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Abstract

I've been told that the Corporate Social Responsibility movement began some 25 years ago. It appears to be based on some assumptions. First, it asserts that shareholders are 'corporate owners'. Second, it describes the traditional view of a corporation as a 'shareholder focused entity'. Having made those assumptions, CSR proponents then urge a change to a 'stakeholder' model.

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Law

CORPORATE SOCIAL RESPONSIBILITY – A WELL-MEANING BUT UNWORKABLE CONCEPT

Bruce Welling*

A CORPORATE SOCIAL RESPONSIBILITY: THE CONCEPT IN A NUTSHELL

I've been told that the Corporate Social Responsibility movement began some 25 years ago. It appears to be based on some assumptions. First, it asserts that shareholders are 'corporate owners'. Second, it describes the traditional view of a corporation as a 'shareholder focused entity'.¹ Having made those assumptions, CSR proponents then urge a change to a 'stakeholder' model.

I don't share those assumptions. Corporations either (i) are people in law, or (ii) have the legal rights and liberties of humans. People, and anyone with humans' rights and liberties, can't be owned. Nor is a corporation a 'shareholder focused entity': it is just a legal person, focused on its own self-interests.² Having rejected those assumptions, I see no reason to adopt a 'stakeholder' model.³

The *UK Companies Act 2006* provides an example of whose interests the 'stakeholder' model might have us consider. Section 172(1) says the following.

A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard, (amongst other matters) to –

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company's employees,
- (c) the need to foster the company's business relationships with suppliers, customers and others,

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¹ Commonly cited as exemplars of the so-called traditional view are the following propositions. 'Corporations exist to provide products or services that produce profits for their shareholders [anon].' And this from Milton Friedman disciples: 'since only people can have social responsibilities, corporations are only responsible to their shareholders and not to society as a whole'. I don't know whether those views are traditional, but they too are suspect.

² More on those two points later.

³ What is a 'stakeholder' anyway? What do you visualise. To me it conjures up shadowy Valley Girls named Buffy, armed appropriately, prowling the mists of Transylvania.

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- (d) the impact of the company's operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members of the company.

CSR proponents would say that a list something like that sets out what Boards of Directors ought to think about when making decisions for a corporation. I am sure their views aren't monolithic, and that they have disagreements among themselves. Let me explain why I think they are on the wrong track.

B WHAT ARE THEY PROPOSING THAT DIRECTORS 'SHOULD' DO?

I note that the *UK Companies Act 2006* s 172(1) tells us that directors 'must ... have regard ... to' items on the list. What do CSR proponents propose? I think there are three possibilities. They might be saying:

- (i) a director *may* consider the interests of 'stakeholders';
- (ii) a director *must* consider the interests of 'stakeholders';
- (iii) a director *owes a legal duty* to consider the interests of 'stakeholders'.

Each possibility is problematic as a legal proposition

As to (i), few corporate lawyers these days would dispute that a director *may consider* a wide range of competing interests when making corporate decisions. Most of us accept that most directors will do so, and we hope they will have hearty debates among themselves about them. But when it comes time to make the decision – whether to vote yea or nay on the resolution before the Board – most of us insist that the vote must be cast by considering only what is best for the person (or persons) to whom each director's fiduciary duty is owed. That is why we have no trouble with possibility (i): it merely describes what directors do all the time. It is a business proposition, not a legal proposition.

As to (ii), if anyone is suggesting that directors must consider 'stakeholders' interests, any lawyer would be wise to ask one vital legal question. Or else what?⁴ Absent any statutory requirement similar to s 172(1) of the *UK*

⁴ That is where the *UK Companies Act 2006* is puzzling. The answer to the 'or else what' question is obvious there: any director who doesn't 'have regard ... to' items on the list is clearly in breach of the statute and is no doubt subject to a penalty of some sort. However, after having had regard to those items, each director is told by the statute that the next move is to 'act in the way he considers ... would be most likely to promote the success of

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Companies Act 2006, the legal answer would be ‘or else nothing’. Each director would be at liberty to have regard to ‘stakeholder’ interests, or to ignore them, before voting on the resolution before the Board in the usual way.

As to (iii), if anyone is suggesting that, as a general legal proposition, a director *owes a legal duty* to consider the interests of ‘stakeholders’, that must be incorrect. Any such duty (a) would have to have a source and (b) would have to be owed to someone. I shall now survey the background we need to demonstrate why neither of those is possible in corporate law theory.

