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THE STAKEHOLDER PRINCIPLE, CORPORATE GOVERNANCE, AND THEORY: EVIDENCE FROM THE FIELD AND THE PATH ONWARD

*P.M. Vasudev**

[I]t makes a great difference in my attitude toward my job as an executive officer of the General Electric Company whether I am a trustee of the institution or an attorney for the investor. If I am a trustee, who are the beneficiaries of the trust? To whom do I owe my obligations?[1]

Owen D. Young (1929)

I. INTRODUCTION

The stakeholder principle has gained increased recognition in corporate governance in the recent times. It is understood, by and large, as a refinement of the more limited conception of business corporations as vehicles whose function is to promote the economic interests of their shareholders. The stakeholder idea has always been present in corporate law. Its scheme of creditor protection, which is one of the foundational principles, is proof of this fact. The stakeholder vision articulated in the recent times is, however, more expansive and proactive. It covers a large number of non-shareholder groups—employees, suppliers, communities, and so on—and seeks to promote active corporate engagement in protecting the interests of these groups and promoting their welfare.

This Article provides an overview of the development of the stakeholder idea, and presents the results from a survey of the U.S., U.K., and Canadian corporations included in the 2012 Global 500[2] for their adoption of the stakeholder principle (the "Survey"). The Survey finds near-unanimous acceptance of the stakeholder vision.

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1. JOHN H. SEARS, THE NEW PLACE OF THE STOCKHOLDER 208-09 (1929). Owen D. Young was the former chairman of General Electric Company. *Past Leaders*, GEN. ELECTRIC COMPANY, http://www.ge.com/company/history/bios/owen_young.html (last visited Mar. 29, 2013).

2. *Global 500*, CNN MONEY, http://money.cnn.com/magazines/fortune/global500/2012/full_list/ (follow pull-down menu, which separates the Global 500 into sections of 100 companies) (last visited Mar. 29, 2013).

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Among the 129 U.S. corporations in the Fortune Global 500 for 2012, excluding Fannie Mae, Freddie Mac, and the U.S. Postal Service which are government-owned/government-sponsored enterprises, all but two of the corporations accept the stakeholder principle in some form. With the twenty-six U.K. and eleven Canadian companies, their endorsement of the stakeholder principle is one hundred percent.[3] The trend of adoption of the stakeholder model is unmistakable, and this has significant implications for corporate theory. This Article also examines how the emerging ideas about stakeholders and the recognition of their interests in law can fit into corporate theory. For doing so, it applies the tools of a nascent school of legal theory—namely, new legal realism ("NLR"). This Article argues for a clear articulation of the conceptual underpinning of business corporations and resolving some inconsistencies in the current framework.

This Article is divided into five Parts. Part II provides an overview of the development of the stakeholder idea in corporate governance. Next, Part III presents the results of the Survey of U.S., U.K., and Canadian business corporations included in the 2012 Global 500. The results affirm the strengthening of the stakeholder principle, and are the foundation for the proposals made in this Article for a statement of corporate theory. Part IV traces the development of corporate theory and its relationship with the stakeholder vision. Referring to the ambiguities and inconsistencies in the structure of corporate law, theory, and governance, Part IV argues for a deliberated statement of the character and objectives of business corporations—one that reflects the experience gained and is attuned to the needs of the present and the future. Finally, Part V concludes with a tentative list of the features that can be considered for inclusion in corporate theory for the twenty-first century and beyond.

II. SHAREHOLDER PRIMACY AND THE STAKEHOLDER PRINCIPLE: AN OVERVIEW

The stakeholder principle has its roots in corporate law and the principle of shareholder primacy.[4] This Part provides a brief outline of the shareholder primacy principle, and the emergence and growth of the stakeholder idea. It has three Sections. Section A outlines shareholder

3. It is, of course, tempting to raise a skeptical eyebrow and question how far the companies are indulging in fashionable rhetoric rather than taking the idea seriously. *See* discussion *infra* Part III.C.

4. Shareholder primacy is usually presented as the central principle of Anglo-American corporate law. *See generally* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value.").

primacy, which is followed, in Section B, with an account of the concern in law for non-shareholder groups. Lastly, Section C provides an overview of the stakeholder regimes that now exist in the United States, Britain, and Canada.

A. Shareholder Primacy: The Governing Rule?

The shareholder primacy rule was developed in the United States and Britain in different circumstances. The differences between the two jurisdictions are significant. This Section reviews the origin of the shareholder primacy principle and its implications in the United States and Britain.

1. The United States

The stakeholder debate has its origin in the preeminent position usually accorded to the shareholders.[5] Traditionally in the common-law countries, shareholders are understood to be the owners of companies.[6] This is more explicit in U.K. company law, where the statutes conventionally term the shareholders as "members" and describe companies as shareholders in the collective.[7] Indeed, they regularly refer to the body of shareholders as the "company."[8] This reflects the underlying notion of identity between the shareholders and the companies. The position is not equally clear or explicit in North American corporate law, but there can be little doubt about the "ownership-like" status of corporate shareholders in the United States and Canada. Shareholders have the right to elect and remove directors who control the corporations.[9] Shareholders are also "residual claim[ant]s," as economic theory stresses.[10] These features establish the preeminence of shareholders in the corporate framework.[11]

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5. The debate launched by Young in 1929 was in this idiom. *See* SEARS, *supra* note 1, at 208-10. Young, who was a lawyer by training, accurately reflected the legal notions about directors' duties as they had developed by then. *Past Leaders*, *supra* note 1; *see* SEARS, *supra* note 1, at 208-10.

6. *See, e.g.*, ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 294 (Harcourt, Brace & World, Inc. 1968) (1932).

7. *See, e.g.*, Companies Act, 2006, c. 46, §§ 16, 112–113 (Eng.).

8. *See, e.g.*, *id.* § 77 (listing a special resolution as one method of changing a company's name).

9. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(k) (West 2006); Canada Business Corporations Act, R.S.C. 1985, c. C-44, § 106(3).

10. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976) (emphasis omitted).

11. Stephen M. Bainbridge pointed out that statutes vest most of the corporate powers, operational and policymaking, in the directors, and has used this feature of corporate law to develop his theory about director primacy. Stephen M. Bainbridge, *Director Primacy: The Means and Ends*

Similar to the law of trusts and agency, corporate law equates the directors of companies with trustees and agents. It places company directors under fiduciary duties because they are supposed to act for others, rather than in their own interests. Consistent with the proprietary idea associated with shareholders, U.S. corporate law has treated directors as custodians of the property of the shareholders since the late nineteenth century.[12] The idea found forceful expression in the famous passages in *Dodge v. Ford Motor Co.*:[13]

> 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, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.
>
> There is committed to the discretion of directors, a discretion to be exercised in good faith, the infinite details of business, including the wages which shall be paid to employees, the number of hours they shall work, the conditions under which labor shall be carried on, and the price for which products shall be offered to the public.
>
> It is said by appellants that the motives of the board members are not material and will not be inquired into by the court so long as their acts are within their lawful powers. As we have pointed out, and the proposition does not require argument to sustain it, 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, and no one will contend that, if the avowed purpose of the defendant directors was to sacrifice the interests of shareholders, it would not be the duty of the courts to interfere.[14]

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of Corporate Governance, 97 NW. U. L. REV. 547, 559-63 (2003) [hereinafter Bainbridge, *Director Primacy*]. The interpretation of Bainbridge, while factually correct, would not detract from the position of the shareholders outlined here. The near-absolute powers the directors now enjoy are the product of a process of legal development, which is outside the scope of this Article. Significantly, Bainbridge has argued in favor of the application of directors' powers for shareholder wealth maximization. *Id.* at 563.

12. *See* Morton J. Horwitz, Santa Clara *Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 200 (1985). This was when most states had enacted general incorporation statutes. *See id.* at 181. Until this happened, the tendency in the United States was to view corporations as institutions created by the state. *Id.* General incorporation encouraged the idea that shareholders entered into a contract, pooled their capital, and elected the directors as their agents to run the companies. *See* Susan Pace Hamill, *From Special Privilege to General Utility: A Continuation of Willard Hurst's Study of Corporations*, 49 AM. U. L. REV. 81, 91 (1999).

13. 170 N.W. 668 (Mich. 1919).

14. *Id.* at 684.

These observations dealt with only one aspect of the case, but the tendency is to present them as the statement of the central principle of corporate law.[15] They are cited as the statement of the shareholder primacy rule that places management under a duty to strive for shareholder wealth maximization.[16] This is, however, an incomplete interpretation of *Dodge*.[17]

Dodge was what one would term an oppression action in U.K. company law. In an oppression action, a minority shareholder who is helpless against the group in control of the company can seek relief against acts that are oppressive towards the minorities.[18] Henry Ford, the majority shareholder in control of the corporation, refused to distribute the retained earnings through dividends and spurned the minority shareholders when they approached him for a discussion.[19] In the action brought by the minority shareholders, Ford presented his defense in terms of public benefit and use of the retained earnings for promoting the public good.[20] It is a different matter that Ford planned to use the funds for backward integration by erecting a smelter that would bring down the costs and improve the competitiveness of Ford cars.[21]

In the factual situation outlined, the court ordered Ford to distribute half the retained earnings as dividends to the shareholders.[22] While doing so, the court also upheld the plans for erecting the smelter, applying what is now called the business judgment rule.[23] Equally important, the court also endorsed corporate philanthropy.[24] In the United States, an element of public interest has generally been considered implicit in the grant of

15. *See generally* Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163 (2008) (critiquing the tendency to present *Dodge* as the statement of the central principle of corporate law).

16. *Id.* at 165.

17. Recently, there is greater awareness of the other implications of the *Dodge* decision. *See id.* at 168 (discussing a more wholesome interpretation of *Dodge*); *see also* M. Todd Henderson, *The Story of* Dodge v. Ford Motor Company: *Everything Old Is New Again*, *in* CORPORATE LAW STORIES 37, 64-67 (J. Mark Ramseyer ed., 2009).

18. *See* Companies Act, 2006, c. 46, § 994 (Eng.); *see also* Lindsey M. Heger, *Help from Across the Pond: Applying the U.K. Law Commission's Presumption that Exclusion from Management in a Private Company Is Unfairly Prejudicial as a Guide to Assessing Claims of Minority Shareholder Oppression in U.S. Closely Held Corporations*, 6 S.C. J. INT'L L. & BUS. 129, 134-35 (2009) ("Under current U.K. corporate law, a minority shareholder is likely to seek relief through . . . the statutory cause of action protecting minority shareholders from oppression, originally adopted and codified in the Companies Act of 1980 as the 'unfair prejudice' remedy.").

19. *Dodge*, 170 N.W. at 671-72.

20. *Id.* at 683-84.

21. *Id.* at 671, 681, 684.

22. *See id.* at 677, 685.

23. *See id.* at 681-82, 684-85.

24. *See id.* at 684.

incorporation by legislatures.[25] Grant of incorporation involves the exercise of public power, and it must advance the public good in some respect.[26] Therefore, corporations can legitimately incur welfare expenditure.[27] By 1919, when *Dodge* was decided, courts in the United States had already upheld the powers of business corporations to:

- Incur expenditure to improve employees' health;[28]
- Provide housing to employees; and[29]
- Set up hospital facilities in the town of business.[30]

Referring to the law on corporate philanthropy, the court observed in *Dodge*:

> These cases, after all, like all others in which the subject is treated, turn finally upon the point, the question, whether it appears that the directors were not acting for the best interests of the corporation. We do not draw in question, nor do counsel for the plaintiffs do so, the validity of the general proposition stated by counsel nor the soundness of the opinions delivered in the cases cited. The case presented here is not like any of them. The difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employ[ee]s, 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. *There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his codirectors owe to protesting, minority stockholders.*[31]

After making this clarification, the court pronounced its much-quoted *dictum* that "[a] business corporation is organized and carried on

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25. *See* JAMES WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970, at 15 (1970); Hamill, *supra* note 12, at 92.

26. *See* 1 JOSEPH STANCLIFFE DAVIS, ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 5-8 (1917); HURST, *supra* note 25, at 15-17.

27. Corporate philanthropy went under attack in the 1960s. The much-cited newspaper article of Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, was an attack on the application of corporate resources by managers for public or charitable purposes. *See generally* Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine), at 32 ("The whole justification for permitting the corporate executive to be selected by the stockholders is that the executive is an agent serving the interests of his principal. This justification disappears when the corporate executive imposes taxes and spends the proceeds for 'social' purposes."). In the framework of Friedman, managers were the agents of shareholders and they had no business to use shareholders' wealth for social or beneficial purposes. *Id.* at 33, 122.

28. *See* People *ex rel.* Metro. Life Ins. Co. v. Hotchkiss, 120 N.Y.S. 649, 651-52 (App. Div. 1909).

29. *See* Steinway v. Steinway & Sons, 40 N.Y.S. 718, 720-21 (Sup. Ct. 1896).

30. *See Hotchkiss*, 120 N.Y.S. at 651-52.

31. Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) (emphasis added).

primarily for the profit of the stockholders."[32] If we also consider the preamble, it is obvious that we cannot interpret *Dodge* as merely laying down the profit maximization or shareholder primacy rule. It does not preclude corporate philanthropy, if it is incidental to the business of the corporation and does not supplant the business or commercial considerations.[33] An interesting question is whether the "incidental" expenditure on philanthropy must have a business connection.[34]

2. Britain

In Britain, the law on corporate philanthropy developed along different lines, conditioned by the prevailing political economy. The corporate form of enterprise in Britain did not carry the strong political and social overtones it did in the United States, which adopted democracy and equality among its founding principles.[35] Companies were understood essentially as economic vehicles in Britain, and the heated debates about corporate power that pulsated in the United States had less relevance on the other side of the Atlantic where the political and power structures were relatively ancient and entrenched.[36]

Public interest was thus not a major factor or consideration in the grant of incorporation in Britain. As a result, ideas about corporate charity or spending money for general welfare had less resonance in the U.K. environment. On the other hand, the principal-agent relationship between shareholders and directors was always strongly etched in the consciousness.[37] As a result, there was an emphasis on protecting the shareholders and curbing the freedom of the directors to deal with corporate resources.[38] *Hutton v. West Cork Railway Co.*[39] presented an early example of this habit of thought. The court had to deal with an

32. *Id.*

33. *See id.*

34. The discussion later in this Article will show that it need not have such a connection to the business or potential for conferring a benefit on the corporation. *See* discussion *infra* text accompanying notes 81-86. This is explicitly codified in the Model Business Corporation Act. *See* MODEL BUS. CORP. ACT § 3.02 (2010).

35. *See* HURST, *supra* note 25, at 1-12.

36. *See id.* at 2-5.

37. *See* ARMAND BUDINGTON DUBOIS, THE ENGLISH BUSINESS COMPANY AFTER THE BUBBLE ACT: 1720-1800, at 293 (Octagon Books 1971) (1938).

38. Adam Smith appears to have been the first to warn about abusive practices by company directors and the consequent injury to the interests of the investor-shareholders. *See* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 700 (Random House, Inc. 1937) (1776). However, complaints about companies go back further. *See* DUBOIS, *supra* note 37, at 293-97.

39. [1883] 23 Ch. D. 654 (Eng.).

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extra-contractual payment to the employees of a company in liquidation.[40] Terming the payment "charity," the court held:

> [The company's majority] can only spend money which is not theirs but the company's, if they are spending it for the purposes which are reasonably incidental to the carrying on of the business of the company. That is the general doctrine. *Bona fides* cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly *bonâ fide* yet perfectly irrational. . . .
>
> . . . It is for the directors to judge, provided it is a matter which is reasonably incidental to the carrying on of the business of the company . . . . The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.
>
> . . . [C]harity has no business to sit at boards of directors *quâ* charity. There is, however, a kind of charitable dealing which is for the interest of those who practise it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose.[41]

Directors could spend money on charity, but it had to benefit the company. Despite the difference in social and political climate in Britain and the United States, the standard laid down in *Hutton* roughly corresponded to the one in U.S. corporate law, which permitted philanthropy that was "incidental." But the U.K. standard was more explicit that incidental welfare expenditure had to be for the primary purpose of earning profits for shareholders' benefit.

Cases such as *Dodge* and *Hutton* reflected the contemporary notions about business corporations. They affirmed the proprietary position of shareholders and established the fiduciary duties that directors owed shareholders. In Britain, *Parke v. Daily News Ltd.*,[42] which is discussed a little later, reiterated the limitations on directors' powers to engage in beneficial acts.[43] These older U.K. cases reflected the contractarian foundations of companies in Britain and the absence of the institutional vision that defines the stakeholder principle.

B. Stakeholder Concerns: Emergence and Development

Since early on, corporate law did not confine its concerns to shareholders. This is evident from creditor protection, which is a

40. *Id.* at 656-57.
41. *Id.* at 671-73.
42. [1961] 1 All E.R. 695.
43. *See infra* text accompany notes 67-73.

longstanding and foundational principle of the law of corporations.[44] In the United States, historically, legislative charters created corporations.[45] Until the late nineteenth century, the institutional idea was dominant in the United States, and corporations were considered distinct legal entities.[46] They were not to be confused with their shareholders.[47] Therefore, there could be no question of shareholders being liable for corporate debts. This left the creditors in a vulnerable position. The characteristic differences between creditors and shareholders, who both had financial involvement in the corporations, were clearly understood.

Firstly, shareholders contributed risk capital to the corporations, and their investment was, by definition, exposed to business risks.[48] The case was different with creditors—both lenders and persons who sold goods or services to the corporations on credit. Creditors, unlike shareholders, did not explicitly assume risk in dealing with corporations.[49] Secondly, despite their financial involvement with the corporations, creditors had no say in the constitution of corporate control—namely, in the election of directors or any other aspect of corporate governance.[50] In this sense, creditors were disenfranchised and were at a disadvantage.[51]

Sensitivity to the vulnerable position of the creditors led to the development of the trust fund doctrine in the United States early in the nineteenth century.[52] The doctrine treated the capital stock of corporations as funds held in trust for the creditors, and its development is evidence of stakeholder concerns in the nascent law of business

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44. William W. Bratton, *Bond Covenants and Creditor Protection: Economics and Law, Theory and Practice, Substance and Process*, 7 EUR. BUS. ORG. L. REV. 39, 40-41 (2006).

45. *See* HURST, *supra* note 25, at 14-17. *See generally* Hamill, *supra* note 12 (discussing "the domination of state law over the regulation of corporations through the early decades of the twentieth century"). This is unlike the position in Britain, which had a large number of unincorporated companies created by private arrangements in the common law. *See* HURST, *supra* note 25, at 6-7. The Joint Stock Companies Act of 1844 was meant to regulate such large unincorporated associations by requiring them to register their constituent documents and placing them under a number of obligations, such as providing financial reports and audit of accounts. *See* Joint Stock Companies Act, 1844, 7 & 8 Vict., c. 110 (Eng.).

46. *See* Bank of Augusta v. Earle, 38 U.S. (13 Pet.) 519, 586-87 (1839).

47. *See id.* at 587.

48. *See* Lawrence E. Mitchell, *The Legitimate Rights of Public Shareholders*, 66 WASH. & LEE L. REV. 1635, 1667-71 (2009).

49. *See* JOSEPH K. ANGELL & SAMUEL AMES, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS AGGREGATE 367-68 (Arno Press 1972) (1832).

50. *See* L. C. B. GOWER, THE PRINCIPLES OF MODERN COMPANY LAW 348, 474-75 (K. W. Wedderburn & O. Weaver eds., 3d ed. 1969).

51. Shareholder immunity to corporate debt was the general rule, although some early charters made shareholders and/or directors personally liable for the liabilities of corporations. *See* 2 JOSEPH STANCLIFFE DAVIS, ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 69, 105-06 (1917).

