NAVIGATING ESG IN CORPORATE GOVERNANCE: BALANCING SHAREHOLDER PRIMACY WITH SUSTAINABLE BUSINESS PRACTICES

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Advancing the environmental, social and governance (ESG) agenda through company law presents challenges, particularly in common law systems, where directors' duties are traditionally seen as prioritising the "interests of the company", a concept closely tied to shareholder interests. Courts generally avoid evaluating the merits of business decisions and focus instead on ensuring that directors follow appropriate decision-making processes. Despite this procedural focus, ESG concerns are becoming an increasingly significant factor in corporate governance. Companies are being pressured to adopt sustainable business practices, and regulatory frameworks are evolving to encourage or require directors to integrate ESG factors into their decision-making. This article explores the evolving role of directors in advancing ESG goals and argues that, while courts continue to emphasise procedural correctness, directors must adapt to the growing societal, regulatory and market expectations surrounding ESG.

I INTRODUCTION

The rise of the ESG movement over the last two decades has fundamentally shifted the landscape of corporate governance. Once viewed as a niche concern of environmental activists and social reformers, ESG has grown into a mainstream consideration for companies, investors and regulators alike. As of 2022, the global ESG asset industry represented USD 30 trillion in investments and is predicted to surpass USD 40 trillion by 2030.[1] Simultaneously, companies continue to face mounting

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1 Saffron Wainwright, Seb Zickus and Oktavia Catsaros "Global ESG assets predicted to hit $40 trillion by 2030, despite challenging environment, forecasts Bloomberg Intelligence" (8 February 2024) Bloomberg <www.bloomberg.com>.

pressure from shareholders, regulators and the public to incorporate ESG principles into their core business strategies.

The origins of ESG can be traced back to a 2004 publication of the United Nations Global Compact, *Who Cares Wins*, which called for businesses to align their operations with principles of sustainable development.[2] Over time, ESG has come to encompass a wide range of issues, including climate change, labour rights, diversity and inclusion, ethical governance and corporate transparency. Today, ESG is seen as an essential component of corporate responsibility and long-term sustainability.

Despite its growing importance, the concept of ESG remains loosely defined, with different organisations, jurisdictions and industries adopting varying approaches to what ESG entails.[3] This lack of clarity can create confusion,[4] particularly in common law jurisdictions where the legal framework has historically prioritised shareholder value. In these jurisdictions, directors have long been required to act in the "interests of the company", a concept that courts have typically equated with maximising shareholder wealth. However, the rise of ESG presents a challenge to this traditional understanding of directors' duties.

This article examines how the courts and regulators in common law jurisdictions are grappling with the integration of ESG into company law. Using recent key cases such as the English cases of *BTI 2014 LLC v Sequana*[5] and *ClientEarth v Shell plc*,[6] and the Singaporean case of *Serene Tiong Sze Yin v HC Surgical Specialists Ltd*,[7] this article analyses whether directors are now expected to consider non-shareholder interests in their decision-making and how the definition of the "interests of the company" may be evolving with respect to ESG issues.

This article makes three main arguments. First, courts in common law jurisdictions continue to prioritise shareholders' interests when defining the company's interests, although ESG considerations are becoming increasingly relevant. Secondly, judicial review of directors' decisions remains focused on procedural correctness, leaving directors with considerable discretion in how they balance competing interests. Lastly, regulatory and societal pressures are pushing directors to take ESG more

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2 United Nations Global Compact *Who Cares Wins: Connecting Financial Markets to a Changing World* (December 2004) at i–ii, v, 3, 5, and 22.

3 For instance, ESG rating standards differ vastly across rating agencies: Aaron K Chatterji and others "Do Ratings of Firms Converge? Implications for Managers, Investors and Strategy Researchers" (2016) 37 Strat Mgmt J 1597; and Robert G Eccles and Judith C Stroehle "Exploring Social Origins in the Construction of ESG Measures" (12 July 2018) Social Science Research Network <www.ssrn.com>.

4 Martin Lipton "ESG, Stakeholder Governance, and the Duty of the Corporation" (18 September 2022) Harvard Law School Forum on Corporate Governance <www.corpgov.law.harvard.edu>.

5 *BTI 2014 LLC v Sequana SA* [2022] UKSC 25, [2024] AC 211.

6 *ClientEarth v Shell plc* [2023] EWHC 1137 (Ch).

