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SHAREHOLDERS AND THEIR PURSUIT OF HAPPINESS: A UNIFYING UNDERSTANDING OF THE CORPORATION

ABSTRACT

In this article, the authors contend that the interests of shareholders must be the paramount concern of the corporation, an implication arising from the status of shareholders as being the 'owners' of the corporation — the corporation being a legal entity comprised of shares for which shareholders have a proprietary interest in. According to the authors however, giving primacy to the interests of shareholders in the context of corporate law and governance does not necessarily involve undermining or ignoring the interests of other stakeholders such as creditors, employees and other participants in society. Nor does it mean that the corporation is simply a legal construct devoid of any social role or influence. Rather, due to the enormous amount of economic activity for which corporations are responsible and the vast number of people employed by, or dependent on the financial success of corporations, the corporation must inevitably be seen as a social institution. Further, as the authors will argue, if we go back to basics and recognise that shareholders are individuals, and each and every aspect of individual activity- including the purchase and disposal of shares- is guided by the pursuit of personal happiness (either explicitly or implicitly), then corporations can give primacy to the interests of shareholders, and still act in the best interests of other stakeholders (such as employees, creditors and the community in general). Recent empirical studies show that there is (at best) a weak correlation between personal happiness and levels of material wealth. Corporations can still give primacy to the interests of shareholders whilst not having to explicitly set out to maximise profits. Once we appreciate the simple yet undisputable point that the corporation is just another form of human activity carried out to assist in the fulfilment of personal happiness, complex theories of the firm and books and articles pondering over how companies can manage shareholder interests can be assigned to the dustbin of legal history.

"The most perfect society is that whose purpose is the universal and supreme happiness."

—Gottfried Wilhelm Leibniz

"Happiness is the meaning and the purpose of life, the whole aim and end of human existence."

—Aristotle

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I INTRODUCTION

A *Objectives of the Paper*

This article outlines a rather simple understanding of the corporation which we believe is indisputable and capable of universal acceptance and application. It is argued that the existing theories and debates regarding the nature and purpose of the corporation, in particular the ‘contractarianism’/‘communitarianism’ dichotomy most prevalent in recent literature about theories of the firm and corporate governance, is a cause of confusion rather than enlightenment. In short, the authors believe that an individual’s ultimate need for personal happiness from the activities in which they engage in provides the basis for a unifying understanding of the corporation.

In the past few decades there has been an explosion in the amount of studies conducted into human happiness and well-being. While noting the diversity in the range of activities through which people choose to express themselves the studies show that at the base we are all essentially the same. While some people prefer singing in a choir as opposed to boxing in a ring, and others prefer repairing motor vehicles to writing poetry, such ostensible differences between humans in fact highlights the strong similarity between us all — that we engage in all sorts of functions and activities for the ultimate objective of obtaining personal happiness and well-being.

Thanks to the ancient works of Aristotle and other moral theorists, it has for centuries been appreciated that ‘happiness’ is the ultimate aim of mankind. The concept of happiness, however, has not been particularly influential outside philosophy classes. The main reason for this, one assumes, is due to the presumption that happiness means and is comprised of different things to different people, and thus is incapable of being reconciled into a unifying principle to guide the development of legal and social policy. However, recent empirical studies show that there are some common factors which contribute to each of us being happy. These include enjoying a high degree of liberty, so that people are free to pursue their individual goals, a sense of participation and control in the activities that one engages in, close personal relationships and good health. These studies also show that there are some things that do not make us happy, one prime example (generally speaking) being money.

1 The relevance of happiness

The importance of these empirical studies cannot be overstated. They bring the concept of happiness out of the philosophy lectures and into the real world, providing a fresh insight to a whole gamete of existing rules, principles and assumptions which are based on what people want and expect. The rules and

assumptions guiding both the operation of corporations and their participants is but one example.

There will no doubt be sceptics who will remain slaves to existing assumptions and principles, particularly those assumptions and principles that rely on economic analysis (for example, that the corporation exists for the sole purpose of maximising wealth for shareholders) despite the emerging evidence of what it is that really matters to people. To this end, it is important to point out that the scientific methodology used to ascertain the results relating to human well-being is the same as that used to obtain medical and biological information about people. Thus, a denial that, for example, money does not cause happiness is just as specious as the claim that excess alcohol does not cause sclerosis of the liver. In this respect it is particularly important to note that one or two counter-examples do not disprove a general point. The claim that some people are happier after they make lots of money no more disproves the point that money does not make people happy, than the fact that one has a relative who had two packets of cigarettes a day and lived until he or she was 100 years of age disproves the link between heavy smoking and throat cancer.

Based on the findings referred to above, the authors argue that elevating the interests of shareholders to being the primary concern of the corporation, does not undermine the interests of other stakeholders. Although there have not yet been any studies conducted on the link between the levels of profit obtained by a company and levels of shareholder happiness, given that shareholders are individuals, and their ultimate goal is to be happy; making money from shares is no more than a means to an end (the end being personal happiness and well-being). Accordingly, if we understand that serving the best interests of shareholders should be about facilitating the happiness of shareholders, rather than strictly about wealth maximisation, we see a natural inter-dependence (rather than conflict) emerge between shareholders and stakeholders. Fulfilment of the common factors which contribute to personal happiness depends on a properly functioning society, in which each and every stakeholder plays a role in some way and therefore needs to be looked after by the corporation.

Importantly, our analysis applies equally to retail investors and institutional investors participating in the sharemarket, given that institutional investors are no more than a group of individuals forming a corporation through which to buy shares for themselves (in the name of the corporation), or on behalf of members of the company. In other words, whether individuals participate in an activity directly by themselves, or through the mechanism of a corporation, their principal ultimate objective always is to be happy. Accordingly, reference to 'shareholder' in this article includes both retail investors and institutional investors.

2 Overview of the article

In Part II of the article, the authors begin by justifying why the interests of shareholders should be the primary concern of the corporation. While over the years a number of arguments in favour of ‘shareholder primacy’ have emerged in the literature on corporate governance, we argue that the most (and indeed only) convincing justification for shareholder primacy is that of shareholder ownership. This argument proceeds on the basis that shares constitute a proprietary interest in the corporation, and ‘ownership’ of the corporation by shareholders entails certain implications as to how the corporation should be structured and managed. The classification of shares being proprietary in nature and shareholders as being owners of the company is more than a theoretical point. Property is the strongest legal interest recognised by our system of law (at least in so far as inanimate objects are concerned) and ownership is the most basal form of proprietary interest.¹ Part III discusses in detail the results which have emerged from recent empirical studies as to what makes people happy, and in particular the negative correlation between levels of personal happiness and levels of material wealth. The authors will suggest that while there have not been any specific empirical studies as to whether these results equally apply to shareholders, there is every reason that they should. We will argue that this view is supported by recent studies on so-called ‘endowment effects’ within corporate agency relationships, which suggests that participants involved in a corporation are not actually guided by pure economic self-interest when making decisions affecting the corporation.

Part IV then proceeds to outline the most significant theories of the firm in contemporary corporate governance literature, contractarianism and communitarianism, and the inevitable conflict that commentators have perceived between the two theories. The authors argue that the perceived conflict between contractarianism and communitarianism is actually misconceived, a view which is gaining some support among ‘team production’ theorists. Once it is understood that all shareholders, as individuals, are guided by the overriding objective of achieving happiness and well-being, and that the fulfilment of happiness and well-being is dependant on a properly functioning society in which the company’s stakeholders (among others) play an important role, rather than the maximisation of profits, we

¹ For a discussion regarding the rationale for the right to property, see Peter Benson, ‘Philosophy of Property Law’, in Jules Coleman and Scott Shapiro (ed), *The Oxford Handbook of Jurisprudence and Philosophy of Law* (2002) 752, who suggest that the right of property stems from the notion of bodily integrity and ‘is an extension of the moral idea underlying the prohibition against slavery to mutual relations among persons respecting their purposive dealings with external things’. He also notes, at 771, that the three incidents of private property are the right to possess, use and alienate. Clearly these are all incidents of shares. Regarding the justification and nature of property ownership, see further, Jeremy Waldron, *The Right to Private Property* (1988); James Penner, *The Idea of Property in Law* (1996); John Locke, *Two Treatises of Government, Book II* (1988 reprint).

see that shareholders and stakeholders depend on each other, rather than having explicitly separate and distinct (indeed conflicting) interests. In our view, a perspective of the corporation with shareholder primacy as the foundation, and shareholder primacy having a broader meaning going beyond strict wealth maximisation to encompass what really is important in facilitating the personal happiness of shareholders, best reflects the fundamental reality of what a corporation is and why individuals choose to participate in them as shareholders. We conclude that once it is acknowledged that the personal happiness of shareholders provides the basis for a unifying understanding of the corporation, this fresh way of thinking about the corporation raises some important questions about the existing governance structure in large corporations (namely the separation of ownership and control), and provides a very useful normative paradigm for guiding the development of corporate law going forward.

II WHY SHAREHOLDER PRIMACY MAKES SENSE

A *Shareholder Primacy: Background*

The shareholder primacy norm encompasses the view that the ‘best interests of the company’ should be considered as ‘the best interests of shareholders’. D Gordon Smith describes the shareholder primacy form from a US perspective as follows:

The structure of corporate law ensures that corporations generally operate in the interests of shareholders. Shareholders exercise control over corporations by electing directors, approving fundamental transactions, and bringing derivative suits on behalf of the corporation. Employees, creditors, suppliers, customers and others may possess contractual claims against a corporation, but shareholders claim the corporation’s heart. This shareholder-centric focus of corporate law is often referred to as shareholder primacy.²

Similarly, prominent US ‘law and economics’ academics Easterbrook and Fischel have expressed the view that ‘the purpose of corporations law is to establish organising principles under which shareholders may conduct the enterprise for their own benefit’.³

² D Gordon Smith, ‘The Shareholder Primacy Norm’ (1998) 23 *Iowa Journal of Corporation Law* 277, 277. See also Lewis D Solomon et al, *Corporations: Law and Policy, Cases and Materials* (4th ed, 1998) 348: ‘Shareholders are considered to be the corporation’s ultimate owners’.

³ Cited in Martin Lipton and Stephen A Rosenblum, ‘A New System of Corporate Governance’ (1991) 58 *University of Chicago Law Review* 187, 205 (they complain that this statement ‘assumes away the potential divergence’ between shareholder and corporate interests). For a contrary view, see Lawrence E Mitchell, ‘A Critical Look at Corporate Governance’ (1992) 45 *Vanberbuilt Law Review* 1263.

In the US, the shareholder primacy norm not only dominates normative discourse among academics in relation to theories of the corporation and the role and place of the corporation in society, but also continues to reflect the actual state of the law. Shareholder primacy is viewed very much in economic terms, with the concept of the best interests of the corporation tied in very much with maximising profits for distribution to shareholders. Thus, the shareholder primacy norm is often referred to as the ‘wealth maximisation norm’.⁴ This strict economic view of shareholder primacy is exemplified by two classic statements made in the United States. The first was by the Michigan Supreme Court in *Dodge v Ford Motor Company*:

A business corporation is organized and carried on primarily for the profit of 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.⁵

The second was not by a lawyer, but by Nobel laureate in economics, Milton Friedman. In a piece written for *The New York Times*, Friedman argued that:

In a free-enterprise, private property system a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.⁶

There have been a number of arguments raised over the years, emanating particularly from academics from the ‘ivy league’ law schools in the United States, but also in other jurisdictions,⁷ in an attempt to justify the shareholder primacy view

⁴ See for example, Stephen M Bainbridge, ‘In Defence of the Shareholder Wealth Maximization Norm: A Reply to Professor Green’ (1993) 50 *Washington and Lee Law Review* 1423. See also Mark J Roe, ‘The Shareholder Wealth Maximization Norm and Industrial Organization’ (2001) 149 *University of Pennsylvania Law Review* 2063.

⁵ 170 NW 684. See also the famous article by Professor Berle, ‘Corporate Powers as Powers in Trust’ (1931) 44 *Harvard Law Review* 1049, which outlined Professor Berle’s arguments for why the corporation exists only to make money for its shareholders.

⁶ See Milton Friedman, ‘The Social Responsibility of Business is to Increase its Profits’, *New York Times*, September 13, 1970, (Magazine) at 32-33, 122, 124, 126.

⁷ See Joseph Healy in *Corporate Governance and Wealth Creation in New Zealand* (2003) 9:

Shareholder value means a business earning a return on invested capital, on an economic basis that at least equals the risk-adjusted return sought by investors, at which point wealth creation equals zero. ... In other words, creating shareholder value means earning an

of the corporation. Three of the more prominent arguments raised in favour of the strict shareholder primacy view are the so-called ‘shareholders as “owners” argument’, the residual claimants argument, and the agency costs argument.

The shareholders as ‘owners’ argument is the most long-standing argument in favour of shareholder primacy, and is based on a view of shares as amounting to a proprietary interest in the corporation and the corporation as a living, breathing entity which is capable of being owned, just like any other form of legal entity. By owning shares, shareholders thereby effectively own the corporation, and therefore from a corporate law and corporate governance perspective, should be treated as the owners of the corporation. As we explain below, we support this argument in favour of shareholder primacy once it is understood what the concept of ‘property’ actually means and because it best represents both what a share and a corporation actually are.

Two of the other mainstream arguments raised in support of a shareholder primacy perspective of the corporation are the residual claimants argument and the agency costs argument, which both derive from the ‘Chicago School’ of law and economic analysis. The residual claimant argument was developed by Easterbrook and Fischel in their work, *The Economic Structure of Corporate Law*. Professor Stout has provided the following useful explanation of the residential claimants argument for shareholder primacy:

Adopting the notion that the corporation can be thought of as a nexus of contracts between and among the shareholders of the firm and other corporate participants, Easterbrook and Fischel argue that the contracts entered into by nonshareholder groups such as employees, managers and creditors are explicit contracts that entitle them to fixed payments, such as salaries and interest payments. In contrast, shareholders rely on an implicit contract that entitles them to whatever remains after the firm has met its explicit obligations and paid its fixed claims. Thus, Easterbrook and Fischel describe shareholders as the sole “residual claimants” and sole “residual risk bearers” in public firms and argue that in accord with shareholders’ implicit “contractual” rights, firms should be run with an eye towards maximising shareholder wealth.⁸

adequate return on savings to compensate for risk-taking. *Corporate governance, in turn, is simply how managers and directors ensure that the assets and resources of the business are used to ensure that sustainable shareholder value is created.*

At 58, Healy goes on to explain why ‘shareholder value’ must continue to be seen in economic terms:

...Managers should understand three things about their shareholders: (i) they want to maximise wealth; (ii) they can transform their wealth into whatever time pattern of consumption they themselves wish and (iii) they choose their own risk profile, so there is no need to diversify on their behalf.

⁸ Lynn A Stout, ‘Bad and Not-So-Bad Arguments for Shareholder Primacy’ (2002) 75 *Southern California Law Review* 1189.

Given that the ‘nexus of contracts’ view of the corporation (explained in more detail in Part Four below) still represents the mainstream theory of the corporation among corporate law academics in the US, the residual claimants argument in favour of shareholder primacy receives widespread support. However, unlike the ownership argument for shareholder primacy which does adequately reflect the real position of shareholders and the corporation, the residual claimants argument is an over-simplification of where shareholders are placed in the corporation, and thus — in our view — cannot be supported. Stout recently made a similar comment: ‘...the residual claimants argument for shareholder primacy is a naked assertion, and an empirically incorrect one at that’.⁹

Stout goes on to argue that it is misleading to suggest that shareholders are entitled to, or actually expect to receive, everything left over after the firm’s explicit contractual obligations have been met.

To the contrary, corporate law allows shareholders to receive payments from firms only when two conditions are met. First, the firms must be doing well enough financially ... to permit the directors to declare a dividend. Second, the directors must actually decide to declare a dividend. Neither contingency can be met unless the directors want it to be met.¹⁰

According to economists, ‘agency costs’ arise from giving directors discretion to manage a corporation in a manner which they consider to be in the best interests of the firm. Because directors are only human, they are imperfect agents, meaning that they are likely to consider not only the interests of the firm when acting, but also their own interests. When self-interest prevails over strict duty, ‘agency costs’ (including shirking, and possibly even stealing from the firm) develop. The agency costs argument in favour of shareholder primacy suggests that a strict duty to maximise profits for shareholders is the most effective way to measure the performance of directors and to maintain director accountability, thus keeping agency costs to a minimum. If directors are allowed to consider the interests of a broader range of constituents, such as consumers, employees and even the local community, directors would simply be given too much discretion to pursue their own agenda rather than adhere to maximising profits — producing agency costs.

What this argument fails to consider, however, is whether agency costs are an acceptable price to pay for a more compassionate, stakeholder-focused corporation. It also places little faith in directors to do what is best for the corporation. As will be explored in more detail in Part IV below, recent studies by a group of academics at the University of Southern California Law School suggest that as individuals become more involved in a corporation, they are likely to become more concerned with the interests of the corporation, rather than their own personal interests, thereby dampening the magnitude of the so-called ‘endowment effect’ (the effect of

⁹ Ibid 1192.

¹⁰ Ibid 1193.

individuals expecting more return on their investment than what they put in initially). While these studies were confined to employees of a corporation, as we suggest further below there is every indication from the studies that the same results would apply to other participants in the corporation- particularly shareholders, but also directors and others.¹¹

If it is made clear that the purpose of the corporation is to facilitate the achievement of personal happiness for its shareholders, which involves accommodating the interests of non-shareholder constituents, rather than adhere strictly to generating short-term profits for shareholders, then we believe that directors would try to act in this way. Indeed, it could be said that agency costs may even decline if directors are forced to take into account a broad range of interests, rather than just the strict economic interests of shareholders. There is simply no empirical evidence to prove that directors are incapable of acting in the best interests of the corporation, when the interests to consider go beyond those of shareholders alone. Rather, such an argument is simply an assertion by those unwilling to move beyond a narrow, economic view of the corporation.¹²

It is our view that the shareholder primacy norm in a general sense represents the best normative assessment of the corporation, however we believe that the norm does not need to be narrowly cast in terms of the strict economic interests of shareholders. The best interests of the shareholders does not necessarily equate with a practice and ethic of wealth maximisation by the corporation.¹³ Indeed, in *Miles v Sydney Meat Preserving Co Ltd*, Chief Justice Sir Samuel Griffith of the High Court of Australia went so far as to say that

[t]he law does not require the members of a company to ... maintain the character of the company as a soulless and boweless thing, or to exact the last farthing in its commercial dealing or forbid them to carry on its operations in a

¹¹ See Jennifer Arlen, Matthew Spitzer and Eric Talley, 'Endowment Effects within Corporate Agency Relationships' (2002) 31 *Journal of Legal Studies* 1.

¹² See, for example, Gregory Scott Crespi, 'Redefining the Fiduciary Duties of Corporate Directors in Accordance with the Team Production Model of Corporate Governance' (2003) 36 *Creighton Law Journal* 623, who argues that based on the team production model of the corporation (discussed in more detail below), traditional fiduciary duty principles should be 'respecified' to run in favour of a larger class of stakeholders than just shareholders.

