have been targeted at states, in part because of the long-term recognition that states have a duty to reduce GHG emissions: see for example the addressees of the 1992 United Nations Framework Convention on Climate Change (UNFCC),[193] the 1997 Kyoto Protocol,[194] and the 2015 Paris Agreement on Climate Change.[195] Moreover, it is interesting to observe that 'as of 31 May 2021, 1,841 cases of climate change litigation from around the world had been identified,'[196] of which 76% were filed against governments.[197] See Figure 4 below for a useful diagram created by Setzer and Higham which illustrates the sheer increase in climate-related litigation cases being brought across the world, particularly those concentrated in the US.[198]

[192] For example, see *Miliedefensie et al. v Shell* [2021] ECLI:NL:RBDHA:2021:5337.
[193] United Nations Framework Convention on Climate Change (adopted 9 May 1992, entered into force 21 March 1994) 1771 unts 107 (unfccc).
[194] Kyoto Protocol to the United Nations Framework Convention on Climate Change (adopted 11 December 1997, entered into force 16 February 2005) 2303 unts 162 (Kyoto Protocol).
[195] Paris Agreement on Climate Change (adopted 12 December 2015, entered into force 4 November 2016) (2016) 55 ILM 740.
[196] J Setzer and C Higham, 'Global trends in climate change litigation: 2021 snapshot' (Policy Report, 2021) *Grantham Research Institute on Climate Change and the Environment and Centre for Climate Change Economics and Policy, London School of Economics and Political Science,* 10.
[197] *ibid.,* 12.
[198] *ibid.,* 10.

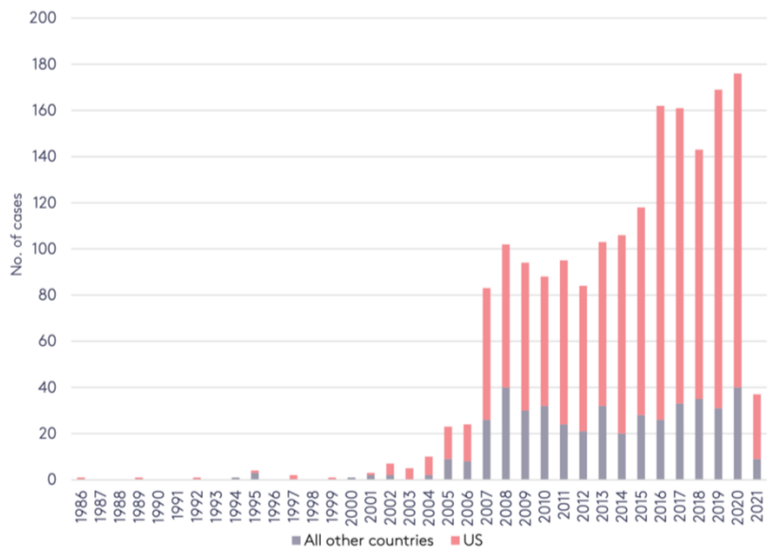

Figure 7: Total cases over time, US and non-US, to 31 May 2021

There are many different ways of dividing up and categorising this growing body of climate litigation. For example, Peel and Osofsky have formulated a typology of climate change litigation which outlines how some cases have climate change at their centre while others simply have it on the periphery or interlinked as an additional, but non-central, complaint during a legal proceeding.[199] Setzer follows this same approach, identifying, for the litigation she examines, whether environmental harm is the core, or an ancillary, issue. Whilst this division may be significant in other contexts, it is less so for this thesis, where two differing categorisations are more important.

3.2.1 Against states or against non-state actors?

First, one needs to distinguish between actions brought against *states*, and actions brought against *private* actors – in particular, corporations or individuals within those corporations. As Pleming reiterates, 'the consequences of climate change are numerous and varied, the legal consequences and therefore the myriad of ways in which litigation

[199] J Peel and HM Osofsky, *Climate Change Litigation: Regulatory Pathways to Cleaner Energy* (CUP 2015).

can be brought increasingly reflect this.'[200] Consequently, it is unsurprising that 'climate change litigation will spread across many different areas of the law,' with a whole host of different complainants being identified.[201] Of those cases filed against states, over half based their argument on the approach adopted in *Urgenda Foundation,*[202] which 'was the first piece of litigation to successfully challenge the adequacy of a national government's overall approach to reducing emissions.'[203]

However, an increasing number of cases are being brought not against states, but instead against non-state actors, especially corporations (such as Carbon Majors).[204] Of the 33 cases Setzer identified, 23 'seek to establish corporate liability for past contributions to climate change, often including arguments about deception and disinformation on the part of the companies.'[205] The ever-growing quantity of cases being brought in the private sector demonstrates 'the need for corporate decision-makers to take a proactive stance on understanding and managing their climate impacts and risks is greater than ever. It is increasingly important for companies not only to disclose but also to manage both physical and transitional risk.'[206] As such, this thesis is concerned with litigation against private actors.

The likelihood of successful actions against non-state actors has been amplified through the increasing reliability of attribution science and the growing number of organisations calculating a particular company's contribution to climate change. Initiated by Heede,

[200] N Pleming and R Keating, 'Climate Change Litigation in the United Kingdom: Planning, Energy and Protest' in I Alogna, C Bakker and JP Gauci, *Climate Change Litigation: Global Perspectives* (Brill, 2021), 86.
[201] *ibid.*
[202] *Urgenda Foundation v State of the Netherlands* [2019] ECLI:NL:HR:2019:2007.
[203] Setzer and Higham, 'Global trends in climate change litigation', 23.
[204] Defined as companies that are 'producers of oil, natural gas, coal and cement' (R Heede, 'Tracing Anthropogenic Carbon Dioxide and Methane Emissions to Fossil Fuel and Cement Producers, 1854–2010' (2014) 122 *Climatic Change* 1, 229.
[205] Setzer and Higham, 'Global trends in climate change litigation', 28.
[206] *ibid.*, 30.

who traced the CO2 and methane emissions from fossil fuel and cement producers,[207] Alogna et al. observe how this has 'been critical for establishing the causal link between corporate activity and climate change, thus fostering litigation.'[208] Interestingly, the very definition of 'climate change' in the UNFCC, 'means a change of climate which is attributed directly or indirectly to human activity that alters the composition of the global atmosphere and which is in addition to natural climate variability observed over comparable time periods.'[209] There is nothing in its definition that excludes corporate actors being held liable for their company's contribution to negative environmental impacts provided it can be illustrated as deriving from their activity. The likelihood of companies being held legally liable for poor environmental performance is therefore intensifying. As the minister of Energy and Clean Growth emphasised, the UK is 'becoming the first major economy to pass new laws to reduce emissions to net zero by 2050 while remaining committed to growing the economy - putting clean growth at the heart of our modern Industrial Strategy.'[210]

3.2.2 Against corporations, or against individuals within the corporation?

A second distinction must also be made, within the actions-against-private-actors category. This second distinction concerns the identity of the private actors that are being targeted. Litigation might be directed against either the fictitious corporate entity itself, or against individuals within it. This is the distinction already alluded to in the introduction, namely that between "enterprise liability" (liability imposed on the corporate entity) and "personal liability" (liability imposed on those within the

[207] Heede, 'Tracing Anthropogenic Carbon Dioxide and Methane Emissions', 229.
[208] I Alogna, C Bakker and JP Gauci, 'Climate Change Litigation: Global Perspectives - An Introduction' in I Alogna, C Bakker and JP Gauci, *Climate Change Litigation: Global Perspectives* (Brill, 2021), 9.
[209] Article 1 UNFCCC.
[210] Department for Business, Energy & Industrial Strategy, 'UK becomes first major economy to pass net zero emissions law' (2019) <www.gov.uk/government/news/uk-becomes-first-major-economy-to-pass-net-zero-emissions-law> accessed 17 January 2022.

enterprise). It is this distinction which the remainder of this chapter explores in greater detail.

It is also interesting to note that litigation being brought against those within the enterprise can be divided up into further sub-categories depending upon which *internal* actor is being targeted. This could include powerful shareholders (such as institutional investors), or powerful financial creditors (such as banks, lending to companies to fund environmentally harmful corporate conduct). However, for reasons of space, this thesis will address the internal actor most involved in orchestrating and controlling corporate business ventures – the directors. The likelihood of litigation being brought against the directors personally is increasing. This is especially the case in light of the recent announcement by ClientEarth that they plan to bring a derivative claim against Shell's board of directors for failing to effectively mitigate against climate risks. As ClientEarth declares, it is 'taking legal action to compel Shell's Board to strengthen its climate transition plans, in the best interests of the company in the long-term.'[211] As we see a global 'move to tackle climate change through litigation', the likelihood that cases could become more prominent in the UK, against UK company directors, is substantially increasing.[212]

This division between enterprise liability and personal liability is conceptually clear, but to understand it fully, and to allow the division to withstand scrutiny, this thesis must precisely outline what is included within the categories "enterprise liability" and

[211] ClientEarth, 'ClientEarth shareholder litigation against Shell's Board: FAQs' (March 2022) <www.clientearth.org/media/puojyzvy/clientearth-shareholder-litigation-against-shell-s-board-faqs.pdf> accessed 21 March 2022.
[212] *ibid.*, 101.

"personal liability". This need for greater precision arises because of the following complication.

When the enterprise is made the target of a regulation, this may result in the enterprise *itself* suffering some loss: for example, damages or a fine. The regulation in question, will not specify how, if at all, the enterprise might then redirect that loss, internally, to the individuals within it. Yet, the enterprise may sometimes choose to do so, thereby imposing its own sanctions on individuals, such as directors, within the enterprise. The enterprise might, for instance, remove the director from office or reduce/claw-back part of their salary. Or, for example, the enterprise may sue the director for breaching obligations they owe to the company through a corporate action. All these actions can be considered as entailing some personal, individual liability, but, crucially, as *internal* personal liability within, and to, the enterprise itself.

The foregoing internal personal liability can be contrasted with what I will now call *external* personal liability. As with the above, this envisages individuals being held personally liable, but now directly to actors other than, and so outside, the enterprise itself. Regulations may impose personal obligations on directors, for example, for breach of which the director will be personally liable, and where the enforcement of the obligation is in the hands of the regulator. Or, alternatively, private law might likewise impose personal obligations on directors, which the private beneficiaries of those obligations can enforce. This is indeed how tort law sometimes operates; imposing duties of care on directors in favour of external 'tort victims' - employees, neighbours, etc. - for breach of which duties the director can be personally liable, and whose enforcement lies in the hands of the *external* victims of the torts the director committed.

Hence, the category-issue this thesis needs to be precise about is this: should the possibility of "internal" personal liability, described above, be placed within the "enterprise liability" category, or within the "personal individual" liability category? In one sense, it matters less where it is placed and more that there is an awareness that it can arise in both scenarios when analysing the merits of enterprise or individual liability. However, analytically, it seems better to include it within the "enterprise liability" category. This thesis' main concern is to analyse the effectiveness of the changes that are entailed by becoming a B Corp. To do that, it will need to be established whether third parties outside the corporation – regulators, tort victims, consumers or investors misled by companies' environmental claims and promises etc., - are, and should be, able to target directors, or are, and should be able, to only target the enterprise itself. Therefore, it is the comparative merits of, specifically, *external* personal liability that is of key importance here. In turn, this will be compared against enterprise liability, which *itself includes* the possibility of some internally redirected personal liability.

3.2.3 *Miliedefensie et al. v Shell* [2021] and *ClientEarth v Shell* [2022]

The categories discussed above are usefully illustrated by two significant examples of recent environmental litigation - one now completed, the other about to be launched – but both involving the Shell Group.

The first claim, brought by Milieudefensie (Friends of the Earth Netherlands) in the Dutch courts, exemplifies the pursuit of enterprise liability.[213] Milieudefensie targeted Royal Dutch Shell plc ('RDS'), the parent company within the Shell group. Orders were sought against *it*, in relation to *its* future behaviour and obligations, but Milieudefensie did not seek any orders or relief against RDS's directors, whether as to their personal liability for

[213] *Milieudefensie v Shell* [2021] ECLI:NL:RBDHA:2021:5337.

harm caused or as to their own future conduct. It is the first case in which a national court has held a private entity responsible for failing to help reduce carbon emissions in accordance with the Paris Agreement and as such, breached its duty of care. Interestingly, RDS may in due course choose *itself* to take internal action against its own directors in light of the case's outcome.

The second claim gives an interesting example of an attempt to impose *internal* personal liability on RDS's directors. The UK environmental law charity ClientEarth is about to launch proceedings, *on behalf of RDS*, against the directors of RDS. The action will seek remedial orders against the directors personally. Yet, as mentioned, it is brought for the benefit of RDS. It is founded on harm which it alleges the Shell enterprise has itself suffered, or will suffer, and responsibility for which the claimants now wish to impose on the shoulders of the directors personally.

Before going into a discussion on the advantages and disadvantages of entity v personal directorial liability, this subsection will give a brief outline of the claims that were levied against Shell in the *Milieudefesnie* case and how the court proceeded to approach them.[214]

3.2.3.1 Arguments of the Milieudefensie case

In April 2019, seven Dutch NGOs and over 17,000 individuals filed an action against RDS, asking the court to '(i) rule that the Shell group's annual CO2 emissions and RDS' failure to reduce them, constituted unlawful acts toward the claimants, and (ii) order RDS to reduce, by end-2030, the Shell group's CO2 emissions by 45 percent (net), relative to 2019 levels.'[215]

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[214] *ibid.*

[215] A Bevan et al., '*Milieudefensie v. Shell* - A Landmark Court Decision For Energy And Energy-Intensive Companies' (*Shearman & Sterling,* 1 June 2021) <www.shearman.com/Perspectives/2021/06/Milieudefensie-v-Shell--Landmark-Court-Decision-For-Energy-Companies> accessed 18 January 2022.

The major claim filed against RDS was its failure to adhere to their carbon emission reduction targets, with the claimants arguing that 'as the top holding company with responsibility for setting the Shell group's corporate strategy, RDS owed the claimants a duty of care under the Dutch Civil Code to take steps to meet the [1.5^{0}C] cap on global warming set in the Paris Agreement.'[216] This is in accord with Hutley and Hartford-Davis' observations about recent Australian climate litigation cases, where they note that 'company directors who consider climate change risks actively, disclose them properly and respond appropriately will reduce exposure to liability.'[217]

3.2.3.2 The Court's judgement

Quoting a whole host of international agreements, the Hague court focused on the responsibility of corporate actors to reduce global carbon emissions. For example, the judgement notes how the press release of the Climate Ambition Alliance, created in 2019 at COP25 in Madrid, expostulated how 'countries cannot take on this task on their own, that non-state action is required for meeting the goal of the Paris Agreement, and that this needs to be done with due observance of the latest scientific findings.'[218] Similarly, at COP21 (Paris), it was observed how states 'welcome the efforts of all non-Party stakeholders to address and respond to climate change, including those of civil society, the private sector, financial institutions, cities and other subnational authorities.'[219] Throughout Hösli's commentary on the case, he observes how the judiciary described the Guiding Principles as an 'authoritative and internationally endorsed "soft law" instrument, which sets out the responsibilities of states and businesses relating to human

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[216] *ibid.*
[217] N Hutley and S Hartford-Davis, 'Climate Change and Directors' Duties: SUPPLEMENTARY MEMORANDUM OF OPINION' (March 2019) *The Centre for Policy Development* <https://cpd.org.au/wp-content/uploads/2019/03/Noel-Hutley-SC-and-Sebastian-Hartford-Davis-Opinion-2019-and-2016_pdf.pdf>, [4].
[218] *Milieudefensie et al. v Shell* [2021] ECLI:NL:RBDHA:2021:5337, [2.4.8].
[219] Paris Agreement on Climate Change 2016, [133].

rights.'[220] Relying on these non-binding international agreements, the Hague judgement formally recognises that there is an international consensus that corporate actors should and are capable of being involved in the protection of the environment.