7 *Serene Tiong Sze Yin v HC Surgical Specialists Ltd* [2020] SGHC 201, [2021] 3 SLR 1269.

seriously, and the future of corporate governance may require a rethinking of the traditional shareholder primacy model.

II DEFINING THE INTERESTS OF THE COMPANY

A The Traditional Common Law View: Shareholder Primacy

At the heart of common law company law is the fiduciary duty of directors to act in the interests of the company. For much of the 19th and 20th centuries, this duty was understood primarily in terms of "shareholder primacy" – the idea that directors are responsible for maximising returns to shareholders. This view has been reinforced by numerous legal decisions, most famously in cases like *Dodge v Ford Motor Co*,[8] where the Michigan Supreme Court held that "A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end".[9] Similar views have been expressed in English cases such as *Aberdeen Railway Co v Blaikie Brothers*, where Lord Cranworth LC referred to the directors' duty as being "to act as best to promote the interests of the corporation whose affairs they are conducting".[10] Corporation or company here "does not … mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body".[11]

The notion that companies exist primarily to serve their shareholders became deeply entrenched in the legal and economic culture of the Anglo-American world. Scholars such as Milton Friedman argued that the sole responsibility of businesses was to increase profits, provided they operated within the bounds of the law.[12] This view dominated corporate governance theory for much of the 20th century, influencing both legal interpretations and business practices.[13]

However, this narrow focus on shareholder value has not gone unchallenged. Critics of shareholder primacy argue that companies have responsibilities to a broader range of stakeholders, including employees, customers, communities and the environment. These critics contend that

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8 *Dodge v Ford Motor Co* 170 NW 668 (Mich 1919).

9 At 684.

10 *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461 (HL) at 471–472.

11 *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286 (CA) at 291 per Sir Francis Evershed MR.

12 Milton Friedman "A Friedman doctrine—The Social Responsibility of Business Is to Increase Its Profits" *The New York Times* (New York City, 13 September 1970).

13 See Jill E Fisch and Steven Davidoff Solomon "Should Corporations Have a Purpose?" (2021) 99 Tex L Rev 1309 at 1319, n 43; and Martin Lipton "The Friedman Essay and the True Purpose of the Business Corporation" (17 September 2020) Harvard Law School Forum on Corporate Governance <www.corpgov.law.harvard.edu>.

businesses should adopt a "stakeholder" model of governance where directors are expected to balance the interests of multiple constituencies, rather than focusing solely on shareholders.[14]

Cases in the 21st century have qualified shareholder primacy, or maximisation of shareholders' value, as different from profit maximisation.[15] Directors are not to maximise profits by any means. They are still expected to comply with the law and not carry out activities that would harm the company, even if it means that the company may have lesser profit in the short run. In addition, it has been emphasised by the courts that the duty of directors is to the *company* and that the scope of the "interests of the company" (and therefore, the directors' duty) can vary depending on its financial or economic situation.[16] That said, when a company is a going concern or financially healthy, directors are justified to consider the "interests of the shareholders" as a proxy for the "interests of the company".[17] Directors at this stage of a company's lifecycle are entitled, but not obliged, to take into account the interests of stakeholders when making decisions on behalf of the company if so doing will further shareholders' interests.[18] Nonetheless, with the upsurge of ESG-related regulations, both nationally[19] and internationally,[20] with which companies are required to comply, there is increasing pressure on directors to consider stakeholders' interests at all times, as failure to comply with these laws and regulations would injure the company.

B Enlightened Shareholder Value and the Success of the Company

In the United Kingdom, the enactment of ss 170–177 of the Companies Act 2006 was intended to codify common law directors' duties. However, the scope of the legislated duties is not exactly similar

14 Luh Luh Lan and Loizos Heracleous "Rethinking Agency Theory: The View from Law" (2010) 35 Academy of Management Review 294.

15 *Ho Kang Peng v Scintronix Corp Ltd (fka TTL Holdings Ltd)* [2014] SGCA 22, [2014] 3 SLR 329.

16 *Sequana SA*, above n 5; and *Foo Kian Beng v OP3 International Pte Ltd (in liq)* [2024] SGCA 10, [2024] 1 SLR 361.

17 At [70].

18 See Lan and Wan, above n *, at 543.

19 For instance, the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 (UK) in the United Kingdom requires United Kingdom-registered companies, and limited liability partnerships with over 500 employees and annual revenue of more than £500 million, to provide environmental reporting. In Singapore, the Environmental Protection and Management Act 1999 (SG) (EPMA), which applies to multiple sectors in Singapore, including energy, power, industry and transport, is the nation's primary piece of legislation for regulating air, water and noise pollution. Non-compliance with the provisions of the EPMA can attract a criminal penalty with fines up to SGD 500,000 under conviction.