¹³ Indeed, in the US, although the wealth maximisation norm continues to represent an accurate description of the law, there have been recent developments, especially the implementation of so-called 'constituency statutes' by most US states which enable directors to consider non-shareholder interests when making decisions affecting the corporation) (particularly in relation to hostile takeover bids), the issue has been raised of whether the 'shareholder wealth maximisation norm' continues to suffice from a normative perspective. See Bainbridge, above n 4.

way which they think conducive to the best interests of the company as a whole.¹⁴

Rather, when considering recent empirical studies concerning what it is that makes people happy, and hence is in their best interests (as explained below), the pursuit of wealth does not register on the list. Indeed, it is even suggested that beyond a level of income which is necessary to satisfy certain psychological needs, the pursuit of wealth actually contributes to *unhappiness*. As will be discussed below, shareholder primacy should be seen in a broader context, with the corporation recognising the interests of a variety of stakeholders which contribute to the overall happiness of shareholders. We will refer to the shareholder primacy norm in this broader sense from now on.

B *Are Shares Property?*

What Are the Implications if Shares Constitute Property?

Few would believe ... that a shareholder's interest in a corporation is property in the same way as the shareholder's interest in her back yard.¹⁵

The above statement represents the common view held by the number of commentators over the years who have been faced with the question of whether shares give rise to a proprietary interest in the corporation, and hence whether shareholders are indeed the 'owners' of the corporation. However, up until now there has also been a universally held view that the question is far from an easy one,¹⁶ with one prominent corporate law academic even saying that the task of

¹⁴ (1912-13) 16 CLR 50, 66. See also John Farrar, *Corporate Governance in Australia and New Zealand* (2001) 41: 'A corporation is the legal personification of a firm that is a social institution. This legal personification should not distort the underlying social reality.'

¹⁵ Kent Greenfield, 'From Rights to Regulation in Corporate Law' in Fiona Patfield (ed), *Perspectives on Company Law: 2* (1997) 15. Greenfield in his article questions the normative justification for basing corporate law rules (including shareholder rights) on metaphorical concepts like property and contract. At 16, Greenfield then goes on to state: 'To say that the shareholders "own" the company is simply unhelpful without a description of why certain aspects of property law are relevant and others are not.'

¹⁶ For a discussion of the difficulties in actually defining the legal status and the nature of a share, see L C B Gower, *Modern Company Law* (4th ed, 1979) 379; Paddy Ireland, Ian Grigg-Spall and Dave Kelly, 'The Conceptual Foundations of Modern Company Law' (1987) 14 *Journal of Law and Society* 149, 152-4; Helen Bird, 'A Critique of the Proprietary Nature of Share Rights in Australian Publicly Listed Corporations' (1998) 22 *Melbourne University Law Review* 131, 138-41; Robert Pennington, 'Can shares in companies be defined?' (1989) 10 *The Company Lawyer* 140; Peta Spender, 'Guns and Greenmail: Fear and Loathing after *Gambotto*' (1998) 22 *Melbourne University Law Review* 96, 110-17; Joylon Rogers, 'Compulsorily

defining the nature of a share was ‘one of the most difficult conceptual issues in company law’.¹⁷

The present authors disagree with both views. Shares do in fact constitute a proprietary interest in the corporation, with the corollary being that shareholders are the owners of the corporation, and the reasoning behind this view is neither complex nor sophisticated. It simply reflects what should be an undisputable fact: a corporation, like a house, has a distinct legal personality,¹⁸ and while a house is a tangible entity comprised of (among other things) bricks and mortar, a corporation is an intangible entity, existing only on paper, and built not from materials and labour, but from a collection of shares in the name of particular individuals or organisations. Thus, while it is undisputed both in the general community and at law that the person who owns the house by connection owns the bricks used to build the house, so it should be an undisputed fact that the individuals who own the shares of a corporation are the owners of the corporation.

It can be presumed that the issue which stands in the way of commentators being able to accept that shares do not in fact meet the description of property, just like a house, boat, car or corporate governance textbook, aside from shares having an intangible quality, is that — unlike (it is also presumed) other things that we traditionally associate with being property, the rights of shareholders in relation to their shares are narrowly cast and quite dependent on a third party — the board of directors. While it may be said that shareholders own the shares, and hence the corporation, they do not have any rights over the assets of the corporation — all

Acquisition under Pt 6A.2 and its implications for minority shareholders’ (2003) 31 *Australian Business Law Review* 97, 101–3.

¹⁷ See Dan Prentice, ‘Alteration of Articles of Association- Expropriation of Shares’ (1996) 112 *Law Quarterly Review* 194, 197. See also Bird, above n 16, 146, who suggests that: ‘Defining property involves submerging oneself in difficult jurisprudential abstractions about the role of property as an institution in society’.

¹⁸ This has been the position since the seminal decision of the House of Lords in *Salomon v Salomon & Co Ltd* [1897] AC 22. In that case, Lord MacNaghten made the classic statement (at 54) that:

The company is at law a different person altogether from the subscribers to the Memorandum and, although it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act. That is, I think, the declared intention of the enactment.

See also s 124 of Australia’s *Corporations Act 2001* (Cth), which confirms that a corporation is a separate entity at law.

While the *Salomon* doctrine of separate legal personality has been criticised as being devoid of coherent policy and principle, it remains the key component of the law. For criticism of the *Solomon* doctrine, see Farrar, above n 14, 26–30, and the various references referred to in that text.

they are entitled to a share of the company's profits via dividend payments — and then only when the directors consider that it is appropriate that these payments are made.¹⁹ It is in this sense that shares are referred to as 'autonomous'.²⁰

We believe the argument that because shares are 'autonomous' that somehow excludes shares from being cast as property is totally misguided. It not only fails to appreciate how property rights work in practice, but also fails to appreciate the depth of the concept of property at law. It is ludicrous to suggest that a property status should not be given to shares because shares by themselves do not encompass an entitlement to walk into a corporation's head office and take the receptionist's computer, and help themselves to biscuits and coffee in the staff room. Unless the corporation is a small quasi-partnership where all the shareholders know each other and there is an agreement that shareholders may stop by company headquarters when they see fit, generally shareholders would not expect such an entitlement to attach to the shares they have purchased, particularly nowadays when shareholders often have a portfolio of shares (such that it would be simply impractical to stop by each and every corporation's office, unless they had a really strong yearning for cream biscuits!), and because modern corporations have a large number of shareholders. Moreover, property is not such an omnipotent force that it captures everything in its realm. No one suggests that because a family may have rented a large screen television for their home rather than purchase one outright, that the house in which the television resides cannot be characterised as a form of property which can be owned by the family. If this was the case, in a credit card society in which many house items are not technically owned by the consumer until paid off outright, home 'ownership' would be a mere fiction. This is an absurd proposition. Hence, the fact that the assets of the corporation belong to (and are controlled by) someone other than shareholders (usually the corporation itself) does not act as a

¹⁹ In Australia, while the general principle is that a corporation is not required to pay a dividend even though it may be making substantial profits, such action may actually amount to oppression (for which remedial action is available) where the directors continually refuse to recommend the payment of dividends. See Julie Cassidy, *Concise Corporations Law* (3rd ed, 2003) 133.

²⁰ See Ireland, Grigg-Spall and Kelly, above n 16, 154. See also Bird, above n 16, 140 who provides a useful description of the autonomous nature of the share:

The share represents a proprietary interest or estate in a corporation but not the corporation's assets. The corporate law doctrine of separate legal entity separates the corporate enterprise from its shareholders. The corporation owns the enterprise, shareholders own shares in the corporation. Further fragmentation occurs by the separation of the rights to possession, management and control of the corporation's assets from other ownership rights. These rights would otherwise be united if all the proprietary interests in the corporation were owned by the one person.

barrier to characterising shares as a form of property (and, consequently, shareholders as ‘owners’ of the corporation).²¹

Not only is this line of reasoning logical, but is supported by the fact that ‘property’ as a concept in law is extremely dynamic and casts a very wide net. When property can exist in ideas,²² thin air, and other items with a similar intangible quality,²³ there is no reason why it cannot extend to so-called ‘autonomous’ items like shares. Eisenberg agrees, suggesting that shareholding is a property right of the kind that A M Honore, in his seminal piece ‘Ownership’, referred to as ‘split ownership’— that is, a form of ownership where the standard characteristics or ‘incidents’ of ownership (discussed in further detail in 2.3 below) are divided between two or more persons.²⁴

Moreover, in writing about what actually are the characteristics of property, Kevin Gray made the following important statement, also demonstrating that property exists in autonomous items:

An extensive frame of reference is created by the notion that ‘property’ consists primarily in control over access. Much of our false thinking about property stems from the residual perception that ‘property’ is itself a thing or resource rather than a legally endorsed concentration of power over things and

²¹ Relevant to this discussion is the distinction between ‘passive’ and ‘active’ property made by Berle and Means in *The Modern Corporation and Private Property* when discussing how modern corporations have a diffuse group of shareholders and a separation of ownership and control. According to Berle and Means, because of the separation of ownership and control in large, modern corporations, shareholders hold ‘passive property ... in shares of stocks or bonds’, while managers hold ‘active’ property, controlling ‘the plant, good will, and organization which make up the modern enterprise’: see A Berle and G Means, *The Modern Corporation and Private Property* (1932, rev. ed. 1967) 347. Apparently, some commentators suggest that this distinction should lead us away from treating the company as the shareholder’s private property towards treating the company as a special sort of property designed to serve a wider set of interests. In our view, however, property is property, and no matter how it is tagged, if something is property there are particular rights that attach to it. Furthermore, we disagree that the property interests of shareholders must yield before the company can accommodate the large interests of society. In our view, as we discuss in this article, the distinct property interests of shareholders and the larger interests of society are inter-dependent. See Sheldon Leader, ‘Private Property and Corporate Governance Part 1: Defining the Interests’ in Fiona Patfield, *Perspectives on Company Law: 1* (1995) 91.

²² Through intellectual property laws protecting such things as copyright, designs and patents.

²³ See Ireland, Grigg-Spall and Kelly, above n 16, 153.

²⁴ Melvin A Eisenberg, ‘Team Production in Business Organizations: The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm’ (1999) 24 *Iowa Journal of Corporation Law* 819, 825; citing A M Honore, ‘Ownership’ in Anthony G Guest, *Oxford Essays in Jurisprudence* (1961) 107, 143.

resources. If “property” is not a thing but a power-relationship, the range of resources in which “property” can be claimed is usually conceded by orthodox legal doctrine. ... The limits of property are fixed, not by the “thinglikeness” of particular resources but by the physical, legal and moral criteria of excludability. By lending the support of the state to the assertion of control over access to the benefits of particular resources, the courts have it in their power to create “property”. But of critical importance in this definitional process is obviously the care with which the courts determine which resources are recognisably non-excludable.²⁵

In endorsing the comments of Professor Gray in the above-cited article, the High Court of Australia in *Yanner v Eaton* (a native title case considering, among other things, whether hunting wild animals in traditional lands gave rise to a proprietary interest in the land), held that:

“Property” is a term that can be, and is, applied to many different kinds of relationship with a subject matter. It is not “a monolithic notion of standard content and invariable intensity”. That is why, in the context of a testator’s will, “property” has been said to be “the most comprehensive of all the terms which can be used, inasmuch as it is indicative and descriptive of every possible interest which the party can have”.²⁶

To emphasise the point that an inability to totally control an object or entity does not militate against the existence of a proprietary interest, an analogy can be made with ownership of the most coveted property interest in contemporary society: real estate. A purchaser of real estate can, by and large, do as he or she wishes with that object — even destroy it. However, when a person purchases the same item with more than one other person, a similar picture emerges as with share ownership. None of the real estate owners can exercise anything approaching total dominion over the property unilaterally. Sure, in the case of shares there is typically a more diverse shareholding and hence control is diluted to a greater extent, but this is a distinction *in degree not nature*. In fact where there are large numbers of owners of property, we see a very similar picture to that of a corporation. It is often difficult and inefficient to manage a property where there are large numbers of owners. In many cases, the owners simply do not have the inclination, time or acumen to attend to all the matters affecting the property. So, they delegate this function out to other persons. In Australia, this entity is known as a ‘body corporate’. The establishment of such an entity hardly changes the fact that the owners have a proprietary interest in the property. How can a decision to create such an entity, which is in fact an exercise of their property rights, be seen as somehow watering down the nature of their interest?

Hence, given the nebulous character of property that is demonstrated above, the commentaries which have attempted to undermine the status of shares do not, in our

²⁵ Kevin Gray, ‘Property in Thin Air’, (1991) 50 *Cambridge Law Journal* 252, 299.

²⁶ *Yanner v Eaton* (1999) 201 CLR 351, 365 (citations omitted).

view, challenge in any way the long accepted maxim that shares are ‘a species of intangible property which comprises a collection of rights and obligations relating to an interest in a company of an economic and proprietary character, but not constituting a debt’.²⁷ The fact that the nature and scope of an interest (represented by a share) is somewhat amorphous and is subject to countervailing interests does not detract from the view that it is proprietary in nature.

We also note that in addition to the more general commentary on the nature and scope of property which provides support for the view that shares give rise to a proprietary interest in the corporation, in the case of *Gambotto v WCP Ltd*,²⁸ the High Court of Australia has endorsed the view that a share, as a form of investment, contains a ‘hard inner core of proprietary rights’.²⁹ *Gambotto* involved a success challenge to a company’s proposed amendment to its constitution to expropriate the shares of a small number of minority shareholders who collectively held approximately 0.3 per cent of shares in the company. In holding that the company’s proposed constitutional amendment amounted to oppressive conduct and articulating the limited circumstances in which a similar amendment may be valid, the majority judgment emphasised the proprietary nature of a share.³⁰ Mason CJ, Brennan, Deane and Dawson JJ stated in that case that:

²⁷ See Pennington, above n 16, 140. See also *Archibald Howie Pty Ltd v Commissioner of Stamp Duties* (NSW) 77 CLR 143, 156; *Yanner v Eaton* (1999) 201 CLR 351.

²⁸ (1995) 182 CLR 432.

²⁹ Note also s 1070A (1) of Australia’s *Corporations Act 2001*, which states that shares are forms of property subject to the laws applicable to personal property.

³⁰ See Bird, above n 16, 134–5:

Gambotto involved a challenge to the validity of an alteration of the articles of association of an Australian publicly listed corporation, WCP Limited. ... The proposed alteration enabled another shareholder ‘entitled for the purposes of the Corporations Law to 90 per cent of more the issued shares’ to compulsorily acquire the remaining issued shares in WCP. WCP’s majority shareholders held 99.7 per cent of the issued capital of the corporation. *Gambotto*, a minority shareholder, challenged the validity of the new compulsory acquisition power. The High Court found in his favour, striking down the new article because it effected a fraud on the majority shareholders.

Two judgments were given by the High Court. Both provided for new restrictions on the use of the alteration power by a majority shareholder to effect a modification or expropriation of minority shares. The majority held that an amendment which inserts a power of expropriation into the articles must satisfy a two-step test. First, the expropriation must be for a proper purpose. Secondly, it must not operate oppressively in relation to minority shareholders. ...

Bird’s article is a rejoinder to Peta Spender, ‘Guns and Greenmail: Fear and Loathing after *Gambotto*’, above n 16.

A share is liable to modification or destruction in appropriate circumstances, but is more than a ‘capitalized dividend stream’: it is a form of investment that confers proprietary rights on the investor.³¹

In light of this and other statements in the High Court’s judgment, the *Gambotto* decision has been the springboard for a great deal of recent academic commentary in Australia (and overseas) regarding the nature of shares and the status of shareholders.³²

*C Shareholders As The ‘Owners’ of the Company.
Corporate Governance Implications of Shareholder Ownership?*

As we alluded to above, we believe that shareholders are the owners of the corporation. This arises simply from shareholders having a proprietary interest in the shares of the corporation, with shares being what the corporation — as a discreet legal entity — is made up of: like bricks are the building blocks of a house, shares are the legal foundation of the corporation.

It is, we believe, therefore incorrect to approach the question of whether shareholders are the owners of the company by treating shares and the corporation as being separate legal entities, and assume that because directors and managers, rather than shareholders, exercise day-to-day control over a corporation’s strategic, financial and administrative affairs,³³ shareholders cannot be considered the owners of the corporation — even if they are considered to have a proprietary interest in the shares of the company. Once it is understood that shareholders have certain rights in the corporation equating to ownership which arise from owning shares in the corporation, we see that shareholders are indeed the owners of the corporation.

³¹ *Gambotto*, at 447. See also the earlier comments of Dixon J of the Australian High Court in *Peters American Delicacy Co Ltd v Health* (1939) 61 CLR 457, 504, who defined a share as ‘[p]rimarily ... a piece of property conferring rights in relation to distributions of income and of capital defined in “many respects” by the articles of association’. Bird, above n 16, 139, notes of the judgment of Dixon J that: ‘By use of the word “primarily”, Dixon J acknowledged that a share has another legal form under the membership contract. He also acknowledged that the articles of association define share rights in “many respects”. These comments suggest that there are incidents of a share which are both proprietary and contractual in nature. They also contemplate that there exist some proprietary aspects of a share which are not defined by the membership contract.’

³² See, for example, Stephen Kevans, ‘Oppression of Majority Shareholders by a Minority? *Gambotto v WCP Limited*’ (1996) 18 *Sydney Law Review* 110; Dan Prentice, ‘Alteration of Articles of Association – Expropriation of Shares’ (1996) 112 *Law Quarterly Review* 194; Deborah DeMott, ‘Proprietary Norms in Corporate Law: An Essay on Reading *Gambotto* in the United States’ in Ian Ramsay (ed), *Gambotto v WCP Limited: Its Implications for Corporate Regulation* (1996) 87.

³³ As articulated by Berle and Means, above n 21.

In order to justify our argument that shareholders are the owners of the corporation, and to consider the implications of shareholders being the owners of the corporation, it is useful to consider what ‘ownership’ actually means in a legal context. Whenever there is a discussion of what ‘ownership’ means and the role that ownership plays in our system of law, reference is usually made to Honore’s seminal piece ‘Ownership’, whereby Honore outlined what he saw as the eleven ‘incidents’ of ownership. These were: the rights to possess, use, manage and receive income, the rights to return of capital, security and transmissibility and absence of term, a prohibition against harmful use, liability to execution and residuary rights. Honore, however, later acknowledged that only four of his eleven indicia were ‘cardinal features’: the rights to unrestricted use, to exclude, to alienate and to immunity from expropriation.³⁴ More recently, there has been an attempt to treat these indicia collectively, rather than as being separate and discreet.³⁵

Based on the indicia of ownership, shareholders certainly enjoy ownership of their shares. It is clear that at the very least, shareholders have the right to use, exclude and alienate in relation to their shares. Sure, at times a member’s shares may be expropriated by the company for particular reasons (as we saw above in mentioning the High Court of Australia’s decision in *Gambotto*), but this is not a simple process and the company’s members typically have some say as to how this occurs — respecting the fact that shares constitute a form of property.

However, commentators have been less willing to accept that shareholders, by extension of satisfying the ownership criteria in relation to shares, satisfy the ownership criteria in relation to the corporation itself (treating the corporation and shares as separate and distinct). This is because when one takes an outsider’s look into the day-to-day operation of a corporation, particularly a large corporation with a widely dispersed group of shareholders, one does not see shareholders enjoying rights in relation to the corporation suggesting ownership in light of Honore’s indicia mentioned above. Instead, due to the separation of ownership and control in modern corporations,³⁶ one sees managers and directors in control at the helm,

³⁴ See AM Honore, ‘Rights of Exclusion and Immunities against Divesting’ (196) 34 *Tulane Law Review* 453, 456–9. Again, we believe that shareholders relationship with its shares, and hence the corporation itself, satisfies these features. For a discussion of Honore’s indicia, see J E Penner, ‘The “Bundle of Rights” Picture of Property’ (1996) 43 *UCLA Law Review* 711, 712–16; Bird, above n 16, 150–152.

