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Anglo-American Directors' Legal Duties and CSR: Prohibited, Permitted or Prescribed?

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Anglo-American Directors' Legal Duties and CSR: Prohibited, Permitted or Prescribed?

The interaction between corporate social responsibility (CSR) obligations and directors' legal duties is underexamined. This article addresses that void by examining directors' duties in case law and legislation across the major commonwealth countries and the U.S.A. It provides an analysis of leading cases and examines how they deal with directors' duties, the doctrine of shareholder primacy, corporate legal theory and CSR. The article reviews fiduciary relations and duties and analyzes the directors' duties to exercise power in the best interests of the company as a whole and for proper purposes. The article concludes that CSR is well within the accepted range of directors' duties and, in some instances, mandates.

L'interaction entre les obligations et la responsabilité sociale des entreprises (RSE) et les devoirs légaux des administrateurs n'est pas examinée d'assez près. L'article tente de combler cette lacune en étudiant les devoirs des administrateurs définis dans la jurisprudence et dans les lois des plus importants pays du Commonwealth et des États-Unis. L'auteur analyse des arrêts importants et examine la façon dont les devoirs des administrateurs sont traités, le principe de la primauté des actionnaires, la théorie juridique concernant les sociétés et la RSE. Il passe en revue les relations et les devoirs fiduciaires et analyse le devoir des administrateurs d'exercer le pouvoir dans l'intérêt supérieur de la Société dans son ensemble et à des fins appropriées. En conclusion, il affirme que la RSE fait bel et bien partie des devoirs et des obligations acceptés des administrateurs et, dans certains cas, de leurs mandats.

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Introduction

The move toward the institutionalization of corporate social responsibility (CSR) in Canada,[1] the U.S.A.,[2] the U.K.,[3] Australia[4] and elsewhere makes an investigation into its legal implications an important endeavour. Although the law of corporations has significant if subtle differences in Canada, the U.S.A., the U.K. and Australia, in terms of the law relating to directors'

1. R. Janda, "Bill C-300: Sound and Measured Reinforcement for CSR: A Report on the Legal and Policy Dimensions of Bill C-300" (1 September 2009), online: Canadian Network on Corporate Accountability <http://www.cnca-rcrce.ca>.
2. Daniel T Ostas, "Cooperate, Comply, or Evade? A Corporate Executive's Social Responsibilities with Regard to Law" (2004) 41 Am Bus LJ 539. And see generally, Joe (Chip) Pitts, "Business, Human Rights, & The Environment: The Role of the Lawyer in CSR & Ethical Globalization" (2008) 26 Berkeley J Int'l L 479; D McBarnet, "Corporate Social Responsibility Beyond Law, Through Law, For Law" in D McBarnet et al, eds, *The New Corporate Accountability* (New York: Cambridge University Press, 2009).
3. *Companies Act 2006* (UK), c 46, s 172.
4. Corporate responsibility reporting has become de facto law for business. See David G Yosifon, "The Law of Corporate Purpose" (2014) 10 Berkeley Bus LJ 181; Paul Redmond, "Directors' Duties and Corporate Social Responsiveness" (2012) 35 UNSWLJ 317; and Benedict Sheehy, "Defining CSR: Problems and Solutions" (2014) J Bus Ethics (forthcoming) [Sheehy, Defining CSR].

duties, it is markedly similar.[5] The basic controversy, as illustrated in the consternation surrounding the decisions in *Peoples Department Stores Inc. (Trustee of) v. Wise*[6] and *BCE Inc. v. 1976 Debenture Holders*,[7] is whether, or when, directors are permitted, prohibited or prescribed to exercise their decision-making discretion to engage the corporation and its assets in activities referred to as CSR—the use of assets to advance the interests of non-shareholder constituents.

It is important to note, in a paper engaging in some comparative law analysis, that the argument is not that the law of corporations is the same in all these jurisdictions. Rather, the claim is that the theoretical underpinnings and practical issues with respect to directors' duties are comparable across all four jurisdictions.[8] The point of taking a multi-jurisdictional approach is that it brings to light trends and patterns that cannot be discerned from a deeper but narrower analysis of a single jurisdiction. In an environment where corporations and corporate law are increasingly felt extraterritorially, indeed globally, a broader view is critical.

Law is a dynamic aspect of society's life. Whereas in the last century Friedman could boldly assert that the corporation's social responsibility was to maximize wealth[9] and Kraakman, in a moment of neo-classical economic triumphalism, declared that corporate law's evolution had reached its zenith in a particularly ideological version of American

5. Bernard S Black et al, "Legal Liability of Directors and Company Officials Part 1: Substantive Grounds for Liability (Report to the Russian Securities Agency)" (2007) Colum Bus L Rev 614. Nonetheless, there are significant differences between Canadian, US and UK law on some of the issues discussed in this article. See M Fadel, "BCE and the Long Shadow of American Corporate Law" (2009) 48 Can Bus LJ 190. Redmond's recent treatment of the topic of director's duties and CSR in Australia illustrates the subtle differences. Redmond, *supra* note 4. See also Sheehy, Defining CSR, *ibid.*

6. *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 28, [2004] 3 SCR 461 [*Peoples Department Stores*].

7. N Dietrich, "Revlon Redux: Reconciling the BCE Case in Change of Control Transactions-Is Lyondell the Better Way" (2009) 10 Bus L Int'l 218; SP Bradley, "BCE Inc. v. 1976 Debentureholders: The New Fiduciary Duties of Fair Treatment, Statutory Compliance and Good Corporate Citizenship" (2009) 41 Ottawa L Rev 1; Fadel, *supra* note 5; J VanDuzer, "BCE v. 1976 Debentureholders: The Supreme Court's Hits and Misses in its Most Important Corporate Law Decision Since Peoples" (2009) 43 UBC L Rev 205; JG MacIntosh, "BCE and the Peoples' Corporate Law: Learning to Live on Quicksand" (2009) 48 Can Bus LJ 255.

8. John Farrar, "In Pursuit of an Appropriate Theoretical Perspective and Methodology for Comparative Corporate Governance" (2001) 13 Austl J Corp L 1.

9. Milton Friedman, "The Social Responsibility of Business is to Increase its Profits", *The New York Times Magazine* (13 September 1970).

shareholder primacy,[10] the facts tell a different story.[11] Even as they were undertaking their research, the planet was going in a different direction—in which corporate power carries corporate social responsibility. From the international and transnational soft law initiatives such as the UN's Global Compact,[12] the Global Reporting Initiative[13] and corporate-sponsored regulatory initiatives such as the Kimberley Process,[14] aimed at improving social performance, to the hard law of regulatory reform and judgments of courts supporting and imposing such social initiatives, law has moved in a different direction at odds with the voices of the business press. Far from precluding expenditure of corporate wealth on social issues as those scholars may suggest,[15] not only does the law allow attention to social issues, but in particular contexts, even mandates such attention.

This article examines the core of discretions and responsibilities surrounding the corporation in the context of CSR. These discretions and responsibilities at law are found in the law of directors' duties. These duties have evolved over the last few centuries to determine the scope of and purpose for the directors of corporations and to provide parameters for the exercise of their discretion. These duties impose a range of legal sanctions from prohibitions, to permissions, to obligations that touch all aspects of CSR.

CSR may be defined as private self-regulation focused on ameliorating and mitigating the social costs of industrial organizations.[16] It has three normative grounds: economic prosperity, social justice, and environmental quality.[17] It is operationalized within the firm through a

10. Henry Hansmann & Reinier H Kraakman, "The End Of History For Corporate Law" (2001) 89 Geo LJ 439. They use the term "ideology" in their work to describe the view. See also, Amir N Licht, "The Maximands of Corporate Governance: A Theory of Values and Cognitive Style" (2004) 29 Del J Corp L 649.

11. Leonard I Rotman, "Debunking the 'End of History' Thesis for Corporate Law" (2009) 33 BC Int'l & Comp LJ 219; Adam Winkler, "Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History" (2004) 67 Law & Contemp Probs 109.

12. United Nations, "UN Global Compact," online : United Nations <http://www.unglobalcompact.org/>.

13. Global Reporting Initiative, online: Global Reporting Initiative <https://www.globalreporting.org>.

14. Kimberley Process, online: Kimberley Process <http://www.kimberleyprocess.com/>.

15. Daniel T Ostas, "Deconstructing Corporate Social Responsibility: Insights from Legal and Economic Theory" (2001) 38 Am Bus LJ 285.

16. Sheehy, Defining CSR, *supra* note 4.

17. J Elkington, *Cannibals with Forks: The Triple Bottom Line of 21st Century Business* (Oxford, UK: Capstone, 1997).

four-responsibilities approach.[18] Within the concept of CSR is a rejection of the idea of medieval law that the corporation is solely a private group. Rather, CSR conceptualizes the corporation as the organizational infrastructure for large multinational, social and political actors, with significant environmental and social impacts.[19] Consequently, these actors must evidence the attributes of citizenship and, as such, the dialogue of corporation citizenship[20] has been engaged.

The argument is not primarily a normative argument about law reform; rather, it is a positive enquiry into the existing legal framework. As such, it works through the well-known and familiar cases; however, it does so at a finer level of detail using the lens of CSR. Rather than simply conducting a review of the high level shareholder primacy norm, which is largely unenforceable in any event[21] and limited to the U.S., the analysis examines the particular aspects of specific directors' duties in relation to both non-shareholder constituents and the norm.

At law, in essence, two basic duties are imposed on directors.[22] There is a basic duty of care and skill, which ensures directors fulfil contractual and tortious obligations, and a fiduciary duty which is often expressed as a duty of loyalty.[23] While it is an oversimplification in that directors are

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18. These are: 1) an economic responsibility to produce goods and to be profitable; 2) a legal responsibility to abide by law; 3) an ethical responsibility to do what is right and fair beyond that required by law; and 4) a voluntaristic responsibility. Archie B Carroll, "A Three-Dimensional Conceptual Model of Corporate Social Performance" (1979) 4 Academy of Management Review 497.
19. Benedict Sheehy, "CSR and Law: Alternative Regulatory Systems," online: (2012) SSRN <http://www.ssrn.com>; Benedict Sheehy, "Conflicts between CSR, Corporate Law and the Problems of Social Costs," online: (2012) SSRN <http://www.ssrn.com>.
20. L Whitehouse, "Corporate Social Responsibility as Regulation: The Argument from Democracy" in J O'Brien, ed, *Governing the Corporation* (London: Wiley, 2005) 141; Lisa Whitehouse, "Corporate Social Responsibility, Corporate Citizenship and the Global Compact: A New Approach to Regulating Corporate Social Power?" (2003) 3 Global Social Policy 299.
21. D Gordon Smith writes "the shareholder primacy norm is nearly irrelevant with respect to conflicts of interest between shareholders and nonshareholders...[it]may be one of the most overrated doctrines of corporate law" in "The Shareholder Primacy Norm" (1997) 23 J Corp L 277 at 322-323.
22. As Sealy points out, they are fewer "duties" than grounds for challenging directors' decisions. LS Sealy, "'Bona Fides' and 'Proper Purposes' in Corporate Decisions" (1989) 15 Monash UL Rev 265.
23. In Canada, see the *Canadian Business Corporations Act*, RSC 1985, c C-44, s 122(1)(a), (e) [*CBCA*]; E Waitzer & J Jaswal, "Peoples, BCE, and the Good Corporate 'Citizen'" (2009) 47 Osgoode Hall LJ 439; VanDuzer, *supra* note 7. In Australia, see the *Corporations Act 2001*, ss 180–183. See Charles O'Kelley & Robert B Thompson, *Corporations and Other Business Associations: Cases and Materials*, 6th ed (Gaithersborg, Maryland: Wolters Kluwer, 2010) at 277. See also, *Model Business Corporation Act*, s 8.30 (1950) [*MBCA*]. For critique and review of change in the *MBCA*, see O'Kelley & Thompson, *ibid* at 324.

not held to tort standards because of the business judgment rule,[24] it is the latter duty in which directors have the most latitude in decision-making and the ambit of which decisions relating to CSR would be challenged. It is not that the duties of skill and care are irrelevant. Rather, directors are able to argue before courts that decisions with respect to CSR are matters of discretion and not matters related to negligence. For the most part, these duties are not markedly dissimilar in their common law and statutory forms. Thus, one may emphasize the common law interpretations without doing violence to the statutorily codified form. The principles remain the same. Finally, in some jurisdictions, such as Delaware, whether the duties of care and contract, or loyalty are at all "fiduciary" is questionable.[25]

In examining the fiduciary duty, we may say that the duty with respect to directors' discretion is singular. It is the duty of a fiduciary toward a beneficiary. Summed up, this duty is to act in the interests of the beneficiary. Correct discharge of the fiduciary duty precludes self-dealing, exploitation or other actions that are the subject of the broadly framed directors' duties. The issue of correct discharge is usually dealt with by reference to the proper purposes doctrine. That doctrine holds that a fiduciary's powers may only be used for the specific and particular objects for which they were given, namely, the benefit of the beneficiary.

In the context of corporate law, directors are a peculiar type of fiduciary. Their duty requires not the conservation of assets as is required of fiduciaries in other contexts, but the opposite: the putting of assets into play, the taking of measured, but ultimately unpredictable risks. To fulfil this duty, directors are given considerable discretion. In this context, the law both guides and exculpates directors in the discharge of their fiduciary duties and, in particular, the exercise of that discretion where purposes are not clear or where benefits fail or negative contingencies may eventuate. This conflict, then, is the foundation for directors' duties which encompass the directors' decisions with respect to corporate actions, including those actions that concern CSR.

24. It has been observed that

> [o]ver time, state courts interpreted the [fiduciary] duties in a manner that left little substance. The business judgment rule and universal adoption of waiver of liability provisions all but eliminated causes of action for breach of the duty of care. The duty of loyalty, particularly self-dealing by officers and directors, could be validated through procedural mechanisms. With proper procedures, the fairness of the transaction was not subject to judicial review. This approach allowed self-dealing by officers and directors almost without limits.

J Brown, "The Irrelevance of State Corporate Law in the Governance of Public Companies" (2004) 38 U Rich L Rev 317 at 318-319.