Though RDS attempted to refute the claims brought by Milieudefensie, arguing that they, as a single corporate entity, could not be held entirely responsible for global climate change, the judgement explicitly concluded it was inconsequential that 'RDS cannot solve this global problem on its own,' but this 'does not absolve RDS of its individual partial responsibility to do its part regarding the emissions of the Shell group, which it can control and influence.'[221] Rather, the fact some carbon emissions could be attributed to RDS' subsidiaries, directly resulted in their breaching this unwritten standard of care. As Hösli observes, 'a noteworthy aspect of the decision is that the court imposed an elevated level of responsibility on RDS.'[222]

3.2.3.3 The impact

The risks arising from failing to manage the impact of climate change on the company's business operations are substantial, with it becoming a necessity for directors to anticipate future legislation in this field and the reputational risks that could derive from a failure to act appropriately. To avoid any liability, it has, in part, become a requirement that a board of directors look beyond any myopic, profit-orientated mindset they usually have, and instead take a more long-term view of their operations: a derivative of shareholder primacy that focuses on long-term corporate success. The *Milieudefensie*

[220] [4.4.11] of the *Miliedefensie* judgement in A Hösli, '*Milieudefensie et al. v. Shell*: A Tipping Point in Climate Change Litigation against Corporations?' (2021) 11 *Climate Law* 195, 199.
[221] *ibid.,* [4.4.49].
[222] Hösli, 'A Tipping Point in Climate Change Litigation' (2021), 200.

case is indicative that companies are being held responsible, or at least being increasingly subjected to threats of litigation for the impact of their activities on the environment.[223]

Similarly, the threat ClientEarth have instigated against Shell's directors personally, highlights there is increasing litigation, not only against corporate entities, but also against individuals within them. As Salau et al., observed in their commentary on the announcement by ClientEarth that they plan to bring this type of claim against Shell, 'it is important for directors to understand that if there is an inconsistency between the company's public position in relation to ESG issues and its internal policies and actions, the company could be liable for making misleading disclosures, which might give rise to regulatory investigations and related derivative claims by shareholders.'[224]

3.3 Corporate Liability vs. Personal Directorial Liability

The rest of this chapter will build on this substantially rising number of climate litigation cases being brought against corporations and the increasing likelihood that directors will be held personally liable for, for example, breaching their duties of good faith (s172 CA) and care (s174 CA) by not effectively mitigating against the risks of climate change. This will provide an insight into why a large portion of my argument will focus on directors' personal liability for failures to mitigate effectively against climate change risks.

In comparing the relative 'effectiveness' of corporate and personal liability, what goals such liability is trying to achieve must be outlined. Why hold either the company, or some person within it, liable in the first place? I argue there are three goals that imposing

[223] [2021] ECLI:NL:RBDHA:2021:5337.

[224] M Salau, N Modell, N Penny-Larter and J Stretton, 'Legal action against Shell urges businesses to make haste in move to Net Zero' (Beale & Co Articles, March 2022) <https://beale-law.com/article/legal-action-against-shell-urges-businesses-to-make-haste-in-move-to-net-zero/> accessed 22 March 2022.

liability is trying to serve. Accordingly, comparing the effectiveness of each type of liability must be done against each of these three goals.

The first goal is '*compensation':* to ensure that those who are harmed as a result of some wrongful environmental behaviour by the company can be compensated for the harm they have suffered. So, it must be asked whether those harmed will be more likely to be compensated if they are able to claim compensation against the company, or against directors.

The second goal is '*deterrence*': to ensure that future environmental misbehaviour is discouraged. It must be asked in what ways companies, and/or the directors within, can be deterred from committing future environmental misdemeanours.

The third goal is '*accountability':* to ensure that those responsible for the harm are held accountable for their misdeeds. It must therefore be asked in which ways such accountability measures should be taken to have the most effect: against the company or against the directors personally?

It will be argued that although enterprise liability has a number of positive attributes and is therefore an important element in regulating the behaviour of companies, it still needs to be supplemented with some personal liability if the three mentioned goals of regulation (compensation, deterrence, and accountability) are to be effectively achieved. Increasing the likelihood of a personal threat to directors as individuals, will be the most effective route to generate a positive environmental regime.

3.3.1 The effectiveness of Enterprise Liability

It is worthwhile beginning by explaining briefly how enterprise liability works, and how it relates to the three goals of regulation mentioned above.

With such liability, the law takes the company as the target of its regulation. It threatens to make the company liable for the harm it causes. The company itself can remain focused on maximising profits, as can those who run it, its directors. But the threat of liability will alter what is, and is not, profitable for the company. This threat to its profits should *deter* the company, and those running it, from acting in environmentally harmful ways. When that deterrence fails to work, then the company itself will be liable to *compensate* those harmed by environmental misbehaviour. And it is of course the company itself that is held *accountable* – it will be the one that must answer for its past misconduct.

Thus, entity liability (or regulation) leaves companies free to maximise profits but aims to constrain what companies can do in pursuit of profit, by imposing costs on companies that do harmful things.

Before this chapter examines how effectively entity liability can achieve the three goals identified, it should begin by noting, but rejecting, a line of argument that claims that artificial entities, such as companies, are by their nature inappropriate targets for regulation.

Historically, a number of proponents for individualism have relied on the idea that 'a corporation cannot possess a guilty state of mind' because it is an artificial entity and as such 'the phenomenon of corporate blame-worthiness is a phantom.'[225] The main foundation for such a mindset is that a corporate entity is an amalgamation of different individuals, and not, in itself, a conscious individual. For example, Fiss maintains that 'the concept of wrongdoer is highly individualistic. It presupposes personal qualities: the

[225] B Fisse and J Braithwaite, *Corporations, Crime and Accountability: Theories of Institutional Design* (CUP 1994), 26.

capacity to have an intention and to choose.'[226] As Woodrow Wilson asserted in 1910: 'you cannot punish corporations. Fines fall upon the wrong persons…upon the stockholders and customers rather than upon the men who direct the policy of the business.'[227] From this perspective, it is wrong to target the company because the company is not a real person, capable of being held 'responsible' for the harm it causes. As Stone observed, 'there 'is no guarantee that [a company] will respond as we should like' – i.e., by punishing the actual individual(s) responsible for the misdeed.[228]

However, this 'individualist' rejection of corporate responsibility and liability seems unconvincing. As Fisse and Braithwaite argue, 'corporations exhibit their own special kind of intentionality, namely corporate policy.'[229] Taking an enterprise liability stance, they draw on French's argument that 'even in infancy the melding of disparate interests and purposes gives rise to a corporate long range point of view.'[230] As such, they contend that through incorporation and the creation of the articles of association and possibly designating an explicit corporate purpose, the "company" has *intention* because it will need to respect and abide by these documents. Further supporting this, they argue that the company's intention is capable of change, so it can be held directly accountable because 'organisations have the capacity to change their policies and procedures.'[231] Additionally, corporations 'can give moral reasons for [their] decision making,' so the individualist argument that companies fail to satisfy any requirements for intentionality,

[226] O Fiss, 'The Supreme Court 1978 Term - Foreword: The Forms of Justice' (1979) 93 *Harvard Law Review* 1, 22-3.
[227] W Wilson, 'The Lawyer and the Community: Addresses to the 33rd Annual Meeting of the American Bar Association' (1910) 35 *Reports of American Bar Association,* 427.
[228] C Stone, *Where the Law Ends: The Social Control of Corporate Behaviour* (Harper & Row, Publishers, 1975), 57.
[229] Fisse and Braithwaite, *Corporations, Crime and Accountability,* 26.
[230] P French, *Collective and Corporate Responsibility* (Columbia University Press, 1984), 45-6.
[231] Fisse and Braithwaite, *Corporations, Crime and Accountability,* 29.

thereby elucidating the corporation's (as opposed to its agents') responsibility, they believe, falls flat.[232]

In the later chapters on the B Corp, (chapters 4 and 5) this notion that companies are able to choose their own *purpose* and as such actively alter how the law could hold them accountable will be discussed as this is particularly relevant for holding B-Corp and other social enterprise companies, or their directors, liable. However, for present purposes, it is sufficient to acknowledge how corporate policy could be construed as implementing corporate *purpose* and consequently, intentionality, giving rise to enterprise liability.

So, this thesis has now rejected the arguments of methodological individualism, and its hostility towards entity liability. Entities are *capable* of being held responsible and liable for harm they cause. Nevertheless, how *effective* is such liability likely to be, in achieving the three regulatory goals described above?

As far as *compensation* goes, entity liability is often likely to be very effective – and often significantly more effective than personal liability. Enterprises usually have deeper pockets than individuals (such as directors). They are also more likely to have an insurance policy. Therefore, in as far as achieving compensation for those harmed by corporate misbehaviour, entity liability is often more effective and superior to personal liability.

Here it is worth acknowledging that companies, can of course, become insolvent and would therefore be unable to provide compensation. Sometimes they may also have, deliberately or otherwise, failed to insure. In these cases, allowing tort victims to also claim compensation from others can increase the chances of compensation being

[232] *ibid.*

delivered. However, even then, the directors may not be the best individuals on whom to impose additional liability.

If one thinks about attempts to extend tort liability beyond a company, the effort so far, has been to make *shareholders* liable. Usually this is targeted at a parent company shareholder within the group.[233] In terms of compensation, the argument for personal liability against, specifically, directors, is weaker than seeking compensation from the corporation.

Similarly, regarding *accountability*, targeting the company itself often seems more appropriate and desirable. If one were to blame individuals within an organisation, the issue arises that it is often difficult to determine accountability within a company: 'organisations have a well-developed capacity for obscuring internal accountability if confronted by outsiders.'[234] As Fisse and Braithwaite explain in a substantive list, the difficulties of enforcing personal liability revolve around five main reasons: (1) 'enforcement overload', (2) 'opacity of internal lines of corporate accountability', (3) 'expendability of individuals within organisations', (4) 'corporate separation of those responsible for the commission of past offences from those responsible for the prevention of future offences' and finally, (5) 'corporate safe-harbouring of individual suspects.'[235] This is further supported by Stone who observes how 'the enterprise's interior relationships remain a "black box."'[236] Even though targeting the individual could be, in his opinion, more effective in many cases, it is nigh impossible for outsiders to

[233] For case law, see: *Chandler v Cape plc* [2012] EWCA Civ 525; *Vedanta Resources plc and another v Lungowe and others* [2019] UKSC 20; *Okpabi and others v Royal Dutch Shell plc and another* [2021] UKSC 3.
[234] Fisse and Braithwaite, *Corporations, Crime and Accountability,* 38.
[235] *ibid.,* 37.
[236] C Stone, 'The Place of Enterprise Liability in the Control of Corporate Conduct' (1980) 90 *The Yale Law Journal* 1, 8.

pinpoint an actual individual responsible for the harm. Therefore, if one agrees that responsibility can be attributed to collective entities, it seems right to sometimes condemn the corporate entity itself, and not merely individuals within it.

Finally, I will turn to perhaps the most important of our three regulatory goals, so far as understanding the limits of corporate liability goes, namely the *deterrent* effect of such liability. As has already been noted, the threat to the company's profits, which the risks of liability entails, should cause the company – and those who are running it – to avoid breaching the regulation in the first place.

It is important to acknowledge that focusing liability on the entity in this way can often be a very good way of deterring businesses from acting harmfully towards the environment. Remember again that this thesis does not advocate *replacing* entity liability with personal liability; it suggests only that, despite the former's strengths, it is sometimes insufficient, and needs *supplementing* with personal liability.

Two particular strengths of entity liability – in terms of achieving high levels of deterrence – should be noted. First, where entity liability is concerned, the monetary penalties are usually greater because companies tend themselves to have deeper pockets than the individuals working within them. It is useful to acknowledge that deterrence is usually seen as a product of (a) the *likelihood* of liability and (b), the *size* of liability. For companies, the size will often be greater.

However, I do not want to exaggerate this strength of corporate liability. Although, admittedly, companies can have larger fines imposed on them, a company cannot be imprisoned. Imprisonment – reserved for humans – is perhaps the 'biggest' liability that can be imposed. Stone reflects this, maintaining that, 'we aim to control the corporation through threats to its profits,'[237] because a corporate entity cannot be punished through, as is the case with an actual human, imprisonment, and as such, the 'most effective way to manipulate corporate behaviour is through its pocketbook.'[238] The issue with relying on this form of deterrence is that 'threats to the corporate treasury don't necessarily intimidate [those in control of choosing the company's policies].'[239] Moreover, although one can impose a larger fine on companies, this is partly because there is less of an impact if one were to impose a smaller fine: their size can cushion them. Smaller fines on individuals, for whom such a fine may be felt much more keenly, may achieve a higher level of impact and, hence, deterrence.

A second *strength* in using corporate liability to achieve deterrence is that the deterrence it achieves is more likely to be 'efficient' (and probably more 'efficient' than that achieved through personal liability). By 'efficient', I mean a reasonable balancing of the costs and benefits of compliance. By threatening to make the company itself pay for the harm, this should encourage companies to take *cost-effective* measures to prevent such harm occurring. Suppose one can work out the cost of some harmful activity, X, and can ensure that companies engaging in this activity will have to pay just this cost. Then, each company will calculate for itself how much it will cost to cease doing X. For each company, where it will be cost effective to stop doing X, it will cease to do X. But if it will be more cost effective to continue to do X and to pay the penalty for X-ing (say because X causes only little harm, but would be hugely expensive for that company to avoid), then it will continue to do X. In this sense, targeting the company can produce more 'efficient' responses, which balance the costs and the benefits of compliance.

[237] Stone, *Where the Law Ends,* 36.
[238] *ibid.,* 38.
[239] *ibid.,* 46.

By contrast, if individuals are targeted, there is a concern that those individuals will over-react to the threat against them. They will not calculate whether, overall, to the company, compliance will be better than breach. Instead, they will just calculate their own individual costs of compliance and breach. Since they will suffer all the costs of breach, they will tend to play safe and comply, even where compliance is not cost effective (from the company's point of view): 'it will instil an overly cautious approach to decision-making'.[240] As such, when deciding the merits of a particular business endeavour, the directors may 'tend to be [too] risk-adverse…causing their firms to waste money on measures that do not deliver meaningful reductions in misconduct rates.'[241] The directors would therefore be too compliant, potentially opening themselves up to the threats discussed in chapter 2. In other words, those pressures deriving from the market and shareholders, who will be able to recognise the risk averse behaviour of the directors through the almost definite reduction in company share value.

Such an 'economic' approach to thinking about the benefits of restricting liability to the company does, of course, assume that compliance is not automatically a good thing, or necessarily an end in itself. It maintains that too much compliance can be bad and targeting individuals can lead to this.

3.3.2 The weakness of entity liability

So far, this chapter has acknowledged some positive qualities of corporate liability in securing the goals of environmental regulation. However, it must now also acknowledge that it suffers a major weakness. The weakness concerns, primarily, its deterrent effects.

[240] J Armour, J Gordon and G Min, 'Taking Compliance Seriously' (2020) 37 *Yale Journal on Regulation* 1, 41.
[241] *ibid.,* 44.

Although one talks about liability imposed on the company deterring *the company* from misbehaving, it is, of course, individuals within the company that will decide how the company responds.

When it targets the company, the law 'is based on an implicit assumption that when the court visits a monetary loss on the corporation…the group responsible…will be made to "feel" what it has done in some way (as by decreased budget, personnel shifts, "calling down" supervisors, changes in quality-control procedures or mechanical layouts, stiffer design specifications).'[242]

How far enterprise liability fails depends, in part, on how effectively enterprises redistribute, internally, losses inflicted on them. The more efficiently they do so, the less need there is for a separate regime of *external personal* liability. External stakeholders would be able to rest content with the claims they can enforce against the *enterprise* itself, knowing the pain they can inflict on it will be efficiently shifted internally to where it matters – namely, onto the directors whose behaviour has fallen short.