³⁵ Benson, above n 1, 759, sees no reason for treating the so-called ‘eleven indicia’ of Honore separately: ‘although each of those incidents is distinct from the others, they are mutually integrated as individually necessary expansions of a single unifying idea of property that reflects the judicial conception’.

³⁶ See Berle and Means, above n 21, 124:

[I]t is therefore evident that we are dealing not only with distinct but often opposing groups, ownership [shareholders] on the one side, control [management] on the other – a control which tends to move further and further away from ownership and ultimately lie in the hands of the management itself, a management capable of perpetuating its

which would suggest that the company's managers and directors, rather than the company's shareholders, are the owners of the company. This is because more than any other individuals who have an involvement in the corporation (including the company's shareholders), the rights that the directors and managers enjoy in relation to the corporation best resemble Honores' indicia of ownership. As Healy has written:

If we asked a visitor from another planet, or a ten-year old child to guess who were the owners of a firm by observing behaviour rather than by reading textbooks in law or economics, there is little doubt that they would point to the company's senior management. This interpretation points directly to the paradox in Berle and Means' famous observation of the separation of ownership and control. If ownership does not imply control, what does ownership mean?

This line of reasoning leads on to the view that if the company is not owned by shareholders, and the shareholders are simply one of a number of stakeholder groups, all of whom enjoy claims against it, then there is no particular reason to think that the interests of shareholders do or should enjoy priority over the interests of other stakeholders.³⁷

Ronald M Green also relies on the separation of ownership in modern corporations, as well as the privilege of limited liability, as reasons why shareholders are not 'owners' of the company in the traditional, legal sense of the word. According to Green:

One problem, long acknowledged in corporate law, is that ownership of a corporation is significantly different from ownership of personal possessions. By and large, shareholders have no right to control the use of corporate assets. Control is vested in a fictitious person, the corporation, under the supervision of the board of directors. Senior managers and directors are fiduciaries not to the "shareholder-owners" of the firm, but to the corporation.

...
[The separation of ownership and control] complicates the simple and morally compelling picture of owners exercising their will through agents whom they have expressly hired for that purpose and who correspondingly owe them

own position. The concentration of economic power separate from ownership has, in fact, created economic empires, and has delivered these empires into the hands of a new form of absolutism, relegating "owners" to the position of those who supply the means whereby the new princes may exercise their power.

³⁷ Healy, above n 7, 57. Our response to this, using an analogy, is that there are a number of situations where an 'outsider' may perceive that the person in day-to-day control of more conventional forms of property such as a house or car is the 'owner', but who are not the 'owners' due to only leasing or borrowing etc. However, we do not shape the law according to these perceptions. The owners in practice are the owners in law. Therefore, the argument that shareholders are not the owners of the company because directors – rather than they – exercise day-to-day control, is wrong, indeed absurd.

duties of loyalty and service. In fact, in exchange for a good return on their investment, shareholders of public corporations have, by everyone's admission, already relinquished most of what we normally think of as the powers of ownership.

...

If [shareholders] do not like the policies or directions taken by a firm in which they have invested, they are free at any time to sell their stock in a very active public market. In these respects, shareholders today have little commitment to the firms in which they invest: they are neither committed to the firm, in the moral sense of caring about its prospects, nor are they committed in the practical sense of having joined their fate to the company's. This essential lack of commitment by shareholders creates a moral reality very different from that presumed in the owner-agent model or in any form of fiduciary relationship.

One other feature of the corporate form, limited liability, contributes to this lack of shareholder commitment. Traditionally, ownership of property has implied privileges: the right to enjoy one's possessions and to exploit the freedoms and opportunities they represent. Ownership also has always implied responsibility for the harms that one's property can inflict on others, but, by and large, this has been a minor consideration in most people's thinking.³⁸

In response to the argument that the separation of ownership and control means that- regarding the corporation- the indicia of ownership are satisfied more by the directors and managers than by the shareholders, it is our view that the separation of ownership and control in fact actually highlights that shareholders (as a collective body) do enjoy ownership of the company, and that they are essentially choosing to exercise these rights by delegating day-to-day control of the company to managers and directors- whilst retaining ultimate control as owners.³⁹ As Eisenberg has written, in considering the work of Honore:

Although shareholdership does not carry all the standard incidents of ownership, it has never been thought that an interest is not a property right unless it carries every such incident. For example, life interests, remainder interests, and easements are property rights, not contractual rights, even

³⁸ Ronald M Green, 'Shareholders as Stakeholders: Changing Metaphors of Corporate Governance' (1993) 50 *Washington and Lee Law Review* 1409, 1413, 1414.

³⁹ See Healy, above n 7, 57 who argues that because groups of shareholders individually have different personal tastes and desires, it is logical that management focus on one objective that all these shareholders have: to generate wealth from their involvement in the company as shareholders. According to Healy: Separation of ownership and management is a practical necessity in large companies- and a reality that smaller companies will have to face if they grow. With many hundreds if not thousands of shareholders, the vast majority of whom have no desire to get involved in how the business is being managed, and no two of whom have the same personal tastes, consumption habits or wealth, managers can do only one thing, or follow one simple instruction: maximise the value of the business. This 'implied instruction' from all shareholders is a fundamental principle of the successful working of a capitalist economy.

though they lack some of the standard incidents of ownership. The body of shareholders has most of the incidents of ownership except direct control, and it has at least indirect control through its rights to elect and remove and to collectively sell all or a majority of the corporation's shares to a single bidder.⁴⁰

In reality, shareholders have ultimate control over the company by voting in directors, and ratifying significant transactions via the mechanism of the annual general meeting. Furthermore, even though the directors do exercise day-to-day control over the company, it must be remembered that this control is tempered by an overriding fiduciary duty to act in the best interests of the company — which really means to act in the best interests of all the corporation's shareholders. Similarly, as Stokes has suggested, it may in fact be a prudent decision for shareholders to delegate day-to-day control over the company to managers and directors who bring particular qualities and expertise to the job, just as most of us invest our money to get a greater return rather than leave it under the bed. According to Stokes,

one of the traditional defences of private property which states that an optimal allocation of resources results from owners ...pursuing their own self-interest could be invoked to justify insisting that the company was run in the interests of the shareholders alone.⁴¹

Ultimately, as we have alluded to in the analogy concerning co-owned real estate and corporations (plus other examples), an incapacity to totally control an object or institution is not indicative of a lack of ownership of the object or institution. Property, and in particular ownership, is multi-faced both in terms of the nature of things that can be owned and the manner in which it can be held. Ownership carries with it a large amount of privileges, one of which is the capacity to delegate control of the entity in question. This capacity does not diminish the nature of the holding, rather it is an incident of it. Moreover, if shareholders do not own the company, who does?

D *Implications of Shareholders Being the Owners*

The traditional characteristics and implications of 'ownership' provides the *necessary link* (which, we believe, has not been provided to date) in the argument that because the shareholders are the owners of the corporation through their ownership of shares, the interests of shareholders should be privileged, *even though legislation and case law has operated to place some restrictions on the powers enjoyed by shareholders via their ownership of shares.*

⁴⁰ Eisenberg, above n 24, 825.

⁴¹ Stokes, 'Company Law and Legal Theory' in Twining (ed), *Legal Theory and Common Law* (1986), 178.

Given that shareholders are the owners of the corporation, and ownership is the strongest form of proprietary interest it follows that their interests should be cardinal in terms of the manner in which the affairs of the corporation are conducted. The corporation should be managed in a manner which gives primacy to the interests of the shareholders, and in the remainder of the article we argue that the most important aim of shareholders is to be happy.⁴²

I Are we advocating a view of the corporation that is anachronistic?

In arguing that shareholder ownership provides the positivist and normative justification for why the interests of shareholders ought to be privileged, we respond (as we think we should) to the argument that has been made in the United States that in light of the nexus of contracts being the dominant theory of the corporation, the shareholder ownership argument is now out of date (as the corporation is now seen as a series of contracts, rather than as a separate entity which is capable of being owned).

According to Professor Bainbridge, writing back in 1993, the shareholder ownership argument is now outdated due to the emergence of the nexus of contracts theory, which Bainbridge considers to be the ‘dominant theory in the US in relation to corporate personality’. According to Bainbridge:

Nexus of contracts theory visualises the firm not as an entity, but as an aggregate of various inputs acting together to produce goods or services. Employees provide labor. Creditors provide debt capital. Shareholders initially provide equity capital and subsequently bear the losses and monitor the performance of management. The firm is seen as simply a legal fiction representing the complex set of contractual relationships between these inputs. In other words, the firm is not treated as a thing, but rather as a nexus or web of explicit and implicit contracts establishing rights and obligations among the various inputs making up the firm.

Bainbridge continues:

Because shareholders are simply one of the inputs bound together by this web of voluntary agreements, ownership is not a meaningful concept in nexus of contracts theory. Someone owns each input, but no one owns the totality.⁴³

The authors disagree with Bainbridge that nexus of contracts puts to an end the shareholder ownership argument in support of shareholder primacy. While nexus of contracts theory may be the dominant theory regarding corporate personality in the

⁴² The implications for corporate governance of shares amounting to property in terms of defining the interests of shareholders in relation to the company are also considered by Leader, above n 21, 85.

⁴³ Bainbridge, above n 4, 1426.

US as Bainbridge suggests, in our opinion it is a totally unrealistic view of the corporation. Although nexus of contracts theory sounds logical and utilises complex and sophisticated economic reasoning, it is far removed from the actual nature of a corporation. The corporation is a legal entity with its own personality, this is achieved by the act of incorporation, it is reflected in the law (by which corporations can hold property in its own right, and can sue and be sued, just like a natural person),⁴⁴ and it is what those who establish and operate corporations actually intend. If a corporation was not an entity in its rights, but rather a series of individual contracts, corporate law would operate very differently to how it does in practice; indeed, there would even be the need for a separate branch of law covering corporations- the law of contracts would provide a sufficient base for regulation. Moreover, regulation of corporations would be next to impossible if the law had to deal with a multitude of different contracts between different parties, rather than a separate and distinct legal entity.

III HAPPINESS: WHAT IS IT AND WHY SHOULD WE PURSUE IT?

A *What is Happiness?*

In *Nicomachean Ethics*, Aristotle wrote that happiness is ‘the whole aim and end of human existence’. According to Aristotle:

Happiness is an activity; and activity plainly comes into being and is not present at the start like a piece of property . . . happiness is good activity, not amusement . . . for, in a word, everything that we choose we choose for the sake of something else--except happiness, which is an end . . . for happiness does not lie in such occupations, but, as we have said before, in virtuous activities . . . Happiness extends, then, just so far as contemplation does, and those to whom contemplation more fully belongs are more truly happy, not as a mere concomitant but in virtue of the contemplation; for this is in itself precious. Happiness, therefore, must be some form of contemplation.

For the ancient Greeks and Romans, to be happy was to live serenely, above the world’s swings of passion and material fortune.⁴⁵ For Epicurus happiness derived from life’s sustainable pleasures, such as tranquil peace of the mind.⁴⁶

There have been numbers of other definitions offered over the centuries, however, in essence happiness is

a pervasive sense that life is good. Well-being outlasts yesterday’s moment of elation, today’s buoyant mood, and tomorrow’s hard time; it is an ongoing

⁴⁴ See, for example, s 124 of Australia’s *Corporations Act 2001*.

⁴⁵ David Myers, *The Pursuit of Happiness* (1992) 16.

⁴⁶ *Ibid.*

perception that this time of one's life, or even life as a whole, is fulfilling, meaningful, and pleasant.⁴⁷

B *Why is Happiness Important – Why Promote Happiness?*

1 *As an empirical fact happiness matters most*

There are two levels where the issue of why happiness is important becomes relevant. The first is at the level of personal motivation and desire, it being suggested that happiness is the ultimate aim of mankind. However, what proof is there of this?

Accordingly to Jeremy Bentham, this premise is incapable of proof. For him, it was the ultimate principle, which could not be proved by another principle: 'is it susceptible of any direct proof? It should seem not: for that which is used to prove every thing else, cannot itself be proved: a chain of proofs must have their commencement somewhere'.⁴⁸

Nevertheless, something more beyond the assertion of the premise can be said. The evidence in favour of this premise is the (practical - not logical) incongruity in the assertion that 'I don't want to be happy'. Such a statement normally prompts puzzlement and requires an explanation — far more so than the denial of any other desire. It normally leads to a suspicion that the agent is either confused, irrational or disingenuous. The same degree of suspicion does not attach to a denial of other desires, which are often regarded as being highly pervasive, such as the desire to be wealthy, wise, famous, beautiful, or even healthy.⁴⁹ This observation supports the view that in the end the thing which we desire most is to be happy.

In addition to this, apart from the intrinsic benefit stemming from happiness, there are derivative benefits flowing from this. The benefits of happiness go beyond the psychic sensation. Happy people report less aches and pains and are more energetic, decisive and flexible. They also tolerate more frustration and are less likely to be abusive and more likely to be lenient. They are more forgiving and are good to have around because they are more willing to help those in need.⁵⁰ 'The feel-good, do-good phenomenon' is genuine. Thus, 'human happiness is both an

⁴⁷ Ibid 24.

⁴⁸ Jeremy Bentham, *An Introduction to the Principles of Morals and Legislation*, in J Bowring (ed) *Works* (1843) 2.

⁴⁹ As an empirical fact, many people seem to pursue such interests even at the expense of happiness. Mill explained this on the basis of the doctrine of 'constant association'. There is such a close connection between these pursuits as a *means* to happiness, that many agents in fact confuse them for the ultimate goal.

⁵⁰ See Myers, above n 45, 20–1.

end — better to live fulfilled, with joy — and a means to a better caring and healthy society’.⁵¹

C *Happiness Should be Encouraged: Utilitarianism is the Correct Moral Theory*

While, as an empirical fact, people *want* to be happy there is a separate question: *should* people be encouraged to pursue happiness? This is a normative question, determined according to which moral theory is the most convincing .

Deontological rights based moral theories represent the current orthodoxy in moral discourse. This is due to the immense increase in ‘rights talk’ over the last few decades,⁵² due to common tendency to advance moral claims and arguments in terms of rights.⁵³ Assertion of rights has become the customary means to express our moral sentiments: ‘there is virtually no area of public controversy in which rights are not to be found on at least one side of the question — and generally on both’.⁵⁴ By reason of this emergence of ‘rights talk’ it is now unquestionable that ‘the doctrine of human rights has at least temporarily replaced the doctrine of maximising utilitarianism as the prime philosophical inspiration of political and social reform’.⁵⁵

However, despite the popularity of such rights-based moral theories, we believe that this popularity is far from justified. Such theories are unable to provide coherent answers to questions pertaining to the provenance of rights and their justification (eg, there is no basis for distinguishing between real and imagined rights, or for prioritising rights which clash with one another).⁵⁶ We believe instead that utilitarianism is the soundest normative theory.

Over the years, there have been several different forms of utilitarianism which have been advanced. In our view, the most cogent (and by far the most influential in moral and political discourse) is hedonistic act utilitarianism, which provides that

⁵¹ Ibid.

⁵² By ‘rights talk’, we also include the abundance of declarations, charters, bills, and the like, such as the *Universal Declaration of Human Rights* (1948); the *International Covenant of Economic, Social and Cultural Rights* (1966); and the *European Convention for the Protection of Human Rights and Fundamental Freedoms* (1966), that seek to spell out certain rights. There were numerous declarations, and the like, of rights prior to the Second World War, such as the *Declaration of Independence of the United States* (1776) and the *Declaration of the Rights of Man and Citizens* (1789), however it is only in relatively modern times that such documents have gained widespread recognition.

⁵³ Almost to the point where it is not too far off the mark to propose that the ‘escalation of rights rhetoric is out of control’: L W Sumner, *The Moral Foundation of Rights* (1987) 1.

⁵⁴ Ibid.

⁵⁵ H L A Hart, *Essays in Jurisprudence and Philosophy* (1983) 196–7.

⁵⁶ Ibid.

the morally right action is that which produces the greatest amount of happiness or pleasure and the least amount of pain or unhappiness.⁵⁷ This theory selects the avoidance of pain, and the corollary, the attainment of happiness as the ultimate goals of moral principle.

The argument in favour of utilitarianism as the principal moral theory is as follows:

⁵⁷ Ideal utilitarianism is the theory that in addition to happiness there are other intrinsic goods such as knowledge, love and beauty (see G E Moore, in *Principia Ethica* (Cambridge University Press, Cambridge, 1903) and accordingly we should also attempt to maximise these virtues. Ideal utilitarianism is unstable and ultimately collapses into hedonistic utilitarianism. It is true that we generally pursue virtues such as love, beauty, knowledge, but we do not do so for their own sake. Rather we seek them because they generally tend to generate pleasure. To the extent that we desire other things such as money, power, virtue or fame it is only because they are generally seen to be a means of achieving happiness, but this does not change the derivative attraction of such virtues (see J S Mill, 'Utilitarianism' in M Warnock (ed), *Utilitarianism* (1986, first published 1861) 251, and D Raphael, *Moral Philosophy* (1981) 34-43). The most recent substitution of note, is to define utility in terms of preference or desire satisfaction. The corresponding theory is called preference utilitarianism. Preference utilitarianism is outlined in R M Hare in *Moral Thinking: Its Levels, Methods and Point* (1981) and P Singer, *Practical Ethics* (2nd ed, 1993). Preference utilitarianism does not have the same degree of self-evident appeal as hedonistic utilitarianism. For example, it is unclear why we should seek to maximise desires which make people unhappy. Further, it is impossible to know which act will maximise desire satisfaction, given the overwhelming number of desires which will invariably need to be considered in any particular case. Also it may be argued that our ultimate fundamental desire is generally, if not always, to be happy and hence that preference utilitarianism, too, collapses into hedonistic utilitarianism; or rather, if happiness is defined broadly enough to include fulfilling what one desires (as we believe is the case; see Singer, above, at 14). then there is no conflict between hedonistic and preference utilitarianism (although getting what we want does not always make us happy). A further distinction is made between act utilitarianism and rule utilitarianism. Act utilitarianism is simply the view that the correctness of an action is judged according to the degree of utility that it promotes. Rule utilitarianism is the view that the rightness of an act is assessed by reference to its compliance with rules established to maximise utility. For the rule utilitarian the principle of utility is used as a guide for the rules we should follow, as distinct to the particular actions we should perform. Due to the difficulty in performing the utilitarian calculus necessary to determine which of a number of options we should choose it is claimed that a set of rules guiding us in our decisions would be more likely to achieve the desired goal. The main problem with rule utilitarianism is that it is inevitable that in complying with the rules there will be occasions when happiness will not be maximised. To refuse to break the rule in such circumstances constitutes 'rule-worship' (see J C C Smart, 'An Outline of a System of Utilitarian Ethics' in J C C Smart and B Williams (eds), *Utilitarianism: For and Against* (10). It is no answer that in most cases it is beneficial to comply with the rule, otherwise we are putting the rule above its justification. If we do break the rule, we are still being guided by the ultimate principle: act utilitarianism; and rule utilitarianism has nothing distinctive to offer.