52. *See* Wood v. Dummer, 30 F. Cas. 435, 436-37 (C.C.D. Me. 1824) (No. 17,944); *see also* ANGELL & AMES, *supra* note 49, at 354-57 (discussing *Wood*).

corporations.[53] The trust fund doctrine, which treated corporate capital as static and fixed in character, was found to be ineffective in dealing with the issue of erosion of capital through losses.[54] It has been replaced by the more wholesome solvency test.[55]

Employees, another important constituency in business corporations, also received attention in corporate law. Several U.S. statutes in the nineteenth century made the shareholders of corporations personally liable for the wages payable to employees.[56] This continued into the twentieth century, with states such as New York imposing personal liability on directors for workers' wages.[57]

In Britain, shareholders did not enjoy the protection of limited liability until 1855. It was, therefore, unnecessary at the time to develop special protections for the creditors of companies. Shareholders were personally liable for companies' debts, and use of the corporate form made no difference to the position. Britain granted the protection of limited liability to shareholders through the Limited Liability Act 1855.[58] This made protection for the creditors a pressing issue because shareholders were no longer personally liable for companies' debts. A set of rules, known as the capital maintenance rules, was developed in Britain to safeguard the interests of creditors.[59] Capital maintenance rules, similar in principle to the U.S. trust fund doctrine, compelled shareholders to pay in the agreed amount of risk capital and protected the corporate resources from the reach of the shareholders.[60] The intention was to preserve the resources for the benefit of creditors.[61]

Capital maintenance rules in Britain included the requirement of court approval for reduction of capital.[62] This principle was also extended to companies purchasing their own shares.[63] The rule that dividends could only be paid to shareholders out of profits was another

53. ANGELL & AMES, *supra* note 49, at 355-56.

54. *See generally* Edwin S. Hunt, *The Trust Fund Theory and Some Substitutes for It*, 12 YALE L.J. 63 (1902) (complaining about the efficacy of the trust fund doctrine).

55. *See* P.M. Vasudev, *Law, Economics, and Beyond: A Case for Retheorizing the Business Corporation*, 55 MCGILL L.J. 911, 934 (2010).

56. *See* HURST, *supra* note 25, at 27-28.

57. *See* David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201, 210-11 (discussing New York's corporations statute).

58. Limited Liability Act, 1855, 18 & 19 Vict., c. 133 (Eng.).

59. Dean Ardern & Maxwell Aiken, *An Accounting History of Capital Maintenance: Legal Precedents for Managerial Autonomy in the United Kingdom*, ACCT. HISTORIANS J., June 2005, at 23, 24.

60. *See id.*

61. *See id.* (discussing an account of the development of capital maintenance rules in Britain).

62. *See* Trevor v. Whitworth, (1887), 12 H.L. 409 at 423 (Eng.).

63. *Id.* at 428-30.

instrument that protected the interests of the creditors.[64] Courts were generally strict in interpreting companies' bylaws to promote the principle of creditor protection. In *Davison v. Gillies*,[65] the court dealt with a provision in the bylaws that enabled the payment of dividends from reserves and observed that "you do not get a reserve fund at all until you have paid your current expenses."[66]

With respect to company employees, the law in Britain developed on a path different from that in the United States. It was more formalistic. Welfare considerations were not prominent in the U.K. framework. As pointed out earlier, courts struck down gratuitous payments to the employees of companies in liquidation.[67] Interestingly in *Parke*, the directors of the company conceded that their "prime duty must be to the shareholders," yet argued that "boards of directors must take into consideration *their duties to employees in these days*."[68] But the court answered, rather legalistically: "But no authority to support that proposition as a proposition of law was cited to me; I know of none, and in my judgment such is not the law."[69]

The *Parke* decision, however, set in motion a process of change. In 1980, almost two decades after the case was decided, amendments were made to the Companies Act 1948[70] to enable terminal payments to employees.[71] The opportunity was also utilized to expand the general scope of directors' duties and introduce the regulatory stakeholder principle in a preliminary form.[72] The amendment placed directors under a duty to consider the "interests of the employees in general" as well as the shareholders.[73]

To be fair, efforts to improve the position of employees of companies in liquidation had begun in Britain even earlier. Companies Act 1948, enacted by a Labor government in post-World War II Britain, was more proactive in espousing employee interests. Subject to some limitations, it bracketed the wages payable to employees and companies' contributions towards their pension and health benefits with the tax arrears due to the government, and employees were given preferential

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64. *See* MacDougall v. Jersey Imperial Hotel Co. (1864) 2 H. & M. 528, 535-36 (Eng.). *MacDougall* appears to be the earliest authority on this subject.

65. [1879], 16 Ch. 347 (Eng.).

66. *See id.* at 347-48 n.1.

67. *See* discussion *supra* Part II.A.2.

68. GOWER, *supra* note 50, at 522-23 (emphasis added).

69. *Id.* at 523 (internal quotation marks omitted).

70. Companies Act, 1948, 11 & 12 Geo. 6, c. 38 (Eng.).

71. Alfred F. Conard, *Corporate Constituencies in Western Europe*, 21 STETSON L. REV. 73, 80-81 (1991).

72. *Id.* at 80.

73. *Id.*

rights in wind-up proceedings.[74] Dues to employees had statutory equal ranking with the secured debts of companies in liquidation.[75] This improved the position of the employees who would have otherwise joined the ranks of unsecured creditors and been more vulnerable.

The law on corporate philanthropy, as already pointed out, has traditionally been more liberal in North America. The power of corporations to spend money on general welfare was recognized in the nineteenth century. In *A.P. Smith Manufacturing Co. v. Barlow*,[76] the court upheld a donation made to Princeton University by a New Jersey corporation.[77] The statute of New Jersey expressly permitted such donations, but the court dismissed the challenge to the donation without referring to the statutory provision.[78] Significantly, the court did not also interpret the contribution in terms of its potential benefit for the corporation, which would have indirectly affirmed the principle of shareholder primacy.[79] The court ruled that "modern conditions require that corporations acknowledge and discharge social as well as private responsibilities."[80] This decision endorsed the stakeholder vision as an independent value. It need not necessarily be justified in terms of its potential to generate benefits for a corporation or its shareholders.

The broad conception of corporations in U.S. law is a historical fact. The view that the corporate goal is limited to earning profits for the benefit of a select group—namely, shareholders—is not the entire truth. Statutory provisions on corporate charity and the decision in *A.P. Smith* affirm this principle. The liberal approach towards corporate philanthropy continues in the United States.[81] *Principles of Corporate Governance: Analysis & Recommendations*,[82] developed by American Law Institute ("ALI"), empowers "corporation[s] to devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes, even if corporate profit and shareholder gain are not thereby enhanced."[83] This travels beyond simple agency or trust

74. *See* Companies Act, 1948, § 319(1).

75. *See id.* § 319(5).

76. 98 A.2d 581 (N.J. 1953).

77. *Id.* at 582, 590.

78. *See id.* at 589-90.

79. *See* C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77, 103-04 (2002).

80. *A.P. Smith*, 98 A.2d at 586.

81. Courts have also upheld charitable actions applying the business judgment rule. *See e.g.*, Ella M. Kelly & Wyndham, Inc. v. Bell, 266 A.2d 878, 879 (Del. 1970); Shlensky v. Wrigley, 237 N.E.2d 777, 781 (Ill. App. Ct. 1968).

82. AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS & RECOMMENDATIONS (1992) [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE].

83. *Id.* § 2.01 & cmt. i; *see also* Douglas M. Branson, *Corporate Governance "Reform" and the New Corporate Social Responsibility*, 62 U. PITT. L. REV. 605, 622-25 (2001) (giving an

paradigms and accepts the idea that corporate resources can be utilized, within limits, for generally beneficial purposes even when no business advantage results from the expenditure. Similarly, the Model Business Corporation Act[84] authorizes a corporation to "to make donations for the public welfare or for charitable, scientific, or educational purposes," if such donations are not prohibited under the constitutions of individual corporations.[85] The issue is not tied to any benefits to the corporation, either actual or potential.[86]

An important contribution to stakeholder theory has come from Margaret M. Blair and Lynn A. Stout, who articulated their team production model of business corporations.[87] Blair and Stout conceived directors as "mediating hierarchs" who are under a duty to promote equity in the distribution of the corporate surplus among different constituencies.[88]

To the north in Canada, the Canada Corporations Act,[89] enacted in 1965, expressly authorizes corporate charity.[90] This is evidence of convergence in U.S. and Canadian law on the subject. The Canada Corporations Act permits contributions for the welfare of employees or former employees and for "any public, general or useful object."[91] There is no comparable provision in the current federal statute—the Canada Business Corporations Act[92] (the "CBCA")—which has adopted a different course. The CBCA posits rough parity among shareholders and non-shareholder groups in business corporations and extends the statutory remedies—namely derivative actions and oppression actions—to non-shareholder groups also.[93] The stakeholder principle received

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interesting discussion on the background of the development of ALI's *Principles of Corporate Governance: Analysis & Recommendations*). There is a risk that this approach of social activism by companies can potentially weaken responsible governance, which is an essential part of the stakeholder principle. It is as much about earning profits in a legitimate manner as it is about how the profits are utilized. It is not sufficient for corporations to make donations, but equally they must practice responsible governance.

84. MODEL BUS. CORP. ACT (2010).

85. *Id.* § 3.02(13).

86. *See id.* § 3.02 & cmt.

87. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 249 (1999) ("We explore an alternative approach that we believe may go much further in explaining both the distinctive legal doctrines that apply to public corporations and the unique role these business entities have come to play in American economic life: the *team production* approach.").

88. *See id.* at 280-81.

89. R.S.C. 1970, c. C-32.

90. *Id.* § 16(1)(e).

91. *Id.*

92. R.S.C. 1985, c. C-44.

93. *See id.* §§ 238–241.

judicial recognition in Canada in 1972 in *Teck Corp. Ltd. v. Millar.*[94] The Supreme Court of Canada recently affirmed the principle in *In re Bankruptcy of Peoples Department Stores Inc. v. Wise*[95] and *BCE Inc. v. 1976 Debentureholders.*[96]

A contribution to the stakeholder idea in Canada came from the Joint Committee of Corporate Governance, which was chaired by Guylaine Saucier and which the Toronto Stock Exchange and other agencies set up to develop guidelines for corporate governance.[97] Affirming the emerging vision, the Joint Committee of Corporate Governance's report references stakeholders and treats corporate accountability as something owed to a broad spectrum of stakeholder groups—not just the shareholders.[98]

C. *The Stakeholder Regime and Its Variants*

A broad stakeholder regime, traveling beyond the limited creditor protection principle, now exists in all the three jurisdictions—namely, the United States, Britain, and Canada. There are two major variants in the legislative approach. The United States and Britain have a directors' duty-based version, while Canada has adopted a remedy-based regime. A third approach, involving board representation to non-shareholder groups, was considered in Britain and Canada but was dropped. This Section examines the prevailing stakeholder models.

1. The Directors' Duty Model: The United States and Britain

Owen D. Young, the chairman of General Electric Company ("GE"), was among the earliest to articulate the stakeholder vision.[99] Viewing the matter from the lens of directors' duties, Young argued in 1929 that their duties must not be restricted to serving the shareholders.[100] This approach takes the principle of central command in

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94. [1972] 33 D.L.R. 3d 288, 314-17 (Can. B.C. Sup. Ct.).

95. 2004 SCC 68, [2004] 3 S.C.R. 461, para. 42 (Can.).

96. 2008 SCC 69, [2008] 3 S.C.R. 560, paras. 36-40 (Can.).

97. *See* JOINT COMM. ON CORP. GOVERNANCE, BEYOND COMPLIANCE: BUILDING A GOVERNANCE CULTURE 3-5 (2001), *available at* http://www.ecgi.org/codes/documents/beyond_compliance.pdf ("This report focuses on key issues where we believe we can improve governance by encouraging a healthier culture in the boardroom.").

98. *See id.* at 45.

99. *See supra* text accompanying note 1.

100. *See* SEARS, *supra* note 1, at 208-10. Young delivered his seminal speech in 1929, ten years after the famous decision in *Dodge*. *Compare id.* ("Owen D. Young, in January, 1929, in an address at the Park Avenue Baptist Church, New York, avowedly accepted the trusteeship idea."), *with* Dodge v. Ford Motor Co., 170 N.W. 668, 668 (Mich. 1919) (indicating *Dodge* was decided on February 7, 1919). Quite possibly, Young was influenced by the idea underlying the oft-quoted passage in the judgment, which appeared to define directors' duties in strict terms—namely, profit maximization for shareholders' benefit. *See Dodge*, 170 N.W. at 684.

business corporations, or the vesting of substantial corporate powers in the directors, as a given. Starting from here, the effort is to promote a broader vision for the directors in performing their functions and greater accountability in the exercise of their powers. Scholars, such as E. Merrick Dodd and Adolf A. Berle, Jr., endorsed Young's approach.[101] In this version, statutes authorize directors to consider non-shareholder interests.[102] By permitting a wider range of considerations, the statutes partially modify the common law, which is understood to limit directors' loyalty to shareholders and constrain them from applying other considerations. The directors' duty model has been adopted in Britain and the United States since the 1980s.[103]

Stakeholder provisions were introduced in several U.S. states during the takeover battles of the 1980s, which led to widespread changes of corporate control, plant closings, and mass layoffs.[104] Quite often, the takeovers were justified in terms of their benefit for the shareholders from potential cost savings and increase in share prices.[105] The shareholder primacy rule, which apparently conferred legitimacy on these practices, was considered a factor in the takeover phenomenon.[106] In response to the complaints against plant closings and consequent disruption in the lives of the affected employees and communities, it was argued that directors' hands were tied by the shareholder primacy rule.[107]

In this background, amendments were made to the corporate statutes in a number of states to empower directors to consider a wide range of interests.[108] The new schema, incidentally, operated in favor of corporate managements, as it improved their ability to protect themselves against hostile takeover bids.[109] Corporate managements,

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101. *See* Wells, *supra* note 79, at 87-88. Initially, Berle was opposed to the idea of broadening the scope of directors' powers and loyalty. *See id.* at 87-90. His opposition was on the ground of practicability, rather than principle. *See id.* at 93-95. However, sometime later, Berle veered around to the view of Dodd and expressed support for broad-basing the duties of corporate directors. *See id.* at 99.

102. *See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 26-27 (1992).

103. *See* Conard, *supra* note 71, at 80-81; Orts, *supra* note 102, at 22, 26-27.

104. *See* Adam Winkler, *Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History*, LAW & CONTEMP. PROBS., Autumn 2004, at 109, 122-23.

105. *See* Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 1009-10 (1992) [hereinafter Bainbridge, *Constituency Statutes*].

106. Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 630 (1992).

107. *See* Wells, *supra* note 79, at 126-27.

108. *Id.* at 127-28; Winkler, *supra* note 104, at 122-23.

109. *See* Wells, *supra* note 79, at 128. "Takeover" is not a legal term or concept in the United States, but the label is widely used to refer to the process of change of corporate control. Change can be accomplished in two ways—namely, mergers and tender offers for purchase of shares in the stock market. Christopher A. Iacono, *Tender Offers and Short-Form Mergers by Controlling*

which lobbied for stakeholder legislation, had mixed motives for doing so—one being to protect their position.[110]

By 1991, twenty-eight states had included stakeholder concerns in their corporate statutes, in different forms.[111] Currently, the number of states with constituency statutes is thirty-one, including Maryland, North Dakota, and Vermont.[112] The stakeholder provision in the Georgia statute, extracted below, is representative:

> A provision that, in discharging the duties of their respective positions and in determining what is believed to be in the best interests of the corporation, the board of directors, committees of the board of directors, and individual directors, in addition to considering the effects of any action on the corporation or its shareholders, may consider the interests of the employees, customers, suppliers, and creditors of the corporation and its subsidiaries, the communities in which offices or other establishments of the corporation and its subsidiaries are located, and all other factors such directors consider pertinent; provided, however, that any such provision shall be deemed solely to grant discretionary authority to the directors and shall not be deemed to provide any constituency any right to be considered.[113]

Although the provisions in all the states were inspired by similar ideas and sprang from similar considerations, they are not identical in their scope and operation. The regimes in the states have variations. Very few states have made the stakeholder regime mandatory and applicable to all acts of the directors. In most states, it is optional and merely enables the directors to apply non-shareholder considerations. Directors are not under any duty to consider stakeholder interests. In many states, the stakeholder rule applies only to decisions that affect corporate control or the "independence" of a corporation. In most jurisdictions, the statutes make a reference to employees and community

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Shareholders Under Deleware Law: The "800-Pound Gorilla" Continues Unimpeded—In re Pure Resources, Inc., Shareholders Litigation, 28 DEL. J. CORP. L. 645, 647 (2003). Corporate law on mergers is clear; they would require the approval of the directors. *Id.* at 649. But the picture is unclear with respect to tender offers for purchase of shares in the market, as a means of unseating current directors and acquiring control—especially when the current directors are not willing to leave. Such "hostile" takeovers would be messy and more expensive for the persons interested in taking over, as they would have to "defeat" the incumbent management. *See* Troy A. Paredes, *The Firm and the Nature of Control: Toward a Theory of Takeover Law*, 29 J. CORP. L. 103, 131-32 (2003) (discussing the ambiguity in the law about takeovers and the role of directors).

110. *See* Branson, *supra* note 83, at 636-37.

111. *See* Nell Minow, *Shareholders, Stakeholders, and Boards of Directors*, 21 STETSON L. REV. 197, 218 (1991).

112. MD. CODE ANN., CORPS. & ASS'NS. § 2-104(b)(9); N.D. CENT. CODE § 10-19.1-50(6); VT. STAT. ANN. tit. 11A, § 8.30(A)(3).

113. GA. CODE ANN. § 14-2-202(b)(5) (2003).

interests and some of them also permit the directors to consider other "pertinent" factors.

The stakeholder versions adopted in U.S. jurisdictions exhibit considerable variety in nature and scope. The following Table 1 identifies the different elements, numbering eleven, in the stakeholder regime and assigns weights relative to their significance.

Table 1. Stakeholder Regime and Its Components

	Criterion	Weight
1	Mandatory consideration of non-shareholder interests by the directors	9
2	Scope - whether provisions apply only to change of control, or as an ongoing principle of management?	18
3	Reference to short-term and long-term interests	1
4	Employee interests	1
5	Customer interests	1
6	Creditor interests	1
7	Supplier interests	1
8	Community and societal interests	1
9	Any other "pertinent" factors	1
10	Affirmation of equality of shareholder interests and other interests	1
11	Explicit protection to directors for considering non-shareholder interests	1
	Total	36

The weight assigned to each factor or element is based on relative significance. Mandatory duty to consider non-shareholder interests has a score of nine (or a quarter of the total), if the regime is applicable only to takeovers and changes in management or control. If, however, the duty is applicable on an ongoing basis, it better reflects the institutional vision of the stakeholder principle and this gets a score of eighteen, which is half the total score of thirty-six. Reference to each individual group is assigned one point. An ideal stakeholder regime must satisfy at least Criteria One to Nine in Table 1. The remaining two criteria are formal in nature. Criterion Ten is merely an affirmation of the principle of the preceding ones, and Criterion Eleven would be more relevant in a litigation setting when the directors are charged with breach of their fiduciary duties. Omitting these last two criteria, which carry a weight of two between them, an ideal regime that fulfills all the remaining criteria must achieve a score of thirty-four. No state reaches this level.

Mandatory application of the stakeholder regime would be crucial in determining the scores of individual states, as it carries one half of the total marks. Among the thirty-one states that have adopted a regulatory stakeholder regime, only two—Arizona and New Mexico—place directors under a compulsory duty to consider non-shareholder interests in all circumstances.[114] Idaho imposes a duty on directors to "consider the long-term as well as the short-term interests of the corporation and its shareholders." Clearly, the word "corporation" used here makes a distinction between corporate and shareholder interests and adopts an inclusive approach that fosters both shareholders and non-shareholder groups. Showing a local bias, the Idaho statute also permits a director to "consider the interests of Idaho employees, suppliers, customers and communities in discharging his duties."[115] Connecticut, which originally imposed a limited duty on directors to consider non-shareholder interests in change of control situations, has since moved to an optional regime but operating on a larger scale. The current rule permits directors to include stakeholder considerations in the discharge of their duties and to do so on an ongoing basis in all situations.[116] In the remaining twenty-seven states, the regime is voluntary.[117] Just three states (Arizona, Idaho, and New Mexico) have stable, non-discretionary stakeholder regimes which require the consideration of all interests in the ongoing governance of business corporations.

