Corporate Stakeholders in New Zealand: The Present, and Possibilities for the Future

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For more than a century the business corporation has been a successful and widely adopted institutional arrangement for creating and distributing wealth. But the power and purpose of corporations and of the entire corporate system has been continuously questioned and debated. The interaction between global economic growth and global social challenge has led to changes in the character and behaviour of corporations and in public expectations about the role and responsibility of corporations within society.¹

I. Introduction

The stakeholder principle has gained increased recognition in corporate governance in the recent times. It is understood, by and large, as a refinement of the more limited conception of business corporations as vehicles whose function is to promote the economic interests of their shareholders.² The stakeholder idea has always been present in company law. Its scheme of creditor protection, which is one of the foundational principles, is proof of this fact.

The stakeholder vision articulated in the recent times is, however, more expansive and proactive. It covers a large number of non-shareholder groups – employees, suppliers, communities and so on – and seeks to promote active corporate engagement in protecting the interests and enhancing the welfare of these groups. This article surveys the companies listed on the New Zealand Stock Exchange to determine how far they reflect the stakeholder idea and include non-shareholder concerns in their governance policies. This is done through an analysis of the governance charters and other materials such as annual reports and mission statements of the companies.

The results of the survey are significant. They point towards rising acceptance of the stakeholder vision in corporate governance in New Zealand.

- 130 companies, including 20 overseas companies, have listed their shares on the New Zealand Stock Exchange.
- 91 of the 130 companies, representing about 70 percent of the total, recognize stakeholders in some form. The companies refer to non-shareholder interests in a number of contexts and present them as an important consideration in developing governance policies and business strategies.
- The ratio is higher for overseas companies, with 15 out 20 (75 percent) acknowledging non-shareholder interests in their governance-related documents.

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The research funding provided by The University of Auckland Business School for this Project is gratefully acknowledged.


² The debate was first stated in these terms by Owen Young, chairman of the General Electric Company in 1929. See E. Merrick Dodd, “For Whom Are Corporate Managers Trustees?” (1932) 45 Harv. L. Rev. 1145 at 1154.
Among the 110 domestic companies of New Zealand 76, or just under 70 percent of the total, recognize non-shareholder interests.

The companies recognize stakeholder interests in different documents – governance charters, annual reports, mission statements and so on. As can be expected, there are variations in content and style among individual companies in their statement of the stakeholder vision.

The stakeholder idea has become prominent in law in most common law jurisdictions – Canada, \(^3\) U.K., \(^4\) and U.S. \(^5\) It has also emerged as a major strand in the disciplines of finance and business management. \(^6\) The current New Zealand statute, the *Companies Act 1993*, \(^7\) does not recognize the stakeholder idea. However, it has an interesting mechanism that empowers companies to name any person as an “entitled person” for the purpose of invoking the statutory remedy against oppression and unfair prejudice or discrimination, among other things. There are no apparent limitations on the constituencies that can be included in this category, and it would be possible for companies to include employees, suppliers or any other stakeholder as entitled persons.

This framework in New Zealand company law offers interesting possibilities for institutionalizing the stakeholder principle in corporate governance. It can be interpreted as a combination of the public and the private. Here, legislation plays a positive role by facilitating stakeholder engagement, and individual companies can determine whether they wish to empower the stakeholders to invoke the statutory remedy against oppression or unfair prejudice. \(^8\) The survey presented in this article also reviews the constitutions of the listed New Zealand companies to find out whether they have made use of the enabling provision in the statute and have empowered any groups to invoke the remedy against oppression or unfair prejudice. The survey found that none of the New Zealand companies have any included provisions on non-shareholder constituencies in their constitutions.

This article advocates the adoption of the stakeholder approach to corporate governance in New Zealand. It points out that the stakeholder principle has received significant recognition in the larger common law jurisdictions – U.S., U.K. and Canada – from which New Zealand has adopted many ideas and principles. Their experience can be valuable in developing a richer and more inclusive theory for company law in New Zealand.

The paper is divided into five parts. Part II provides an overview of the stakeholder idea, viewing it from the lens of management theory and legal theory. This is important in explaining the concept and its adoption in management theory and practice, as well as understanding the challenges in developing a legally workable stakeholder model of governance. The discussion stresses the need for a developing unifying approach towards the stakeholder principle for institutionalizing it in the

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\(^3\) See e.g. the provisions on derivative action and the oppression remedy in the *Canada Business Corporations Act* (R.S.C. 1985, c. C-44), Sections 238-241.

\(^4\) More recently in the U.K., the stakeholder principle is stated at some length in the *Companies Act 2006*, Section 172.

\(^5\) For extracts of the stakeholder provisions in various American jurisdictions, see (1992) 21 Stetson L. Rev. 279.

\(^6\) See e.g. James Post *et al.*, supra note 1.

\(^7\) No. 105.

\(^8\) To be clear, stakeholder empowerment was not the apparent intention of the drafters of the New Zealand *Companies Act*. I have explained this later in the paper. Yet the mechanism provided in the statute can be applied to promote the stakeholder principle, and this is an important argument made in the article.
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governance framework of companies. Part III presents the data and the results from the survey of the companies listed on the New Zealand Stock Exchange and an analysis of their implications.

Part IV is about company law and the stakeholder principle. It outlines the shareholder primacy philosophy of corporate law in the English-speaking world and traces the emergence and growth of the stakeholder idea from the crucible of shareholder primacy. The discussion points out the increased awareness about the need for a more institutional approach in lawmaking for business corporations, away from limited contractarian notions and the private ordering paradigm. Part V concludes with a plea for the adoption of a stakeholder vision in corporate theory in New Zealand.

II. The Stakeholder Principle – Its Understanding In Business Management and Law

The stakeholder vision is offered as a contrast to the traditional shareholder model which treats companies as the property of the shareholders and understands the corporate goal or objective as maximizing the benefit of the shareholders. The stakeholder model, on the other hand, perceives companies as institutions or organizations that have broader terms of reference. It recognizes a number of constituencies – shareholders, employees, suppliers, communities and so on, all of which have an interest or a stake in the organization and are entitled to consideration. The constituencies are not necessarily viewed in hierarchical terms, nor do any of them have automatic preference over the others.

As pointed out, about 70 percent of the listed companies in New Zealand recognize non-shareholder groups and their interests as a consideration in corporate governance. This is clearly accepted as a management principle. The stakeholder principle in corporate law is, however, a different matter. Widespread acceptance of the stakeholder model is a fact in management practice, but there can be significant issues in developing a workable version in law. Quite obviously, there are characteristic differences between the two disciplines – law and business management – and divergent considerations influence the development of doctrines in the two streams. It is equally obvious that rigid and procrustean rules would be out of place – both ideologically and as a practical matter. They would simply not work. This part examines ideas about corporate stakeholders in management theory and how they relate to the discipline of law and the legal setting.

In management, the usual practice is to recognize the stakeholder idea as a broad principle that guides companies in formulating business strategies and governance policies. In general, there would be little need to go beyond this general recognition of the principle; a detailed policy on the implementation of the principle and defining the positions of the parties would be unnecessary. It is implicit in the acknowledgment of the stakeholder idea that it would lead on to action, and non-shareholder interests would be reflected, in an appropriate manner, in a company’s strategies and policies. There is no warrant for significant elaboration or specificity, precise definitions or any ranking or prioritizing among the different stakeholder groups – things that would be typically important considerations in law.

New Zealand Refining Company (NZRC) presents a typical sample of the variety of recognition and acknowledgment that stakeholders receive in management practice. NZRC is a midsized company
with sales of NZ$397million in 2008. It had 3,179 shareholders and 384 employees in that year.\(^9\) The annual report of the company has, in all, 19 references to “stakeholders.” The references appear in various contexts, which include:

- Vision statement (“we aim to delight our customers, shareholders, staff and other stakeholders”),\(^10\)
- Partnership with stakeholders in environmental and sustainability projects\(^11\)
- Statement of Directors and Management Commitment (providing “shareholders and other stakeholders with the assurance that the Company delivers on its promises”)\(^12\)
- Ethical and Responsible Decision Making (reference to “the highest standards of corporate behaviour towards our stakeholders.”)\(^13\)
- Capital Risk Management (stress on “safeguard[ing] the Group’s ability to continue as a going concern in order to provide returns for shareholders and benefit for other stakeholders”)\(^14\)

Often, the trend in NZRC’s annual report is to bracket stakeholders and shareholders together. This can be interpreted as evidence of weaker consciousness of the differences between shareholders and other constituencies – a thing often stressed in corporate theory. The repeated affirmations of the stakeholder principle NZRC has made in its annual report are either statements of facts or policy. Viewed from the legal lens, they are rather generally worded. There is no clear identification of any specific groups included in the omnibus term “stakeholders.” Indeed the feedback form at the end of the report, which requires disclosure of the capacity of the person providing feedback, lists a number of non-shareholder groups and finally leaves a residual category.\(^15\) This is an indication of the difficulties in listing the stakeholders. The idea is, essentially, open-ended in management theory and practice.