- P1 Morality is the ultimate set of principles by which we should live.
 P2 Morality consists of the principles which dictate how serious conflict should be resolved.
 P3 We all value and our strongest desire is to be happy.
 P4 The ultimate principle governing our conduct should promote our ultimate aim.
 P5 The ultimate principle must apply equally to all of us.
 C Therefore, the aim of morality is to maximise happiness.

While this is a rather cursory justification for the elevation of utilitarianism as the primary moral theory, it does serve to illustrate that there is a tenable argument for the view that happiness not only matters most, but that people should also be encouraged to pursue happiness.

For non-utilitarians it is important to emphasise that there is no reason to resist the pursuit of personal happiness simply because there are no tenable moral theories urging people to forego the pursuit of personal happiness. In any event, as a matter of psychological reality, this would be self-defeating: a moral theory which fails to reflect our ultimate desire (to be happy) would very quickly become redundant. This view could be challenged on the grounds that morality is normative, not descriptive in nature: an ‘ought’ cannot be derived from an ‘is’,⁵⁸ and hence the fact that we desire happiness does not entail that we should desire it. However, the principle that each person should do that which makes them happy does not encapsulate the moral theory we are advancing; rather, in our view it is important that any moral theory does not impinge on our ultimate desire which is to be happy.

D *The Argument Morality has no Role in Business*

It could be argued that happiness (and in fact moral discourse in its entirety) is not relevant to corporate activity because there is a fundamental discord between business and morality. Broadly, there are three different theories that have been postulated seeking to limit the application of moral principle to business practice. First, it has been suggested that the relationship is one of independence — ethics has no role in business. Secondly, it has argued that it is harmonious — the pursuit of profits and ethics are viewed as mutually supportive goals. Finally, it has been urged that the pursuit of profit trumps moral principle. We consider the theories in that order.

⁵⁸ This has been used as an argument against a naturalistic view of morality. However, see C R Pigden, ‘Naturalism’ in P Singer (ed), *A Companion to Ethics* (1991) 421, 422–6, where he points that this phenomenon simply reflects the conservative nature of logic - you cannot get out of it, what you do not put in.

1 *The Independence Thesis*

1.1 *The Universalisability of Moral Judgments*

The surface nature of moral language suggests that moral principle is applicable to all human conduct, whether public or private,⁵⁹ and provides the ultimate evaluative framework by which our behaviour is judged. The notion of contracting out of morality seems untenable. A key feature of moral judgments is that they are universalisable. A judgment is universalisable if the acceptance of it in a particular situation entails that one is logically committed to accepting the same judgment in all other similar situations. Accordingly, whenever one judges a certain action or thing (situation) as having a particular moral status then one is logically committed to the same judgment about any relevantly similar action or situation.⁶⁰ If an action is morally good or bad, then it is so in all *relevantly* similar situations in which that action is performed. The context in which an action is performed does not appear to constitute a relevant difference. Deliberately lying to another person is wrong irrespective of whether it is done in private or in the context of sport, politics or other fields of human endeavour. So too, it would seem to appear, in the case of (corporate) business activities. In order to justify the independence thesis, it is necessary to identify a *relevant* difference between business activities and other activities which are subject to moral evaluation.

1.2 *Exception to Universalisation – Activities with Internal Settled Rules?*

A possible basis for distinguishing business from most other human endeavours — which are clearly subject to moral evaluation — is that business is a ‘self contained’ activity. That is, it is already governed by relatively settled and clear principles and standards. Moral rules appear to apply most acutely to govern conduct between private individuals, which is largely unregulated by other norms. Thus, it is morally reprehensible to lie, break promises or cheat on our partners, and so on.

Business on the other hand has its own settled rules, and hence, it can be argued, there is no scope for morally evaluating activities conducted within the scope of business. The boxer who intentionally injures his opponent is immune from moral blame, even though his conduct would be clearly reprehensible if performed in a different setting. Corporate and business activities are regulated by extensive and

⁵⁹ For the difference between particular and public reasons, see S Freeman, ‘Contractualism, Moral Motivation & Practical Reason’ (1987) 88 *Journal of Philosophy* 281–304.

⁶⁰ It has been suggested that numerical differences are irrelevant. This refers to specific descriptions of the person, relation or situation. Thus, the fact that the judgment relates to a particular person (such as John Smith), place (such as Melbourne), relation (John’s mother) is irrelevant. Also irrelevant are generic differences: tastes, preferences, and desires: see J L Mackie, *Ethics: Inventing Right and Wrong* (1977) 83–102.

complex legal rules and principles. Hence, just like boxing, the activities performed by corporations should not be immune from moral evaluation.

This attempt to excise corporations and business from the sphere of moral evaluation, fails because it places too much weight on the importance of the existence of established rules. The level of sophistication, organisation or system that underlies an area of human endeavour is generally irrelevant to its amenability to moral evaluation. This is shown by the fact that activities which produce undesirable outcomes, such as drug trafficking, people smuggling and child pornography do not attract moral immunity irrespective of their level of internal regulation and organisation.

There certainly may be instances where following the rules of an existing rule governed practice may provide a general immunity from moral blame. Tackling another player in conformity with the rules of soccer, refusing to pass a weak student, serving the first person in queue are all perfectly justifiable actions. However, this has nothing to do with the fact forms of conduct are regulated by rules (of sport, academia and etiquette respectively), but rather because the rules themselves have either been designed in light of pre-existing moral norms or at least are not morally objectionable in themselves. Similarly, the only reason that boxing is morally acceptable is because the good consequences from it outweigh the bad — the need to respect the autonomy of the boxers weighs more heavily in the moral calculus than the possible harm that might occur as a result of condoning fighting in a controlled environment.

Further, those involved in generally non-offensive rule governed activities never acquire an *absolute* indemnity from moral censure. For example, it is reprehensible for organisers of a boxing context to pit a professional skilled fighter against a rank amateur or for a referee to permit a fight to continue after one boxer has been clearly rendered defenceless. Hence, even in relation to rule governed practices which are generally regarded as being morally acceptable, moral norms continue to play a supervisory role. This role is so cardinal that morality remains a constant catalyst for rule changes to the practices — to ensure that they continue to conform to changing, more enlightened, moral standards. A good example is racial vilification in sport. For decades, it was deemed acceptable to make racist slurs to rivals on the sporting field — it did not violate any of the rules of the game. However, more recently the community has become less tolerant to such abuse. This changed community normative standard is now firmly entrenched in the rules of many sports.

It follows that the mere fact that corporations and business has well settled rules, procedures and protocols for all aspects of their activities does not provide them with immunity from moral norms. The important question is whether corporations conform to minimal moral standards.

1.3 *The Subjective and Imprecise Nature of Moral Judgments*

A further rationale that has been advanced for the independence thesis is that morality has no role in business because it is too subjective and, given its indeterminate nature, is incapable of providing guidance concerning business practice.⁶¹ To this, there are three counters. First, one of us has previously argued that moral principles are in fact objective, capable of logical proof.⁶² The mere fact that it is sometimes *difficult* to find moral answers, does not derogate from this — in the same way that difficulties in finding cures for many physical illnesses does not mean that there are not necessarily better forms of treatments.

Secondly, for sceptics who are unconvinced about the objectivity of moral judgments, even if we accept that moral judgements are by their very nature imprecise and often indeterminate, this has not limited their application to other human endeavours and activities, such as politics, law, or even sport. Why then should the situation be any different in the case of corporate business activities?

Thirdly, the fact that the moral status of an activity has not been resolved and the application of moral principles to it has not produced clear standards of conduct pertaining to that activity, generally results in increased moral reflection and assessment upon the matter, rather than an abandonment of such discourse. For example, the fact that activities such as abortion and cloning are morally equivocal has proved a catalyst for further moral dialogue and debate on such issues — not less, or none at all.

Accordingly, since there is no relevant difference between corporate and business activities and other activities which are regulated by moral principles, the independence thesis is unsound. We now examine the second basis upon which it has been contended that morality has only a limited role in business — the harmony thesis.

E *The Harmony Thesis*

The harmony thesis also provides that business should not be regulated by moral principles. It differs from the independence thesis because it claims that the reason for this is not because the two goals are incompatible, but rather because they overlap. Although the goals are very different in their content, it is argued that the pursuit of one will promote the other. Thus, the claim is that the most successful businesses are those which adopt moral practices and vice versa — the best way for businesses to maximise moral good is to maximise profit.

⁶¹ Friedman, above n 6, 1.

⁶² M Bagaric, 'A Utilitarian Argument: Laying the Foundation for a Coherent System of Law' (2001) 10 *Otago Law Review* 163; M Bagaric, 'Internalism and the Part-time Moralists: An Essay About the Objectivity of Moral Judgments' (2001) 2(2) *Journal of Consciousness and Emotion* 255.

1 Only ethical businesses make money?

There are three arguments that can be offered in support of the harmony thesis. As is alluded to above, the first is simply the view that ethical business practices are most likely to maximise profits. Although the cutting of corners and failure to observe moral principles by corporations may have short-term benefits, eventually businesses engaging in such conduct will fail. The argument is that consumers will invariably become aware of the immoral practices of the corporation, and exact vengeance in the form of either refusing to buy goods or services from such businesses or, in some cases, taking legal action against them. A case in point being the huge legal payouts that have recently been awarded against tobacco companies in the United States.

However, such an argument is unacceptable. Morally unsound business activities only result in long term loss of profits where the consumers are in a position to affect the profitability of such businesses. However quite often this is not the case because consumers may never become aware of the offensive practices. For example, fragrance lovers may be unaware of cruel animal testing conducted by perfume manufacturers. Other consumers may not be in a position to take remedial action, such as legal action, against the business due to insufficient financial means or lack of standing — for example, where an unsafe product impacts upon future generations⁶³ or people in third world nations. Thus there is no necessary link between profit and ethical business practice.

The credibility of this argument in support of the harmony thesis is further undermined by the fact that it has no operation in cases where the goods or service in question is an essential commodity (such as water or electricity services) over which there exists a monopoly or control by a conglomerate. In such circumstances, consumers are deprived of a realistic choice but to trade with the business.

2 Difficulty in attaining good moral results — the competence argument

The difficulty involved in determining which business measures should be implemented in order to achieve the best social results is another reason that has been advanced in support of the harmony thesis.⁶⁴ Rather than directly aspiring to achieve moral good, it has been argued that, corporate officers should pursue more concrete and attainable objectives, which experience has shown generally serve to advance such goals. If we directly seek to achieve the morally best results we would be bound to fail because moral concepts and requirements are too imprecise. It would be far better if one is not distracted by such inexact pursuits and focused on the attainment of goals such as profit making, which experience has shown will generally advance human flourishing. Further, corporate officers have no expertise

⁶³ K Arrow, 'Social Responsibility & Economic Efficiency' (1973) 21 *Public Policy*.

⁶⁴ As we saw earlier, it has also been used to support the independence thesis.

or competence in social policy; they should do what they know best: make money.⁶⁵ Thus in effect, it is suggested that we should adopt a type of rule utilitarian methodology in a bid to achieve morally desirable ends — where the ultimate goal is morally sound outcomes and the suggested means for achieving this is corporate profit. This rationale, however, takes the harmony thesis only so far.

[The competence argument] makes sense only insofar as corporations undertake social engineering projects that are indeed beyond their abilities; but does it require special skills or advanced knowledge to be concerned about discriminatory hiring or promotion practices within your own company or the devastating effects of your waste products on the surrounding countryside?⁶⁶

Further, a rule that prescribes that businesses should be profit driven because this is the best means of producing morally desirable outcomes, is at its highest a rule of thumb. Where there is a clear conflict between making money and an important moral principle the former must presumably yield. The harmony thesis in this form cannot justify, for example, the sale of unsafe products or deliberately misleading consumers regarding the essential attributes of a product. Ultimately, in such circumstances we see that morality still comes up trumps.

3 *Promise to shareholders to maximise profits*

A third possible justification for the harmony thesis is that businesses ‘owe’ it to their shareholders and investors to make profit maximisation the cardinal objective.⁶⁷ ‘Owe’ in this context is used in a normative sense, inferring that investors and shareholders invest in business in the reasonable expectation that they will be profit focused and hence it would be morally reprehensible for businesses to act contrary to this — it would violate the moral prescription that one should keep their promises. This argument fails for several reasons.

First, few investors who put their finances into a business receive an express promise that their funds will be only used to maximise profit.⁶⁸ It could be claimed that although investors do not receive an express promise as to the manner in which their funds will be used, there is widespread knowledge in the community that the sole aim of business is to maximise profit and hence there is at least a tacit promise to this end. However, even if businesses did promise to investors to use the funds solely to advance profit, this does not justify the harmony thesis. Promise keeping is not the highest order moral requirement. It is undoubtedly morally permissible and necessary to break a promise where keeping it would result in significant harm to another person. For example, there is no question that it is appropriate to break a

⁶⁵ Friedman, above n 6; P Drucker, *Management* (1970).

⁶⁶ R C Solomon, ‘Business Ethics’ in Singer, above n 58, 354, 360.

⁶⁷ Friedman, above n 6.

⁶⁸ C Stone, *Where the Law Ends: The Social Control of Corporate Behaviour* (1975).

promise to meet a friend or colleague in order to attend to an emergency. Business, too, would be justified in breaking a ‘profit promise’ to shareholders where keeping the promise would violate higher order moral virtues.

In order to get at least some mileage out of the ‘promise to shareholder argument’, it could be contended that while the existence of a promise does not absolutely justify the harmony thesis, it goes at least a partial way to doing so by providing a prima facie reason why profit maximisation should be the main business goal.

However, even this less ambitious form of the argument fails. It is not true that one always has even a prima facie obligation to uphold a promise. The content of a promise can often affect the reason for keeping it.⁶⁹ Implicit in the words ‘prima facie’ is the notion that the act it relates to should be done *unless* there are other more compelling considerations. If even in the absence of other more compelling considerations, the act still should not be performed, due to its abhorrent nature, then the use of the term ‘prima facie’ is not only redundant, but also incorrect. Thus, a corporate officer would not have an obligation to approve the sale of dangerous goods, no matter how profitable the arrangement was to the corporation.

F *Business Principles Override Moral Principles*

Finally, it could be suggested that business principles override moral principles. This is the least tenable explanation of the relationship between morality and business. It flies in the face of a fundamental aspect of moral practice and discourse. As a definitional matter, morality consists of the ultimate set of principles by which we should live and sets out the principles which dictate how important human issues should be resolved. Moral judgments are capable of trumping all other types of principles. It is a settled social convention that moral prescriptions can be invoked to justify breaches of all other types of standards and rules; whether they relate to norms of sport, politics, etiquette or even law. Thus, we do not condemn the politician who disregards party policy and casts a conscience vote, and many people are even prepared to excuse the murderer who commits the offence out of compassion for another.⁷⁰

There is simply no reason that the practice of providing goods or services for the purpose of making a profit should override morality. Like all practices, it can be carried on in a productive or harmful manner. As we have seen, the internal content of such an activity could be so repugnant that not only is it not appropriate that the

⁶⁹ C L Ten, ‘Moral Rights & Duties in a Wicked Legal System’, *Utilitas* (1989) 139.

⁷⁰ Opinion polls indicate that most people are firmly in favour of euthanasia. Recent polls in the United Kingdom, the United States and Canada show approval rates for euthanasia of 78 per cent, 68 per cent, and 78 per cent respectively (Legislative Assembly of the Northern Territory of Australia, *Report of the Inquiry by the Select Committee on Euthanasia: The Right of the Individual or the Common Good?* (1995) vol 1, 50–1).

ultimate norm or standard of the activity should be the pursuit of profit, but rather it is not appropriate that the activity should be allowed to operate at all. If a business is involved in the provision of such services as slavery, drugs or child pornography then the fact it will promote material prosperity is irrelevant. Labelling an activity a 'business' does not give it an immunity from moral evaluation.

The dominance of morality over business is further evidenced by the fact that when it is accepted that a certain state of affairs would promote the moral good, it is not a relevant question to then ask whether we should strive to attain that state of affairs — of course we should. One does not need a further justification for attempting to implement that state of affairs. This is not so in the case of making a profit. Even if we accept that a certain activity will make a dollar, this does not necessarily mean that we should condone it. The activity might be drug trafficking, dumping dangerous waste or selling contaminated food. In such circumstances there is always logically a further question which we must ask: does the money making activity violate a moral norm?

1 Summary of the general link between business and ethics

In all other areas of life, moral principles are the ultimate standards by which we evaluate and assess activities and actions. Business is a label, describing one of many types of human activities. Irrespective of how desirable an activity is felt to be the universalisability and pervasiveness of morality is such that it applies to properly regulate the actions performed within the relevant activity. This is so even in relation to practices such as medicine or charitable services.

The fact that corporate activities are not different in any relevant sense from the range of activities to which moral principles are applicable shows that they too are caught within the sphere of moral evaluation. As such, moral principles are the ultimate evaluative standard of business conduct and should prevail where there is tension between them and business principles.

G What Makes People Happy?

Given that morality and happiness do and should matter most, the next issue, is what actually makes people happy? A central, and indeed crucial, component of our society is that people express and project themselves in vastly different ways, by pursuing an infinite range of activities (ranging from protesting against corporations, to buying and selling shares in these corporations). We have different passions, goals, desires and therefore ultimately different means and perceptions of happiness. Thus it could be contended that happiness is simply too vague an ideal to be used as the basis for guiding and shaping the development of legal and social policy. However, it is important to understand that the different ways in which we go about living our lives is not as different as what first appears: these ways are, in

the words of Aristotle, simply a ‘means’ to an ‘end’— the end being the fulfilment of what makes us happy.⁷¹

Similarly, Tim Kasser in *The High Price of Materialism* (discussed in more detail below) refers to the way in which we each go about expressing and satisfying our needs — those needs central to the fulfilment of happiness — in different ways. According to Kasser:

Although needs provide a basic motivation to do something, they do not tell us exactly how to satisfy them. The way needs express themselves and the extent to which they are satisfied depend on a number of factors, including our personality, lifestyle, values, and the culture in which we live. For example, if I am hungry, my need for sustenance motivates me to eat. The way that I satisfy this need will vary depending on my personal tastes and on my environment. If I like sweet foods, I might seek out an orange or some candy; if I like salty foods, I might prefer pretzels or potato chips; if I live in Japan, I might eat sushi; if I live in Lebanon, I will be likely to eat hummus. Personality and societal context provide frameworks for need expression and satisfaction by suggesting particular pathways and behaviours we might follow.⁷²

And, moreover, as recent empirical studies have shown, not only do we each place the fulfilment of personal happiness as our ultimate objective, but what actually makes each of us happy is essentially the same.

H *The Pursuit of Happiness*

In one of the most interesting and important books of the late 20th century, *The Pursuit of Happiness*, David Myers draws together the results of hundreds of surveys from across the world on human happiness to try and piece together some common variables about what make people happy.

1 *Representative sampling*

The methodology used in the surveys reported in David Myers’ book is the same as that adopted in relation to most scientific experiments: a hypothesis is developed and is then tested through experimentation involving a representative and a

⁷¹ In ‘Utilitarianism’, J S Mill also explained that the reason why we pursue different activities is connected with our overriding objective of personal happiness. According to Mill, emphasising the importance of happiness is not to deny that human beings pursue more specific goals such as knowledge or artistic and cultural activity or moral goodness, and that they pursue these things for their own sake. These are some of the “ingredients” which go to make up a life of happiness.

