Ruiteng Liu

What should Directors do?
Implementing Entity Primacy in New Zealand

Faculty of Law

Victoria University of Wellington

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Abstract

To whom should directors owe their duties? This question has been dominated by two competing theories: shareholder primacy and stakeholderism. The debate, however, has neglected a third contender, entity primacy. Entity primacy suggests directors should maximise the value of the company and sustain it as a going concern. This paper argues New Zealand should adopt an entity primacy conception of directors' duties, drawing on the entity maximisation sustainability model developed by Andrew Keay. Entity primacy is normatively desirable as a compromise between a two theory dichotomy and can lead to better decision-making by directors. The paper locates New Zealand as a shareholder primacy jurisdiction and the historical reasons for this, before looking at the United Kingdom, Canada, Australia and Delaware.

The paper proposes four steps which New Zealand should take to implement entity primacy. First, s 131 of the Companies Act 1993 should be amended to include a list of interests which directors can take into account when they make decisions, drawing on recent legislative developments in Canada. Second, strategic reports inspired by the United Kingdom and monitored by an executive body should be introduced to ensure directors are maximising the value of the company so affected stakeholders and interests can hold directors to account. Third, corresponding changes to soft law should be embraced, unlike in Australia, with the incorporation of a 'social licence' representing a novel way of changing how directors exercise their discretion. Fourth, an expanded set of complainants should be able to pursue derivative actions. Altogether, these four steps shift directors' incentives away from a shareholder primacy paradigm towards an entity primacy conception of company law.

Key words: *"company law", "shareholder primacy", "stakeholderism", "stakeholder theory", "directors' duties"*, "*duty of good faith", "entity primacy", "enlightened shareholder value", "narrative reporting", "strategic reports", "social licence to operate", "derivative actions"*

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Introduction

Shareholder primacy has always been considered to be a longstanding feature of directors' duties in New Zealand (NZ).[1] The notion that the ultimate role of the company is to maximise value for shareholders has dictated how directors have approached their duties. Shareholder primacy is, however, coming under increasing attack. In 2019, the Chief Executive (CEO) of the Financial Markets Authority (FMA) questioned whether shareholder primacy is still tenable in an age where companies are responsible for environmental disasters and bankruptcies which affect more than just shareholders.[2]

This follows a trend overseas,[3] where prominent organisations such as the Business Roundtable in the United States of America (USA) are redefining the purpose of a company to serve not just shareholders, but stakeholders from employees to the environment.[4] Likewise, the World Economic Forum also urged for a shift away from "shareholder capitalism" to "stakeholder capitalism".[5] After Covid-19, the significant challenges for companies has been posited as a "litmus test" for stakeholderism.[6] These developments have resurrected a debate in NZ about the purpose of the company.[7]

This paper discusses whether it is desirable for directors to owe statutory duties to a wider set of stakeholders in NZ. The answer is important, as it determines how directors should

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[1] Peter Watts "Directors' duties - sources and beneficiaries" in Peter Watts, Neil Campbell and Christopher Hare (ed) *Company Law in New Zealand* (LexisNexis, 2016) 373 at 382-383.

[2] Rob Everett, Chief Executive of the Financial Markets Authority, "Thinking beyond shareholders" (NZ Capital Markets Forum, 21 March 2019).

[3] See: John Ruggie "The Paradox of Corporate Globalization: Disembedding and Reembedding Governing Norms" in Peer Zumbansen (ed) *The Oxford Handbook of Transnational Law* (Oxford University Press, Oxford 2020) (forthcoming).

[4] Business Roundtable "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'" (19 August 2019) <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>.

[5] Klaus Schwab "Why we need the 'Davos Manifesto' for a better kind of capitalism" (1 December 2019) World Economic Forum <https://www.weforum.org/agenda/2019/12/why-we-need-the-davos-manifesto-for-better-kind-of-capitalism/>.

[6] Alissa Kole Amico "The Pandemic is the Litmus Test of Stakeholderism" (4 May 2020) Harvard Law School Forum on Corporate Governance <https://corpgov.law.harvard.edu/2020/05/04/the-pandemic-is-the-litmus-test-of-stakeholderism/>. See also: Colin Mayer "Shareholderism Versus Stakeholderism – a Misconceived Contradiction. A Comment on 'The Illusory Promise of Stakeholder Governance' by Lucian Bebchuk and Roberto Tallarita" (European Corporate Governance Institute paper, 2020) at 4.

[7] See: Peter Watts "To whom should directors owe legal duties in exercising their discretion? — a response to Mr Rob Everett" (Company and Securities Law Bulletin, May 2019).

make decisions when managing a company.[8] The solution is entity primacy. Directors are obliged to maximise the value of the entity, rather than the interests of any shareholder or stakeholder, and sustain it as a going concern.[9]

Entity primacy represents a compromise which is flexible enough to take into account stakeholder interests to the extent it benefits the company, while ensuring shareholders retain an incentive to invest capital into the company. It is also a theory gaining judicial attention. Chief Justice Helen Winkelmann, alongside Susan Glazebrook and Ellen Francis JJ, have described entity primacy extrajudicially as "arguably mandated" by NZ legislation.[10] This recognition challenges whether shareholder primacy should remain an accepted description of company law in NZ, and how entity primacy can be designed as a compromise in the wider debate about the purpose of the company.

To address these issues, this paper is divided into ten sections. Section I begins by outlining the underlying debate between stakeholderism and shareholder primacy. Section II then considers the extent NZ's current law embraces shareholder primacy. Section III argues why entity primacy represents a desirable compromise and can lead to better decision-making by directors. Section IV traces the historical conceptions of the company and how the current prominence of shareholder primacy is a product of socioeconomic expectations of the company during the 20th Century.

The paper then explores four common law jurisdictions as possible models for reform. Section V starts with Enlightened Shareholder Value (ESV) in the United Kingdom (UK), a model predicated on shareholder primacy. Section VI looks at why Australia rejected ESV and the ascendancy of entity primacy in academic discourse there. Section VII then considers legislative developments in Canada as a model for shifting towards entity primacy. Section VIII examines director primacy in Delaware, but rejects the theory as a solution to the debate in NZ.

Section XI of the paper address how entity primacy can be implemented in NZ through a package of reforms aimed at realigning directors' behaviour. The section begins by

[8] Andrew Keay "Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model" (2008) 71 MLR 663 at 665.

[9] At 679.

[10] Helen Winkelmann, Chief Justice of New Zealand, Susan Glazebrook and Ellen France, Judges of the Supreme Court of New Zealand, "Climate-change and the Law" (Paper prepared for the Asia Pacific Judicial Colloquium, Singapore, 28-30 May 2019) at [114].

proposing an amendment of s 131(1) of the Companies Act 1993, which addresses a directors' good faith duty modelled on the Canada Business Corporations Act 1985 (CBCA). It then turns to the importance of adopting corresponding reporting requirements, similar to the UK, which require directors to prepare a strategic report looking at how they have complied with the factors listed under the proposed amendment. Further soft law changes through the introduction of a 'social licence', contrary to Australian developments, is also considered. The section then finishes by looking at expanding the category of complainants who can pursue a derivative action to enforce directors' duties. Section X concludes.

I Shareholder Primacy vs Stakeholderism

Underlying the debate over the company's purpose and directors' duties is the dichotomy between two competing theories: shareholder primacy and stakeholderism. This section seeks to unpack the divide by explaining the arguments for and against each, before locating NZ within this debate as a jurisdiction which embraces shareholder primacy.

A Shareholder primacy

The arguments in favour of shareholder primacy are well-rehearsed. There are three main ones. First, according to Henry Hansmann and Reinier Kraakman, there is "no…serious competitor" to shareholder primacy as the most optimal route in the "pursuit of aggregate social welfare".[11] This is because maximising shareholder returns encourages investment in companies and induces the company to be run in the most efficient way possible, thereby benefiting society with lower cost products and new innovations.[12]

Second, prioritising shareholders is efficient and certain. This is because it would be too difficult for directors to balance the interests of different stakeholders, whereas shareholders provide an identifiable class of interests.[13] It also ensures directors are much more easily held accountable, with directors' remuneration sometimes tied with share performance for listed companies.[14] Furthermore, any attempt to dilute shareholders'

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[11] Henry Hansmann and Reinier Kraakman "The End of History for Corporate Law" (2001) 89 Geo LJ 439 at 441.

[12] Paul Davies *Introduction to Company Law* (3rd ed, Oxford University Press, Oxford, 2020) at 311.

[13] Andrew Keay "Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?" (2010) 7 ECFR 369 at 383.

[14] Lucian Bebchuk and Roberto Tallarita "The Illusory Promise Of Stakeholder Governance" (2020) Cornell LRev (forthcoming) at 29-30.

control over the company may lead to directors pursuing their own self-interest under the guise of stakeholderism, which is detriment for everyone involved with the company.[15]

Third, shareholders are the residual claimants and therefore have the greatest incentive to monitor the directors and ensure the company succeeds. This is because if the company is liquidated, shareholders are the last in line to any remaining assets. If the company thrives, shareholders receive dividends and higher prices for shares which can be transferred.[16] Shareholders are also arguably vulnerable as they do not have the same contractual protections with the company as creditors or employees, which justifies the control they have over the company. If shareholders are not protected, then they will not invest in the company.[17]

On the other hand, shareholder primacy suffers from a number of defects. The most notable is that shareholders can be rationally apathetic and in practice do not often wield the powers given to it under incorporation statutes.[18] Shareholders will also have varying levels of access to information and the opportunity costs of obtaining information is high relative to any benefits they may gain.[19] Likewise, not all shareholders are homogenous. Some are interested in making a short-term profit from an increase in the share price, others are interested in the long-term growth of the company.[20] This is especially problematic in large, widely held companies, though this is less prevalent in NZ which is populated by many smaller, concentrated companies.[21]

Shareholder primacy has also been criticised as encouraging excessive risk-taking and short-term decision-making which increase share price, undermining the extent companies can survive as a going concern in the long-term. This is coupled with criticisms of the share price being a poor estimate of a company's value.[22] This

[15] At 55-56.

[16] Keay, above n 13, at 377.

[17] At 398-399.

[18] Stephen Bainbridge "Director versus Shareholder Primacy: New Zealand and USA Compared" (2014) NZ L Rev 551 at 564.

[19] At 567.

[20] Lynn Stout "New Thinking on 'Shareholder Primacy'" (2012) 2(2) Accounting, Economics, and Law 1 at 3. See also: James Edelman "The future of the Australian business corporation: a legal perspective" (Speech to Supreme Court of New South Wales Commercial & Corporate Law Conference, Sydney, 29 October 2019) at 10.