The generalist understanding of the stakeholder principle is evident from the works of management scholars. R. Edward Freeman, who revived the stakeholder debate in the 1980s, adopted a very broad framework for his model.\(^16\) The timing of Freeman’s work is significant. It was the period when the economic theory of business corporations, which emphasized shareholder value, was becoming influential.\(^17\) It was also the era of hostile takeovers in the United States, and the benefit for the shareholders through higher share prices was offered as the justification for many of the takeovers. The takeovers often had serious consequences for non-shareholders – for employees of the plants that were closed and the communities where the plants were located.\(^18\) In this sense,


\(^10\) Ibid. at 2.

\(^11\) Ibid. at 2, 8 and 56.

\(^12\) Ibid. at 21.

\(^13\) Ibid. at 26.

\(^14\) Ibid. at 92.

\(^15\) Ibid. at 118.


Freeman’s espousal of the stakeholder vision can be interpreted as a reaction to the mono-dimensional shareholder value model and its consequences.

In setting out the stakeholder approach, Freeman defined the term “stakeholders” to include “any group or individual who can affect or is affected by the achievement of the firm’s objectives.” This is a very “broad-brush” definition, lacking specificity. Starting from this liberal viewpoint, Freeman listed a wide-ranging group as “examples” of stakeholders. The list included media, competitors, consumer advocates, environmentalists, and special interest groups.

The stakeholder conceptualization of Edward Freeman is, by legal standards, staggering in its breadth. Among the groups identified by Freeman, lawyers and persons with legal training will probably be more accustomed to viewing at least one of them – competitors – in adversarial terms. With competitors, the legal mind might not readily receive the suggestion of community of interests that is implicit in the stakeholder vision.

More recently James Post et al. have defined the corporate objective or function in the following terms, viewing it from the stakeholder perspective:

> The corporation is an organization engaged in mobilizing resources for productive uses in order to create wealth and other benefits (and not to intentionally destroy wealth, increase risk, or cause harm) for its multiple stakeholders.  

This description is useful as a working definition of the stakeholder model of governance. It sets an overarching goal for a business corporation – namely, “create wealth and other benefits . . . for its multiple stakeholders.” The corporate enterprise would be geared towards achieving this goal of benefiting all of its stakeholders. Significantly, James Post et al. did not develop a list of the stakeholders, either illustrative or exhaustive. They merely clarified that “corporate managers should attempt to identify their significant and legitimate stakeholders (particularly those who are non-contractual and involuntary, and hence easily overlooked). . .”

The references to “legitimacy” and the “non-contractual and involuntary” nature of the involvement of stakeholder groups are significant. They are proof of the attention that management theory pays to the fact of a group being affected by the operations or the policies of a business corporation, rather than its legal relationship with the corporation. The approach of James Post et al. brings out, quite clearly, the quintessential character of the stakeholder vision in management theory – as a guiding principle in governance unconstrained by legal notions of rights, duties or priorities.

The position would be different in law. In the legal setting, we can identify a number of practical difficulties with the broad stakeholder model envisioned in management theory. The stakeholder vision is clear enough as a statement of principle. It is easy to acknowledge that various non-shareholder groups – employees, customers, suppliers, and so on – have interests in corporations. Rather, it would it be difficult to argue that these segments do not have any interest in the corporate

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19 R. Edward Freeman, supra note 15 at 25.
20 James Post et al., supra note 1 at 17.
21 Ibid.
enterprises. This characterization, however, does not resolve the problems in developing a version of the stakeholder model in the conventional legal mould.

The first issue is that the legal system, as it has developed and as it exists, is not seriously concerned with “interests,” pure and simple.²² The system is built around “rights,” and provides remedies for the breach of rights. A conventional lawyer will likely find the “interests” of the various stakeholders, which management theory recognizes, somewhat obscure. To the lawyer, the idea would be amorphous, and his/hers natural tendency will be to look for clearly-defined “rights” that can be enforced. The legal mind needs the position or the rights of the various constituencies to be defined with reasonable clarity and the interests of the different groups to be ranked or prioritized.²³ These characteristics of the legal system can be considered the inflection point at which legal theory and management theory part ways. Beyond this, it becomes difficult to reconcile or harmonize the two.

In law, it would not be sufficient to stop with mere recognition of the interests of the stakeholders. It is necessary to go further and develop these interests into reasonably clear legal rights that can be enforced in the courts. Again, there would be significant challenges in defining and prioritizing the relative positions and the rights of the various groups in business corporations. This would involve assigning weights to each of them and devising methods for determining the relative weights.

The problem is compounded by the adversarial system of litigation in which judges must make a choice between the litigants. In substance, the stakeholder idea is about balancing and reconciling various interests which may sometimes be in conflict with one another. For the legal system to deal with conflicts among different constituencies, the broad principle of commonality of interests would not be adequate.²⁴ Indeed, it would be out of place. The stakeholder principle would be of little use even if there was no disagreement with it.²⁵ These are some of the complexities in developing a legal model of the stakeholder corporation.

²² Roscoe Pound pointed out that recognition of interests is a step, sequentially the first, in the development of a more complete legal order culminating in the recognition of a right and providing a remedy for its breach. Roscoe Pound, Roscoe Pound, Jurisprudence (St. Paul, Minn.: West Publishing, 1950) Vol. IV. The legal order conceived by Pound would have greater validity for private disputes and/or complaints against inappropriate use of public power. The principle may not be entirely applicable to the corporate governance and its regulation, which are essentially institutional character.

²³ A legal analogy would be about the position of the creditors among whom the assets of a debtor must be distributed. The classification of creditors in secured and unsecured and then ranking within the class of secured creditors, as those with the first charge and second or pari passu charge and so on, are examples of the manner in which the legal system typically operates.

²⁴ People’s Department Stores Inc. (Trustee of) v. Wise, 2004 SCC 68, [2004] 3 S.C.R. 461, a recent case decided by the Supreme Court of Canada, is a good example of such conflict. The plaintiffs were the creditors of a company which was in a better financial position than another company with which it merged as part of a corporate reorganization. The merger did not lead to business improvement and the combined entity went into liquidation. The plaintiffs who were unsecured creditors could not make any recovery. They argued that the corporate reorganization, which compromised their position by making them the creditors of a corporation that was financially weaker, was not in their interests. The court had to decide whether the directors owed fiduciary duties of loyalty and care to the creditors in the reorganization.

²⁵ In People’s, ibid., the Supreme Court of Canada stated the stakeholder vision in elaborate and approving terms, but it is debatable how far the principle found actual application in the decision.
The shadow of these difficulties is apparent in the conservative approach towards the stakeholder idea in the *OECD Principles of Corporate Governance* (2004). The relevant part of the *OECD Principles* reads:

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.26

This formulation of the stakeholder concept is legalistic. The *OECD Principles* stop with recognizing stakeholders with “rights” that are either “established by law or through mutual agreements.” In effect, stakeholders are only those who have legal or contractual rights against companies. If this is to be the guiding principle, then the position of the stakeholders would be necessarily limited— as defined in the law or the contract from which they derive their rights.

Expositions by management scholars and the more legalistic version in the *OECD Principles* are pointers to the tension that is inherent in the stakeholder idea as a management concept and in legal practice. The former tends to be more inclusive and open, but the latter is necessarily restrictive and specific. The case of New Zealand Refining Company, discussed earlier, proves this point. The company’s annual report makes it clear that the accountability of the board is confined to the shareholders. The relevant section reads:

**Board accountability**

The Board is ultimately responsible for setting the strategic direction of the Company, oversight of the management of the Company and direction of its business strategy, with the ultimate aim being to increase shareholder value while sustaining and ensuring the obligations of the Company are properly met. The Board is accountable to shareholders for the performance of the Company.27

Significantly, “increas[ing] shareholder value” is presented as the “ultimate aim” of the company. There could be difficulties in increasing “shareholder value while sustaining and ensuring the obligations of the Company (sic) are properly met.” Experience has shown that the shareholder value maxim can give rise to significant conflicts between the shareholders and other groups. The takeover battles in the U.S. in the 1980s, often waged in the idiom of shareholder value, led to plant closings and mass redundancies with serious consequences for the employees and the communities in which the plants were located. There would be significant challenges for the legal system in handling inter-constituency conflicts in business corporations and attempting to resolve them.

In developing a legal version of the stakeholder model, we must be sensitive to the issues outlined above. They must underpin any debate on the stakeholder principle from the legal or regulatory perspective.

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III. Stakeholders in New Zealand – A Survey of Listed Companies

The stakeholder vision is increasingly accepted by companies. This thesis draws support from the study of the companies listed on the New Zealand Stock Exchange (NZX). This part presents the data gathered in the survey and the conclusions they suggest. The survey consisted of two parts – namely, (1) review of governance charters and other documents of the companies for determining the recognition of stakeholder interests, and (2) examination of constitutions of the companies to find out whether companies have included non-shareholder groups as “entitled persons” under the Companies Act. The second part of the survey is, logically, restricted to companies incorporated in New Zealand. The overseas companies listed on NZX, mainly Australian and U.K., are not governed by the New Zealand statute and would not be relevant here.