In order to illustrate the shortcomings of entity liability, an analysis of internal personal liability is required to assess whether these external stakeholders can rely solely on entity liability.

3.4 The shortcomings of internal directorial liability

This section is going to show that threatening the company may often not make those inside the company – the actual decision makers – behave as the law wants. Deterring the company does not sufficiently deter the individuals within it.

[242] Stone, *Where the Law Ends,* 45.

To prove this, it must be queried how a threat to the company could make a difference to the decision of individuals inside the company – e.g., its directors. I shall set out *three* ways in which pain inflicted on the company could make a difference to the directors – could threaten and, therefore, *deter them.* It shall be argued that each of these three ways has some effect, but too little to provide sufficient effective deterrence. It might be noted that these three ways in which liability imposed on the company could, in turn, be passed onto, and thus deter, directors, are what I referred to earlier as 'internal personal liability'.

3.4.1 The failure of a company's internal labour market

One way in which threats imposed on the company would deter directors personally would be if directors faced the likelihood of losing their jobs when they failed to make their company comply with its obligations.

The problem with the company's internal labour market, however, is that, in practice, when a company is subjected to enterprise liability, the director(s) responsible often keep their jobs and are sometimes promoted.

Directors are treated as business experts and, more often than not, as the best-informed individuals in relation to a particular business venture. They should have the most informed information about its likely success and have insight into the risks in their company's market and sector. Consequently, if the enterprise *itself* is found liable for a particular environmental misdemeanour, the existing shareholders are unlikely to reduce the pay of, or sack, the directors whose company is suffering due to its breaking environmental regulations. It can be difficult to replace the directors and/or upon replacement, the new individuals would have to learn that sector and business' risks and opportunities. Through the directors' expertise, 'corporations…have access to practical and theoretical knowledge which dwarfs that of individuals.'[243] This will sometimes explain why directors manage to successfully maintain their jobs after their enterprise is found liable: if an improvement is desired in the company's behaviour, the existing directors will likely be some of the most knowledgeable about that sector/company – i.e., they will be best placed to help the company regain its value.

Moreover, as Stone muses, prevailing practices in modern corporations '[do] not include internal auditing procedures to prove such negative feedback to the subunit that was responsible.'[244] Those in the highest levels of authority are often immune from the financial squeeze or in a position where they are able to distribute the losses away from themselves and on to unsuspecting stakeholders.

This could cast light on why executive pay is so astronomically high when compared to the remainder of their work force. Jailani reports that 'a survey has shown that the ratio of the pay of an average FTSE 100 CEO to the average pay of a full-time employee in the UK had multiplied from 47:1 in 1998 to 128:1 in 2015.'[245]

This is especially the case if one approaches this from an agency theory conception on the motivations of directors – namely, that their main aim is to increase their personal profits. Kraakman lends support to this perspective, maintaining that a number of tactics to constrain director selfishness, 'may not overcome a risk-averse manager's temptation to 'cheat' shareholders by surreptitiously choosing business strategies that are less profitable to the firm but less risky for its managers.'[246]

[243] T Donaldson, 'Corporations and Morality' (1982) 1 *Journal of Business Ethics* 3, 125.
[244] Stone, *Where the Law Ends,* 45.
[245] Q Jailani, 'Reforming executive pay: variable performance pay and the prevailing levels of pay' (2018) 39 *Company Lawyer* 7, 218.
[246] R Kraakman, 'Corporate Liability Strategies and the Costs of Legal Controls' (1984) 93 *The Yale Law Journal* 5, 865.

However, because this thesis can only focus on a limited area, this section simply endeavours to illustrate that director remuneration and job security is largely unaffected by enterprise liability if they, as an individual, cannot be found personally responsible for the refuted decision.

3.4.2 The failure of performance related pay

If directors are paid for performance, then they will often earn more if the company is more profitable, and they will earn less if the company is less profitable. Performance related pay has been defined as referring to 'incentive plans which are based on performance targets.'[247] Anything that hurts the company's profits, hurts the directors' own pocket. On this view, making the company (and its profits) suffer makes the directors suffer. Thus, threats to the company should equally deter directors.

However, a crucial problem with the ways in which companies internally reprimand their boards of directors stems from the fact that, directors who have behaved poorly, often go on to keep their bonuses and avoid any personal financial impact.

As the earlier chapter on shareholder primacy notes, performance related pay can encourage myopic thinking. As Bennett et al.,[248] muse, 'performance-contingent bonuses lead to CEOs taking short-term actions to meet the goals (cutting R&D and increasing accruals), as well as performing just well enough to meet the goal but going no further to avoid ratcheting up future goals.'[249] While this tactic encourages the pursuance of short-term profit maximisation endeavours, it is also problematic in the context of a company being found liable for something and subsequently being fined. As this subsection will

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[247] *ibid.,* 212.
[248] B Bennett, J Carr Bettis, R Gopalan and T Milbourn, 'Compensation Goals and Firm Performance' (2017) 124 *Journal of Financial Economics* 2.
[249] A Edmans, *Response to the Green Paper on Corporate Governance Reform* (2017) <https://alexedmans.com/wp-content/uploads/2015/02/Green-Paper-Response-201701216.pdf> accessed 19 April 2022.

argue, even when a company is fined, members of the board are able to spread the costs and avoid substantial impact to their own personal finances.

The main critique posed at performance related pay regimes is the fact they are often linked to quite short-term targets. Jailani found that 'where the vesting period for a CEO is approaching, this typically results in cuts to R&D and the postponement of long-term capital expenditure.'[250] Similarly, Edmans' also argues that due to our current approach to performance related pay, 'complex, opaque bonuses and long-term incentive plans' have become associated with short-term business ventures that 'should be scrapped and replaced by long-horizon equity.'[251] This, they both argue, is because linking executive pay to the company's longer term performance, at least 5 years, would incorporate losses that derive from the company being found liable for mismanagement of risks and unforeseen endemics/pandemics, such as covid 19. For example, if the enterprise were found liable, like in the *Milieudefensie* case, the costs would then be borne by all the executives and stakeholders.

However, under the majority of current performance related pay regimes in operation, it seems that the executive are able to protect themselves from financial disadvantage. For example, the Wall Street Journal reported the 'then-CEO of AT&T Randall Stephenson received roughly $32 million in compensation last year, while about 20,000 AT&T workers lost their jobs.'[252] This trend is repeated across global businesses and in turn casts light on the ineptitude of internal liability mechanisms. How can disconnected stakeholders – e.g., consumers or potential investors – rely on companies truly holding

[250] Jailani, 'Reforming executive pay', 215.
[251] Edmans, *Response to the Green Paper,* 4.
[252] J Kelly, 'AT&T CEO's Multimillion Compensation Increased While Thousands Of Employees Were Terminated' (Forbes, March 16 2020) <www.forbes.com/sites/jackkelly/2020/03/16/att-ceos-multimillion-compensation-increased-while-thousands-of-employees-were-terminated/?sh=3360d9707929> accessed 20 April 2022.

their irresponsible directors to account instead of deviating and divesting the burden on to them? This is where either internal personal liability, or alternatively, external personal liability mechanisms can step in.

Current pay systems, which focus too much on the short term, mean directors can safely ignore penalties which the company will suffer, but suffer only in the long term.

One way to address that might be to make their pay ever more 'long term'. Edman's proposes a long-term CEO equity stake which 'cause[s] not only higher profits, but also innovation and stewardship of employees, customers, suppliers, and society.'[253] Crucially for Edman's argument, is that the time horizon of equity is extended 'beyond the executive's departure,' as this will remove the threat of executives sitting passively if their stock is doing well or extensively reducing R&D and investing in quick turnaround, high yield, endeavours if their company is performing badly on the stock market.[254]

But achieving that has long proved very difficult. Generally, directors use their power and control to ensure that their pay is not really that sensitive to long term performance.

So, a better way may be to 'cut out the middleman' of the company: instead of threatening the company and hoping this will in turn lead to directors suffering lower pay, simply threaten the directors personally.

3.4.3 The issues with directors' duties

Directors are duty bound to maximise profits – see chapter 2. Here it was shown that in doing so, liabilities threatening the company are 'instrumentally relevant' – potential

[253] Edmans, *Response to the Green Paper,* 2.
[254] *ibid.,* 8.

costs directors must factor into their calculations when deciding on what will maximise profits.

So, on this view, directors who fail to take into account liabilities imposed on the company are at risk of breaching their own duties to the company. Fear of liability for breach of duty will make directors ensure their company complies with its liabilities.

However, the third problem in ensuring that the directors responsible for a company's misdemeanours are held accountable through internal personal liability mechanisms, and perhaps the one with the most impact, relates to these duties. As mentioned in the previous chapter, issues arise as to the duties' subjectivity. The focus of this subsection relates to, firstly, the fact that in a large number of scenarios, directors, whose companies are harming others and the environment, whose companies may be breaching enterprise liability rules, may not themselves be in breach of their own duties to their company. Secondly, an extremely prevalent issue is the duties' enforceability; there is little chance of a corporate action or derivative claim succeeding. The following two sub- subsections (3.4.3.1) and (3.4.3.2) will explain these two notions in more depth. The purpose of explaining these issues is because it gives greater strength to my argument that society cannot rely on internal personal liability mechanisms if real improvements in corporate behaviour are desired.

3.4.3.1 What's wrong with the content of the directors' duties?

One of the main issues with the content of the directors' duties is the boards' ability to either avoid or seek relief from liability for any breaches of duty.[255]

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[255] Post Bilta (*Jetivia SA v Bilta (UK) Limited* [2015] UKSC 23) which rejected the existing precedent of Stone (*Stone & Rolls Ltd v Moore Stephens* [2009] UKHL 39), directors cannot now attribute their own fault to the company, thereby rendering the company an equally guilty party and preventing the company suing them under the ex turpi causa doctrine. Therefore, this doctrine is no longer a problem in suing a director for the benefit of a company.

There is the possibility for directors to acquire authorisation or ratification for breaches of duty which could prevent a successful internal claim against them. Both of these will be discussed in turn to illustrate how internal personal liability mechanisms can be successfully circumvented by the responsible directors(s).

3.4.3.1.1 Authorisation

In our current legal system, it is feasible for a director to gain *ex ante* approval for something they have done. According to s180(4)(a) CA, 'the general duties have effect subject to any rule of law enabling the company to give authority, specifically or generally, for anything to be done (or omitted) by the directors, or any of them, that would otherwise be a breach of duty.' However, it seems unlikely for directors to routinely ask shareholders for approval, in advance, of what they are doing. Especially in circumstances where what they are seeking approval for, would breach external (enterprise) liability rules, harming the company. Repetitively asking shareholders to sanction, in advance, management decisions would probably seem too much like an abdication of managerial responsibility. Therefore, little focus is needed on this mechanism, as the much more likely and common mechanism invoked is that of ratification.

3.4.3.1.2 Ratification

Unlike authorisation, ratification, is an *ex post* excusal of something, in this case, that the directors have done. Contained within s239 CA, directors can rely on this internal mechanism to release them from liability for any conduct 'amounting to negligence, default, breach of duty or breach of trust in relation to the company.'[256] All they require is a resolution by the members of the company (the shareholders) in their favour, excusing the action/omission/decision.[257]

[256] s. 239(1) CA.
[257] s. 239(2) CA.

Limiting the breadth of this mechanism, a number of constraints on its invocation exist. The most debilitating of these is the requirement that shareholders eligible to vote cannot be 'connected' with the director(s) whose actions are being questioned.[258] 'Connected' is defined in s252(2)(a)-(e) CA and includes, for example, family members. As such, only shareholders disparate from the director can vote in favour of their action, thereby limiting the likelihood of success. However, interestingly, "family members" does not include the exclusion of an individual who is the director's 'grandparent or grandchild, sister, brother, aunt or uncle, or nephew or niece' (s253(3)). This thereby throws into question how far the limitations on those who can vote for ratification actually affects the director concerned.

Perhaps more relevant is the court's consideration of the mere *likelihood* of ratification during a derivative claim proceeding. The likelihood of ratification is one of the discretionary factors taken into account by the court when musing whether to give permission for a derivative claim (discussed later in 3.4.3.2.2).

In smaller companies, ratification is often beyond the reach of the wrongdoing director, given that their votes (and votes of those connected to them) cannot be counted. But in larger companies, that's not true. In larger companies, most shareholders will be free to have their votes counted (being unconnected with the wrongdoer). Most will be told by the rest of the board that the derivative claim is hugely distracting and potentially harmful to the company; that although the directors did, technically, make/allow the company to breach external liability rules, they did this in good faith, and actually for the benefit of the company and its shareholders.

[258] ss. 239(3) and (4) CA.

Accordingly, it is far from clear whether the directors actually breached their duties at all, and even if they did, given they did so in the name of benefitting the shareholders, shareholders should not try to pass on the losses to the directors – they should take it on the chin themselves (i.e., let the loss lie with their company). More often than not, most shareholders will probably accept this line or argument because the threat of reputational damage from entering the courts with a derivative claim, would likely lead to even greater losses in their share value. Which in turn, as discussed in chapter 2, would open the company up to the threat of a takeover.

3.4.3.1.3 A brief observation from the ClientEarth v Shell investor briefing[259]

When attending the investor briefing about ClientEarth's decision to threaten the board of Shell with a derivative claim for their mismanagement of climate change, it was interesting to observe that they, as a minority shareholder, were trying to enlist the support of other shareholders. This is most likely because of the weight given by a court to the likelihood of ratification. If ClientEarth can illustrate that a large body of shareholders are opposed to Shell's boards' actions, they will increase the chance of being successful at the first permission hearing stage. Thereby removing a route that Shell's lawyers could rely upon by claiming that no other shareholder has advocated support for ClientEarth's action and would thus ratify the action.

3.4.3.2 Enforcement Problems

3.4.3.2.1 The Corporate Action

One mechanism worth briefly mentioning that a company can invoke to bring proceedings against its own directors internally is through a corporate action. For this to be successful, whoever has the authority to take such a managerial decision will decide whether to sue the director(s) for their breach of duty. Following *Breckland,* there is no

[259] ClientEarth webinar on their Shell proceedings: *Investor Briefing* (31st March 2022).

stand-alone rule in company law about who has the authority to decide if the company should/would proceed with a corporate action.[260] However, in general, the Model Articles grant this power to the board: 'subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company.'[261] As a matter of principle, it seems unlikely a board would choose to sue itself or one of its members, thereby creating a precedent for scapegoating.

Mitigating the effects of this, slightly, Regulation 4 of the Model Articles grants shareholders a reserve power whereby, by special resolution, they can 'direct the directors to take, or refrain from taking, specified action.'[262] Alternatively, shareholders also have the power to change the members of the board by ordinary resolution.

However, the previously mentioned case of *Breckland,* confirmed the principle of *Quin* that through the shareholders buying shares in a company, they implicitly accept that it is for the board of directors to manage the company and as such, the shareholders should not be able to override their decision on the continuance or severance of a corporate action.[263]

Therefore, the following section will consider the alternative route internal shareholders can take against their board/an individual on the board for breaching their duties: the derivative claim.

[260] *Breckland Group Holdings Ltd v London & Suffolk Properties Ltd* [1989] BCLC 100.
[261] The Companies (Model Articles) Regulations 2008, Regulation 3.
[262] *ibid.,* Regulation 4(1).
[263] *Quin & Axtens Ltd v Salmon* [1909] AC 442.

3.4.3.2.2 The Derivative Claim

3.4.3.2.2.1 Background context of the derivative claim

Unlike the corporate action, this internal liability mechanism is wielded by the shareholders of an enterprise *on behalf of the company* for harm committed *against it* by its directors.