Reflecting the origin of the stakeholder rule in the takeover battles, many states restrict stakeholder considerations to the limited issue of change of control or retaining corporate independence.[118] Even in this narrow sphere, there is no obligation for the directors to consider non-shareholder interests; the directors can elect whether to consider their interests. Mandatory application and scope are vital in determining the efficacy of the stakeholder regime, and the weights assigned to each of them reflect their relative significance.

The stakeholder regime in the states can be measured by applying the criteria identified in Table 1 above, on a scale of thirty-six. An analysis of the thirty-one states that have adopted the regime reveals significant divergence in the scores of individual states, despite the commonality of theme—namely, protecting the interests of non-

114. *See* ARIZ. REV. STAT. ANN. § 10-2702 (2004); N.M. STAT. ANN. § 53-11-35(D) (2003).

115. IDAHO CODE ANN. § 30-1702 (2005).

116. CONN. GEN. STAT. ANN. § 33-756 (2005).

117. *See, e.g.*, ALA. CODE § 10A-2-11.03(c) (2010); ARK. CODE. ANN. § 4-27-1202(c) (2001); CONN. GEN. STAT. ANN. § 33-756; GA. CODE ANN. § 14-2-202(b)(5) (2003); IOWA CODE ANN. § 491.101B (West 1999); LA. REV. STAT. ANN. § 12:92(G) (2010); MO. REV. STAT. § 351.347 (West 2001); S.D. CODIFIED LAWS § 47-33-4 (2007); TENN. CODE ANN. § 48-103-204 (2012).

118. *See, e.g.*, ALA. CODE § 10A-2-11.03(c); ARIZ. REV. STAT. ANN. § 10-2702; IOWA CODE ANN. § 491.101B; LA. REV. STAT. ANN. § 12:92(G); MO. REV. STAT. § 351.347.

shareholder constituencies in business corporations. The scores are presented in Figures 1 and 2, *infra*.

As noted, three states have mandatory stakeholder regimes. Among the remaining twenty-eight states where the principle is voluntary, directors in twenty states can consider the interests of non-shareholder constituencies in all decisions.[119] This is a more expansive approach, although its efficacy is weakened by the fact that the regime is optional. Tennessee has a rather unique scheme of provisions.[120] Its regime is not affirmative in content; it neither requires directors to consider stakeholder interests, nor facilitate or enable them to do so.[121] Rather, Tennessee merely protects the directors if they have also considered non-shareholder interests in making decisions.[122]

Admittedly, the stakeholder regime introduced in the United States in the 1980s has its limitations. To begin with, it is not mandatory in most jurisdictions. It is episodic in approach and confines itself, in several jurisdictions, to takeovers and changes of control. It does not apply to ongoing governance. The statutory regime neither discards shareholder primacy, nor does it entitle non-shareholder groups to bring actions against corporations. Yet the principle marks the entry of an institutional vision of business corporations in the organizing statutes. The amendments are also significant as indicators of the concerns that animated the discourse on business corporations. They gave statutory shape to the problems and issues that were prominent in boardrooms in determining corporate policy and strategy.

In a limited number of cases, courts have examined directors' defensive actions against takeovers—devised specifically with reference to the stakeholder statutes and the considerations they recognize.[123] In general, courts have been willing to apply the stakeholder statutes to validate the acts of incumbent directors. In *Baron v. Strawbridge & Clothier*,[124] the court upheld the reclassification of stock by the directors in defending a tender offer.[125] In *Amanda Acquisition Corp. v. Universal Foods Corp.*,[126] the refusal of the directors to redeem poison pill rights was affirmed.[127] Use of poison pills by the directors as a defense against hostile takeover was also upheld in *Georgia-Pacific Corp. v. Great*

119. *See* ARK. CODE. ANN. § 4-27-1202(c); GA. CODE ANN. § 14-2-202(b)(5); TENN. CODE ANN. § 48-103-204.

120. *See* TENN. CODE ANN. § 48-103-204; Orts, *supra* note 102, at 30.

121. *See* TENN. CODE ANN. § 48-103-204; Orts, *supra* note 102, at 30.

122. *See* TENN. CODE ANN. § 48-103-204.

123. *See* Orts, *supra* note 102, at 32-35.

124. 646 F. Supp. 690 (E.D. Pa. 1986).

125. *Id.* at 697-98.

126. 708 F. Supp. 984 (E.D. Wis. 1989).

127. *See id.* at 1015-16.

Northern Nekoosa Corp.[128] Similarly, a "white knight" defense to takeovers was accepted in *Keyser v. Commonwealth National Financial Corp.*[129]

The reported cases on constituency statutes were all about corporate control and protecting the incumbent managements. Significantly, there are no reports of conflicts among the stakeholder groups *inter se* and the handling of the conflict by the directors or the courts.[130] These would be equally, if not more, relevant in the ongoing governance of business corporations. Stakeholder governance is essentially about the ongoing consideration that all corporate constituencies must receive in decisions and policies.[131]

The stakeholder principle has received substantial acceptance in corporate governance. ALI's influential *Principles of Corporate Governance: Analysis and Recommendations* recognizes that "[t]he long-term profitability of the corporation generally depends on meeting the fair expectations of [stakeholder] groups" and endorse that a "corporation's business may be conducted accordingly."[132] Pointing out that the constituency statutes impose a higher standard of care on the directors, Eric Orts interpreted their enactment as signaling a "foray toward broader corporate law reform in the United States."[133]

Delaware, which boasts the largest number of public corporations, has not included the stakeholder principle in its statute.[134] However, the idea *is* present in Delaware law. More than once, Delaware courts have recognized the stakeholder principle. In *Unocal Corp. v. Mesa*

128. 727 F. Supp. 31, 32-33 (D. Me. 1989). The term "poison pills" refers to the right of the directors to issue shares in specified circumstances—usually takeover bids that pose a threat to the management. *See* Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. CORP. L. 381, 381-82 (2002).

129. 675 F. Supp. 238, 262 (M.D. Pa. 1987). A "white knight" is a friendly outsider that helps management in defending itself against a hostile takeover bid. *See* Stephen M. Bainbridge, *Precommitment Strategies in Corporate Law: The Case of Dead Hand and No Hand Pills*, 29 J. CORP. L. 1, 7-8 (2003).

130. Stakeholder disputes have been considered by the Canadian courts in the recent years. *See, e.g.*, BCE Inc. v. 1976 Debentureholders, [2008] 3 S.C.R. 560, paras. 4-22 (Can.); *In re* Bankruptcy of Peoples Dep't Stores Inc. v. Wise, [2004] 3 S.C.R. 461, paras. 4-25 (Can.); Air Canada Pilots Ass'n v. Air Canada Ace Aviation Holdings Inc., (2007) CanLII 337, paras. 1-11 (Can. Ont. Super. Ct.). In all the three cases, the court in effect ruled in favor of the shareholders. *See BCE*, 3 S.C.R. at paras. 113-14, 166-67; *Peoples*, 3 S.C.R. at paras. 53, 71; *Air Canada*, 2007 CanLII 337, paras. 87-88, 91-93.

131. *See* Bainbridge, *Constituency Statutes*, *supra* note 105, at 1000-04 (distinguishing between "operational decisions," such as plant closings, and "structural decisions," such as takeovers, in the application of stakeholder interests).

132. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 82, at § 2.01 cmt. f.

133. *See* Orts, *supra* note 102, at 92, 133.

134. *See* JEFFREY W. BULLOCK, DEL. DIV. OF CORPS., 2011 ANNUAL REPORT (2012), *available at* http://corp.delaware.gov/2011CorpAR.pdf.

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Petroleum Co.,[135] the court upheld the defensive tactics adopted by the Unocal board against a hostile takeover bid.[136] In doing so, the court referred to the directors' "fundamental duty and obligation to protect the corporate enterprise, which includes stockholders . . . ."[137] This observation affirmed a more institutional vision of a business corporation—as something more than a mere aggregation of its shareholders. Accordingly the court stressed the duty of the board towards the enterprise as a whole—which necessarily includes groups such as employees, suppliers, and customers.[138]

In *Paramount Communications, Inc. v. Time Inc.*,[139] the court strengthened the stakeholder trend by upholding action taken by the directors of Time Inc. to protect the company's corporate culture and journalistic integrity, overriding shareholder interests.[140] Again in *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*,[141] the court ruled that the fiduciary duties of directors could extend to the creditors of corporations "operating in the vicinity of insolvency."[142] Chancellor William T. Allen defined the scope of their duties: "[The board has] an obligation to the community of interests that sustained the corporation, to exercise judgment in an informed, good faith effort to maximize the corporation's long-term wealth creating capacity."[143]

There are, however, other strands in Delaware corporate law. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[144] the court had to deal with the takeover and the breakup of a corporation.[145] In that situation, the court treated the board of directors as auctioneers for the shareholders, and charged them with a duty to procure the highest possible price for the shares.[146] There was little room for non-shareholder groups in that framework. The *Revlon* principle was recently reiterated in *In re Netsmart Technologies, Inc. Shareholders Litigation*.[147]

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135. 493 A.2d 946 (Del. 1985). For the significance of this decision, see Mitchell, *supra* note 106, at 611-13.

136. *See Unocal*, 493 A.2d at 958.

137. *See id.* at 953-54.

138. *See id.* at 955.

139. 571 A.2d 1140 (Del. 1989). For a critique of this decision from the perspective of shareholder primacy, see Minow, *supra* note 111, at 208-11.

140. *See Paramount Commc'ns*, 571 A.2d at 1153-55.

141. Civ. A. No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).

142. *See id.* at *34.

143. *Id.*

144. 506 A.2d 173 (Del. 1986).

145. *See id.* at 176-79.

146. *See id.* at 182.

147. 924 A.2d 171, 192-93 (Del. Ch. 2007).

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It would be difficult to reconcile the shareholder-centric outcomes in *Revlon* and *Netsmart* with the institutional vision that animated *Unocal* and *Paramount Communications*. The latter cases were based on a broader vision of corporate enterprises. The dichotomy between the two sets of cases is because of the different factual situations the court dealt with in these cases. The result is two conflicting visions of business corporations. This stresses the need for developing corporate theory that is wholesome, harmonious, and comprehensive. In this effort, judicial decisions can provide valuable inputs.[148]

Recently, Britain expanded and strengthened the stakeholder principle in the Companies Act 2006.[149] The provision, extracted below, is comprehensive in scope and sets out the principle with clarity:

> 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.[150]

The regime is mandatory and applies to all companies on an ongoing basis.[151] At first glance, the provision may appear radical, but it is not really so. It treats the "success of the company for the benefit" of shareholders as the overriding objective, and subordinates all other considerations.[152] In promoting corporate success of this variety, directors are under a duty to consider the interests of non-shareholder groups also. The statutory provision broadens the fiduciary duties of directors. It moves away from the restrictive approach traditionally applied in common law and the emphasis it was understood to place on shareholder primacy. Directors are now under a duty to consider a variety of other interests in promoting the success of the companies. There can be little dispute with the proposition that a company must be successful before it can take proper care of its various stakeholders—

148. *See infra* Part IV.A.
149. *See* Companies Act, 2006, c. 46, § 172 (Eng.).
150. *Id.* § 172(1).
151. *Id.* § 172(3).
152. *See id.* § 172(2).

including shareholders. The principle of "enlightened shareholder value"[153] now legislated in Britain finds increasing acceptance among corporations as the Survey below finds.[154]

2. The Stakeholder Remedy Model: Canada

Among the common law jurisdictions, Canada was the earliest to grant legislative recognition to the stakeholder principle. It did so by including non-shareholder groups in the remedies available under the CBCA—namely, derivative actions for wrongs to a corporation and the oppression remedy for wrongs to specific individuals or groups.[155] Traditionally, these remedies were available only to shareholders.

A committee (the "Dickerson Committee"), which was directed by Robert W. V. Dickerson and which produced the CBCA, recommended the extension of the statutory remedies against managements to all the constituencies in business corporations.[156] In so recommending, the Dickerson Committee bracketed all stakeholders together, including shareholders.[157] This approach can be traced to the Dickerson Committee's understanding of shareholders. The Dickerson Committee adopted the Berle-Means paradigm of passive shareholders who played no meaningful role in a company—in any case, not commensurate with the proprietary position attributed to them in corporate theory.[158] The Dickerson Committee treated shareholders as little more than security holders, some years before this position was formally proclaimed for the shareholders in economic theory.[159] This framework had little place for the so-called proprietary position of the shareholders or the idea that

153. *See* David Millon, *Enlightened Shareholder Value, Social Responsibility and the Redefinition of Corporate Purpose Without Law*, *in* CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS 68, 68 (P.M. Vasudev & Susan Watson eds., 2012); Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59, 78-79 (2010) (internal quotation marks omitted).

154. *See infra* Part III.A–B.

155. *See* Canada Business Corporations Act, R.S.C. 1985, c. C-44, §§ 238–241.

156. *See* 1 ROBERT W. V. DICKERSON ET AL., PROPOSALS FOR A NEW BUSINESS CORPORATIONS LAW FOR CANADA ¶ 485 (1971) [hereinafter 1 DICKERSON ET AL.].

157. *See id.*; 2 ROBERT W. V. DICKERSON ET AL., PROPOSALS FOR A NEW BUSINESS CORPORATIONS LAW FOR CANADA § 19.01 (1971).

158. *See* 1 DICKERSON ET AL., *supra* note 156, at ¶ 10.

159. *See generally* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989) (noting that "the corporate structure is a set of contracts through which managers and certain other participants exercise a great deal of discretion that is 'reviewed' by interactions with other self-interested actors"). Before them, Michael C. Jensen and William H. Meckling described shares as "divisible residual claims" and assumed non-voting shares in their hypothetical model. *See* Jensen & Meckling, *supra* note 10, at 311, 351-52. These reflected the reality of shareholder inefficacy in corporate America. *See* Easterbrook & Fischel, *supra*, at 1443; Jensen & Meckling, *supra* note 10, at 351-52.

directors were their elected surrogates.[160] Shareholders had no special position or rights and were, in substance, little different from other groups, such as employees, suppliers, and creditors who also had interests in the corporations.

With this thinking, the Dickerson Committee extended the two remedies in the CBCA—namely, derivative action and relief against oppression—to a generic class of "complainants." [161] The term "complainant" is defined as follows:

> "[C]omplainant" means
> (*a*) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
> (*b*) a director or an officer or a former director or officer of a corporation or any of its affiliates,
> (*c*) the Director, or
> (*d*) any other person who, in the discretion of a court, is a proper person to make an application under this Part.[162]

Shareholders, as already pointed out, are swept under the omnibus class of "security" holders, which would include both shareholders and creditors who have lent money to corporations under bonds or debentures. [163] Other than security-holders, directors and officers, including those who held office in the past, are included in complainants. The director of corporations, a government official, is also empowered to take action, presumably in the public interest. Finally, the court has the discretion to determine any other person as being "proper" to invoke the remedies provided in the statute. The statute's conception of the groups that may have complaints against business corporations is, thus, quite broad.

Referring to the stakeholder remedy in the CBCA, Stephanie Ben-Ishai developed the "team production" model of Canadian corporate law.[164] Ben-Ishai argued that corporate law in Canada accords primacy to directors and, considering the nature of the oppression remedy, that the directors of Canadian corporations can be assimilated to the

160. *See* Easterbrook & Fischel, *supra* note 159, at 1443.

161. *See* Canada Business Corporations Act, R.S.C. 1985, c. C-44, §§ 238–241.

162. *Id.* § 238.

163. *See id.* § 2.

164. *See* Stephanie Ben-Ishai, *A Team Production Theory of Canadian Corporate Law*, 44 ALTA. L. REV. 299, 302 (2006) ("This article applies the Team Production Theory developed by American corporate law scholars, Margaret Blair and Lynn Stout, to argue that Canadian corporate law's understanding of public corporations . . . reflects a director primacy norm rather than a shareholder primacy norm.").

"mediating hierarchs" conceived in the team production theory of Blair and Stout.[165]

It is, however, an open question how far the stakeholder remedy provided in the CBCA has been effective. The results in recent stakeholder cases—*BCE* and *Peoples*—went against the creditors, although the court in both cases formally endorsed the stakeholder vision.[166] In *Peoples*, the Supreme Court of Canada ruled that directors of corporations did not owe fiduciary duties to creditors.[167] In *BCE*, which was an action under the oppression remedy, the court declined to consider the issue of injury to the interests of the creditors, despite the statute facilitating it.[168] The court was more concerned with the "rights" of the parties.[169] In another important case, *Air Canada Pilots Ass'n v. Air Canada ACE Aviation Holdings Inc.*,[170] the court refused to recognize the Pilots Association of Air Canada as a complainant for questioning a proposal of Air Canada to distribute assets among its shareholders.[171]

The Canadian experience is a pointer to the limitations of the courts as guardians of the interests of non-shareholder groups. In stakeholder conflicts, the issue is often about "interests" which may not have crystallized into well-defined "rights" with which the legal system is familiar. The adversarial system of the courts and technical rules of form, procedure, and evidence are other impediments for the courts' ability to effectively respond to stakeholder disputes. These are some issues with the remedy-based approach to the stakeholder principle.

3. The Third Alternative: Representation and Empowerment

A third version of the stakeholder regime is providing representation for non-shareholder groups on corporate boards and empowering them to participate in governance. This is prevalent in Germany, where public corporations have a broad cross-section of people on their boards, including employee representatives.[172] The model, termed "codetermination," is a participatory arrangement designed to promote a broader stakeholder approach to governance.[173]

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165. *See generally id.*

166. *See* BCE Inc. v. 1976 Debentureholders, 2008 SCC 69, [2008] 3 S.C.R. 560, paras. 36-40, 113-14, 166-67 (Can.); Peoples Dep't Stores Inc. v. Wise (*In re* Peoples Dep't Stores Inc.) 2004 SCC 68, [2004] 3 S.C.R. 461, paras. 42, 53, 71 (Can.).

167. *Peoples*, 2004 SCC 68, at paras. 53, 71.

168. *See BCE*, 2008 SCC 69, at paras. 95-96, 113-14.

169. *See id.* at paras. 127-33, 161-63.

170. 2007 CanLII 337 (Can. Ont. Super. Ct. J.).

171. *Id.* at paras. 87-88, 91-93.

172. Conard, *supra* note 71, at 78-79.

173. *See id.*

The representation-and-empowerment model could have been expected to be popular in the English-speaking countries, considering their political history and ideas about representative democracy. But this has not been the case. The subject of stakeholder representation, in particular employee representation on boards, was discussed in Britain and even earlier in Canada, but both counties abandoned the idea. Significantly, resistance to the idea came from the labor unions in both countries. In Britain, in the wake of recurrent labor unrest in the 1970s, the Dickerson Committee of Inquiry on Industrial Democracy was formed with Lord Alan Bullock as the chair, to inquire into labor participation in company boards.[174] The committee reported the reluctance of labor unions to sit on boards.[175]

In Canada, the Dickerson Committee explored the representation approach even earlier.[176] The Dickerson Committee had no quarrel with the argument about stakeholders or their representation in boards, but it had reservations about enlarging the electorate.[177] Hence, the Dickerson Committee rejected representation as a regulatory model.[178] While doing so, it pointed out that few legal impediments existed for including a wider section of stakeholders on the boards if the corporations wanted to do so.[179] The Committee also recorded that "trade unions ha[d] not shown much interest in having representation on the boards of corporations."[180]

In the United States, the idea of stakeholder representation does not appear to have been considered with seriousness. A possible explanation is a degree of adversarialism that has traditionally informed union-management relationship and the consequent inability to conceive other possibilities.[181] Alfred F. Conard pointed out that the milieu prevailing in the United States did not encourage the representation model.[182]

In the common-law countries, impediments to the codetermination model are apparently cultural. The trend in these countries is more in favor of having centralized powers in boards, but with a broader mandate in decision-making. The top-down structure is retained, and efforts are

174. DEPARTMENT OF TRADE, REPORT OF THE COMMITTEE OF INQUIRY ON INDUSTRIAL DEMOCRACY, 1977, Cmnd. 6706, at v-vi (U.K.).

175. *See id.* at 35-36.