This part consists of three sections. The first section explains the dataset used in the survey and the exclusions made from the complete list of issuers traded on NZX. The next section presents the data and the results from an examination of the governance-related documents of the companies – their governance charters, annual reports, and the like. It also has an analytical discussion of the results. The last section is about companies incorporated in New Zealand and the inclusion of non-shareholder groups in their constitutions. An overview of applicable theory is woven into the discussion of data and results from the empirical study.

a. The Survey – Determination of the Dataset

The dataset for the survey is drawn from the securities listed on NZX, which numbered 170 at the end of 2009.\(^{28}\) The number of issuers is, however, smaller because some, such as Allied Farmers Ltd, ASB and Barramundi, have more than one security listed on NZX. The issuers also include non-company entities such as income funds and trusts, which would not be relevant for the survey. This paper is concerned with enterprises organized in the corporate form, more specifically their adoption of the stakeholder.

The stakeholder principle would have greater relevance for companies with significant operations in whatever sector – manufacturing, trading, service or banking and finance. Normally such issuers would have sizable numbers of employees, vendors, and customers and have a significant presence in the community. In other words, these companies would have “stakeholders” with real and substantial stake in the corporate enterprise. This would not be equally true with non-company issuers such as income funds, unit trusts or property trusts, and this is another reason for excluding them from the survey.

The process of elimination, outlined above, leaves a net balance of 130 companies for the survey. Among these, there are two classes – companies incorporated in New Zealand (110) and those formed in other jurisdictions (20). The survey of governance-related documents, such as charters and annual reports, for the purpose of identifying their recognition of stakeholder interests covers all the 130 companies listed on NZX, but the review of constitutions for inclusion of non-shareholder

\(^{28}\) The survey presented here was made during November 2009-January 2010, and is based on the listings of that period. The survey covers the companies listed on the New Zealand Stock Exchange (NZX) only. It did not extend to the Debt Market (NZDX) (http://www.nzx.com/markets/nzdx/), or the Alternative Market (NZAX) (http://www.nzx.com/markets/nzax/), accessed March 8, 2010.
groups is restricted to the New Zealand companies as explained earlier. The numbers are set out in the table below.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Sample Considered in Survey</th>
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<tbody>
<tr>
<td>Number of securities listed on NZX</td>
<td>170</td>
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<tr>
<td>Total number of issuers</td>
<td>160</td>
</tr>
<tr>
<td>Non-company issuers - namely, income funds, property funds, trusts, and the like</td>
<td>40</td>
</tr>
<tr>
<td>Company issuers</td>
<td></td>
</tr>
<tr>
<td>New Zealand companies</td>
<td>110</td>
</tr>
<tr>
<td>Overseas companies</td>
<td>20</td>
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</tbody>
</table>

b. Stakeholder Survey – A Review of Governance-Related Documents

This part of the survey covers the larger sample of 130 companies – both New Zealand and overseas. The governance-related documents of these companies were examined to find out whether the companies acknowledged any concerns for non-shareholder groups. The documents include corporate governance charters, board charters, codes of ethics and conduct, best practices codes, annual reports and other similar material.

By far, annual reports are most commonly used by the companies to state their concerns for non-shareholder constituencies. The other documents which frequently reflect stakeholder interests are corporate governance charters (e.g. Abano Healthcare, Austral Pacific Energy, and Fletcher Building) and board charters (e.g. ANZ Banking Group, Team Talk and Tower).

As noted earlier, a total of 91 companies out of the 130 included in the survey acknowledged non-shareholder groups and their interests in one or more governance-related documents. In percentage terms, this is about 69 percent of the total. There is a marginal, yet significant, difference in the percentage when we compare New Zealand-incorporated companies with the overseas companies listed on NZX. A slightly higher ratio of overseas companies (75 percent) recorded stakeholder concerns in governance-related documents, vis-à-vis 69 percent for New Zealand companies. The results of the survey for all the companies listed on NZX and the breakup of New Zealand and overseas companies are presented in the table below.
Table 2

Stakeholder Interests – A Survey of NZX Listed Companies

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Companies Recognising</th>
<th>Companies Not Recognising</th>
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<tbody>
<tr>
<td>Number of Companies</td>
<td></td>
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<tr>
<td>Stakeholder Interests</td>
<td></td>
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</tr>
<tr>
<td>Number</td>
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<td>Percentage</td>
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<td>Overall</td>
<td>130</td>
<td>91</td>
<td>70</td>
</tr>
<tr>
<td>New Zealand companies</td>
<td>110</td>
<td>76</td>
<td>69</td>
</tr>
<tr>
<td>Overseas companies</td>
<td>20</td>
<td>15</td>
<td>75</td>
</tr>
</tbody>
</table>

The figures below present, respectively, the position of stakeholder concerns for all the companies listed on the New Zealand Stock Exchange and the comparative data of New Zealand and overseas companies.

Figure 1

Recognition of Stakeholder Interests - The Position Overall

- Companies recognizing stakeholder interests: 70%
- Companies not recognizing stakeholder interests: 30%
The evidence about the adoption of the stakeholder vision by the companies is quite impressive. At over two-thirds, it is apparent that the companies treat the issue with considerable seriousness, and this is in line with the trend in law for the strengthening of the stakeholder idea, which is reviewed in Part IV. It is clearly an emerging trend, and it is quite probable that it would become even stronger in the future.

Among all the companies, Sanford Limited, a New Zealand company, has published an independent document with the title “Sustainable Development Report.” This is, apparently, a regular annual feature in the company and is probably inspired by the nature of its business – seafood which is increasingly considered a scarce resource. The sustainability report of Sanford addresses different dimensions of sustainability – environmental, social and economic – and exhibits significant concern for non-shareholder groups and the externalities of corporate business.

There can be an issue with the nature or character of the documents in which the companies have acknowledged their concern for the non-shareholder groups. Not all these documents are legal in character, in the sense of a company’s constitution or statutory filings under securities regulation such as prospectuses. Undoubtedly, all companies use governance charters, annual reports and other such material to a considerable measure for purposes such as building the brand image of their products and services and the corporate reputation for the quality of governance. This raises the question whether the statements made in these documents are mere rhetoric, lacking substance.

in the legal sense. If this were to be so, the references to stakeholders and their interests need not be taken seriously. But to do so would be inappropriate for a number of reasons.

Firstly, many of the documents reviewed in the survey can be traced to securities regulation, either directly or through the listing rules of the stock exchange. NZX Listing Rules requires companies to disclose in their annual report “any corporate governance policies, practices and processes, adopted or followed” by them. The corporate governance charters of the companies can be related to this rule. Similarly, annual reports are a requirement under the Companies Act. It is, therefore, difficult to argue that the governance-related documents examined in the survey and their contents have no legal backing or effect. In any event, the statements made in the documents would be “representations” in common law and reliance on the representations can give rise to legal consequences.

Secondly, it is in the very nature of the common law system that the law is found in the society. Simeon Baldwin observed:

The common law on any point existed, in theory at least, before any case in which it may be applied. It was the practice of the people, or the rule which to them seemed naturally right.

In a nutshell, the general practices in the society at a given point in time and the prevailing value system would tantamount to the common law. In deciding cases, courts would merely apply the law distilling it from current practices and values, and as a result, the judges merely codify or crystallize the law, rather than create it. If this standard is applied, evidence about the acceptance of the stakeholder principle, presented here, can be construed as representing the common law on the subject. The results from survey on corporate stakeholders are impressive and they point towards an emerging consensus among the companies. For all these reasons, the affirmations made by companies in their governance-related documents deserve to be treated with seriousness and respect.

c. The Stakeholder Principle as a Legal Right – A Survey of New Zealand Companies

The stakeholder vision adopted by the companies, discussed above, is recorded in their governance-related documents. The provisions on “entitled persons” in the New Zealand Companies Act can be viewed as a potential mechanism for empowering the non-shareholder groups. The definition of an “entitled person” reads:

entitled person, in relation to a company, means—

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30 New Zealand Stock Exchange Listing Rules, Rule 10.5.3(l).
31 Section 208.
33 See Roscoe Pound, “The New Feudalism” (Address delivered at the Annual Meeting of the Kentucky State Bar Association, 1930) (1930) 35 Com. L. J. 397. This is, in turn, derived from Pound’s view that the laws of a society represent its consciousness and predispositions.
34 An issue here would be about the content and wording of the stakeholder statements made by companies. New Zealand Refining Company, referred to earlier, can be treated as a typical example. The references to stakeholders are quite generic and lack precision. This takes us back to the point raised earlier – about the understanding of the stakeholder principle in management theory and practice and in law.
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(a) a shareholder; and

(b) a person upon whom the constitution confers any of the rights and powers of a shareholder.35

It is, apparently, open to companies to empower any person or group by including them as “entitled persons” in the constitution. This will enable the entitled persons to invoke the remedy against oppression, unfair prejudice or unfair discrimination,36 or seek injunctive relief.37 It is possible, in theory, to strengthen the position of non-shareholder groups in this manner.