C CORPORATE HISTORY AND THE CURRENT STATE OF CORPORATE LAW

I remind you of some history. Most of you will be familiar with it.⁵

1 English law pre-1720

Once upon a time business corporations were created by Royal Charter. Creating corporations was a Royal Prerogative. Interestingly, the King’s prerogative did not extend to making other people, shareholders for example, liable for the debts of the corporations he created.⁶ Only the corporation was liable. Early scholars thus deduced that a Charter Corporation had legal personality.⁷ After 1688 most corporations were chartered by Parliament, there being some doubt about what Royal prerogatives had survived the Glorious Revolution. It was clear to everyone that Parliament had power to impose liability on shareholders, but it didn’t do so.⁸

2 English registered companies after 1844

In 1844 the English Parliament enacted the original statute to create registered companies. This type of incorporation found overseas homes in Australia and New Zealand, though not in most of Canada. Three important facts have been largely forgotten about registered companies. First, they were originally conceived as variations on the well known theme of Charter Corporations.

the company for the benefit of its members as a whole’. In short, get on with the real task at hand.

⁵ I’ve written about this historical development in greater detail in *Corporate Law in Canada: the Governing Principles 3rd ed* (Scribblers Qld 2006) pp 81 - 109, and have made reference to many earlier works (some much earlier) on the topic.

⁶ See Lindley, *A Treatise on the Law of Companies* 5th ed (London Sweet & Maxwell 1891) at 3.

⁷ Two of the most prominent examples were the East India Company and the Hudson’s Bay Company.

⁸ Parliamentary chartering had a rather short history. Corporations, or at least newly-incorporated ones, became suspect creatures after one of the greatest stock market crashes in history spawned the *Bubble Act* of 1720.

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The original 1844 statute described them in section 1: ‘Whereas it is expedient ... to invest such Companies with the Qualities and Incidents of Corporations, with some Modifications’. Second, one of the main modifications was the statutory imposition of liability on the shareholders: section XXV of the 1844 statute said clearly ‘but every ... Shareholder shall ... be and continue liable as he would have been if the said Company had not been incorporated’.⁹ Third, and curious to a 21st century Canadian eye, the shareholders were statutorily envisioned somehow *as being* the newly incorporated company: section XXV said ‘[the shareholders] shall be ... incorporated ... for the Purpose of suing and being sued’. As you all know, the English House of Lords confirmed the statutory enshrinement of corporate personality on registered companies in the 1896 Salomon case, interpreting the 1862 version of the *Companies Act*.

I’ve always wondered whether it was the statutory words ‘the shareholders] shall be ... incorporated’ that inspired the English cartoon depiction of a registered company. You’ll be familiar with it: stick men in a box, or on a stage behind an opaque curtain. The stick men are the shareholders, whom you see when you draw aside the curtain of lift the cover on the box.¹⁰ Thus, I deduce, arose the English (and Australian, and much of the Commonwealth’s) view on fiduciary duties: each director (i) owes a fiduciary duty to the company, but (ii) ‘the company’ is the shareholders.¹¹

3 The American view

The Americans invented a different view. They typically say that each director owes fiduciary duties to the corporation and to the shareholders. I understand the duty to the corporation. I don’t know what to make of an obviously conflicting duty owed to ‘the shareholders’. Imagine a corporation with a million shareholders spread across the USA and beyond. Would every director’s duties always conflict? Could any director ever decide anything?

⁹ That statutory imposition of shareholder liability was withdrawn by the unfortunately named *Limited Liability Act* of 1855. The two statutes were combined into the *Companies Act* 1862. More than 130 years of English, Australian and Kiwi company law were based on the 1862 model.

¹⁰ Thus the inelegant (to my Canadian ears) phrase ‘lifting the corporate veil’.

¹¹ Though, mysteriously, there isn’t a fiduciary duty owed to each of the shareholders. The duty is said to be owed to ‘the company as a whole’, which I take to mean to either the group of shareholders or to some notional shareholder who is some mystic amalgam of the wants and expectations of all the shareholders, averaged somehow to take all into consideration without focusing on what each might require. As to the former, a duty to a group is anathema to the common law system, which can only handle duties owed by one person to one other person. As to the latter, that’s too complicated for the likes of me: I see it as mystification.