[21] Bainbridge, above n 18, at 570.

[22] Keay, above n 13, at 405-406. See also: Stout, above n 20, at 10-11.

prioritisation of shareholders' interests can affect other stakeholders detrimentally. Companies can externalize the impacts of its production on society, such as polluting the environment.[23] Shareholder primacy does not adequately address harms which can arise from incomplete contracts with stakeholders and groups who are involuntarily affected by companies' actions, such as tort victims.[24] Furthermore, shareholders are not the owners of the company, with the company retaining a separate legal personality, a point which will be explored later.[25] Shareholders only own shares, which should not give them control over a company's assets.[26]

B Stakeholderism

With shareholder primacy suffering from a "crisis of confidence" according to some, stakeholderism has been proffered as a potential replacement.[27] Although there are diverging interpretations of stakeholderism,[28] the accepted view is directors should be obliged to act in the interests of all stakeholders and not just shareholders.[29] In other words, to quote the British Academy, "the purpose of business is to solve the problems of people and planet profitably, and not profit from causing problems."[30] Stakeholderism emphasises companies' "responsibilities to the community" which directors should take into account in their decision-making.[31] Directors have at least an ethical obligation and social expectation to consider stakeholder interests, given the impact directors' decision-making can have on stakeholders. In particular, no stakeholder should necessarily be favoured over another.[32]

Moreover, stakeholders are arguably more vulnerable than shareholders. This is because most stakeholders are not the beneficiaries of any fiduciary duties from the directors, nor do they necessarily have contractual protections.[33] Stakeholderism also encourages

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[23] Davies, above n 12, at 313.

[24] Keay, above n 13, at 405-406.

[25] At 394.

[26] At 395-396.

[27] Lynn Stout "The Shareholder Value Myth" (Cornell Law Faculty Publications, Paper 771, 2013).

[28] David Millon "Enlightened shareholder value, social responsibility and the redefinition of corporate purpose without law" in PM Vasudev and Susan Watson (ed) *Corporate Governance after the Financial Crisis* (Edward Elgar Publishing Limited, 2012) 120 at 130.

[29] Monique Cikaliuk and others "Board of Directors and Stakeholders: Building Bridges of Understanding" (2017) 23 NZBLQ 202 at 205.

[30] The British Academy "Principles for Purposeful Business" (2019) at 8.

[31] Edwin Dodd "For Whom are Corporate Managers Trustees" (1932) 45 Harv LR 1145 at 1153.

[32] Cikaliuk, above n 29, at 206-207.

[33] Keay, above n 8, at 673-674.

directors to take a more long-term perspective in their decision-making which ensures the sustainability of the company's activities.[34] These developments are reflected in the increasing engagement listed companies in NZ are having with stakeholderism by integrating stakeholder values into their corporate governance documents.[35]

There are, however, significant criticisms of stakeholderism. The most prominent are the uncertainties implementing stakeholderism in practice. There is no universally accepted definition of who a stakeholder is.[36] It is also difficult for directors to identify which stakeholder interests they should take into account and how to reconcile competing stakeholder priorities.[37] This may lead to an overreliance on directors to regulate the interests of stakeholders when they are not qualified to do so.

There are also considerable questions over which stakeholders will be able to hold directors to account. This may lead to directors being able to advance their own interests under the guise of stakeholderism.[38] Furthermore, an emphasis on stakeholderism can lead to a "chilling effect" on other areas such as employment law which may lead to more meaningful outcomes for stakeholders.[39] This is because any shift towards stakeholderism represents such a significant change to the status quo that a large amount of political capital would need to be used to achieve it.[40] Unlike shareholders, stakeholders do not control the appointment or removal of directors, nor do they have any way of influencing directors' decisions.[41] Similarly, there is no universally accepted measure of stakeholder welfare which directors' remuneration can be tied to.[42]

Stakeholderism has also been condemned to be an "illusory promise".[43] This is because there are no incentives for directors to consider the interests of stakeholders. In practice, writers such as Lucian Bebchuk and Roberto Tallarita have sought to discredit

[34] Cikaliuk, above n 29, at 203.

[35] PM Vasudev "Corporate stakeholders in New Zealand – the present, and possibilities for the future" in PM Vasudev and Susan Watson (ed) *Corporate Governance after the Financial Crisis* (Edward Elgar Publishing Limited, 2012) 120 at 124.

[36] Keay, above n 8, at 675-676.

[37] Cikaliuk, above n 29, at 209.

[38] Bebchuk and Tallarita, above n 14, at 60-61.

[39] At 59.

[40] See also: Matteo Gatti and Chrystin Ondersma "Can A Broader Corporate Purpose Redress Inequality? The Stakeholder Approach Chimera" (2020) JCL (forthcoming).

[41] Bebchuk and Tallarita, above n 14, at 34. See also: Amico, above n 6.

[42] Bebchuk and Tallarita, above n 14, at 49.

[43] At 28.

stakeholderism by pointing out most boards lack the commitment to consider stakeholder interests even if their companies subscribe to non-binding pledges, such as the Business Roundtable's rejection of shareholder primacy in the USA.[44]

II Shareholder Primacy in New Zealand

"Change is in the wind"[45] and there seems to be an almost irreversible shift from shareholder primacy towards stakeholderism in NZ's academic discourse.[46] This matters, as law can set the trend for how directors behave.[47] Despite these developments, this section will discuss how there is negligible support in NZ's common law and statutes for stakeholderism.[48] Nevertheless, in light of finance company collapses, the global financial crisis and now the consequences of Covid-19, it makes sense to revisit s 131 and whether a compromise such as entity primacy maybe the best way forward.

A Hard Law: Companies Act 1993

The starting point for considering to whom directors should owe their duties is s 131(1). Directors are obliged to "act in good faith and in what the director believes to be the best interests of the company". The duty is "owed to the company and not to shareholders".[49] Nonetheless, this statutory formulation does not clarify what the "best interests of the company" mean and if it can converge with those of any natural person from the company.[50] The subjective character of the section means directors can choose to maximise shareholder's value or consider stakeholder perspectives if it is in "the best interests of the company".[51] The Supreme Court has recently cautioned against the use of

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[44] Lucian Bebchuk and Roberto Tallarita "Stakeholder' Capitalism Seems Mostly for Show" *The Wall Street Journal* (online ed, New York, 7 August 2020).

[45] Chapman Tripp "New Zealand Corporate Governance: Trends and Insights 2019" at 3.

[46] Chapman Tripp "Climate-change Risk – implications for New Zealand company directors and managed investment scheme providers" (Legal Opinion, 2019) at [87.1].

[47] Edward Rock "For Whom is the Corporation Managed in 2020?: The Debate Over Corporate Purpose" (European Corporate Governance Institute paper, 2020) at 21-22.

[48] Jonathan Barrett and Ronán Feehily *Understanding Corporate Law* (4th ed, LexisNexis, 2019) at 185.

[49] Section 169(3). See: Jessica Palmer "Understanding the Director's Fiduciary Obligation" (2006) 12 NZBLQ 315 at 323.

[50] At 315.

[51] Susan Watson "Almost codified almost 20 years on: the effect of the Companies Act 1993 on the development of directors' duties in New Zealand" in Adolfo Paolini (ed) *Research Handbook on Directors' Duties* (Edward Elgar Publishing. 2014) 105 at 108.

hindsight and rejected interpreting this section in an objective light for most circumstances.[52]

The drafters of s 131, however, rejected stakeholderism.[53] This was because "competing responsibilities" for directors may render accountability "extremely difficult".[54] Although the Law Commission emphasised "the best interests of the company" is not the same as shareholder interests and was owed to the "enterprise itself",[55] the Commission's concern was "more about future shareholders rather than non-shareholder groups".[56] This reasoning firmly grounds NZ within the shareholder primacy camp.

Moreover, shareholder primacy remains the orthodox position in relation to directors' duties. This is most noticeable in two respects. First, shareholders have the power to appoint or remove directors, with the shareholders able to appoint themselves as directors.[57] Second, the Act stipulates directors, through the board, manage the "business and affairs" of the company.[58] Nevertheless, this power is subject to the company's constitution,[59] which can be amended by shareholders via special resolution.[60] Consequently, shareholders have a significant amount of leverage to control how the company is managed.[61]

There are only limited circumstances where directors have duties to other groups. Directors *may* make benefits for employees if the company ceases its business in whole or part.[62] Directors must not trade recklessly[63] or incur obligations it cannot reasonably meet.[64] Where companies are nearing insolvency, there is an obligation for directors to

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[52] *Madsen-Ries v Cooper* [2020] NZSC 100 at [112] [*Madsen-Ries*]. Contrast with: *Fletcher v National Mutual Life Nominees Ltd* [1990] 3 NZLR 641 at 661 (HC) and *Hedley v Albany Power Centre Ltd (in liq)* [2005] 2 NZLR 196 at [64]. See generally: Gordon Williams *Corporations and partnerships in New Zealand* (Kluwer Law International, 2011) at 241.

[53] Peter Watts *Directors' Powers and Duties* (LexisNexis, Wellington, 2015) at 132.

[54] Law Commission *Company Law Reform and Restatement* (NZLC R9, 1989) at [194].

[55] At [188].

[56] At [189]-[190]. See also: Vasudev, above n 35, at 130.

[57] Watts, above n 1, at 384.

[58] Section 128(1).

[59] Section 128(3).

[60] Sections 32 and 106.

[61] Watts, above n 1, at 384-385.

[62] Section 132.

[63] Section 135.

[64] Section 136.

consider creditor's interests.[65] Nonetheless, outside of these narrow situations, there is no legal obligation for directors to take into account the interests of stakeholders.

Practically, it is very challenging to argue s 131 can apply to stakeholder interests as the provision stands. This was due to the Law Commission's view of the Companies Act, where obligations to stakeholders such as employees "go beyond the best interests of the company" and should be addressed though other legislation instead.[66] For instance, consider the temptation to ascribe liability to the directors of Pike River Mine after the mine explosion which killed 29 miners. The directors do not owe a "*direct* duty" to the victims under the Act and any claim will need to be through the company.[67] Arguably, it is in the company's best interests to protect the health and safety of their employees. These sentiments, however, are not be sustainable in a system where shareholder primacy prevails.[68]

B Soft Law: Corporate Governance Codes

The position for stakeholders is not much better in the soft law instruments available. Take the NZX Corporate Governance Code for example, which operates on a "comply or explain" basis for listed companies in NZ.[69] Shareholder primacy informs the very purpose of the Code, which recognises "boards are in place to protect the interests of shareholders".[70] The provisions addressing stakeholders in the Code are weak, with companies allowed to choose whether or not they wish to conduct environmental, social and governance reporting.[71] Even then, boards only choose to do such reporting in NZ if shareholder rights and community concerns prompt them to do so.[72]

Another example is the FMA Corporate Governance Principles. The principles are designed to assist "non-listed and public-sector companies" who can voluntarily choose

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65 *Re South Pacific Shipping Ltd* (2004) 9 NZCLC 263570 (HC) at [125].