As noted, there are no apparent limitations on the groups that can be named as entitled persons. By including non-shareholder groups in the constitution, a company can institutionalize the stakeholder principle. Not stopping with acknowledging or accepting the stakeholder vision in governance-related documents, it is open to companies to actually empower non-shareholder constituencies. Considering the broad concept of “oppression” in company law in the Commonwealth jurisdictions, this can be effective in enabling the stakeholders to question actions or policies that harm their interests unreasonably. I offer this as a stakeholder perspective of the New Zealand *Companies Act*.

The survey revealed that no company has made use of the option available in the *Companies Act* to empower non-shareholder groups. This is not surprising. The concept of “entitled persons” appearing in the statute was never intended to apply to stakeholders, and this has been clarified by the Law Commission. Referring to the definition of an “entitled person” in the *Companies Act*, the Law Commission stated:

[T]his definition has been added in recognition of the existence of companies where some significant power or entitlement (eg, the right to residue where a solvent company is liquidated) is vested in a person other than a shareholder, and of the right of that person to protect that interest. . . 38

Clearly, the plan was to include persons having rights similar to those of the shareholders – possibly persons claiming under the shareholders. There was, simply, no legislative intention to include non-shareholders in the framework of the companies’ statute.39 Indeed, the Law Commission considered “social purposes” to be outside the scope of company law, and was inspired in this matter by H.W. Ballantine, the American scholar and advocate of libertarian corporate law.40

While launching the company law review exercise in the 1980s, the Law Commission “indicated that it was not attracted to the view that wider social purposes should be imposed upon companies through the *Companies Act,*” and believed that the task was better left to other legislation.41

35 Section 2(1).
36 Section 174.
37 Section 164. Other than the remedies mentioned, entitled persons are also treated on par with the shareholders for certain other purposes – mainly, unanimous consent to specified actions (Section 107) and in liquidation proceedings (e.g. Sections 241(2) and 250(2)).
39 This intention has to be imputed to the Parliament which accepted the recommendation of the Law Commission, and by implication, its reasoning.
40 *Ballantine on Corporations* (Chicago: Callahan, 1946).
41 See the discussion in *Company Law: Reform and Restatement* (Report No. 9) (Wellington: Law Commission, 1989) at 66.
Describing the response to its proposal to eschew “social” considerations in the company statute, the Law Commission stated:

The responses we received agreed. In particular, the inclusion of a provision such as is found in section 4 of the State-Owned Enterprises Act 1986 (which requires state-owned enterprises to act in a socially responsible manner) was opposed by a number of respondents and none supported the inclusion in the Companies Act of the imposition of a system of worker participation in management.42

It is not clear which persons or agencies submitted these responses, and whether they represented a broad cross-section of the society and the spectrum of interest groups. In any event, this view prevailed and the result is that the New Zealand Companies Act consciously avoids a broader conception of corporate enterprises. It disdains any “social” considerations clouding company law. This is, perhaps, not unnatural considering that the Companies Act was conceived in the 1980s, which were the heydays of what George Soros has termed “market fundamentalism.”43

The issue is about the validity of the narrow conception of companies. It has become more urgent in the present times – in the post-Enron, post-AIG world in which we live. In New Zealand, the string of finance company failures in the recent years and the serious consequences for the investors who had their savings in them provide a wake-up call, as it were, and they stress the need for promoting a greater sense of responsibility in corporate governance.

It may be time to look for other theoretical frameworks for the corporate form of business enterprise. The current model relies, almost entirely, on private contractual arrangements and the market processes leading to ideal outcomes – mostly understood as immediate economic gain.44 The stakeholder principle offers a handle for developing a richer and more nuanced theory for the companies of the future. The principle has made considerable progress in other common law jurisdictions, as discussed below, and New Zealand can benefit from their experience.

IV. Corporate Law, Shareholder Primacy and Stakeholders – An Overview

The stakeholder principle has its roots in the history of company law, and must be appreciated in that context. This part provides a brief outline of the philosophy of company law in the English-speaking world, the shareholder primacy principle and the emergence and growth of the stakeholder idea. To be clear, the company law in New Zealand is derived from principles developed in the larger common law jurisdictions. Historically, company law in New Zealand was based on the U.K. model. The current statute, enacted in 1993, represented a departure from this trend. The New Zealand Companies Act 1993 draws considerable inspiration from North American corporate law.”

42 Ibid.
43 George Soros used this term to refer to the mono-dimensional view of life and institutions – purely economic – and faith in the perfection of market processes. See e.g. The Crisis of Global Capitalism: Open Society Endangered (New York: Public Affairs, 1998).
44 It is true that the Law Commission referred to the need to develop “appropriate regulation to prevent abuse” of the corporate form, but its overriding concern was providing a “simple and cheap method of incorporation” that did not “frustrate the economic and social benefits of the company form.” Supra note 41 at 4-5. The reference to “social” benefits is curious, considering its subsequent statements on the social dimension cited earlier.
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law, which has its distinctive identity and some significant variances from British company law. Michael Ross (1994) pointed out:

For 150 years, New Zealand company law was derived mainly from English law. In contrast, the Companies Act 1993 is based on a North American model.45

New Zealand Law Commission, in its report Company Law Reform: Transition and Revision (1990), acknowledged the North American influence:

[T]he Commission's draft [is not] based on any one overseas model, although the (US) Model Business Corporations Act has been of great assistance, as was the work of the Dickerson report46 which preceded the Canada Business Corporations Act.47

The discussion on corporate theory in this part is mostly about the trajectory of developments in the U.K., U.S. and Canada. This part has three sections. The first traces the origin of shareholder primacy, which is usually presented as the central principle of Anglo-American law of business corporations. The next section discusses the development of a concern in law for non-shareholder groups and the third provides an overview of the stakeholder models in Britain, America and Canada.

1. Shareholder Primacy – The Governing Rule?

The debate on stakeholders and the efforts in law to protect their interests have their origin in the position that is usually accorded to the shareholders in the legal framework of companies.48 The traditional notion in the common law countries is that shareholders own the companies. This is more explicit in British company law where the statutes conventionally term the shareholders as “members” and describe companies as shareholders in the collective.49 Indeed, they regularly refer to the shareholders as the “company.”50 These features in the law reflect the prevailing ideas about the identity of shareholders and companies, who are understood as one and the same.

The position is not equally clear in North American corporate law, but there can be little doubt about the “ownership-like” status of the shareholders in the U.S. and Canada. The shareholders’ right to elect and remove the directors who control the corporations and their position as the “residual claimants,” which economic theory stresses,51 underscore the pre-eminence of the shareholders in the corporate framework.52

45 “Evaluating New Zealand’s Company Law” (1994) 1 Agenda 189.
48 The debate launched by Owen Young in 1929, supra note 2, was in this idiom. Owen Young, who was a lawyer by training, accurately reflected the legal notions about directors’ duties as they had developed by then.
49 Companies Act 2006, Section 16(2).
50 See e.g. ibid., Section 77 about change of company name by a special resolution of the shareholders.
51 See e.g. Michael C. Jensen & William H. Meckling, supra note 15. To be fair, the “nexus of contracts” imagery presented by Jensen and Meckling included non-shareholder groups. This is, however, of little practical significance because economic theory advocated shareholder value as the corporate objective.
52 Stephen M. Bainbridge has recently pointed out that statutes vest most of the corporate powers, operational and policymaking, in the directors, and has used this feature of corporate law to develop his
Starting from here, company law adopted principles from the law of trusts and agency and equated the directors of companies with trustees and agents. The directors were placed under fiduciary duties because they were supposed to act for others, rather than in their own interests. This was also consistent with the proprietary idea associated with the shareholders. The directors were understood as the custodians of the property of the shareholders. These ideas found forceful expression in the famous passages in the judgment in *Dodge v. Ford Motor Co.* (1919),

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or to the non-distribution of profits among stockholders in order to devote them to other purposes.

There is committed to the discretion of directors, a discretion to be exercised in good faith, the infinite details of business, including the wages which shall be paid to employees, the number of hours they shall work, the conditions under which labor shall be carried on, and the prices for which products shall be offered to the public. It is said by appellants that the motives of the board members are not material and will not be inquired into by the court so long as their acts are within their lawful powers. As we have pointed out, and the proposition does not require argument to sustain it, it is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others, and no one will contend that if the avowed purpose of the defendant directors was to sacrifice the interests of shareholders it would not be the duty of the courts to interfere.

It is a different matter that these observations of the Michigan court dealt with only one aspect of the case, but they have been seized by many as the central principle of corporate law and have become the starting point of educating students in the subject. It is understood as the statement of the principle of shareholder primacy and placing companies under a limited duty to strive for shareholder wealth maximization. This is, however, an incomplete interpretation of the case.