As the previous chapter outlined, according to s170, directors ultimately owe their duties to 'the company.' Though this has been interpreted by the judiciary as being synonymous with shareholder interests, in the context of enforcing directors' duties, it has been understood as actually referring to the company, as its own entity. For example, in the case of *Edwards v Halliwell,*[264] Jenkins LJ explained the two limbs of the *Foss v Harbottle*[265] rule as: (i) prima facie, the company is the proper claimant against wrongdoing by the board, and (ii) no individual member should be permitted to bring an action 'for the simple reason that, if a mere majority of the members of the company…is in favour of what has been done, then *cadit quaestio.'*[266] The problem arises where the board of directors decide, as the voice piece of the company choosing the business ventures embarked upon, not to bring any form of claim against their own wrongdoing.

Extensive normative debate exists regarding this problem when directorial duties are breached but the board decide not to pursue any action. If as s170(1) holds, the duties are owed to the 'company,' then breach of any one of the directors' duties causes harm to the company *itself*. The company should therefore be capable of bringing proceedings to remedy these infringements even when the board of directors are choosing not to pursue any action because it would fundamentally harm their positions on the board.

[264] [1950] 2 All ER 1064.
[265] [1843] 67 ER 189.
[266] *Edwards v Halliwell* [1950] 2 All ER 1064, [1066]-[1069].

As Cox, the lawyer who successfully led the *Milieudefensie*[267] and *Urgenda Foundation*[268] cases, observed in an interview: 'CEO's must take the responsibility to explain to their shareholders why the [carbon] transition must be accelerated…the net is closing in.'[269] This section will therefore endeavour to outline the keyway *internal* stakeholders – namely, the shareholders - are able to bring proceedings against directors. It will also explain the issues with the current company law regime; one that derives from the shareholder-centric enforcement rules. Interestingly, a recent conference panel, discussing net zero and interrelated business law, shared this sentiment, observing that 'the main problem in changing corporate behaviour in the furtherance of achieving net zero goals is not the absence of duties and corresponding rights…but their enforcement.'[270]

Chapter 5 will go into more detail re- derivative claims in the context of B Corps - but for now it is useful to note how this problem infiltrates the history of derivative claims and more recent climate-related litigation.

3.4.3.2.2.2 The derivative claim

It is a key principle of company law that when judging a decision that has already been taken, and subsequently turned out to be a poor decision, hindsight bias cannot comprise the analysis. As such, derivative claims often fail because the judiciary often look at the *process* undertaken by the decision-maker, as opposed to the *result,* and are reluctant to intervene in commercial decisions.

267 [2021] ECLI:NL:RBDHA:2021:5337.
268 [2019] ECLI:NL:HR:2019:2007.
269 D Baazil and H Miller, 'The Man Who Beat Shell: How an Unknown Lawyer Won Historic Suit' (Bloomberg Green, 16 June 2021) < www.bloomberg.com/news/articles/2021-06-16/-petrolhead-who-beat-shell-shows-how-law-can-fight-climate-change> accessed 21 March 2022.
270 G Csillag and S Badovska, 'Business Law and the Transition to a Net Zero Carbon Economy – A Conference Report (Part 3)' (2021) *Oxford Business Law Blog.*

Crucially, however, in the UK's current formation of corporate law, derivative claims are the main way shareholders are able to bring legal actions against directors for breaching their duties. Therefore, in the context of holding directors personally liable for a failure to effectively mitigate against climate risks or choosing to pursue a business venture that leads to negative press and/or a devaluation in share value, it is an avenue worth exploring.

Now embodied by Part 11 CA, derivative claim proceedings allow a shareholder, or group of shareholders, to bring litigation against the board of directors for the harm they have caused to the company through breaching their duties. Section 260(3) CA outlines how 'a derivative claim…may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director.' Codifying the common law, Gibson LJ noted that 'the shareholder will be allowed to sue on behalf of the company if he is bringing the action bona fide for the benefit of the company for wrongs to the company for which no other remedy is available.'[271] When bringing a derivative claim a number of hurdles have to be passed by the shareholder(s) for a successful action to go ahead. The first hurdle requiring satisfaction is contained in s263(2) which provides for three mandatory bars that automatically negate any further proceedings. These are: (a) when 'a person acting in accordance with section 172…would not seek to continue the claim,' (b) where the act or omission being refuted is yet to occur, where it has been authorised by the company and, (c) where the act or omission has occurred, it has been subsequently ratified.

Rather than placing emphasis on s263(2)(a), the court has historically interpreted this provision in favour of the shareholder. This derives from precedent, with historic cases

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[271] *Barrett v Duckett* [1994] 1 BCLC 243, [250].

such as *Carlen v Drury* holding that the 'court is not required on every occasion to take the Management of every Playhouse and Brewhouse in the Kingdom' into account.[272] This reluctance of the judiciary to intervene in commercial decisions recurs in more recent cases, such as *Iesini,* where Lewison J noted that 'the weighing of all of [the] considerations [in s263(2)(a) is] essentially a commercial decision, which the court is ill-equipped to take, except in a clear case.'[273] As Keay analyses, this case established the idea 'a court should only refuse permission where *no* director would seek to continue the claim.'[274] However, it is important to note that this doesn't give the derivative claim the status of success, it simply allows the court to go on to consider the second hurdle: the discretionary factors.

Contained within s263(3), the discretionary factors the judiciary look at are:

a. 'whether the member is acting in good faith in seeking to continue the claim
b. the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it
c. where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—
    i. authorised by the company before it occurs, or
    ii. ratified by the company after it occurs
d. where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company

[272] [1812] 35 ER 61.
[273] *Iesini v Westrip Holdings Ltd* [2010] BCC 420, [85].
[274] A Keay, 'Applications to continue derivative proceedings on behalf of companies and the hypothetical director test' (2015) 34 *Civil Justice Quarterly* 4, 362.

e. whether the company has decided not to pursue the claim
f. whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.'[275]

Of particular relevance for this discussion is s263(3)(b) (italicised above) and the reference to the importance an hypothetical director would attach to pursuing the action. Warren J asserted in *Airey v Cordell* that 'it is not for the court to assert its own view of what it would do if it were the board.'[276] This is especially relevant to later discussions of the B-Corp model and derivative claims, as an hypothetical director of such a corporation could have very different parameters attributed to their s172 duties. However, for present purposes, it is interesting to quote the statistics used by Keay that 'in only three of the 22 cases heard so far, from October 2007 until August 2015, have the courts felt that the case of the applicant was so weak that in fact no director would seek to continue the claim.'[277] This is indicative of their reluctance to make a commercial decision in an sphere where both the shareholders and directors concerned likely have significantly more exposure to the problem and expertise in the area. In *Franbar Holdings,* one of the considerations by the court was the benefit arising for the company if the derivative claim proceeded.[278] To assist with the judicial analysis, the courts identified a number of factors an hypothetical director would take into account before deciding to pursue a claim: (i) its prospects of success, (ii) the enforceability of any judgement obtained, (iii) disruption of

[275] 263(3) CA (italics added).
[276] [2007] BCC 785, [75].
[277] Keay, 'Applications to continue derivative proceedings', 357.
[278] *Franbar Holdings v Patel* [2008] EWHC 1534.

the litigation to the company's business, (iv) costs of the proceedings, and (v) the impact on the company's reputation.[279]

3.4.3.2.2.3 The problems with derivative claims

There are a number of issues associated with derivative claims: the most prevalent of these are the fact only shareholders have standing to bring the action and that the shareholder(s) are ascribed with 'a high evidentiary burden…which they are unlikely to meet. Since costs are allocated to the loser in the UK, the factual implementation continues to serve as a strong disincentive for private shareholder enforcement and good governance.'[280]

Legislation dictates that only 'a member of a company,' i.e., a shareholder, has standing to bring this sort of action.[281] In a situation involving a company oriented around shareholder primacy, or even ESV, the standing rules fit with the notion that shareholders, as the sole beneficiaries who are financially tied to the company, should be capable of bringing some sort of action for directorial breaches of duty – to help protect their vested interest. As will be discussed later in chapter 5, this is a pertinent problem for individuals wanting to bring an enforcement against a director/board of directors who are affiliated with companies that have 'self-selected' to be more socially-orientated – such as is the case with B-Corps.

As has been argued, one goal of corporate law is the maximisation of shareholder value 'because this ordinarily tends to serve the broader goal of advancing social welfare.'[282]

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[279] *ibid.*

[280] D Gibbs-Kneller and D Gindis, 'De jure convergence, de facto divergence: A comparison of factual implementation of shareholder derivative suit enforcement in the United States and the United Kingdom' (2019) *European Business Law Review,* 1.

[281] 260(1) CA.

[282] J Armour et al., 'Beyond the Anatomy' in R Kraakman et al., *The Anatomy of Corporate Law: A Comparative and Functional Approach* (OUP, 3rd edn, 2017), 271.

However, as Kraakman observes, 'for this to be true, regulatory measures must be used to impose the social costs of corporate activities onto the firm's bottom line where affected parties cannot bargain with the firm.'[283] Essentially, a nod is being made towards the fact stakeholders, excluding shareholders, have no standing against the board of directors, even when their rights are interfered with by the company and as a direct result of director action. This issue can be partially alleviated by NGO and socially orientated firms purchasing shares in a company and then deciding to bring derivative proceedings against the board. Although this is very rarely the case, a prevalent example is ClientEarth's announcement that it intends to bring proceedings against Shell; however, this is fairly rare due to the high financial cost and no guarantee of success at either judicial hurdle.

Another major issue for shareholders in succeeding in a derivative claim against a director is the court's inclination to consider whether a personal action or a s994 CA proceeding is a realistic alternative avenue. Due to issues of space, this consideration will not be explored in much detail.

It is sufficient to acknowledge that the court look to see whether such an action could be feasible. For example, in *Barrett,* Gibson LJ observed '[shareholders] will be allowed to sue on behalf of the company if he is bringing the action bona fide for the benefit of the company for wrongs to the company for which no other remedy is available.'[284] However, he went on to observe, 'if the action is brought for an ulterior purpose or if another adequate remedy is available, the court will not allow the derivative claim to proceed.'[285] A similar sentiment was repeated in the cases of *Mumbray*[286] and *Jafari-Fini,* where the

[283] *ibid.*
[284] *Barrett v Duckett* [1994], [250].
[285] *ibid*.
[286] *Mumbray v Lapper* [2005] EWHC 1152.

availability of alternative remedies, for instance s994 proceedings and personal claims, were factors the court considered relevant for their subsequent refusal of the derivative claims.[287] More recently, the same justification was followed by the judge in *Bridge v Daley,* where they maintained it would be more appropriate to assess the claims in question via a s994 petition.[288]

It is therefore evident that derivative claim proceedings are subject to a number of hurdles that are difficult to surpass. However, the existence of their threat and feasibility does serve to pressurise directors to deter from breaching their duties outright. Depending how the ClientEarth derivative proceeding is treated by the courts, a new understanding of directors' duties could be introduced. Already, legal practitioners are observing 'it is clear that climate change litigation is here to stay and specifically more climate-related litigation will be brought directly against companies and their boards. The legal action has relevance for all companies, not just in the energy sector, as all businesses will shortly be required to make disclosures relating to how they are fulfilling their environmental obligations.'[289]

3.4.4 Conclusion on entity liability's shortcomings

It has been shown how the law has a choice between enterprise and personal liability. Enterprise liability has several positive points in its favour. However, it was illustrated that if it is to 'deter' companies, it must deter the individuals who decide the activities of the company. This can only be done effectively if somehow the 'pain' that is inflicted, or threated to be inflicted, on the company, is in turn, passed on to those responsible individuals. I outlined three ways in which this transfer may occur, but none of these

[287] *Mohammad Jafari-Fini v Skillglass Ltd* [2004] EWHC 3353 (Ch).
[288] [2015] EWHC 2121 (Ch).
[289] Salau et al., 'Legal action against Shell'.

three ways was shown to work effectively. This leaves the risk that merely threatening or punishing the company itself, cannot, and will not, change the behaviours of those who matter – the decision makers (i.e., the directors). By explaining the shortcomings of internal personal liability, it has been made apparent that there are significant shortcomings – whether legal, or practical – in the effectiveness of internal redistribution.

This is where it may be more beneficial to supplant enterprise liability with increased external personal liability – imposing obligations owed to, and enforceable by, external actors. Summarising Stone's proposal, Fisse and Braithwaite do not entirely reject that, 'individual liability is seen as necessary to take up "some of the slack" where enterprise liability is deficient.'[290] For example, they explain how 'breaches of company rules may jeopardise opportunities for promotion or even retention of one's job' and 'above all, there is the risk of being shamed before one's peers.'[291] Relying on directors feeling shame or guilt, however, is an unpredictable and unreliable form of retribution. In many cases where the directors are aware their actions are leading to environmental misdemeanours but are simultaneously also increasing profits exponentially - protecting their positions within a company from the threat of e.g., an hostile takeover or shareholder coup d'état – one cannot rely on their feelings of guilt to precipitate real change. Therefore, as Stone maintains, 'if corporations are to be kept honest, the law should be prepared to close in, wherever feasible, on key personnel.'[292]

It is important to note, however, that even if this is the case, personal liability will be a supplement to, not a replacement of, enterprise liability (and its corresponding mechanisms for internal liability). Therefore, the judgement against Shell in the

[290] Fisse and Braithwaite, *Corporations, Crime and Accountability,* 67.
[291] *ibid.,* 79.
[292] Stone, *Where the Law Ends,* 69.

Milieudefensie litigation is still an overall positive, even though it was "only" enterprise liability, and simultaneously, it is also still a positive that Shell's directors might now have to answer 'internally' to Shell (through a claim brought on its behalf) for their poor environmental stewardship. Likewise, in chapter 5, when the effectiveness of the B Corp model is considered, the focus is *still* on whether B Corps themselves, as enterprises, can be held liable for failing to be as good as they say they will be, and whether B Corps will in turn pass on such liability to directors. Additionally, these questions will be supplemented by asking whether *external* actors can sue the directors of B Corps.

3.5 Conclusion

The purpose of this chapter was to explain the choice between regulation targeting a company itself and regulation targeting the individuals within that company.

To do so, it cast light on the increasing number of climate litigation cases being brought against corporations and beginning to be brought against their personnel. This served to illustrate the very real threat corporations are beginning to experience in regard to their climate and environmental impact/activities. While the merits of entity liability were explored, it became apparent a regime of personal liability would help bolster any shortfalls this type of regulation experienced.

Throughout the following two chapters, the pressures discussed in Chapter 2 and the opportunities for litigation discussed in this chapter will provide a framework of analysis for the for-profit social enterprise company model, the B Corp.