66 Law Commission, above n 54, at [195].

67 Alison Pavlovich and Susan Watson "Director and Shareholder Liability at Pike River Coal" (2015) 21 Canterbury LRev 1 at 26.

68 At 19.

69 NZX "Corporate Governance Code" (1 January 2020) <https://www.nzx.com/regulation/nzx-rules-guidance/corporate-governance-code>.

70 At 3. See: Susan Watson "Moving beyond Virtue Signalling Corporate Sustainability for New Zealand" in Beate Sjåfjell and Christopher Bruner (ed) *Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, Cambridge, 2020) 176 at 180.

71 Watson, above n 70, at 181.

72 Stevie Dobbs and Chris van Staden "Motivations for Corporate Social and Environmental Reporting: New Zealand Evidence" (2016) 7 Sustainability Accounting, Management and Policy Journal 449 at 466.

to follow them.[73] Principle 8 recognises that it is "in shareholders' interests" to take into account stakeholders.[74] Again, shareholder primacy prevails by prioritising shareholders, with the commentary to the Principle acknowledging shareholders as "the ultimate owners of companies".[75] Consequently, these soft law codes have been criticised as "water[ed] down".[76]

C Is Stakeholderism the Right Alternative?

Stakeholderism has its supporters in NZ. The theory became especially attractive in NZ after the collapse of financial companies and the 2009 financial crisis as a means of correcting these market failures.[77] According to Jonathan Barret and John Horsley, companies have a role to play in relation to societal issues and the law is behind the times. This is especially acute in the context of environmental pollution in a country relying on food exports and tourism. As companies enjoy the benefits of limited liability, they ought to also take on the burdens of this "legal privilege".[78] The law should "humanize" the best interests of the company by allowing it to embrace a "pluralistic approach" to stakeholders while accompanied by corresponding changes to soft law codes.[79] Another suggestion has been to introduce statutory duties which expressly reject shareholder primacy and incorporate mandatory duties which compel directors to consider stakeholders such as the environment.[80]

On the other hand, shareholder primacy has been fiercely defended by some. Peter Watts has criticised stakeholderism as "socialism" and "not justiciable".[81] He clarifies that there is no legal duty for directors to necessarily maximise profits in NZ, even for

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[73] Financial Markets Authority "Corporate governance in New Zealand: Principles and guidelines" (2018) <https://www.fma.govt.nz/assets/Reports/180228-Corporate-Governance-Handbook-2018.pdf> at 4.

[74] At 26.

[75] At 27.

[76] Watson, above n 70, at 185.

[77] Vasudev, above n 35, at 140.

[78] See also: John Farrar "Frankenstein Incorporated or Fools' Parliament? Revisiting the Concept of the Corporation in Corporate Governance" (1998) Bond LR 142 at 162.

[79] Jonathon Barret and John Horsely "Social Justice and the Veil of Incorporation: A New Zealand Perspective" in Ivan Tchotourian *Company Law and CSR: New Legal and Economic Challenges* (Bruylant, 2018).

[80] Julia Maskill "Extending Directors' Duties to the Natural Environment: Perfect Timing for Greener Companies in Aotearoa New Zealand?" (2016) 22 Auckland U L Rev 281 at 310-311.

[81] Peter Watts "Shareholder primacy in corporate law – a response to Professor Stout" in PM Vasudev and Susan Watson (ed) *Corporate Governance after the Financial Crisis* (Edward Elgar Publishing Limited, 2012) 42 at 43.

shareholders.[82] Watts warns legally enforceable duties to consider stakeholders' interests may be litigiously costly, cause companies to switch to other corporate vehicles such as partnerships and reduce director's accountability.[83] Moreover, NZ boards are arguably already taking into account stakeholders in their decision-making. For example, an empirical study found 70 per cent of NZ companies listed on the NZX acknowledged stakeholders other than shareholders.[84] The question, however, is the degree non-shareholder stakeholders should feature in directors' decision-making.[85]

III Entity Primacy: A Compromise

Entity primacy, also known as the entity maximisation sustainability model, stresses directors should seek to maximise the wealth of the "corporate fund" or the entity itself.[86] This model is best described by Andrew Keay and has been subsequently applied to NZ by Susan Watson.[87] According to Keay, there are two dimensions to entity primacy. First, directors must maximise the long-term value of the company.[88] This means looking beyond profit and instead, focussing on value such as the company's own reputation, brand, goodwill, intellectual property and research and development.[89] Second, directors need to ensure the company is sustainable as a going concern and avoid irrecoverable insolvency.[90]

These ideas have also resonated with other writers. Colin Mayer has pointed out "the reason why companies exist is to fulfil their purpose", which acknowledges the company as an independent entity.[91] Margaret Blair and Lynn Stout in their team production theory envisage the company as a "mediating hierarchy" between the competing interests of those who make firms-specific investments and insulates directors from the clutches of

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[82] At 43.

[83] Watts, above n 53, at 139.

[84] Vasudev, above n 35, at 126.

[85] Institute of Directors "The top five issues for directors in 2020" (19 December 2019) <https://www.iod.org.nz/resources-and-insights/news-and-articles/the-top-five-issues-for-directors-for-2020/#>.

[86] Susan Watson "What More can a Poor Board Do? Entity Primacy in the 21st Century" (2017) 23 NZBLQ 142 at 142.

[87] See: Watson, above n 86 and Andrew Keay *The Corporate Objective* (Edward Elgar Publishing, United Kingdom, 2011).

[88] Keay, above n 87, at 198.

[89] At 201.

[90] Keay, above n 8, at 679.

[91] Collin Mayer *Prosperity* (Oxford University Press, Oxford, 2018) at 6.

any particular stakeholder.[92] Other authors have also discussed the concept of instrumental stakeholderism, where the company gains a competitive advantage by taking into account the interests of stakeholders.[93] Entity primacy builds on these academic trends.

The full bench of the Supreme Court has recently acknowledged entity primacy as an alternative to both shareholder primacy and stakeholderism.[94] The Court noted entity primacy was "effectively the [same] approach" as the Law Commission's original draft of the Companies Act.[95] The draft would have included a hierarchy of duties, where other duties to shareholders, creditors and employees were subject to the "fundamental duty" for directors to act in the best interests of the company.[96] Although the hierarchy was inexplicably dropped for no apparent reason in the final version of the Companies Act, this does not necessarily mean Parliament had rejected entity primacy as a possible model.[97]

The Court also referred to the "bests interests of the company" and "best interests of the shareholders" interchangeably when discussing the importance of maintaining solvency.[98] The wording may imply a shareholder primacy reading of directors' duties, but this is not necessarily inconsistent with an entity primacy approach, given shareholder interests can be considered under the latter. Regardless, the Court did not comment on which of the models were correct and left the door open for a future case to settle the debate.[99]

A Normatively desirable

Entity primacy regards shareholder primacy as an unsatisfactory description of NZ's law. This is because directors effectively act as the company and have derived their powers

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[92] See: Lynn Stout and Margaret Blair "A Team Production Theory of Corporate Law" (1999) 85 Va LRev 247.

[93] Monique Cikaliuk and others "Board of directors: building relationships with non-shareholder stakeholders" in Jonas Gabrielsson, Wafa Khlif and Sibel Yamak (ed) *Research Handbook on Boards of Directors* (Edward Elgar Publishing, Cheshire, 2019) 209 at 213.

[94] *Madsen*-Ries, above n 52, at [30].

[95] At fn 7.

[96] Law Commission, above n 54, at [194].

[97] Justice Tompkins "Directing the Directors: The Duties of Directors under the Companies Act 1993" (1998) 2 Waikato LRev 13 at 15.

[98] *Madsen*-Ries, above n 52, at [32].

[99] At [31].

from statute rather than the shareholders.[100] It challenges the entitlement shareholders have to company dividends while enjoying a shield from negative externalities created by the company.[101] Entity primacy also differs from stakeholderism as it does not prioritise environmental or social interests as an end in itself for the company, though directors who completely ignore these interests would be doing so at their peril.[102] Overall, entity primacy has been touted by Keay as a compromise between the "individualism of shareholder primacy and the collectivism of stakeholder[ism]".[103]

As a compromise, it has four advantages. First, entity primacy provides an answer to the longstanding question of whether it is in the public interest to regulate directors' duties, considering the negative externalities companies can have on non-shareholder stakeholders.[104] Second, entity primacy enables the directors to acknowledge the contributions made by stakeholders to the company. According to Watson, this has a legitimising effect which can promote long-term relationships with stakeholders and enhance the corporate fund.[105] Third, it recognises companies exist for commercial reasons as directors ultimately have to maximise the entity's value, which reconciles theory with practice.[106] Four, by framing the duty as one owed to the company, it lessens the risk of directors pursuing their own selfish ends by focussing on one entity as opposed to multiple stakeholders.[107]

Entity primacy is based on the separate legal personality of the company, which is explicitly acknowledged by the Companies Act.[108] This is why treating the company's fund differently from the shareholder makes sense. The company exists due to the act of

[100] Chris Noonan and Susan Watson "The Foundations Of Corporate Governance In New Zealand: A Post-Contractualist View Of The Role Of Company Directors" (2007) 22 NZULR 649 at 655, 657 and 666. See also: Susan Watson "The significance of the source of the powers of boards of directors in UK company law" (2011) 6 JBL 597 at 611.

[101] Paddy Ireland "Corporate Schizophrenia: The Institutional Origins of Corporate Social Irresponsibility" in Nina Boeger and Charlotte Villiers (ed) *Shaping the Corporate Landscape: Towards Corporate Reform and Enterprise Diversity* (Hart Publishing, Oxford, 2018) 13 at 24.

[102] Watson, above n 70, at 188-189. See also Keay, above n 87, at 205.

[103] Keay, above n 87, at 175.

[104] Barnali Choudhury and Martin Petrin *Corporate Duties to the Public* (Cambridge University Press, Cambridge, 2019) at 36.

[105] Watson, above n 70, at 188.

[106] Vasudev, above n 35, at 135.

[107] Compare with: Mariana Pargendler "The Corporate Governance Obsession" (2016) 42 JCL 359 at 399.