176. *See* 1 DICKERSON ET AL., *supra* note 156, at 9-10.

177. *See id.*

178. *See id.*

179. *Id.* at 10.

180. *Id.*

181. "Nexus of contracts," the memorable phrase coined by Jensen and Meckling, perhaps captured this sense accurately. *See* Jensen & Meckling, *supra* note 10, at 311. The emphasis is on each group sorting out their rights and establishing their entitlements to the best of their ability, rather than acting collectively in a spirit of cooperation for common progress. *See id.* at 351-52.

182. *See* Conard, *supra* note 71, at 80.

made to enlighten the leadership, as it were, with stakeholder considerations. There has been little effort at diffusing corporate power and empowering people at the middle or lower levels. To be clear, such efforts would probably undermine the efficiency of corporate enterprises. Central command is among the chief advantages of the corporate form, and it undoubtedly promotes greater efficiency, both in planning and in execution. It avoids a bureaucratic approach, which can be especially problematic for corporations to operate in the highly competitive globalized markets of the present age.

For another reason, lack of formal representation of the stakeholders may not be a major issue in the emerging landscape. Ideas about director independence and board committees have gained significant traction, and they have the potential to promote a broader vision in the boards of public corporations. Board committees and independent directors are not, in theory, identified with any particular group, such as shareholders or management. This feature can promote greater balance and encourage the application of wider perspectives in shaping policies and strategies even when specific stakeholder groups have no representation in the boards.

III. THE STAKEHOLDER PRINCIPLE AND ITS ACCEPTANCE: A PEEP INTO THE "REAL WORLD"

The stakeholder debate, as pointed out, began in the 1930s.[183] Eighty years on, it is now time to assess how far the idea has gained traction. How far do companies recognize the stakeholder vision and incorporate it in their governance structure, policies, and practices?[184] To answer this question, this Part presents the results of the Survey of U.S., U.K., and Canadian corporations numbering 166 in all, excluding government-owned or government-sponsored enterprises, included in the 2012 Global 500.[185]

This Part has three Sections. Section A presents the numerical results—namely, the number of corporations that accept or recognize the stakeholder principle. This is followed, in Section B, by an analysis of

183. *See supra* text accompanying notes 99-100.

184. This Article treats the stakeholder vision, notions about corporate responsibility or social responsibility, and corporate citizenship as broadly similar concepts that seek to carry companies beyond the limited profit-maximizing or shareholder-value-maximizing models. There are no significant peculiarities underlying each of these concepts, and they do not warrant a differential treatment.

185. *See Global 500*, *supra* note 2; *Countries*, CNNMONEY, http://money.cnn.com/magazines/fortune/global500/2012/countries/Australia.html (follow pull-down menu, which separates the Global 500 by country) (last visited Mar. 29, 2013). The Global 500 includes 132 U.S. companies, 26 U.K. companies, and 11 Canadian companies. *Countries*, *supra*.

the results including samples of the forms in which the principle finds a place in companies' documents. Finally, Section C examines the issue about rhetoric and reality in the affirmation of stakeholder concerns by corporations.

A. The Numbers

Among the 2012 Global 500, 169 are based in the United States, Britain, and Canada.[186] These companies are the sample used in the Survey on the stakeholder principle. The country-based breakup of the corporations is given in Table 2 below:

Table 2: Corporations in the 2012 Global 500

United States	132
United Kingdom	26
Canada	11
Sub-total	**169**
Other countries	331
Total	**500**

Out of the 132 U.S. companies, three were eliminated. Two are government-sponsored enterprises (Fannie Mae and Freddie Mac), and one is owned and operated by the U.S. government (the U.S. Postal Service).[187] This left a net number of 166 corporations for the survey—129 U.S., 26 U.K., and 11 Canadian.

I reviewed the governance-related documents and statements of the companies to determine whether they recognize the stakeholder principle and, if so, identify the manner or style in which this is done. The method was to search for references to non-shareholder groups and understand how the companies treat the role and interests of these groups. The documents reviewed included mainly: governance guidelines, annual

186. *Countries*, *supra* note 185.

187. U.S. POSTAL SERV., POSTAL FACTS 2012, at 23 (2012), *available at* http://about.usps.com/who-we-are/postal-facts/welcome.htm; *Company Overview*, FANNIE MAE, http://www.fanniemae.com/portal/about-us/company-overview/about-fm.html (last visited Mar. 29, 2013); *Global 500*, *supra* note 2; *see also Where Do GSEs, Like Fannie Mae and Freddie Mac, Appear in the GPD Accounts?*, BUREAU ECON. ANALYSIS (Oct. 24, 2008), http://www.bea.gov/faq/index.cfm?faq_id=508 ("Government-sponsored enterprises (GSEs) are private companies that were established and chartered by the federal government."). With government-sponsored enterprises, the presumptions are that the stakeholder paradigm is, to a considerable extent, inherent in their structure and they would not operate with the limited motive of benefiting their shareholders.

reports, reports on corporate responsibility and sustainability, and vision and mission statements.

The results from the Survey are impressive. A total of 98.44% (164 of 166) companies covered in the Survey have included non-shareholder interests among their concerns.[188] The results are presented in Figure 3, *infra*.

No significant difference is seen among the companies in the three jurisdictions. The number of companies that do not recognize stakeholder interests or social responsibility is quite small in all three—the United States, Britain, and Canada. Individual data for each jurisdiction are provided in Table 3 below:

Table 3: Recognition and Non-Recognition of the Stakeholder Idea Separated by Country

	Net number of companies considered	Companies recognizing stakeholder idea	Companies not recognizing stakeholder idea
U.S.	129	127	2
U.K.	26	26	0
Canada	11	11	0
Total	166	164	2

In percentage terms, acceptance of the stakeholder idea is 100% by U.K. and Canadian corporations and 98.79% by U.S. corporations. Only two American corporations, Berkshire Hathaway and INTL FCStone, make no reference to groups other than shareholders or customers in the governance-related documents available on their respective websites.

B. *The Stakeholder Principle: A Qualitative Survey*

As already pointed out, there is evidence of corporate philanthropy and a concern for non-shareholder groups at least since the late nineteenth century.[189] Yet in the recent decades, the stakeholder idiom and expansive ideas about corporate social responsibility have become more influential. Now they can be considered a part of mainstream governance theory and practice. Increased attention to stakeholders in the recent years is recorded in the statement of BT PLC ("BT") (2012 Global 500 rank 358), the U.K. telecommunication services company:

188. Predictably, there is considerable variety in the forms in which the corporations provide a place for the stakeholder idea in their governance structure. *See infra* Part III.B.

189. *See supra* Part II.A.

"Business responsibility matters to BT. In fact social and environmental responsibility has been a central part of our business strategy since the early 1990s."[190] Similarly, BAE Systems (2012 Global 500 rank 386), referred to corporate responsibility in the following terms in its annual report for 2011: "Creating a successful and sustainable business requires more than financial results. The Group places great importance not just on what we do, but how we do it. Responsible business is embedded within the Group's strategy."[191]

There is considerable variety in the documents companies have chosen for stating stakeholder concerns or corporate responsibility. These include corporate governance guidelines, vision/mission statements, corporate citizenship/responsibility statements, and sustainability/social responsibility reports. Significantly, and perhaps understandably, several companies paraphrased their stakeholder concerns in the idiom of benefit for the companies' business.[192] Hewlett-Packard Company (2012 Global 500 rank 31) stated the idea quite bluntly: "Good citizenship is good business. We live up to our responsibility to society by being an economic, intellectual and social asset to each country and community in which we do business."[193] A statement of Time-Warner Inc. (2012 Global 500 rank 381) reflects a similar attitude, although it is couched in relatively broader terms: "Time Warner continues to excel operationally and financially and at the same time has been able to focus on supporting and improving the communities in which our employees work and live."[194]

The trend in favor of the stakeholder principle and responsible practices is becoming stronger because they make good business sense. This invites a question whether corporate responsibility is just a business expedient or independent policy. It may not be necessary to strain the issue with such scrutiny, and it is better to accept healthy and responsible corporate governance at face value—unless, of course, it is merely a veneer meant to hide other tendencies. Indeed, the concept of enlightened shareholder value now adopted in Britain's Companies Act

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190. *Global 500, supra* note 2; *Our Story*, BT, http://www.btplc.com/responsiblebusiness/ourstory/ (last visited Mar. 29, 2013).

191. BAE SYS., ANNUAL REPORT 2011, at 55 (2011), *available at* http://bae-systems-investor-relations-v2.production.investis.com/~/media/Files/B/BAE-Systems-Investor-Relations-V2/PDFs/results-and-reports/reports/2012a/ar-2011.pdf; *Global 500, supra* note 2.

192. This reflects the historical thinking on the subject. See the observations of the court in Hutton v. W. Cork Ry. Co., [1883] 23 Ch.D. 654 at 673 (Eng.). To some extent, companies appear to be helpless in the matter. Their efforts at philanthropy in the 1960s were branded as ego-trips for the managers at the cost of the shareholders.

193. *Corporate Objectives*, HEWLETT-PACKARD, http://welcome.hp.com/country/lamerica_nsc_carib/en/companyinfo/corpobj.html (last visited Mar. 29, 2013); *Global 500, supra* note 2.

194. *Corporate Responsibility: Letter from Jeff Bewkes*, TIME-WARNER (Oct. 2012), http://www.timewarner.com/our-company/corporate-responsibility/; *Global 500, supra* note 2.

2006 is based on the idea of common interest, although it is presented in hierarchical terms.[195] Also, recent concepts, such as the "balanced scorecard," encourage precisely the variety of behavior that companies that swear by the stakeholder principle profess.[196] There should be nothing wrong, in principle, in combining good business with good ethics. It is what balanced scorecards are about.

There is evidence of companies strengthening their commitment to values in corporate governance, regardless of business conditions. BT's Nominating and Governance Committee is a main board committee responsible for "the determination and review of BT's governance policies, particularly with regard to corporate governance, ethics, business principles, international trading regulation issues and data protection."[197] J. Sainsbury PLC (2012 Global 500 rank 302) is another case-in-point.[198] It described the implications of following ethical and eco-friendly practices in price-sensitive markets in the following terms:

> Although customers are increasingly price-conscious, ethical and environmental issues remain important for them.
>
> We believe that by considering the wider social, environmental and economic impacts of our business, we are able to meet our customers' expectations by acting responsibly on their behalf. This ultimately delivers long-term shareholder value by securing our future ability to grow as a profitable business.[199]

Amazon.com, Inc. (2012 Global 500 rank 206) is a recent entrant into the Global 500.[200] It has a somewhat unique position on stakeholders and corporate responsibility. Its vision is restrictive, and the company expressly confines its responsibility to issues of immediate relevance to its business. Amazon.com, Inc. believes that its "greatest contribution to the good of society comes directly from these core business activities," which it describes as supporting innovation among

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195. *See* Companies Act, 2006, c. 46, § 172 (Eng.).

196. *See* Robert S. Kaplan & David P. Norton, *The Balanced Scorecard—Measures that Drive Performance*, HARV. BUS. REV., Jan.–Feb. 1992, at 71 ("The balanced scorecard includes financial measures that tell the results of actions already taken. And it complements the financial measures on customer satisfaction, internal processes, and the organization's innovation and improvement activities—operational measures that are the drivers of future financial performance.").

197. BT, BETTER FUTURE REPORT 2012, at 144 (2012), *available at* http://www.btplc.com/Responsiblebusiness/Ourstory/Sustainabilityreport/downloadcentre/buildreport/index.aspx (check all seven sections of the *Better Future Report 2012*, then click on "Create Your PDF").

198. *Global 500*, *supra* note 2.

199. *Sainsbury's Signs Partnership to Manage Outpatient Pharmacies at Guy's and St Thomas'*, J SAINSBURY, (Oct. 23 2012), http://www.j-sainsbury.co.uk/mobile/%5Cmobilenewsarticle?id=7306.

200. *Global 500*, *supra* note 2.

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its business associates—namely, vendors, customers, web developers, and so on.[201]

An interesting trend is visible among companies in the financial sector that was badly hit in the financial crisis of 2008 and 2009 ("Financial Crisis"). Companies that emerged relatively unscathed exhibited a tendency to present corporate responsibility as their distinguishing feature that sets them apart from others in the industry. The statements of Aviva PLC (2012 Global 500 rank 148), a U.K. financial company, are revealing:

> As the global economy faces its toughest challenge in decades, so do many of the world's best-known organisations. Customer confidence has taken a knock in the financial services sector along with share prices. While Aviva's robust approach to risk management and financial planning means we are well placed to weather the economic storm, our approach to C[orporate] R[esponsibility] also sets us apart in terms of maintaining customer trust and setting new standards in global corporate citizenship.[202]

Considerable variety is seen in the form in which the companies stated their concerns for the stakeholders or their notions of corporate responsibility. To some extent, this reflects the diverse nature of their businesses, which range from manufacturing, extractive, or utility corporations (General Motors Co. ("General Motors"), ExxonMobil Corp., and BT), to retailers (Wal-Mart Stores, Inc. and Tesco PLC), brand-name owners (Nike, Inc.), and financial and healthcare service companies (Citigroup Inc. and Cardinal Health, Inc.).[203] The nature of

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201. *See Amazon in the Community*, AMAZON, http://www.amazon.com/b?ie=UTF8&node=13786411 (last visited Mar. 29, 2013).

202. AVIVA, CORPORATE RESPONSIBILITY REPORT 2009, at 3 (2009), *available at* http://www.aviva.com/library/reports/cr09/files/2009_Report.pdf; *Global 500*, *supra* note 2.

203. *See* CARDINAL HEALTH, STANDARDS OF BUSINESS CONDUCT 46 (2009), *available at* http://www.cardinalhealth.com/mps/wcm/connect/9d7531004b9a772b8a71eedaeb3529b5/StandardsofBusinessConduct_20120613.pdf?MOD=AJPERES&lmod=-424261771&CACHEID=9d7531004b9a772b8a71eedaeb3529b5 ("Cardinal Health is committed to being a responsible citizen in the communities and countries where we are located and encourages employees to share their time, talent, knowledge and skills with charitable organizations."); CITIGROUP INC., 2011 GLOBAL CITIZENSHIP REPORT 3 (2012), *available at* http://www.citigroup.com/citi/about/data/2011citizenship_report.pdf; EXXONMOBIL, 2011 CORPORATE CITIZENSHIP REPORT 6 (2012), *available at* http://www.exxonmobil.com/Corporate/Files/news_pub_ccr2011.pdf; WAL-MART, 2012 GLOBAL RESPONSIBILITY REPORT 2-3 (2012), *available at* http://az204696.vo.msecnd.net/download/1099/2012-global-responsibility-report_129823695403288526.pdf ("With every passing year, we also feel more strongly that sustainability is critical to our business and to driving Everyday Low Costs and leverage for shareholders. Operating more efficiently is tied directly to the productivity loop that allows us to deliver low prices and increase sales."); GEN. MOTORS, GENERAL MOTORS SUSTAINABILITY REPORT 7 (2012), *available at* http://gmsustainability.com/REPORT_BUILDER.html ("It also has become clearer that reducing waste and increasing efficiency is good for the bottom line of the business. GM has long

their businesses will definitely shape the concerns and define their approach. Manufacturing companies that own and operate large plants are necessarily different from corporations that have no significant manufacturing operations. The case is also different with companies in the financial and healthcare sectors.

The companies covered in the Survey, as pointed out, accept the stakeholder idea or social responsibility in principle. The logical next step is implementation, for which companies must develop a stakeholder model of governance and integrate it in their policies and business strategy. In this respect, Magna International Inc. (2012 Global 500 rank 385), the Canadian automotive company, has an interesting model for fostering stakeholder interests.[204] The company, which describes itself as a "Fair Enterprise Corporation," has a well-defined and transparent framework for its stakeholder policy.[205] It earmarks specified portions of its resources for each stakeholder group, and these commitments are recorded in the company's constitution.[206] The stakeholder allocations provided in Magna International Inc.'s Corporate Constitution are summarized in Table 4 below.

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recognized this convergence of customer, regulatory and business imperatives, and we are addressing them more aggressively than ever."); NIKE, SUSTAINABILITY BUSINESS PERFORMANCE SUMMARY 9 (2012), *available at* http://www.nikeresponsibility.com/report/files/report/NIKE_SUSTAINABLE_BUSINESS_REPORT__FY10-11_FINAL.pdf ("At Nike, one way we seek to deliver shareholder value is through sustainable growth. To us, *sustainable growth* means our long-term vision to deliver profitable growth decoupled from constrained natural resources, even as we work to deliver value to our shareholders in the near term."); TESCO, CORPORATE RESPONSIBILITY REVIEW 2012, at 3 (2012), *available at* http://www.tescoplc.com/files/pdf/reports/tesco_cr_review_2012.pdf ("You will see Tesco doing the right things for all its stakeholders—customers, communities, suppliers, shareholders and staff—and that means listening more, behaving responsibly across the business and measuring ourselves against the highest standards.").

ExxonMobil (2012 Global 500 rank 2) has stated:

> ExxonMobil is committed to addressing the challenge of sustainability—balancing economic growth, social development, and environmental protection so that future generations are not compromised by actions taken today. Our corporate citizenship approach is designed to contribute to society's broader sustainability objectives and to manage the impact of our operations on local economies, societies, and the environment.

EXXONMOBIL, *supra*; *Global 500*, *supra* note 2.

Citigroup Inc. (2012 Global 500 rank 60) has noted:

> Citi's citizenship efforts are an extension of our goal to make tactical business decisions that create shared value for those we work with and those we impact. Our two citizenship focus areas are financial inclusion and environment sustainability. We advance those priorities thanks to an unmatched global footprint, deep local knowledge, coordination across business lines, and a company-wide commitment to fostering innovation.

CITIGROUP INC., *supra*; *Global 500*, *supra* note 2.

204. *Global 500*, *supra* note 2.

205. *See* MAGNA INT'L INC., MAGNA'S CORPORATE CONSTITUTION, *available at* http://www.magna.com/migrated/en/pdf/Corporate_constitution.pdf (last visited Mar. 29, 2013).

206. *See id.*

Table 4: Magna International Inc.'s Stakeholder Framework[207]

Stakeholder Group	Provision in the Constitution
Eligible employees	Allocation of 10% of pre-tax profits.
Shareholders	Distribution of at least 20% of the profits over three years.
Management	Allowance of incentive bonuses up to 6% of pre-tax profits.
Research & development	Allocation of a minimum of 7% of pre-tax profits.
Social responsibility	Allocation of up to 2% of pre-tax profits to "charitable, cultural, educational and political purposes to support the basic fabric of society."
Common shareholders	"[R]ight to approve any investment in an unrelated business in the event such investment together with all other investments in unrelated businesses exceeds 20[%] of Magna's equity."

By adopting this model, Magna International Inc. attempts to provide concrete shape to the stakeholder concerns. Most companies, however, stop with making a reference to stakeholder concerns in broad terms and presenting them generally as a factor in governance. These are not followed up with efforts to classify or rank the interests of various groups.