In *Dodge*, the court also upheld the business judgment rule and corporate philanthropy. In the U.S., an element of public interest has been traditionally considered implicit in granting incorporation. The idea is that the exercise of public power in granting a charter of incorporation must advance the

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theory about director primacy. “Director Primacy: The Means and Ends of Corporate Governance” (2003) Nw. U. L. Rev. 547. The interpretation of Bainbridge, while factually correct, would not detract from the position of the shareholders outlined here. The near-absolute powers the directors now enjoy are the product of a process of legal development, which is outside the scope of this article. Significantly, Bainbridge has argued in favour of the application of directors’ powers for shareholder wealth maximization.


Ibid. online version at 8.
public good in some respect.\textsuperscript{55} By the time \textit{Dodge} was decided, American courts had upheld the legitimacy and legality of business corporations:

- Incurring expenditure to improve employees’ health (\textit{People Metropolitan Life Insurance Co. v. Hotchkiss}\textsuperscript{56})
- Providing housing to employees (\textit{Steinway v. Steinway & Sons}\textsuperscript{57})
- Setting up hospital facilities in the town of business (\textit{Corning Glass Works v. Lucas}\textsuperscript{58})

After referring to \textit{Steinway} and other similar cases, the Michigan court observed:

These cases, after all, like all others in which the subject is treated, turn finally upon the point, the question, whether it appears that the directors were not acting for the best interests of the corporation. We do not draw in question, nor do counsel for the plaintiffs do so, the validity of the general proposition stated by counsel nor the soundness of the opinions delivered in the cases cited. The case presented here is not like any of them. The difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employe[e]s, like the building of a hospital for their use and the employment of agencies for the betterment of their condition, and a general purpose and plan to benefit mankind at the expense of others, is obvious. \textit{There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his codirectors owe to protesting, minority stockholders}.\textsuperscript{59} (Emphasis mine)

It was after clarifying this position that the court laid down its oft-quoted \textit{dictum} about the corporate objective – that a “business corporation is organized and carried on primarily for the profit of the stockholders.” Considering the preamble, it would be inappropriate to interpret \textit{Dodge} as merely laying down the profit maximization rule, and nothing else.\textsuperscript{60}

The law on corporate philanthropy developed along somewhat different lines in Britain. It was conditioned, understandably, by the prevailing political economy. In Britain the corporate form of business enterprise did not carry political and social overtones, unlike in the U.S. It was understood essentially as an economic vehicle, and issues like corporate power that were so prominent in the debate in contemporary America had little relevance in Britain with its relatively ancient and entrenched power structures.

\textsuperscript{57} 17 Misc. 43, 40 N.Y. Supp. 718 (1896).
\textsuperscript{58} 37 F. (2d) 798 (App. D.C. 1929).
\textsuperscript{59} \textit{Supra} note 53, online version, at 7-8.
Ideas about corporate charity or company directors spending money for general welfare would resonate little in the British environment. Here the principal-agent relationship between the shareholders and the directors was quite clear; the emphasis was on protecting the shareholders and curbing the freedom of the directors to deal with the corporate largesse. These ideas found expression in *Hutton v. West Cork Railway* (1883) in which the court had to deal with an extra-contractual payment to the employees of a company in liquidation. Terming it “charity,” the court held:

> Charity has no business to sit at boards of directors *qua* charity. There is, however, a kind of charitable dealing which is for the interest of those who practise it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose.

> [M]oney which is not theirs but the company’s, if they are spending it for the purposes which are reasonably incidental to the carrying on of the business of the company. That is the general doctrine. Bona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fide yet perfectly irrational... It is for the directors to judge, provided it is a matter which is reasonably incidental to the carrying on of the business of the company... The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.

It is not as though the directors could not spend money on charity, or “cakes and ale,” but it had to be for the benefit of the company. This is not very different from American corporate law, which permitted philanthropy that was “incidental” to the “primary” purpose of earning profits for the benefit of the shareholders.

The law laid down in cases such as *Dodge v. Ford Motor Co.* and *Hutton v. West Cork Railway* reflected, more or less, the contemporary notions about companies and business corporations. They affirmed the proprietary position of the shareholders and established the fiduciary character of the directors’ relationship with the shareholders. In Britain, the limitations on directors’ powers to engage in beneficial acts were reiterated in *Parke v. Daily News Ltd* (1962). The case was somewhat similar to *Hutton v. West Cork Rly.* (1884). It was about a special payment to the former employees of a company which had sold its business and terminated the employees. The payment was challenged by a shareholder and it was upheld by the court. The decision indicates the strength of the agency idea in British company law and the stricter notions about the fiduciary duties of the directors. Equally, it reveals relative obliviousness to the institutional approach towards corporate governance which has become more prominent in the recent times.

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62 (1883) 23 Ch. D. 654 at 673.


65 *Supra* note 62.
2. Stakeholder Concerns – Emergence and Growth

Ideas about ownership of companies by the shareholders and the fiduciary character of the relationship between the directors and the shareholders emerged in the 19th century. At the time, companies were mostly used as vehicles for pooling the financial capital of investor-shareholders. From the early times, there is evidence of awareness that the law could not confine its concerns merely to the shareholders of companies. In other words, the stakeholder idea is as old as company law itself. The creditor protection principle, which is of longstanding and foundational in the law of corporations, demonstrates this. The efforts in company law to protect the creditors arose from the peculiar character of business corporations.

In Britain, shareholders did not enjoy the protection of limited liability until 1855. It was, therefore, unnecessary to develop special protections for the creditors of the joint-stock companies. Shareholders continued to be personally liable for the debts of the companies, and the use of the corporate form made no difference to the position.

Things were different in the U.S. where, historically, corporations were created under legislative charters. Until late 19th century, the dominant idea was that corporations were distinct legal entities and were not to be confused with their shareholders. As a result, there could be no question of the shareholders being liable for corporate debts. This left the creditors of corporations, in particular the creditors of financially weak corporations, in a vulnerable position. The major differences between creditors and shareholders, who both had financial involvement in the corporations, were clearly understood.

To begin with, the shareholders contributed risk capital to the corporations and their investment would be necessarily exposed to business risks. But the case was different with lenders and persons who sold goods or services on credit. This latter class, the creditors, did not, in principle, assume explicit risk in doing business with the corporations. Like the shareholders, the creditors had financial involvement with the corporations, but unlike the shareholders, they had no say either in the election of the directors or in any other aspect of the governance of the corporations. The creditors were, thus, at a clear disadvantage. This was the general position, but the charters of some early corporations made the shareholders and/or directors personally liable for corporate debt.

Considering the vulnerable position of the creditors, the court as early as 1824 developed what came to be called the Trust Fund Doctrine. Under the doctrine, the capital stock of corporations was treated as funds held in trust for the creditors. This is further proof of stakeholder concerns in the

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66 This is unlike the position in England, which had a large number of unincorporated companies created by private arrangements in the common law. *Joint Stock Companies Act 1844* (7 & 8 Vict., c. 110 & 111 (U.K.) was meant to regulate such large unincorporated associations by requiring them to register their constituent documents and placing them under a number of obligations such as providing financial reports and audit of accounts.


law of business corporations. The Trust Fund Doctrine, which treated the corporate capital as static and fixed in character, has since been abandoned in favour of the solvency test.70

Employees, another important constituency in business corporations, also received attention in the law. In the 19th century, many American statutes made the directors personally liable for the wages payable to the employees of corporations.71 This continued into the 20th century, with states such as New York holding the directors liable for workers’ wages.72

In Britain, as noted earlier, the protection of limited liability was made available to the shareholders in mid-19th century through the Limited Liability Act 1855.73 This development raised the issue of protection for the creditors because the shareholders would no longer be personally liable for the debts of companies. The Capital Maintenance rules were developed to safeguard the interests of the creditors of companies. Capital Maintenance rules, which were based on the same principle as the American Trust Fund Doctrine, attempted to protect the companies’ resources from the reach of the shareholders and safeguard them in the interests of the creditors.74 It was considered necessary to protect the creditors who were, in a sense, disenfranchised.

Since 19th century, there was a requirement in British company law for regulatory approval of any reduction of capital. The principle was extended to companies purchasing their own shares.75 Similarly, the rule that dividends to shareholders could only be paid out of profits was developed to protect the creditors.76 The courts were generally strict in interpreting the articles of association of the companies and ensured that it was consistent with the principle of creditor protection. This is clear from cases such as Davison v. Gilles77 in which the court considered a provision in the articles of association for payment of dividends by a company from its reserves. The court observed that “you do not get a reserve fund until you have paid your current expenses.”78

The law developed on a different path with respect to the employees of companies. As noted earlier, gratuitous payment to the employees of a company in liquidation was struck down by the court in Hutton v. West Cork Railway (1883), and the position was reaffirmed in 1962 in Parke v. Daily News Ltd. In Parke, the directors’ submissions to the court were significant and they indicated the emerging mood. The directors conceded that their “prime duty must be to the shareholders,”

70 For complaints about the efficacy of the Trust Fund Doctrine, see Edwin S. Hunt, “The Trust Fund Theory and Some Substitutes for It” (1902) 12 Yale L. J. 63.
71 See J.W. Hurst, supra note 55 at 27.
73 18 & 19 Vict., c. 133.
75 Trevor v. Whitworth (1887), 12 App. Cas. 409 (H.L.).
76 MacDougall v. Jersey Imperial Hotel Co. (1864), 2 H. & M. 528 appears to be earliest authority on this subject.
77 (1879), 16 Ch.D. 347n.
78 Cited in Ardern & Aitken, supra note 74 at 44.
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yet argued that “boards of directors must take into consideration their duties to employees in these days” (emphasis mine). The court however answered, rather legalistically:

[B]ut no authority to support that proposition as a proposition of law was cited to me; I know of none and in my judgment such is not the law.