20 There are several international laws and regulations on ESG issues, including Directive 2022/2624 on Corporate Sustainability Reporting [2022] OJ L322/15, which applies to large companies listed in the European Union. Many other nations outside of the European Union have adopted the sustainability-related standards set by the International Sustainability Standards Board.

to their common law predecessors. Section 172 of the Act, which was intended to codify the directors' duty to act bona fide in the interests of the company, requires that directors promote the success of the company "for the benefit of its members as a whole". In so doing, s 172 directs them to "have regard" to a range of non-shareholder interests, including the interests of employees, the company's impact on the environment and the need to foster relationships with suppliers and customers.

This approach is known as "enlightened shareholder value" (ESV).[21] Under ESV, directors are still required to prioritise shareholder value, but they are encouraged to take a longer-term and more holistic view of what constitutes the success of the company. The logic behind ESV is that companies can only deliver sustainable returns to shareholders if they also consider the interests of other stakeholders and manage ESG-related risks.

The United Kingdom Supreme Court's decision in *BTI 2014 LLC v Sequana* provides a useful illustration of how s 172 will be interpreted in practice.[22] In *Sequana*, the Court had to decide whether directors owed a duty to consider the interests of creditors when distributing dividends. The Court held that directors must consider creditors' interests once a company is insolvent or nearing insolvency, but it reaffirmed that the primary duty of directors is to promote the success of the company for the benefit of shareholders. This case highlights the delicate balancing act that directors must perform under ESV: they must consider the interests of non-shareholder stakeholders, but they are not required to prioritise those interests unless specific circumstances (such as insolvency) arise.

The concept of ESV has also been influential in other jurisdictions. For example, in Singapore, which still applies the traditional common law directors' duty, the Court of Appeal recently held:[23]

> The [directors' fiduciary] duty is a duty to act in the best interests of the company, and this enjoins directors to have regard to the interests of different stakeholders, including creditors, *at all times*. It is simply that when the company is financially healthy, directors would be justified in treating the interests of shareholders as a proxy for the interests of the company and in according commensurately less or even no discrete weight to the interests of creditors.

As explained in Part II(A) above, these changes in legal attitude, even under the common law, reflect a growing recognition that businesses must balance the interests of multiple stakeholders to achieve long-term success – particularly in a world where environmental, social and governance risks are becoming more prominent.

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21 Companies Act 2006 (UK) (explanatory note) at [325].

22 *Sequana SA*, above n 5.

23 *Foo*, above n 16, at [70] (emphasis added).

III ADVANCING THE INTERESTS OF THE COMPANY

A Judicial Review of Corporate Decisions

When it comes to enforcing the directors' duty to act bona fide in the interests of the company, one of the defining features of common law company law is the deference that courts show to directors' subjective business judgement. This is subject to a low minimum objective standard: that no intelligent and honest person in the position of a director could reasonably have believed that the transactions entered into were for the benefit of the company.[24] The principle of judicial deference is rooted in the belief that directors are better positioned than judges to make complex business decisions, particularly in light of the uncertainty and risks inherent in corporate management.

The idea that courts should not "second guess" business decisions was famously articulated by Lord Wilberforce in *Howard Smith Ltd v Ampol Petroleum Ltd*.[25] In that case, the Court refused to interfere with the directors' decision to issue new shares, even though the respondents argued that the decision was made to entrench the current board.[26] Lord Wilberforce stated that courts should not substitute their judgement for that of the directors, as long as the directors acted in good faith and within the scope of their authority.[27]

This principle of judicial deference continues to guide courts in common law jurisdictions today. In recent cases, such as *ClientEarth v Shell plc*,[28] courts have emphasised that directors have a broad discretion to determine how best to manage ESG risks, as long as they consider relevant factors and follow proper decision-making processes. In *ClientEarth*, an environmental group brought a derivative action against the petroleum giant Shell, claiming that the company's board had breached its duties by failing to adopt a more aggressive climate change strategy.[29] The High Court of England and Wales dismissed the claim, ruling that directors are not required to adopt specific ESG strategies advocated by a minority of shareholders.

The case of *Tiong Sze Yin Serene v HC Surgical Specialists Ltd* in Singapore similarly reinforced the principle of judicial deference.[30] In this case, the Court upheld the directors' discretion in managing the company's affairs, despite allegations that the board had failed to adequately address the conduct of a potential business partner. The Court found that, as long as the directors acted in

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24 *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 62 (Ch) at 74.