Chapter 4 Self-Selecting to become a (UK) "B Corp"

4.1 Introduction

The following chapter will give an insight into the rising prominence of socially oriented for-profit business models, specifically the B Corp model. This will involve an overview of the legal changes required when a company changes into a B Corp and the reasons companies may choose to become a B Corp. As Jacobs observes, 'many companies have strategically incorporated under less-traditional models that provide, or supposedly provide, them with more flexibility to consider factors other than maximizing shareholder gains, such as various sustainability concerns.'[293]

4.2 What is a B Corp?

The "B Corp" is not a new legal form provided by the law, as is the case with other sustainability/socially orientated enterprise legal forms, such as Community Interest Companies (CICs)[294] or Charitable Incorporated Organisations (CIOs).[295] Rather, it is a label on offer from a private non-profit organisation, B Lab, that existing for-profit companies, incorporated as registered companies under CA, can apply to themselves.[296]

B Lab was founded by Andrew Kassoy, Bart Houlahan and Jay Coen Gilbert in 2007. They sparked the B Corp movement which has recently 'reached [the] critical milestone…of an

[293] B Jacobs and B Finney, 'Defining Sustainable Business – Beyond Greenwashing' (2019) 37 *Virginia Environmental Law Journal* 2, 92.
[294] Defined as: 'A limited liability company designed for social enterprises which has the specific aim of providing benefit to a community and uses its income, assets and profits for the community it is formed to serve. It can be limited by shares or by guarantee but must satisfy a community interest test.' (Thomson Reuters Practical Law Glossary, *Community Interest Company (CIC)*).
[295] Defined as: 'A legal form designed specifically and exclusively for charities. CIOs are registered with the Charity Commission. They are corporate bodies with limited liability.' (Thomson Reuters Practical Law Glossary, *Charitable Incorporated Organisation (CIO)*).
[296] For more information about who B Lab are and what they stand for, see: <www.bcorporation.net/en-us/>.

inclusive, equitable, and regenerative economic system.'[297] In July 2022, the number of global B Corps surpassed 5000.[298]

The B Corp movement is comprised of a network of B Lab and Sistema B organisations. Each region or nation has its own distinct branch of B Lab (or Sistema B organisation), creating a B Global Network which shares a unified vision to implement the B Lab purpose: to 'transform…the global economy to benefit all people, communities, and the planet' and make 'business a force for good.'[299] The choice to have a distinct organisation for each region/nation was to make it easier to empower 'the B Corp movement at the local level.'[300]

B Lab UK orchestrate the B Corp movement at the UK level. B Lab UK was itself incorporated in 2015 as a Private Limited Company by guarantee without share capital, and with an exemption from the use of 'Limited' in the company's name.[301] This thesis shall focus on the distinct requirements for UK companies to become B Corps. The importance of changing from the traditional for-profit orchestration of a business is emphasised by the CEO of Patagonia, a retail company with long-standing B Corp certification, who stated, 'the B Corp movement is one of the most important of our lifetime, built on the simple fact that business impacts and serves more than just shareholders.'[302] To be entitled to acquire this label, a company must fulfil certain

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[297] A Kassoy, B Houlahan and J Coen Gilbert, 'Passing the Torch: A note from B Lab's Co-Founders' (7 July 2022) <www.bcorporation.net/en-us/news/blog/passing-the-torch-note-b-lab-co-founders> accessed 5 September 2022.
[298] *ibid.*
[299] B Lab website <www.bcorporation.net/en-us> accessed 22 April 2022.
[300] B Lab website <https://www.bcorporation.net/en-us/movement/global-network> accessed 3 September 2022.
[301] Companies House, Company number: 09388752 <https://find-and-update.company-information.service.gov.uk/company/09388752> accessed 5 September 2022.
[302] R Marcario (CEO Patagonia) quoted on B Lab website <www.bcorporation.net/en-us/> accessed 12 February 2022.

requirements – requirements specified not by law, but by their regional/national branch of B Lab.

The following subsection will detail how a company becomes a B Corp, explaining the process and various changes required of a company who is “transforming”.

4.3 The changes required to become a B Corp

In order to become a B Corp, a number of hurdles have to be surpassed. Here, it is useful to distinguish between two categories of hurdles: those that are backwards looking and those that are more future looking. The former involve B Lab looking at the past and current behaviour of a corporation, while the latter involve an enterprise making commitments to its future behaviour. Most of these future commitments must be set out in the company’s own constitution.

4.3.1 The Backwards Looking Hurdles

Provided the company ‘operate[s] for profit in a competitive market, and [has had] at least 12 months of operations,’ the initial qualifying hurdle is met.[303] To accommodate those companies who have not operated for more than 12 months, B Lab has introduced a “pending B Corp” status label, so the company is able to signify to future investors, collaborators and consumers that it acts in accordance with B Corp standards. The existence of this ‘pending’ label highlights the increasing importance being placed on more stakeholder friendly business ventures in the corporate community.

B Lab then outline a further backwards looking step requiring satisfaction. This is ‘to complete and submit the free B Impact Assessment (BIA), a confidential online tool used to measure, improve and verify [a] company’s social and environmental performance.’[304]

[303] B Lab UK website, *How to Certify as a B Corp* <https://bcorporation.uk/b-corp-certification/how-to-certify-as-a-b-corp/> accessed 25 April 2022.
[304] *ibid.*

According to their website, the BIA contains 'roughly 200 questions tailored to [a] company's size, sector and location' and 'measures [its] positive impacts on [its] workers, suppliers, community and the environment [and] includes a Disclosure Questionnaire, highlighting any sensitive practices, fines, and sanctions related to the company.'[305] 80+ points are required to achieve B Corp certification.'[306] Following this step, B Lab begin looking to the future – the following sub-section will therefore focus on these forwards looking hurdles.

4.3.2 The Forwards Looking Hurdles

In addition to the backwards looking hurdles discussed above, B Lab has created a number of what I am terming, forwards looking hurdles. These are forwards looking in the sense they are to do with future behaviours and activities of B Corps.

The first of these involves a one-off submission fee of £250 (plus VAT), 'to ensure the company's commitment to the full verification process.'[307] The same fee is required of Pending B Corps to verify their dedication to going through the changes required – so they are deterred from simply gaining the label for a year to boost revenue when they have no intention of finishing the full process.[308] This is then substantiated by an annual subscription fee and the condition that the company 'need[s] to reverify every three years, achieving a verified score of 80+ points on the [BIA].'[309]

As well as paying a fee to ensure the enterprise has a financial incentive not to renege on its new status, it is required to publish an annual impact report 'to share [its] progress

[305] *ibid.*
[306] *ibid.*
[307] B Lab UK website, *Pricing* <https://bcorporation.uk/b-corp-certification/pricing/> accessed 27 April 2022.
[308] The annual certification fees are 'calculated based on [the] company's total revenue on the last set of audited accounts,' until the company's revenue exceeds £1bn at which point B Lab UK provide customised information (B Lab UK, *Pricing)*
[309] B Lab UK*, How to Certify as a B Corp.*

and goals.' [310] The purpose of this report is four-fold: (1) to 'be transparent and accountable to [the company's] stakeholders…about the social and environmental impact [the company] are creating and planning,' (2) to 'showcase that beneficial impact is possible, and inform the wider community about best practices for achieving it,' (3) to 'encourage an open conversation between companies, stakeholders and investors' and (4) to 'help build the business case for responsible business by making data and case studies widely available.'[311] In chapter 5 the effectiveness of this report will be considered, however, for present purposes it is sufficient to outline that the purpose of the report is to ensure those outside the company are aware of how the B Corp is fulfilling its promises and the label's requirements.

Perhaps the most onerous but significant forwards looking hurdle is the way in which B Lab differentiate its label from being the same as a normal sustainability label: to qualify as a B Corp, the company must amend its articles of association. This involves incorporating 'mission-aligned legal language' into its constitution.[312] Justifying why a legal requirement is required, B Lab asserts in its explanation, that 'to distinguish a "B Corp" from other organisations, it is necessary and helpful to include a legal requirement in its constitution to strengthen the extent to which these other [stakeholder] factors can be taken into account.'[313] While every B Corp must incorporate such a legal requirement

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[310] *ibid.*
[311] B Lab UK, 'Writing an Annual Impact Report: A guide for B Corps by B Lab UK' (2019) <https://pardot.bcorporation.net/l/39792/2019-11-19/95x5kj> accessed 27 April 2022, 4.
[312] B Lab UK, 'Is it a requirement of every business looking to certify as a B Corp?' <https://bcorporation.uk/b-corp-certification/how-to-certify-as-a-b-corp/legal-requirement/> accessed 9 May 2022.
[313] B Lab UK, *The 'Legal Requirement' for a B Corp in the UK – An Explanation* (September 2018) <https://drive.google.com/file/d/1h0iswtPoGeKW3nJqwketYsXBsFKn4aG5/view> accessed 9 May 2022, [3.5].

into its constitution, for the purposes of this thesis, only those required by B Lab UK will be analysed.

B Lab UK requires applicant companies to make two crucial changes to their constitutions. The first is the inclusion of an 'objects clause'. The second is a modified version of the director's duty which is found in s172 CA. Each will be considered in turn.

4.3.2.1 Insertion of an objects clause

The objects clause which applicant companies must adopt reads as follows: (1) 'The objects of the Company are to promote the success of the Company;

(i) *For the benefit of its members as a whole*; and

(ii) Through its business and operations, *to have a material positive impact on (a) society and (b) the environment, taken as a whole*.'[314]

The wording of this objects clause, underlined above, explicitly removes any hierarchy between shareholders and non-shareholder stakeholders. The success and purpose of a B Corp is thereby affiliated and measured against the company's promotion of "both" (as highlighted above) member benefits while having a 'material POSITIVE impact on society and the environment.'

A potential problem with the drafting of the objects clause lies with its lack of clarity. More specifically, this relates to the ambiguity surrounding whether there is a single purpose or whether it offers two different purposes. As the explanatory notes accompanying the directors' duties in the CA claim, 'it is very important that directors

[314] B Lab, 'United Kingdom: Company Limited by Shares Legal Requirement' (*B Lab Global,* 2022) <www.bcorporation.net/en-us/legal-requirement/country/united-kingdom/corporate-structure/company-limited-by-shares/> accessed 5 January 2022 (italics added).

understand the purposes of the company, so that they are able to comply with their [duties under s171 and s172].'[315]

If one accepts that there is a single purpose – namely to make the company a success – the realisation of this is dependent on two things that will be instrumentally relevant. The first of these is ensuring a benefit for members. The second is to ensure a social and environmental benefit. Therefore, for any decision – whether to switch to a greener, but more expensive, fuel for example – directors must do what will "make the company more successful". In working out which decision will indeed make the company more successful they will be required to factor in the impact each decision would have on both members and on society and the environment. Such a view retains the same consequentialist approach currently seen in s172, except that it also now treats the impact on *members* in consequentialist terms as well.

Alternatively, the objects clause could be interpreted as offering two different purposes. One being to make the company successful (for the benefit of its members) and the other, to have a positive social/environmental impact. If this is the case, there may be a problem when the two purposes conflict or there is a tension between them. It could simply be saying that both purposes are legitimate, so either may be pursued in any – and indeed in every – decision. Therefore, it could be argued that it would be of no importance that through pursuing purpose 1, purpose 2 could no longer be achieved. Even if through pursuing purpose 1, purpose 2 was made even more difficult to achieve in the short or long term. Under this argument, purpose 1 would still have been achieved and hence the

[315] UK Public General Acts, 2006 c. 46, Explanatory Notes, Territorial Extent and Devolution, Chapter 2, 'Relationship between the duties and the company's constitution', [317].

directors would have fulfilled one of their obligations: company success or having a positive social/environmental impact.

On the other hand, neither of these interpretations may be correct and a completely alternative, better reading exists. Without a clear precedent, this question remains an open ended one, which is entirely subject to the interpretation of the individual(s) making a judgement.

4.3.2.2 Changing the directors' duties

The second constitutional clause that must be adopted amounts to, as noted above, a restatement, with modifications, of the duty of directors found in s172. It states:[316]

> *(2) A Director must act in the way he or she considers, in good faith, most likely to promote the success of the Company in achieving the objects set out in paragraph (1) above, and in doing so shall have regard (amongst other matters) to:*[317]
>
> *a. the likely consequences of any decision of the Directors in the long term and the impact any such decision may have on any affected stakeholders,*[318]
>
> *b. the interests of the Company's employees,*
>
> *c. the need to foster the Company's business relationships with suppliers, customers and others,*

[316] B Lab, 'United Kingdom: Company Limited by Shares Legal Requirement' (highlight added to illustrate the new language added by B Lab UK).
[317] The statutory s. 172 wording reads: 'for the benefit of its members as a whole' as opposed to success being affiliated with the B Corp objects clause.
[318] The highlighted part is added to the statutory s172 wording.

d. *the impact of the Company's operations on the community and the environment and on affected stakeholders,*[319]

e. *the desirability of the Company maintaining a reputation for high standards of business conduct and the impact this has on affected stakeholders, and*[320]

f. *the need to act fairly as between members of the Company,*

(together, the matters referred to above shall be defined for the purposes of this Article as the "Stakeholder Interests" and each a "Stakeholder Interest"). '[321]

By repeating similar language to the CA, B Lab is able to provide some clarity and certainty to the factors it believes directors should be promoting. There are two key differences which become apparent when comparing the B Corp articles to the statutory duty. The first of these relates to the directors' duty to promote the company's success – namely, "success" must now be defined in accordance with 'the objects of the company', as set out in the company's constitution. As we have just seen, above, the broad thrust of the stated objects is to achieve a genuine balancing of interests between shareholders and stakeholders. However, the precise meaning of the wording is unclear. This lack of clarity in the meaning of the company's stated objects inevitably infects the amended statement of the directors' duties, which 'piggybacks' on the company's objects clause. The second difference focuses on certainty – the interests of stakeholders are more clearly sign-posted as factors directors should have regard to while promoting the company's success.

[319] *ibid.*
[320] *ibid.*
[321] *ibid.*

The meaning to be given to the restatement of the duty in s172 is further clarified by a third clause which B Corps must incorporate into their constitutions. This third clause reads as follows: directors acting in 'good faith' 'shall not be required to regard the benefit of any particular Stakeholder Interest…as more important than any other.'[322]

Rather than relying on the nuances of clause (1), B Lab explicitly introduces a clause apposite to shareholder primacy – the hierarchy automatically granted to shareholders in the UK, is undermined. By choosing to become a B Corp, introducing this language into the articles of association, the directors of these companies are obliged to balance all stakeholder interests when performing their s171 and s172 duties: promoting the success of the company and not deviating from its constitution and purpose.

4.4 Why companies might choose to register as a B Corp

On the surface level, the main attraction, for a company itself, in becoming a B Corp seems to be the acquirement of a label certifying the company's social and environmental credentials. As an easily recognisable mark known throughout the market, it serves as a signalling mechanism to all its stakeholders, including potential investors, customers and the government. The B Corp label provides clarity to the 'sheer volume of definitions, rankings, and rating systems' in existence, acting as a clear metric for external stakeholders.[323] As Jacobs and Finney observed in their study on different "sustainability" claims, 'the term ["sustainable" has] broad contours [that] encompass many, disparate dimensions, including all, or some combination of, environmental, employment, social, financial, and governance concerns,' and as a consequence, there is 'definitional ambiguity [that] poses many risks for businesses, e.g., the risk of inconsistencies,

[322] *ibid.*
[323] Jacobs and Finney, 'Defining Sustainable Business', 95.

consumer and investor confusion and misunderstanding, and claims of greenwashing.'[324] This links to discussions in chapter 2 where it was illustrated that a key issue with the pressure exerted by the media is that it is uncertain whether their declarations and online company declarations about their environmental impact are reliable. It is widely accepted that the attractiveness of the B Corp label, in part relates to this ambiguity, as Vieira asserts, 'the legal form is definitely being used as a kind of social branding.'[325]

In other words, the benefit of the B Corp label is that it is indicative of actual legal change being adopted and as such, it is a less fickle indication of a company's dedication to stakeholders and the environment. Linking in part to the ambiguities surrounding "sustainability" a major problem with our current system is the prevalence of greenwashing. As the creator of The True Cost[326] documentary noted in his discussion of what inspired his delving into the fast fashion industry's cost to society and the planet, there is a real danger of 'misinformation' because companies have come to realise the necessity of appearing sustainable to entice consumers and investors into purchasing from their company.[327] This they are able to do by 'giv[ing the] impression they're on the vanguard' of sustainable business ventures through their advertising and marketing techniques.[328] Through truly changing their articles of association, incorporating sustainability into their very core, consumers and potential investors can rely on B Corps to truly "practice what they preach". As Morgan asserts, from a public image standpoint,

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324 *ibid.,* 129.
325 H Vieira, 'How beneficial are benefit corporations?' (Business Review: LSE Blogs, 21st February 2017) < https://blogs.lse.ac.uk/businessreview/2017/02/21/how-beneficial-are-benefit-corporations/> accessed 9 December 2021.
326 A Morgan, M Siegle, S McCartney, L Firth, V Shiva and D Blickenstaff, *The True Cost* (2015).
327 C Ames, *What is the True Cost of the Fashion Industry? (Has it Changed?) with Andrew Morgan* (The Social Entrepreneurship & Innovation Podcast, 14th December 2021) <www.socialentrepreneurship.fm/200-true-cost-of-fashion/#play> accessed 27 April 2022, 00:30.
328 *ibid.,* 00:31.

one must have the means to work out 'what is actually systemically changing versus what is just dressed up': the B Corp label enables this differentiation.[329]

Through containing an explicit clause in a constitution about a company's "purpose", Campbell and Yeung would argue that an entity is given 'direction', 'legitimacy' and 'motivation.'[330] This, Lambooy et al., maintain is a necessity, and a definite benefit of B Corps; they recommend 'that company purpose is made explicit, so as to avoid *'de facto'* adherence to maximising shareholder value with a short-term focus.'[331] As their study concluded, 'legal instruments such as including an explicit societal value creation aim into the company purpose in the articles of association can function as the 'stick' needed to help boards to make sustainability a business-critical issue, and thus [enhances] the capacity for long-term value creation of the company.'[332] This same sentiment is shared by Stubbs who, quoting Schaltegger et al., asserts that 'if a company wants to improve its sustainability performance, it has to change its business model such that environmental and/or social objectives are integrated into the core business logic, resulting in business models with a "fundamentally new logic of doing business on the basis of solving environmental and social sustainability problems."'[333]

It is thereby clear a consensus exists regarding the benefits of real legal change, as opposed to a company simply signing up to a voluntary agreement, for which they cannot be held accountable.