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4 Canadian corporations are different

Canadian history is curiously different. In 1864 – barely two years after England consolidated its 1844 and 1855 statutes and set the standard for the registered companies you are familiar with – what are now Ontario and Quebec enacted a Letters Patent statute.¹² It bore no resemblance to the 1862 *English Companies Act*. The letters patent *corporations* created under it bore little resemblance to registered companies. They were much like the old Charter Corporations, created by a civil servant wielding power delegated by Crown appointment. They were immune from the *ultra vires* rule that so complicated registered companies' law for over a century. They were, like their Charter predecessors, clearly legal persons.¹³

The United Provinces disunited and became two of the original four Canadian provinces when the country of Canada was born in 1867. All four original provinces had letters patent statutes, as did the Dominion of Canada.¹⁴ Other provinces joined later. Eventually, six of the eleven (including Federal) incorporating jurisdictions had letters patent statutes. The other five adopted English (registered companies) Model statutes, but the combined population of those five paled in comparison to that of the letters patent jurisdictions.¹⁵

Canada thus developed largely on letters patent corporate law. That all changed, beginning in the 1970s. The *Canada Business Corporations Act* was conceived by a committee and born of the Parliament of Canada in 1975.¹⁶ The committee, and Parliament, firmly rejected the English model and opted for a uniquely Canadian version of the New York and Delaware statutes. That version has since swept the country.¹⁷ The *CBCA*, and its provincial clones,

¹² Ontario and Quebec were then a British colony called The United Provinces of Upper and Lower Canada. The statute was 27-28 Vict c 23.

¹³ See *Bonanza Creek Gold Mining Co v The King* [1916] 1 AC 566, 26 DLR 273 (Ont JCPC).

¹⁴ Each of the ten provincial legislatures has the power to create corporations, as does the Federal Parliament. Nova Scotia and New Brunswick were the other two original provinces: they were, and they remain, far smaller and less populated than Ontario and Quebec.

¹⁵ The former letters patent provinces now account for more than 65% of Canada's population; the percentage would have been even higher in the latter half of the 19th century.

¹⁶ Note the word 'business'. Non-business corporations aren't covered. They are incorporated under other statutes in Canada.

¹⁷ Nova Scotia (2.9% of Canada's population) remains based on the English model that it switched to around 1900; Prince Edward Island (0.4% of Canada's population) is still letters patent; British Columbia (13.2% of Canada's population) has a weird statute, unlike any I've seen elsewhere.

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enact a powerful version of the corporate personality principle and the fiduciary obligation rule.

CBCA s 15(1) A corporation has the capacity and, subject to this Act, the rights, powers and privileges of a natural person.

CBCA s 122(1) Every director and officer of a corporation in exercising their (sic) powers and discharging their (sic) duties shall

(a) act honestly and in good faith with a view to the best interests of the corporation

Now for the interesting fact. Shareholders are not to be confused with the corporation's personality. A *CBCA* corporation is born without any shareholders at all; it merely has one or more 'first directors'. It is conventional for the first directors to issue some shares soon after incorporation, but as far as I know it isn't compulsory. Thus, immediately after incorporation, each director owes a statute-based, fiduciary-like duty to the corporation. That corporation is a new person, sprung adult and fully armed to face the world, presumably to pursue its own self-interest.

Because of our letters patent history and our present *CBCA*-based statutes, Canadian corporate law is simpler. Directors owe duties to the corporation. The corporation means the legal person – the perfect capitalist pig – created by the statutory process. A director of such a legal person would do well to consider what *it* wants done on *its* behalf, not what other less capitalist people like humans and shareholders might want.

D WHY CSR WON'T WORK

We digressed from our review of corporate social responsibility with one point left to consider. That point involved the possibility that, as a general legal proposition, a director *owes a legal duty* to consider the interests of 'stakeholders'. I said that must be incorrect. Any such duty (a) would have to have a source and (b) would have to be owed to someone.

We now have all the data we require to demonstrate that the proposed general legal proposition is false.

As to (a), there are three sources of legal obligation in the common law system. They are (1) common law, (2) Equity, and (3) statute. As to (b), let's consider the possibility that a duty might be owed to 'stakeholders' based on each of those three sources.

1 Is there a common law duty?

I know of none. But what if someone claimed that there was? What do corporate law principles compel by way of response?

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From the English and Australian point of view, a fiduciary duty – *ie* an Equitable obligation – is owed to the company. Regardless whether ‘company’ is construed as some collective or averaged shareholder group, it is an Equitable duty owed to someone who is not the amorphous ‘stakeholder’ of CSR lore. In the common law system, Equity outranks common law. If common law analysis leads to one conclusion and Equitable analysis leads elsewhere, we’ve known for nearly 400 years that the Equitable result prevails.¹⁸ One could say, I suppose, that if the alleged common law duty led to the same conclusion as the Equitable fiduciary result the common law conclusion would not be displaced. However, the common law result would be moot. Since the fiduciary obligation would always be owed, the result would always be the Equitable result. The fact that one might sometimes reach the same result by conjuring up and applying a common law duty would be uninteresting, and would offend *Occam’s Razor*.