25 *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC).

26 See 826–828.

27 At 832.

28 *ClientEarth v Shell plc* [2023] EWHC 1137 (Ch).

29 Derivative actions are explained further in Part IV.

30 *HC Surgical Specialists Ltd*, above n 7.

good faith and considered the relevant factors, they were entitled to make business decisions based on their commercial judgement.

B The Role of Bad Faith, Illegality and Irrationality

Although courts generally defer to directors' business judgment, they will intervene if there is evidence of bad faith or when the decision-making was illegal or irrational. Bad faith typically involves situations where directors act in their own interests rather than the interests of the company, such as when they engage in self-dealing or fail to disclose conflicts of interest. In these cases, courts have been more willing to scrutinise the substance of directors' decisions.

When considering whether there was illegality in decision-making, the question is not whether the director has done some wrongful act, as that would outrightly not be in the interests of the company. Rather, the issue is whether the discretion has been exercised within the decision-maker's authority. Consequently, as in administrative law, the decision-maker is expected to base their decisions on relevant considerations.[31] Similarly, in corporate law, directors are required to have genuinely accounted for the requisite interests when making managerial decisions.[32] The test for irrationality is whether no reasonable director could have arrived at the same decision. This standard, derived from the "*Wednesbury* unreasonableness"[33] test in administrative law, sets a high bar for plaintiffs seeking to challenge directors' decisions. As long as a decision is within the realm of reasonableness, courts will uphold it, even if it turns out to be financially unsuccessful.

In practice, this means that directors retain considerable discretion to balance competing interests, including those related to ESG factors. Courts are unlikely to impose specific ESG strategies on companies, leaving it to directors to determine how best to manage risks related to climate change, social responsibility and governance.

C Global Regulatory Trends

Although the principle of shareholder primacy remains strong in many common law jurisdictions, there is growing recognition that businesses must adapt to the changing regulatory landscape. In Europe, for example, the Corporate Sustainability Due Diligence Directive (CSDDD) that came into force on 25 July 2024 imposes significant obligations on companies to integrate ESG considerations

31 In the United Kingdom, see *Padfield v Minister of Agriculture, Fisheries and Food* [1968] AC 997 (HL); *British Oxygen Co Ltd v Minister of Technology* [1971] AC 610 (HL). In Singapore, see *Registrar of Vehicles v Komoco Motors Pte Ltd* [2008] SGCA 19, [2008] 3 SLR 340.

32 See *Re W&M Roith Ltd* [1967] 1 WLR 432 (Ch).

33 *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223 (CA). The principles laid down in this case were later confirmed in the House of Lords' decision in *Council of Civil Service Unions v Minister for the Civil Service* [1985] AC 374 (HL).

into their governance structures.[34] Under the CSDDD, companies are required to conduct due diligence on their environmental and social impacts, and directors will be held accountable for ensuring that the company complies with sustainability requirements.

Similarly, the European Union's Sustainable Finance Disclosure Regulation requires financial institutions to disclose how they integrate ESG risks into their investment processes.[35] These regulations are part of a broader effort by European policymakers to align corporate governance with the goals of the European Green Deal, which aims to make Europe the first climate-neutral continent by 2050.[36]

In the United States, the situation is more mixed. While the Securities and Exchange Commission has adopted new rules that require public companies to disclose their climate-related risks and greenhouse gas emissions by 6 March 2024, the effective date of implementing the rules has been stayed, pending the outcome of judicial review proceedings brought by some states.[37]

In Asia, jurisdictions such as Singapore and Hong Kong have introduced ESG reporting requirements for listed companies. The Singapore Exchange requires listed companies to produce sustainability reports, which must include a board statement outlining the company's sustainability practices.[38] Similarly, the Hong Kong Stock Exchange mandates ESG reporting for listed companies, with an emphasis on climate-related risks and opportunities.[39]

These global regulatory trends indicate that ESG is becoming a central consideration in corporate governance, and a consideration to which directors in common law jurisdictions will need to adapt. While courts may continue to defer to directors' business judgment, the growing body of ESG-related

34 Directive 2024/1760 on Corporate Sustainability Due Diligence [2024] OJ L. The CSDDD applies both to companies established in a European Union member state with more than 1,000 employees and a net worldwide turnover of at least €450 million in the last financial year, and to companies established outside of the European Union with a net turnover in the European Union of at least €450 million in the last financial year. In addition, companies with a franchising or licensing business model in the European Union, and a net turnover in the European Union of at least €80 million in the last financial year, also come under the purview of CSDDD.