[108] Companies Act 1993, s 15.

incorporation and is therefore distinct from its constituent parts, such as shareholders.[109] The reasoning is consistent with the Law Commission's insistence s 131 was owed to the "enterprise itself".[110] It can also be reconciled with the Privy Council's recognition of a company as a distinct legal person from an individual who was a director, majority shareholder and employee of that company.[111]

B Better decision-making

Entity primacy can lead to better decision-making. Watson uses the example of Cadbury's closure of its Dunedin factory. The decision to move offshore saved costs and increased dividends greatly benefited its shareholders. The board, however, could have also considered the negative impacts on the company's reputation in the community and redundancies for employees under entity primacy.[112] This emphasises the intangible characteristics of the corporate fund which, in Watson's view, are routinely ignored by directors under shareholder primacy.[113]

Consider Pike River Mine as an example. This is a sobering illustration of where the board focussed on short-term productivity and financial goals to the detriment of health and safety, with tragic consequences.[114] These pressures are partially due to shareholder primacy, where the board needed more capital from shareholders but were faced with production difficulties which could undermine the company's credibility.[115] While entity primacy requires the company to be sustained as a going concern, an issue for Pike River, it also mandates directors to maximise the long-term value of the company. The latter means directors need to ensure there are adequate systems in place to the protect the health and safety of workers, which did not happen.[116] In the absence of a statutory duty for directors to consider health and safety, in stark contrast to the duties imposed on managers or employers, entity primacy is one way of holding directors to account.[117]

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[109] Keay, above n 87, at 183.
[110] Law Commission, above n 54, at [188].
[111] *Lee v Lee's Air Farming Ltd* [1961] UKPC 33, [1961] AC 12 at 25 [*Lee*].
[112] Watson, above n 86, at 160.
[113] At 146.
[114] Justice Graham Panckhurst, Stewart Bell and David Henry *Royal Commission on the Pike River Coal Mine Tragedy Volume I and Overview* (October 2012) at 12.
[115] At 17.
[116] At 18.
[117] At 33.

Entity primacy also confirms what is already occurring in practice for some companies in NZ. For instance, Air New Zealand appointed a Union leader to the board so they have someone with the expertise to help the company reduce conflicts with employees.[118] Another illustration is the Bank of New Zealand developing a gender diversity strategy for its employees in order to improve the company's competitive advantage.[119] Although these are cited as examples of instrumental stakeholderism, they arguably coincide with an entity primacy view of directors' duties.[120] Directors are prioritising what is in the best interests of the company and any benefits to stakeholders are merely a means to this end.

C Difficulties

While there are many benefits to entity primacy, there are also challenges. In NZ, a 'one-person' company is a dominant feature of the commercial landscape, alongside small, closely-held companies with few shareholders. It is impossible in these situations to distinguish between the company's best interests from those of the shareholders.[121] Companies by themselves do not have a "will", hence entity primacy risks giving directors unparalleled discretion to make decisions especially where it is difficult to measure certain aspects of the corporate fund, such as reputation.[122] This may lead to directors to making decisions nominally in the company's best interests which in reality only further the directors' own interests.[123]

Consequently, it is unlikely decisions made by directors would ever be challenged outside situations involving insolvency.[124] While this might be true as a matter of practice, the law discussed earlier clearly draws a legal distinction between the same person who acts as a shareholder and as a director.[125] This challenges the perception that the company's interests "cannot be distinguished" from the human persons who form it.[126]

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[118] Cikaliuk, above n 93, at 219-220.

[119] At 220-221.

[120] At 223.

[121] Neil Campbell "Corporate Personality" in Peter Watts, Neil Campbell and Christopher Hare (ed) *Company Law in New Zealand* (LexisNexis, 2016) 23 at 35.

[122] Min Yan "The failure of the entity maximisation and sustainability model" (2013) 34 Co Law 272 at 274 and 276-277.

[123] Ian Maitland "How Insiders Abuse the Idea of Corporate Personality" in Eric Orts and N Craig Smith (ed) *The Moral Responsibility of Firms* (Oxford University Press, Oxford, 2017) at 118.

[124] Watts, above n 53, at 135.

[125] Watson, above n 70, at 186 and see: *Lee*, above n 111.

[126] *Brady v Brady* (1987) 3 BCC 535 at 552 (CA).

The other difficulty comes from directors using entity primacy as "virtue signalling", while doing nothing to change the status quo under shareholder primacy.[127] This is where directors justify decisions on the basis they are maximising the value of the company when in reality they only intend to only benefit themselves or the shareholders.[128] The issue here justifies the need for there to be an enforcement mechanism which ensures directors do not abuse their powers, which is discussed later in this paper.

IV Historical Conceptions of the Company

Shareholder primacy was not always the predominant theory of the company. To understand how the present situation came to be, there is merit in looking at how conceptions of the company have changed according to contemporary demands. The development of separate legal personality was a crucial turning point for entity primacy. This point would be lost during debates about the company's purpose in the twentieth century, only to remerge as a possible solution to the present dilemma between shareholder primacy and stakeholderism. Several historical developments have contributed to this.

A Before Salomon

First, there was the recognition of the corporate body for charitable purposes under Roman and Canon law. The public dimension was important to these bodies. In England during the 16th Century, recognition of the company as a distinct legal entity could only occur through Crown grant or statute.[129] At the time, such a grant became a tool for mercantilism, colonialism and a means for the State to project its power while benefiting private enterprise.[130] Later examples where a company was incorporated by statute were for infrastructure projects such as canals or railway lines.[131]

This was accompanied by the rise of the joint stock company (JSC). To an extent, the JSC was similar to the modern company incorporated by statute, as it entailed many stockholders, a distinct management and transferable stock.[132] Unlike modern

[127] Watson, above n 70, at 188.
[128] At 188.
[129] Susan Watson "The Development of the Modern Company" in Susan Watson and Lynne Taylor (ed) *Corporate Law in New Zealand* (Thomson Reuters, Wellington, 2019) 13 at 17 and Farrar, above n 78, at 145.
[130] At 18.
[131] Choudhury and Petrin, above n 104, at 10.
[132] Paddy Ireland "Capitalism without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality" (1996) 16 JLH 41 at 42.

companies, however, the separation between the joint stock fund and stockholders was premised on economics and accounting, rather than in law.[133] In particular, the rules of double-entry bookkeeping meant the accounts of the stockholders were kept separate from the those of the business.[134] These JSCs were seen as partnerships, which gave rise to the view perpetuated under shareholder primacy of the company as an aggregate of individual shareholders who have an ownership claim over the company's assets.[135]

The JSC would be latter replaced by 'deed of settlement' companies. As it was challenging to obtain a Crown grant, many would use contract and trust law to create a de-facto "separation of the fund in a trust" in order to aggregate capital between business partners.[136] The trust was not recognised as a separate legal person by the common law and remained vulnerable to creditors.[137]

B Salomon

The situation would change after the onset of general incorporation statutes in the 19th Century. These statutes recognised the concept of limited liability, where the shareholders would only be liable up to the amount of capital they have contributed to the company. This would, in turn, lead to the House of Lords in *Salomon* confirming the existence of separate legal personality. Their Lordships would comment "the company is not in law the agent of the subscribers", which is a clear rejection of agency theories predicated on shareholder primacy.[138] What began as an economics and accounting distinction between the company and its shareholders led to a legal separation, where the company is regarded as a separate legal entity from its shareholders.

Entity primacy makes sense in light of separate legal personality. *Salomon*, and its subsequent confirmation by statute, means it is possible to conceptualise the company as containing its own fund, comprised of physical and intangible assets.[139] Moreover, the company derives its existence and legal status through the incorporation statute.[140] This is important, as it means the company should not be run for the shareholders, or any

[133] At 43.
[134] Watson, above n 129, at 16-17.
[135] Paddy Ireland "Common law and myth of shareholder ownership" (1999) 62 MLR 32 at 39.
[136] Watson, above n 129, at 19.
[137] LCB Gower "The English Private Company" (1953) 18 LCP 535 at 535-536.
[138] *Salomon v Salomon* [1896] UKHL 1, [1897] AC 22 at 51 per Lord Macnaghten.
[139] Susan Watson "The taxonomy of a company" in Susan Watson and PM Vasudev (ed) *Innovations in Corporate Governance: Global Perspectives* (Edward Elgar Publishing, Cheshire, 2017) 75 at 85.
[140] At 89.

particular stakeholder. It is also consistent with how the company can survive its directors or shareholders, which may change over time.[141] As Watson forcefully argues, it is no longer accurate to describe the company as merely an association of its shareholders, a misguided view based on partnership law which remains popular today.[142]

C Rise of shareholder primacy

Despite discussion of the company as an independent entity, the transition towards general incorporation statutes also took away the need for there to be a public benefit when a company is incorporated.[143] The capture of the company by entirely private interests meant a different normative basis was necessary to explain the company's legal existence. The shift to large, widely held companies resulted in a preference for protecting shareholders, as they were the ones investing capital into the company but faced increasing difficulties of guarding against directorial abuse, a view which was inherited by the drafters of NZ's Companies Act.[144]

Shareholder primacy gained prominence following a debate in the USA between Adolf Berle Jr and Edwin Dodd during the 1930s. Berle advocated for companies to be run for the benefit of the shareholders.[145] The directors was likened to trustees, who owed fiduciary obligations to shareholders.[146] In contrast, Dodd's questioned whether it was appropriate to think of directors as trustees who operated solely for the benefit of shareholders as beneficiaries, on the basis the directors owed their duties to the company.[147] Dodd's saw companies as "economic institutions" with social obligations, given the enormous power companies have over people's lives .[148]

Ultimately, it was Berle's view which prevailed both in the USA and here too. This was famously embodied by Milton Friedmann in the 1970s as: [149]

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141 Watson, above n 86, at 142-143. See also: Company Act 1993, s 15 and Carsten Gerner-Beuerle and Michael Anderson Schillig *Comparative Company Law* (Oxford University Press, Oxford, 2019) at 61.

142 Susan Watson "Corporate Legal Personality" in Susan Watson and Lynne Taylor (ed) *Corporate Law in New Zealand* (Thomson Reuters, Wellington, 2019) 63 at 79-80.

143 Choudhury and Petrin, above n 104, at 15.

144 Law Commission, above n 54, at [23].

145 See: Adolf Berle Jr "Corporate Powers as Powers in Trust" (1931) 44 Harv LRev 1049.

146 At 1073-74.

147 See: Dodd, above n 31.

148 At 1148.

149 Milton Friedman "A Friedman doctrine - The Social Responsibility Of Business Is to Increase Its Profits" *The New York Times* (online ed, New York, 13 September 1970).