25. See, e.g., chapter 4 in O'Kelley & Thompson, *supra* note 23, but see *Graham v Allis-Chalmers Mfg Co*, 188 A(2d) 125 at 130 (Del Sup Ct 1963).

As noted, the article works through well-known principles and doctrines. The point of the article is not to propose reform or to contest those doctrines. Rather, the purpose is to place CSR within the existing framework. The article begins with a review of fiduciary relations and fiduciary duties. It then proceeds to an analysis of the components of the directors' duty to exercise power in the best interests of the company as a whole. That section is followed by an examination of the proper purpose doctrine. Having examined these two fiduciary foundations of directors' duties, the article turns to examine the cases advanced as precluding CSR and those in which CSR concerns have been permitted. The section following this examination of the cases examines the legislated duties relevant to the fiduciary obligations imposed on directors. The final section examines the role of the business judgment rule and the role internal governance rules may play in directors' decision-making and CSR.

I. *Fiduciary relationships and fiduciary duties*

Fiduciary relationships in commerce are no different than they are elsewhere in the law. The relationship, as stated in *Hospital Products Ltd. v. United States Surgical Corporation,* is:

> [O]ne of confidence, which may be abused...[where there] is an inequality of bargaining power...[where] the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of this position.[26]

Where a fiduciary relationship is found to exist, the law imposes fiduciary duties to protect the vulnerable party. These duties are to act in good faith, in the interests of the beneficiary, and not to abuse the powers and position of the fiduciary.[27] These same duties are imposed on company directors, as a class, in relation to the company.

As Lord Cranworth LC in his classic statement of the obligation of corporate directors put it:

> The Directors are a body to whom is delegated the duty of managing the general affairs of the Company. A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such

26. (1984), 55 ALR 417 at 454 (HLA) [*Hospital Products*].
27. *Boardman v Phipps*, [1967] 2 AC 46 HL (Eng).

> agents have duties to discharge of a fiduciary nature towards their principal.[28]

In the American context, the widely accepted statement of fiduciary duties in commercial relations comes from a joint venture case. In that case, *Meinhard v. Salmon*, Cardozo opined:

> Joint adventurers...owe to one another...the duty of finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of honor the most sensitive is then the standard of behaviour.[29]

Accordingly, the basic evaluation of exercise of directors' discretion with respect to CSR must fall within the fiduciary obligations just outlined. These obligations are quite general and do not provide adequate parameters to address something as specific as CSR. The next section of the article moves the argument further by providing an analysis of the law pertaining to the object of the fiduciary duties.

II. *To whom are fiduciary duties owed?*

There are, in essence, three distinct alternatives for the status of beneficiary of corporate directors' fiduciary duty. These are: the organization or enterprise as a going concern, the stakeholders generally including shareholders, or the shareholders specifically to the exclusion of all other constituents. As will be argued throughout this article all three are potentially correct; however, it depends upon the particulars of the case.

First, the usual case requires directors to focus the exercise of their discretion on the company as a whole, to keep the enterprise operating to maximize the overall value of the enterprise.[30] This focus allows shareholder wealth to be maximized as a by-product of successful management of the enterprise as a going concern. This focus, as opposed to the view of exclusive shareholder wealth maximizing at all times, is consistent with other law that imposes limits on shareholder wealth maximization.[31] In

28. *Aberdeen Rlwy Co v Blaikie Bros* (1854), 1 Macq 461 at 471 (HL Scot).

29. *Meinhard v Salmon*, 164 NE 545 at 546 (NY App Ct 1928).

30. Thomas A Smith, "The Efficient Norm fo Corporate Law: A Neotraditional interpretation of Fiduciary Duty" (1999) 98 Mich L Rev 214; N Licht, *supra* note 10. This is Jensen's argument: Michael C Jensen, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function" (2001) 7 European Financial Management Review 297.

31. For example, securities law prohibits market manipulation that may maximize shareholder wealth. See discussion in Matthew T Bodie, "AOL Time Warner and the False God of Shareholder Primacy" (2006) 31 J Corp L 975.

this case, it is understood that as fiduciaries, directors owe their duties to the company and not to the shareholders. The classic statement of this position is in *Percival v. Wright*.[32] In the U.S.A., in the case of *Northeast Harbor Golf Club, Inc. v. Harris,* the doctrine has been explicated most clearly.[33] The court requires "full disclosure to the appropriate corporate body,"[34] not necessarily shareholders at all. Accordingly, arguments that directors breach their duties by misappropriating shareholder wealth in the implementation of CSR are incorrect. This point will be argued more fully below.

This position is clarified by the duty of proper purpose, which focuses the object of directors' attention on the company. It focuses on the company as the beneficiary of the duty by explicitly excluding purposes foreign to the affairs, operations and organization of the company. In other words, purposes that do not advance the company are precluded by law.[35] This approach is evident in *Walker v. Wimborne*,[36] where Mason explained:

> [D]irectors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them.[37]

The rule laid down in *Walker v. Wimborne* has been adopted in *Lonhro Ltd. v. Shell Petroleum Co. Ltd.* that "the best interests of the company... are not exclusively those of its shareholders but may include those of its creditors."[38] This understanding of the object of directors' duty clearly encompasses CSR, as it is clear from this judgment that non-shareholders

32. *Percival v Wright*, [1902] 2 Ch 421 [*Percival*].

33. That case both consolidated earlier judicial thinking and moved beyond the prior standards of *Guth v Loft, Inc*, 5 A(2d) 503 (Del Sup Ct 1939), the "line of business test," the *Durfee v Durfee & Canning, Inc*, 323 Mass 187 at 199, 80 NE (2d) 522, 529 (Mass Sup Ct 1948) "fairness test," as well as the effort to consolidate the two in *Miller v Miller*, 301 Min 207 at 222. The *Northeast* court rejected all of these prior cases because of the inability of those cases to capture the fundamental breach of duty to the corporation, which could only be exposed and dealt with fairly and adequately where there had been full disclosure to the corporation. The court adopted the American Law Institute's *Principle of Corporate Governance* (Philadelphia: American Law Institute, 2008) at para 5.05, which requires "full disclosure to the appropriate corporate body...an absolute condition precedent" to the defences that the company rejected the opportunity for any reason including line of business, or that the action of the director amounts to a lack of fairness, and as applied in *Klinicki v Lundgren* 695 P (2d) 906 (Or Sup Ct 1985) [*Klinicki*].

34. *Klinicki, ibid.*

35. JP Heydon, "Directors' Duties, and the Company's Interests" in PD Finn, ed, *Equity and Commercial Relationships* (North Ryde, NSW: Lam Book Co, 1987) 122. See also O'Kelley & Thompson, *supra* note 23.

36. (1976), 137 CLR 1 (MCA) [*Walker*].

37. *Ibid.*

38. *Lonhro Ltd v Shell Petroleum Co Ltd*, [1980] 1 WLR 627 at 634, HL (Eng) [*Lonhro Ltd*].

can be included in the sphere of concern without breaching the fiduciary duty. Indeed, there is a positive duty upon directors to consider non-shareholder constituents—at least in some instances.

The second view is similar to the first, and can be illustrated by reference to Blair and Stout's team production theory.[39] Simply put, Blair and Stout argue that directors are to use their discretion to mediate the stakeholder hierarchy within the firm to maximize the overall enterprise value, which may ultimately benefit shareholders. In this view, directors are required by law to balance the competing interests of stakeholders both with and external to the firm through a range of liabilities from employment law, to environmental law, to creditors. In the particular context of the vicinity of insolvency, directors are required to shift the focus of their duties away from shareholders and other internal interests toward the interests of creditors. Shareholders' interests are subordinated to those of other parties.

This approach requires the fiduciary to exercise his or her powers in relation to all persons or stakeholders associated with the company. This conception of the duty, while clearly the most amenable to CSR, must still be subjected to a positive law analysis. The interests that are the objects of the directors' duty are typically understood to range from creditors, to employees, to people in the community. The duty to these other non-shareholder constituents typically arises in different contexts. In the first instance, with respect to creditors, the court in *Speis v. R*[40] clarified the nature of the duty. The court held that the duty to creditors is not an on-going duty, but a contingent duty that arises as the prospect of insolvency emerges. Further, as the duty provides creditors with no cause of action against directors, it is an "imperfect obligation."[41] The situation is different in Canada where no obligation to creditors arises, although they may be considered.[42] In the U.S.A. the situation has changed recently. While previously the court had held that once the corporation approaches insolvency, or is in the "vicinity of insolvency," there is a fiduciary duty to creditors,[43] recent case law has denied that obligation.[44]

39. Margaret Blair & Lynne Stout, "A Team Production Theory of Corporate Law" (2001) 85 Va L Rev 247.

40. [2000] 18 ACLC 727 [HCA].

41. *Re New World Alliance Pty Ltd; Sycotex Pty Ltd v Baseler*, (1994) 122 ALR 531 at 550, cited in *Walker*, *supra* note 36 at 94.

42. B Reiter, *Directors' Duties in Canada*, 3rd ed (Toronto: CCH Canadian, 2006) at 59; Brian Morgan & Harry Underwood, "Directors' Liability to Creditors on a Corporation's Insolvency in Light of the Dylex and Peoples Department Stores Litigation" (2003) 39 Can Bus LJ 336.

43. *Geyer v Ingersoll Publishing Co*, 621 A (2d) 784 at 787-790 (Del Ch 1992).

44. *North American Catholic Educational Programming Foundation, Inc v Gheewalla*, 2007 WL 1453705 (Del Sup Ct).

Further, the directors' duties and hence the company's borders are expanded beyond the narrower interests of shareholders to employees. For example, although it is not commonly part of the law of corporations per se,[45] it is clear that directors have duties to employees in Australia.[46] In the U.S.A., by way of statutes and case law,[47] directors have an obligation to employees, again, particularly in the context of insolvency.[48] These acts may criminalize efforts by directors to avoid paying employee entitlements. A similar provision is found in the *CBCA*.[49] Directors' duties are also extended to employees via workplace safety laws.[50]

Beyond obligations to employees, directors' duties extend beyond the company to the environment.[51] Environmental protection laws extend directors' liabilities and hence their duties even beyond the corporation, its shareholders and employees, to the community in which it resides and operates. Personal liability for taxes, torts, general compliance and even criminality support a view that opposes subordination of all interests to those of shareholders, as does directors' right to make charitable donations.[52]

As stated in *Harlowe's Nominees Pty Ltd. v. Woodside (Lakes Entrance) Oil Company NL*:

> Directors in whom are vested the right and the duty of deciding where the company's interests lie and how they are to be served may be concerned with a wide range of practical considerations, and their judgment, if exercised in good faith and not for irrelevant purposes, is not open to review in the courts.[53]

45. *Companies Act 1993* (NZ), 1993/105, s 132. New Zealand's legislation is an exception to this general approach.

46. *Corporations Law Amendment Act (Employee Entitlements) Act 2000* (Cth).

47. *Stafford v Purofied Down Production Corp*, 801 F Supp 130 (ND Ill 1992). Additionally, directors may be liable for delinquent pension contributions. See *Plumbers' Pension Fund, Local 130 v Niedrich*, 891 F (2d) 1297 (7th Cir 1989); NY Lab Law § 198-a.

48. *Credit Lyonnais Bank Nederland, NV v Pathe Communications Corp*, 1991 WL 277613 at 34 (Del CL). There is some question, nonetheless, as to the "zone of insolvency" test from *Kipperman v Onex Corp*, 411 Br 805 (ND Ga 2009).

49. *CBCA*, *supra* note 23, s 119.

50. See, e.g., *Occupational Health and Safety Act 2004* (Vic).

51. See, e.g., *Environment Protection Act 1970* (Vic), s 20C(3), or *Canada's Environmental Protection Act*, RSC 1999, c 33, s 273. For discussion of the US position, see Geoffrey Christopher Rapp, "A New Direction for Shareholder Environmental Activism: The Aftermath of Caremark" (2006) Wm & Mary Envtl L & Pol'y Rev 163.

52. *AP Smith Mfg Co v Barlow*, 98 A (2d) 581 (NJ Sup Ct 1953) [*Smith and Barlow*]; Faith Stevelman Kahn, "Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy" (1997) 44 UCLA L Rev 579; Victor Brudney & Allen Ferrell, "Corporate Charitable Giving" (2002) 69 U Chicago L Rev 1191.

53. [1968] 121 CLR 483 at 493 [*Harlowe's*].

The third interpretation of the duty is shareholder primacy—here defined as a broad focus on the shareholders as a whole. A version of shareholder primacy that requires maximizing shareholder wealth to the exclusion of all other interests is an economic norm that is generally not reflected in law except, as argued below, in the case of takeovers. Much of the discussion of this latter version of shareholder primacy is a political and ideological debate about the desirability of following the economic norms associated with Kaldor-Hicks efficiency, preferencing wealth generation over fairness in distribution and other norms.[54]

In *Ngurli v. McCann*, the High Court held, citing with approval the judgment of Evershed MR:

> [P]owers conferred on directors by the articles of association of companies must be used bona fide for the benefit of the company as a whole...the phrase 'company as a whole', does not mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body.[55]

Here, the shareholders are emphasized, but what is expected of shareholders? Evershed's answers might be considered bizarre if the fact pattern of the case is not understood. He states, "the shareholder must proceed upon what, in his honest opinion, is for the benefit of the company as a whole."[56] The High Court continues, explaining what this means and how it applies in the context of the case. The case actually deals with minority oppression in which a director, who was also a majority shareholder by operation of law, was using his power to take control of the company. In other words, the shareholder's interest comes to the fore in a case of oppression—indeed, it is as a result of the harm of oppressive conduct that the (any) shareholder gets the right of the oppression remedy that is appropriately attached to directors' duties. The area of oppression is an important one in the discussion of shareholder primacy generally and directors' discretion to provide benefits to non-shareholder constituencies, as will be discussed in various sections below, and in some detail in the section dealing with the so-called hard cases.

The American law, despite many protestations to the contrary, is unclear. In Delaware, the leading corporate law jurisdiction, the law refers

54. Licht, *supra* note 10; Ronald Chen & Jon Hanson, "The Illusion Of Law: The Legitimating Schemas Of Modern Policy And Corporate Law" (2004) 103 Mich L Rev 1; Kent Greenfield, *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities* (Chicago: University of Chicago Press, 2005).