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[329] *ibid.,* 00:32.
[330] A Campbell and S Yeung, 'Creating a sense of mission' (1991) 24 *Long Range Planning* 4, 10-20.
[331] T Lambooy, A Argyrou and S Tideman, 'Enabling Company Boards to Create Sustainable Companies: The Connection between Sustainability, Company Leadership and Law' (2020-22) *University of Oslo Faculty of Law Legal Studies: Research Paper Series,* 55.
[332] *ibid.*
[333] W Stubbs, 'Strategies, practices, and tensions in managing business model innovation for sustainability: The case of an Australian B Corp' (2019) *Corporate Social Responsibility and Environmental Management,* 1064.

4.5 Conclusion

This chapter has focussed on the changes required of a company when they wish to acquire B Corp certification. Throughout the following chapter, the impact of these changes on the behaviours of the company's directors will be analysed. It will query whether the results from the pressure framework of chapter 2, and the regulatory liability framework of chapter 3, change when a company becomes a B Corp. Through changing, the company makes 'a public commitment to [B Lab's] values;'[334] a change which is supposed to incorporate the fact that 'at the heart of a B Corp's constitution is the "triple bottom line".'[335]

[334] B Lab UK, 'Writing an Annual Impact Report', 4.
[335] B Lab UK, *The 'Legal Requirement' for a B Corp in the UK,* [3.7].

Chapter 5 Does Self-Selection into a B Corp actually change a company's (i.e., its directors') approach to its environmental impact?

5.1 Introduction

This chapter analyses how effective changing into a B Corp is likely to be in improving the environmental footprint of a company and its subsidiaries. To do so, it builds on the foundations laid down in chapters 2 and 3.

Following the framework of chapter 2, it looks at the various forms of pressures exerted on the decision makers of a company (the directors), and analyses in what ways these pressures are likely to change as a result of the company becoming a B Corp. It will also draw on the lessons learned from chapter 3's analysis of regulatory action. More specifically, it considers how far the change to a B Corp increases the likelihood of directors facing personal liability for their company's breach of corporate environmental regulations. This will involve hypothesising about the different approach the judiciary could have to a company and its directors if they choose to amend its articles of association to become a B Corp. As Hutley observes, 'the exposure of individual directors to "climate change litigation" is increasing, probably exponentially, with time,'[336] and as such, 'company directors can, and in some cases should be considering the impact on their business of climate change risks, to the extent they intersect with the interests of the firm.'[337]

In particular, this chapter will be looking at how B Corps are constrained, focusing on the constraint's lack of universal application, its content and enforceability. Ultimately, it will be argued that the B Corp model, requiring a definite legal change in a company's constitution, may be impossible to introduce for wider adoption in the fast fashion

[336] Hutley and Hartford-Davis, *SUPPLEMENTARY MEMORANDUM OF OPINION,* [9].
[337] *ibid.,* [2].

industry, as these companies would have to entirely amend their business operations; the very nature of fast fashion being incongruent with sustainability.

5.2 Is the substance of the constraint, that a B Corp accepts, sufficiently demanding?

As discussed in the previous chapter, two legal constraints are imposed on a B Corp through amending its articles of association. The first is the inclusion of a corporate purpose. The second is the change made to the directors' duties, specifically the amended language of s172 and, due to the purpose and constitution of the company changing into a more stakeholder-centric enterprise, the correlative s171 duty.[338]

5.2.1 What does s172(1) say and mean for a B Corp?

A key legal question regarding the substance of the constraint imposed on B Corps is the following: given the duties in the CA are mandatory legal rules that, in the absence of express statutory permission, cannot be changed, can the inclusion of some constitutional language legally alter the directors' duties and thereby impose a sufficiently demanding constraint on a company's, and its directors', activities? Such a change could have an impact on the internal pressure of the directors' duties, discussed in chapter 2, and thereby change how directors approach the question of pursuing stakeholder-interests as opposed to purely profit maximisation schemes.

To begin this analysis, it is useful to work out which duty the directors owe – i.e., the s172(1) duty, as stated in statute, or the 'modified section 172 clause' (set out in chapter 4).

Although there is no statutory provision stating that 'the duties in ss.171-177 are mandatory and cannot be modified or excluded,' it is presumed that a duty is mandatory

[338] s. 171 CA: 'A director of a company must - (a) act in accordance with the company's constitution, and (b) only exercise powers for the purposes for which they are conferred.'

unless, and to the extent that, it expressly permits variation or exclusion.[339] The argument in favour of understanding these sections (from ss171-177) in this way is the fact that each is expressed as "a duty," rather than as, for example, a right.[340] As such, each duty takes the form of "a director must XYZ."

On this basis, the drafters of a company's constitution cannot replace the duty found in, say, s172 by an alternative provision of their own choosing, unless s172 itself expressly says this wholesale replacement is permissible. And s172 says no such thing. The assumption then, that a B Corp can replace s172 with a different provision of its own drafting seems incorrect.

Nevertheless, s172 does expressly allow for a *degree of variation* in the content of the duty found in s172(1). More precisely s172(2) reads: 'where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.'

Since a B Corp clearly will have, by virtue of its amended constitution, 'purposes other than the benefit of its members', s172(2) will apply. Consequently, the duty imposed on the directors of the B Corp, under s172(1) will now be modified in the way described in s172(2). However, the directors' duty is still that found in s172(1), albeit with the modification required by s172(2). The directors' duty is not that found in the B Corp's own constitution.

339 Note how, for example, s172 clearly does so through s172(2).
340 The case *Fulham v Richards* shows that other provisions that are not expressed as legal duties may be interpreted as therefore being excludable (*Fulham Football Club (1987) Ltd v Richards* [2011] EWCA Civ 855).

It must then be asked how a court would interpret precisely what the modification to s172(1), which s172(2) introduces means. No court has done so yet. Two possibilities suggest themselves.

First, the court might decide that s172(1), interpreted in the light of the company's statement of purpose, imposes on directors a duty identical to the wording found in the B Lab restatement of the directors' duty, including all the references to stakeholders. In other words, the B Lab restatement has effectively 'done the court's interpretive job for it', articulating precisely how s172(1) is to be read for a company with a B Lab purpose.

However, it certainly is not inevitable or obvious that a court would reach this conclusion. For, secondly, the court might do its own interpretive work, and decide that s172(1), when interpreted in the light of the company's purpose, still has a meaning far different from the B Lab statement. How significant this would be is questionable, however, the court might decide that s172(2) has no impact on 'stakeholder interests' being made a priority in the matters to which directors must have regard. Though, it is interesting to note that it would still clearly remove the 'hierarchy' of member interests above all others.

Taking this further, moving beyond exactly what s172(1) would mean for a B Corp, what is clear is that it would still be a 'subjective' duty. Therefore, whatever changes it makes to the wording of s172(1), directors are still only required to achieve these in good faith – i.e., they will only breach the duty if they have no belief that their actions will achieve the constitutional purpose. Though discussing benefit corporations,[341] as opposed to B Corps, Reiser notes how when a company changes into a non-traditional for-profit

[341] 'A benefit corporation is a [USA and Canadian] legal tool to create a solid foundation for long term mission alignment and value creation' (B Lab United States & Canada, *Benefit Corporations* <https://usca.bcorporation.net/benefit-corporation/> accessed 18 September 2022).

corporation, 'the statutes offer little guidance to shareholder or fiduciaries on the thorny issue of how profit and social good should be balanced. They allow directors to forgo profit maximisation in favour of social good production or vice versa, but they do not instruct directors on how to exercise this broad discretion.'[342] In this sense, some of the restrictions placed on B Corps are minimal, as it is up to the directors to use their discretion in interpreting how to achieve the purpose.

5.2.2 What does s171 mean for a B Corp?

It must next be ascertained what the s171 duty means for a B Corp. B Lab UK make no attempt to change the statutory wording of s171, however, the statutory wording (of s171) does itself reflect each company's constitution.

This could thereby have a corresponding effect on s172. While the duties are separate, a 'defence' that is available under s172 is not available under s171. Under s172, even if its stakeholder elements have been increased by the constitutional changes noted, it is not likely to make much difference. This is because of the 'good faith' defence – it will remain a subjective duty. Thus, directors who fail to adjust their behaviour to reflect those increased stakeholder elements are still unlikely to be found in breach of their s172 duty.

However, it might be argued that liability under s171 is now much more likely. S171 has no 'good faith' defence. This has no relevance to s172. But it does mean that if directors who were still exclusively focusing on profit were sued under s171 instead, they might seem to be more likely to face liability – given the absence of a good faith defence.

On paper, this seems rather likely. However, in practice, judges prefer to defer to directors, and they will be reluctant to forgo that deference simply because a claim is

[342] D Reiser, 'Benefit Corporations - A Sustainable Form of Organization' (2011) 46 *Wake Forest Law Review* 3, 612.

brought under s171 rather than s172. Courts will be reluctant to reintroduce overly prescriptive judicial intervention through reinterpreting s171; the directors are *directors* because of their commercial experience and expertise.

Having explained how the legal rules have changed for directors, it needs to be queried if these changes are large: i.e., how restrictive they are. The one definite conclusion is that they are certainly now more about balancing – not prioritising stakeholders, but also no longer prioritising shareholders – albeit within the directors' subjective opinions.

The remainder of this chapter will discuss the feasibility of whether this "new duty" can be enforced and if so, by whom and to what extent. This will have a direct impact on how restrictive this clause is. If it changes the threshold for judicial intervention or grants rights to non-shareholder stakeholders, the constraint could be extremely restrictive, exerting a strong pressure on the directors to prioritise stakeholder interests over profit maximisation.

5.3 Can the constraints in ss171 and 172 be legally enforced?

As a private label certifying corporations' new statuses as B Corps, enforcement partially rests with B Lab. Section 5.5 will discuss B Lab's role in enforcing the constraints, however, the present section looks at the possibility of legal enforcement.

The purpose of this section is to evaluate the extent to which an individual/entity could try to invoke their rights, if they believe a B Corp is neglecting or breaching its articles/duties. As this has not occurred before, it is important to note this analysis is hypothetical. However, the ways in which this could theoretically be done involves either of the legal changes required by B Labs: one route looks at the breach of a company's purpose and the other looks at the breach of the newly formulated duties. Throughout this section, the problems that arise, especially related to the enforcement of the newly formulated duties will feature prevalently. It will be argued that the UK's current formation of the CA fails to provide adequate protection to the stakeholders of B Corps.

5.3.1 Enforcement of the change to its stated purpose

The first issue is whether, through incorporating the new B Corp articles into a company's constitution, the purpose has changed sufficiently to be understood as an objects clause that explicitly restricts the actions of directors and the company. According to statute, 'unless a company's articles specifically restrict the objects of the company, its objects are unrestricted.'[343]

It seems clear that the 'purpose clause' a B Corp must include in its constitution is indeed an objects clause that restricts the company's objects. Assuming this is correct, the question arises about how this clause can be enforced. Essentially, there are two ways it can be enforced. One way – already alluded to above - is as an action against directors for breach of duty. If directors fail to respect the purpose provision, they risk breaching the duty found in s171(a) – the duty to 'act in accordance with the company's constitution.' This first way of enforcing the constitutional purpose clause will be discussed in greater detail in 5.3.2 below.

The second way the clause could be enforced is through an action under s33 CA. S33 says that 'the provisions of a company's constitution bind the company and its members…as if there were covenants on the part of the company and of each member to observe those provisions.' So, action could be taken, *against the company* itself, to insist that *it* follow its stated purpose.[344]

[343] Section 31(1) CA.
[344] Recall, that chapter 2 briefly discussed this form of action in 2.3.2 in the context of a pressure exerted on directors pushing them towards prioritising shareholder interests.

It is worth noting that this form of enforcement would constitute a form of 'entity liability': proceedings would lie against the company itself, not against its directors. In chapter 3, I observed that entity liability often fails to achieve improvements in corporate behaviour because such liability for the company is not 'transferred' onto the shoulders of those who actually decide how well (or how badly) the company will behave. However, this criticism would not apply here. This is because enforcement of s33 does not entail a threat to the company's profits, with the hope that this threat may induce better behaviour. Rather, the typical remedy that follows enforcement action under s33 is an injunction, compelling the company to act in accordance with the constitution. Given this very strong form of order, enforcement of s33 ought, in theory, to result in clear changes to corporate behaviour, even though it is directed 'only' against the company, and not personally against directors.

It should be immediately observed that, under s33, only members can take such enforcement action. Third parties would have no right to enforce the purpose clause in this way. But, as was discussed in the context of the ClientEarth/Shell derivative proceeding, there is a possibility for NGOs or activist shareholders to buy a single/minimal share in the corporation, thereby giving them standing to bring such a proceeding.

In an ordinary, for-profit company, the company's constitution will not typically say 'the company must put its shareholders' interests first'; and so, the shareholders' power to, specifically, enforce the articles is not really that relevant to whether such a company will be run in a shareholder primacy or stakeholder way. Hence little emphasis was placed on this route in chapter 2. However, in a B Corp, there *will* be a provision in the articles saying what the company's purpose is. Each shareholder's right to enforce the articles may therefore seem to be of more relevance.

Taking the perspective that this object's clause makes a difference, analysis could be structured in the follow way. For a B Corp, any stakeholder-friendly individual/entity can buy a single share in such a company. If they feel the stated purpose, with its *genuine* commitment to stakeholders, is not being met on some occasion, they could then bring a 'personal' action under s33 to enforce the constitutional purpose provision. The court would be bound to agree with the shareholder and would have to injunct the company against pursuing the contested, stakeholder-unfriendly, action. It is also interesting to note that by proceeding in this way, the shareholder would avoid the pitfalls faced if, instead, they brought a derivative claim for the directors' breach of duty in ignoring the articles, e.g., under s171 or s172 (discussed in the following section 5.3.2).

If this argument were accurate, the pressures exerted by shareholders on a B Corp become much more significant: shareholder control rights would be a very significant pressure pushing the directors towards stakeholding. This would occur because any single shareholder with a concern for stakeholders would be allowed to ensure that the company/its directors genuinely followed the stakeholder-friendly purpose of the B Corp.

However, this argument exposes itself to a number of issues undermining its strength.

One of these lies in my analysis contained in chapter 4, namely that this purpose clause itself is not entirely clear about how many or what the actual purpose of a B Corp is. Unless a company restricts its activity through an objects clause in its articles, then their activities remain unrestricted. Even when a company has incorporated an objects clause, provided the decisions of the directors are roughly in line with this objective and they are acting in good faith, little cause of action could arise. In the case of B Corps, B Lab explicitly explains that the directors have the authority to act in the way they believe will achieve *one* or all of the company's "purpose(s)": note that this will be discussed in greater depth during discussions of the annual review (5.5.1).[345]

As such, it is uncertain how a court may approach such a provision if there is ambiguity around what the purpose clause truly entails, especially if the directors can prove they have been acting in good faith. Therefore, in practice, it can easily be argued that this change to the stated purpose of the company would be difficult for a shareholder to enforce through s33. Thus, the pressure *actually* exerted on directors by this enforcement measure would be minimal; it would be unlikely to, in itself, push them towards pure stakeholderism if they are simply required to fulfil one or more of the purposes as one of these is to ensure the company is successful for the benefits of its members.