> …there is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits…

It is this view of shareholder primacy which would be challenged by the CEO of the FMA as "never…valid or sustainable".[150] While lawyers like Peter Watts insist profit maximisation is not mandated anywhere in company law,[151] social norms and practice would suggest otherwise.[152] Ultimately, the Companies Act in NZ was a product of its time, when shareholder primacy dominated corporate governance discourse.[153]

V United Kingdom: Enlightened Shareholder salue

Although the historic debate between shareholder primacy and stakeholderism would later overshadow entity primacy as a possible solution to defining a company's purpose, it is useful to consider comparative approaches to reform. One prominent model for NZ is ESV,[154] where the law was used to set the benchmark for desirable "business behaviour".[155] Under s 172(1) of the Companies Act 2006 (UK), directors must act according to what they consider to be "most likely to promote the success of the company for the benefit of its [shareholders] as a whole". The section explicitly required, as opposed to merely permitted, directors to consider the long term impact of decisions, employees, suppliers, customers, the community, the environment, the company's reputation and fairness between shareholders.[156] This, however, is only the default position and can be amended by the company's constitution.[157]

The duty, while owed to the company,[158] prioritises shareholders because the company as an "artificial legal person" is "close to meaningless" according to the authors of *Gower and Davies*.[159] This is one of the main objections to entity primacy. By preserving

[150] Everett, above n 2.
[151] Watts, above n 81, at 42-43.
[152] See: Watson, above n 70.
[153] Vasudev, above n 35, at 13.
[154] Richard Annandale "Sustainable shareholder value: a period of enlightenment for New Zealand?" (2008) 16 Waikato LR 291 at 292.
[155] Companies Act 2006 (explanatory note) at [326].
[156] Andrew Keay "Having regard for stakeholders in practising enlightened shareholder value" (2019) 19 OUCLJ 118 at 124. See also: Alastair Hudson *Understanding Company Law* (2nd ed, Routledge, New York, 2018) at 123.
[157] Section 172(2).
[158] Section 170(1).
[159] Paul Davies and Sarah Worthington *Gower: Principles of Modern Company Law* (10th ed, Sweet & Maxwell, England, 2016) at [16.37].

shareholder primacy, the section protects the legal powers shareholders hold over the company in a similar way to NZ.[160] It also recognises the English common law view of the company's interests as one and the same as the interests of present and future shareholders.[161] This avoids displacing "the contractual and legal basis" of the UK's economy, minimising negative externalities which any transition to stakeholderism would otherwise necessitate.[162]

Furthermore, ESV expressly recognises stakeholders are important to the long-term success of companies[163] and was heralded by some as a "radical" departure from the common law.[164] The inclusion of other stakeholders dilutes the power of shareholder primacy in the UK.[165] Section 172 was meant to change directors' decision-making[166] and replace a short-term focus on profit with consideration of long-term company relationships.[167] This is especially important in the current Covid-19 pandemic, where companies can engage in "quasi-humanitarian" efforts by closing down businesses before any government mandated lockdown in the health interests of employees, suppliers and customers.[168] There is also an educational value which can help directors make decisions,[169] though this has been criticised as directors do not need to be reminded to do so.[170]

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[160] Christopher Bruner *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* (Cambridge University Press, Cambridge 2013) at 29.

[161] *Gaiman v National Association for Mental Health* [1971] Ch at 330

[162] David Walker "A review of corporate governance in UK banks and other financial industry entities" (HM Treasury, 26 November 2009) at 137 as cited in Andrew Keay *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge, 2012) at 215.

[163] David Millon "Enlightened shareholder value, social responsibility and the redefinition of corporate purpose without law" Corporate Governance after the Financial Crisis (Edward Elgar Publishing Limited, 2012) 68 at 79.

[164] *Duties of Company Directors* (Department of Trade and Industry, June 2007) <http://www.dti.gov.uk/files/file40139.pdf>.

[165] Justice Helen Winkelmann, foreword in Susan Watson and Lynne Taylor (ed) *Corporate Law in New Zealand* (Thomson Reuters, Wellington, 2019).

[166] Company Law Review *Modern Company Law for a Competitive Economy: Developing the Framework* (Department of Trade and Industry, 2000) at [5.1.17].

[167] At [2.22]

[168] Philip Gavin "Directors' Duty under UK Law to Promote the Success of the Company during the COVID-19 Pandemic" (30 April 2020) Oxford Business Law Blog <https://www.law.ox.ac.uk/business-law-blog/blog/2020/04/directors-duty-under-uk-law-promote-success-company-during-covid-19>.

[169] Keay, above n 162, at 258 and Alistair Alcock, John Birds and Steve Gale *Alcock, Birds and Gale on The Companies Act 2006* (Jordans Publishing, Bristol, 2007) at 146.

[170] Bebchuk and Tallarita, above n 13, at 13-14.

A Strategic reports

ESV was also accompanied by reporting requirements.[171] Early versions of these requirements,[172] as Andrew Keay pointed out, allowed directors to exclude "environmental, employee and community matters" if the directors thought they are immaterial, without the need to provide any explanation.[173] Moreover, directors have an incentive to report less information for fear of undermining the company's comparative advantage.[174] This was further aggravated by directors disclosing too little for fear of liability and the difficulties enforcing the reporting requirements.[175] Moreover, as shareholders are the main audience, they may not necessarily ensure directors adequately address non-financial matters.[176] Therefore, disclosure aimed at ensuring directors are at least some way accountable was initially less than effective.[177]

These issues have been partly remedied. Directors in major companies are obliged prepare a strategic report to shareholders on how they performed on s 172.[178] Some of the factors go beyond the matters listed, ranging from anti-corruption and respect for human rights.[179] Directors "must include" how they have dealt with the factors set out under s 172,[180] thereby increasing the attention to each stakeholder listed in their decision-making and increasing their accountability to shareholders.[181] These

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[171] Companies Act 2006 (UK), s 414C.

[172] Section 417.

[173] Andrew Keay "An Analysis Of The UK's 'Enlightened Shareholder Value Approach" (2007) 29 Sydney LR 577 at 604. See section 417(5).

[174] Andrew Keay "The duty to promote the success of the company: is it fit for purpose in a post-financial crisis world?" in Joan Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar Publishing, 2013) 50 at 78.

[175] Charlotte Villiers "Narrative reporting and enlightened shareholder value under the Companies Act 2006" in Joan Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar Publishing, 2013) 97 at 128.

[176] David Millon, above n 163, at 94.

[177] Andrew Johnston "Market-Led Sustainability through Information Disclosure The UK Approach" in Beate Sjåfjell and Christopher Bruner (ed) *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, Cambridge, 2019) 204 at 211. See also: Samantha Fettiplace and Rebecca Addis "Evaluation of the Companies Act 2006" (Department for Business, Innovation and Skills, 2 August 2010) at 77.

[178] Section 414B.

[179] Section 414CB.

[180] Companies (Miscellaneous Reporting) Regulations 2018 (UK), reg 4.

[181] Companies (Miscellaneous Reporting) Regulations 2018 (UK) (explanatory notes) at [7.3]. See also: Keay, above n 156, at 125.

developments were complemented by corresponding requirements in soft law codes.[182] In one sense, the UK can be seen as a "leader" by requiring companies to report back on stakeholders while nudging directors towards "greater social responsibility.[183] This conclusion may have been premature though, as some have argued little has substantively changed in how directors prepared their reports compared to before.[184]

B Challenges in practice

ESV rejects stakeholderism as "neither workable nor desirable".[185] Acting for the "benefit of its members" indicates directors should only take into account stakeholder concerns to the extent it aligns with shareholder's interests[186] and shareholder interests will always prevail if there is a conflict.[187] Although directors are not meant to merely "pay lip service" to the section according to the explanatory notes,[188] there is an absence of guidance on how directors should balance competing interests between non-shareholder stakeholders.[189] In particular, directors may not necessarily have the expertise to adequately weigh stakeholder's interests.[190] That said, these criticisms might be overstated. Directors routinely balance competing interests between stakeholders and s 172 arguably codifies what is already in practice.[191] Therefore, ESV is arguably no different from what is currently permissible for directors to consider in NZ.[192]

There is an accountability deficit in how ESV operates in the UK. ESV relies on the director's own discretion and good faith, without any consideration of reasonableness.[193] It also creates the ability for directors to eschew their responsibilities to shareholders for

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182 Financial Reporting Council "The UK Corporate Governance Code" (2018) at [5].

183 Cynthia Williams and John Conley "An Emerging Third Way - The Erosion of the Anglo-American Shareholder Value Construct" (2005) 38 Cornell Intl LJ 493 at 550.

184 Andrew Keay and Taskin Iqbal "The impact of enlightened shareholder value" (2019) 4 JBL 304 at 322.

185 Company Law Review "Modern Company Law for a Competitive Economy: Completing the Structure" (London, Department of Trade and Industry, 2000) at [3.5] and Bruner, above n 160, at 35.

186 Keay, aboven 162, at 110.

187 Andrew Keay *Directors' Duties* (Jordan Publishing, Bristol, 2014) at [6.34].

188 Companies Act 2006 (UK) (explanatory notes) at [328]

189 Keay, above n 186, at 131.

190 Mark van der Weide "Against Fiduciary Duties to Corporate Stakeholders" (1996) 21 Del JCorpL 27 at 60 as cited in Keay, above n 187, at [6.142].

191 At [6.144]. See also: Mary Arden *Common Law and Modern Society: Keeping Pace with Change* (Oxford University Press, Oxford, 2015) at 224.

192 Richard Williams "Enlightened Shareholder Value In UK Company Law" (2017) 35 UNSWLJ 360 at 366-367.

193 See (11 July 2006) 585 GBPD HL at 591–593 as cited in Keay, above n 186, at 241.

personal reasons, justified as a balancing of stakeholder interests.[194] The courts are unlikely going to second-guess decisions which directors make provided they can reason that it benefits the shareholders.[195] These factors, combined with a dearth of available cases, mean the chances of success in litigation against directors under s 172 is stacked against claimants.[196] Ironically, ESV has the same issues with accountability as the rejected approach under stakeholderism.[197] Although directors may act conservatively in response to s 172, the section "lacks teeth" and directors are effectively shielded from litigation.[198]

Practically, only the board or shareholders can enforce any breaches of s 172 through derivative actions.[199] None of the non-shareholder stakeholders listed can take action and they may not even know that their interests have been ignored until it is too late.[200] Keay posits that it is unlikely the UK courts would following the lead in Canada and broaden derivative actions for non-shareholder stakeholders.[201] Shareholders are also unlikely to take derivative actions on behalf of other stakeholders due to the cost and uncertainty such an action entails.[202] Consequently, whether ESV has benefited stakeholders remains unclear[203] and shareholder primacy remains supreme in the UK.[204]

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194 Keay, above n 186, at 133.