55. *Ngurli v McCann,* [1953] 90 CLR 425 at 438 [*Ngurli*], citing *Greenhalgh v Arderne Cinemas Ltd,* [1951] Ch 286 at 291.

56. *Greenhalgh v Arderne Cinemas Ltd,* [1951] Ch 286 at 291.

sometimes to "the corporation and its shareholder" and at other times, to the "corporation" only. The significance of the distinction is debated[57]—some arguing it is significant, others to the contrary—but in the first instance it would seem most consistent with principles of statutory interpretation that the distinction is meaningful. The basic principle of surplusage is that each word or phrase in the statute is meaningful and useful, and thus, an interpretation that makes a distinction is to be favoured, and an interpretation that would render a word or phrase redundant or meaningless should be rejected.[58] Following this principle, it would appear that the two uses are to be distinguished and the better approach would be an interpretation that allows for a legal organization operating an enterprise on the one hand, and shareholder-members who have rights in the legal organization on the other.[59] Further, it should be noted that in this context, the statute never refers only to "shareholder" without "corporation." It is proper therefore to infer that the two should not be treated as interchangeable. A better interpretation is that the fiduciary duty is first to the corporation, which at times can be seen as identical to those of the shareholders, or whose interests at times may be interchangeable. However, such a position is inconsistent with the view discussed in greater detail below that shareholder primacy means at all times and in all instances, shareholders short-term interests are the whole of directors' duties. If that were the case, why bother with the term "corporation" at all?

Thus, regardless of how one conceives of the object or recipient of fiduciary obligations, CSR is clearly within the accepted interpretations of the fiduciary duty in most instances. In some ways, it may be said that CSR, rather than being a discrete corporate agenda, is a core aspect of directors' duties that increases as the needs and demands of society change. Indeed, this view of the reality of corporate power and responsibility in contemporary society driving change in corporate law norms is found in the case law. As Berger J opined in *Teck Corp. Ltd. v. Millar*:

> [A] classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would

57. Christopher M Bruner, "The Enduring Ambivalence of Corporate Law" (2008) 59 Ala L Rev 1385; David Millon, "Two Models of Corporate Social Responsibility" (2011) 46 Wake Forest L Rev 523; Andrew S Gold, "Theories of the Firm and Judicial Uncertainty" (2012) 35 Seattle UL Rev 1087; Yosifon, *supra* note 4.

58. William N Eskridge et al, *Cases and Materials on Legislation: Statutes and the Creation of Public Policy*, 3rd ed (St. Paul, Minnesota: West, 2001) at 833.

59. A position which accords with my reading of *Grand Metropolitan Public Ltd v Pillsbury Co*, 558 A (2d) 1049 (Del Ch 1988); *TW Services, Inc v SWT Acquisition Corp*, 1989 WL 20290 (Del Ch); and, *Paramount Communications, Inc v Time, Inc* 571 A (2d) 1140 (Del Sup Ct 1989) [*Paramount*].

> argue that in doing so they were not acting bona fide in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered bona fide the interests of the shareholders...if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.[60]

In sum, the law offers four potential beneficiaries of directors' fiduciary duties. These are the company, the company with interests more sharply defined, shareholders and stakeholders. First, it is understood that as fiduciaries, directors owe their duties to the company and not to the shareholders. This view does not preclude CSR. The second focuses on the company as the beneficiary of the duty by explicitly excluding purposes foreign to the affairs, operations and organization. Interestingly, the case law on this approach has specified particular interests that are to be taken into account. A third interpretation of the duty focuses on the shareholders as a whole. Such an interpretation, while potentially precluding CSR, need not do so. Indeed, the law, as shall be argued in detail below, empowers directors to move beyond shareholder interests into charitable giving. The fourth approach requires the fiduciary to exercise his or her powers in relation to all persons or stakeholders associated with the company. This approach is wholly consistent with CSR, where CSR is understood to be granting benefits to non-shareholder constituents. Again, as shall be demonstrated below, law imposes such a duty on directors. Thus, regardless of which object one selects as the object of the duty, the duty is not inconsistent with CSR. Indeed, law mandates CSR in a number of situations, while only prohibiting it in a few.

With this overview of the nature and object of the duty, we now turn to examine the specifics of the core fiduciary duty—the duty to act bona fide for the company as a whole.

III. *Duty to act bona fide for the company as a whole*

This duty, to act bona fide for the company as a whole, is the core corporate directors' duty. It makes in the first instance reference to good faith. While the better interpretation is objective—i.e. "genuine"—the courts have also

60. *Teck Corp v Millar* (1972), 33 DLR (3d) 288 (BCSC) at 314 [*Teck Corp*] and cited with approval in *Peoples Department Stores*, *supra* note 6 at para 42.

interpreted it subjectively to mean "with the best of intentions."[61] As to the latter interpretation, it is well understood that good faith, as a subjective concept, is not readily measureable. Rather, it is an approach toward evaluating action and decision-making, something intangible, altruistic and other-oriented. This orientation toward the other is a true hallmark of the fiduciary—able to affect the legal relations of another party and being obligated to do so in that other party's best interests. To hold this position and discharge the duty requires the holder to act in good faith not only in the objective sense of genuine, but subjectively with intent of the other's benefit. Although it is evident from the foregoing and the cases which follow that the duty cannot be broken up into it discrete elements for purposes of application,[62] for purposes of analysis of its application to CSR, it is helpful to attempt to do so. There are three parts to the duty: bona fide, benefit of the company, and company as a whole. Each of these will be considered in turn.

1. *Bona fide*

The first part of the duty, to act bona fide, has caused confusion in company law because it has been separated from the rest of the phrase "in the interests of the company as a whole."[63] Properly it must be connected to the phrase to set parameters for the investigation and to avoid an irrelevant investigation into subjective intent and honesty. The standard test set out in *Mills v. Mills*,[64] is that the bona fide exercise of fiduciary powers precludes use for self-interest or a purpose foreign to that for which it was granted.[65] Simply put, bona fide or good faith requires the best interests of company and not some collateral purpose.[66] Bona fide includes a general law duty of honesty and also the exercise of independent judgment concerning what precisely the best interests of the company are.[67] As a result, in the first instance, bona fide does not preclude CSR; rather, it sets the parameters. As the court stated in *Howard Smith Ltd. v. Ampol Petroleum Ltd.*[68]:

61. Sealy, *supra* note 22 at 269. For an in-depth discussion of the concept of "good faith" see Benedict Sheehy, "Good Faith in the CISG: Interpretation. Problems in Article 7" Pace International Law Review, ed, *Review of the Convention on Contracts for the International Sale of Goods (CISG)* (Munich: Sellier European Law, 2005) 153.
62. *Peters' American Delicacy Co Ltd v Heath*, [1939] 61 CLR 457 (HCA).
63. Sealy, *supra* note 22 at 269
64. [1938] 60 CLR 150 (HCA) [*Mills v Mills*].
65. Adopted in *Howard Smith Ltd v Ampol Petroleum Ltd*, [1974] AC 821 (PC) [*Howard Smith Ltd*].
66. *Hospital Products*, *supra* note 26.
67. *Southern Resources Ltd v Residues Treatment & Trading Co Ltd*, [1988] 14 ACLR 569.
68. *Howard Smith Ltd*, *supra* note 65.

> To define in advance exact limits beyond which directors must not pass is, in their Lordships' view, impossible. This clearly cannot be done by enumeration, since the variety of situations facing directors of different types of company in different situations cannot be anticipated.[69]

As a matter of law, where bona fide is found to exist, the law offers directors protection: "[i]t would be wrong for the court to substitute its opinion for that of the management, or indeed to question the correctness of the management's decision, on such a question, if bona fide arrived at."[70]

In sum, the bona fide requirement does not preclude CSR, and as noted above, may very well include it.

2. *For the company*

The second part of the duty precludes the exercise of powers for reasons that are foreign to the organization and operations of the company. It is not clear whether this duty means that the "company as a whole"—i.e. the organization or enterprise—is distinct from or distinguishable from the shareholders. Further, it is unclear whether in referring to the organization, it includes shareholders, or even other stakeholders who may include creditors.[71]

In a decision that has sparked much controversy,[72] the Supreme Court of Canada opined in *BCE Ltd. v. 1976 Debenture* as follows:

> Often the interests of shareholders and stakeholders are co-extensive with the interests of the corporation. But if they conflict, the directors' duty is clear — it is to the corporation. The fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation. The content of this duty varies with the situation at hand. At a minimum, it requires the directors to ensure that the corporation meets its statutory obligations. But, depending on the context, there may also be other requirements. In any event, the fiduciary duty owed by directors is mandatory; directors must look to what is in the best interests of the corporation.[73]

But, neither the duty to shareholders nor to the creditors is fiduciary. Lord Diplock held: "best interests of the company...are not exclusively those

69. *Ibid* at 835.
70. *Ibid* at 835.
71. *Walker*, *supra* note 36.
72. Dietrich, *supra* note 7; Bradley, *supra* note 7; Fadel, *supra* note 5; VanDuzer, *supra* note 7; MacIntosh, *supra* note 7.
73. 2008 SCC 69 at paras 37-38, [2008] 3 SCR 560 [*BCE Inc*].

of its shareholders but may include those of its creditors."[74] Indeed, the position is identical to Australian judicial interpretation. In the case of *Brunninghausen v. Galvanics* the court held: "[t]he general principle that a director's fiduciary duties are owed to the company and not to shareholders is undoubtedly correct, and its validity is undiminished."[75] The essence of this aspect of the duty is to the company or corporation, a concept, which despite at least a century of consideration, was not well settled in law.[76]

What is clear from the case law is that the company, in most interpretations, includes parties other than the member-shareholders. Accordingly, a narrowly conceived duty focused on the shareholders is incompatible with most understandings of the company. The better understanding of the company includes non-shareholders. As a result, it may well be argued that CSR was not precluded by the more widely accepted, broader understanding of the company.

3. *The company as a whole*

The third element of the duty requires an inquiry into the meaning of the "company as a whole," for the undisputed law is that directors have a duty to pursue the best interests of the company as a whole. This obligation is often interpreted in two ways: first as meaning the shareholders; or second, as referring to a broader range of interests in which shareholders interests are usually prioritised. Both positions are appropriately referred to as "shareholder primacy"; however, within the scholarly community, there is a wide range of opinions as to what the term "shareholder primacy" means.

The failure to identify exactly what is meant by the term has led to considerable confusion in the interpretation of a number of important cases from *Dodge v. Ford*[77] to more recent cases such as *Paramount Communications Inc. v. Time Inc.*,[78] and *eBay Domestic Holdings, Inc. v. Newmark.*[79] To some, shareholder primacy means that shareholder wealth maximization is the goal of the corporation and the overarching directors'

74. *Lonrho, supra* note 38 at 634.

75. *Brunninghausen v Galvanics*, [1999] 17 ACLC 1247 at para 43, citing with approval *Percival, supra* note 32.

76. Benedict Sheehy, "CSR, Theories of the Firm and Models of the Corporation," online: (2012) SSRN <http://www.ssrn.com>; Benedict Sheehy, "The Importance of Corporate Models: Economic And Jurisprudential Values And The Future Of Corporate Law" (2004) 2 DePaul Bus & Comm LJ 463 [Sheehy, "The Importance"].

77. *Dodge v Ford Motor Company*, (1919) 204 Mich 459 (Mich Sup Ct 1919) [*Dodge v Ford*].

78. *Paramount, supra* note 59.

79. *eBay Domestic Holdings, Inc v Newmark* 16 A (3d) 1 (Del Ch 2010) [*eBay Domestic Holdings*].

duty from which all others are derivative.[80] Although it seems problematic to suggest that overall corporate wealth is readily equated to shareholder wealth, its advocates equate the two without comment or justification. To others, the idea is somewhat weaker, not limiting shareholders' interests to shareholder wealth. This slightly weaker version may be put thus: only shareholders' interests are important to the exclusion of other constituencies. This interpretation of shareholder primacy has two implications: one is that shareholders may have non-wealth maximizing objectives such as governance, political powers or control, and second, that other stakeholders may be ignored. To other scholars, shareholder primacy is no more than simply stating that among the legitimate and various interests within the organization, those of shareholders are to be preferred.[81] A final interpretation of shareholder primacy is that shareholders' interests are the basic reference point in all decision-making.

Conceptually, the meaning of shareholder primacy is ambiguous. It may mean anything from the relatively uncontentious assertion that substantively corporate law puts the fundamental rights of corporate structure in the hands of shareholders (common to all jurisdictions under consideration in this article), to the American positive analysis that shareholders have priority among the stakeholders—i.e. that corporate decisions must in some way benefit shareholders, to the normative argument that corporate law should favour shareholders as a result of equitable doctrine and conceptions of the corporation as private law. Although this latter view is common to many corporate law scholars, shareholder primacy is taken further among law and economics scholars. To them it is an expression of the economic normative argument that efficiency (for investors) should be the goal of corporate law. To some shareholder primacy goes even beyond that and becomes part of an overall ideology—we live in the best of all worlds having found the ultimate destiny which brings history to an end in an economic ideology[82]—a view that is equally derided by others in both law[83] and business.[84] Thus, to state shareholder primacy is the foundation of corporate law without defining the term is problematic. Shareholder

80. This is Hansmann and Kraakman's view: Hansmann & Kraakman, *supra* note 10; Stephen M Bainbridge, *The New Corporate Governance in Theory and Practice* (Oxford: Oxford University Press, 2008) at 53; and Yosifon, *supra* note 4.

81. Smith, *supra* note 21 at 323.

82. Hansmann & Kraakman, *supra* note 10.

83. Rotman, *supra* note 11; Winkler, *supra* note 11; Easterbrook & Fischel, "Pangloss meets the Coase Theorem" (1992) 105 Harv L Rev 1408.