⁷² Tim Kasser, *The High Price of Materialism* (2002) 25–6.

statistically significant number of respondents.⁷³ This method is far more accurate than haphazard sampling.⁷⁴

To ascertain people's sense of well-being, people were asked to report their feelings of happiness or unhappiness along with their thoughts of how satisfying their lives were⁷⁵ — the results were that people who feel happy also think their lives are satisfying. Sometimes this was probed according to a single measure, on other occasions researchers probed with multi-item measures. One method which was used to gauge the impact of suspected variables on happiness was to give two equivalent groups an experience that differed only in that factor. Thus, in order to determine if people are happier by finding money, people were randomly assigned to either experience or not experience this factor.⁷⁶

In terms of how happiness is tested, happiness is obviously a state of mind and the ultimate and only judge is the individual. If you feel happy, you are happy. Despite this, there is obviously the problem that people may be disingenuous in their self reports of happiness. And indeed, there is a distinct tendency for people to over-report good feelings.⁷⁷ However, this does not undermine the accuracy of the studies. This is because happiness is a relative concept:

To discover who is happiest, and why, we need only assume that those who say they are 'very happy' or 'completely satisfied' do experience greater well-being than those who say they are unhappy or dissatisfied.⁷⁸

2 *Eliminating distorting variables*

Another possible bias in the results is the momentary moods of people. This does not, however, impugn the validity of the results, for two reasons. First, people tend to attribute judgements of well-being to their overall situation as opposed to transient feelings. It is noteworthy that the happiness level of people is remarkably consistent over their lifetime. Secondly, people experience both good and bad transient mood altering experiences. Thus, to the extent these experiences impact on subjective feelings of well-being they will in a properly selected sample of people cancel each other out in terms of the overall result. Further, when comparing across samples each sample will have approximately equal numbers of people in good and bad moods at the time of the respective studies. It follows that the same empirical techniques that have been used to test scientific truths apply here. Therefore, according to the authors, the findings are as equally valid as other

⁷³ In this regard he noted that 1,500 randomly sampled people provides an accurate snapshot of 100 million people, at *Ibid*, 17.

⁷⁴ See Myers, above n 45, 17.

⁷⁵ *Ibid* 24.

⁷⁶ *Ibid* 18–9.

⁷⁷ *Ibid* 27.

⁷⁸ *Ibid* 28.

findings which are more readily believed and relied on — including medical and biological findings.

As noted below, apart from the work of Myers, there has been an explosion in empirical studies in recent years about what makes people happy, meaning that ‘happiness’ is increasingly becoming a scientific rather than a theoretical concept. The overriding pursuit of happiness is now a psychological truism rather than a ‘heady’ aspirational objective. Furthermore, there is now a dedicated international journal, the *Journal of Happiness Studies* which is devoted to articles based on empirical studies of what makes people happy (or indeed unhappy). The study of happiness is thus becoming a discipline in itself, and one with great practical relevance for a number of other disciplines including law.

This development is very powerful, particularly when the practical application and pursuit of happiness in professional disciplines has never really taken off or been taken seriously, mainly because of the preconception that happiness cannot be defined. Now that empirical studies have highlighted that happiness is capable of being defined, the implications — in terms of influencing public policy and the development of the law — are potentially enormous. First, it is necessary to outline the results derived from the empirical studies as to what makes people happy.

I *Results of Empirical Studies on Happiness and Well-Being*

I *The disassociation between money and happiness*

Empirical studies that have been conducted on the link between levels of wealth and happiness have consistently shown that there is only a modest connection between wealth and happiness. Indeed, based on studies conducted by Ronald Inglehart, there is a much stronger connection between democracy and happiness as there is between wealth and happiness. From representative samples of around 170,000 people from a number of different countries, Inglehart concluded that there were rather significant national differences in the levels of happiness experienced by people.⁷⁹ For example, year after year, the Danes, Irish and Dutch were happier and more satisfied with life than the French, Greeks and Italians. From these studies, one point made by Inglehart was that a nation’s well-being correlated only modestly with national affluence. In interpreting these results in his book, David Myers stated that:

Moreover, the surveyed nations differ in ways other than affluence, making it hard to disentangle cause and effect. For one thing, the most prosperous nations have enjoyed stable democratic governments, and there is a striking link between a history of stable democracy and national well-being. The thirteen nations that have maintained democratic institutions continuously

⁷⁹ Ronald Inglehart, *Culture Shift in Advanced Industrial Society* (1990).

since 1920 all enjoy higher life satisfaction levels than do the nations whose democracies developed after World War II or have not yet fully emerged.⁸⁰

Thus, across countries there is not a strong link between happiness and wealth. Similar results emerge within countries. It is not the case that within any country that the happiest people are the rich. Again in his book Myers, citing a University of Michigan survey, notes that what matters more than *absolute* wealth is *perceived* wealth.

Money is two steps removed from happiness. Actual income doesn't much influence happiness; how satisfied we are with our income does. If we're content with our income, regardless of how much it is, we're likely to be happy. Strangely, however, there is only a slight tendency for people who make lots of money to be more satisfied with what they make. It's true: satisfaction isn't so much getting what you want as wanting what you have.⁸¹

Myers further points to a wide-ranging survey of the happiness levels of Americans from 1955 to 1990 during which time wealth (measured as purchasing power) doubled, the study noting that there was no increase in the happiness levels of respondents. This led Myers to conclude:

So, whether we base our conclusions on self-reported happiness, rates of depression, or teen problems, our becoming better off over the past thirty years has not been accompanied by one iota of increased happiness or life satisfaction... Once beyond poverty, further economic growth does not appreciably improve human moral.⁸²

It seems that 'if not wracked by hunger or hurt, people at all income levels can enjoy one another and experience comparable joy'.⁸³

This, however, has not curtailed the growth in materialism. In a survey by the American Council of Education of over 200,000 students entering college the portion agreeing that an important reason for their going to college was 'to make more money' increased from approximately 50 per cent in 1970 to nearly 75 per cent in 1990. The portion of students who considered it very important or essential that they become 'very well off financially' increased from 39 per cent in 1970 to 74 per cent in 1990. This correlated with a similar change on those who aspired to 'develop a meaningful philosophical life', which dropped from 76 to 43 per cent during the same period.⁸⁴

⁸⁰ Myers, above n 45, 36.

⁸¹ Ibid 39.

⁸² Ibid 43-4

⁸³ Ibid 39.

⁸⁴ Ibid 32.

2 *The benefit of wealth continues to be overestimated*

Further, people continue to overestimate the effect that having more money has on happiness levels. As Myers states:

With each raise the extra money soon ceased to be extra, the new luxuries soon lost their luxurious feeling. So it goes as the treadmill elevates to incomes of over a hundred thousand dollars. At lower incomes people think that with more money they'd be happier and more generous. But seldom is this so. Indeed, a recent Gallup poll offered the astonishing result that people with incomes of under ten thousand dollars give 5.5 per cent to charity, and those earning fifty to sixty thousand give a stingier 1.7 percent.⁸⁵

That wealth does not result in happiness is a fact recognised by those who are extremely wealthy. As reported by Myers in his book, a survey of 41 of the wealthiest Americans listed by Forbes Magazine, found them to be only slightly happier than average.

Wealth, after all, brings prestige, more choice of activities such as travel, and opportunities to satisfy one's desire to help others and change the world. Still, four in five of these people, all with net worths well over \$100 million, agreed that "money can increase or decrease happiness, depending on how it is used".⁸⁶

3 *Relative wealth impacts on happiness*

Another interesting finding recorded by Myers is that happiness is largely determined according to the attainment of others: we feel good or bad depending on whom we compare ourselves to.⁸⁷

Happiness shrivels with the gap between what we have and what we want, what we have and what we expected to have by now, what we have and what our neighbours have.⁸⁸

This explains the reason that happiness increases when a person escapes poverty, but societies do not become happier as they progress from relative poverty to affluence.⁸⁹

This disassociation between wealth and happiness was confirmed in an equally significant book by Tim Kasser. Tim Kasser's *The High Price of Materialism*,

⁸⁵ Ibid 53.

⁸⁶ Ibid 40.

⁸⁷ Ibid 56.

⁸⁸ Ibid 57.

⁸⁹ Ibid 56.

published in 2002,⁹⁰ provides the most useful scientific explanation to date as to why personal well-being is not connected to the accumulation of wealth, but rather depends on basic core needs — what Kasser refers to as ‘psychological needs’. Kasser’s book contains a series of empirical studies, both clinical and laboratory that he and his colleagues conducted, as well as by other psychologists and social scientists, from countries around the globe. Importantly, the population samples in the studies included preschoolers, college students and adults from all around the world.

4 The pursuit of wealth in fact is inimical to happiness — the negative effects of materialism

Kasser’s study not only confirms previous studies in the area which have shown that beyond satisfying basic needs (such as food, shelter and clothing), further material wealth has very little impact on our happiness and well-being, but shows that people who focus on the accumulation of wealth and material possessions are actually *more likely to be unhappy*, and will experience anxiety, depression, low self-esteem and other problems. Thus, there is in fact a negative correlation between wealth and happiness.

A key point made by Kasser in his book is that materialistic values are counter-productive, as over time they actually increase insecurity which is one of the primary causes of unhappiness.

Desires to have more and more material goods drive us into an ever more frantic pace of life. Not only must we work harder, but, once possessing the goods, we have to maintain, upgrade, replace, insure, and constantly manage them. Thus, in the journey of life, materialists end up carrying an ever-heavier load, one that expends the energy necessary for living, loving, and learning—the really satisfying aspects of that journey. Thus materialism, although promoting happiness, actually creates strain and stress.⁹¹

He further notes:

In recent years, scientific investigators working in a variety of fields have begun to tally the cost of a materialistic lifestyle. Although the body of empirical literature on materialism is not large, especially compared with what we know about topics such as depression, stereotyping, neurons, and memory, its findings are quite consistent. Indeed, what stands out across the studies is a simple fact: people who strongly value the pursuit of wealth and possessions report lower psychological well-being than those who are less concerned with such aims.

⁹⁰ See Kasser, above n 72.

⁹¹ *Ibid.*, xi.

In his book, Kasser points out that a number of other investigators studying materialism, from around the world, have reached exactly the same conclusion as he did: that materialistic values are associated with low as opposed to high well-being.⁹² Kasser refers, for example, to an Australian study by Shaun Saunders and Don Munro that found that strong materialistic values in a group of Australian students was associated with increased feelings of anger, anxiety, and depression, and with decreased life satisfaction. Kasser goes on to state:

What happens to the quality of our lives when we value materialism? The answer, as we have seen from the studies described is, ‘The more materialistic values are at the center of our lives, the more our quality of life is diminished’. In samples of adolescents, college students, and adults, with various means of measuring materialistic values and well-being, results show a clear pattern of psychological (and physical) difficulties associated with holding wealth, popularity, and image as relatively important.⁹³

Perhaps the best illustration of this negative correlation between happiness and wealth creation comes from a study of lottery winners by Philip Brickman, which Kasser refers to in his book.⁹⁴ In this study, 22 individuals who had recently won large amounts of money in the Illinois state lottery were compared with a group of people who lived near the recently rich individuals. All study participants were asked about their general happiness and how much pleasure they derived from everyday experiences (for example, talking with a friend, eating breakfast, hearing a funny joke). The happiness of lottery winners was no different from that of people who had not experienced a large increase in their wealth, and the lottery winners actually reported being *less* pleased with everyday events.

5 *The explanation for the growth in materialism*

Kasser writes that materialism as a value can quickly lose its persuasiveness when it is shown that materialism is really a coping mechanism to respond to insecurity (caused by non-nurturing parents, anxiety, poverty etc), but which in the long-term leaves people feeling more insecure. According to Kasser:

My understanding of the connection among insecurity, a materialistic value orientation, and well-being is that sometimes people experience circumstances (non-nurturing parents, poverty, death anxiety) that lead them to feel insecure. This causes unhappiness and dissatisfaction, as security needs must be satisfied for good psychological health. At the same time, insecurity also makes it likely that people will pursue materialistic aims, as both inner predispositions and external consumer culture suggest that resources can purchase security. Thus, materialistic values are both a symptom of an

⁹² Ibid 21.

⁹³ Ibid 14.

⁹⁴ Ibid 44.

underlying insecurity and a coping strategy taken on in an attempt to alleviate problems and satisfy needs.⁹⁵

Kasser refers to two recent studies (one studying the dreams of proven materialistic people, the other studying whether talk of death sparked materialistic tendencies) which provide support for the idea that insecurity drives people to focus on materialistic goals, even if they may not consciously admit to such motivational underpinnings. This is what Kasser refers to as 'nonconscious processes'.⁹⁶

Happiness scientists also explain the quest for materialism as demonstrating our capacity for 'miswanting'. Daniel Gilbert of Harvard University's psychology department, working with a team including psychologist Tim Watson and Nobel laureate in economics, Daniel Kahneman, found from their study that our work in acquiring material

'things' – such as homes, children, careers and wealth – is all based on how happy we predict they will make us. However, we overestimate the intensity of the happiness that these things bring, due to underestimating our capacity to adjust. For example, the new BMW will probably make us happy for a couple of weeks, or even months, but within about six months it will have become like wallpaper in our lives: there, but no longer able to provide the charge of joy it gave us initially.⁹⁷

6 *The things that do make people happy*

So then what does make people happy? From the work compiled by Myers and Kasser, among others, we can now say that there are indeed *common ingredients* in terms of what makes each of us happy.

6.1 *Participation*

From studies reported by Myers in *The Pursuit of Happiness*, it has been found that people function best in circumstances of democracy and personal freedom. This is because involvement and a sense of contribution and control over the activities that impact on one's life are key factors in generating a sense of well-being among individuals. The connection between participation, control and happiness manifests in many sorts of domains: 'study after study finds that when workers have more control — when they can help define their own goals and hours and when they can participate in decision making — their job satisfaction rises'.⁹⁸ In a slightly different context, a study by Judith Rodin, encouraging nursing home patients to

⁹⁵ Ibid 42.

⁹⁶ Ibid 37.

⁹⁷ See Julie Macken, 'The Hunt for Happiness', *The Australian Financial Review* (Sydney), 24 October 2003.

⁹⁸ Myers, above n 45, 130.

contribute more to the policies determining their environment in the nursing home, found that ninety three per cent became more alert, active and happy.⁹⁹ Myers notes that ‘similar results have been obtained after allowing prisoners to move chairs and control the room lights and the TV’.¹⁰⁰ Another interesting point to emerge is that the more developed the institutions of direct democracy, the happier the individuals are, irrespective of the outcome of the democratic process.¹⁰¹

6.2 Pursuing projects and goals

People need to be given the opportunity to actively pursue projects. The more challenged a person is, whether by a job, hobby or sport, the happier he or she is likely to be.¹⁰² To this extent, happiness is best generated from intellectual and physical challenges, not mindless passivity — such as watching television. Studies have found that in general ‘the less expensive (and generally more involving) a leisure activity, the happier people are doing it. Most people are happier gardening than power boating, talking to a friend than watching TV’.¹⁰³ One proviso to this is that while work can be a source of satisfaction, it should not be over done. Regular periods of relaxation are conducive to happiness.¹⁰⁴

6.3 Close personal connections are important

Close friendships are also important to health and happiness.¹⁰⁵ Moreover, married people are normally happier than singles.¹⁰⁶ More generally, individualist societies are less collectively happy than communal societies. Being deprived of familiar attachments prompts a sense of meaninglessness. According to Myers:

People in competitive, individualist cultures such as the United States, have more independence, make more money, take more pride in personal achievements, are less geographically bound near elderly parents, are less likely to prejudge those outside their groups, and enjoy more privacy. ... But compared to collectivists, individualists are also lonelier, more alienated, less

⁹⁹ Judith Roden, ‘Aging and Health: Effect of the Sense of Control’ (1986) 233 *Science* 1271.

¹⁰⁰ Myers, above n 45, 115.

¹⁰¹ Bruno Frey and Alois Stutzer, ‘Happiness Prospers in Democracy’ (2000) 1 *Journal of Happiness Studies* 79.

¹⁰² The study was conducted by Professor M Argyle. One quirky result was that people who watch television soaps were happier than those who did not, but watching lots of soaps was counter-productive to happiness. See T Reid, ‘Some Research That May Bring You a Degree of Happiness’ *The Age* (Melbourne), 6 October 1998.

¹⁰³ Myers, above n 45, 137

¹⁰⁴ Ibid 139.

¹⁰⁵ Ibid 144.

¹⁰⁶ Ibid, Ch 9.

likely to feel romantic love, more likely to divorce, more homicidal, and more vulnerable to stress related diseases.¹⁰⁷

Thus in a nutshell the things that are conducive to happiness are fit and healthy bodies, realistic goals, self-esteem, optimism, an outgoing personality, a sense of control, close relationships, challenging work and active leisure, punctuated by adequate rest and a faith that entails communal support, purpose and acceptance. The overriding myth about happiness is that it can be bought with money — just like any other commodity.

7 *Kasser's 'psychological needs'*

Kasser forms similar conclusions regarding the things that are necessary for happiness- as well as those that aren't. In *The High Price of Materialism*, Kasser states that there are four sets of 'psychological needs' that are necessary for the motivation, functioning and well-being of all humans: (1) **safety, security and sustenance** — the human desire to remain alive and avoid early death — as well as have a roof over our heads, food on the table, and clothing to protect us (ie 'the essentials of life'); (2) **competence, efficacy and self-esteem** — this involves a feeling that we are capable of doing what we set out to do and of obtaining the things we value. Competence and esteem needs also entail a desire to have a more positive than negative view of ourselves and to like ourselves. In essence, to fulfil these needs each of us must feel like a competent and worthy person (3) **connectedness** — the human desire for intimacy and closeness with others; these needs lead us to belong to larger groups, such as churches, neighbourhood organisations, and teams; and (4) **autonomy and authenticity** — a desire for freedom to act on one's own and to have a feeling that one is self-directed, rather than feeling pressured or burdened by our circumstances, we need to pursue activities that provide us with challenge, interest and enjoyment (similar to what Myers said were the virtues of participation and pursuing challenging projects). By doing so, we can feel ownership of our own behaviour, and thus feel both authentic and autonomous.¹⁰⁸

This focus on 'psychological needs' rather than materialistic pursuit as the cause of happiness accords with the views of J S Mill in the seminal work 'Utilitarianism'. According to Mill, human beings, because of the distinctively human capacities they possess, require more to make them happy than the accumulation of plausible sensations. They are made happy not by 'lower pleasures', but by the 'higher pleasures' — the pleasures of the intellect, of the feelings and imagination, and of

¹⁰⁷ Ibid, 147–8.

¹⁰⁸ Kasser, above n 72, 24–5. See Kofi Ankomah, Book Review, *Human Nature Review* (2003) 3, 108, 109.

the moral sentiments.¹⁰⁹ In short, Mill believed that happiness depended not only on the *quantity* but also the *quality* of pleasures.