5.3.2 Enforcement of the changes to the directors' duties

Of relevance to the enforcement of the changed B Corp directors' duties, are the potential issues that could derive from one of the personal liability actions discussed in chapter 3: the derivative claim procedure.

The traditional approach adopted towards derivative claims was detailed in Chapter 3. Building on this, this subsection will explain how the problems already in existence for derivative proceedings are exacerbated in the context of B Corps, particularly the rules related to standing. The UK judiciary's approach to social enterprise/not-for-profit enterprises will also be discussed, as in their current approach, the derivative claim

[345] B Labs, 'The 'Legal Requirement' for a B Corp in the UK – An Explanation' (2018), 3.12.

appears to fall short of protecting these companies and their stakeholders from the actions of their directors who continue to pursue ventures motivated by profit.

5.3.2.1 Standing Issues

The first problem with the current standing rules on derivative claims is the legislative requirement that only 'a member of a company,' i.e., a shareholder, has standing to bring this sort of action.[346] As was detailed earlier in this chapter, the B Corp legal amendment to an enterprise's articles of association makes a point of equalising the interests of shareholders and other stakeholders. Consequently, it would seem a logical conclusion to believe that, as no stakeholder group is prioritised above another, the company affects each stakeholder equivalently and hence, non-shareholder stakeholders should be able to bring this form of proceeding.

In a normal for-profit scenario, the standing rules make more sense because the shareholders are both prioritised by the directors' duties (s172(1)) and are residual claimants. As Keay describes, shareholders are residual claimants 'in that, they will benefit if the company's fortunes increase, but they will lose out if the company hits hard times (with their claims being last in line if the company is liquidated), and in their capacity as residual claimants they have the greatest stake in the outcome of the company.'[347]

Of crucial importance to this debate is the inclusion of clause 4 of the B Corp UK legal requirements: 'nothing in this Article express or implied, is intended to or shall create or grant any right or any cause of action to, by or for any person (other than the

[346] 260(1) CA.
[347] Keay, 'Company directors behaving poorly', 657.

Company).'[348] Consequently, non-shareholder stakeholders have no standing to bring a derivative claim against a director of a company that breaches these articles. This feeds into the question of whether the incorporation of "B Corp articles of association" truly amounts to real change. As Strine observes, 'a sceptic might wonder whether boards can in fact make this choice [between shareholder interests and those of other stakeholders] even if they want to do so, because only stockholders are given rights under the statute.'[349] Even in a B Corp scenario, if no stakeholders can bring proceedings against the board of directors for, for example, ineffective climate mitigation as their "B Corp" duties entail, 'there is a legitimate concern that the investors will simply abandon their principles and demand that the board go with the highest price in the end-game scenario.'[350]

Nass voices the same sentiment, namely that 'while the legislation gives shareholders a cause of action, it prevents consumers and other members of the public from enforcing the company's dual-purpose beyond boycotting the company's products or services. This presents something of a moral hazard that creates an opportunity for greenwashing that the legislation should seek to prevent.'[351] Providing evidence of this assertion, Nass reports how 'consumer behaviour has a significant effect on the socially conscious corporations themselves, as 72% of companies with environmental and social policies outperform the general stock market.'[352] In other words, 'those with the greatest interest

[348] B Lab, 'United Kingdom: Company Limited by Shares Legal Requirement' (*B Lab Global,* 2022) <www.bcorporation.net/en-us/legal-requirement/country/united-kingdom/corporate-structure/company-limited-by-shares/> accessed 5 January 2022.
[349] L Strine, 'Making it Easier for Directors to "Do the Right Thing"?' (2014) 4 *Harvard Business Law Review* 235, 246.
[350] *ibid.*
[351] M Nass, 'The Viability of Benefit Corporations: An Argument for Greater Transparency and Accountability', (2014) 39 *J Corp L* 875, 887.
[352] *ibid.,* 877.

in ensuring that the company does good have the least power to enforce it.'[353] Instead, 'traditionally profit-motivated shareholders' wield the ultimate authority to bring an action.[354]

However, whilst the preceding points have much force, they miss an important consideration. As has recently been seen with the ClientEarth/Shell litigation, it is possible for an NGO or non-profit company to buy a minimal holding in a company – at least if it is a larger or listed company. This socially or environmentally orientated shareholder would thereby gain standing to bring a derivative claim. This possibility guarantees that B Corp directors are not safe from derivative claims simply because no concerned non-shareholder stakeholders have standing to bring an action.

Moreover, as is increasingly the case, shareholders choosing to invest in these types of company, are doing so *because* of their B Corp credentials. Even if this turned out to be part of a wider scheme for the investing company/shareholder to greenwash their activities, they will still be concerned with the continuation of the B Corp label they chose to invest in. This can be seen with the example of Danone who have recently declared their intentions to only invest in and acquire B Corps – with the ultimate aim of themselves becoming the largest B Corp in existence. It is therefore likely that these investors could choose to bring a derivative suite, even though the traditional shareholder is associated with wealth maximisation - to ensure their public image remains intact as an investor in a company that promotes sustainability.

Hence, though standing is excluded for wider stakeholders, one cannot exclude the possibility of a derivative claim on this ground because of, as seen with ClientEarth, the

[353] Blodgett et al., 'Benefit Corporation Governance', 243.
[354] *ibid.*

likelihood that a smaller holding is purchased by an activist company for the very reason of bringing a derivative suite. The effect of this is amplified by the other prospect that a large majority of the shareholders investing in B Corps are doing so because of a genuine interest in improving their sustainable credentials or to improve their public image: both result in an investor motivated to keep the B Corp on track.

This section will next consider how the hypothetical director requirements of derivative claims (263(2)(a) and 263(3)(b)) could be interpreted differently for B Corps in light of the re-formulated "172 duty" and how this could be a disincentive for companies considering legally changing into a B Corp if the directors could be held to a new, uncertain standard.

5.3.2.2 The derivative claim proceedings and interpretation for B Corps

As chapter 3 outlined the process of a derivative claim (in section 3.4.3.2.2), this section will instead discuss the issues that arise for untraditional for-profit organisations. The UK judiciary's general approach to socially and environmentally orientated enterprises seems to place very little emphasis on the fact they have converted away from the traditional for-profit company format.

This is explicitly made clear in *Stimpson* where the judge, when discussing whether to permit the derivative claim against the company's directors, asserted: though 'paragraph (f) [of the company's articles] provides for a purpose other than the benefit of the members,' 'the objects other than those that provide directly for the benefit of the company's members are very much the minority.'[355] As such, it was made clear that factors and interests unconnected to those of the shareholders were inconsequential to the proceedings: other factors were given greater priority. This position is further

[355] *Stimpson v Southern Landlords Association* [2009] EWHC 2072 (Ch), [27].

confirmed by the cases of *Langley Ward*[356] and *Parry v Bartlett,* which Keay notes are the only cases mentioning the 172(1)(a)-(f) factors.[357] Therefore, he concludes, 'given the fact that the provisions in the statutory scheme involving [172] are not the subject of significant comment in the case law, that the aforementioned factors are going to be considered infrequently.'[358]

Consequently, how the judiciary approach a B Corp may be no different from the way they approach the average for-profit corporation. As such, the judiciary would seem to give discretion to the commercial prowess of the directors. Their specialised knowledge and experience in the sector they work within would be given deference: as was maintained in chapter 3, the judiciary shy away from giving commercial judgements, rather their aim is to give a judgement on the existing laws and precedents. Therefore, it can be assumed they would not give permission for the derivative claim based on the directors' decision to pursue a business venture that disregards one of the corporation's stakeholder "purposes".

If one takes this to be the case, it is clear the current UK system is ill-fitting for derivative proceedings against the directors of B Corps and socially/environmentally orientated companies. By approving the amendments made to the articles of association, shareholders of these companies, and potential investors, should ideally be able to rely on the fact that if a director is misusing their power – for example, choosing to pursue a financially rewarding business venture with detrimental consequences for the environment, or alternatively, a business venture that only promotes the environmental

[356] *Langley Ward Ltd v Trevor & Anor* [2011] EWHC 1893 (Ch).
[357] [2011] EWHC 3146 (Ch).
[358] Keay, 'Applications to continue derivative proceedings on behalf of companies', 350.

footprint of the company, disregarding the employees – they should have grounds to bring a derivative proceeding on behalf of the company to protect it.

5.3.2.2.1 The hypothetical director tests

Conversely, if one takes a different stance, instead arguing that the change in articles could precipitate a change in the approach of the judiciary, focusing on the fact a B Corp's directors' duties are amended to remove any hierarchies between stakeholder interests, it is interesting to hypothesise how the derivative claim procedure could change. This discussion relates majoritively to the two hypothetical director test considerations.

As was discussed in chapter 3, the judiciary's approach to the hypothetical director tests is from the perspective of s172, assessing whether they believe the company's directors would choose to pursue the derivative claim because it would be beneficial to the success of the company. When an essentially new s172 duty is incorporated into a B Corp's articles, however, this assessment could be thrown into flux, as the directors of B Corps have legally accepted to constrain their activities and instead abide by a s172 duty which doesn't prioritise shareholder interests in the promotion of the success of the company. "Success" is instead affiliated with the overall promotion of the company's objects and the appeasement of all its stakeholder interests. As such, an hypothetical director of these types of companies should forgo profitability if all other stakeholder interests are benefitted – no stakeholder interest is meant to trump that of another.

Theoretically, this could therefore change the way the judiciary consider the hypothetical director tests in a derivative proceeding. Unlike *Langley Ward*[359] and *Parry,* they should note the company has chosen to make a legal change to how they were incorporated and

[359] [2011] EWHC 1893 (Ch).

as such, how s172 is understood by the company.[360] The pressure then exerted on the directors of these companies would then be far different from the conclusion of chapter 2. They would be encouraged to avoid any possibility of a derivative claim proceeding occurring because how the judiciary will interpret their role as an hypothetical director would be open to ambiguity: they, as directors, could be held to a higher level of responsibility for stakeholders.

5.3.3 The other internal personal liability mechanisms and B Corps

While the above section has focused on the personal liability mechanism for breaches of duty, it is also worth briefly commenting on whether the other two mechanisms discussed in chapter 3 would change in a B Corp context. These two mechanisms are firstly, if the director would be more likely to be sacked if they fail to comply with existing corporate environmental regulations. Secondly, if the directors would be more likely to lose salary or their bonuses if they fail to keep their companies compliant.

For each mechanism, there is nothing about B Corp certification that suggests there will be any impact on how these two internal personal liability mechanisms play out in practice. Therefore, no further consideration of these two mechanisms is required.

This subsection was simply to illustrate that by becoming a B Corp, the directors would not expose themselves to any increased or decreased liability in regard to the other two avenues of personal liability discussed in chapter 3.

5.4 Pressures shareholders can exert that are unrelated to legal-enforcement mechanisms

This chapter has so far outlined how activist shareholders could, in an hypothetical scenario, bring legal action against the directors personally for failing to uphold their

[360] [2011] EWHC 3146 (Ch).

promises to protect the environment. For example, they have the opportunities to enforce the constitution (s33) and bring a derivative claim for a breach of duty by the directors. Thus, it would seem that shareholders are able to have a critical and active role in a B Corp's existence provided they are prepared to ultimately bear the costs of bringing such liability proceedings.

There are a number of other shareholder powers discussed throughout chapter 2 which will now be briefly analysed to assess whether, in the context of a B Corp, they push directors towards prioritising stakeholder interests over profit maximisation. As these derive from their positions as shareholders, they do not come with the consequences of legal enforcement proceedings that usually take large amounts of effort and time, at significant financial expense.

It was ascertained in chapter 2 that shareholders, through their position as shareholders in a company, have authority to remove a director,[361] powers to reject any tenure lasting over 2 years[362] and rights to approve directorial remuneration.[363] As such, it was concluded that directors were directly tied to shareholder approval ratings because their finances and job security were under direct shareholder control. Such a position remains unchanged in a B Corp scenario. Therefore, the shareholders continue to wield a large proportion of power that they can exert over their directors to pressurise them towards pursuing their interests.

[361] s.168 CA.
[362] s.188 CA.
[363] s.226B(2) The Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019.

However, unlike the normal for-profit entity example discussed in chapter 2, in the case of B Corps, it is possible that the shareholders chose to invest in that particular company because of its credentials *as a B Corp*.

Moreover, with the feasibility that NGOs or activist stakeholders could purchase minimal shares in a B Corp that is failing to uphold its promises as a B Corp, it cannot be concluded with certainty that the shareholder powers – both through their legal enforcement opportunities and their rights, deriving from their positions as shareholders – would pressurise directors towards pursuing profit maximisation schemes as opposed to pursuing ventures that prioritise stakeholder interests.

What can be concluded is that the pressures exerted by the shareholders of a B Corp will still push directors along the continuum of shareholder primacy maximisation. It just is not certain whether the shareholder interests will be for pure profit maximisation. As such, this pressure remains slightly uncertain because it could push directors towards stakeholding or, conversely, push them towards profit maximisation.

5.5 Will the constraints be "enforced" by B Lab?

Another question about the constraints imposed on a B Corp is whether, and to what extent, it will be enforced by B Lab. If, as the previous section noted, non-shareholder stakeholders have very limited opportunities to bring enforcement proceedings against a B Corp and/or its board of directors, they are heavily reliant on B Lab exercising a certain degree of oversight.

There are three main ways in which B Lab is able to bring enforcement measures against companies who are in breach of their B Corp label, each of which is a form of enterprise liability and helps non-shareholder stakeholders gain a clear picture of what the B Corp in question is doing. These measures take the form of (1) the annual review, (2) a public complaints process and, (3) the termination of B Corp certification. It is useful to acknowledge how each of these provides a pressure on the directors of a B Corp as, as was discussed in chapter 2, reputation and corporate image are a crucial part of a company's business model if they want to maintain and increase consumers and investors. Thereby, B Lab may be able to manipulate the pressures exerted by stakeholders on B Corp directors – either encouraging them to take a stance against the corporation in question and e.g., blockade them, or paint a positive perspective of them.

5.5.1 The Annual Review

Once a company has become a B Corp, B Lab requires it to produce an annual report describing how it has fulfilled its obligations as a B Corp – for example, how it has contributed to the B Lab mission of making a positive material impact on society and the environment.

A potential problem with the annual review being considered an effective enforcement measure, is that it calls for a comply or explain retort. Historically, a number of legal theorists have argued that a key contention with the enforcement of e.g., the Corporate Governance Code, making its provisions less effective, is the fact its enforcement relies solely on the notion of "comply or explain." For example, Armour describes how this practice 'led to a culture of box-ticking with which it was straightforward for companies to comply, without necessarily engendering good performance.'[364]

Drawing on a similar model, directors of B Corps simply have to explain why they have failed to make a positive impact on society and/or the environment.[365] As 3.12 of the legal requirements explains: 'this does not mean to say that the directors will necessarily be in

[364] Armour, Deakin and Konzelmann, 'Shareholder Primacy and the Trajectory of UK Corporate Governance', 10.
[365] B Labs, 'The 'Legal Requirement' for a B Corp in the UK', 3.17.

breach of their duties to the Company any more than if the Company failed to make a profit in the relevant financial year. *What is important is that the directors act in good faith and in accordance with their other duties (including the duty of skill and care) so that the strategy and activities of the Company are directed towards the aim of achieving a positive material impact and that there is a reasonable prospect this will be achieved in time*.'[366] Giving such subjectivity to the directors could be understood as either a commercial necessity or potentially reinforcing the underlying current of shareholder primacy – will directors truly choose to pursue a new stratagem when they are legally unconstrained to do so?