84. Robert Teitelman, "Most cited: Shareholder governance as accepted wisdom" *The Deal Economy* (8 June 2012), online: The Deal Pipeline <http://www.thedeal.com/thedealeconomy/most-cited-shareholder-governance-as-accepted-wisdom.php#ixzz2VKx1Nc6M>.

primacy does not equate the shareholders' interests with 'the company as a whole.'

While it is uncontroversial to state that in all the jurisdictions discussed, the structure of corporate law clearly favours the shareholders over all other constituents, for example, by granting rights to shareholders to vote on essential corporate decisions such as constitutional amendments, the sale of substantially all of the assets, and winding up, it is another thing to substitute the shareholder for the corporation itself. This overly broad version of shareholder primacy equating shareholders to the company is not instructive in terms of day-to-day operations. Business cannot be run on the basis of shareholder interests alone as daily operations requires the complexity of the balancing of competing claims in a dynamic environment. Nevertheless, much of the leading corporate law and the orthodox economic analysis takes this more extreme version, conflating practical, positive and normative concepts into a single concept and declaring that shareholder wealth maximization, to the exclusion of all other non-shareholders, is operative, positive and normative corporate law.[85] This statement is not an accurate statement of the law in operative, positive, or normative terms as shall be explained next. These conceptual distinctions, although they may seem fine or merely semantic, are far from it. Rather, eliding these concepts makes it difficult if not impossible to determine when directors are overstepping their boundaries on the one hand, or properly attending to their duties on the other. For example, is a director who in one decision fails to prioritize short-term shareholder wealth by attending to stakeholder concerns that have implications for the long-term viability of the enterprise in breach of their duties? Identifying and clarifying the concepts provides them with a brighter line with which to guide their decisions.

First, in factual and practical terms, there are four issues. One is the simple fact that the corporators are usually the directors. Second, directors appear not to consider the interests of shareholders in their decision-making.[86] Third and more problematic, it now appears that the majority of shareholders hold their shares for a mere matter of seconds—in the U.S., 20-22 seconds to be precise.[87] To follow this line of inquiry in

85. Benedict Sheehy, "Shareholders, Unicorns and Stilts: An Analysis of Shareholder Property Rights" (2006) 6 JCLS 165.

86. Smith, *supra* note 21.

87. Michael Hudson, cited in Paul Farrow, "How long does the average share holding last? Just 22 seconds" (18 January 2012), online: The Telegraph Group <http://www/michael-hudson.com>. Hudson's statement on his own website is "a few seconds": Michael Hudson, "Euro-Bankers Demand of Greece" (10 May 2012), online: Michael Hudson <http://michael-hudson.com.

legal analysis, "what would the 22 second shareholder's interests be?" is self-evidently absurd. This problem requires the court to engage in a rather subjective imaginative exercise. It requires the court to imagine a particular type of shareholder, then place itself in the position of that shareholder, and then decide whether to challenge and replace directors' business judgement—a task the courts have traditionally been loathe to do. Fourth, assuming the court is persuaded to go down that path, there are significant obstacles to identifying which specific shareholder, among the remaining minority, the court ought to be imagining and taking into consideration. Some courts have solved the problem by deferring the interests of the long-term shareholder. In a case which continues to cause concern in the academy, *Paramount Communications Inc. v. Time Inc.*,[88] the court explicitly refused the wishes of shareholders to capitalize on a significant premium Paramount was willing to pay. The court held that Time's corporate culture was a value that the directors legitimately sought to protect.

Professor Hu identified this problem over a decade ago: there is no single shareholder interest as a reference point for directors or courts.[89] Long-term and short-term, or even short-selling shareholders (if one chooses to include the latter category) have conflicting interests and law does not provide any way to decide which interest is to be preferred.[90] Even if it is given that it is the "medium-term" shareholder whose interests are to be pursued, as management scholars argue, it is still unclear what those interests may be. Presume they are not interested in governance, or any corporate affairs other than profit—an arguable point with fluctuations in mergers and acquisitions activity as well as the increasing interest among institutional investors in CSR and socially responsible investing generally.[91] Even with this presumption, one still needs to answer whether that medium-term shareholder is interested in capital gain or income stream growth.[92]

88. *Paramount*, *supra* note 59.
89. Henry TC Hu, "Risk, Time and Fiduciary Principles in Corporate Investment" (1994) 38 UCLA L Rev 277. See more recently, Bodie, *supra* note 31.
90. Bodie, *Ibid.*
91. United Nations, "Principles for Responsible Investment," online: PRI Associaiton <http://www.unpri.org> [United Nations, PRI]; Benjamin Richardson, "From Fiduciary Duties to Fiduciary Relationships for SRI: Responding to the Will of Beneficiaries" (2011) Journal of Sustainable Finance and Investment 5; Benjamin Richardson, "Are Social Investors Influential?" (2012) 9 European Company Law 183.
92. Hu, *supra* note 89.

Second, the formulation of the duty that equates the company as a whole to the interests of the shareholders is legally problematic.[93] Although directors may have to take shareholders' interests into consideration, as is clear from the case of *Ngurli v. McCann*,[94] directors owe legal duties to several parties. In addition to the corporation, which is the main focus of their duties, directors will owe duties to creditors, employees and even wider society. In fact, it is only upon the rarest occasions that directors have a duty to shareholders themselves. Indeed, the law allows them to make decisions directly in opposition to the wishes of the majority of shareholders.[95] This particular and explicit rejection of shareholder primacy sets non-American law onto a different trajectory.[96]

For example, in *Teck Corp. Ltd. v. Millar*, the court allowed directors to reject awarding a contract to the majority shareholder, Teck. The directors instead awarded it to another mine developer which would ultimately frustrate Teck's ability to gain control of the company. The board, once it became aware of Teck's advancing bid, acted quickly and specifically entered into the contract to thwart Teck. Teck claimed that the directors were actuated by an improper purpose. Berger J of the BC Supreme Court stated:

> [M]y own view is that the directors ought to be allowed to consider who is seeking control and why. If they believe that there will be substantial damage to the company's interests if the company is taken over, the exercise of their powers to defeat those seeking a majority will not necessarily be categorised as improper....[I]n seeking to prevent Teck obtaining the contract, the defendant directors were honestly pursuing what they thought was the best policy for the company...they wanted to see the company's principal asset, its copper property, developed efficiently and profitably."[97]

What is interesting in this judgment is that the company is clearly not equated with the shareholders at all. On the contrary, the company is viewed as an entity and an enterprise with its own objectives.[98] The interesting argument

93. This is one of Welling's objections to CSR. Bruce Welling, "Corporate Social Responsibility —A Well-Meaning But Unworkable Concept," online: Corporate Governance ejournal <http://www.epublications.bond.edu.au>.

94. *Ngurli*, *supra* note 55. As noted above, the case is a minority oppression case and does not mean shareholder primacy; rather, in a parallel to D Gordon Smith's interpretation of *Dodge v Ford*, *supra* note 77, the court is dealing with the issue as an minority oppression.

95. *Australian Metropolitan Life Assurance Co Ltd v Ure*, [1923] 33 CLR 199 (HCA) [*Australian Metro*].

96. Reiter, *supra* note 42 and rejected in the *Peoples Department Stores*, *supra* note 6 at para 42.

97. *Teck Corp*, *supra* note 60 at 330.

98. CMV Clarkson, "Kicking Corporate Bodies and Damning Their Souls" (1996) 59 Mod L Rev 557.

by Smith is that it is the overall claims on the corporation as a whole, the overall value or wealth of the enterprise, which is the focus of the directors' duties—not preferring shareholders, bond holders, stakeholders or any other constituency.[99]

In the Supreme Court of Canada judgment in *Peoples Department Stores Inc. (Trustee of) v. Wise*, Major and Deschamps JJ wrote:

> We accept as an accurate statement of law that in determining whether [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.[100]

In the leading corporate law court of the world, Chancellor Allen of the Delaware court identified the problem of focusing on the shareholder as proxy for the interests of the company. He queried what interests must be considered and how funds could be spent. He observed that the issue becomes most pointed in the takeover context. He described it as follows:

> [T]he issue in the takeover case was not whether a donation of corporate funds could be made to a museum or college...the issue was frequently whether all of the shareholders would be permitted to sell their shares, whether a change in corporate control would occur; and often whether a radical restructuring of the enterprise would go forward, with dramatic effects on creditors, employees, management, suppliers and communities....Whether a board of directors could take action that precluded shareholders from accepting a non-coercive, all cash tender offer.

He queried:

> [W]hose interests is the board...supposed to foster and protect when substantially all of the shareholders want to sell [their] control of the corporation? The long-term/short-term distinction could not persuasively be used to answer or evade that question...it is...a different thing to justify precluding the shareholders from selling their stock at a large immediate profit on the ground that in the long run that will be good for them... In *Paramount Communications, Inc. v. Time, Inc.*...the Delaware Supreme Court seems to have expressed the view that corporate directors, if they act in pursuit of some vision of the corporation's long-term welfare, may take action that precludes shareholders from accepting an immediate high-premium offer for their shares.[101]

99. Smith, *supra* note 30. A view that is consistent with Jensen, *supra* note 30.
100. *Peoples Department Stores*, *supra* note 6.
101. William T. Allen, "Our Schizophrenic Conception of the Business Corporation" (1992) 14 Cardozo L Rev 261 at 274-276.

This statement by a leading jurist in the state that provides the lodestar for corporate law and litigation is quite clear: CSR cannot be precluded on the grounds of shareholder interest and shareholder interests cannot be taken to stand as proxy for the company. Determining the interests of the company as a whole is better understood as distinct from the interests of the shareholders. If the law intended the directors to owe a duty to shareholders, it could easily have done so. However, it has explicitly rejected such except in the rarest of circumstances.[102] In fact, the current position is a position that has evolved from the earlier position of directors as shareholders' agents in the joint stock company, to a position, via law reform, approaching the other end of the spectrum.[103]

Third, from a theoretical perspective there are also problems with the formulation of the duty as a duty to the shareholders rather than the corporate organized enterprise. Hard shareholder primacy places shareholder wealth generation ahead of all other objectives for a variety of normative, theoretical and operational purposes, essentially seeking to solve the agency problem by incentivizing directors by compensating them in (hopefully increasingly valuable) shares.[104] There are fundamental flaws in the underlying assumptions which are fatal to this model.[105] The basic assumptions are as follows: that companies are rational organizations, that directors act rationally, that share value reflects actual productivity and that shares are traded in rational markets. On these assumptions, increases in shareholder value will represent underlying productivity gains, real revenue streams, and well-managed assets. Not only are these assumptions untrue—as countless scandals and the recent financial crisis clearly indicate—directors themselves are not nearly as focused on shareholder wealth maximization as the literature would suggest.[106]

As the late professor of sociology and law, Phillip Selznick points out, even if the aggregate of shareholders is the point of reference, it is clear that no single individuals are held in mind. He states:

102. *Coleman v Myers*, [1977] 2 NZLR 225 (NZCA).

103. Argued by Bainbridge as "Director Primacy" Stephen M Bainbridge, "Director Primacy and Shareholder Disempowerment" (2006) 119 Harv L Rev 1735.

104. MJ Roe, "The Shareholder Wealth Maximization Norm and Industrial Organization" (2000) 149 U Pa L Rev 2063; Smith, *supra* note 21.

105. For an excellent critique, see Lynn Stout, "Bad and not-so-bad arguments for shareholder primacy" (2001) 75 S Cal L Rev 1189.

106. Phil Rosenzweig, *The Halo Effect: ...and the Eight Other Business Delusions That Deceive Managers* (New York: Free Press, 2007); Amitai Aviram, "What Do Corporate Directors Maximize? (Not Quite What Everybody Thinks)" (2010) 6 Journal of Institutional Economics 47; John C Coffee, "Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance" (1984) 84 Colum L Rev 1145; Richard Roll, "The Hubris Hypothesis of Corporate Takeovers" (1986) 59 The Journal of Business 197.

> The important point is that decision making in the light of long-run benefits presumes a concept of the institution. The enterprise as a going concern, as a relational entity, becomes the focus of policy and strategy...it has to do with all the empirical requirements of organizational survival...these requirements become operative goals.[107]

In other words, the purpose for which the power is being exercised is for the benefit of the organization, not some hypothetical shareholder and from a director's or CEO's perspective the survival of the organization, which includes the survival of the CEO and other senior members of the enterprise, is contingent upon such an understanding and not a hypothetical shareholder.

In summary, the law does not impose a duty on directors to the shareholder except in the particular context of takeovers discussed in detail below.[108] Rather, the duty is to the corporation—and the debate then turns as to what or who best represents the corporation? The corporation's survival may be the goal and indeed, if one looks at other aspects of the law, such as creditor administrations and re-structuring, this perspective makes considerable sense. Evidently, the law requires directors to consider a range of matters in their decision-making in addition to shareholder interests. Indeed, directors are negligent if they fail to do so.[109] It is a breach of directors' duties to fail to use care, skill and diligence in making decisions—a shortcut heuristic "shareholder interest" is not only a cognitive error,[110] but a fallacy in the understanding and application of legal duties.[111] In light of the foregoing, the obligation on directors is not to maximize shareholder wealth; rather, it is the well-being of the corporation that may well require foregoing shareholder wealth to pursue other objectives.[112]

107. Phillip Selznick, *Law, Society and Industrial Justice* (New York: Russell Sage Foundation, 1969) at 47.

108. Chen & Hanson, *supra* note 54.

109. Joe (Chip) Pitts, *Corporate Social Responsibility—A Legal Analysis* (Markham, ON: LexisNexis, 2009).

110. Chen & Hanson, *supra* note 54.

111. For example, the Supreme Court of Canada case *BCE Inc*, *supra* note 73, which held that "the corporation's duties as a responsible corporate citizen" are to be included in directors' decision-making. That case followed an earlier case in which the same court held a permissive approach to integrated, sustainable decision-making was appropriate (*Peoples Department Stores*, *supra* note 6). In Australia a Parliamentary Joint Committee took the view that corporate law "permits directors to have regard for the interests of stakeholders other than shareholders" (Austl, Commonwealth, Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Responsibility: Managing risk and creating value* (Canberra: Senate Printing Unit, 2006) and noted Australian corporate law scholars note the array of candidates and discussion on the topic (RP Austin et al, *Company Directors: Principles of Law and Corporate Governance* (Chatswood, NSW: LexisNexis Butterworths, 2005) at 50-54).