The American view of a director’s fiduciary duties leads to the same conclusion. The only difference – that directors’ fiduciary duties are said to be owed both to the corporation and to the shareholders – doesn’t change the fact that the duties are owed to specified people who are not the ‘stakeholders’. Once that point is admitted, the above analysis applies.

Similarly in Canadian corporate law the fiduciary duty owed to ‘the corporation’ takes precedence over any common law duty alleged to be owed to ‘stakeholders’. The reasoning is the same, except it is more powerful. The source of each director’s duty is the statute, which even more clearly outranks the common law.¹⁹

2 Is there an Equitable duty?

I know of none. But what if someone claimed that there was? What do corporate law principles compel by way of response?

First, we know that Equity recognises directors’ fiduciary duties to English companies, American corporations (and perhaps their shareholders), and to Canadian corporations (whether letters patent or *CBCA*). It seems unlikely that Equity would also recognise an obviously conflicting duty to ‘stakeholders’.

¹⁸ *Earl of Oxford’s Case* (1615) 1 Rep Ch 1 & App, 1 W & TLC 615 (King James).

¹⁹ I wrote more extensively on this theory of higher ranking obligations displacing lower ranked duties in ‘Individual Liability for Corporate Acts: the Defence of Hobson’s Choice’ in *Ruled by Law: Essays in Memory of Justice Sopinka* (Butterworths Canada 2003 Lionel Smith ed), also published at (2000) 12 Supreme Court L Rev 55. There is a differently organized version of the same set of arguments in *Welling Corporate law in Canada: the Governing Principles* (Scribblers Queensland 2006) at 143-152.

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Second, if Equity did recognise that conflicting duty, it would put each director in a conflict situation most of the time.²⁰ A director placed in a conflict situation can't be allowed to prefer one duty (or self-interest) over the duty to the corporation. Nor could the director abandon an Equitable duty to someone else and prefer the corporation's interests. The only honourable option for a director in such a conflict situation is to disclose the conflict to each person to whom a duty is owed and withdraw from the decision-making process. Note that each director would be obliged to withdraw, leaving the Boardroom empty. No decision could be made.

That explains the situation under the traditional English view, the traditional Australian view, and the American view. It would be different for *CBCA* corporations.²¹ The statutory obligation to act in the best interests of the corporation would outrank the alleged Equitable obligation to 'stakeholders'. Any director accused of abandoning the 'stakeholders' would have the perfect defence: 'I obeyed the higher legal obligation'.

3 Is there a statutory duty?

I know of none.²² But what if someone claimed that there was? What do corporate law principles compel by way of response?

In jurisdictions where a director's fiduciary duty is Equitable, a statutory provision imposing a duty to 'stakeholders' would prevail. However, one would have to interpret the statutory provision to determine to what extent it displaced the traditional Equitable obligation. I suggest that no legislature in the common law world would displace it to any great degree, absent a major re-think of its basic corporate law structure.

In jurisdictions like Canada and Australia, where a director's fiduciary obligation is statutory, the conclusion might be that the director owed two equally ranking obligations. If so, each director would have to refrain from voting on a resolution whenever the two duties conflicted. That would often happen.

There is, however, another possibility. Under the *CBCA*, a federal statute, breach of any statutory obligation is an offence.²³ The Federal Parliament

²⁰ We are all familiar with the concept of a fiduciary duty conflicting with the fiduciary's self-interest. The underlying principles and the applicable rules are the same when fiduciary duties owed simultaneously to two beneficiaries conflict.

²¹ And, I suggest, for Australian companies under the current statute, because the fiduciary duty is statutory.

²² Except for the *UK Companies Act 2006* s 172(1), as to which see footnote 4.

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controls criminal law in Canada. Breach of a federal statute like the *CBCA* would appear to be a criminal offence. I say that obeying the criminal law is an obligation owed to Her Majesty the Queen of Canada. I say that is a higher ranking obligation than a duty owed to some 'stakeholder'.²⁴

I'm not sure whether the same type reasoning would apply regarding state-based criminal law in Australia.

²³ *CBCA* s 251 Every person who, without reasonable cause, contravenes a provision of this Act or the regulations for which no punishment is provided is guilty of an offence punishable on summary conviction.

²⁴ Unless the 'stakeholder' provision was also in a Canadian federal statute that provided a similar type of criminal offence for breach. Are criminal offences ranked these days?