The decision in Parke set in motion a process of change. In 1980, almost two decades after the case was decided, amendments were made to the company legislation to enable terminal payments to former employees. Significantly, the opportunity was also utilized to expand the general scope of directors’ duties and introduce the stakeholder principle. The directors were placed under a statutory duty to consider the “interests of the employees in general” as well as the shareholders.

Even earlier, efforts had begun to improve the financial position of the employees of companies in liquidation. They were provided special protection in company law. The Companies Act 1948, which was enacted in the aftermath of World War II and during Labour rule, espoused employee interests in a more proactive manner. Subject to some limitations, it bracketed the wages payable to employees and companies’ contributions towards their pension and health benefits with the tax arrears due to the government, and the employees were given preferential rights in winding up proceedings. The dues to the employees had statutory equal ranking, or were placed pari passu, with the secured debts of companies in liquidation. This improved the position of the employees who would, otherwise, have joined the ranks of unsecured creditors and been more vulnerable in winding up proceedings.

As noted earlier, the law on corporate philanthropy has always been quite liberal in North America. The position that corporations could engage in general welfare activities was established in the 19th century. This is because business corporations in the U.S. operated in an environment that was qualitatively different from Britain. In the American republic, incorporation was generally understood as a privilege granted by the legislature through the exercise of public power, and public interest had to be a consideration in the grant of charters to the corporations. In this framework, it would not be inappropriate for the corporations to take initiatives for amelioration. Indeed, many American corporate statutes expressly permitted corporate philanthropy.

In A.P. Smith Mfg. Co. v. Barlow, the court upheld a corporate donation to Princeton University. Although the governing statute, that of New Jersey, permitted corporations to make donations, the court dismissed the challenge to the donation without interpreting it in terms of its potential benefit for the corporation, which would have indirectly affirmed the principle of shareholder primacy. The court ruled that “modern conditions require that corporations acknowledge and discharge social as well as private responsibilities.” This suggests that the stakeholder approach was accepted as

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80 Ibid.
81 Companies Act 1980, Section 74(1)
82 Ibid. Section 46(1).
83 Companies Act 1948, Section 319.
84 98 A.2d 581 (N.J. 1953).
86 A.P. Smith, supra note 84 at 586.
an independent fact, and it need not have any specific reference to potential benefit for the shareholders.

The broad conception of corporations in American law is a historical fact. The view that the corporate goal is limited to earning profits for the benefit of a select group – namely, shareholders did not represent the entire truth. The statutory provisions on corporate charity and the decision in A.P. Smith can be cited as proof of this. The liberal approach to corporate philanthropy continues in America.87 Recently, the governance principles developed by American Law Institute empower corporations to “devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes,” even when “corporate profit and shareholder gain are not thereby enhanced.”88 This approach, again, travels beyond the agency or trust paradigms and accepts the idea that the resources of a corporation can be utilized, within limits, for generally beneficial purposes even when no business or commercial benefit results from the expenditure.

Similarly, the Model Business Corporations Act authorizes a corporation to “to make donations for the public welfare or for charitable, scientific, or educational purposes,” if they are not prohibited under the constitution.89 This is yet another affirmation of the broad conception of corporations in American law and the public interest considerations framing them.

In Canada the Canada Corporations Act,90 which is the previous federal statute enacted in 1965, specifically authorized corporate charity, similar to many of its American counterparts. It is not clear whether Canada charted its own course in this matter or was influenced by American practice. In any case, the Canada Corporations Act permitted business corporations to make contributions for the welfare of employees or former employees and for “any public, general or useful object.”91

Significantly, there is no comparable provision in the current statute – the Canada Business Corporations Act (CBCA).92 It has charted a different course. The CBCA provides a remedy that can be potentially used by non-shareholder groups, both to question harm to the corporate interests through derivative action and harm to specific groups through the oppression remedy. These are discussed in greater detail in the next section.

The stakeholder principle received judicial recognition in Canada in 1972 in Teck Corp. v. Millar.93 It has been recently affirmed by the Supreme Court of Canada, at the level of doctrine, in People’s94 (2004) and BCE Inc. v. 1976 Debenture-holders95 (2008). It is, however, debatable how far the court applied the principle. The outcome in both of the recent cases went against the creditors who had

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87 Courts have also upheld charitable actions applying the business judgment rule. See e.g. Shlensky v. Wrigley, 237 N.E.2d. 777 (III. App. Ct. 1968) and Ella M. Kelly & Wyndham, Inc. v. Bell, 266 A.2d 878 (Del. 1970).
88 American Law Institute, Principles of Corporate Governance: Analysis and Recommendations, §2.01. For an interesting discussion on the background of the development of the principles, see Douglas Branson, supra note 49.
89 American Bar Association, Model Business Corporations Act (2005), §3.02.
90 S.C. 1964-65, c. 52.
91 Ibid., section 14.
92 R.S.C. 1985, c. C-44.
94 Supra note 24.
brought the actions. This can be explained by the traditions of the legal system and the unease of the courts in dealing with mere “interests” as distinguished from clearly-defined rights.96

An important contribution to the stakeholder idea in Canada has come from the Saucer Committee (2001). The committee was set up by the Toronto Stock Exchange, Canadian Venture Exchange and Chartered Accountants of Canada to develop guidelines for corporate governance. The report of the committee clearly reflects the emerging stakeholder vision. It repeatedly refers to “stakeholders” and treats corporate accountability as owed to the broad spectrum of stakeholders, rather than just the shareholders.97

3. The Stakeholder Regime and Its Variants

At present, there are two major variants in the legislative approach towards non-shareholder groups – the directors’ duty-based which has been adopted in Britain and America, and the remedy-based one adopted in Canada. A third approach – providing board representation to non-shareholder groups – was considered in the U.K. and Canada, but it was not adopted. This section examines the stakeholder models.

a. The Directors’ Duty Model – U.K. and U.S.

As pointed out earlier Owen Young, chairman of General Electric Company, was among the earliest to articulate the stakeholder vision. Young viewed the matter from the lens of directors’ duties, and argued that their duties must not be restricted to serving the shareholders.98 This approach took the principle of “central command” in business corporations, or the vesting of very substantial corporate powers in the directors, as a given. Starting from here, the effort was to promote a broader vision for the directors and greater accountability in the exercise of their powers. The approach articulated by Owen Young has been endorsed by scholars such as E. Merrick Dodd99 and Adolf Berle100 for promoting greater harmony in corporate functioning.

In the directors’ duty version, the directors are expressly authorized by the statutes to consider non-shareholder interests. By doing so, legislation, to some extent, modifies the common law which limits directors’ loyalty to the shareholders and constrains them from applying other considerations. The directors’ duty model has been adopted in the legislative reforms in Britain and America since the 1980s. As pointed out earlier, directors in the U.K. were placed under a general duty in 1980 to consider the interests of the employees also. In the same decade – 1980s – several American states introduced stakeholder provisions in their statutes.

96 I will revert to this issue in Section (3) below, when discussing Canada’s current remedy-based approach to the stakeholder principle.
98 Young, supra note 2, delivered his seminal speech in 1929, ten years after the famous decision in Dodge v. Ford Motor Co. Quite possibly, Young was influenced by the idea underlying the oft-quoted passage in the judgment which appeared to define directors’ duties in strict terms – namely, profit maximization.
99 Ibid.
100 Initially, Adolf Berle was opposed to the idea of broadening the scope of directors’ powers and loyalty. His opposition was on the ground of practicability rather than principle. However, sometime later Berle veered around to the view of Merrick Dodd and expressed support for broad-based the duties of corporate directors. See Harwell Wells, supra note 85.
The stakeholder provisions introduced in the American jurisdictions were a direct result of the takeover battles of the 1980s, which led to widespread changes of corporate control, plant closings and sizable layoffs of employees. In many cases, as noted earlier, the takeovers were justified in terms of the benefit they conferred on the shareholders through increases in share prices. The shareholder primacy rule, which appeared to confer legitimacy on the practices, cast its shadow on the takeover phenomenon. To counter the complaints about plant closings and disruption in the lives of the affected employees and communities, it was argued that directors’ hands were tied by the shareholder primacy rule in corporate law.