112. Benedict Sheehy, "Scrooge—The Reluctant Stakeholder: Theoretical Problems in The Shareholder-Stakeholder Debate" (2005) 14 U Miami Bus L Rev 193.

The argument is not that shareholders or profit maximization are to be ignored. As Ruder argued in 1965 that:

> [R]eliance upon traditional profit maximization theory does not amount to a rejection of modern day notions of corporate responsibility. Within the confines of the business judgment rule there is ample opportunity for expenditure of corporate funds upon worthwhile public welfare measures. The only limitation is that corporate policy must be reasonably related to long-term corporate profit.[113]

The great fear of neoclassical economic conservative commentators in the business press as well as the academy,[114] that such discretion would lead to rampant abuse of directors' powers, has not eventuated, as will be discussed below in the section dealing with legislation.[115]

It is clear from the foregoing that the duty to act bona fide for the company as a whole, far from precluding CSR, makes considerable room for it. CSR may well guide decision-making by the board of directors as a demonstration of bona fides, both subjectively and objectively. Further, contrary to the view that CSR is incompatible with the company as a whole, CSR is wholly consistent with developing case law in the area. Accordingly, it may well be the correct position that law mandates imposing on directors a duty to take a CSR approach.

Having examined the law's concern with the organization and its enterprise, and seeing that CSR is wholly compatible with, if not a better interpretation of directors' duty to the company as a whole, we now turn to examine in detail the specific nature of the second aspect of directors' fiduciary duty, the duty to act for a proper purpose.

IV. *Duty of proper purpose*

The duty of proper purpose deals with the reasons for which directors exercise discretion. The determination of whether a director has breached this fiduciary duty will hinge on whether the power has been exercised for a proper purpose. What exactly are the proper purposes for which the exercise of the powers is legal?

The courts have established a two step analysis. Firstly, there is an analysis of the power, followed secondly, by an analysis of whether it was exercised for proper purposes.

113. David Ruder, "Public Obligations of Private Corporations" (1965) 14 U Pa L Rev 209 at 223.

114. Licht, *supra* note 10.

115. Jonathan D Springer, "Corporate Constituency Statutes: Hollow Hopes and False Fears" (1999) 85 Ann Surv Am L.

The procedure was set out by Lord Wilberforce in *Howard Smith Ltd. v. Ampol Petroleum*[116]:

> It is necessary to start with a consideration of the power whose exercise is in question...[and] having ascertained, on a fair view, the nature of this power, and having defined as can best be done in the light of modern conditions the...limits within which it may be exercised, it is then necessary...to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not.[117]

In determining the substantial purpose, the court does not ignore that potentially conflicting purposes may exist, including directors' self-interest. The court will find a proper purpose so long as the motivating or substantial purpose is not a prohibited interest—i.e. a manifestation of disloyalty. As opined in *Mills v. Mills*, it is "not required by the law [that directors]...live in an unreal region of detached altruism and to act in the vague mood of ideal abstraction from obvious facts which must be present to the mind of any honest and intelligent man when he exercises his powers as a director."[118] And further,

> When the law makes the object...or purpose of a body of men, the test of the validity of their acts, it necessarily opens up the possibility of an almost infinite analysis of the fears and desires, proximate and remote, which, in truth, form the compound motives usually animating human conduct.[119]

Thus the law recognises a range of motives, conflicts and dynamics in the experience of everyday life. It does not lay down a hard and narrow line in its conception of human nature, at least in this instance.

Rather, the director may well have an interest. However, as Ipp J, of the High Court of Australia put it, if one is to impugn a director's decision, "[i]t must be shown that the substantial purpose of the directors was improper or collateral to their duties as directors of the company. This issue is not whether a management decision was good or bad; it is whether the directors acted in breach of their fiduciary duties."[120] This supports the view that directors may well exercise discretion to engage in CSR, contrary to the views of some scholars who believe that such directors' exercise of decision-making power is contrary to law.

116. *Howard Smith Ltd, supra* note 65.
117. *Ibid* at 835.
118. *Mills v Mills, supra* note 64.
119. *Ibid* at 185.
120. *Permanent Building Society (in liq) v Wheeler*, [1994] 12 ACLC 674 at 676-677 (WASC).

The proper purposes analysis is undertaken primarily in three contexts that place a focus on the shareholder. These contexts are: where a share issue is challenged,[121] registration or transfer of shares[122] and transactions undertaken for a collateral purpose—often for the purpose of defeating a takeover bid (discussed in detail in the next section).[123] In all of these cases, the same overriding issue comes to the fore: was the exercise of the power done for a proper purpose—i.e. for the benefit of the company? In those cases, shareholders often take to the courts to protect their interests. Yet, in these cases, unless the shareholder plaintiff proves otherwise, the courts will accept that the directors acted for a proper purpose, such purpose being in the interests of the beneficiary of the fiduciary duty, the company. Using the principles of CSR as guides for the exercise of discretion in directing a company, directors are most unlikely to fall afoul of their duties to act for a proper purpose. Rather, the maximizing of the overall wealth claims on the company is in fact best done by pursuing a CSR strategy. Thus, CSR, far from being an improper purpose, is well within the acceptable purposes of the directors' discretionary powers.

V. *CSR: the hard cases and the applied cases*

There are a group of cases that some law scholars declare preclude directors' use of corporate resources for non-profit activities for the benefit of non-shareholder constituencies. These cases, because of the weight given and interpretations drawn, merit further examination. The first case we will examine is the case of *Hutton v. West Cork Railway Co.*[124] In that case the court reversed a directors' decision to provide benevolence toward employees. Bowen LJ's oft repeated statement of the law is used to argue that law does not permit benevolence with company assets. Bowen stated: "[t]he law does not say that there are to be no cakes and ale, but that there are to be no cakes and ale except such as are required *for the benefit of the company*."[125] This felicitous anachronism has drawn attention away from the real issue in the case. The judgment in that case turned not on whether the company could do such acts. As Bowen LJ put it:

121. *Whitehouse v Carlton Hotel Party Limited,* [1987] 162 CLR 285 (HCA); *Howard Smith Ltd, supra* note 65; *Harlowe's, supra* note 53; *Mills v Mills, supra* note 64.

122. *Australian Metro, supra* note 95; *Ngurli, supra* note 55; *Re Smith & Fawcett Ltd,* [1992] 2 All ER 542 CA [Eng] [*Smith & Fawcett*].

123. *Darvall v North Sydney Brick & Tile Co,* [1989] 15 ACLR 230 (NSWSC) [*Darvall*]; *Pine Vale Investments v McDonnell & East Ltd,* [1983] 8 ACLR 199; *Winthrop Investments v Winns,* [1979] 4 ACLR 1 (NSWSC); *Revlon, Inc v MacAndrews & Forbes Holdings, Inc,* 506 A (2d) 173 (Del Sup Ct 1986) [*Revlon*].

124. (1883) 23 IR 654 (Ch D) [*Hutton*].

125. *Ibid* at 672 [emphasis added].

> They [directors] are not to keep their pockets buttoned up and defy the world unless they are liable in a way which could be enforced at law or in equity...[the issue is] whether...it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carrying on of the company's business for the company.[126]

Rather, the prohibition against corporate benevolence arose from the operational context—the termination of business.

The law lords in *Hutton* were at pains to point out that the answer to the question turns on whether the company is a going concern or in winding up. Further, they clearly distinguish shareholder interests as not being the issue. Bowen opined:

> The money which is going to be spent is not the money of the majority. That is clear. It is the money of the company....They can only spend money which is not theirs but the company's, if they are spending it for purposes which are reasonably incidental to the carrying on of the business of the company.[127]

Given that the company was being wound up and that the company would have no need of an on-going work force, there was no basis for the expenditure. Essentially the case is similar to a liquidation in that the cash of the company must go to the legitimate expenses incurred. To use the case to argue that CSR is prohibited by the ratio is to do violence to the judicial reasoning. In fact, the case makes it clear that sums or resources in addition to legal entitlements ought to be paid to labour as obviously in the interests of the corporation. In the words of Bowen: "that sort of liberal dealing with servants eases the friction...and is, in the end, a benefit to the company."[128]

A second case, *Parke v. Daily News,*[129] is one in which a newspaper publisher was to be shut down. Upon the sale and closure of the business, the directors decided to make an *ex gratia* payment to employees who would no longer be working for the corporation. The issue in the case, however, is not about CSR, but about proper purposes. In that case the court opined: "The view that directors...are entitled to take into account the interests of the employees, *irrespective of any consequential benefit to the company*...[has] no authority to support that proposition as a proposition

126. *Ibid.* This directive goes some distance to answering Welling's concern in his article, *supra* note 93.
127. *Hutton, ibid* at 671.
128. *Ibid* at 673.
129. [1962] Ch 927.

of law[.]"[130] Given that the facts of this case are quite similar to *Hutton v. West Cork Railway Co.*, it is unsurprising that the outcome was similar.

In the U.S.A., the case of *Dodge v. Ford*,[131] which has been widely used by scholars (though less so by the courts[132]) as authority against CSR, is similarly misunderstood.[133] Indeed, the case has been at the centre of the debate for decades. The issue among scholars appears to be less about directors' duties and shareholder primacy than about an unstated assumption about the meaning of the term "shareholder primacy." As alluded to above, where the term is taken to mean nothing but shareholder wealth maximization and all else is a breach, then the case looks like it stands for the proposition that directors can and must only maximize wealth. Bainbridge and others who believe shareholder primacy means only shareholder wealth maximization argue that *Dodge* stands for that proposition.[134] They quote Ostrander J's statement "[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."[135]

Where "shareholder primacy" means simply a preference of shareholders' interests ahead of the claims of other legitimate constituents,[136] however, the case loses its power and significance. A different view of shareholder primacy, one that is consistent with Blair and Stout's team production model appears to be a better interpretation. It is explained by D. Gordon Smith.

Smith's analysis of the case in his article on the doctrine of shareholder primacy develops an interpretation that introduces an important historical dimension that is not contained in the reported decision. Smith observes that the doctrine of shareholder primacy[137] is really a precursor to the contemporary law on minority oppression.[138] In the historical context, the case has little to say in terms of the focus of directors duties *vis-a-vis* the corporation.

The historical facts are that Ford, the majority shareholder, was trying to squeeze out the minority Dodge brothers and he did so by refusing to declare dividends. His was an obvious effort to thwart the Dodges, which

130. *Ibid* at 929 [emphasis added].

131. *Dodge v Ford*, *supra* note 77. See also, Geoffrey Miller, "Narrative and Truth in Judicial Opinions: Corporate Charitable Giving Cases" (2009) Mich St L Rev 831.

132. Yosifon, *supra* note 4.

133. Lynn Stout, "Why We Should Stop Teaching Dodge v. Ford" (2008) 3 Va L & Bus Rev 163.

134. Bainbridge, *supra* note 80.

135. *Dodge v Ford*, *supra* note 77 at 467.

136. Blair & Stout, *supra* note 39.

137. Bainbridge holds it as a representative of the doctrine.

138. Smith, *supra* note 21 at 318; Miller, *supra* note 131.

he did by expanding the business in a rather transparently random way as well as instituting a variety of employee and public benefit projects to achieve his aims. To refocus Ford, the court held that an understanding of the proper purpose of directors' powers was determined by the nature of the company. The court stated:

> The difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employe[e]s [sic], like the building of a hospital for their use and the employment of agencies for the betterment of their condition, and a general purpose and plan to benefit mankind at the expense of others, is obvious[.] 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.* The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself.[139]

The court noted that "it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others."[140] The court was struggling at this point in history with the identification of the changes in the corporate organization—with members transitioning to investors.[141] It is interesting to see the wide scope of CSR that the court allowed, from the founding of a hospital to unspecified agencies to help workers that could be within the valid exercise of directors' discretionary powers. Indeed, the legal issue addressed by the court in the case was the change of the corporation from a business to a charity, a change which would require a change to the constitution, and such a change in all commonwealth jurisdictions and the U.S.A. can only be done with shareholder approval.[142] Accordingly, the issue as framed by the court in the case is not CSR, but a change in the objects or purpose of the company from business to charity. Again, in the preceding quotation the court states that it is "obvious".

The case focuses on the rights of members in relationship to other members. As a result, the better interpretation Smith concludes is as follows: "[i]n short, *Dodge v. Ford Motor Co.* is best viewed as a minority oppression case. The case convincingly establishes the link between the shareholder primacy norm and the modern doctrine of

139. *Dodge v Ford*, *supra* note 77 at 506-507 [emphasis added].
140. *Ibid* at 507.
141. Morton J Horwitz, *The Transformation of American Law, 1780–1860* (Cambridge, MA: Harvard University Press, 1977) at 93.
142. *Dodge v Ford*, *supra* note 77.

minority oppression"[143] and is not an authority for shareholder primacy as shareholder wealth maximization or an authority against CSR.

Consider the more recent well-known American case of *Shlensky v. Wrigley*, which concerned a decision by directors not to install lights at a stadium where the installation would have generated additional revenues from night time games. The directors' decision not to have games played at night was based on a concern for the potentially detrimental effects on the neighbourhood surrounding the stadium. The community protection objective was their motivating purpose. Shareholders opposed the decision and brought the matter before the courts. On appeal the court stated:

> [I]t appears to us that the effect on the surrounding neighborhood might well be considered by a director who was considering the patrons who would or would not attend the games if the park were in a poor neighborhood...the decision is one properly before directors and the motives alleged in the amended complaint showed no fraud, illegality or conflict of interest in their making of that decision.[144]

In yet another American case that sets a wide range of CSR activities within the proper purpose constraints on directors' decision-making discretion, *AP Smith Manufacturing*,[145] the court stated:

> There is no suggestion that it [the donation] was made indiscriminately or to a pet charity of the corporate directors in furtherance of personal rather than corporate ends. On the contrary, it was made...in the reasonable belief that it would aid the public welfare and advance the interests of the plaintiff as a private corporation and as part of the community in which it operates. We find that it was a lawful exercise of the corporation's implied and incidental powers under common-law principles and that it came within the express authority of the pertinent state legislation[.] Corporations have come to...insure and strengthen the society which gives them existence and the means of aiding themselves and their fellow citizens. Clearly then, the appellants, as individual stockholders whose private interests rest entirely upon the well-being of the plaintiff corporation, ought not be permitted to close their eyes to present-day realities and thwart the long-visioned corporate action in recognizing and voluntarily discharging its high obligations as a constituent of our modern social structure.[146]

This statement merits comment. The judges have clearly stated that the corporation is a participant in society, and must recognize such and

143. *Ibid* at 507.
144. *Shlensky v Wrigley*, 237 NE (2d) 776 at 180-181 (Ill App Ct 1968).
145. *Smith and Barlow*, *supra* note 52 at 160-161.
146. *Ibid* at 160-161.

contribute to society. Further, the court makes it clear that shareholders may not "close their eyes to the present-day reality...of our modern social structure." The court observes that the corporation relies on the community and has a duty to support that community in return. To cause the corporation to fulfil this duty is a proper purpose for directors' exercise of their powers.