According to Kasser, ‘well-being and quality of life increase when these four sets of needs are satisfied and decrease when they are not’.¹¹⁰ Kasser refers to these psychological needs as ‘intrinsic values’, which are ‘based in people’s real psychological needs, support their growth and development, and are inherently satisfying to pursue’. Kasser states that:

Compared with materialistic people, those who believe intrinsic values are relatively important report enhanced happiness, greater psychological health, better interpersonal relationships, more contribution to the community, and more concern for ecological issues. These findings are substantiated by work of researchers using different value measures, and by research conducted with various age and cultural groups.¹¹¹

J Using Happiness Studies to Understand Shareholders and the Corporation

In Part IV below, the authors suggest that the empirical findings on happiness above can be applied to shareholders, in order to understand why people invest in shares and to construct a new theory of the corporation based on this understanding. The obvious arguments that will be made against this approach is that there have yet to be any specific empirical studies on what makes shareholders (rather than individuals generally) happy, and that to use psychological studies on happiness to reassess the role and purpose of the corporation, and by implication corporate law and internal corporate governance practices, is an overly radical step which does not justify a departure from the existing economic assumptions about the role of corporations.

As to the first point, while it is true that there have not been any specific empirical studies on what makes shareholders happy, this does not mean that the above findings are not applicable to shareholders also. What the findings demonstrate is that the ultimate objective of all individuals, including shareholders, is to be happy, and that shareholding — like buying a car, undertaking a university degree or playing with the dog, is a form of ‘need expression’— something that we as humans do in an attempt to achieve our ultimate objective. To use Aristotle, shareholding is no more than a ‘means’ to an ‘end’ — with that ‘end’ being the fulfilment of personal happiness. Accordingly, while a separate study on what makes shareholders happy may be an interesting pursuit to reaffirm what we are saying here, it is not strictly necessary.

¹⁰⁹ See Ted Honderich (ed), ‘Happiness’ in *The Oxford Companion to Philosophy* (1995) 332.

¹¹⁰ Kasser, above n 72, 98.

¹¹¹ *Ibid* 98.

Furthermore, there has been recent empirical studies carried out in the United States which we believe can be used to support the argument that strict wealth maximisation is not a priority of shareholders once they are a part of the corporation in which they have invested. As noted briefly earlier on in this article, the studies were carried out by Jennifer Arlen, Matthew Spitzer and Eric Talley of the University of Southern California Law School, and were designed to see whether so-called ‘endowment effects’ apply to participants in a corporate agency relationship, ie the corporation.¹¹² In very simple terms, ‘endowment effects’ essentially involve a person wanting more for something that they have had an involvement in, than what they initially put in.¹¹³ Outside of the context of a corporate agency relationship, the most cited example highlighting the endowment effect involved coffee mugs at Cornell University in the US, which sold for \$6 in the university bookstore. The study showed that whereas conventional economic theory would predict that the mugs would be distributed randomly from those who valued the mugs less to those who valued the mugs more, in fact very few mugs were actually traded. This was because the study’s result showed that the ‘median buyer’ was not willing to pay more than \$2.25-\$2.75 to purchase the mug, whereas the ‘median seller’, due to coming to value the mug even though they did not initially pay for it, required \$5.25 in order to sell it.¹¹⁴

The study of Arlen et al was similar to the above-mentioned experiment, but looked at the behaviour of employees in a hypothetical corporation. In the experiment, the employees were asked to decide between a mug and a pay rise in a series of rounds. In each round, subjects received a contract to work for the company, which was contingent on the firm’s performance — with the level of pay dependant on whether the firm earned a high or low profit. It was explained that the mug was a central factor of production, and hence giving up the mug could lead to increased profits for the corporation which would be distributed to employees in the form of higher wages (under the terms, the amount would always be \$2 if the firm earned a low profit, but the amount varied from \$3 to \$15 if the firm earned a high profit).

What the studies showed was that the employees were more willing to give up their mug than in the Cornell University study above. While there was some very technical economic reason behind this result (looking at differences in behaviour between those that were ‘endowed’ and those that weren’t ‘endowed’ with the mug at the start of the experiment), the clear message that came out of the results was

¹¹² Arlen, Spitzer and Talley, above n 11.

¹¹³ Technically, ‘endowment effects’ mean the divergence between the amount a non-owner of an entitlement would be willing to pay for an entitlement and the minimum amount the person would be willing to demand for it if they initially owned it. The former is significantly less than the latter. See generally Richard Thaler, *The Winner’s Curse: Paradoxes and Anomalies of Economic Life* (1992) 63-78.

¹¹⁴ See Daniel Kahneman, Jack Knetsch and Richard Thaler, ‘Experimental Tests of the Endowment Effect and the Coase Theorem’ (1990) 98 *Journal of Political Economy* 1352.

that in a corporate agency relationship, participants are more willing to put the interests of the corporation first for the benefit of all the corporation's stakeholders, and are less concerned with what is in their own personal self-interest. In our language, what we would say that the hypothetical employees were doing was acting in a way which best facilitated the achievement of personal happiness, when we see that in light of the studies of Kasser, Myers and others above, that happiness is less about the fulfilment of profits and more about having in place positive relationships (including with other stakeholders in a company) achieved through acting communally rather than individualistically.

While this study was limited to employees, the results show that it is also applicable to shareholders. Arlen and her team discuss that the results can be explained based on an 'exchange-value hypothesis'— whereby the business agency context 'makes salient the 'exchange value' of the mug rather than its consumption value, thereby causing subjects to treat it as a fungible good. This conjecture is consistent with evidence that individuals do not endow goods that they view predominantly as trading goods or stores of value.'¹¹⁵ Given shares are inherently designed to be exchanged rather than consumed, we are certain that a similar study of shareholders would produce the same results.

Regarding the second point that use of happiness studies in corporate law and governance is radical and inappropriate, this is a spurious argument that should also be rejected. Scholars have for years seen the benefit of an inter-disciplinary approach to considering and reassessing the law.¹¹⁶ As Millon says, '[a]s legal academics engaged in normative discourse, we will always have much to learn from our colleagues in the humanities and social sciences'.¹¹⁷ Indeed, an inter-disciplinary approach is particularly legitimate in the field of corporate governance and theories of the firm, for example, contractarianism, and its off-shoots (eg team production theory) utilise economic and financial literature, and communitarianism is a concept that emerged in sociology and political science long before it entered the legal arena. Importantly, even Tim Kasser, a non-lawyer, recognised the potential of his and others' happiness studies in the field of corporate law and governance. In the final chapter to *The High Price of Materialism*, Kasser wrote;

Other things I have said in this book ... might suggest that because companies and the capitalist economic system are most concerned with making money, they are by definition highly materialistic and thus intrinsically oriented. This need not be the case. Some companies have

¹¹⁵ See Arlen, Spitzer and Talley, above n 11, 27–8.

¹¹⁶ See for example, Carl Edwards, 'In Search of Legal Scholarship: Strategies for the Integration of Science into the Practice of Law' (1998) 8 *Southern California Interdisciplinary Law Journal* 1.

¹¹⁷ See David Millon, 'New Directions in Corporate Law: Communitarians, Contractarians and the Crisis in Corporate Law' (1993) 50 *Washington & Lee Law Review* 1373.

corporate structures that support equality among workers through job tasks, salary structures, and profit sharing. Other companies have made significant strides in allowing employees opportunities to spend more time with their families (especially at crucial life junctures) and to improve their education. Still others place environmental responsibility at the forefront of their corporate concerns or include charitable giving as an essential component of their balance sheet, even allowing employees paid leave to volunteer for community organisations.

What these examples show is what I have been trying to emphasize in this book: materialism is relative. *Materialistic values become unhealthy when they are highly important in comparison with other values for which we might strive.* The question is one of balance, and these examples show that corporations may be able to balance their materialistic aims with healthier, more intrinsically oriented ones. *The key will be to help corporations recognize that their best interests lie in attaining this balance, and that making money for themselves and their stockholders need not be their sole, or even primary, mandate. Corporations could instead be seen as organisations designed to encourage the health of their employees, to contribute to the welfare of their community, and to help heal the earth. This would no doubt be a clear change in orientation for some companies, but not an impossible one.*¹¹⁸

Moreover, far from studies of human happiness being removed from the discipline of corporate law and governance and hence being irrelevant, a new movement—referred to as ‘behavioural law and economics (BLE)’ shows otherwise. The BLE movement really has the same objective as our application of happiness studies to corporate governance — to reassess existing presumptions and doctrines in the law based upon how people *actually behave* rather than as economic theory *assumes* they behave, and is gaining support in the United States and elsewhere.¹¹⁹

Just as we are attempting to justify a review of corporate law rules and corporate governance structures in light of scientific evidence that all individuals ultimately want to be happy and there is a proven negative correlations between wealth and happiness, the BLE movement is advocating a reassessment of a wide variety of laws on the basis of actual- rather than hypothesised-human behaviour. Further, just as we are saying that the corporation needs to be understood as a means of facilitating the happiness of shareholders (principally) and other stakeholders rather than purely maximising profits, the BLE movement understands that people do actually care about the well-being of others — even at the expense of material self-interest.

¹¹⁸ Kasser, above n 72, 111 (emphasis added).

¹¹⁹ See for example, Christine Jolls, Cass R Sunstein and Richard Thaler, ‘A Behavioural Approach to Law and Economics’ (1998) 50 *Stanford Law Review* 1471; Cass R Sunstein (ed), *Behavioural Law and Economics* (2000).

Hence, there is ample support for utilising happiness studies in the field of corporate governance, and to apply the empirical findings on happiness discussed above to shareholders and their relationship with the corporation.

IV SHAREHOLDERS WANT, ABOVE ALL, TO BE HAPPY: TOWARDS A UNIFYING UNDERSTANDING OF THE CORPORATION

A *Existing Theories of the Corporation: Contractarianism versus Communitarianism*

The critical debate relating to theories of the firm and corporate governance generally between so-called ‘communitarians’ and ‘contractarians’ is a modern day reflection of the classic exchange between Professors Dodd and Berle in the *Harvard Law Review* now 70 years ago as to how far the duties of duties, and more generally the obligations of the corporation, extend.¹²⁰

The most useful explanation of contractarians and communitarians, and distinction between them, for our purposes comes from David Millon (a communitarian) in the article, ‘New Directions in Corporate Law: Communitarians, Contractarians, and

¹²⁰ See Berle, above n 5; Dodd, ‘For Whom are Corporate Managers Trustees?’ (1932) 45 *Harvard Law Review* 1145; Berle, ‘For Whom Corporate Managers *Are* Trustees: A Note’ (1932) 45 *Harvard Law Review* 1365. See C A Harwell Wells, ‘The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century’ (2002) 51 *Kansas Law Review* 77, who looks at the Berle and Dodd exchange, and the issue of corporate social responsibility, from an historical perspective. For a discussion of the different theoretical models of the company as they relate to the rights and interests of shareholders, see Jennifer Hill, ‘Public Beginnings, Private Ends – Should Corporate Law Privilege the Interests of Shareholders?’ (1998) 9 *Australian Journal of Corporate Law* 21; Paula Darvas, ‘Section 249D and the “Activist” Shareholder: Court Jester or Conscience of the Corporation?’ (2002) 20 *Company and Securities Law Journal* 390, 392-402; Jennifer Hill, ‘Changes in the Role of the Shareholder’ in R Grantham and C Rickett (eds), *Corporate Personality in the 20th Century* (1998) 175; Ross Grantham, ‘The Doctrinal Basis of the Rights of Company Shareholders’ (1998) 57 *Cambridge Law Journal* 554; Fiona Macmillan Patfield, ‘Challenges for Company Law’ in Fiona Macmillan Patfield (ed), *Perspectives on Company Law: 1* (1995) 7–15; Stephen Bottomley, ‘From Contractualism to Constitutionalism: A Framework for Corporate Governance’ (1997) 19 *Sydney Law Review* 277; David Millon, ‘Theories of the Corporation’ [1990] *Duke Law Journal* 201. There are, however, many more academic articles and monographs dealing with theoretical models of the corporation in general, and more specifically how different models of the corporation (be they economic, political, classical, neo-classical, contractarian, communitarian, constitutional and so on) inevitably incorporate different perspectives on the status, function and powers of shareholders within the corporation.

the Crisis in Corporate Law' in the *Washington & Lee Law Review*. Millon discusses contractarians as follows:

Today's advocates of the shareholder primacy position- including the current focus on institutional investor activism- rely on a "contractarian" anti-regulatory, individualistic stance. Proponents argue against corporate law rules that mandate or inhibit particular corporate governance relationships. They would instead leave it up to the various participants in corporate activity to specify their respective rights and obligations through contract. According to this view, state corporate law provides the terms of the contract by which shareholders purchase management's undivided loyalty to their welfare. The key term is management's fiduciary duty to direct the corporation so as to maximise shareholder wealth.

...
In contrast to contractarians, "communitarians" more readily look to legal rules to structure relations among the corporation's diverse constituent groups, believing that corporate law must confront the harmful effects on nonshareholder constituencies of managerial pursuit of shareholder wealth maximisation. For example, a plant closing may serve the interests of shareholders while imposing substantial uncompensated costs on laid-off workers and on a local community that has made infrastructure investments in the expectation of a continued corporate presence. ... Communitarians are sceptical about the practical efficacy of contract as a mechanism by which nonshareholders can protect themselves ex ante from these sorts of harmful effects.

Millon goes on:

Communitarians also differ from contractarians in emphasizing the broad social effects of corporate activity. Contractarians tend to focus on the corporation's internal relationships, applying a cost-benefit analysis to a relatively narrow range of more or less readily monetizable interests. Communitarians see corporations as more than just agglomerations of private contracts; they are powerful institutions whose conduct has substantial public implications.¹²¹

¹²¹ Millon, above n 117, 1377-9. Other leading articles explaining and distinguishing contractarianism and communitarianism include Lyman Johnson, 'New Approaches to Corporate Law' (1993) 50 *Washington & Lee Law Review* 1713, 1716, in which the author talks of a 'normative collision' in corporate law; Michael E DeBow and Dwight R Lee, 'Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation' (1993) 18 *Delaware Journal of Corporate Law* 393, 393:

For years now, debates over the proper scope and content of corporate behaviour and corporate law have exhibited one regularity; they almost always involve a clash between those who treat corporations as contractually-based, profit-maximizing entities, and those who wish corporations could be made to be something else.

See also Macmillan Patfield, above n 120, 9:

In the United States, contractarianism remains the most supported approach to perceiving the corporation, due to the continued support for the so-called ‘nexus of contracts’ theory. A useful explanation of the nexus of contracts theory is provided by Bainbridge:

Nexus of contracts theory visualises the firm not as an entity, but as an aggregate of various inputs acting together to produce goods or services. Employees provide labor. Creditors provide debt capital. Shareholders initially provide equity capital and subsequently bear the risk of losses and monitor the performance of management. Management monitors the performance of employees and coordinates the activities of all the firm’s inputs. The firm is seen as simply a legal fiction representing the complex set of contractual relationships between these inputs. In other words, the firm is not treated as a thing, but rather as a nexus or web of explicit and implicit contracts establishing rights and obligations among the various inputs making up the firm. Because shareholders are simply one of the inputs bound together by this web of voluntary agreements, ownership is not a meaningful concept in nexus of contracts theory.”¹²²

In the United Kingdom, however, communitarianism, or what is referred to there as the ‘stakeholder’ perspective of the corporation, dominates, academic commentary regarding theories of the firm. Cheffins provides a useful explanation as to why stakeholder theory is the dominant theory of the corporation in the UK:

The thinking is that companies are too important to the economy to exist for the benefit of a single constituency, namely the shareholders. Regulation which secures fair treatment for potentially vulnerable stakeholder groups is

Contractarians essentially assume that people should be able to make their own choices and bargains free from legal intervention. Communitarians take the view that the state ought to enforce certain duties which are owed, as an ethical matter, to other members of the community. These views have quite different consequences for the position of non-shareholder corporate stakeholders. Contractarians are not in favour of the alteration of the legal model of the company in order to recognise non-shareholder stakeholders; communitarians are.

The ‘communitarian’ perspective of the corporation is a modern day reformulation of the commentary by Professor Dodd 70 years ago in a famous exchange in the *Harvard Law Review* (see above n 120). Professor Dodd believed that treating the corporation as a separate legal entity to its shareholders (so-called ‘natural entity theory’) accommodated a managerial approach that focuses on interests other than those of shareholders (eg employees, creditors and the community).

¹²² Bainbridge, above n 4, 1426–7. The classic article on nexus of contracts theory is Michael C Jensen and William H Meckling, ‘Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure’ (1976) 3 *Journal of Financial Economics* 305.

therefore justified, even if the measures in question may reduce corporate profits.¹²³

Professor Jennifer Hill describes the competing views of communitarians¹²⁴ and contractarians as a ‘schism in the definition of corporate governance’ between the view that restricts the relationship to between shareholders and managers, and the one which expands corporate governance to include a wider range of persons associated with the enterprise.¹²⁵

It has been assumed that elevating shareholder interests to the primary objective in corporate governance, based on their position as ‘owners’ of the company, should be resisted as it means that the company must be treated as a purely economic institution to maximise wealth, thus undermining the interests of other stakeholders.¹²⁶ However, we do not believe that the interests of shareholders need to be narrowly cast in such a way, and based on this we do not believe that there is a necessary conflict between the interests of shareholders and the interests of other stakeholders. This will be explained further below when we outline how the empirical studies on what makes people happy can be used as the basis for a renewed, unifying understanding of the corporation.

The point that there may in fact be a complementary relationship between shareholders and stakeholders is not new — it has been raised in many different contexts before (a recent example being the so-called ‘third way’ approach to corporate governance advocated by Joseph Healy in his book *Corporate*

¹²³ Brian Cheffins, ‘Corporations’ in Peter Cane and Mark Tushnet (ed), *The Oxford Handbook of Legal Studies* (2003) 485, 498–9.

¹²⁴ Professor Hill has provided a very useful and succinct summary of the history and objectives of communitarians in one of her previous articles: ‘In recent years, “communitarian” scholarship has arisen in the United States as a strong counterpart to shareholder-centred models of the corporation. Grounded in sociology and notions of the corporation as community, communitarianism focuses on the vulnerability of non-shareholder constituencies and challenges the individualistic premises of the contractual theory of the corporation’: Jennifer Hill, ‘Public Beginnings, Private Ends – Should Corporate Law Privilege the Interests of Shareholders?’, above n 120, 23–4; see also David Millon, ‘Communitarianism in Corporate Law: Foundations and Law Reform Strategies’ in Mitchell (ed) *Progressive Corporate Law* (1995) 1. According to DeBow and Lee, above n 121, 17ff, the term “communitarian” was adopted in the late 1980’s by a group of academics led (in some sense) by sociologist Amitai Etzioni. These academics shared a belief that the liberal theories that dominated English-speaking politics for centuries placed too much emphasis on individual rights and not enough on community needs and civil obligations.

¹²⁵ Jennifer Hill, ‘Visions and Revisions of the Shareholder’, above n 120, 161 (see particularly page 42 for a discussion of the implications potentially arising from the way in which shareholders are characterised); also Ian Ramsay, ‘The Corporate Governance Debate and the Role of Directors’ Duties’ in Ian Ramsay (ed), *Corporate Governance and the Duties of Directors* (1997) 2, 2–3.

¹²⁶ See, for example Greenfield, above n 15, 1.