195 At 137-138 and *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] UKPC 3, [1974] AC 821 at 834. See: Marc Moore "Shareholder primacy, labour and the historic ambivalence of UK company law" in Harwell Wells (ed) *Research Handbook on the History of Corporate and Company Law* (Edward Elgar Publishing Limited, Reading, 2018) 142 at 147.

196 Georgina Tsagas "Section 172 of the Companies Act 2006: Desperate Times Call for Soft Law Measures" in Nina Boeger and Charlotte Villiers (ed) *Shaping the Corporate Landscape: Towards Corporate Reform and Enterprise Diversity* (Hart Publishing, Oxford, 2018) 131 at 137.

197 Keay, above n 186, at [6.37].

198 Keay, above n 174, at 87.

199 Companies Act 2006 (UK), ss 260-263 and Keay, above n 86, at 137-138. See: Joan Loughrey, Andrew Keay and Luca Cerioni "Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance" (2008) 8 JCLS 79 at 96. See generally: Andrew Keay and Joan Loughrey "An assessment of the present state of statutory derivative proceedings" in Joan Loughrey (ed) *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Edward Elgar Publishing, 2013) 187.

200 Keay, above n 87, at [6.194].

201 At [6.160].

202 At [6.165]-[6.166]. See also: Andrea Lista "Directors' duties in the UK" in Adolfo Paolini (ed) *Research Handbook on Directors' Duties* (Edward Elgar Publishing, Reading, 2014) 72 at 84.

203 Keay, above n 187, at [6.189] and Keay and Iqbal, above n 184, at 318.

204 Johnston, above n 177, at 216-217. See also: Keay, above n 13, at 413.

VI Canada: Entity Primacy in practice

Developments in Canadian corporate governance are salient for NZ. This is because NZ's Companies Act was partly based on the Canada Business Corporation Act 1985 (CBCA).[205] Consequently, movements towards an entity primacy conception of director's duties in Canada should not go unnoticed. This section begins by outlining the common law which nudged Canada towards stakeholderism, before discussing the recent statutory changes to the CBCA and enforcement issues. It concludes by looking at the lessons for NZ based on the Canadian model.

A Common Law

The historic Canadian position on directors' duties was similar to NZ's law today. Directors owed their duties to the company and the company's interests were seen as the same thing as the collective interests of all shareholders'.[206] It was risky for directors to prioritise stakeholder interests to the detriment of shareholders.[207] The position changed following two Supreme Court of Canada decisions. The Court rejected equating the company's best interests with that of the shareholders.[208] Instead, directors must act in the best interests of the company and it may be "legitimate…for the board of directors to consider…the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment".[209] Where there is a conflict between stakeholder's interests and the company, the directors must prioritise the interests of the company, reflecting a view based on entity primacy.[210]

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[205] Michael Ross "Evaluating New Zealand's Companies Law" (1994) 1 Agenda 189 at 189 and Law Commission, above n 54, at [5].

[206] J Anthony VanDuzer *The Law of Partnerships and Corporations* (4th ed, Irving Weisdorf, 2018) at 378 and *Hercules Managements Ltd v Ernst & Young* (1997) 2 SCR 165. PM Vasudev "Corporate Law and its Efficiency: A Review of History" (2010) 50 Am J Leg Hist 237 at 278-279.

[207] Robert Milnes "Acting in the Best Interests of the Corporation: To Whom is this Duty Owed by Canadian Directors? The Supreme Court of Canada in the BCE Case Clarifies the Duty" (2009) 24 Banking & Finance Law Review 601 at 602.

[208] *Peoples Department Stores Inc v Wise* (2004) SCC 68; [2004] 3 SCR 461 at [42] [*Peoples*]. See also*:* *Teck Corp Ltd v Millar* (1972), 33 DLR (3d) 288 (BCSC).

[209] *Peoples*, above n 208, at [42] as cited in *BCE Inc v 1976 Debentureholders* (2008) SCC 69 at [38] [*BCE*].

[210] At [42]. Yvan Allaire & Stephane Rousseau, "To Govern in the Interest of the Corporation: What is the Board's Responsibility to Stakeholders other than Shareholders?" (2015) 5(3) J Management & Sustainability 1 at 14.

The change would improve board decision-making by compelling directors to consider the interests of important stakeholders.[211] Directors were instructed to resolve any conflicts between stakeholders "equitably and fairly",[212] "viewed as a good corporate citizen".[213] Some were optimistic that these developments indicate Canada was embracing stakeholderism in corporate governance.[214] Nevertheless, it was unclear how directors could balance stakeholder interests if they diverged and what the new standards meant.[215]

A prominent criticism was that directors are poorly positioned to balance stakeholder interests, where they become accountable to no-one.[216] The law became "uncertain and flexible".[217] Directors could justify serving their own interests on the basis that it benefits a particular stakeholder,[218] provided they left a paper trail detailing how they weighed competing stakeholder interests which allegedly furthered the best interests of the company.[219]

B Statutory reform

Canada recently adopted entity primacy in s 122(1.1) by instructing directors that when they are acting in the "best interests of the corporation", they may "consider stakeholder's interests such as "shareholders, employees, retirees and pensioners, creditors, consumers, governments, the environment and the long-term interests".[220] The hope was that statutory reform could incentivise changes in director's behaviour, such as making long-

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[211] Catherine Francis "Peoples Department Stores Inc. v. Wise: The Expanded Scope of Directors' and Officers' Fiduciary Duties and Duties of Care" (2005) 41 Can Bus LJ 175 at 183.

[212] *BCE*, above n 209, at [82] and VanDuzer, above n 206, at 621.

[213] At [66] and [81].

[214] Carol Liao "The Next Stage of CSR for Canada: Transformational Corporate Governance, Hybrid Legal Structures, and the Growth of Social Enterprise" (2013) 9(1) JSDLP 53 at 73.

[215] Sarah Bradley "BCE Inc v 1976 Debentureholders: The New Fiduciary Duties of Fair Treatment, Statutory Compliance and Good Corporate Citizenship" (2009) 41 Ottawa LRev 325 at 330-331.

[216] VanDuzer, above n 206, at 622 and 632. See also: James Tory "A Comment on BCE Inc" (2010) 48 Can Bus LJ 285 at 286 and Bradley, above n 215, at 345-346.

[217] VanDuzer, above n 206, at 633. See also: Samuel Carsley "A Rudderless Regime: The United Kingdom's "Enlightened Shareholder Value" As A Model For The Duty Of Loyalty In Canada" (LLM thesis, University of Toronto, 2010).

[218] VanDuzer, above n 206, at 633. See also: Jeff MacIntosh "Directors' duties in Canada: paintings in a stream?" in Adolfo Paolini (ed) *Research Handbook on Directors' Duties* (Edward Elgar Publishing., Reading, 2014) 44 at 67.

[219] MacIntosh, above n 218, at 62.

[220] Jean du Plessis "Directors' duty to act in best interests of the corporation: 'Hard cases make bad law'" (2019) 34 AJCL 3 at 21.

term considerations "an internalized business norm".[221] The provision mentions a largely identical set of stakeholders to ESV.[222] The statutory formulation is slightly broader than the common law and is also non-exhaustive in terms of the interests which can be considered.[223]

Crucially, the CBCA does not prioritise shareholders as in the UK, thereby treating shareholders equally as other stakeholders in relation directors' decision-making. The CBCA has inherited the prevailing flaws of the common law, namely how should a director balance the interests of stakeholders when they compete against one another.[224] Law firms have recommended companies implement an engagement policy with affected stakeholders to minimise their legal risk.[225] Another issue is the extent directors can be held accountable by the stakeholders identified under s 122(1.1). The reforms include requirements for publicly traded companies to disclose information relating to the interests of employees, retirees and pensioner on a comply or explain basis, which are significantly less comprehensive than the UK regime.[226]

C Enforcement issues?

There are two avenues for stakeholders to enforce directors' duties. First, stakeholders could seek a derivative action to benefit the company, as the director's duty of loyalty is owed to the company.[227] The courts, in theory, have the discretion to allow any stakeholder to be a "complainant" if they are a "proper person" to bring the claim under s 238. In practice, however, only shareholders, and in a few instances creditors, have availed themselves of the remedy.[228] This is despite indications that the courts should be more sympathetic to stakeholder interests in light of *BCE* and *Peoples Department Stores*.

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221 Camille Paquette "Promoting the Long-Term Management of Public Corporations through a Reform of Canadian Corporate Law" (2019) 24 Appeal: Review of Current Law and Law Reform 19 at 39.

222 Compare with Companies Act 2006 (UK), s 172.

223 Anita Anand "A New Dimension To Directors' Duties: Bill C-97" (26 August 2019) The Canadian Bar Association <https://www.cba.org/Sections/Business-Law/Articles/2019/Bill-C-97>.

224 Edward Waitzer and Douglas Sarro "In Search Of Things Past And Future: Judicial Activism And Corporate Purpose" (2018) 55 Osgoode Hall LJ 791 at 803.

225 Norton Rose Fullbright "Legal update: Stakeholders' primacy: paradigm shift confirmed" (September 2019) <https://www.nortonrosefulbright.com/en-ca/knowledge/publications/a979357b/stakeholders-primacy-paradigm-shift-confirmed>.

226 Department of Finance Canada "Investing in the Middle Class: Budget 2019" at 67.

227 Canada Business Corporations Act, s 239. See *BCE*, above n 209, at [43].

228 VanDuzer, above n 206, at 635.

Second, stakeholders could, in theory, apply for the unfair prejudice remedy.[229] This is triggered if the directors are "oppressive", "unfairly prejudicial" or "unfairly disregards" the "interests of any security holder, creditor, director or officer" and breaches their "reasonable expectations".[230] Directors could be liable if they did not fairly consider all relevant stakeholder interests in reaching a decision.[231] The stipulation that the "interests of any security holder" and so forth left stakeholders with little to work with, unless they could establish a connection to shareholders or creditors.[232] This is because the remedy itself was initially designed to protect minority shareholders.[233]

The situation for stakeholders is worsened when courts are reluctant to second guess directors' decisions under a common law 'business judgment rule',[234] provided it is within "a range of reasonable alternatives".[235] Stakeholders are left without any feasible remedies to enforce directors' duties.[236] This suggests little will practically change when directors make decisions.[237] The reforms also only represent a "reactive, lengthy and expensive recourse mechanism" for addressing wider societal issues, such as climate change and environmental sustainability.[238]

D Impactful or a "hollow promise"?[239]

It is questionable whether the common law and statutory reforms are impactful. Instead, the changes were likely more symbolic.[240] Short-termism and its fixation on procuring profits to the detriment of long-term value creation for the company has arguably not

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[229] Canada Business Corporations Act, s 241 and *BCE*, above n 209, at [45].