The case of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[147] is sometimes thought to constrain the discretion of directors in attending to CSR. The case does not do so. Rather, the decision clearly turns on the facts. The directors of Revlon had set up an auction and then created a lock-up (anti-takeover strategy).[148] In other words, the directors had determined to sell the company by auction and then sought to prevent the highest bidder from winning. While the initial objective had been to keep the company's enterprise operating as a going concern, an objective within directors' discretion and enhancing CSR, as we have seen in *Teck*, once it became clear that a break up of the company was inevitable, the directors' obligation changed from consideration of constituency or CSR interests to obtaining the highest price. It could be argued that this is simply a particular application of the duty of care. In the case of a sale, whether in this case the sale of the corporate equity, or any other sale, the directors' duty is clearly to maximize the value.

The court opined:

> [A] board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders... However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.[149]

In other words, the court is not precluding CSR obligations; rather, it is delineating when those obligations end.

The ongoing debate in American corporate law scholarship concerning shareholder primacy and directors' duties is basic in this context.[150] On the one hand, there are a number of scholars who take the view that shareholder primacy is the positive law. On the other hand, a number of leading scholars take a different view—that shareholder interests are

147. *Revlon, supra* note 123; followed in *Mills Acquisition Co v Macmillan, Inc*, 559 A (2d) 1261 at 1282 (Ill Sup Ct 1988).

148. The court notes "The somewhat complex maneuvers of the parties necessitate a rather detailed examination of the facts."

149. *Revlon, supra* note 123 at 182.

150. Yosifon, *supra* note 4.

one among many interests to be taken into account in decision-making. The focus of the debate tends to be the *Ford, Unocal, Revlon,* and more recently, *eBay v. Newmark*,[151] cases.

All of these cases are fundamentally driven by the fact patterns and specific contexts. The cases of *Ford* and *eBay* are about whether a company limited by shares can ignore shareholder interests for purposes of the public good. The clear answer is no. Such companies are set up to benefit shareholders and directors cannot act contrary to that purpose, at least indefinitely.

The court's position on this matter in *eBay v. Newmark* has interesting echoes of *Dodge v. Ford* and as such merits a full quotation of the relevant section:

> The corporate form in which craigslist operates, however, is not an appropriate vehicle for *purely philanthropic* ends, at least not *when there are other stockholders* interested in realizing a return on their investment. Jim and Craig opted to form craigslist, Inc. as a for-profit Delaware corporation and voluntarily accepted millions of dollars from eBay as part of a transaction whereby eBay became a stockholder. Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards *include* acting to promote the value of the corporation for the benefit of its stockholders. The "Inc." after the company name has to mean at least that. Thus, I cannot accept as valid for the purposes of implementing the Rights Plan a corporate policy that specifically, clearly, and admittedly *seeks not to maximize the economic value* of a for-profit Delaware corporation for the benefit of its stockholders.[152]

There should be nothing surprising or concerning for most corporate law scholars in these words. The court is simply affirming that directors have a wide range of factors to include in decision-making, that those factors are dynamic, rising and falling over time, but that fundamentally, a corporation cannot ignore shareholder wealth interests (not necessarily maximization) when called upon by shareholders to do so. The court provided that even in the context of a Delaware incorporated corporation, directors still maintain a very wide discretion. Promoting shareholder benefits is *included* as one valid objective, and a prohibition on *not seeking to maximize economic value* are identified as constraints on directors' discretions. The court will not interfere with directors' decisions as long as those decisions have some relation to shareholder benefit, only narrowed to *Unocal's* enhanced standard of "rational relation" in the context of takeovers.

151. *eBay Domestic Holdings, supra* note 79.
152. *Ibid* at 60-61 [emphasis added].

The *eBay* decision is similar to *Dodge v. Ford*. In both cases, the one party respondent was not interested in wealth—i.e. was pursuing a public purpose—whereas the party applicant was invested for the private purposes of a return on private equity investment. In *eBay v. Newmark* the court observed "[a]ll directors of Delaware corporations are fiduciaries of the corporations' stockholders."[153] This particular position may mark Delaware as potentially distinct from at least some of its sister states. As demonstrated above, none of the other Commonwealth jurisdictions examined in this article have this duty that is focused on the corporate body—what may be perhaps a better way of interpreting this statement is that among the duties of directors under the Delaware law is a duty to shareholders. Some such statement is wholly consistent with the argument here: the argument is not that directors have no obligations to or can flout shareholders' interests with impunity. Rather, the point is that directors have a range of constituents and a number of considerations that are to be invoked in decision-making.

As the court stated in *eBay*, "[p]romoting, protecting, or pursuing non-stockholder considerations must lead at some point to value for stockholders."[154] Where a rights agreement poison pill was adopted to thwart monetization of craigslist.com, the court held that the directors were in breach of their fiduciary duties of "promoting stockholder value," not maximization. Indeed, what the court found objectionable in that case is that the whole purpose of the rights agreement was to thwart that objective[155]—a purpose clearly and fundamentally contrary to the concept of the corporation limited by shares.

The case of *Revlon*, like other similar cases, occurred in the context of takeovers or wind ups where the survival of the enterprise operated by the company was not expected. In these contexts, the court's examination and evaluation of directors decision-making with reference to the corporation refers back to the shareholders, the final constituency to have any interest at all. Again, the court has held that shareholder interests cannot be ignored, and indeed, in this wind up context, shareholders' economic interests are paramount. Yet, it begs two questions: which shareholders, and which of their interests? One could imagine, for example, a transaction in which either or both the selling institutional investors and acquiring investors have CSR policies that require consideration of social impacts—a

153. *Ibid* at 44.
154. *Ibid* at 57.
155. *Ibid* at 59.

position held by major investment groups subscribing to the PRI.[156] In such circumstances the interests of shareholders certainly include wealth maximization; however, such a wealth maximization norm need not exclude social responsibilities of the corporation. This is, in part, the meaning of the statement in *Unocal*, "like another business decision, the board has a duty in the design and conduct of an auction to act in the best interests of the corporation and its shareholders."[157] The directors in *eBay* failed because they acted in the absence of a credible threat and their response was not proportionate—i.e. the *Unocal* test.

To say that the doctrine of shareholder primacy means exclusively maximizing shareholder wealth is incorrect.[158] The controversy arising from *Revlon* has a clear solution within the case itself. The court stated that "the board may have regard for various constituencies in discharging its responsibilities provided they are rationally related benefits accruing to the stockholders." The statement does not preclude granting of benefits to other stakeholders; rather, the consideration of other stakeholders cannot be done in the absence of some benefit to shareholders—a position some distance from the understanding of shareholder primacy as shareholder wealth maximization or shareholder exclusivity—and interestingly, a position wholly consistent with the jurisprudence of over a century and a half, beginning with *Hutton v. West Cork Railway*.

Thus, the point of the cases is not that CSR is prohibited; rather, the point is that directors' decision-making powers and the exercise of their discretion must include the shareholders among the beneficiaries. In no case is the director impugned or censured for engaging in CSR or considering interests other than those of the shareholders. Further, except in the specific context of takeovers or winding up transactions, shareholders' interests need not be at the forefront of directors' minds or dominant when decision-making.[159] Simply, they are among other touch points for decision-making. It is unfortunate that this jurisprudence arises almost solely in the context of takeovers and so its applicability in other contexts

156. United Nations, PRI, *supra* note 91. This point is also made in David A Wishnick, "Corporate Purposes in a Free Enterprise System: A Comment on eBay v. Newmark" (2012) 121 Yale LJ 2405 at 2413.

157. Note that the court assumes the two interests are co-terminus and does not identify what those interests are to be.

158. Notwithstanding Chancellor Strine's statement equating shareholder primacy with shareholder wealth maximization. See Yosifon, *supra* note 4 at 16.

159. This is the court's concern in *eBay v Newmark*. The court in that case took the higher standard of review, the "enhanced scrutiny rule" from *Unocal* created in response to possible exploitation by directors at corporate and shareholder expense in the context of takeovers, because the action taken by the directors—the creation of a Rights Plan favouring themselves—is readily subject to abuse. See *eBay Domestic Holdings*, *supra* note 79 at 49-51.

is unclear, but as it does, it is only appropriate to limit its application to that takeover context.[160]

In Canada, the Supreme Court has clarified directors' obligation to non-shareholder constituents in both the *Peoples* and *BCE* litigation. In the former case, the court stated in obiter:

> We accept as an accurate statement of law that in determining whether they [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.[161]

In *BCE*, the same court stated: "In *Peoples Department Stores*, this Court found that although directors *must* consider the best interest of the corporation, it may also be appropriate, although not mandatory, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders."[162] The controversy surrounding the case, which in that instance required the directors to consider the interests of bondholders, and which ultimately led to an increased level of court deference to directors, as noted, has led to some controversy. The controversy appears to be that there has been little articulation of the increased discretion and most troublingly, the increased discretion has come without added duties to act as a counter-balance.[163] It may well be that the Court, using the language of "corporate citizenship," is pointing to the need to re-conceptualize the corporation and its large social and ecological footprint as a social and political actor with an eye to better regulation of it as such.

Nevertheless, in terms of the topic at hand, none of the hard cases in any way prohibits CSR. Rather, each case, put in its proper context, does no more than act to reinforce doctrines and ratios established in the earlier discussion of directors' duties. In other words, there is nothing in these latter cases prohibiting or even putting boundaries on CSR that is out of the ordinary with respect to corporate law of directors' duties properly understood.

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160. The earlier discussion would lead one to suggest that given the wide range of discretions and jurisprudence on directors' duties and decisions, to place a form of shareholder primacy in which shareholder wealth maximization is the sole and overriding objective of directors' duties is contrary to law. In *eBay Domestic Holdings*, the court makes the observation of the dual standards of review available—one in the ordinary course of business, the "deferential business standard," and another in the takeover context, "the enhanced scrutiny standard" from *Unocal*.

161. *Peoples Department Stores*, *supra* note 6.

162. *BCE Inc*, *supra* note 73.

163. VanDuzer, *supra* note 7.

VI. *CSR: the legislation*

The legislation across the jurisdictions under consideration allows directors to take account of CSR in their decision-making. As noted earlier, the legislation is not inconsistent with the common law. For the most part it embodies the fiduciary duties and the duties of skill and care already analysed. From the U.K.'s recent identification and address of the issue in its latest reform of company law[164] to the U.S.A.'s constituency legislation, the legislation has refused to see corporations as being exclusively about shareholder wealth maximization. The corporation serves other purposes.

Consider, for example, the most recent company law statute in the U.K. The relevant section creates a mandatory duty to consider non-shareholder interests. The section reads:

> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
> (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.
>
> (2) 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.
>
> (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

There is yet to be significant judicial interpretation of this section.[165] However, it clearly imposes a duty on directors to consider non-

164. Scholarly opinion is divided as to the interpretation of the section as conservative, merely codifying existing law, (Andrew R. Keay, "The Duty to Promote the Success of the Company: Is it Fit for Purpose?" online: (2010) SSRN <http://www.ssrn.com>) or reforming (Ian Havercroft & Arad Reisberg, "Directors' Duties Under the UK Companies Act 2006 and the Impact of the Company's Operations on the Environment," online: (2010) SSRN <http://www.ssrn.com>). The consensus, however, is that it has and will have little effect in changing practice. To the extent practice is changing, it is doing so in response to normative changes in the commercial environment—i.e. the license to practice—rather than legislative reform.

165. See discussion in Keay, *ibid.*

shareholders. The section unequivocally states that the consideration must occur in light of the benefit of the members and take into consideration the long-term effects on the company.[166] Although it has been argued that this provision is no more than a codification of the existing position, that view is hard to sustain. While corporate law in the U.K. has provided wide latitude to directors in terms of decision-making discretion, it has not mandated such. Further, the law of corporations has not identified which shareholder-members are to be considered. Here the statute does exactly that: it uses mandatory language and identifies the long-term shareholder. Given that corporate law has neither identified the other interests that may properly be considered, nor mandated consideration of the long-term,[167] the section is reform. This analysis, however, is not the end of the matter.

When one considers the long term, it is difficult to consider the members as a whole in any light other than as forming an organization, a collective and an enterprise in its own right. Section 172(1)(a) only makes sense when interpreted that way. This interpretation coalesces with Selznick's idea that "decision making in the light of long-run benefits presumes a concept of the institution [and]...the empirical requirements of organizational survival."[168] It cannot be the interests of one constituency to the disregard and detriment of all others. The long term is the ongoing life of an organization, an interest directly contrary to the short-term shareholder interests which drive the stock market analysts' tyranny.[169] Further, the section makes an explicit acknowledgement of the social footprint. It requires consideration of employment and the institutional implications of decisions by reference to community and "reputation... of business conduct." Clearly, these latter two issues are not susceptible to accurate measurement. Yet surely, they are core aspects of company powers and hence ought to be core company responsibilities.