As already pointed out, several companies declare that their ultimate goal is to serve the long-term interests of the company and shareholder value. For example, Honeywell International Inc. (2012 Global 500 rank 284) stated: "The primary functions of the Honeywell International Inc. Board of Directors are to oversee management performance on behalf of the shareowners, to ensure that the long-term interests of the shareowners are being served, to monitor adherence to Honeywell standards and policies, to promote the exercise of responsible corporate citizenship . . . ."[208]

Clearly, long-term interests of the shareholders and corporate interests, which necessarily include non-shareholder groups, are considered synonymous. This idea underpins the stakeholder vision recently included in the U.K. Companies Act 2006, discussed earlier.[209] It is difficult to overstate the importance of the profitability and viability of corporate enterprises operating in competitive markets. The recent experience of General Motors offers sobering lessons in this regard. Its

207. *Id.*

208. HONEYWELL INT'L, CORPORATE GOVERNANCE GUIDELINES (2012), *available at* http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTY1NTA1fENoaWxkSUQ9LTF8VHlwZT0z&t=1; *Global 500*, *supra* note 2.

209. *See* Companies Act, 2006, c. 46, § 172 (Eng.); *supra* text accompanying notes 144-48.

healthcare and pension obligations are reported to be a significant drag on the company, and these obligations were instrumental in the Financial Crisis, which resulted in the bailout of General Motors by the U.S. and Canadian governments and partial nationalization.[210]

In some companies, the shareholders are bracketed with other groups such as employees and customers, and no significant distinction is made among them.[211] The Home Depot U.S.A., Inc. (2012 Global 500 rank 116) has stated:

> Corporate governance is part of our culture and is founded on our daily commitment to living values and principles that recognize our ethical obligations to our shareholders, associates (employees), customers, suppliers, and the communities in which we operate. We understand our responsibility to behave ethically, to understand the impact we have on people and communities and to fairly consider the interests of a broad base of constituencies.[212]

I have earlier referred to the tradition of corporate philanthropy in the United States.[213] Reflecting this tradition, many U.S. corporations present their social responsibility in simple terms of charitable contributions and community donations.[214] The following statement of Lowe's Companies, Inc. (2012 Global 500 rank 190) is an example: "At Lowe's, we believe community involvement extends beyond the

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210. *See* Antony Currie et al., *G.M. Bankruptcy Loomed for Years*, N.Y. TIMES, June 2, 2009, at B2; Steven Greenhouse, *G.M.'s New Owners, Labor and Government, Adjust to Roles*, N.Y. TIMES, June 2, 2009, at B1; Michael E. Levine, Op-Ed., *Why Bankruptcy Is the Best Option for GM*, WALL ST. J., Nov. 17, 2008, at A19; Micheline Maynard, *For Chief, Little Time and a Full Plate*, N.Y. TIMES, June 2, 2009, at B1.

211. *See, e.g.*, TESCO, *supra* note 203, at 3.

212. *Corporate Governance Overview*, HOME DEPOT, http://ir.homedepot.com/phoenix.zhtml?c=63646&p=irol-govHighlights (last visited Mar. 29, 2013); *Global 500*, *supra* note 2.

213. *See supra* text accompanying notes 12-34, 76-86.

214. For example, Amazon.com, Inc. has noted:

> We also contribute to the communities where our employees and customers live. Our contributions can be seen in many ways—through our donations to dozens of nonprofits across the United States, through the disaster relief campaigns that we host on our homepage, through our employees' volunteer efforts, through the grants that we make to the writing community, and through the Amazon Web Services credits that we provide to educators.

Amazon in the Community, *supra* note 201.

Another example is The Kroger Company (2012 Global 500 rank 75), which has stated:

> We believe it is both our privilege and obligation to engage in our communities, protect the environment and have a positive economic impact. Our many achievements from 2011 reflect that we are moving forward. We will continue to do so because our Kroger associates embrace sustainability in their everyday business practices.

KROGER CO., SUSTAINABILITY, IMPROVING TODAY TO PROTECT TOMORROW: 2012 SUSTAINABILITY REPORT 3 (2012), *available at* http://www.socialfunds.com/shared/reports/1346829179_Kroger_2012_Sustainability_Report.pdf; *Global 500*, *supra* note 2.

boundaries of the traditional retail setting. Whether it's helping with natural disaster recovery or taking an active role in programs that make our neighborhoods better places to live, we are committed to helping our neighbors through alliances with well-respected organizations."[215]

Beyond statements of the stakeholder vision and affirmations of corporate responsibility, many companies also prepare reports on these issues.[216] Some of them go further and obtain independent assurance about the contents of their reports on responsibility and sustainability.[217] For instance, BP PLC (2012 Global 500 rank 4), stated: "External and internal stakeholders have been essential in shaping this report. Many of their insights and opinions are highlighted here and online. We also include observations and a summary statement from our external assurance provider, Ernst & Young."[218] The evidence suggests that the stakeholder principle is undergoing a process of development in corporate governance. Evidence of acceptance of the stakeholder ideal is strong, and there is also a trend among the companies to take concrete action to actualize the principle in their governance framework and policies.

C. Stakeholder Concerns: Rhetoric and Reality

Considering the concern exhibited by the corporations for stakeholders, a question arises about the seriousness with which they

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215. *Corporate Citizenship: Commitment to Community*, LOWE'S, http://www.lowes.com/cd_Corporate+Citizenship_674540029_ (last visited Mar. 29, 2013); *Global 500*, *supra* note 2.

216. *See, e.g.*, GEN. MOTORS, *supra* note 203, at 5; MCDONALD'S, 2011 GLOBAL SUSTAINABILITY SCORECARD 1 (2011), *available at* http://www.aboutmcdonalds.com/content/dam/AboutMcDonalds/Sustainability/Sustainability%20Library/2011-Sustainability-Scorecard.pdf; TESCO, *supra* note 203, at 4-5.

217. *See, e.g.*, CITIGROUP INC., *supra* note 203, at 13; *see also* AVIVA, SECURING OUR FUTURE: CORPORATE RESPONSIBILITY REPORT 2011, at 51 (2011), *available at* http://www.aviva.com/library/reports/cr11/docs/complete-report.pdf ("Aviva has commissioned Ernst & Young LLP to provide external assurance and a commentary on this 2011 online corporate responsibility report."). Citigroup, Inc. has explained:

> While developing this report, we sought feedback from Ceres, a network of investors, environmental organizations and other public interest groups working with companies and investors to address sustainability challenges. Ceres convened an independent group of experts on environmental, social and governance issues representing a global range of stakeholders and constituencies. This group reviewed a draft of this 2011 Citizenship Report and provided feedback on the materiality of our reporting and on our 2011 performance.

CITIGROUP INC., *supra* note 203, at 13.

218. BP, BUILDING A STRONGER, SAFER BP: SUSTAINABILITY REVIEW 2011 (2012), *available at* http://www.bp.com/assets/bp_internet/globalbp/STAGING/global_assets/e_s_assets/e_s_assets_2010/downloads_pdfs/bp_sustainability_review_2011.pdf; *Global 500*, *supra* note 2; *see* text accompanying notes 217-18. Interestingly, there was an accident involving BP's offshore drilling operations in the Gulf Mexico in 2010.

treat the issue and the efforts they make to implement the principle. Joel Bakan was critical of what he perceived as disingenuous corporate behavior in making claims about social responsibility.[219] In discussing Enron Corp., Bakan conceded that the issue was about "flawed institutional character," and admitted that this was true of "all publicly traded corporations," including "even the most respected and socially responsible among them."[220]

The stakeholder principle is about improving the institutional character of corporations. To begin with, it is unnecessary to deny a potential element of rhetoric in the stakeholder or social responsibility claims made by companies.[221] But complete cynicism would be unfair.[222] There are several dimensions to the stakeholder issue. For instance, risk management offers a useful tool for assessing the genuineness of the stakeholder concerns a corporation might profess. In the emerging landscape, risk is a pervasive factor and the risks range from environmental and financial to product safety and political. Often it is useful for a corporation to view the issue of risk from the stakeholder lens and pursue a risk management strategy based on the stakeholder principle. For example, the safety features in a hazardous plant or operation can be interpreted in terms of the company's concern for the environment or the community in which it operates.

The interrelationship between risk management and stakeholder governance is evident in the recent Deepwater Horizon oil spill issue of BP PLC in the Gulf of Mexico.[223] BP PLC reportedly had a cost-cutting strategy that contributed to the Deepwater Horizon oil spill.[224] This brings out the perils in pursuing short-term advantages with potential stakeholder risks. The company has set up a twenty-billion-dollar fund to meet claims arising from the spill, and the experience of BP PLC can be

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219. JOEL BAKAN, THE CORPORATION: THE PATHOLOGICAL PURSUIT OF PROFIT AND POWER 58-59 (Free Press 2005) (2004).

220. *Id.* at 28.

221. A case-in-point is a news report about the Walt Disney Co. ("Disney"). *See* Tamar Lewin, *After Victory over Disney, Group Loses Its Lease*, N.Y. TIMES, Mar. 10, 2010, at A14. The company is accused of securing the eviction of a civil society organization, Campaign for a Commercial-Free Childhood ("CFFC"), from its place in Boston. *See id.* CFFC had campaigned against the marketing of "Baby Einstein" videos by Disney and successfully persuaded Disney to offer refunds for the DVDs the company had sold. *Id.*

222. *See, e.g.*, Jared Diamond, *Will Big Business Save the Earth?*, N.Y. TIMES, Dec. 6, 2009, at 12. Jared Diamond, a professor of geography at the University of California at Los Angeles and a self-confessed skeptic about big business, has written about Wal-Mart Stores, Inc.'s recent emphasis on sustainability in its seafood purchase policies and the environmental initiatives of Chevron Corp. in Papua New Guinea. *Id.*

223. *See* Ayesha Rascoe, *UPDATE 4—BP, Firms Made Risky Decisions Before Spill—Report*, REUTERS (Jan. 5, 2011, 9:35 PM), http://www.reuters.com/article/2011/01/06/oilspill-bp-causes-idUSN0528610520110106.

224. *Id.*

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a wake-up call for companies.[225] It should encourage them to adopt more committed stakeholder practices.

As pointed out, the stakeholder principle is about improving the institutional character of business corporations. It is about incremental improvements, halting and gradual though the process may be. Viewed in this perspective, a broad acceptance of the stakeholder principle represents progress. It is better to begin with a corporation that professes responsibility and persuade it to be more committed to the principle, rather than question the company's motives. It would be even worse to have companies that are either neutral on the issue or actively oppose the principle on conventional grounds—namely, divided loyalty of the managers, lack of clarity and accountability, impact on corporate competitiveness, and so on.

To be fair, most companies have gone to some lengths to demonstrate their commitment towards non-shareholder groups. The evidence, presented here, includes practices such as income earmarks, publishing responsibility reports, and obtaining assurance reports from independent agencies. Also, corporations are bound to be influenced by the exhortations they make about social responsibility and the stakeholder principle. They will be constrained by their rhetoric that makes it difficult for them to engage in contrary behavior.

IV. THE STAKEHOLDER PRINCIPLE AND CORPORATE THEORY FOR THE TWENTY-FIRST CENTURY

The evidence on adoption of the stakeholder principle by companies is impressive. The trend for companies to widen their concerns has arguably become stronger since the Financial Crisis.[226] A challenge that remains is for corporate theory and law to explore the scope for better institutionalizing the stakeholder principle in their framework.

This Part argues for a formal statement of the theory underpinning business corporations. It consists of three Sections. Section A reviews the development of corporate theory. Section B applies tools from an emerging school of legal theory—namely, NLR to develop corporate theory—and also examines the issue of legal validity of the stakeholder

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225. BP, SUSTAINABILITY REVIEW 2010, at 2, 9 (2011), *available at* http://www.bp.com/liveassets/bp_internet/globalbp/STAGING/global_assets/e_s_assets/e_s_assets_2010/downloads_pdfs/bp_sustainability_review_2010.pdf.

226. *See, e.g.*, *When Your Calendar Is a Moral Document: A Conversation with Reverend Jim Wallis*, MCKINSEY Q., Jan. 2010, at 2. Jim Wallis, a prominent advocate of corporate social responsibility, pointed out the increased focus on values at the 2010 World Economic Forum meeting in Davos, Switzerland. *See id.* at 2-5.

statements made by companies in different documents. Section C concludes with a plea for a formal statement of corporate theory.

A. Corporate Theory and Its Development: An Overview

The theory underlying business corporations is derived from numerous sources, including legislation and judicial decisions. These are, in turn, colored by economic interpretation, opinions of experts and scholars, and popular notions about corporations. These diverse sources bring different perspectives, not all of which are mutually consistent. The resulting theory is a loose amalgam of various elements. It is not necessarily a single integrated framework with parts that are internally consistent. Rather, corporate theory resembles a cluster or a grid of ideas and its pattern must be deduced through analysis. Often it is not possible to achieve a concrete and coherent shape. In the amalgam that is corporate theory, a degree of inconsistency is apparent among some of the elements.

Table 5 below provides a rough timeline summary of the development of corporate theory. The course of development has been influenced and shaped by the ideas that were dominant at different periods. Table 5 interprets events in their chronological order to identify the significant elements in corporate theory over time. This method is helpful in determining the adequacy of the theory for the present and the foreseeable future.

Table 5: Development of Corporate Theory: A Timeline

	Dominant Ideas	Application/Recognition
Early nineteenth century	Corporations were a strictly legal conception and were understood as creatures of the state or the sovereign.	*Trustees of Dartmouth College v. Woodward*:[227] Chief Justice John Marshall referred to a corporation as a "mere creature of law."[228]
Late nineteenth century	Following the enactment of general incorporation statutes, there was a tendency to equate corporations with the joint-stock companies of Britain.	*Santa Clara County v. Southern Pacific Railroad Co.*:[229] The U.S. Supreme Court observed that corporations were equivalent to natural persons.[230]
Early twentieth century	Shareholders were assimilated to a position of ownership in corporations, and the directors were understood to be their elected surrogates.	Implicit in *Dodge*: The court famously defined the duty of the directors to maximize profits for the shareholders, which has since been treated as the central principle of corporate law.[231]
Mid-twentieth century	There was a rising awareness about corporate power and an emphasis on the social responsibility of business corporations.	Reflected in *A.P. Smith*: The Court held that "modern conditions require[d] . . . corporations [to] acknowledge and discharge social as well as private responsibilities . . . ."[232]

227. 17 U.S. (4 Wheat.) 518 (1819).
228. *Id.* at 636.
229. 118 U.S. 394 (1886).
230. *See id.* at 396.
231. *See* Dodge v. Ford Motor Co., 107 N.W. 668, 684 (Mich. 1919); discussion *supra* Part II.A.1.
232. A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 586 (N.J. 1953).

	Dominant Ideas	Application/Recognition
1970s onwards	There was the rise of economic interpretation of corporations: corporations were seen as a "nexus of contracts," and there was an emphasis on shareholder value and private ordering as the best guarantor of efficiency.	Accepted in legal theory, such as Robert Charles Clark's influential commentary accepting that managements' duty is to maximize shareholder value.[233] Shareholder value maxim applied recently *In re Citigroup Inc. Shareholder Derivative Litigation*:[234] The Delaware court observed that the "discretion granted [to] directors and managers allows them to maximize shareholder value in the long term . . . ."[235] In Canada, *BCE* recognized the shareholder value maxim: The Supreme Court of Canada was mainly influenced by the benefit the shareholders would derive from the leveraged buyout transaction impugned in the action.[236]

To be clear, the picture is more complex and less linear than suggested in Table 5 above. The table is an effort to detect the *major* line of development of corporate theory and summarize it. It reveals that the proprietary idea associated with shareholders and their right to derive benefit from the corporations was not the only strand. Alongside, ideas about corporate responsibility and stakeholder interests have also been recognized at least since the late nineteenth century, especially in the United States. These were expressly affirmed in *Dodge*, although the case has since been cited *solely* as the authority for the shareholder primacy and profit maximization principles.[237] *A.P. Smith* offers a powerful illustration of the non-shareholder concerns that have animated corporate theory.[238] The more expansive corporate framework conceived in *A.P. Smith* has a place for non-shareholder groups, as much as for the

233. *See* ROBERT CHARLES CLARK, CORPORATE LAW 594 (1986).
234. 964 A.2d 106 (Del. Ch. 2009).
235. *Id.* at 139.
236. *See* BCE Inc. v. 1976 Debentureholders, 2008 SCC 69, [2008] 3 S.C.R. 560, paras. 127-33, 161-63 (Can.).
237. *See* discussion *supra* Part II.A.1.
238. *See* A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 583-86 (N.J. 1953).

shareholders. Case law and legislation are two major sources of corporate theory. The discussion that follows identifies the difficulties with the present framework of judicial decisions as well as statutes, and outlines their implications for the current theoretical underpinnings of business corporations.

1. Judicial Decisions and Corporate Theory

Understandably in the common law tradition, judicial decisions have played a significant role in shaping corporate theory. This is evident from Table 5 above. Consistent with the same tradition, legislation has not been proactive in developing an explicit theory to underpin business corporations. In the complex world that now exists, there is a need for a formal theory of business corporations that is well-deliberated and reflects the experience gained with corporations. In this effort, court decisions are undoubtedly valuable resources, but there is need for caution in treating judicial pronouncements as the statement of theory. For some time now, legal realists have been highlighting the issues with judicial lawmaking.[239] The following are some problems, specifically in the context of corporate theory.[240]

a. Decisions Are Rendered in the Context of Specific Facts

A judicial decision is rendered in the context of the facts in a case.[241] There can be no complaint about this because courts must deal with the facts of individual cases and are not expected to lightly embark on inquiries into policy. But difficulties arise when these decisions are

239. *See* Michael Steven Green, *Legal Realism as Theory of Law*, 46 WM. & MARY L. REV. 1915, 2000 (2005) ("Rather than being the embarrassment that the philosophers have made it out to be, realism is, I believe, a respectable competitor in the jurisprudential marketplace."). The dissatisfaction with judicial precedent as the source of law existed long before the rise of American legal realism. Jeremy Bentham, the founder of the positivist school, was unsparing in his criticism. Bentham wrote:

> It is the judges (as we have seen) that make the common law. Do you know how they make it? Just as a man makes laws for his dog. When your dog does anything you want to break him of, you wait till he does it, and then beat him for it. This is the way you make laws for your dog: and this is the way the judges make law for you and me.

JEREMY BENTHAM, *Truth Versus Ashhurst; or, Law as It Is, Contrasted with What It Is Said to Be*, *in* 5 THE WORKS OF JEREMY BENTHAM 231, 235 (John Bowring ed., Russell & Russell Inc. 1962) (1823).

240. Victoria Nourse & Gregory Shaffer, *Varieties of New Legal Realism: Can a New World Order Prompt a New Legal Theory?*, 95 CORNELL L. REV. 61, 101-08 (2009) (discussing a more recent analysis of "judging" and the development of legal realism).

241. Decisions also usually reflect the social and historical contexts. *See* Catharine Wells, *Situated Decisionmaking*, 63 S. CAL. L. REV. 1727, 1745 (1990) ("[A] belief in situated decisionmaking . . . sees all legal reasoning as 'situated' in the sense that it operates within a structure that is constructed by the decisionmaker's own unique mode of participation in the ebb and flow of human events.").

treated as the public policy on vital subjects—such as corporate governance. In corporate theory, there is evidence of incongruities when we attempt to weave principles from case law into an integral framework.

As pointed out earlier, the Supreme Court of Delaware adopted an institutional approach in *Unocal* and referred to the directors' "fundamental duty and obligation to protect the corporate enterprise, which includes stockholders."[242] *Paramount Communications* and *Credit Lyonnais* took a similar approach.[243] In these cases, the court treated corporations as institutions and attempted to protect the larger institutional interests, distinct from the more narrow interests of the shareholders.[244] There is, however, another group of cases that do not fit in with this view. In *Revlon*, the court treated the board of directors as auctioneers for the shareholders and charged them with a duty to procure the highest possible price for the shares.[245] There was little room in this milieu for non-shareholder groups or their interests.