In this background, amendments were made to the corporate statutes to empower the directors to consider a wide range of interests. The new schema, incidentally, operated in favor of corporate managements, as it improved their ability to protect themselves against hostile takeover bids. In fact, corporate managements actively lobbied for stakeholder legislation and had mixed motives for doing so – protecting their position as well as ensuring the continuity of business operations. This background is important in understanding the nature and scope of the legislative provisions inserted in the statutes. By 1991 a total of 28 states had included stakeholder concerns in their corporate statutes, in varying forms. The following extract from the Georgia statute is representative of the stakeholder provisions adopted in many jurisdictions:

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

In most of the states, the directors can consider non-shareholder interests only in case of attempts for takeover or change of control. In other words, the stakeholder principle does not have uniform or ongoing application. The only exceptions are Arizona, Idaho and New Mexico, which have adopted a more expansive version and have made the stakeholder principle mandatory in corporate

101 “Takeover” is not a legal term or concept in America, but the label is widely used to refer to the process of change of corporate control. Change can be accomplished in two ways – namely, mergers and tender offers for purchase of shares in the stock market. Corporate law on mergers is clear; they would require the approval of the directors. But the picture is unclear with respect to tender offers for purchase of shares in the market, as a means of unseating current directors and acquiring control – especially when the current directors are not willing to leave. Such “hostile” takeovers would be messy and more expensive for the persons interested in taking over, as they would have to “defeat” the incumbent management. On the ambiguity in the law about takeovers and the role of directors, see Troy A. Paredes, “The Firm and the Nature of Control: Toward a Theory of Takeover Law” (2004) 29 J. Corp. L. 103.


103 For the extracts from the statutes, see supra note 5.

104 Georgia Code Ann. §14-2-202(b)(5).
governance. In any event, the statutory provisions mark the entry of the modern stakeholder idea in corporate legislation, despite an element of hesitation.

It is significant that Delaware, which is home to the largest number of public corporations, is not among the states that have included the stakeholder principle in their statutes. This is, however, not to suggest that the idea does not find a place in Delaware corporate law. The courts have, by implication, recognized the stakeholder principle in a number of cases. In Unocal Corp. v. Mesa Petroleum Co.,\(^\text{105}\) decided in 1985, the court upheld the defensive tactics adopted by the board of Unocal against a hostile takeover bid launched by Mesa. In doing so, the court referred to the directors’ “fundamental duty and obligation to protect the corporate enterprise, which includes stockholders.” This observation can be interpreted as affirming a more institutional vision of the corporation. It perceived business corporations as more than just aggregations of their shareholders, and stressed the duty of the boards towards the enterprise as a whole.

The trend was further strengthened in 1990 with the decision in Paramount Communications, Inc. v. Time, Inc.\(^\text{106}\) In this case the court upheld the action taken by the directors of Time, Inc. to protect the company’s corporate culture and journalistic integrity, subordinating shareholder interests in the process. The decision of the Delaware Court of Chancery in Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.\(^\text{107}\) is another important milestone in the Delaware court’s journey on the stakeholder path. Ruling that the fiduciary duties of the directors could extend to the creditors of corporations “operating in the vicinity of insolvency,” Chancellor Allen defined the scope of their duties:

[The board has] an obligation to the community of interests that sustained the corporation to exercise judgment in an informed, good faith effort to maximize the corporation’s long-term wealth creating capacity.\(^\text{108}\)

An important contribution to stakeholder theory has come from Margaret Blair and Lynn Stout, who articulated their team production model of business corporations.\(^\text{109}\) Blair and Stout have conceived directors as the “mediating hierarchs” who would ensure equity in the distribution of the corporate surplus among the different constituencies.

There are, however, other strands in the development of corporate law in Delaware. In Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,\(^\text{110}\) the court had to deal with a takeover and inevitable breakup of the corporation, post the takeover. In that situation, the court treated the board of directors as auctioneers for the shareholders and charged them with a duty to procure the highest

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\(^{106}\) 571 A.2d 1140 (Del. 1990). For a critique of this decision from the perspective of shareholder primacy, see Nell Minow, “Shareholders, Stakeholders, and Boards of Directors” (1992) 21 Stetson L. Rev. 197.  


\(^{108}\) Ibid. at 38 (**1156).  


\(^{110}\) 506 A.2d 173 (Del. 1986).
possible price for the shares. There was little room for non-shareholder groups in that milieu. The Revlon principle was recently reiterated in In re Netsmart Technologies, Inc.\textsuperscript{111} It would be difficult to reconcile Revlon and Netsmart with cases such as Unocal and Paramount Communications, which were based on a broader vision of corporate enterprises. The dichotomy is understandable considering the different facts situations with which the court had to deal in the cases. This illustrates the perils in relying entirely on judicial decisions in developing corporate theory. The need is for greater deliberation that can facilitate the development of a more wholesome theory to underpin business corporations. I will revert to this issue in the conclusion.

Recently, U.K. expanded and strengthened the stakeholder principle in its corporate statute. The British stakeholder model is also, as noted earlier, based on the directors’ duty concept. Recently, the company legislation in the U.K. has adopted the expansive stakeholder version in its Companies Act 2006. The provision is quite comprehensive and sets out the principle with considerable clarity. It is extracted below.

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

(a) the likely consequences of any decision in the long term,
(b) the interests of the company’s employees,
(c) the need to foster the company’s business relationships with suppliers, customers and others,
(d) the impact of the company’s operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.\textsuperscript{112}

The regime is mandatory and applies on an ongoing basis. At first glance, the statutory provision appears somewhat radical, but it is not really so. It treats the “success of the company for the benefit” of the shareholders as the overriding objective, and subordinates all other considerations. In any case, black-letter law now puts forth the stakeholder model as a principle of governance, and broadens the fiduciary duties of the directors. It moves away from the restrictive approach traditionally applied in common law and the emphasis on shareholder primacy. Directors are now under a duty to consider a variety of interests in promoting the success of the companies. There can be little dispute with the proposition that a company must be successful before it can take proper care of its various stakeholders.

b. The Stakeholder Remedy Model – Canada

Among the common law jurisdictions Canada was, in fact, the earliest to grant legislative recognition to the stakeholder principle. It did so by including non-shareholder groups also in the remedies available under the Canada Business Corporations Act (CBCA) – namely, derivative actions for

\textsuperscript{111} C.A. No. 2563-VCS, 2007 WL778612 (Del. Ch.).
\textsuperscript{112} Companies Act 2006, Section 172(1) (U.K.).
wrongs done to a corporation and the oppression remedy for the wrongs to specific individuals or groups in the corporation. The Robert Dickerson Committee, which produced the CBCA, recommended extending the statutory remedies against managements to all the constituencies in business corporations:

[The remedy] is made applicable to all cases of conduct that are “oppressive or unfairly prejudicial to or in disregard of the interests of” any security holder, creditor, director or officer and not just to the narrow case where a shareholder is oppressed in his capacity as a shareholder.

In making the recommendation, the Dickerson Committee bracketed all stakeholders together, including shareholders. This approach is derived from the committee’s understanding of the role of the shareholders. It is quite apparent that the Dickerson Committee adopted the Berle-Means paradigm of passive shareholders who played no meaningful role – one commensurate with the proprietary position attributed to them in corporate theory. Indeed, the Dickerson report expressly rejected the notions about corporate democracy and the voting rights of shareholders:

We have also rejected the argument made by some that “corporate democracy” should be improved by investing corporate shareholders with some of the powers now commonly exercised by directors. In our view, this idea is quite misconceived, not least because the analogy between democracy and in a political context and the relationships between the shareholders and directors of a corporation is tortured and misleading.

As a result, the Dickerson Committee treated the shareholders as little more than “security holders,” several years before this position was formally proclaimed for the shareholders in economic theory. This framework had little place for the so-called proprietary position of the shareholders, or the idea that the directors were their elected surrogates. The shareholders had no special position or rights and were, in substance, little different from other groups – such as employees, suppliers and creditors who also had interests in the corporations.