The U.S. position is not that different. U.S. directors are not wholly free of such obligations. Indeed, the constituency legislation, as it is known, imposes certain similar duties, but usually only in particular contexts—again, takeovers.[170] For example, the *Ohio Revised Code* §1701.59 (F) offers:

> [A] director, in determining what the director reasonably believes to be in the best interests of the corporation, shall consider the interests of the

166. Welling argues that this duty without sanction is rather meaningless. Welling, *supra* note 93.
167. Keay, *supra* note 164.
168. Selznick, *supra* note 107 at 47.
169. *Ibid.*
170. Roberta Romano, "Comment: What Is the Value of Other Constituency Statutes to Shareholders?" (1993) 43 UTLJ 553.

> corporation's shareholders and, in the director's discretion, may consider any of the following:
> (1) The interests of the corporation's employees, suppliers, creditors, and customers;
> (2) The economy of the state and nation;
> (3) Community and societal considerations;
> (4) The long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.[171]

While the corporations law in the U.S.A. is state-based and varies considerably across jurisdictions, there is the common model code or similar provisions, which a number of jurisdictions have followed.[172] Illinois,[173] Pennsylvania[174] and other states have similar provisions, as does the American Law Institute's *Principles of Corporate Governance*,[175] which are permissive in nature.[176] That is, the legislation allows a range of other interests to be considered by directors, but does not mandate such consideration.

This view of the company as a whole, as an organization or institution providing an object for directors' attention—as opposed to or beyond the ethereal shareholder—is helpful. It both avoids the obvious shareholder fictions and provides necessary guidance for directors. It adds some reality to the actual complex balancing task facing directors. As Millon observes, corporate norms (and by implication, directors) need to (1) promote stable relations between certain non-shareholder constituencies and the corporation, (2) adjust the gains between shareholders and non-shareholders, (3) address the fairness in allocation of transaction costs, and (4) look for ways to include in decision-making those most directly effected by such decisions.[177] This view works well with Smith's view that the objective of directors' duties is to increase the overall value of the company including that of shareholders, as opposed to shareholders only

171. Ohio Revised Code §1701.59

172. John H Matheson & Edward S Adams, "A Statutory Model for Corporate Constituency Concerns" (2000) 49 Emory LJ 1085; Stephen M Bainbridge, "Interpreting Nonshareholder Constituency Statutes" (1992) 19 Pepp L Rev 971. The Delaware General Corporation Law Section 122(9) provides that a corporation has the power to "make donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof."

173. Ill Comp Stat Ann 805/8.85.

174. 15 Penn Stat § 1715.

175. American Law Institute Principles Of Corporate Governance §2.01.

176. Bainbridge, *supra* note 172 at 987—a position which has changed very little in the last two decades. The Connecticut code makes consideration of non-shareholder interests mandatory. Connecticut Gen Stat § 33-756 (2006).

177. David Millon, "New Directions In Corporate Law: Communitarians, Contractarians, And The Crisis In Corporate Law" (1993) 50 Wash & Lee L Rev 1373 at 1388.

and to the detriment of other claimants.[178] A broader scope to directors' duties facilitates the exercise of discretion for the task. The modelling developed by Jensen fails to address the difficult and complex tasks of corporate directors and so cannot be a guide for the evaluation of their decisions by courts or the development of corporate law.[179]

The Canadian position is an interesting one. On the one hand, Canada has stepped ahead of its American cousin through the judgments in *Peoples* and *BCE*. Indeed, its legislation allows the courts the discretion to fashion such duties and rights. On the other hand, it has not fully developed its approach.[180] It is at a halfway point between soft law and hard law.

The attempted legislative response by way of Bill-300, the *Corporate Accountability of Mining, Oil and Gas Corporations in Developing Countries Act,* and its failure to be passed, led the Canadian government to create an Industry Canada CSR website and Extractive Industries Counsellor.[181] Interestingly, perhaps the best way to characterize these steps is what sociologists of law describe as "incipient law." Such law, as Selznick explains, is "created by a stabilized public sentiment or pattern of organization; it refers to a compelling claim of right or a practice so viable and so important to a functioning institution as to make legal recognition in due course highly probable."[182] Although the legislation did not pass in this form, it is highly likely that its failure is not the end of the matter. Bill C-300 directly emerges from wide stakeholder consultation that took place through the National Roundtables on Corporate Social Responsibility and the Canadian Extractive Sector in Developing Countries. It is consistent with the recommendations of the National Roundtables Advisory Group."[183] As Janda stated, "[t]here are good precedents internationally and within existing Canadian practice for the kinds of measures Bill C-300 envisages."[184]

Indeed, that part of the extractive industry that is connected to the jewellery industry is being regulated by a number of international private law systems such as the Kimberley process, the Responsible Jewellery Council and others. Such initiatives may meet with limited success because they are not unlike their public law counterparts, which also suffer

178. Smith, *supra* note 30.
179. Licht, *supra* note 10.
180. PM Vasudev, "Stakeholders in the Canada Business Corporations Act: An Appraisal and Some Proposals," online: SSRN <http://www.ssrn.com>.
181. Government of Canada, "Corporate Social Responsibility" (1 December 2011), online: Industry Canada <http://www.ic.gc.ca>.
182. Selznick, *supra* note 107 at 32.
183. Janda, *supra* note 1 at 2.
184. *Ibid* at 2.

from regulatory failure. Despite the failings of private law initiatives, such initiatives leave in their wake a sense among NGO's and civil society that social costs can be controlled and that private regulation can accomplish something, even if it is not to the extent that its advocates want. These initiatives, while far from perfect, likely provide more than what would have been achieved in their absence. The Canadian Extractive Industries Counsellor has had very limited success because, at least in part, she was limited by policies of the government of the day that prioritized economic rights to the detriment of human rights.[185] Greater success may be obtained in the fullness of time when a government more disposed towards human rights takes power, and modifies the jurisdiction and power of the Counsellor. In Australia, various Parliamentary bodies have examined the issue of CSR, and although to date, no bills have been tabled to legislate CSR, it is far from a dead topic.[186]

If directors were to be challenged for socially responsible decisions as contrary to the interests of the corporation, and they were not able to state that there was an ultimate benefit to the corporation, there are two avenues potentially available to exculpate them. These are the business judgment rule and the unique organizing document, the corporate constitution or charter.[187] Both of these rule sets may alter the directors' liability—indeed, the constitution may positively re-direct it.[188] It is certainly possible to create provisions within a constitution to permit a wide range of discretions and obligations, which may provide little or no benefit to either the corporation or its shareholders, at least in terms of economic gain. These two approaches are discussed next in turn.

185. Catherine Coumans, "Mining and Access to Justice: From Sanction and Remedy to Weak Non-Judicial Grievance Mechanisms" (2012) 45 UBC L Rev 651. See also, Catherine Coumans, "Submission to the Government or Canada's Review of Corporate Social Responsibility Strategy for the Canadian Executive Sector" MiningWatch Canada (8 January 2014), online: MiningWatch Canada <http://www.miningwatch.ca>.

186. Redmond, *supra* note 4. See also, Austl Commonwealth, Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations Report* (Sydney: Australian Government, 2006).

187. Articles of Association (United Kingdom) and Certificate of Incorporation (Delaware, United States).

188. Generally, little attention is paid to the constituting documents with the exception of some special purpose corporations such as the Benefit Corporation in the USA, or other non-shareholder companies such as companies limited by guarantee. See, e.g., *Vermont Benefit Corporations Act* tit *IIA*, s 21 (2009).

VII. *Exculpation of directors' exercise of discretion*

Prior to turning to that discussion it is worth addressing a point made by Yosifon.[189] In his paper, he objects to directors being excused from shareholder wealth maximization on the basis of the business judgment rule. Yosifon believes that directors can only enter into plans to benefit non-shareholder constituents by failing to be forthright about the objectives of their decision. Because of his interpretation of shareholder primacy as an inviolable duty to maximize shareholder wealth at all times in all instances, he believes that directors who wish to benefit non-shareholders cannot do so except by subterfuge. This approach, he argues, is analogous to the U.S. military's infamous practice: "don't ask, don't tell," which he rightly describes as "a dishonorable and dysfunctional way to bring non-shareholder interests into the boardroom, where formal law forbids their presence."[190]

Yosifon is correct in this characterization; however, there is clear, open and frank discussion about the pursuit of social objectives by the majority of large industrial organizations around the world through their sustainability initiatives and related reporting.[191] These decisions, whether to participate in the UN's Global Compact, the International Organization for Standardization's 26000, the Global Reporting Initiative, or other international private regulatory systems, appear to be within the range of legally permitted discretions—at least if one considers that they are clearly being made on the explicit advice of lead corporate counsel globally. Further, participation in such schemes is more than mere rhetoric.[192] It should be remembered that counsel that advise these corporations also advise shareholders who might be looking to increase funds available to shareholders by opposing such schemes. Certainly, it doubtful that the Delaware court, which entertains shareholder lawsuits contesting corporate investments in various types of activities, would declare the practice illegal.

189. Corporate responsibility reporting has become de facto law for business. See KPMG, "KPMG International Survey of Corporate Responsibility Reporting 2013" (9 December 2013), online: KPMG <http://www.kpmg.com>; Yosifon, *supra* note 4.

190. KPMG, *ibid*; Yosifon, *ibid*.

191. KPMG, *ibid*. See Sheehy, Defining CSR, *supra* note 4; Perry E Wallace, "Climate Change, Fiduciary Duty, and Corporate Disclosure: Are Things Heating up in the Boardroom" (2008) 26 Va Envtl LJ 293.

192. Lisa Fairfax, "The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms" (2006) 31 J Corp L 675.

1. *Business judgment rule*

The first approach to defending directors against an attack for taking non-shareholder considerations into decision-making is by way of the business judgment rule. The rule is a doctrinal and positive expression of the extent of the law's deference to directors' decision-making powers and discretion. Although the courts have stated time and again that they are unwilling and not competent to substitute their own view of what the right or better decision would be,[193] in many jurisdictions, legislation has been passed explicitly declaring that in the absence of compelling evidence to the contrary, directors are entitled to be taken as operating bona fides and within their discretions.[194]

In the U.S.A., where the rule originated, it has been explained thusly: "directors of a corporation...are clothed with [the] presumption, which the law accords to them, of being [motivated] in their conduct by a bona fide regard for the interests of the corporation whose affairs the stockholders have committed to their charge."[195] In Australia, the statutory version states that:

> A director or other officer of a corporation who makes a business judgment is taken to meet...their...duties...in respect of the judgment if they: make the judgment in good faith for a proper purpose; do not have a material personal interest in the subject matter of the judgment; and inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and rationally believe that the judgment is in the best interests of the corporation.[196]

In other words, where directors have discharged their duties, they have a complete defence to any challenge to their decisions. Indeed, it is hard to see why the statutory rule was enacted as it seems redundant.[197] Some see it as dangerous.[198] The statutory business judgment rule, however, is not ubiquitous as neither the Canadian nor the U.K. legislation has a business

193. See, e.g., *Darvall, supra* note 123: "the purpose of the court's jurisdiction...is...not to substitute an ex post decision for that of the directors, on the merits of a particular dealing. It is to assure the integrity of their decision at the time in the exercise of their fiduciary powers."

194. *Smith & Fawcett, supra* note 122 at 308.

195. *Gimbel v Signal Cos*, 316 A (2d) 599 at 608 (Del Ch 1974).

196. *Corporations Act 2001* (Cth), s 180(2); *CBCA, supra* note 23, s 123(5).

197. Paul Redmond, "Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule?" in Ian Ramsay, ed, *Corporate Governance and the Duties of Company Directors* (Melbourne: University of Melbourne, 1997). In the US, see Franklin Gevrutz, "The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?" (1994) 67 S Cal L Rev 287.

198. Mark Byrne, "Directors to hide from a sea of liabilities in a new safe harbour" (2008) 22 Austl J Corp L 255.

judgment rule. Those jurisdictions see the basic principles enshrined in the case law as sufficient.[199]

Yet, the business judgment rule has an important contribution to understanding the relationship between CSR, directors' discretion and their duties. Viewed in the negative, Reinhardt and Stavins observe "[t]he business judgement rule makes fiduciary duties difficult to enforce, and it effectively grants managers discretion to 'temper business decision-making with their perceptions of social values.'"[200] They continue: "as a practical matter, as long as managers can plausibly claim that their actions are in the long-run interests of the firm, it is almost impossible for shareholders to challenge the actions of managers who act in the public interest."[201]

Questions may be posed concerning the scope of the business judgment rule. In Australia, the statutory answer is as quoted above: as far as "[t]he director's or officer's belief that the judgment is in the best interests of the corporation is a rational one."[202] In other words, as Reinhardt and Stavins explain: "Corporate managers' decisions can be regarded as irrational—and thus not protected by the business judgement rule—only if they 'go so far beyond the bounds of reasonable business[.]"[203] Accordingly, directors pursuing CSR strategies are free to do so. Where they are challenged, they should expect complete protection from the business judgment rule. This position is wholly paralleled by U.S. law.[204] All of the cases discussed to this point corroborate this view. In every one of them, the court upheld decisions in favour of non-shareholder constituencies except in the case of an auction. Although none of these cases were decided on the basis of the business judgment rule, it may well be argued that these cases would support the view that CSR type decisions fall within the normal business judgment of directors and so are not reviewable by the courts.

2. *Objects clause and the corporate constitution*

Historically, the purpose of the corporation was set out in its constituting documents. This constitution contained an objects clause which, among other things, guided the directors of the corporation with respect to the exercise of discretion in decision-making: what was within the scope of the

199. *Mapleleaf Foods Inv v Schneider Corp* (1998), 42 OR (3d) 177 at 192. Referred to with approval in *Peoples Department Stores*, *supra* note 6 at 39.
200. Forest L Reinhardt & Robert N Stavins, "Corporate social responsibility, business strategy, and the environment" (2010) 26 Oxford Review of Economic Policy 164 at 167 [footnotes omitted].
201. *Ibid* at 9.
202. *Corporations Act 2001* (Cth), s 180(2).
203. Reinhardt & Stavins, *supra* note 200 at 9.
204. See Smith, *supra* note 21 at 286-288.

objects of the corporation; and whether that corporation was a charitable corporation or a trading corporation. Both facets of the objects clause limited and guided the directors' decision-making in terms of strategic decisions as well as more specific tactical decisions concerning the expenditures and revenues of the entity. This approach may be considered an *ex ante* approach to permitting or even mandating CSR.