There are difficulties in reconciling *Revlon* with *Unocal* and *Paramount Communications*, which were based on a broader vision of corporate enterprises. The dichotomy is understandable, considering the different factual situations with which the court had to deal in these cases. In *Revlon*, the court had no occasion—indeed, no business—to consider the issues affecting non-shareholders. The result is two strands of judicial decisions that do not add up to a harmonious whole.

b. Court Rulings Are Based on Choices Made from Among Rival Arguments

In the prevailing adversarial system, the limited task of the court is to choose from among the rival arguments made at the bar. The submissions would, in turn, be determined by the facts. The question is about the appropriateness of distilling corporate theory from judicial decisions, which are based on the limited submissions of litigants and on their version of the facts. Quite often, the arguments of rival parties do not offer a reasonable perspective that is sufficiently broad for developing a theory for the vital socioeconomic institution—namely, the business corporation. The arguments advanced in a court might not adequately reflect the institutional character of corporations.

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242. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953-54 (Del. 1985).

243. *See* Paramount Commc'ns Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1989); Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., Civ. A. No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991).

244. *See supra* text accompanying notes 134-43 (discussing the development of *Unocal*, *Paramount Communications*, and *Credit Lyonnais* from the stakeholder perspective).

245. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1985).

c. Rival Submissions Are Actuated by Parties' Self-Interests and Not by Public Policy Considerations

Another issue with adjudication in the courts is the limited self-interest of the parties, which defines their submissions. In presenting a case, a litigant would necessarily be driven by the specific goals that he/she wishes to achieve from the legal process. For instance, when John Norton Pomeroy argued in *Santa Clara* that a corporation is only its shareholders in the collective, his motive was to limit tax liability for his client-corporation through this interpretation.[246] It would be difficult to treat the arguments as objective or dispassionate. Pomeroy's concerns were less about advancing justice, in any sense of the term, or the frontiers of knowledge about corporate theory.[247] Self-interest of the parties and its impact on litigation are real issues. They are yet another limitation of case law as *the* source of corporate theory.[248]

2. Legislation and Corporate Theory

Legislation is another source from which we can glean some aspects of the theory underlying business corporations. The statutes under which corporations are created imbue them with a number of qualities or attributes, such as:

- 1. Corporations as association of individuals;
- 2. Corporations as incorporated vehicles for business enterprise;
- 3. Corporations as vehicles for pooling financial capital; and
- 4. Corporations as vehicles that issue securities for trade in the stock market.

246. *See* Horwitz, *supra* note 12, at 177-78.

247. I am conscious of legal practitioners being assimilated to officers of the court, and their task is to facilitate the court to arrive at the right decision. It is debatable how far this ideal is realized in practice. In any event, it is undermined by the adversarial principle in litigation and the remuneration system that both define lawyers' loyalties.

248. There is a view—usually termed "neoconservative"—that the pursuit of self-interest by every individual or group would collectively promote the public interest. Milton Friedman (1912-2006) was an effective proponent of this idea, borrowing the "invisible hand" phrase of Adam Smith. *See* MILTON FRIEDMAN & ROSE FRIEDMAN, FREE TO CHOOSE: A PERSONAL STATEMENT 1-2 (1980) ("[A]n individual who 'intends only his own gain' is 'led by an invisible hand to promote an end which was no part of his intention.'" (quoting ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 217 (Encyclopædia Britannica, 2d ed. 1990) (1787))). In substance, the Friedman argument was that self-interested actions inherently promoted the public good. For an interesting commentary on neoconservative philosophy, see Stephen Eric Bronner, *Is Neoconservatism Dead?*, GUARDIAN (Aug. 31, 2007, 4:00 PM), http://www.guardian.co.uk/commentisfree/2007/aug/31/isneoconservatismdead. Irrespective of whether one agrees with this view, the argument would be less valid in business corporations where the power is effectively centralized in the directors, de jure, and full-time executives, de facto. Other than this, there is the law which restricts directors' loyalty to the shareholders and treats higher share prices as the corporate objective. Ho, *supra* note 153, at 72. In this milieu, the ability of the other groups to pursue their self-interest is quite limited.

Here again, a difficulty is that these elements are not necessarily consistent with one another. It makes a difference which attributes receive greater emphasis or prominence in the framework and which ones receive less.[249] For example Attribute One—corporations as "associations of individuals"—is relatively ancient, and it turns the focus on the shareholders who have contributed the risk capital of the companies.[250] This idea still survives in the company legislation in Britain, as already pointed out.[251] But the emphasis in the Delaware statute switched to Attribute Four—the corporation as a security-issuing vehicle—in the early twentieth century.[252]

In Britain, Companies Act 1948 was largely based on Attributes Two, Three, and Four listed above. The statute treated share capital as the financial resource raised for substantive business activity and forbade companies from dealing in their own shares through practices such as buybacks.[253] In that framework, there could be no question of a company holding its own shares or assisting others to acquire the shares. The clarity of this vision has been diluted in the Companies Act 2006, which, incidentally, *also* espouses the stakeholder principle. Subject to conditions, now some companies can purchase and hold their own shares and even assist others to purchase the shares.[254] These provisions point towards "commoditization" of shares *a la* North America. Obviously, the boom in the stock market since the 1980s made an impact, and trade in financial securities gained a legitimacy it lacked in the aftermath of the Great Depression and World War II.[255]

In sum, the current theory of corporations gleaned from legislation and case precedents has significant gaps, ambiguities, and incongruities. It is not a harmonious framework, but a cluster of ideas drawn from several judicial pronouncements and specific elements in the statutes. The philosophy underlying the corporate statutes requires closer

249. *See* HURST, *supra* note 25, at 11-12 (affirming the significance of the role played by statutes in shaping corporate governance); E. Merrick Dodd, *Statutory Developments in Business Corporation Law, 1886–1936*, 50 HARV. L. REV. 27, 27-31 (1936).

250. The Supreme Court recently supported this idea, albeit vaguely, when it referred to corporations as "associations of citizens." *See* Citizens United v. Fed. Election Comm'n, 130 S. Ct. 876, 908 (2010).

251. *See supra* text accompanying notes 62-75.

252. *See* LAWRENCE E. MITCHELL, THE SPECULATION ECONOMY: HOW FINANCE TRIUMPHED OVER INDUSTRY 30 (2007).

253. *See* Companies Act, 1948, 11 & 12 Geo. 6, c. 38, §§ 54, 59–61, 64–65 (Eng.).

254. *See* Companies Act, 2006, c. 46, §§ 678, 690–692 (Eng.).

255. David D. Hale, *The Economic Consequences of Global Capital Market Integration or a New Explanation for the Anglo-Japanese Financial Market Excesses of the 1980s*, 12 U. PA. J. INT'L BUS. L. 485, 486-89 (1991). At this writing in 2013, however, we must reckon with the events in the stock market since the onset of the Financial Crisis in 2008 and revisit the role of financial markets and ideas about trade in securities as a means to promote general prosperity.

examination. Commoditization of shares and the elevation of financial capital above the substantive business of corporate enterprises are important issues, and there is a need to revisit them in the post-Enron Corp., post-Financial Crisis world.

B. The Stakeholder Principle: Some Useful Perspectives

1. New Legal Realism and the Stakeholder Principle

NLR, an emerging school of legal theory, provides some tools in developing corporate theory for the twenty-first century and includes the stakeholder principle in the framework of corporate enterprises. NLR, as the title suggests, is derived from conventional realism but moves beyond its disenchantment with judicial lawmaking and doctrinal formalism.[256] Classical realism is essentially negative in content, rather than a positive statement of theory. In contrast, NLR identifies a proactive role for law and advocates greater engagement of the law with contemporary issues.[257] Victoria Nourse and Gregory Shaffer present NLR as a response to:

> [the] challenges—of globalization, terror, and the inability of financial markets to restrain themselves, of gaping income inequality (with eighty percent of gains in U.S. net income over three decades going to one percent of the population), of societies poised as if on a hair trigger to react globally to the latest crisis, of states realizing their mutual dependence and vulnerability but not knowing how to address them.[258]

Arguing that "[t]his confluence of challenges comprises the new world order," Nourse and Shaffer question: "whether the theoretical categories that have dominated law, of markets and efficiency, of rights and texts and procedures, are capable of addressing the experience confronting us on the front pages of our newspapers, an unprecedented market collapse, and the unexpected triumph of political mobilization."[259]

Starting from this premise, NLR advocates a more interdisciplinary approach and greater legal activism in handling the present challenges. It retains the principles of classical realism and relies on incremental improvements. NLR adopts, among other things, the efforts of the old model to "redefine law in terms of the centrality of facts and empirical evidence" and apply social science perspectives in dealing with issues.[260]

256. Nourse & Shaffer, *supra* note 240, at 96-97.

257. *See* Howard Erlanger et al., *Forward: Is It Time for a New Legal Realism?*, 2005 WIS. L. REV. 335, 343-45; Nourse & Shaffer, *supra* note 240, at 71-72.

258. Nourse & Shaffer, *supra* note 240, at 71 (footnote omitted).

259. *Id.* at 71-72.

260. *Id.* at 72.

NLR seeks to be more expansive and inclusive than the old. It is described as "optimistic, maintaining that law is a world of action and our responsibility is to participate in it."[261] To accomplish this goal, NLR adopts a number of tools and techniques developed in the recent decades. There is, for example, a stress on "translation between high-quality research using a variety of methods, on the one hand, and law/policy, on the other."[262] NLR also continues with a stress on values, similar to classical legal realism. Felix S. Cohen argued in 1935:

> We never shall thoroughly understand the facts as they are, and we are not likely to make much progress towards such understanding unless we at the same time bring into play a critical theory of values . . . . Legal description is blind without the guiding light of a theory of values.[263]

Given its broad approach, NLR predictably has some disagreements with the law-and-economics school and its more narrow beliefs and concerns, such as simple wealth maximization, individuals as rational actors, and efficiency of the markets.[264] NLR theorists argue that there is little difference between old formalism, driven by laissez-faire ideas, and the new model, which treats economic efficiency as the desideratum.[265] NLR, on the other hand, recognizes that:

- Individuals are vulnerable and subject to institutional influence;
- The state is a supportive institution, though subject to malfunction;
- Empirical but non-reductive studies are valuable in developing legal theory; and
- Participation and mediatory approaches are important.[266]

The stakeholder theory of corporate governance would sit quite comfortably in the paradigm of NLR outlined above. The stakeholder principle shares these ideas—namely, the vulnerability of individuals, the need for institutional support, and the importance of a mediating

261. *Id.* at 137.

262. *Id.* at 83 (quoting E-mail from Elizabeth Mertz, Professor, Univ. of Wis. Law Sch., to Victoria Nourse, Professor, Emory Univ. & Univ. of Wis. & Gregory Shaffer, Professor, Univ. of Minn. (May 26, 2009) (on file with Professor Victoria Nourse & Professor Gregory Shaffer)) (internal quotation marks omitted).

263. Felix S. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809, 848-49 (1935).

264. Nourse & Shaffer, *supra* note 240, at 96-97; *see also* JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 118-22 (2008) (noting a recent assertion of efficiency of the stock markets in corporate governance).

265. *See* Nourse & Shaffer, *supra* note 240, at 97-98 (providing a comparative table of the features of the two schools).

266. *Id.* at 132.

rather than an adversarial approach to resolve disputes and conflicts. Major themes in the stakeholder theory are the imbalances in the corporate structure (centralization of powers), the ramifications of lopsided corporate objectives (such as an emphasis on shareholder value), greater awareness of the institutional character of business corporations, and the need to balance and reconcile the community of interests represented in them.[267]

NLR is more capable of addressing some crucial issues in corporate governance and responding more effectively to the challenges. The stakeholder model recognizes the state as a facilitator, rather than an impediment.[268] The state, acting through elected assemblies, has the responsibility to develop appropriate frameworks and mechanisms through legislative policy and to encourage private actors to move towards optimum results. The stakeholder vision eschews the "command-and-control" approach, and is not about the traditional policing role played by the state.

Behavioral economics,[269] microanalysis of institutions,[270] and law in action[271] are some of the other tools in the NLR framework. These are applied in analyzing law and legal theory, and they can be instrumental in institutionalizing the stakeholder model. In the new paradigm, the law is not entirely passive; it seeks to shape behavior and events more dynamically and proactively. These emerging ideas, which are shaping the environment, present an opportunity to update corporate theory and law and to promote healthy and responsible governance of business corporations.

2. The Stakeholder Principle in Conventional Common Law

To be clear, institutionalizing the stakeholder vision is possible even in the more formalistic setting of the common law.[272] In this effort, the empirical evidence presented here is important. The fact that the stakeholder principle finds widespread acceptance among companies

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267. *See* Bainbridge, *Director Primacy*, *supra* note 11, at 557-58; Hansmann & Kraakman, *supra* note 4, at 440-42.

268. *See* Nourse & Shaffer, *supra* note 240, at 132.

269. *See* Daniel A. Farber, *Toward a New Legal Realism*, 68 U. CHI. L. REV. 279, 279-81 (2001).

270. *See* Edward L. Rubin, *The New Legal Process, the Synthesis of Discourse, and the Microanalysis of Institutions*, 109 HARV. L. REV. 1393, 1424-26 (1996).

271. *See* Erlanger et al., *supra* note 257, at 339-41; Stewart Macaulay, *The New Versus the Old Legal Realism: "Things Ain't what They Used to Be,"* 2005 WIS. L. REV. 365, 385-92.

272. I am aware that the classical vision of the common law presented here was largely discredited, especially in the United States, by American legal realism. *See* Rubin, *supra* note 270, at 1394-96. In my view, the vision is not entirely inaccurate or invalid. No doubt legal realism turned the focus on many follies in the common law system of legal development and adjudication, but it would be more productive to view it as a step in the path of incremental progress.

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makes it, *ipso facto*, an integral part of the corporate landscape and a feature of prevailing practices and current values. It can, therefore, be viewed as an emerging principle of the common law on corporate governance. Simeon E. Baldwin observed: "The common law on any point existed, in theory at least, before any case in which it may be applied. It was the practice of the people, or the rule which to them seemed naturally right."[273]

Baldwin presented the common law as endogenous to the society.[274] The general practices at a given point in time and the prevailing value systems would be the foundations for the common law.[275] In deciding legal cases, courts would merely apply the law, distilling it from current practices and values. Roscoe Pound reflected this idea when he stated that judges—indeed, even legislators—merely codify or crystallize the law, rather than create it.[276] More recently, Patrick Devlin referred to the tradition of legal adjudication by looking at contemporary practices and notions of morality.[277]

The evidence on the adoption of the stakeholder principle by public corporations is solid. Many corporations state their stakeholder concerns in a moralistic tone, which suggests that the issue is also viewed in ethical terms. If prevailing practices and customs and ethical notions are treated as the common law then, as already pointed out, adoption of the stakeholder vision by corporations renders the model a principle of the common law on the subject of corporate governance.

3. The Legal Force of Stakeholder Declarations

In considering the stakeholder model from the legal perspective, the content and wording of the stakeholder statements made by the companies are relevant. Most often, the references to stakeholders are in general terms and lack the level of precision usually found in legal documents. They would make little sense in the universe of conventional

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273. Simeon E. Baldwin, *Education for the Bar in the United States*, 9 AM. POL. SCI. REV. 437, 447 (1915).

274. *See id.*

275. In my view, the common law system also has political origins—in the Norman conquest of England and the establishment of the omnipotent central government. When towns and boroughs began to obtain charters from the crown in return for payment, circa the twelfth century, they attempted to keep the central government out of what they perceived as their internal affairs. *See* 1 CHARLES GROSS, THE GILD MERCHANT 5-8 (1890). For instance, the charter granted to Ipswich in 1200 repeatedly affirmed the "liberties and free customs" of the boroughs and that "justice shall be done . . . according to the ancient custom of the borough of Ipswich and of our free boroughs." *Id.* at 6-8.

276. *See* Roscoe Pound, *The New Feudalism*, 16 A.B.A. J. 553, 554 (1930). This is, in turn, derived from Pound's view that the laws of a society represent its consciousness and predispositions. *Id.*

277. *See* PATRICK DEVLIN, THE JUDGE 177-78 (1979).

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law. Are the statements meant to be legally binding? Do they create a right in the beneficiaries to seek enforcement through regular legal process, if a company commits any breach? If so, what is the measure or standard to be applied by a court in providing a remedy? These are some typical questions that would arise in the legal setting, and they can undermine the "stakeholder principle as law" argument advanced here.

The legalistic approach seeks to reduce the stakeholder principle to a term of contract, and the questions would be valid only if the issue is viewed from the contractarian lens.[278] The argument advanced here is, on the other hand, about the stakeholder principle as an emerging rule of law both in the NLR paradigm and by applying the conventional notions about the common law and its development. Here, it would be unnecessary—in fact, inappropriate—to test the issue with tools from the law of contract.

Yet another perspective is available for analyzing the legal dimension of the stakeholder issue. This is about the character of the document in which companies record their stakeholder concerns. As mentioned earlier, the following are the common documents that companies use for this purpose:

- Corporate governance guidelines;
- Vision/mission statements;
- Corporate citizenship/responsibility statements; and
- Sustainability/social responsibility reports.

From a management or governance perspective, possibly it makes little difference which document a company has selected for declaring its stakeholder concerns. This could, however, have some relevance from a regulatory or legal standpoint. Among the four documents listed above, at least one of them—namely, corporate governance guidelines—has a link with regulation. The guidelines are now mandatory in most jurisdictions, and listed companies must develop guidelines or charters that set out their governance policies.[279] Therefore, it is possible to argue that these guidelines are legal documents with binding force and validity. Companies are under an obligation to apply the stakeholder principle they espouse in the guidelines.

Several companies—including AmerisourceBergen Corporation, The Boeing Company, Citigroup Inc., GE, Microsoft Corporation, and Sunoco, Inc.—have included stakeholder concerns among the

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278. John F. Coverdale, *Why the Bottom Line Is Not the Bottom Line: John Paul II's Concept of Business*, 49 J. CATH. LEGAL STUD. 474, 483-86 (2007).

279. *See, e.g.*, N.Y. STOCK EXCH., NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 303A.09 (2009), *available at* http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp_1_4&manual=%2Flcm%2Fsections%2Flcm-sections%2F.

responsibilities of their boards of directors.[280] They declare, in their corporate governance guidelines, the community of interests among non-shareholders and shareholders. The statement of The Boeing Company (2012 Global 500 rank 123) on the subject is typical:

> Directors' basic responsibility is to exercise their business judgment to act in what they reasonably believe to be the best interests of the Company and its shareholders. The Board selects the CEO and works with the CEO to both elect/appoint other officers and ensure that the long-term interests of the Company and its shareholders are being served. The Board and the officers recognize that the long-term interests of the Company and its shareholders are advanced when they take into account the concerns of employees, customers, suppliers and communities.[281]

Interestingly, the statement of The Boeing Company corresponds almost exactly with the stakeholder vision recently included in the U.K. Companies Act 2006.[282] In other words, the statute codifies or reflects a practice that has already emerged. Several companies have made similar provisions in their governance charters.[283] When companies affirm the

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280. *See* AMERISOURCEBERGEN CORP., CORPORATE GOVERNANCE PRINCIPLES para. 1 (2012), *available at* http://www.amerisourcebergen.com/investor/External.File?item=UGFyZW50SUQ9MTIzODc0fENoaWxkSUQ9LTF8VHlwZT0z&t=1 ("Both the Board of Directors and management recognize that the long-term interests of stockholders are advanced by responsibly addressing the concerns of other stockholders and interested parties, including employees, recruits, customers, suppliers, ABC communities, government officials and the public at large."); CITIGROUP INC., CORPORATE GOVERNANCE GUIDELINES 1 (2012), *available at* http://www.citigroup.com/citi/investor/data/corpgovguide.pdf?ieNocache=912 ("The Board of Directors' primary responsibility is to provide effective governance over the Company's affairs for the benefit of its stockholders, and to consider the interests of its diverse constituencies around the world, including its customers, employees, suppliers and local communities."); GEN. ELECTRIC CO., GOVERNANCE PRINCIPLES para. 1, at 1 (2012), *available at* http://www.ge.com/pdf/company/governance/principles/ge_governance_principles.pdf ("Both the board of directors and management recognize that the long-term interests of shareowners are advanced by responsibly addressing the concerns of other stakeholders and interested parties including employees, recruits, customers, suppliers, GE communities, government officials and the public at large."); MICROSOFT CORP., MICROSOFT CORPORATION CORPORATE GOVERNANCE GUIDELINES, (2012), *available at* http://public.thecorporatelibrary.net/policies/gov_13829.pdf ("The Board recognizes that the long-term interests of shareholders are advanced by responsibly addressing the concerns of other stakeholders including employees, customers, suppliers, government, and the public."); SUNOCO, INC., CORPORATE GOVERNANCE GUIDELINES 1 (2011), *available at* http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9ODQ1Mzd8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1 ("Both the Board and management recognize that the long-term interests of Sunoco are advanced by responsibly addressing the concerns of other constituencies, including employees, customers, suppliers and the communities in which Sunoco operates.").