Governance and Wealth Creation in New Zealand),¹²⁷ and there is even an emerging theory in the United States based on the team production model of the corporation which is based on an inter-relationship, rather than conflict, between the various constituencies in the corporation acting as a team.¹²⁸

B *Team Production Theory of Corporate Law*

In a relatively recent paper published in the *Virginia Law Review*, academics Margaret Blair and Lynn Stout outlined a new theory of the corporation based on economic analysis of team production. Blair and Stout's 'team production theory' has generated a great deal of interest in academic circles as it challenges the dominant view of shareholder primacy, by suggesting that the role of the corporation is not limited to maximising economic returns for shareholders, but rather is intended to resolve team production problems. As a result, neither shareholders nor other stakeholders are the primary concern, rather the corporation and the legal rules regulating corporations treat shareholders and stakeholders as a 'team', each contributing to the corporation in different ways.

¹²⁷ See Healy, above n 7, 11 in which Healy presents his so-called 'third way' to defining the relationship of corporate governance and shareholder interests as follows: 'I believe passionately in the primacy of shareholder value. I also believe, however, that the shareholder-value maximisation objective must be achieved in the context of ethical and responsible company behaviour.' He continues, at 12, by stating:

I don't believe that there is any inconsistency between pursuing shareholder interests and ensuring that the interests of other stakeholders (employees, customers, communities, etc) are also met, if not exceeded. ... What I mean by a "third way" when thinking about shareholder value, is a way that addresses any public perception that the only alternative to stakeholder and "triple bottom line" approaches is a "harsh" and "aggressive" drive to maximise immediate profits without due regard for future profits. I emphasise that such a public perception is a caricature based on flawed models which are often narrowly defined in a way that presents a misleading sense of what a shareholder value philosophy really means. ... No business will be able to sustain growth in shareholder value without first ensuring that employee morale and commitment is high. Equally, no company operating in a competitive arena can grow shareholder value without ensuring customer satisfaction is high.

See also Macmillan Patfield, above n 120, 15 who attempts to unify the contractarian and communitarian models based on a consistent underlying rationale of the corporation facilitating business activity: 'One possible rationale for company law, therefore, is that of *facilitating business activity* and legitimising the power which results from that activity by the recognition of a whole range of stakeholder interests, including the public interest'.

¹²⁸ See Gregory Scott Crespi, 'Redefining the Fiduciary Duties of Corporate Directors in Accordance with the Team Production Model of Corporate Governance' (2003) 36 *Creighton Law Review* 623, 624.

Team production, and in particular the problems arising from team production, has been a popular area of research in economic literature for years, and this literature was the source of Blair and Stout's theory of the corporation. According to Blair and Stout, team production problems arise in situations where a productive activity requires the combined investment and coordinated effort of two or more individuals or groups. The problems arise because if the investment of members of this 'team' is firm specific (meaning difficult to recover once committed to the project), and if output from the enterprise is non-separable (meaning that is difficult to attribute any particular portion of the joint output to any particular member's output), it becomes very difficult to determine how any 'surpluses' (or 'rents') generated by this production should be divided. This is because surpluses invite both 'shirking' (which essentially means free-riding off the efforts of others) and rent-seeking (whereby individuals waste time and money competing for a share of a fixed amount of wealth). Blair and Stout suggest that as trying to prevent these team production problems through the mechanism of explicit contracts is next to impossible, this function can be achieved by the corporation as an 'institutional substitute' for explicit contracts. The structure of the corporation, along with the legal rules regulating the corporation, act as a 'mediating hierarchy' by which team members give up important rights (including property rights over the team's joint input) to the corporation as a separate legal entity. At the top of his hierarchy is the board of directors, whose authority over the use of corporate assets is virtually absolute. Hence, the 'team production model' of the corporation takes shape.

...It is misleading to view a public corporation as merely a bundle of assets under common ownership. Rather, a public corporation is a team of people who enter into a complex agreement to work together for their mutual gain. Participants – including shareholders, employees, and perhaps other stakeholders such as creditors or the local community – enter into a “pactum subjectionis” under which they yield control over outputs and key inputs (time, intellectual skills, or financial capital) to the hierarchy. They enter into this mutual agreement in an effort to reduce wasteful shirking and rent-seeking by relegating to the internal hierarchy the right to determine the division of duties and resources in the joint enterprise. They thus agree not to specific terms or outcomes (as in a traditional “contract”), but to participate in a process of internal goal setting and dispute resolution.¹²⁹

The very interesting aspect of the team production model is how, through the utilisation of economic literature on team production problems, it attempts to redefine the relationship between shareholders and other stakeholders in trying to

¹²⁹ Margaret Blair and Lynn Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247, 278. See also Margaret Blair and Lynn Stout, 'Director Accountability and the Mediating Role of the Corporate Board' (2001) 79 *Washington University Law Quarterly* 403. For an assessment of the team production model, see David Millon, 'New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law' (2000) 86 *Virginia Law Review* 1001; Cheffins, above n 123, 498–9; Crespi, *ibid*.

best represent how the corporation actually operates in practice. As Blair and Stout point out, the effect is to set in place a model of the corporation which is consistent with both the ‘contractarian’ and ‘communitarian’ model of the corporation — thus demonstrating (at least in terms of the rather narrow perspective in which Blair and Stout approach the issue), that there isn’t an irreconcilable conflict between contractarian and communitarian schools as commentators like Millon have warned. Blair and Stout state in relation to the paramount role of directors within the mediating hierarchy that:

... boards exist not to protect shareholders per se, but to protect the enterprise-specific investments of all the members of the corporate “team”, including shareholders, managers, rank and file employees, and possibly other groups, such as creditors. Because this view challenges the shareholder primacy norm that has come to dominate the theoretical literature, our analysis appears to parallel many of the arguments raised in recent years by the “communitarian” or “progressive” school of corporate scholars who believe that corporate law ought to require directors to serve not only the shareholders’ interests, but also those of employees, consumers, creditors, and other corporate “stakeholders”. We believe, however, that our mediating hierarchy approach, which views public corporation law as a mechanism for filling in the gaps where team members have found explicit contracting difficult or impossible, is consistent with the “nexus of contracts” approach to understanding corporate law.¹³⁰

In many ways, our happiness-based understanding of the corporation accords with the team production model, in that we also perceive the various participants in the corporation to be a ‘team’ working together towards a common objective, but rather than perceiving this objective as the rather abstract concept of ‘production’, we consider that the relationship between these constituents is more basic: the corporation’s stakeholders form part of a properly-functioning society which shareholders depend on for the fulfilment of their psychological needs (and hence their level of personal happiness), and stakeholders depend on a properly-functioning corporation for their well-being and happiness.

The team production theory does head somewhat towards recognising this, although Blair and Stout’s thesis does not specifically refer to the pursuit of happiness by individuals, or to what facilitates personal happiness. Cheffins notes in commenting on the team production model that ‘team’ coordination within the corporation encourages ‘other-regarding’ behaviour by directors.¹³¹ According to Cheffins, Blair and Stout justify this by raising experimental evidence about human behaviour to ‘discredit’ the traditional economic assumption that people act strictly to maximise their own welfare.¹³² The welfare of others, and how the corporation impacts on this, is important also, similar to what we are saying.

¹³⁰ Blair and Stout, ‘A Team Production Theory of Corporate Law’, *ibid*, 253–4.

¹³¹ See Cheffins, above n 123, 499.

¹³² See Blair and Stout, ‘Director Accountability and the Mediating Role of the Corporate Board’, above n 129.

Cheffins is, however, sceptical of basing a theory on experimental evidence on human behaviour to counter long-established economic assumptions, noting:

While the experimental data currently available are compelling enough to justify corporate law scholars paying attention to cognitive biases that are inconsistent with mainstream economic thinking, the evidence remains sufficiently equivocal to suggest that a prudent dose of caution is appropriate.¹³³

The inevitable caution among corporate law academics in using empirical studies on happiness as opposed to mainstream evidence on shareholder primacy as the basis for a theoretical understanding of the corporation is certainly an issue that the authors intend to be subject in raising our preferred model of the corporation, and have therefore been very conscious to outline our model with particular care. That said, we believe that our happiness-based model of the corporation should receive more widespread support among corporate law scholars than the team production model as it based on a single premise — the overriding objective to pursue personal happiness — which is easier to understand (everyone at least has some instinctive understanding of what it is to be ‘happy’), has more widespread application, and is more effective than the team production model in reflecting a deeper reality of why corporations exist and why shareholders participate in corporations.

C *Shareholders and their Overriding Objective of Personal Happiness:
A Unifying Understanding of the Corporation*

1 *Understanding the role of the corporation*

Our basic premise in this article is that as all shareholders are individuals (including institutional shareholders, which are legal entities controlled by individuals), and as the overriding objective of individuals is to be happy, we are not compelled to view the corporation, and the rules of company law governing corporations, as a mechanism designed solely to facilitate wealth maximisation.

Shareholding is another form of what Tim Kasser described as ‘need expression’. Shareholding is just like all other forms of activity that individuals engage in to satisfy the ‘psychological needs which are crucial to the fulfilment of happiness’. In other words, while it is important that the corporation is financially successful, this is not the only concern of shareholders — even though they may not think so at the time of their investing in the company. Rather, the corporation is a nexus: not a nexus of contracts as described by law and economics commentators, but rather a nexus by which bonds can be formed between shareholders and the variety of stakeholders that interact with the corporation.¹³⁴ This formation of bonds,

¹³³ Cheffins, above n 123, 499, citing Arlen et al, above n 11.

¹³⁴ See Arie de Geus, *The Living Company* (1997), in which it is argued that there is fault in the view that companies are merely generators of profit rather than a

accommodating a broad range of stakeholder interests, is not designed for the corporation to make as much money as possible for shareholders as money in and of itself does not produce happiness, but rather to contribute towards the establishment of a better sense of community — with the studies showing that a communal rather than individualist spirit is, through the formation and maintenance of positive relationships, more likely to facilitate personal happiness.

This ‘nexus of bonds’ explanation for how the corporation is used principally to facilitate personal happiness is increasingly relevant in contemporary society given the more dominant and influential role that corporations play. Twenty of the largest corporations in the world are said to now have a combined market capitalisation which is greater than the total GDP of all but 20 of the members of the United Nations general assembly.¹³⁵ In this sense, everyone is a stakeholder. In at least one way, and probably in many ways, we depend on a corporation or have or can offer something for which a corporation depends. So much was recognised even in the 1930’s, when Berle and Means, commenting on the two hundred largest non-banking corporations in the United States, wrote in, *The Modern Corporation and Private Property*:

These great companies form the very framework of American industry. The individual must come in contact with them almost constantly. He may own an interest in one or more of them, he may be employed by one of them, but above all he is continually accepting their service. If he travels any distance he is almost certain to ride on one of the great railroad systems. The engine which draws him has probably been constructed by the American Locomotive Company or the Baldwin Locomotive Works ...

... Even where the individual does not come into direct contact, he cannot escape indirect contact with these companies, so ubiquitous they have become. There are few articles of consumption to whose production one of the big companies has not to some extent contributed.¹³⁶

As shareholders we simply cannot avoid establishing relationships with the corporation’s stakeholders, and we depend on all kinds of stakeholders in a variety of different ways, either directly (for example, the formation of a close friendship) or indirectly (for example, the stakeholder may offer a thing or a service which makes the task of satisfying a psychological need much easier) in our pursuit of

community of human beings. When companies disappear, the bonds with employees, suppliers, customers and local communities are broken.

¹³⁵ Sir John Browne, Group Chief Executive, BP, ‘Governance and Responsibility – The Relationship between Companies and NGO’s: A Progress Report’, Arthur Anderson Lecture at the Judge Institute of Management Studies, Cambridge University, 29 March 2001. Cited in Andrew Lumsden, ‘Soft Hearts or Soft Heads: The Case for a New View of the Altruistic Corporation’ (2003) 25 *Australian Corporate Law Bulletin*, 19 December 2003.

¹³⁶ Berle and Means, above n 21, 19–28.

personal happiness. In this sense, the company's stakeholders and society in general are becoming, if not are, interchangeable concepts. Hence, with personal happiness — including the happiness of shareholders — dependant on a properly functioning society by which the various needs which contribute to happiness can be fulfilled, it is crucial that the corporation shift its primary focus away from maximising profits for shareholders and instead towards engineering positive relationships with its stakeholders.

2 *Justification for a happiness-based theory of the corporation*

Even if a certain form of human activity, like buying into a company, has an explicit materialistic objective (ie shareholders would usually say that they buy shares to make money), it still depends on a society capable of providing a framework in which individuals can gain the means to participate in this form of activity. A preliminary requirement to the ability to work, buy shares and build up wealth (for whatever reason), is satisfaction of at least basic needs (ie it is inescapable that people need to eat and be healthy as a preliminary to any form of human endeavour), as well as social and emotional needs (ie people need love, friendship and so on to gain the motivation to strive for objectives, including purely materialistic objectives; moreover, a network of friends, plus a properly functioning social arrangement (friends, family, education etc) is needed to be informed of the means to make money, and to gain the skills and base to make money), and a favourable political environment (ie material wealth depends on a well-functioning democratic, free market nation).¹³⁷

Accordingly, even for human activities which we typically think are engaged in for purely materialistic reasons, there is a base requirement that individuals first enjoy the satisfaction of a host of non-materialistic needs, needs which in fact have been found to be a common ingredient in achieving personal happiness. As Adam Smith wrote in *The Theory of Moral Sentiments*:

All the members of the human society stand in need of each other's assistance ... where the necessary assistance is reciprocally afforded ... the society flourishes and is happy.¹³⁸

Hence, we start to see that even if the shareholder primacy norm is framed in very narrow, economic terms, the strict pursuit of wealth as an objective does not exist in isolation. Rather, as we have outlined above in discussing the 'nexus of bonds', it depends on a well-organised, properly functioning society, whereby each stakeholder that interacts with the corporation does so in a beneficial manner in terms of contributing in some (even perhaps indirect) way to the happiness of

¹³⁷ See generally, Mark J Roe, *Strong Managers, Weak Owners* (1994), for a discussion of the influence of politics in terms of the development of corporate governance structures in the United States.

¹³⁸ Pt 3, Sec 3, Para 7 and Pt 2, Sec 2, Ch 3, Para 1, cited in Farrar, above n 14, 40.

shareholders. But if we can take a step back from the traditionally narrow-cast shareholder primacy norm to look at the interests of shareholders in a deeper context of what contributes to the happiness of shareholders, then a positive, reciprocal arrangement between the interests of shareholders and other stakeholders is unquestionable. This is highlighted in the following statement of leading US corporate governance scholar David Millon:

Simply by virtue of membership in a shared community, individuals owe obligations to each other that exist independently of contract. *We are born into civil society and thereby inherit the benefits of life in a community. The value of those benefits depends in large part on the quality of the social environment.* That in turn is determined by the behaviour of one's fellow citizens, which is largely a matter of their values and goals. ... Acknowledging our interdependence, we must recognize our responsibility for the quality of the lives of all community members. The state acts appropriately when it enforces such duties.

...

*Liberty is empty without taking into account those primary needs upon which adequate conceptions of individual dignity and human flourishing depend. Basic physical comforts, facilities for intellectual and emotional growth, and enriching social environments are necessary if individuals are to have meaningful opportunities to define and pursue their own life-plans and to participate with civility in a community of interdependence.*¹³⁹

Similarly, in emphasising the complementary relationship between the economic and social objectives of the corporation, Michael Porter and Mark Kramer wrote in a recent article published in the *Harvard Business Review* that:

Companies do not operate in isolation from the society around them. In fact, their ability to compete depends heavily on the circumstances of the locations where they operate. Improving education, for example, is generally seen as a social issue, but the education level of the local workforce substantially affects a company's potential competitiveness. The more a social improvement relates to a company's business, the more it leads to economic benefits as well. ... In the long run, then, social and economic goals are not inherently conflicting but integrally connected. Competitiveness today depends on the productivity with which companies can use labor, capital, and natural resources to produce high-quality goods and services. Productivity depends on having workers who are educated, safe, healthy, decently housed, and motivated by a sense of opportunity. Preserving the environmental benefits not only society but companies too, because reducing pollution and waste can lead to a more productive use of resources and help produce goods that consumers value.¹⁴⁰

¹³⁹ Millon, above n 117, 1382–3 (emphasis added).

¹⁴⁰ Michael Porter and Mark Kramer, 'The Competitive Advantage of Corporate Philanthropy' (2002) 80 *Harvard Business Review* 56, 57. See also Lumsden, above n 135.

Indeed, the basic definition of ‘stakeholder’ implies a rich inter-dependency between the corporation (with the shareholders as the ultimate owners of the corporation) and its stakeholders. The term ‘stakeholders’ refers both to people whose well-being is tied to the corporation’s success, such as employees, suppliers, charities and communities, and also means ‘those groups without whose support the organization would cease to exist’.¹⁴¹ In his work, ‘*Strategic Management: A Stakeholder Approach*’, R E Freeman argued that just as stakeholders can be affected by organisations, organisations can also be affected by stakeholders. According to Freeman, it was legitimate for people in business to ‘spend time worrying about [their] strategy for stakeholders because [stakeholders] can affect the accomplishment of [business] goals and plans’.¹⁴²

In our view, using the empirical findings as to what contributes to personal happiness to provide a better reflection of what is really in the best interests of shareholders and therefore how a corporation should be structured and managed, while being a novel and sophisticated venture, essentially maintains the status quo. Unlike communitarianism, our approach to understanding the corporation does not impose any challenge to the shareholder primacy norm which has guided the development of corporate law and corporate governance for at least the last century. To maintain certainty in the law and to main director accountability under the law, under our model shareholder primacy remains the central component, however ‘the interests of shareholders’ is to be viewed in a broader context of how the corporation can assist in facilitating the happiness of shareholders, rather than just filling the pockets of shareholders with dividend cheques. This is not such a radical change of approach, given shareholder primacy, like any other principle or doctrine of corporate law, should be subject to ongoing re-examination and revision. There is no reason why corporate law cannot continue along, albeit with shareholder happiness rather than profit maximisation being the guiding objective. As Johnson has written:

Who says shareholder primary should now and in all settings be the central norm in corporate law, and by what authority do they speak on and what historical evidence do they rely? Other notions in our collective lives, for

¹⁴¹ R Edward Freeman, *Strategic Management: A Stakeholder Approach* (1984) 31. For a discussion, see Kathleen Hale, ‘Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes’ (2003) 45 *Arizona Law Review* 823, 21–22ff.

¹⁴² Freeman, *ibid* 23. See also Professor Simon, in one of a string of articles on communitarianism in the 1993 *Washington & Lee Law Review*:

Because business success depends heavily on good relations and reputation with governments, customer, suppliers, workers, and the general public, one can always describe a corporate decision that benefits non-shareholder constituencies as serving the shareholders’ long run interest in good corporate relations and reputation.

William H Simon, ‘What Difference Does it Make Whether Corporate Managers Have Public Responsibilities?’ (1993) 50 *Washington & Lee Law Review* 1697, 1699.

example, what it meant a hundred years ago when someone spoke about ‘transportation’ or ‘communication’, change over time. Likewise, perhaps it is appropriate that shareholder primacy was regarded as the guiding norm for much of the twentieth century and remains an important norm even now, but corporate law no more than other notions such as transportation or communication has a pre-formed, unalterable and acontextual character. The very image that comes to mind when we speak of corporate law in the years ahead may change as surely as our image of transportation and communication today brings to mind automobiles, airplanes and fax machines, not horses, steamboats or the telegraph.¹⁴³

Similarly, Healy goes even further and supports our view that shareholder primacy should not be viewed strictly in terms of maximising profits. Rather, the success of the corporation, and hence the interests of shareholders (both from an economic and non-economic perspective), is best served by adopting an *accommodative* approach in which the interests of a broad range of stakeholders are considered.