Although there may be problems with comply and explain based reports, there are a number of benefits. These revolve around, for example, flexibility for companies and their directors to pursue business ventures they believe are the most beneficial to their companies; as market experts, power and choice are granted to them.

It is also important to note that despite relying on comply or explain enforcement mechanisms, compliance rates with the Corporate Governance Code seem to be high.[367] Though the managers of a company are permitted to use their subjectivity and intuition, due to reputational damage and/or investor pressure to abide by market expectations, these comply or explain mechanisms tend to encourage compliance. This is even more likely considering that B Lab directly review the comply or explain reports produced by the affiliated B Corps. As Cho observes, 'at least for the time being, third-party entities

[366] *ibid.,* 3.12 (italics added).
[367] This is illustrated by a review conducted by the Financial Reporting Council which reported that '73% [of the companies review] claim[ed] full compliance, and 95% report[ed] that they were either complying with all, or all but one or two, of [the 2016 corporate governance code's] 54 Provisions.' (Financial Reporting Council, *Annual Review of the UK Corporate Governance Code* (January 2020), 3).

like B Lab indirectly but effectively represent public will and oversight for the company that "capitalism-with-a-conscience" consumers support.'[368]

5.5.2 The Public Complaints Process

B Lab describes how it will 'investigate material, credible, and specific claims against a current B Corp in one of the two following categories': (1) 'intentional misrepresentation of practices, policies, or outcomes claimed during a company's certification process' and, (2) 'breaches of the B Corp Community's core values as expressed in [the] Declaration of Independence.'[369]

The Declaration of Independence expostulates B Lab's vision of 'a global economy that uses business as a force for good. This economy is comprised of a new type of corporation – the B Corporation – which is purpose-driven and creates benefit for all stakeholders, not just shareholders.'[370] This standard is substantiated through its claims that: 'we must be the change we seek in the world,' 'all business ought to be conducted as if people and place mattered,' 'through [a business'] products, practices, and profits, [they] should aspire to do no harm and benefit all' and, 'to do so requires that we act with the understanding that we are each dependent upon another and thus responsible for each other and future generations.'[371]

Provided the complaint 'falls within the parameters' of the categories above and no precedent exists – i.e., B Lab has never made a decision on a similar scenario – it will

[368] M Cho, 'Benefit corporations in the United States and community interest companies in the United Kingdom: Does social enterprise actually work' (2016) 37 *Journal of International Law & Business* 1, 172.
[369] B Lab Global, 'A formal complaint process is an essential complement to the B Corp Certification verification and review' <https://www.bcorporation.net/en-us/standards/complaints> accessed 19 May 2022.
[370] B Lab, 'Measuring a company's entire social and environmental impact' **Error! Hyperlink reference not valid.**> accessed 19 May 2022.
[371] *ibid.*

'conduct a full investigation and present the results to its independent Standards Advisory Council.'[372]

B Lab detail the four consequences upon the completion of a complaint procedure. These are: the B Corp label is revoked, 'the company is placed on probation, with specific remedies required to maintain the certification,' 'certification is upheld, with disclosure made transparent on the company's B Corp public profile' or that certification is upheld.[373] As the most extreme enforcement measure dispensed by B Lab, the following subsection will discuss revocation of the label, and the mere threat of revocation, in greater depth.

5.5.3 The Possible Termination of B Corp Certification

Whether it be through the threat of termination of B Corp certification or the actual removal of certification, the fact this is a possibility, is a keyway in which B Lab is able to exercise a degree of control over B Corps.

Through having this power, B Lab can threaten misdemeaning companies with reputational damage. Upon the termination of B Corp certification, B Lab would post on its website, informing stakeholders (including potential investors, acquirers and consumers) of the company's failure to uphold their commitment to B Corp status. As Chapter 2 detailed, threats to reputation that involve shareholders and/or stakeholders being able to use their powers of exit and/or voice, would likely pressurise the directors. In the case of B Corps, pressurise them to try and abide by their B Corp commitments.

A possible critique is the fact many stakeholders rely on B Lab to administer "justice" even though it is its own private entity. This is prevalent in a recent case concerning

[372] B Lab Global, 'A formal complaint process'.
[373] *ibid.*

Danone, the largest multinational B Corp. In 2021 Danone North America 'cut the contracts of 89 small organic dairy farms in New York and New England.'[374] While B Lab does not regulate how a corporation chooses its supply chains, simply requiring 80 points in their BIA, with Danone cutting these 89 contracts, Goldberg observes how it was a well-known fact '[these farms] would have few options for survival and very possibly face financial ruin.'[375] He goes on to quote a letter sent to Danone from a number of US Representatives condemning the behaviour of Danone: 'by all accounts, your decision to sever the contracts of these 89 farms was one based solely on maximizing profits, regardless of the devastating consequences for the families and communities you cast aside and despite the reputational benefits and profit you gleaned from their work.'[376] The letter continued, expostulating that 'your actions against these Northeast farmers are in direct conflict with the B Corp commitment of 'balancing profit with purpose' and 'using business as a force for good.''[377]

B Lab's response to all of this was limited, resulting in its simply publishing a statement about how the actions of Danone had not changed its B Corp status – though it did observe how it may reduce its BIA score. However, Danone's BIA score was not reduced enough to result in the revocation of its B Corp label. In an email to Organic Insider, the senior public relations manager at B Lab US and Canada postulated, 'B Lab's standards were created to provide a framework for continual improvement and evaluation of positive impact and negative risk of a company's social and environmental performance, transparency, and accountability throughout all aspects of their business… Danone North

[374] M Goldberg, 'With Danone Cutting the Contracts of 89 Small Organic Dairy Farmers, B Corp has Made a Decision About the Company's Certification Status' (*Organic Insider,* 27.10.21) <https://organicinsider.com/newsletter/b-corp-danone-certification-status-cut-contracts-89-organic-dairy-farmers-new-york-new-england-your-weekly-organic-insider/> accessed 20 May 2022.
[375] *ibid.*
[376] *ibid.,* quoting the lawmakers Peter Welch, Chellie Pingree, Jared Golden and Annie Kuster.
[377] *ibid.*

America has been and continues to be a strong advocate for the B Corp movement, and while these decisions could impact a company's score, it does not affect certification status.'[378]

This case highlights how B Lab's enforcement regime may not always provide sufficient protection to stakeholders, as even though it looked into the Danone case, the company still scored well enough on the BIA. This provokes questions about the threshold a company would need to breach before revocation of its label became the punishment enforced against them. To mitigate the effects of this issue, there are all the other restraints and actions that can be taken against companies, in this case B Corps, as has been detailed throughout this thesis: for example, derivative claim proceedings and public complaint proceedings.

5.6 The external constraints imposed aren't on all companies: market pressures

Two considerations have to be taken into consideration by the directors when choosing whether to adopt the B Corp label.

One of these relates to the sections above: how demanding are the constraints imposed by the label? The more demanding, the higher the 'costs' of committing to the label and the less likely the costs will be covered by the benefits. The second relates to how great the benefits are from joining the label.

This depends on the particular sector and whether stakeholders demand and/or reward the label's adoption. As was discussed in chapter 2, under the UK's ESV policy, market performance continues to inform a large proportion of directorial decisions as their personal and company's value is attributed to stock market success. This is particularly

[378] *ibid.*

the case for fast fashion, where its very existence relies on being able to provide cheap products in a short period of time – a practice that, as chapter 1 outlined, has had dire consequences for our planet's ecosystem and the environment.

Therefore, even though some companies may choose to change their articles of association to transform into B Corps, the label's existence will fail to entice every for-profit company to change into a self-restrained corporation. In the fast fashion industry this is particularly noticeable, as its very business model is orientated around exploiting resources, and often people. In this sector, though the B Corp label is openly available for companies to adopt, there is no sign that it is being readily adopted by companies who are profiting from their fast fashion business models. If one takes the example of Patagonia, a long-established fashion brand with B Corp certification, it has recently announced that "earth is now our only shareholder."[379] In practice, this means that a charitable trust now controls the profits it makes which, the CEO, 'Yvon Chouinard [has said will] not [be] reinvested in running the business [but] would go to fighting climate change.'[380] However, in an interview with BBC News, the chairman, Charles Conn noted that the fashion company has 'higher prices,' going on to assert that 'cheap fashion was "anathema" to the brand.'[381] It is therefore distinct from fast fashion: though it may be able to pave some sort of example, it cannot be considered to fall within the sector of "fast fashion" because its practices do not align with this definition.

It can thus be argued that the external restraints imposed by the B Corp label fall short of actually creating a level playing field: those companies motivated by profit and who are

[379] Y Chouinard, 'Earth is now our only shareholder' (Patagonia Home Page) <https://eu.patagonia.com/gb/en/home/> accessed 17 September 2022.
[380] D Thomas, 'Patagonia: Billionare boss gives fashion firm away to fight climate change' (BBC News, 16th September 2022) <www.bbc.co.uk/news/business-62906853> accessed 17 September 2022.
[381] *ibid.*

arguably the worst offenders, are not hindered by their lack of a B Corp label. As chapter 1 illustrated, “fast fashion” is still a thriving business model – it clearly has so far not been hindered by the lack of any company falling within the definition of “fast fashion” achieving B Corp certification.

If there is a limited transition within a sector, for the companies to try and become more sustainable, the market pressures exerted on these companies remain the same as those discussed in chapter 2. In other words, the pressures deriving from e.g., takeover pressures, share value considerations etc., will still feature prominently in these directors’ decision-making processes – pushing them towards profit maximisation. The limited adoption of the label in the fashion sector – with absolutely no adoption in the fast fashion sector - ensures that minimal change to the capital market pressures exerted on directors occurs. If a key competitor is financially flourishing without adopting the B Corp label, it is clear why some companies see no real benefit in adopting it. Through adopting the label, they would have to depart from their fast fashion business plan, instead becoming a slow, or sustainable fashion corporation. This is an extremely pertinent problem in practice.

This thesis does not explore this factor further, however, due to issues of space. Instead, it has focused on how for-profit companies, choosing to defer away from traditional for-profit business models are subsequently treated and how effective this treatment is. Throughout this chapter, it has also queried whether a B Corp certified company has truly changed the way its directors approach business decisions – looking at how the pressure framework of chapter 2, and the liability framework of chapter 3, manifest in the B Corp context.

5.7 Conclusion

The benefits accruing for B Corps are beginning to show. This is highlighted by multinational corporations such as Danone paving the way for other larger companies to improve their green credentials and sustainability image by acquiring B Corps.

As the market, especially consumers, begin to award those with undeniable green credentials, the B Corp label is becoming a definite way companies can exemplify the way they are beneficially treating their people and the planet.

As I highlighted throughout this chapter, there are a number of issues with the label, for example, how enforceable misdemeanours are when they occur. In particular, it has been illustrated that the pressures exerted on directors in traditional for-profit companies - pressures that push them towards profit maximisation schemes – could remain the same. With no established precedent in this sphere, analysis has drawn on similar, though not identical, social enterprise corporation cases. It is therefore hypothetical in nature, simply illustrating how, having looked at existing climate litigation judgements and trends, B Corp certified corporations could be treated.

In the fast fashion sector, the label is currently difficult, if not impossible, to acquire, as the very practice of fast fashion is, in its current format, incongruent with sustainability. There is a growing awareness in this sector that recycling fabric will be the future. In this sense, companies could certainly aim to self-select away from the traditional fast fashion thesis dominating current practice. This can be seen with fashion companies, such as Patagonia, taking on the label. However, by becoming a B Corp, it successfully distinguishes itself from fast fashion. For fast fashion to be sustainable (as defined by B Lab) it will require a new conceptualisation: no longer can fast fashion be about creating new garments from raw materials, it will need to reformulate its business model and thereby change its very definition.

Conclusions

Throughout this thesis, a framework to assess the choices directors make due to the pressures exerted on them in a for-profit corporation context have been analysed. It has been queried whether changing into a B Corp by going through B Lab's certification process encourages a more environmentally friendly decision-making process for the company/its directors. It has also been examined whether such a change is beneficial to the company, from both a reputational and consumer perspective, as well as the perspective of those within the company or working in the same sector.

Chapter 1 simply outlined the issues, particularly the environmental issues, deriving from the fast fashion sector. The following two chapters endeavoured to create a framework to assess the pressures exerted on directors from internal and external actors.

An examination of the internal pressures - those coming from the statutory duties and shareholder powers - found that directors are encouraged to pursue profit maximising schemes that simply give lip service to stakeholder concerns. Such a conclusion was further supported by an examination of the external pressures. These included market pressures and those deriving from consumers, regulators, NGOs and the media. While some consumers, and a number of NGOs fight against corporate environmental misdemeanours, it was illustrated that overall, the pressures that derive from other factors override these: pushing directors to pursue profit maximisation. This, it was shown, has a strong impact in the fast fashion sector, where consumer overconsumption (and their desire for low priced products) coupled with shareholder powers and market demands *result in the* fast fashion paradox which has extreme environmental consequences.

Chapter 3 looked at regulatory pressures, specifically questioning whether stakeholders could rely on entity liability and its internal personal liability regime to ensure the environment remains unharmed. It was illustrated that though entity liability can be more beneficial in regard to the amount of compensation it is able provide to victims, something more than entity liability is required if one wants to guarantee deterrence and ensure accountability. This is where, what I termed, external personal liability stepped in. It was shown that if directors are threatened with personal liability, as well as their corporation being held liable, it is more likely that real change will ensue. While there are a number of pitfalls to these sorts of actions, for example the derivative claims procedure, cases such as the ClientEarth/Shell derivative proceeding highlight that action may begin to be taken against these directors for their failure to respect environmental regulations.

By creating this framework, this thesis allowed for an in-depth analysis of the B Corp model. This involved looking at the various pressures exerted on this socially orientated form of for-profit company to see whether they were any different for B Corp directors. In other words, it was questioned whether companies who certify as B Corps are more likely to respect environmental concerns and, if they breached their promises, whether they could be held liable: through both entity liability mechanisms and personal liability mechanisms.

One of the main issues for the B Corp model in my sector of focus (the fast fashion sector) was identified as its lack of universality – i.e., the problem that its benefits did not outweigh the *fundamental nodus* of fast fashion: that it is an industry reliant on cheap, low cost, (and subsequently environmentally damaging) garments.

Moreover, it was illustrated that most of the pressures exerted on directors in the normal for-profit scenario (discussed in chapter 2) remained unchanged for B Corp directors.

Hence, a number of directors would be encouraged to pursue shareholder interests if they could avoid liability. While this takes quite a cynical view of those companies changing to become B Corps, theoretically, the derivative claims procedure would not change and the enforcement practices of B Lab seem to be quite limited (note however that there is limited information available about the enforcement proceedings B Lab have taken). Therefore, analysis focussed on the text of the B Corp articles and the information published on the various B Lab websites. This information illustrated that the legal standing of an individual trying to bring liability proceedings against a B Corp, or its directors, for pursuing environmentally damaging business ventures would remain unchanged.

However, this is not to say that the B Corp model does not have its benefits. The analysis of this thesis has taken the extreme stance of looking at an hypothetical B Corp that does not want to respect its B Corp promises. In real life, this seems unlikely to be the case. I simply wanted to highlight that from a company law perspective, very little changes when a company becomes B Corp certified.

It will be interesting to see how the derivative claim proceeding brought by ClientEarth against Shell plays out. Depending how the judiciary treat ClientEarth's claims, a more extreme form of derivative proceeding could precipitate, one in which a directors' breach of social and/or environmental misdemeanours becomes sufficient for a minority, activist shareholder to bring action against the directors for their decision to pursue profits. If this were the case, a whole new sphere of proceedings and regulatory action could be carved out and brought against supposedly "socially and environmentally orientated" companies.

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