281. THE BOEING CO., CORPORATE GOVERNANCE PRINCIPLES 1 (2012), *available at* http://www.boeing.com/corp_gov/corp_gov_principles.pdf.

282. *See* Companies Act, 2006, c. 46, § 172 (Eng.); *see supra* text accompanying note 150 (quoting Section 172 of Companies Act 2006).

283. *See, e.g.*, ING GROEP N.V., CHARTER OF THE EXECUTIVE BOARD OF ING GROEP N.V.

stakeholder principle in clear terms and include it in corporate governance guidelines, they are obviously serious about it. The guidelines, as pointed out earlier, can be traced to regulation. This can be a consideration in determining the legal force and effect of the statements about stakeholders included in them.

In a limited technical sense of regulatory connection, the case is different with other documents such as vision/mission statements, corporate citizenship/responsibility statements and sustainability reports. These are not, at present, regulatory requirements and are voluntary in nature. Yet they are statements of corporate policy and acknowledge the vision that animates governance. They would be valuable as evidence of practice and can be treated as representations in the legal sense. These are some reasons for treating declarations of stakeholder concerns with seriousness, wherever they may be made.

C. Corporate Theory: A Case for a Formal Statement

The loose theoretical framework that can now be assembled from judicial precedents and legislation has some anomalies and incongruities, as I have pointed out. At any rate, it is possible to argue that shareholder primacy is the central principle, and shareholder value is the primary and overriding corporate objective or goal. This position is at odds with corporate practice. Business corporations, as revealed in the Survey presented here, increasingly recognize non-shareholder groups and their importance in promoting long-term corporate interests.

In some cases, courts have no doubt adopted an institutional view of business corporations that considers non-shareholder groups and their interests.[284] But the law is still constrained by the traditional ideas about shareholders and the "principal-agent" paradigm of their relationship with the directors. These factors inhibit the development of stakeholder governance. There is a need to iron out the wrinkles and creases in corporate theory and align it with current management theory and practice. There is a case for a formal statement of corporate theory—a set of overarching principles that define the character, goals, and functions of business corporations. A public statement of theory can be effective in correcting the anomalies in the current framework of

para. 2 (2012), *available at* http://www.ing.com/web/file?uuid=977d9620-ee2a-4232-9f88-c8b073876196&owner=b03bc017-e0db-4b5d-abbf-003b12934429&contentid=23224 ("In performing its duties, the Executive Board shall carefully consider and act in accordance with the interests of the Company and the business connected with it, taking into consideration the interests of all the stakeholders of the Company.").

284. *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1989); A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 586 (N.J. 1953).

business corporations and promoting greater harmony in the functioning of this significant socioeconomic institution.

Not the least among the reasons for a formal theory of corporations is the persisting stream of negative opinion about them. Suspicions about business corporations and unease with their power and influence have existed since the eighteenth century.[285] They continue to the present. The complaints about corporations made in the recent years include short-termism and preoccupation with share prices,[286] their apparently insatiable appetite for profit and power,[287] and an autocratic culture of functioning that is opposed to the democratic values of the society.[288]

Recently, evidence of the disquiet about corporations was seen in a poll on the decision of the U.S. Supreme Court in *Citizens United v. Federal Election Commission*.[289] In this case, the Supreme Court put its seal of approval on corporate funding of elections, and the decision has been controversial.[290] A poll found that eight in ten respondents opposed the decision, and the disapproval cut across party affiliations: 85% of Democrats, 76% of Republicans, and 81% of Independents.[291]

Experience in the Financial Crisis also serves as a reminder of the rationale behind some of the restrictions, such as those on size and activities, applied in corporate law during most of the nineteenth century. The perils of the unfettered freedom of corporations to pursue any business activity were evident in the case of American International Group, Inc. ("AIG"). The Credit Default Swaps ("CDS") business done in the Financial Services division of AIG brought the entire company to its knees exposing the other divisions, including the insurance unit and its thousands of policyholders, worldwide, to the risks of serious loss and the sudden disappearance of insurance protection for no fault of theirs.[292]

285. *See* BAKAN, *supra* note 219, at 6.

286. *See* LAWRENCE E. MITCHELL, CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT 4 (2001) [hereinafter MITCHELL, CORPORATE IRRESPONSIBILITY] ("Maximize stockholder profit. This is the watchword of our corporate faith. It is a dictate that arises from the legal structure of the American corporation and the rules of corporate law.").

287. *See* BAKAN, *supra* note 219, at 58; MITCHELL, CORPORATE IRRESPONSIBILITY, *supra* note 286, at 98-99.

288. MITCHELL, CORPORATE IRRESPONSIBILITY, *supra* note 286, at 238-39, 241.

289. 130 S. Ct. 876 (2010); *see* Dan Eggen, *Poll: Large Majority Opposes Supreme Court's Decision on Campaign Financing*, WASH. POST (Feb. 17, 2010, 4:38 PM), http://www.washingtonpost.com/wp-dyn/content/article/2010/02/17/AR2010021701151.html?sid=ST2010021702073.

290. *See Citizens United*, 130 S. Ct. at 903, 925.

291. Eggen, *supra* note 289.

292. *See* William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943, 959-60 (2009) (discussing in-depth the AIG bailout); Mary Williams Walsh, *Bigger Holes to Fill: A $150 Billion Rescue for A.I.G. as It Reports a $25 Billion Loss*, N.Y. TIMES, Nov. 11, 2008, at B1; Mary Williams Walsh, *Risky Trading Wasn't Just on the Fringe at A.I.G.*, N.Y. TIMES, Feb. 1, 2010, at B1.

Size is another issue. During the Financial Crisis, the huge amount of financial assistance that the U.S. and U.K. governments extended to the financial corporations was justified on the ground that these companies were "too big to fail."[293] Whatever the other merits of the decision, it was tantamount to endorsing less-than-responsible governance practices at these corporations. The events leading to the Financial Crisis revealed the systemic risks inherent in large agglomerations.[294]

The facts and the outcome in *Citizens United* offer fresh lessons on the need for a formal statement of corporate theory. In a significant passage, the Supreme Court referred to corporations as "associations of citizens."[295] It is not clear if the citizens referred to here are the shareholders. In any case, it is debatable whether a contemporary corporation, in fact, represents an association of citizens.[296] The following exchange in the Supreme Court revealed the openness of current theory; it stresses the need for a deliberated consensus on the issues of corporate character and goals:

> GENERAL KAGAN [Solicitor General, Department of Justice]: A lot of [corporations] do [contribute to both political parties], which is a suggestion about how corporations engage the political process and how corporations are different from individuals in this respect. You know, an individual can be the wealthiest person in the world but few of us -- maybe some -- but *few of us are only our economic interests.* We have beliefs, we have convictions; we have likes and dislikes. Corporations engage the political process in an entirely different way and this is what makes them so much more damaging.
> CHIEF JUSTICE ROBERTS: Well, that's not -- I'm sorry, but that seems rather odd. *A large corporation just like an individual has many diverse interests.* A corporation may want to support a particular candidate, but they may be concerned just as you say about what their shareholders are going to think about that. They may be concerned that the shareholders would rather they spend their money doing something

293. *See* SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 161, 200 (2010).

294. *See id.* at 200, 208-09, 211 (calling for the dismantling of the large U.S. investment banking houses because they are "too big to exist").

295. *Citizens United*, 130 S. Ct. at 908.

296. The case involved a non-profit corporation, but the plea made was for striking down the statutory provisions that prohibited funding of elections by all corporations without any distinction about their character. *See id.* at 892-93. During the arguments in the Supreme Court, the federal government specifically declined a suggestion from the Court that the case can be confined to non-profit corporations. *See* Transcript of Oral Argument at 42, *Citizens United*, 130 S. Ct. 876 (No. 08-205). The government expressed a fear that if non-profit corporations were to be excluded from the prohibition, business corporations would use non-profit corporations as conduits to participate in the electoral process. *Id.*

else. *The idea that corporations are different than individuals in that respect, I just don't think holds up.*[297]

Business corporations are only human constructs, and it is ironic that so much obscurity apparently surrounds their character. The presence of a formal theory on the subject can make a meaningful difference to the situation. The complaints and criticisms made about corporations cannot be brushed aside lightly. They deserve to be addressed, and action is needed to promote greater convergence between business/corporate interests and larger socioeconomic interests. Developing a formal theory of corporations would help in turning the focus on the key issues in the corporate framework and in identifying solutions. This is, appropriately, a task for legislation, which represents the statement of public policy on a given subject.

The function of corporate legislation, it has been argued, is limited to facilitating business.[298] According to this school, regulating the business activities of corporations in their various aspects, such as employment, environmental care, anticompetitive practices, and so on, must be the concern of individual branches of law and applies to all enterprises, irrespective of their form of organization—proprietary, partnership, or corporate.[299] In other words, there is no justification for singling out corporations and attempting to regulate them structurally.[300] Regulation, according to this school, must be "external," rather than structural or organic.[301]

External regulation of corporations has existed for several decades now, and its limitations are evident. If we consider the object of regulation as guiding behavior and deterring deviant trends, doubts arise about the capacity of external regulation to accomplish these goals. Bakan's discussion of GE is instructive.[302] GE was found to have committed forty-two "major legal breaches" between 1990 and 2001.[303] The charges included breach of regulations on environmental care, employee safety, product safety, and defrauding the government in defense contracts.[304] GE has paid the penalties levied on it, and the

297. Transcript of Oral Argument, *supra* note 296, at 1, 53 (emphases added).

298. *See* HENRY WINTHROP BALLANTINE, BALLANTINE ON CORPORATIONS 44, 46 (rev. ed. 1946) (appearing to be the first to make this argument); HURST, *supra* note 25, at 151-53 (writing in 1970 at the zenith of American industrial power and offering the commercial success of business corporations as validation of the minimalism of corporate law and the "enabling" character of the statutes).

299. *See* Winkler, *supra* note 104, at 128-30.

300. *See id.* at 129-30.

301. *See id.* at 128.

302. *See* BAKAN, *supra* note 219, at 75-79.

303. *See id.*

304. *See id.*

pattern does not suggest that the penalties have been deterrent in their effect. Rather, GE apparently adopted a purely economic approach and treated the penalty as an item of cost that was affordable.[305]

External regulation has proved its limitations. The need is for multipronged approaches in dealing with complex issues such as corporate governance. External regulation can be usefully coupled with internal or structural regulation, considering the unique features of business corporations—the vast resources they control, central command, absence of significant proprietary interest in the executives, and their vulnerability to market compulsions. If we accept the institutional character of companies, there is a case for legislation to move away from minimalism and to seek a more active role in guiding corporate conduct. There is evidence that this trend is already at work. Increasingly, stock exchange rules and securities regulations are more interventionist, and they seek to guide the governance of listed companies.[306]

A theory of business corporations, stated in legislation, would necessarily reflect a degree of consensus on the subject and provide valuable guidance in issues involving corporations. Developing such a theory is undoubtedly a challenge. For want of better alternatives, elected legislatures with all their limitations present themselves as the appropriate agency to handle the task. This is for a number of reasons:

- Foremost is the fact that corporations *are* created under legislation.[307] As the creators of corporations, it would be appropriate and legitimate for legislation to explain or articulate their underlying theory—namely, character, goals, and functions.[308]

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305. *See id.* at 79-80.

306. *See* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 599-600 (2003).

307. This fact cannot be seriously disputed. A corporation can come into existence only by complying with the terms of a statute, and the statute would govern the corporation during its lifetime. *See* Easterbrook & Fischel, *supra* note 159, at 1420. To put an end to the corporation, again, one must follow the procedure prescribed in the statute. Robert Hessen argued that there is an inherent right of the citizens to attain incorporation, which is not dependent on the will of the sovereign. *See* ROBERT HESSEN, IN DEFENSE OF THE CORPORATION 22 (4th prtg., 1980). This much became a reality with the advent of the general incorporation statutes in the nineteenth century. *See id.* at 29-31. These statutes represented the emergence of a broad consensus about making the corporate form available to all. But the terms on which incorporation will be granted is a different issue. This must necessarily depend on the prevailing social and economic circumstances and reflect the lessons learned from the experience with corporations.

308. This is not a completely novel idea. In the British Commonwealth, most statutes carry a brief preamble, which states the objects of the legislation. For example, Companies Act 2006 includes the following preamble:

> An Act to reform company law and restate the greater part of the enactments relating to companies; to make other provision relating to companies and other forms of business organisation; to make provision about directors' disqualification, business names,

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- The statutes enacted by the elected legislatures of modern democratic societies represent, in effect, statements of public policy on a given subject. Understood thus, the statutes that create corporations carry a moral obligation to promote their healthy functioning and minimize externalities. To some extent, the stakeholder statutes already accomplish this goal.
- In the recent decades, the discourse on democratic theory has been enriched by ideas about deliberation and public reasoning.[309] They move beyond traditional notions of democracy, which were formalistic and confined, more or less, to numbers, the majority rule, and the election procedure.[310] The outcome of the democratic process and its quality did not receive significant attention. There is now evidence of rising consciousness about the *legitimacy* of the democratic process and its outcome and a decline of the idea that electoral democracy represents an end in itself. This development augurs well for corporate legislation to assume a more robust role in defining the goals for corporations—in terms of what it expects them to do and how they should function.[311]

To play the more expansive role advocated here, legislation must move beyond narrow notions of property and contract, which are

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> auditors and actuaries; to amend Part 9 of the Enterprise Act 2002; and for connected purposes.

Companies Act, 2006, c. 46 (Eng.). The U.S. Securities Exchange Act of 1934 has a lengthy statement of the "[n]ecessity for regulation." *See* Securities Exchange Act of 1934, 15 U.S.C. § 78b (2006). The plea made here is only for a more elaborate statement.

309. *See* James D. Fearon, *Deliberation as Discussion*, *in* DELIBERATIVE DEMOCRACY 44, 44-63 (Jon Elster ed., 1998); *see also* AMARTYA SEN, THE IDEA OF JUSTICE 322-28 (2009) (discussing public reasoning and its place in democratic societies). Amartya Sen presents, in Chapter 15, deliberation as the idea underlying democracy and "democracy as public reason." *See id.* at 324. The historical accuracy of this characterization of majority rule and its underlying idea is questionable, although Sen's version presents an ideal which the democratic system can strive to attain. In my opinion, the voting system in its origin was more concerned with liberty and self-determination than it was with reasoned deliberations in assemblies.

310. *See, e.g.*, John Adams, *Thoughts on Government, Applicable to the Present State of the American Colonies*, *in* REVOLUTIONARY WRITINGS: 1775–1783, at 49, 50-54 (Gordon Wood ed., Library of Am. 2011) (1776) (explaining the rationale for elections and the majority rule).

311. At the same time, lobbying has emerged as a regular profession, and government policy—both legislative and executive—is susceptible to lobbying's influence. Predictably, business corporations with their resources and expertise are active in lobbying. *See* Michael D. Lord, *Corporate Political Strategy and Legislative Decision Making: The Impact of Corporate Legislative Influence Activities*, 39 BUS. & SOC'Y 76, 78 (2000). Emerging ideas about deliberative democracy and justice can potentially check power politics and promote better reasoning in the formulation of public policy. It is about considering *all* points of view—including the corporate or business dimension.

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dominant in the current theory of business corporations. Corporations of the present and the future are and will be increasingly driven by an institutional vision and culture. Legislation, as the statement of public policy, must equally reflect this vision. In this effort, a possibility for the statutes is to adopt the "enlightened shareholder value" model recently included in the Companies Act 2006.[312] This is subject to the caveat that the statute, as a whole, has a wholesome and consistent theme. As pointed out earlier, it is possible to view the stakeholder provision in the Companies Act 2006 as a standalone provision, rather than the organizing principle.[313]

Yet the U.K. statute offers specific guidance to corporations in managing their business and affairs. Shareholder benefit is stated to be the goal, but this is coupled with a duty to consider the other diverse interests included in the corporate framework.[314] Such a provision can take care of a complaint against the general exhortations of the stakeholder principle—namely, that they do not provide explicit guidance to corporations in ordering their affairs.[315] It can also substantially resolve the inconsistencies in the law in Delaware, discussed earlier.[316] While the U.K. model may not be perfect, it offers at least a practicable solution to the Great Debate in corporate governance, and a useful starting point.[317]

There is an important question about the legitimacy of the law, more specifically statutory law, stating a theory of business corporations. This conflicts with the recent emphasis on market arrangements and their efficiency. The case for legislative statement becomes stronger when the following are considered:

- Corporations are a hybrid construct, which the society and the state, seen as two distinctive entities, collaborate to create and operate.
- The dividing line between the state and the society and notions about the public and the private in the Anglo-American tradition are considerably erased by the strengthening of the democratic principle and emerging awareness of the need to provide good governance

312. *See* Ho, *supra* note 153, at 78 (discussing Section 172 of the Companies Act 2006).

313. To illustrate, the statutory remedies in the Companies Act 2006 are not available to non-shareholder groups. *See* Companies Act, 2006, §§ 260–69, 994–996 (addressing derivative actions and unfair prejudice to shareholders, which both apply only to "a member of a company").

314. *See* Ed Waitzer & Johnny Jaswal, Peoples, BCE, *and the Good Corporate "Citizen,"* 47 OSGOODE HALL L.J. 439, 480 (2009).

315. *See id.* at 479-80.

316. *See supra* text accompanying notes 134-48.

317. *See* Lynn A. Stout, *New Thinking on 'Shareholder Primacy,' in* CORPORATE GOVERNANCE AFTER THE FINANCIAL CRISIS, *supra* note 153, at 25, 25-26.

according to evolving circumstances, rather than the raw application of values developed in a different age and setting.

- There is no simple acceptance of the idea that all the actors in corporations—for example, employees and communities—are there purely because they have chosen to be there (by contract) and have negotiated the best terms possible for that contract.
- There is greater sensitivity to the power structures in business corporations and the trends seen in their governance, historically and in the recent past—notably, rising levels of managerial pay and stagnation in the pay of other employees.

V. CORPORATE THEORY FOR THE TWENTY-FIRST CENTURY–SOME POTENTIAL FEATURES

Developing a theory of corporations for the present and the future is a daunting task. In charting the course, the past offers valuable guidance. To begin with, the new theory must be animated by an institutional vision. In this effort, the stakeholder idea is a valuable tool. The stakeholder idea has its origin in greater sensitivity to what are termed the "externalities" of corporate practices—namely, the impact that corporations have on employees, environment, communities, and so on. It is about justice in the collective—with the corporation understood as an institution.