I don’t believe that there is any inconsistency between pursuing shareholder interests and ensuring that the interests of other stakeholders (employees, customers, communities, etc) are also met, if not exceeded. ... No business will be able to sustain growth in shareholder value without first ensuring that employee morale and commitment is high. Equally, no company operating in a competitive arena can grow shareholder value without ensuring customer satisfaction is high.¹⁴⁴

Healy goes on to quote from Collins and Perras who state that thinking beyond the so-called ‘traditional’ realm of what is in the short-term economic interests of shareholders is also justified when considering the historical meaning of ‘shareholder primacy’. Hence, structuring internal corporate governance arrangements and enacting corporate law rules with a view to maximising shareholder happiness may be a very natural, and indeed long overdue, reformulation of the shareholder primacy norm:

Contrary to business school doctrine, ‘maximising shareholder wealth’ or ‘profit maximisation’ has not been the dominant driving force or primary objective through the history of visionary companies. Visionary companies pursue a cluster of objectives, of which making money is only one- and not necessarily the primary one. Yes, they seek profits, but they’re equally guided by a core ideology- core values and sense of purpose beyond just making money. Yet, paradoxically, the visionary companies make more money than the more purely profit-driven comparison companies.¹⁴⁵

¹⁴³ Johnson, above n 121.

¹⁴⁴ Healy, above n 7, 12.

¹⁴⁵ See J Collins and J Perras, *Built to Last* (1997) 8, cited in Healy, above n 7, 65. According to Collins and Perras’ research, \$1 invested in the ‘visionary companies’ in 1926 would have been worth \$6,365 by 1990, compared to \$955 from the ‘comparison companies’ and \$415 from the general market.

Finally, we should point out that we do not believe there to be any contradiction in our view of the corporation both as an entity which is owned by shareholders due to characterising shares as property, and as an institution which must accommodate the interests of a broad range of stakeholders. Property as a concept is capable of, and indeed characteristically does, accommodate a range of different concerns/issues rather than being strictly a economic tool. Reference is made by Greenfield to a number of judicial decisions where the concept of ‘property’ was given this meaning. Accordingly, it would not be undermining the status of shares as property owned by the shareholders, to turn its attention to not-strictly-economic issues which would facilitate shareholder happiness. According to Greenfield:

Notwithstanding the “illusion of absoluteness” that accompanies much property-rights rhetoric, property has always been subject to reasonable regulation. The broad principle that one should not use one’s property to inflict harm on others has been “routinely applied” in US courts since the nation’s beginning. The Supreme Court recognised over one hundred and fifty years ago that “while the rights of rights of private property are sacredly grounded, we must not forget that the community also have [sic] rights”. (*Charles River Bridge v Warren Bridge*, 36 US (11 Pet) 420, 548 (1937)). A property owner cannot burn noxious trash in her backyard so as to cause a nuisance to her neighbours, for example, and a factory owner may not operate a factory that is unreasonably dangerous to the employees working there.¹⁴⁶

3 *Arguments against a ‘happiness-based’ perspective of shareholding and the corporation*

In this section we outline some of the main arguments which could be raised against elevating shareholder happiness to the primary objective of companies, and respond to each of them with our point of view, and possible solutions. We stress here that this is by no means an exhaustive list of the arguments that may be raised against our happiness objective, and space limitations also prevent us from detailing every single response to all the possible arguments that can be raised against our approach.

What we will say at the outset, however, is that common to each of the possible arguments below is a misconception of what we intend by our happiness-based model of the corporation. It is clear that one thing we are not saying is that the corporation cannot still be guided on a day-to-day basis by an objective of achieving profits which can be distributed to shareholders, and directors still cannot

Profitability is a necessary condition for existence and a means to more important ends, but it is not the end in itself for many of the visionary companies. Profit is like oxygen, food, water, and blood for the body; they are not the point of life, but without them, there is no life (p 8).

¹⁴⁶ Greenfield, above n 15, 16–7.

be judged (at least partly) according to their performance in generating profits for the company.

It would be an absurd proposition to suggest that the agenda of a corporation should switch from the blind economic pursuit of pursuing profits for the sake of it, to an objective of not pursuing profits for the sake of it. It is not a social evil for shareholders to receive dividend payments from the corporation from time to time, as these payments can be used by shareholders to assist in their pursuit of happiness by helping to pay off the family home, have a well-earned holiday and/or achieve other positive goals which are conducive to happiness. The generation of profits also benefits others such as the company's directors, employees and suppliers.

But as studies presented by Myers, Kasser and others show, however, there is a point where the generation of wealth actually reduces one's level of happiness, and indeed leads to unhappiness. Accordingly, if a corporation focuses solely on maximisation of profits, rather than extending its focus to accommodate the interests of other stakeholders and maintain a positive bond between the corporation and its stakeholders, these studies would suggest that the happiness of shareholders (as well as the company's stakeholders) would deteriorate. Hence, an argument that is premised on the view that strict wealth maximisation leads, in overall terms, to the most optimal outcomes is flawed.

Similarly, recent empirical studies on happiness show that, as most of us deep down would suspect, money by itself does not generate happiness. It is only a means to satisfy what is really important to us — those needs which make us happy. To say that the corporation's endeavours to generate profits is all that anyone that participates in the corporation, and in particular shareholders, care about therefore demonstrates a failure to make the final step in the inquiry as to why individuals participate in the corporation as shareholders.

*D Other Activities Can Be Engaged in for Pleasure;
The Purpose of Shareholding Is To Make Money*

As was alluded to in section 3.4, the most obvious argument that could be made against a happiness-based understanding of shareholding and the corporation is that shareholders buy into a company with a view to enjoying an economic reward (in the form of dividends, and a profit upon sale) and hence the corporation is justified in focusing on wealth maximisation.¹⁴⁷

¹⁴⁷ Consider the comments of Professor Bainbridge in this regard:

... most investors do not regard their investment in corporate stock as a charitable donation made to benefit non-shareholder constituencies. Their investment in corporate stock must bring them a rate of return commensurate with the risks they are taking. If it does not, they will

Individuals can engage in a host of different activities, from joining a political party to going disco dancing on a Friday night, to form relationships and satisfy psychological needs which are conducive to happiness; shareholding is different in that it has a clear end game- to make money. As Joseph Healy recently wrote:

Shareholders invest in companies with the desire to increase the value of their investment. They do so in the belief that the purpose of a business, unlike a church, charity or club, is to engage in activities that make profit. Management's job is to make decisions that ensure EVA is maximised. Without this clarity of purpose it would be difficult for shareholders to hold management accountable.

...

If shareholders want to support social causes they are at liberty to make charitable donations from their dividend income or realised share wealth; it is not the duty of managers, directors or the agents of the shareholders to determine the social priorities of governments, charities and shareholders.¹⁴⁸

As we suggested above, however, shareholding is no different to any other form of human activity which individuals engage in. Shareholding, like riding a bike or writing a law review article, is a form of need expression, with the end game being the achievement of personal happiness. Hence, as studies show that a life focused on wealth creation and materialistic values actually results in unhappiness rather than an increase in happiness, we see that shareholding — a form of human activity, like any other, engaged in to assist in the pursuit of personal happiness — cannot be solely about making money. Given that the interests of shareholders as a whole is the primary concern of the corporation, a strict focus on maximising profits for shareholders therefore cannot be pursued, as (based on the above-mentioned studies) this is not what makes shareholders happy. Shareholders may think that the primary purpose of their investment is to make money and that success judged on this criteria will bring them happiness. But they are wrong. The focus of corporate activity should not be permitted to perpetuate this misconception.

E *The Interests of Society are Best Met by Maximising Company Profits*

The argument that society benefits from corporations that are focused on the bottom line, and hence any departure from a strict wealth maximisation approach (as our happiness-based model necessarily involves) is detrimental to society, is a convenient argument raised from time to time by contractarians — principally in response to the claims of communitarians.¹⁴⁹ The argument, in our view, is best

divest stock in favour of other investments, or at least, monitor management more closely.

¹⁴⁸ See Bainbridge, above n 4, 1433.

¹⁴⁸ See Healy, above n 7, 56.

¹⁴⁹ See generally Bainbridge, above n 4; Jonathan R Macey, 'An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties' (1991) 21 *Stetson Law Review* 23; Richard Warren,

encapsulated by Michael DeBow and Dwight R Lee in an article published in the *Delaware Journal of Corporate Law*.¹⁵⁰ DeBow and Lee, in discussing how a focus on profit maximisation — by encouraging a more efficient allocation of resources—satisfies consumer needs and hence has a positive impact on social welfare, provide two arguments against communitarianism.

The first [reason] is that an attempt to make businesses more community-minded would entail a substantial politicization of corporate decision making. Replicating governmental and political structures and processes within the business world would produce the same sort of interest group politics and incentive and information problems that plague government action. *The second reason is that corporate law as now framed encourages profit maximization, an under-appreciated discipline that benefits the public at large as well as the shareholder-owners.*¹⁵¹

This second point is expanded on further on in the article:

In the broader economic sense, society is the real principal of business decisions, since the primary objective of all economic activity is to serve the interests of consumers. The only way for managers to implement the idea of profit maximization is to seek out or create profit opportunities by satisfying consumer demand. Once the importance of the relationship between profit maximization and efficient resource allocation is grasped, it is easy to see why profit maximization benefits people in addition to a corporation's shareholders. In fact, the largest "nonshareholder constituency" is the public at large. Once this point is understood, corporate law can then be analysed in terms of creating the right set of incentives in order to promote the twin goals of profit maximization and efficient resource allocation.¹⁵²

In our view, there is an inherent flaw in this argument. As we adverted to above, society and the economy are not interchangeable terms. Society is made up of more than just shareholders and consumers, the corporation being more than just an economic institution designed to manufacture consumable items and fill the pockets of shareholders. We have made this very clear in our article. As we have discussed, nowadays everyone is a stakeholder of probably many corporations, and have a variety of different relationships with corporations. Indeed, we would argue that the corporation is the most important institution in our society, even more so than government. Corporations provide the bulk of jobs in our community by which individuals are capable of being sustained and fulfil their psychological needs; corporations have an impact on the environment through their workplace practices and corporate policies (including philanthropy); corporations, through the

Corporate Governance and Accountability (2000). See also Healy, above n 7, 53, Millon, above n 120, 217; Dodd, above n 120.

¹⁵⁰ DeBow and Lee, above n 121.

¹⁵¹ Ibid 404–5 (emphasis added).

¹⁵² Ibid 417–8.

mass media, control or at least substantially influence our perceptions of ourselves and of the community and world in which we live.

The relationship between the corporation and society thus comprises a range of complex variables. It is not enough for the corporation to be economically efficient; it must be socially conscious. A social conscience involves more than just recognising that a corporation exists in a society. That is axiomatic. A social conscience involves an understanding of what our society is, and recognising the multitude of stakeholders that form part of our society. The interests of 'society' are not met by our corporations' achieving huge profits if our environment is being destroyed, and factories are being closed down with associated job losses and deterioration in social infrastructure.

F Difficulties in Measuring the Effectiveness of Management in Facilitating Shareholder Happiness

Communitarianism is often attacked on the basis that by requiring directors to consider the interests of a broad range of stakeholders when making decisions, rather than strictly focus on maximising profits, directors become less accountable as it difficult to judge whether the directors are doing their job. According to Green, this is referred to a 'control problem, caused by directors and managers considering interests other than the shareholders, whereby 'if managers are empowered to set constituency against constituency, in the end all power will fall into management's hands'.¹⁵³

In other words, it is easier to assess the performance of directors by looking at the company's profit and loss statement, than by considering reports as to how the corporation is going in establishing and maintaining positive relationships with its various stakeholders. As Healy recently wrote:

Having shareholder-value creation as an overriding objective gives managers a clear sense of what they must do. Competing or conflicting objectives will simply confuse and then provide excuses for poor management.¹⁵⁴

The same argument could therefore be used to attack the efficacy of our happiness-based model, given that — as we explained above — shareholder happiness

¹⁵³ Green, above n 38, 1417. See also Healy, above n 7, 54:

In a stakeholder philosophy managers and directors equally have no principled criterion for decision making and for measuring performance. In the absence of a dominant objective, a stakeholder-based business is likely to fail if competing with a shareholder-value based business within an industry. An economy based on stakeholderism as the dominant value system will fail against an economy that understands the primacy of shareholder value.

¹⁵⁴ Healy, above n 7, 69.

depends on the corporation establishing and maintaining such positive relationships with the various stakeholders of the corporation, rather than focus strictly on maximising profits. The difference, however, between our conception of the corporation and the view of communitarians, is our model does not involve a radical departure from the present corporate law and governance arrangements: at its core remains the shareholder primacy norm, albeit reconfigured on the basis that ‘the interests of shareholders’ are best served by the corporation facilitating the formation of bonds with its various stakeholders with a view to maximising shareholder happiness, rather than by the corporation focusing on nothing else but profits. The corporation is still encouraged to generate profits, and indeed it is recognised that such profits distributed to shareholders can serve a useful purpose in happiness terms, but the materialistic pursuit of profits is limited and cuts off before it can trigger unhappiness in shareholders by breaking the bonds they rely on to satisfy their psychological needs.

Accordingly, we concede that a communitarian model of the corporation would present problems in terms of being able to maintain effective director accountability, yet we believe that director accountability would not be a problem under a happiness-based model once it is accepted that shareholder primacy continues to be the target by which performance can be assessed, but that the target has been redesigned to some extent so that it is legitimate for directors and managers to take into account issues beyond whether profits will be increased or not when making decisions. It is not unrealistic that the performance of directors can be effectively measured, and hence accountability maintained and promoted under our happiness model. Ultimately, the directors would still be servants of the shareholders, and if the directors are not capable on a regular basis of clearly explaining to shareholders how the decisions they have made facilitate happiness and therefore are in the best interests of shareholders, they would soon be voted out of office by their masters. Director accountability could not be any more direct and healthy.

V COMMENTS

In 1993, US Law Professor Lyman Johnson, asked the question: ‘[w]ill corporate law be an important subject of intellectual inquiry in the years ahead, or will it be a kind of academic sideshow’. Professor Johnson continued:

By “important” I do not simply mean prominent and highly regarded in the academic or larger social sphere, although that is an integral part of what I mean. I also mean whether the subject of corporate law is important to those of us who do corporate law, in the sense of dealing not just with intriguing intellectual ideas but with matters that we personally value and even cherish. ... This “will” question – will corporate law be a significant field of inquiry –

prompts a “can” question: “Can corporate law be important if shareholder primacy remains the elective focus?”¹⁵⁵

As the authors have outlined in this article, the answer to this ‘can’ question is ‘yes’. In this article, the authors have explained how an inherent human objective, happiness, can form the basis for a unifying understanding of the corporation. This happiness-based model of the corporation maintains shareholder primacy as the guiding norm for corporations law, however shareholder primacy is redefined in order to reflect what is really important to shareholders: fulfilment of psychological needs (among other things, being the formation of strong relationships, satisfaction of basic needs to live, a sense of participation, control and self-worth) which contribute to personal happiness, rather than strict wealth maximisation — with studies showing that a focus on materialistic values is actually the cause of unhappiness rather than happiness.

Once we understand that the happiness of shareholders depends on the satisfaction of these psychological needs which are conducive to personal happiness, rather the accumulation of wealth achieved through corporations focusing on profits, we see the potential of our happiness model to address a perceived conflict in corporate governance between ‘contractarians’ who believe that shareholder primacy equates with wealth maximisation, and ‘communitarians’ who believe that corporations are public, rather than private, institutions and hence have social obligations. Shareholder primacy and corporate social responsibility do not have to be mutually exclusive concepts. As we have argued, there is no reason why ‘shareholder primacy’ cannot be redefined to accommodate the fulfilment of social obligations which are conducive to shareholder happiness (principally through building and maintaining positive bonds with the corporation’s various stakeholders), particularly as empirical studies on what makes people happy suggest that this better reflects what is in the best interests of shareholders than economic assumptions which equate shareholder interests with profits and wealth maximisation.

While on the surface modern corporations appear to be strictly focused on achieving profits for shareholders, and shareholders appear to buy and exchange shares in different corporations purely to make money, the empirical studies on happiness discussed in this article show that the real motivations of corporations and their shareholders are in fact much deeper and humanistic. The formation of corporations and activities associated with shareholding are really just examples of ‘need expression’— things we as individuals do with an overriding objective in mind of being happy. As studies have shown that strict wealth creation, without also satisfying other, social needs such as building and maintaining relationships and enjoying a sense of community in the way we live, is likely to cause unhappiness rather than contribute to happiness, we must not see shareholder primacy as purely about the corporation maximising profits.

¹⁵⁵ Johnson, above n 121, 1713.

Accordingly, while happiness studies may not feature regularly (if at all!) in financial press reports or in the annual reports of corporations, participation in the pursuit of happiness (principally for shareholders, but also other stakeholders) goes to the heart of why corporations exist, and hence why individuals willingly invest in corporations and participate as shareholders. More than any other theoretical model of the corporation does or possibly can do, our happiness-based model of the corporation reflects the reality of shareholders' and other participants' relationship with the corporation. Given that happiness is the most important objective of every living human being, and there are common ingredients to the fulfilment of happiness which we all share, our happiness-based model is also capable of universal application — it is applicable to every single form of corporation in every single jurisdiction in the world. Accordingly, the happiness-based model of the corporation provides a superior normative paradigm by which we can assess the effectiveness of existing corporate governance arrangements and corporate laws, and guide the future direction of corporate law based on the understanding that the law is an excellent mechanism by which the corporation can become more effective in facilitating the happiness of shareholders.

In concluding, based on our analysis in this article, we wish to raise our concern, from a happiness perspective, with the dominant governance structure in large public corporations, the separation of ownership and control. Even though the separation of ownership and control has given enormous power to directors and managers and really limited the role that shareholders play in modern corporations, this governance structure has been allowed to continue unabated — the widespread belief being that it is in the best interests of shareholders, and hence is consistent with the shareholder primacy norm. Directors and managers are specialised in making money for the corporation (so the argument runs), and therefore should be given essentially free rein to do this, as this serves the interests of shareholders who simply want to make money off their investment.

Given, however, that happiness studies have smashed any false assumptions of their being an indisputable interconnectedness between shareholder primacy and wealth maximisation, we see that the separation of ownership and control, and in particular the overly passive role of shareholders in the corporation as a consequence of management's almost unbridled power over the corporation, now sits on a decidedly shaky foundation. In our view, once we understand that personal happiness depends largely on strong relationships and a sense of participation and control in one's life, the separation of ownership and control, with its characteristic 'physical and psychological distance' between directors and shareholders,¹⁵⁶ at least in general terms is clearly a barrier to, rather than a facilitator of, shareholder happiness.

In a series of forthcoming articles, the authors will raise and explore in detail some corporate law reform initiatives designed to bridge the separation of ownership and

¹⁵⁶ See Hale, above n 141.

control in a manner which is consistent with our happiness-based model of the corporation, whilst also remaining loyal to the present system as much as possible by recognising that directors and managers do serve a valuable role in the modern corporation.