[230] Section 241 and *BCE*, above n 209, at [67]-[68].

[231] Milnes, above n 207, at 617.

[232] VanDuzer, above n 209, at 636. See also: Stephanie Ben-Ishai and Poonam Puri, "The Canadian Oppression Remedy Judicially Considered: 1995-2001" (2004) 30 Queen's LJ 79 at 96 and Waitzer and Sarro, above n 224, at 807.

[233] MacIntosh, above n 148, at 59.

[234] *BCE*, above n 139, at [40].

[235] VanDuzer, above n 209, at 621.

[236] At 636.

[237] MacIntosh, above n 148, at 68.

[238] Poonam Puri "Green but Not Enough Sustainability in Canadian Corporate Governance" in Beate Sjåfjell and Christopher Bruner (ed) *Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, Cambridge, 2020) 146 at 151.

[239] Thomas Posyniak "Realizing a "Pious Wish" of Peoples and BCE: Enforcement of Pluralist Theory and Corporate Environmental Responsibility" (2012) 23 JELR 99 at 132.

[240] Anand, above n 223.

changed in the decade since the common law has shifted.[241] This is because it is much easier to quantify short-term benefits than it is to measure long-term harms to stakeholders.[242] Consequently, directors now have greater discretion but less risk of litigation.[243]

There has been much debate on how to address these issues. Some have argued for following ESV,[244] others have advocated for back to the law as before.[245] There is also a debate over whether the courts, [246] or the legislature are better placed to enact any changes.[247] The creation of a representative specialised agency to deal with disputes between different stakeholders, focussing on conflict resolution, has been mooted as a possible solution.[248] Another has been to enact statutory changes which specify directors should only act where it creates "long-term *shared* value" for both the company and its stakeholders.[249]

There is also a push for stronger enforcement pathways for stakeholders. [250] One suggestion has been to amend the statutory formulation of the unfair prejudice remedy by replacing "any security holder, creditor, director or officer" with "stakeholders". [251] Another is to expand the definition of "complainant" so more stakeholders can take

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[241] Waitzer and Sarro, above n 224, at 788-789, Ed Waitzer and Johnny Jaswal "Peoples, BCE, and the Good Corporate "Citizen" (2009) 47 Osgoode Hall LJ 439 at 469 and Camille Paquette "Promoting the Long-Term Management of Public Corporations through a Reform of Canadian Corporate Law (2019) 24 Appeal: Review of Current Law & Law Reform 19 at 20-21.

[242] Waitzer and Sarro, above n 224, at 808.

[243] Poonam Puri "The Future of Stakeholder Interests in Corporate Governance" (2010) 48 Can Bus LJ 427 at 432.

[244] Gail Henderson "The Possible Impacts Of "Enlightened Shareholder Value" On Corporations' Environmental Performance" (LLM thesis, University of Toronto, 2010) at 65.

[245] Patrick Lupa "The BCE Blunder: An Argument in Favour of Shareholder Wealth Maximization in the Change of Control Context" (LLM thesis, University of Toronto, 2009) at 51-52.

[246] Sarah Mehta Alexander "Directors Duties Under The CBCA: Shareholder Theory Versus Stakeholder Theory Consideration Of Stakeholder Theory's Legal And Moral Supremacy" (LLM thesis, University of Toronto, 2012).

[247] PM Vadusev "Strengthening the Stakeholder Principle: The Path of Corporate Law" (LLM thesis, University of Toronto, 2011) at 415

[248] At 416-417.

[249] Evguenia Paramonova "Steering Toward "True North": Canadian Corporate Law, Corporate Social Responsibility, and Creating Shared Value" (2016) 12 McGill International Journal of Sustainable Development Law and Policy 26 at 44.

[250] See: Posyniak, above n 239.

[251] Waitzer and Sarro, above n 224, at 814.

advantage of derivative actions.[252] These could offer a possible model for NZ, by changing incentives for directors and compelling them to take into account stakeholder interests on the threat of liability.[253]

VIIAustralia: Shareholder Primacy

As a comparative interest, Australia bears remarkable similarities with NZ. The Australian equivalent of s 131(1) of NZ's Companies Act is framed in near identical terms.[254] Like NZ, shareholder primacy remains supreme, where directors must act in the best interests of the company which means the collective shareholders, despite the company's separate legal identity.[255] Like NZ, this is assessed subjectively, though with an objective gloss[256] and a reluctance to second-guess director's decision-making.[257]

Significantly, Australia's has consciously chosen to retain shareholder primacy. The Corporation and Markets Advisory Committee (CAMAC) explicitly rejected ESV on the basis that directors could already consider stakeholder interests such as "environmental and other social impacts" and any amendment would risks rendering directors less accountable to shareholders.[258] In particular, the lack of any guidance on how to balance stakeholder interests under ESV meant reforming the law was undesirable in Australia.[259] The status quo was seen as sufficient for directors to take into account stakeholder interests.[260] Similar sentiments were echoed in a Parliamentary Joint Committee (PJC)

[252] Michael Kerr, Richard Janda and Chip Pitts *Corporate Social Responsibility: A Legal Analysis* (Markham, LexisNexis, 2009) at 184.

[253] Waitzer and Sarro, above n 224, at 817.

[254] Corporations Act 2001 (Aus), s 181(1)(a): "A director or other officer of a corporation must exercise their powers and discharge their duties in good faith in the best interests of the corporation".

[255] *Greenhalgh v Arderne Cinemas Ltd* [1951] CH 286 at 291 (CA) and *Ngurli v McCann* (1953) 90 CLR 425 at 438; [1953] HCA 39 at [24]. Ashley Black "General Principles" in *Australian Corporation Law Principles and Practice* (online looseleaf ed, LexisNexis) at [3.2A.0010] and *Laws of Australia* (online looseleaf ed, Thomson Reuters) at [4.2.1880].

[256] *Bell Group Ltd (in liq) v Westpac Banking Corp (No 9)* (2008) 39 WAR 1, 70 ACSR 1 at [4619] [*Bell Group*] and Rosemary Langford and Ian Ramsay "Directors' duty to act in the interests of the company: Subjective or Objective?" (2015) 2 JBL 173 at 181. See also: Laws of Australia (online looseleaf ed, Thomson Reuters) at [4.2.1890].

[257] *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306 (CA).

[258] Corporations and Markets Advisory Committee "The social responsibility of corporations" (December 2006) at 111.

[259] At 111.

[260] At 7. See also: Daniel Crennan QC "The Future of the Corporation: The Regulator's Perspective" (Speech to the Supreme Court of New South Wales Annual Corporate and Commercial Law Conference Sydney, 29 October 2019).

report.[261] Stakeholders are better protected through external legislation,[262] a view echoing our own Law Commission.[263] The courts can clarify what "changing community expectations" are,[264] an approach which has been subsequently criticised as "beyond the legitimate function of a court" to change director's behaviour.[265]

Shareholder primacy is under increasing scrutiny.[266] The issue regained prominence following a Royal Commission inquiry into banking misconduct, where banks prioritised their shareholders at the expense of customers.[267] Some have argued that the notion of the "best interests" of the company can be stretched as far as to include respect for human rights in offshore supply chains.[268] The ASX attempted to introduce the principle of a "social licence" to operate, which was ultimately abandoned following strenuous opposition.[269] The principle would have required directors to have regard for stakeholder interests and views, ranging from customers to the local community.[270] Despite this, the ASX obliges directors of listed companies in Australia to report on how they are managing "material exposure to environmental or social risks",[271] which range from activities "adversely affect[ing] human society" from pandemics to environmental

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[261] Parliamentary Joint Committee on Corporations and Financial Services "Corporate responsibility: Managing risk and creating value" (21 June 2006) at [4.39].

[262] Corporations and Markets Advisory Committee, above n 258, at 113.

[263] Law Commission, above n 54, at [195].

[264] Corporations and Markets Advisory Committee, above n 258, at 111.

[265] TF Bathurst and Naomi Wootton in "Directors' and Offices' Duties in the Age of Regulation" in Pamela Hanrahan and Ashley Black (ed) *Contemporary Issues in Corporate and Competition Law* (LexisNexis, Australia, 2019) 3 at 22.

[266] See: Judith Fox "Shareholder primacy: Is there a need for change?" (Governance Institution of Australia Discussion paper, 2014).

[267] Kenneth Hayne *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, 2019) at 401. See: Pamela Hanrahan "Companies, Corporate Officers And Public Interests: are we at a Legal Tipping Point?" (2018) 36 C&SLJ 665.

[268] Riana Cermak "Directors' Duties to Respect Human Rights in Offshore Operations and Supply Chains" (2018) 36 C&SLJ 124 at 144.

[269] Janet Albrechtsen "Fads and Fantasy Hijacking Corporate Governance' (online ed, The Australian, 25 July 2018).

[270] ASX Corporate Governance Council "Corporate Governance Principles and Recommendations: 4th Edition" (consultation paper, 2018) at 25.

[271] ASX Corporate Governance Council "Corporate Governance Principles and Recommendations: 4th Edition" (December 2019) at 27-28.

pollution.[272] In Australia, soft law is arguably keeping up with societal expectations in a way which hard law is not.[273]

Moreover, like NZ, there is some suggestion that entity primacy is beginning to hold sway.[274] Recent judicial pronouncements suggest the interests of the company and its shareholders are "correlative", but not identical.[275] There are other "legitimate interests" beyond shareholders which directors can take into account.[276] Likewise, the PJC report did not identify the best interests of the company to be the same as those of the collective shareholders,[277] unlike in the CAMAC report.[278] Instead, the PJC discussed how directors can act in "enlightened self-interest" and consider the "legitimate interests" of stakeholders to the extent it benefits the company, with a view towards the "long-term viability" of the company.[279] Furthermore, the Royal Commission on banking misconduct,[280] a judge[281] and a prominent lawyer have all discussed extrajudicially how directors owe their duty to the company and therefore, can take into account stakeholder interests if it benefits the company.[282]

Although entity primacy fits within the existing statutory wording in Australia,[283] the approach has been criticised on the basis that the entity is an "empty concept" and

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[272] At 36.

[273] Victoria Baumfield "The Australian Paradox Conservative Corporate Law in a Progressive Culture" in Beate Sjåfjell and Christopher Bruner (ed) *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, Cambridge, 2019) 161 at 175.