In the recent decades, the emphasis on justice in collective arrangements has become greater. Traditionally in the Anglo-American conception, ideas about justice or ethics have been more in the sense of the individual, rather than the collective.[318] John Rawls's *Theory of Justice* made a significant contribution in strengthening the ideas about the collective, or institutional, model of justice.[319] The framework discussed here is offered as a possible approach to developing a theory

318. The prescriptions of John Locke about property rights or the ideas of Thomas Jefferson about liberty were derived from a conception of the individual struggling against an omnipotent, as-yet untamed sovereign. *See* JOHN LOCKE, TREATISE OF CIVIL GOVERNMENT AND A LETTER CONCERNING TOLERATION 18-33 (Charles L. Sherman ed., 1965); DAVID N. MAYER, THE CONSTITUTIONAL THOUGHT OF THOMAS JEFFERSON 45-51 (1994). The individualist element was equally present in the works of Jeremy Bentham and, for example, his depiction of "pleasure" and "pain" as the motives for human behavior. *See* JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION ¶¶ II–VI (Neill H. Alford, Jr. et al. eds., Legal Classics Library 1986) (1780).

319. *See generally* JOHN RAWLS, THEORY OF JUSTICE (rev. ed. 1999) (1971).

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of corporate justice. Rawls reformulated the following principles of justice in 2001:

> (a) Each person has the same indefeasible claim to a fully adequate scheme of equal basic liberties, which scheme is compatible with the same scheme of liberties for all; and
> (b) Social and economic inequalities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity; and second, they are to be to the greatest benefit of the least-advantaged members of society . . . .[320]

These principles can, with some modifications, be adapted to the stakeholder vision in corporate governance. The process of adaptation can start from the second principle. Corporate organizations are essentially unequal in their constitution.[321] Centralization of powers in the directors is the norm, which is acceptable in Rawls's framework—provided the powers of the directors place them under an obligation to protect the interests of the other groups that do not have power and are vulnerable.[322] This idea resonates well with the stakeholder theory, which is egalitarian in its vision and method and stresses the importance of considering the interests of *all* the groups without specific preference for any of them.

The stakeholder theory can, without serious complaint or criticism, accept the inequality in corporate organizations and the concentration of powers in the boards. Unified command is indispensable for business efficiency. This is subject to the condition that the directors who hold the powers are under a duty to consider the interests of all of the groups.[323]

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320. JOHN RAWLS, JUSTICE AS FAIRNESS: A RESTATEMENT 42-43 (Erin Kelly ed., 2001) [hereinafter RAWLS, JUSTICE AS FAIRNESS].

321. The ongoing debate on executive compensation, including the efforts under the Dodd-Frank Wall Street Reform and Consumer Protection Act, is proof of this fact. *See* 15 U.S.C. §§ 78n–n-1 (Supp. V 2012) (establishing executive compensation disclosure and approval mechanisms); Minor Myers, *The Perils of Shareholder Voting on Executive Compensation*, 36 DEL. J. CORP. L. 417, 427-29 (2011).

322. *See* RAWLS, JUSTICE AS FAIRNESS, *supra* note 320, at 42-43; Myers, *supra* note 321, at 425-26. This idea is quite aligned to the definition of stakeholder interests in management theory proposed by James E. Post, Lee E. Preston, and Sybille Sachs. *See* JAMES E. POST ET AL., REDEFINING THE CORPORATION: STAKEHOLDER MANAGEMENT AND ORGANIZATIONAL WEALTH 19, 46-52 (2002). Post, Preston, and Sachs were particularly concerned about groups that had no legal power or right over the corporations. *See id.* at 48-50. The duty-based approach advocated by Rawls is found in a verse in the New Testament: "Every one to whom much is given, of him will much be required; and of him to whom men commit much they will demand the more." *Luke* 12:48. In popular culture, the same idea is reflected in the statement: "With great power comes great responsibility." SPIDER-MAN (Marvel Enters. 2002).

323. This has been accomplished, by and large, in the U.K. Companies Act 2006. *See* Companies Act, 2006, c. 46, § 172 (Eng.).

The consideration to which the other groups are entitled, and the resulting security and lack of vulnerability, would promote Rawls's first principle of liberty. As emphasized by the great philosophers John Locke and Thomas Jefferson, an individual must first be secure before she can realize liberty and its benefits.[324] In the present age, "human vulnerability and mutual interdependence" are real, as Nourse and Shaffer pointed out.[325] They argued: "[L]iberty alone is not enough: other concerns may be in tension with liberty, whether they are conceived in terms of separate values or as aspects of liberty itself. These values include concerns over equality, efficiency, and security."[326]

Rawls's reference to "the greatest benefit of the least-advantaged" in his second principle is somewhat troublesome. It reflects the idea of affirmative action. The stakeholder theory, in its essence, is about equal consideration for all groups, rather than affirmative action for the benefit of the weak. The stakeholder vision spans a wide spectrum—from a minimum of responsible corporate practices that do not inflict serious externalities (including market distortions) or mitigate them in any event at one end, to voluntary activism and initiatives for amelioration at the other.[327] The latter—activism and social initiatives—is welcome but not essential, but the former—attention to externalities—is an imperative.

Economic interpretation is a valuable source of material for developing a new theory of corporations. Economic theory has greatly enhanced the understanding of contemporary business corporations and their governance.[328] It is, however, a mixed bag, and we must be selective in dealing with it. The emphasis on agency costs continues to be relevant, as evident from the events in the Financial Crisis. Many corporations in the financial sector engaged in unsustainable business practices and assumed unmanageable risk, and large bonus payments were made to senior managers for these questionable decisions.[329] This is a recent demonstration of the agency issue stressed in economic theory.

The prescriptions in economic theory about shareholder value and aligning the interests of the managers and the shareholders through stock

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324. *See* Thomas Jefferson, *The Present State of Manufactures*, *in* THE PHILOSOPHY OF MANUFACTURES: EARLY DEBATES OVER INDUSTRIALIZATION IN THE UNITED STATES 15, 17 (Michael Brewster Folsom & Steven D. Lubar eds., 1982) (1785); JOHN LOCKE, THE SECOND TREATISE OF GOVERNMENT 70-71, 73 (Thomas P. Peardon ed., 1952) (1690).

325. *See* Nourse & Shaffer, *supra* note 240, at 135.

326. *Id.*

327. *See* Lance Moir, *What Do We Mean by Corporate Social Responsibility?*, 1 CORP. GOVERNANCE 16, 17, 19 (2001).

328. *See* Jensen & Meckling, *supra* note 10, at 305-07.

329. In 2003, Warren E. Buffett issued prophetic warnings about the risks in derivatives and the incentive system applied for the derivatives business of major financial corporations. *See* BERKSHIRE HATHAWAY, 2002 ANNUAL REPORT 13-15 (2003), *available at* http://www.berkshirehathaway.com/2002ar/2002ar.pdf.

options have proven to be simplistic, although they appeared to work in the short term. The shareholder value maxim and stock options played an important role in the failures seen at the turn of the century in major corporations such as Enron Corp., WorldCom Inc., and Tyco International Ltd.[330] They placed the managers under pressure to meet earnings expectations, neglecting the long-term interests of the corporations.[331]

To be fair, Michael C. Jensen and William H. Meckling referred to Pareto optimality while advocating shareholder value as the goal of corporate governance.[332] This was in 1976. In Jensen and Meckling's conception, every group was deriving value from the corporations—except the shareholders who languished from stagnant share prices.[333] *Ceteris paribus*,[334] they argued, everyone will be better off if share prices increased.[335] But *ceteris* is never *paribus* in this dynamic planet. The decades since have witnessed industrial decline and loss of manufacturing and other skilled jobs in the western countries.[336] These developments have occurred alongside the rise in share prices, which lasted until 2008. Since then there has been a slide and partial recovery in share prices, which points towards a degree of instability inherent in the market.

There is increasing evidence of corporations moving away from the short-termism that underpins the shareholder value idea.[337] It is, however, doubtful how far corporations attempt to actualize the professed ideals about the long-term and sustainability. A recent survey found that the criteria applied for determining managerial incentives are still the conventional ones—earnings per share ("EPS"), revenue,

330. *See* John R. Graham et al., *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & ECON. 3, 36 & n.15 (2005).

331. *See id.* at 5, 35-36. A survey of more than 400 CFOs of U.S. corporations reported that almost eighty percent of them would have been ready to alter the financial reports to meet analyst expectations about profits. *See id.* at 32-36.

332. *See* Jensen & Meckling, *supra* note 10, at 327-28.

333. *See id.* at 351.

334. *Ceteris paribus*, a latin expression, means "if all other relevant things, factors, or elements remain unaltered." MERRIAM-WEBSTER, MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 188 (10th ed. 1996).

335. *See* Jensen & Meckling, *supra* note 10, at 313-14, 351.

336. *See generally* ROBERT E. SCOTT, ECON. POLICY INST., UNFAIR CHINA TRADE COSTS LOCAL JOBS: 2.4 MILLION JOBS LOST, THOUSANDS DISPLACED IN EVERY U.S. CONGRESSIONAL DISTRICT (2010), *available at* http://epi.3cdn.net/91b2eeeffce66c1a10_v5m6beqhi.pdf (reporting 2.4 million jobs lost or displaced since 2001 because of the growing U.S. trade deficit with China, which "has been a prime contributor to the crisis in manufacturing employment over the past seven years").

337. *See, e.g.*, THE ASPEN INST., LONG-TERM VALUE CREATION: GUIDING PRINCIPLES FOR CORPORATIONS AND INVESTORS (2009), *available at* http://www.aspeninstitute.org/sites/default/files/content/docs/bsp/FinalPrinciples.pdf.

operating income, net income, and free cash flow.[338] Research expenditure or investments, which would be more about the future and the long-term, are prominently missing from the criteria. Companies need to move seriously beyond rhetoric and develop practices and principles that actually turn managerial focus towards the long term. This is a potential issue for a new theory of business corporations.

Encouragement of high executive pay is another issue with economic theory. The issue is even more acute in the post-Financial Crisis world. Economic scholars conferred legitimacy on high executive pay and bonus policies, which played a role in encouraging the credit derivatives business in the financial sector and the resulting crisis.[339] The Dodd Frank Wall Street Reform and Consumer Protection Act[340] attempts to deal with the issue through a nonbinding shareholder vote on executive compensation.[341] Executive pay is an important area for action. Compensation committees have existed in business corporations for some time now, and providing them with objective and transparent guidelines can promote greater reason and equity in corporate executive pay structures. This can be an element in the new corporate theory.

Economic theory does not pay much attention to the distinction between debt and equity and the perils of excessive leverage. There are reports that corporate leverage increased significantly in the recent decades.[342] There is a case for a survey of the debt levels of companies and the consequent risk of financial stress. This can be an important area for future research. Excessive leverage is inimical to stability, and there is a case for including this issue in the new theory.

The economic prescription about grant of stock options to managers strengthened the trend for the commoditization of shares. The bull phase in the stock market from the early 1980s until 2008 appeared to affirm the practice, but the decline in share prices since then raises questions—both practical and ethical—about treating shares as commodities and encouraging companies to issue and deal in them freely.[343] The recent market instability underscores the need for reconsidering finance-centric

338. *See* Daniel Sungyeon Kim & Jun Yang, Behind the Scenes: Target Setting of Annual Incentive Plans 7, 23 tbl.1 (Dec. 8, 2012) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1361814.

339. *See* BERKSHIRE HATHAWAY, *supra* note 329, at 14; Scott Elaurant, *Corporate Executive Salaries—The Argument from Economic Efficiency*, ELECTRONIC J. BUS. ETHICS & ORG. STUD., Dec. 2008, at 35, 35, *available at* http://ejbo.jyu.fi/pdf/ejbo_vol13_no2.pdf.

340. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S.C.).

341. *See id.* at § 951 (codified at 15 U.S.C. § 78n-1 (Supp. V 2011)).

342. *See* David Henry, *The Time Bomb in Corporate Debt*, BUS. WK., July 27, 2009, at 22, 22-23.

343. *See* Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 320-22 (2012).

governance policies and for weaning companies away from preoccupation with the stock market and share prices. In promoting the stakeholder principle and re-conceptualizing the business corporation for the future, it would be necessary to move beyond some troubling shadows of the past—namely:

- The idea that companies are shareholders in the collective;
- Preeminence of the shareholders, and directors as their elected surrogates or agents; and
- The idea that a company is equivalent to a natural person in itself and must be assimilated to humans, so it can claim all the rights and protections available to individuals.[344]

These historical notions lack relevance or validity for the present. They originated in a different age, and it is time to move beyond them—towards a clearer vision that better reflects the needs of the present and the future. In the effort to re-conceptualize business corporations, the following descriptions, by Gerard Carl Henderson and James Treat Carter, can be handy: "[The] corporate device is not an expression of any inherent philosophic quality in the group—of any group will, or group organism. It is no more than a convenient technical device"[345] used "to achieve the practical results desired, of unity of action, continuity of policy, and limited liability."[346]

Similar thinking can be detected in the following observations of the New York court in *Farmers' Loan & Trust Co. v. Pierson*:[347]

> [A] corporation is more nearly a method than a thing, and . . . the law in dealing with a corporation has no need of defining it as a person or an entity, or even as an embodiment of functions, rights and duties, but may treat it as a name for a useful and usual collection of jural relations, each one of which must in every instance be ascertained,

344. The "natural person" idea was used in the United States for practical purposes—to remove the restrictions applied to corporations. *See* David L. Ratner, *Corporations and the Constitution*, 15 U.S.F. L. REV. 11, 12 (1981). A variant of the natural person idea can be seen in the efforts of the German scholar, Otto Gierke, to conceive an independent "corporate personality"—one with moral and ethical attributes. *See* OTTO GIERKE, POLITICAL THEORIES OF THE MIDDLE AGE 67-72 (Frederic William Maitland trans., Cambridge Univ. Press 1938) (1900).

345. GERARD CARL HENDERSON, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW: A CONTRIBUTION TO THE HISTORY AND THEORY OF JURISTIC PERSONS IN ANGLO-AMERICAN LAW 167 (1918).

346. JAMES TREAT CARTER, THE NATURE OF THE CORPORATION AS A LEGAL ENTITY WITH ESPECIAL REFERENCE TO THE LAW OF MARYLAND 35 (1919).

347. 222 N.Y.S. 532 (N.Y. Sup. Ct. 1927).

> analyzed and assigned to its appropriate place according to the circumstances of the particular case, having due regard to the purposes to be achieved.[348]

The conception of business corporations in the CBCA is most closely aligned to this idea.[349] In the Canadian federal statute, a corporation is merely a device or a mechanism designed for business activity. It comes into existence on the grant of certificate of incorporation by a public official. A new theory of business corporations can adopt this principle, which can help in avoiding the confusion between corporations and their shareholders, mystifying corporations with references to the "corporate personality," or treating them as natural persons.

348. *Id.* at 543-44.

349. *See* Canada Business Corporations Act, R.S.C. 1985, c. C-44 (Can.).

APPENDIX

Figure 1. Stakeholder Score: Assessing State Statutes on a Scale of Thirty-Six—Arizona to Mississippi

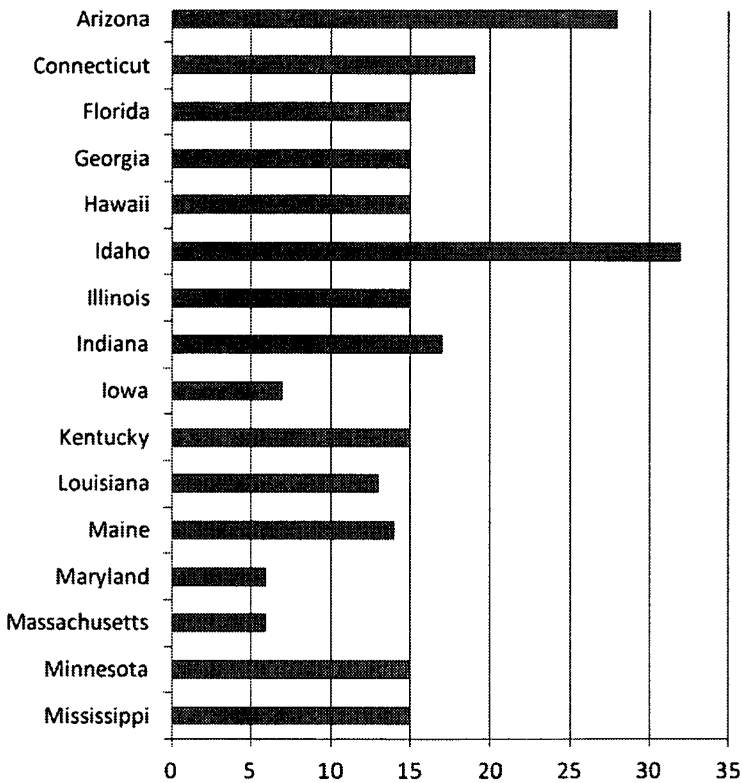

Figure 2. Stakeholder Score: Assessing State Statutes on a Scale of Thirty-Six—Missouri to Wyoming

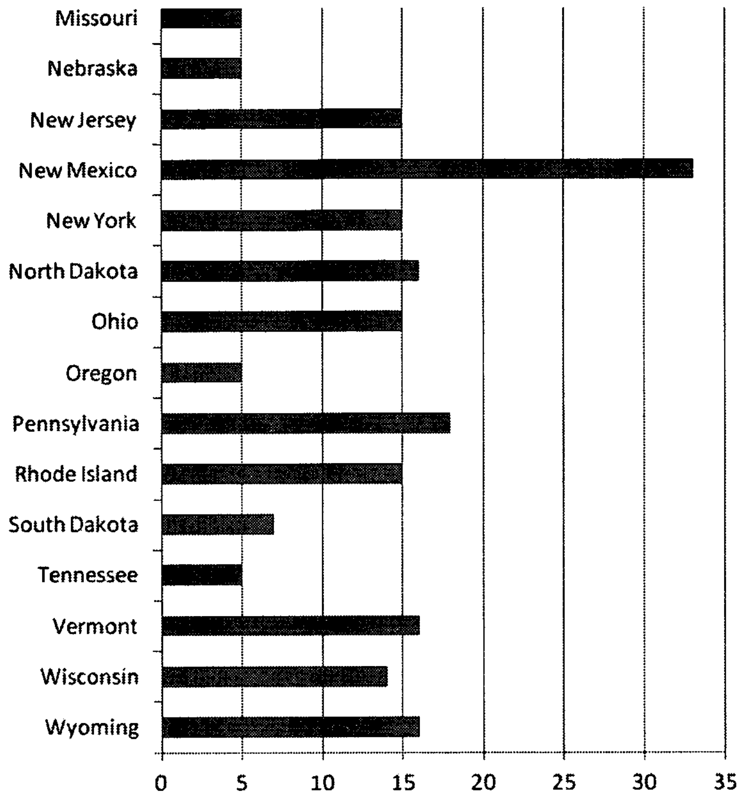

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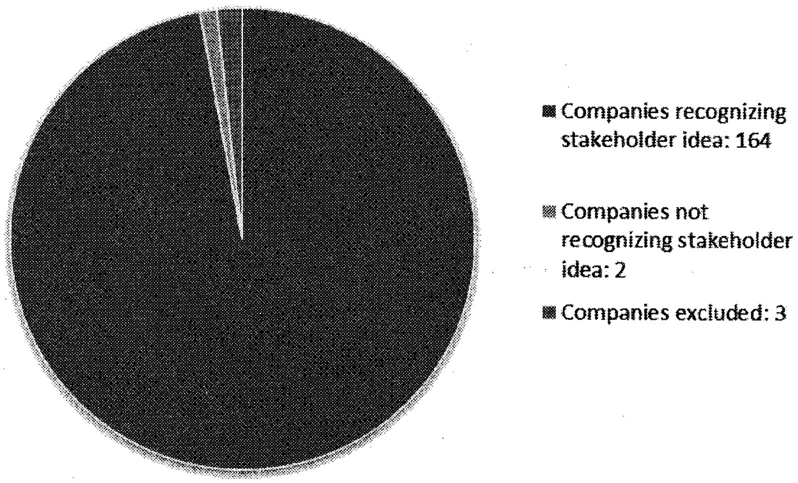
Figure 3: Stakeholder Idea Among U.S., U.K., and Canadian Corporations in the 2012 Global 500



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