The Canadian Parliament accepted the recommendation of the Dickerson Committee and, as a result, both the remedies in the CBCA – derivative action and relief against oppression – are available to a generic class of “complainants.” The term “complainant” is defined as follows:

“Complainant” means

(a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates,
(b) a director or an officer or a former director or officer of a corporation or any of its affiliates,
(c) the Director, or

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113 Canada Business Corporations Act, Ss. 283-241.
114 Ibid. at 163.
115 Proposals for a New Business Corporations Law, supra note 46 at 3.
(d) any other person who, in the discretion of a court, is a proper person to make an application under this Part.\textsuperscript{117}

Interestingly, the definition does not use the term “shareholders.” It sweeps them under “security” holders, which would include both shareholders and creditors who have lent money to the corporations under bonds or debentures. This is clear from the definition of “security,” extracted below:

“Security” means a share of any class or series of shares or a debt obligation of a corporation and includes a certificate evidencing such a share or debt obligation\textsuperscript{118}

Other than security-holders the statutory definition of complainants, extracted earlier, names directors and officers, including those who had held office in the past. The Director of corporations, a government official, is also empowered to take action, presumably in the public interest. Finally, the court is given the discretion—a carte blanche—to determine any other person as being “proper” to invoke the remedies provided in the statute. The CBCA’s conceptualization of the groups that may have complaints against business corporations is, thus, quite broad. The figure below explains the extended concept of complainants in the Canada Business Corporations Act.

\begin{center}
\textbf{Figure 3}
\end{center}

\begin{center}
\textbf{The Concept of “Complainant” in the Canada Business Corporations Act}
\end{center}

\begin{center}
\begin{tikzpicture}
  \node (director) {Director or officer, current or former};
  \node [right of=director, xshift=2cm] (directorgov) {Director (government official)};
  \node [below of=director, yshift=-1cm] (holder) {Holder or beneficial owner of any security, current or former};
  \node [right of=holder, xshift=2cm] (anyother) {Any other person approved by the court};
  \node [below of=complainant, yshift=-1cm] (complainant) {Complainant};
  \path (complainant) edge [->] (director); 
  \path (complainant) edge [->] (directorgov);
  \path (complainant) edge [->] (holder);
  \path (complainant) edge [->] (anyother);
\end{tikzpicture}
\end{center}

Referring to the remedy in the CBCA which is, in theory, available to a wide range of constituencies, Stephanie Ben-Ishai has developed the “team production” model of Canadian corporate law.\textsuperscript{119}

\begin{footnotes}
\textsuperscript{117} CBCA, Section 238.
\textsuperscript{118} CBCA, Section 2.
\end{footnotes}
Ishai has argued that corporate law in Canada accords primacy to the directors and that, considering the nature of the oppression remedy, the directors of Canadian corporations can be assimilated to the position of “mediating hierarchs” conceived for them in the team production theory of Margaret Blair and Lynn Stout.\footnote{Supra note 109.}

It is, however, an open question how far the stakeholder remedy provided in the \textit{CBCA} is effective. As noted earlier, the results in recent stakeholder cases – \textit{People’s} (2004)\footnote{Supra note 24.} and \textit{BCE} (2008)\footnote{Supra note 95.} – went against the creditors, despite the court affirming the stakeholder vision. In \textit{People’s}, the Supreme Court of Canada ruled that the directors of a corporation did not owe fiduciary duties to the creditors. In \textit{BCE}, which was an action under the oppression remedy, the court declined to consider the issue of injury to the interests of the creditors, despite the statute facilitating it. In yet another important case, \textit{Air Canada Pilots Association v. ACE}\footnote{[2007] O.J. No. 89 (Sup. Ct.) (QL), 2007 CanLII 337. Online: \url{http://www.canlii.ca/en/on/onsc/doc/2007/2007canlii337/2007canlii337.pdf}, accessed December 18, 2009.}, the court refused to recognize the Pilots Association of Air Canada as a complainant for the purpose of questioning a proposal of the corporation to distribute assets to the shareholders.

The Canadian experience is a pointer to the difficulties in placing complete reliance on the courts to protect the interests of non-shareholder groups. In stakeholder conflicts, the issue is often about “interests” which may not have crystallized into “rights” with which the legal system is familiar. The adversarial system of the courts and technical rules of form, procedure and evidence are other impediments for the courts’ ability to effectively respond to stakeholder disputes. These are some issues with the remedy-based approach to the stakeholder principle.

c. \textbf{The Third Alternative – Representation and Empowerment}

The discussion on stakeholder variants would be incomplete without a brief reference to the third option – namely, representation of non-shareholder groups on boards and empowering them to participate in governance. This is prevalent in Germany where the public corporations must have a broad cross-section of people on their boards, including employee representatives, and the principle is termed “codetermination.” The theory is that the participatory arrangement will promote the broader stakeholder approach to governance.

The “representation and empowerment” model could have been expected to be popular in the English-speaking countries, considering their political history and ideas about representative democracy. However, it has not been so. The subject of stakeholder representation, in particular employee representation on boards, has been discussed but the idea was abandoned. Significantly, resistance to the idea has come from the labor unions both in Britain and Canada. In the U.K. in the wake of recurrent labor unrest in the 1970s, a committee, grandiloquently termed the “Committee on Industrial Democracy” was constituted under the chairmanship of Lord Bullock, to enquire into
the issue of labor participation in corporate boards. The committee reported the reluctance of the labor unions to sit on the boards.\textsuperscript{124}

In Canada, the Dickerson Committee began with the representation and empowerment approach. Acknowledging the prevailing notions about non-shareholder groups, the committee observed:

Suggestions have been made from time to time that corporation law focuses too narrowly on shareholders, and ignores the reality that others, especially the corporation’s employees and creditors, are affected by and concerned with what corporations do. It follows from this, so the argument goes, that these groups should have some voice in the choice of corporate directors. Moreover, it is said, there is a broad public interest in corporations and this interest should also be represented in corporate boardrooms.\textsuperscript{125}

The original idea was, thus, about empowering the non-shareholder groups by permitting them to have representative directors. The Dickerson Committee had no quarrel with the validity of the argument about stakeholders, but had reservations about enlarging the electorate. It stated:

[B]ut we do not see any practical way, in the context of a corporations act, in which it can be implemented. The problem is one of establishing the electorate.\textsuperscript{126}

After stating this difficulty, the Dickerson Committee rejected the representation approach in dealing with stakeholder interests. Pointing out that few legal impediments existed for including a wider section of stakeholders on the boards if the corporations wanted, the committee discarded a regulatory model as unworkable. While doing so, it specifically referred to the fact that the “trade unions ha[d] not shown much interest in having representation on the boards of corporations.”\textsuperscript{127} This was an important consideration for the Dickerson Committee to explore other means of fostering the interests of non-shareholder groups.

In the U.S., the idea of stakeholder representation does not appear to have been considered with seriousness. A possible explanation is entrenched proprietary ideas associated with shareholders and a consequent inability to conceive other possibilities. Alfred Conard pointed out that the milieu in the United States did not encourage the representation model.\textsuperscript{128}

Apparently, there are significant cultural impediments to the principle of codetermination which has been adopted in Germany. In the common law countries, the trend appears to be more in favor of continuing with centralized powers in the boards, and providing them with a broader mandate in decision-making. The trend is to retain the top-down structure in corporate organizations, and then enlighten those at the top, rather than diffuse the corporate power and empower people at the middle or bottom levels.

In any event, the lack of formal representation for the stakeholders may not be a major issue in the emerging milieu. Director independence, a concept that has received significant emphasis in the


\textsuperscript{125} Proposals for a New Business Corporations Law at 9.

\textsuperscript{126} ibid.

\textsuperscript{127} ibid. at 10.

\textsuperscript{128} Alfred Conard, “Corporate Constituencies in Western Europe” (1992) 21 Stetson L. Rev. 73.
recent years, can promote a broader vision in the boards of public corporations. Independent directors are expected to be objective and balanced in their role, and they can promote a wider perspective in the board even if there is no specific representation for the stakeholders.

V. A Stakeholder Model for New Zealand? Some Thoughts

The current Companies Act in New Zealand is limited in its conceptualization. It is, as noted earlier, based on the traditional shareholder model and is based on the idea that private contracting and market processes can produce the best outcomes. Non-shareholder constituencies do not receive significant consideration in the regime. This is not to deny the traditional concern for creditors which is now implemented through the insolvency test. Additionally, the directors are under a duty not to continue with business operations when there is potential risk to a company’s creditors, which is usually termed “reckless trading.” This duty not to trade recklessly is an important tool in ensuring that the use of the corporate form does not prejudice the creditors, or for breach of the duty, the directors would be personally held to account.

New Zealand is an exception to the trend in other common law jurisdictions for an increasingly robust recognition of the stakeholder principle. There have been efforts in the other jurisdictions to develop a more expansive regulatory version. The current statute in New Zealand, which germinated in the late 1980s and was enacted in the 1990s, reflects the market ideology which was dominant at the time. An129 Recent events and corporate failures have demonstrated the simplistic nature and the limitations of the market-oriented approach. Equally, they stress the importance of promoting a responsible culture of governance. They present an opportunity to revisit the theory of companies which are, arguably, a very important economic institution. The stakeholder principle can be a useful tool in the efforts to develop a richer, more inclusive and nuanced theory that reflects the lessons of the past and avoids dogmatic or doctrinaire approaches.

The new theory must reflect the unique features of the corporate landscape in New Zealand. The experience with the stakeholder models in other jurisdictions, discussed earlier, would be valuable and they can be the starting point in developing a version to suit the climate of New Zealand. In this effort, empirical studies of the companies in New Zealand, or at least a representative sample of them, and the experience with the Companies Act 1993 since its introduction would be valuable. The survey of companies can cover shareholding and control patterns, employment and economic data on revenues and income, and any specific advantages derived from the use of the corporate form. These are important areas for future research.

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129 For evidence of the dominant school of thought in New Zealand at the time, see e.g. David Henderson, Misguided Virtue: False Notions of Corporate Social Responsibility (Wellington: New Zealand Business Round Table, 2001).