35 Regulation 2019/2088 on Sustainability-Related Disclosures in the Financial Services Sector [2019] OJ L317/1.

36 See European Commission "Sustainability-related disclosure in the financial services sector" (3 May 2024) <www.finance.ec.europa.eu>.

37 Zoya Mirza and Lamar Johnson "SEC battles climate disclosure rule legal challenges" (27 March 2024) ESGDive <www.esgdive.com>.

38 See Singapore Exchange "Sustainability Reporting" <www.sgx.com>.

39 See Hong Kong Exchanges and Clearing Ltd *Implementation Guidance for Climate Disclosures under HKEX ESG reporting framework* (April 2024).

regulations suggests that directors can be held to higher standards of accountability when it comes to managing environmental and social risks.

IV IMPLICATIONS ON ACTIVISM

A Derivative Actions and Shareholder Engagement

ESG activists are increasingly using litigation as a tool to hold companies accountable for their environmental and social impacts. However, derivative actions – lawsuits brought by shareholders on behalf of the company – remain difficult to pursue in most common law jurisdictions. Courts are generally reluctant to allow such actions unless there is clear evidence that directors have breached their fiduciary duties and, even then, they may deny the action if it is not in the company's interests.

In the case of *ClientEarth*, the High Court of England and Wales rejected a derivative action brought by environmental activists against Shell.[40] The court emphasised that directors have a broad discretion to determine how best to balance the company's financial interests with the correlative environmental risks. Moreover, the Court questioned whether the litigation was truly in the company's interests, given that the activists held only a small number of shares in Shell.[41]

Instead of relying on litigation, ESG activists may find more success through shareholder engagement. Shareholders have several mechanisms at their disposal to influence corporate governance, including voting on resolutions at annual general meetings, proposing shareholder resolutions and removing directors who they perceive have failed to act in the company's best interests. By building coalitions with institutional investors and other shareholders, activists can create pressure for companies to adopt more sustainable business practices.

B The Role of ESG Codes and Rules

Although ESG codes and guidelines are typically non-binding, they play an increasingly important role in shaping corporate governance.[42] Many companies are adopting voluntary ESG frameworks that require them to disclose how they are managing environmental, social and governance risks. These disclosures provide transparency for shareholders and allow them to hold directors accountable for their decisions.

For example, the Task Force on Climate-related Financial Disclosures, and now the IFRS Foundation, requires that companies report on their climate-related risks and opportunities.[43]

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40 See *ClientEarth*, above n 28.

41 At [69].

42 That said, ESG codes are increasingly becoming binding or mandatory in nature.

43 The Task Force on Climate-related Financial Disclosure completed its work in October 2023. The IFRS Foundation has now taken over the Task Force's role of monitoring the progress of companies' climate-related disclosures.

Similarly, the Sustainability Accounting Standards Board provides industry-specific guidelines for ESG reporting, helping companies standardise their disclosures and enabling investors to make more informed decisions.[44]

These codes also encourage directors to consider ESG factors when making business decisions. Although directors are not legally obliged to adopt specific ESG strategies, the growing emphasis on transparency and stakeholder engagement has made it more difficult for directors to ignore these concerns.

V CONCLUSION

The courts' procedural approach to reviewing directors' duties strikes a delicate balance between ensuring accountability and preserving directors' discretion to manage company affairs. While courts ensure that directors follow proper decision-making processes, they are reluctant to impose substantive requirements on directors to adopt specific ESG strategies. This deference aligns with traditional principles of company law, which prioritise shareholder interests but allow directors to consider other factors, such as environmental and social concerns, when promoting a company's long-term success.

For ESG activists, shareholder engagement is likely to be a more effective tool for promoting sustainability than litigation. By working with shareholders, activists can push for changes in corporate governance that reflect broader societal values. ESG codes and guidelines further support this process by encouraging transparency and accountability, while allowing directors the flexibility to balance competing interests.

As societal and regulatory expectations continue to evolve, ESG considerations will play an increasingly important role in shaping corporate governance. Although directors are not yet required to prioritise ESG factors over shareholder value, the growing emphasis on sustainability suggests that ESG will increasingly become an integral part of corporate decision-making in the years to come.

44 SASB Standards "About us" (20 June 2023) <www.sasb.ifrs.org>.