Although today the strength of the objects clause and the related doctrine of *ultra vires* is all but finished in most common law jurisdictions,[205] the corporation's objects may both guide and exculpate directors in and for their decisions. For example, section 2.1 of Australian Ethical Investment Limited's constitution provides that the company will order its affairs including its investments so as to aid:

> (a) the development of workers' participation in the ownership and control of their work organisations and places;...(e) the amelioration of wasteful or polluting practices;...(h) activities which contribute to human happiness, dignity and education; (i) the dignity and well being of non human animals; (j) the efficient use of human waste; (k) the alleviation of poverty in all its forms.[206]

This constitution allows investment decisions to be made on matters that are extraneous from an economic or financial perspective while critical to social objects. Indeed, while the company is a trading company and so seeks to make a profit for the shareholders, it aims, as noted in the constitution, to make the employees significant shareholders. Directors of such companies have a particular mandate to engage in CSR activities, and the mandate will inform and shape their particular duties.

VIII. *Balancing changing priorities in a dynamic environment*

As the cases indicate, the context is determinative of the obligation, which although always directed to the corporation, may require a particular constituent to be considered or ignored. In a pre-incorporation or pre-purchase context, the company may be liable to outsiders about to invest and so require directors to attend to those interests.[207] As such, it is better law to state that the focus of company attention, and hence the focal point for directors' duties, are not set in stone.

205. Paul J Omar, "Powers, Purposes and Objects: The Protracted Demise of the Ultra Vires Rule" (2004) 16 Bond L Rev 93.

206. Australian Ethical Investment Limited, "Constitution" (27 November 2008), online: Australian Ethical Investment Limited <http://www/australianethical.com.au>.

207. *Meridian Global Funds Management Asia v Securities Commission*, [1995] 3 NZLR 7 (PC) and *Sons of Gwalia v Margaretic*, [2007] 231 CLR 160 (HCA)—the latter modified by legislative reform.

It is not as if the court or the legislature has dictated "you must maximize shareholder wealth in all instances" or even "shareholder interests must always come first or you are in breach of your fiduciary obligations." Rather, the law is that directors are required to exercise discretion, as Blair and Stout argue, balancing a dynamic team engaged in production.[208] This statement means that directors are required both to determine objectives and to prioritize between those competing objectives on an ongoing basis.[209] In organizational terms, this issue is described as goal complexity.[210] Accordingly, directors both need and have a wide berth of discretion—a position recognized at law through the doctrine of judicial deference and the business judgment rule.

Again, in *BCE Inc. v. 1976 Debenture Holders*, the court stated:

> There is no principle that one set of interests — for example the interests of shareholders — should prevail over another set of interests. Everything depends on the particular situation faced by the directors and whether, having regard to that situation, they exercised business judgment in a responsible way.[211]

In *Peoples Department Stores Inc. (Trustee of) v. Wise*, the same court opined:

> The various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(a) of the CBCA. At all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.[212]

Directors must shift priorities to address operational issues as, for example, when operations require them to begin to deal with new substances and so environmental concerns become paramount, or where new machinery or new processes are implemented, to attend to occupational health and safety issues. These priorities may indeed be destructive of shareholder wealth, yet at law they must be addressed and prioritized over shareholder wealth. Economic ideas of efficient breach that condone non-compliance on the basis of economic norms, cannot be allowed to override fundamental legal obligations—something even Milton Friedman acknowledged when

208. *Blair & Stout, supra* note 39.
209. Licht, *supra* note 10.
210. Michael D Cohen, "Conflict and Complexity: Goal Diversity and Organizational Search Effectiveness" (1984) 78 The American Political Science Review 435.
211. *BCE Inc, supra* note 73 at para 84.
212. *Peoples Department Stores, supra* note 6.

he added to his prescription "to make as much money as possible" the condition "while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom."[213] Directors must balance and shift priorities regularly and promptly if they are to discharge both their legal duties and operational responsibilities. Far from an unwavering focus on shareholder wealth, the directors' job is a continual balancing act in a dynamic, ever-changing environment. Law acknowledges and protects that reality.

In dealing with what might be considered a line of hard cases, the *Revlon* line,[214] which some have interpreted as mandating continual shareholder primacy and wealth maximization, particularly in a takeover context, the Supreme Court of Canada made the following observations.

> What is clear is that the Revlon line of cases has not displaced the fundamental rule that the duty of the directors cannot be confined to particular priority rules, but is rather a function of business judgment of what is in the best interests of the corporation, in the particular situation it faces. In a review of trends in Delaware corporate jurisprudence, former Delaware Supreme Court Chief Justice E. Norman Veasey put it this way:
>
> > [I]t is important to keep in mind the precise content of this "best interests" concept—that is, to whom this duty is owed and when. Naturally, one often thinks that directors owe this duty to both the corporation and the stockholders. That formulation is harmless in most instances because of the confluence of interests, in that what is good for the corporate entity is usually derivatively good for the stockholders. There are times, of course, when the focus is directly on the interests of stockholders. But, in general, the directors owe fiduciary duties *to the corporation,* not to the stockholders.[215]

Reinforcing this view of a duty to multiple stakeholders in the dynamic environment of decision-making, statutory derivative actions in a number of jurisdictions[216] provide rights to non-shareholders suggesting that it is not only shareholder interests that need to be taken into account by directors when making decisions. For example, in Australia, section 1324(1) of the *Corporations Act* provides:

213. Friedman, *supra* note 9.

214. *Revlon, supra* note 123 and *Unocal Corp v Mesa Petroleum Co*, 493 A (2d) 946 (Del Sup Ct 1985).

215. E Norman Veasey & Christine T Di Guglielmo, "What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments" (2005) 153 U Pa L Rev 1399 at 1431.

216. Melissa Hoffman, "The Statutory Derivative Action in Australia," online: (2006) 13 Corporate Governance ejournal <http://www.bond.edu.au>.

> Where a person has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes or would constitute: (a) a contravention of this Law; (b) attempting to contravene this Law;...the Court may, on the application of [ASIC], or a person whose interests have been, are or would be affected by the conduct, grant an injunction on such terms as the Court thinks appropriate, restraining the first-mentioned person from engaging in the conduct and, if the opinion of the Court it is desirable to do so, requiring a person to do any act or thing.

Although, as Bainbridge rightly observes, whether a court prefers shareholder primacy or social responsibility, it ultimately does not matter: "[u]nder either approach, directors who consider non-shareholder interests in making decisions, like directors who do not, will be insulated from liability by the business judgment rule."[217] This is true, at least where their decisions are not in clear breach of their duties. From a practical perspective, as noted, there is little real threat of personal director liability in any event.[218] Yet it is important to note that directors' duties are not interpreted by courts as statically focused on some pole star or objective function as Jensen, Meckling and other economists may have it.[219]

Conclusion

In the contemporary environment of increased demands on industrial organizations housed in corporations, polarized political debate, and expanding corporate reach, the guidance and delineation of directors' legal duties, management responsibilities and social obligations becomes more complex. In light of these developments, CSR is seen as a problem as well as a solution.[220] It is a problem in that it is thought to be contrary to corporate law, and contrary to shareholders' interests. It is a solution in that it accepts the realities of organizational goal complexity and allows corporations to act in ways that reflect their social context and hence, social obligation.[221] The law's conception of the corporation is problematic and complex,[222]

217. Bainbridge, *supra* note 172 at 980.

218. Brown, *supra* note 24.

219. Jensen, *supra* note 30.

220. CA Harwell Wells, "The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century" (2002) 51 U Kan L Rev 77.

221. Sheehy, "The Importance," *supra* note 76.

222. F Patfield, "Challenges for Company Law" in F Patfield, ed, *Perspectives of Company Law* (London: Kluwer Law Inemational, 1995) cited in Michael Cody, "Evaluating Australia's Corporate Law Reform from an Organisational Theory Perspective" (2008) 21 Austrl J Corp L 210:

> "Company law is complex because it is concerned with the structuring and organisation of economic power...If we want our company law to play any sensible role at all then we must resign ourselves to the fact of its conceptual complexity. Laws about complex subjects in complex societies should be so otherwise they run the risk of becoming entirely marginal and irrelevant to those matters which they purport to govern."

with the predictable outcome that the parameters of directors' discretion and delineation of directors' duties with respect to the corporation is even more problematic. The discretion given to directors to some degree reflects that difficulty and complexity just as the focal points of their responsibility is contingent to the environment, including the social environment, which makes up the corporate context.

Corporate directors owe an obligation, albeit an imperfect one, to non-shareholders,[223] as indeed, they do to shareholders when one considers structural shareholder primacy.[224] If one wishes to discuss trajectories of corporate law[225] in the Hegelian terms of Hansmann and Kraakman,[226] it would seem that the synthesis is moving away from shareholder wealth maximization and moving instead toward a broad perspective of the corporation as an institution with a strong component of CSR.[227]

This is evident from the case law and legislation discussed above. Directors are prohibited from taking account of non-shareholder constituents only in the most limited context of actions. Directors are permitted to take account of non-shareholder constituents in any of their regular business decisions. Finally, in the context of takeovers, they are commanded by law to consider the interests of non-shareholders. To suggest that CSR is beyond the scope of directors' discretion and that to engage in CSR activities benefiting non-shareholder constituents is a breach of duties is simply incorrect. Even in American law, with its shareholder primacy doctrine, the context-driven duties described above operate. CSR is part of corporate law.

The discussion illustrates this complexity in the dynamic context in which corporate directors must execute their responsibilities. It is inaccurate to declare that the company is concerned with the exclusive interest of shareholders' wealth maximization. Contrary to Hansmann and Kraakman's view of shareholder wealth maximization dominating the world for its own good—i.e. referring to the good of both the company and the world—society has moved beyond. Law in both practice and theory

223. As Welling points out, as no corollary rights have been granted to affected parties (Welling, *supra* note 93). Interestingly, D Gordon Smith makes the observation that directors do not owe shareholders a duty in respect of the shareholder primacy norm. He writes "although it is possible for shareholders to prevail on claims that the board of directors violated the shareholder primacy norm, such cases are extremely rare," (Smith, *supra* note 21 at 288).

224. As noted above, D Gordon Smith observes that the shareholder primacy norm, the basic norm in US law is largely unenforceable, (Smith, *supra* note 21 at 322-323).

225. Brian Cheffins, "The Trajectory of (Corporate Law) Scholarship: Inaugural Lecture" (Paper delivered at the University of Cambridge, October 2003), (Cambridge: Cambridge University Press, 2004).

226. Hansmann & Kraakman, *supra* note 10.

227. Rotman, *supra* note 11. See also, Winkler, *supra* note 11.

needs to keep abreast of its changing environment and nowhere more so than in the realm of corporate law regulating the growing corporation with its great reach and powers. Corporate commentators deride the ideological foolishness of shareholder primacy,[228] and Jack Welch has referred to it as "the dumbest idea in the world."[229] Those who have made their careers on espousing it as part of neo-classical economic religion and conservative ideology[230] are unlikely to "see the light."[231]

Although both shareholder primacy and the shareholder democracy movements have been overtaken by the decline of the large publicly traded corporation,[232] the debate still goes on. Davis points out that the large industrial enterprise that was a defining feature of the American socio-economic landscape (and arguably a significant part of the developed world as well), first described by Berle and Means, is no longer. That corporation provided significant levels of domestic employment, was funded by dispersed shareholdings, was involved in manufacturing and infrastructure and was long-lasting.[233] In its stead are a number of corporations that offer far fewer jobs and have low levels of domestic manufacture, among other things. The shares in these corporations are held and controlled by a small group of institutional investors.[234] These institutional investors have taken a vast amount of the savings of small time investors who have been forced to invest in the share market because of the privatization of government pension schemes, hoping to secure retirement incomes.[235] The institutional investors are largely uninterested in the social aspects of corporate behaviour: their focus is short-term profits, which are more readily gained by sacrificing long-term viability, which includes consideration of social and environmental concerns. These shareholders cannot be expected

228. Teitelman, *supra* note 84.
229. Francesco Guerrera, "Welch Condemns Share Price Focus" (12 March 2009), online: Financial Times <http://www.ft.com>, cited in Lynn A Stout, "On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialsm (in the Closet)" 36 Seattle UL Rev 1169 at 1180.
230. Stephen Bainbridge, "Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship" (1997) 82 Cornell Law Review 856; Lawrence E Mitchell, *Progressive Corporate Law* (Boulder: Westview Press, 1995); Stout, *ibid.*
231. Dan M Kahan, Hank Jenkins-Smith & Donald Braman, "Cultural Cognition of Scientific Consensus" (2011) 14 Journal of Risk Research 147; Kevin N Dunbar & David Klahr, "Scientific Thinking and Reasoning" in Keith J Holyoak & Robert G Morrison, eds, *The Oxford Handbook of Thinking and Reasoning* (Oxford: Oxford University Press, 2012). Much of this psychology is applied to the specific problem in Licht, *supra* note 10.
232. Gerald F Davis, "The Twilight of the Berle and Means Corporation" (2011) 34 Seattle UL Rev [Davis, The Twilight]; Gerald F Davis, *Managed By The Markets: How Finance Reshaped America* (Oxford: Oxford University Press, 2009).
233. Davis, The Twilight, *ibid* at 1124.
234. *Ibid* at 1136.
235. *Ibid* at 1138.

to shift their focus to the long-term because of pressures on them from hedge-funds and other financial institutions, as well as their own self-interest in compensation structures directly related to short-term financial performance.

Thus, where corporations are essentially operating using peoples' pensions and generating massive externalities,[236] it is less appropriate than ever that they be left to the unscrutinized wanderings of the invisible hand with the law's support. The law should not mandate that directors consider only some imaginary shareholder.[237] The public company has changed, and with it, public duties. The demand for CSR and its facilitation by appropriate interpretation and application of directors' duties is a fundamental step in that direction.

236. Benedict Sheehy, "Corporations And Social Costs: The Wal-Mart Case Study" (2004) 24 JL & Com 1.
237. Sheehy, *supra* note 112.