[274] Rosemary Langford "Best Interests: Multifaceted But Not Unbounded" (2016) 75 CLJ 505 at 525. See also: *ASIC v Cassimatis* (No 8) (2016) 336 ALR 209, [2016] FCA 1023 at [482]-[483].

[275] *Bell Group*, above n 256, at [4389]. See: du Plessis, above n 220, at 21.

[276] At [4385].

[277] Parliamentary Joint Committee on Corporations and Financial Services, above n 261, at [4.31].

[278] Corporations and Markets Advisory Committee, above n 258, at 84. See: Shelley Marshall and Ian Ramsay "Stakeholders And Directors' Duties: Law, Theory And Evidence" (2012) 35 UNSWLJ 291 at 302.

[279] Parliamentary Joint Committee on Corporations and Financial Services, above n 261, at [4.32].

[280] Hayne, above n 267, at 401–402.

[281] JD Heydon "Directors' duties and the company's interests" in PD Finn (ed) *Equity and Commercial Relationships* (Law Book Company, 1987) as cited in Robert Austin "Directors' Duties: When Statute Seeks to Enact Equitable Obligations" in Pamela Hanrahan and Ashley Black (ed) *Contemporary Issues in Corporate and Competition Law* (LexisNexis, Australia, 2019) 25 at 37.

[282] Neil Young "Must directors maximise shareholder value? The Australian experience (Speech to Supreme Court of New South Wales Corporation Law Conference, 8 September 2015) as cited in Austin, above n 281, at 37.

[283] Du Plessis, above n 220, at 20.

meaningless by itself.[284] Similarly, there is a risk in stretching the statutory wording as "an accordion term" inappropriately and benefiting stakeholders where there is no "clear corporate benefit".[285] Despite the objections, it is likely that the law needs to be reformed to reflect reality and acknowledge the role stakeholders play in the best interests of the company.[286] Short of reform, it can be difficult for directors to determine which stakeholders have a "legitimate claim" in the company.[287]

VIII Delaware: Director Primacy

While this paper advocates for an entity primacy conception of the company, one alternative posited in the debate over the company's purpose is director primacy. Director primacy view directors as the "Platonic guardian" and the principal means of managing the company.[288] This is because directors receive their mandate to manage the company from statute, rather than the shareholders.[289] The ends of the company is the maximisation of shareholder wealth, as shareholders are providers of capital and are the traditional beneficiaries of the duty.[290] Shareholders, however, have competing interests and face collective action costs when making decisions.[291] Consequently, director's should have "largely unfettered discretion" to make decisions while being protected from encroachment by the courts or shareholders.[292]

Delaware is one example of a jurisdiction which largely embodies director primacy. [293] As a comparative interest, the majority of Fortune 500 companies are located in Delaware and the jurisdiction has a reputation for being a benchmark jurisdiction in corporate

[284] Austin, above n 281, at 38

[285] Langford, above n 274, at 526.

[286] Jean du Plessis "Shareholder Primacy and Other Stakeholder Interests" (2016) 34 C&SLJ 1 at 6. and Jean du Plessis "Corporate Social Responsibility and Contemporary 'Community Expectations'" (2017) 35 C&SLJ 30 at 45-46.

[287] Rosemary Langford "Stakeholder Interests – Balancing Or Considering?" (2014) 32 C&SLJ 64 at 67.

[288] Stephen Bainbridge *The New Corporate Governance in Theory and Practice* (Oxford University Press, Oxford, 2008) at 60.

[289] Bainbridge, above n 18, at 565. Companies Act 1993, s 128(1).

[290] At 554.

[291] At 566-567.

[292] At 568.

[293] *Revlon Inc v MacAndrews & Forbes Holdings Inc* 506 A2d 173 (Del 1986) at 182 [*Revlon*].

governance.[294] Consequently, there is merit in investigating whether Delaware's success as an embodiment of director primacy can be replicated in NZ.

A Delaware Law

While Delaware does not explicitly adopt director primacy, in practice it does.[295] Directors owe their duties to both shareholders and the company.[296] This position is not universally accepted,[297] as shareholders have the power to vote in directors and on certain company decisions.[298] Despite the objections, a considerable degree of deference is granted to directors. Shareholders in Delaware have "virtually no power to initiate corporate action", unlike in NZ.[299] This is because directors have a statutory mandate to manage the company,[300] retaining the ability to approve or veto any amendments to the constitution prior to voting by shareholders.[301] Consequently, Delaware's model of corporate governance is described as "board-centric".[302] Moreover, the 'business judgment rule' is a rebuttable presumption that directors make decisions in good faith for the best interests of the company.[303] This means directors are essentially shielded from liability if they can justify there will be some benefit for the shareholders, even in the future.[304]

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[294] See: Mohammed Hemraj "Why Delaware? The US corporations' preference to incorporate in Delaware: the search for justification" (2016) 37 Com Law 254 and Division of Corporations "Why Businesses Choose Delaware" <https://corplaw.delaware.gov/why-businesses-choose-delaware/>.

[295] Kevin Turner "Settling the Debate: A Response to Professor Bebchuk's Proposed Reform of Hostile Takeover Defenses" (2006) 57 Ala L Rev 907 at 927 and Bainbridge, above n 288, at 105.

[296] *Katz v Oak Industries Inc* 508 A2d 873 (Del 1986) at 879. See also: Delaware Corporation Law and Practice (online looseleaf ed, LexisNexis) at 15.02 and Franklin Gervurtz *Corporation law* (2nd ed, Thomson Reuters, 2010) at 315.

[297] See: George Dent Jr "Academics In Wonderland: The Team Production And Director Primacy Models Of Corporate Governance" (2008) 44 Hous LR 1213.

[298] Leo Strine "The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law" (2015) 50 Wake Forest LRev 761 at 784. See also: Rock, above n 47, at 17 and Bruner, above n 160, at 37.

[299] Bainbridge, above n 18, at 561. See also: Bruner, above n 160, at 39.

[300] Delaware General Corporation Law, § 141.

[301] Delaware General Corporation Law, § 242.

[302] Bainbridge, above n 18, at 562. *McMullin v Beran* 765 A2d 910 (Del 2000) at 916 See generally: J Travis Laster and John Mark Zeberkiewicz "The Rights and Duties of Blockholder Directors" (2015) 70 The Business Lawyer 33 at 35-36.

[303] *Aronson v Lewis* 473 A2d 805 (Del 1984) at 812.

[304] Antony Page and Robert Katz "Freezing Out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon" (2010) 35 Vt LRev 211 at 232

Shareholder wealth maximisation is the ultimate goal of a Delaware incorporated company.[305] Despite attempts to narrow this principle to specific circumstances such as takeovers[306] and the lack of any statutory direction,[307] shareholders have remained the main beneficiaries of directors' duties.[308] There is dicta to suggest directors can take into account the interests of stakeholders such as "creditors, customers, employees, and perhaps even the community"[309] in situations such as insolvency[310] or a takeover.[311] Although some have argued this is a lapse into stakeholderism,[312] the Delaware Supreme Court clarified that directors may take into account the interests of other stakeholders only if it benefits the interests of shareholders.[313] Directors who pursue stakeholder interests at the expense of shareholders risk breaching their duty of loyalty.[314]

As a side note, constituency statutes are gaining traction across many states in the USA. These largely permit directors to consider the interests of stakeholders if it is in the long-term interests of the company.[315] Consequently, most are arguably an embodiment of entity primacy.[316] Delaware does not have one. This is because such statutes do not give stakeholders corresponding abilities to enforce them while reducing director accountability.[317] Moreover, practice suggests constituency statutes do not feature heavily beyond the takeover context[318] and it is unclear for directors how they should prioritize competing stakeholder interests.[319] The phenomenon has been described by the

[305] Stephen Bainbridge "Director Primacy: The Means and Ends of Corporate Governance" (2003) 97 NWULR 547 at 550.

[306] Jill Fisch and Steven Solomon "Should Corporations have a Purpose?" (European Corporate Governance Institute paper, 2020) at 118.

[307] See: Lynn Stout, above n 27 and Lyman Johnson "Unsettledness In Delaware Corporate Law: Business Judgment Rule, Corporate Purpose" (2013) 38 Del JCorpL 405 at 432

[308] *eBay Domestic Holdings, Inc v Newmark* 16 A3d 1 (Del Ch. 2010) at 34 [*eBay*]. See also: William Allen "Corporate Takeovers and Our Schizophrenic Conception of the Business Corporation" (1992) 14 Cardozo LRev 261 at 268.

[309] *Unocal Corp v Mesa Petroleum* Co 493 A2d 946 (Del 1985) at 955-56

[310] *Equity-Linked Investors L.P v Adams* 705 A2d 1040 (Del Ch 1997) at 1058.

[311] *Ivanhoe Partners v Newmont Mining Corp* 535 A2d 1334 (Del 1987) at 1341–42.

[312] Vasudev, above n 35, at 133.

[313] Revlon, above n 293, at 182.

[314] *eBay*, above n 308, at 34

[315] Stephen Bainbridge *Corporate Law* (3rd ed, Thomson Reuters, 2015) at 249.

[316] Keay, above n 87, at 227-228.

[317] Gervurtz, above n 296, at 324

[318] Strine, above n 298, at 771.

[319] Fisch and Solomon, above n 306, at 122.

former Chief Justice of Delaware's Supreme Court as "an exercise in feeling good than in doing good".[320]

B A theory for New Zealand?

Stephen Bainbridge, one of the architects of director primacy, has explicitly considered the applicability of the theory to NZ.[321] On one hand, NZ directors are already afforded a wide discretion in business judgment.[322] Bainbridge concedes, however, it is "not obvious" NZ needs to change its current regulatory settings.[323] The proliferation of small, closely held companies[324] and concentrated share ownership in NZ means the distinction between ownership and control is blurred.[325] This obviates the need for NZ directors to hold the same amount of power over the company as their Delawarean counterparts.[326]

Moreover, there are theoretical objections to director primacy. One challenge is the lack of accountability directors have to shareholders, or any other stakeholder.[327] Another is that it ignores situations where decision-making is delegated to groups other than the directors.[328] In NZ, director primacy cannot explain why shareholders have the power to vote on "major transactions",[329] or the ability to dilute the director's powers by amending the company's constitution.[330] Finally, the public provision of social welfare in NZ mean directors do not need as much authority to cater for stakeholders.[331] This is in stark contrast to the USA, where company law and directors fill in the gap left by an inadequate social welfare system, such as providing insurance for employees.[332] Compared to entity primacy, director primacy does not have the same descriptive and normative power when applied to NZ.

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[320] Strine, above n 298, at 768.

[321] Bainbridge, above n 18.

[322] Companies Act 1993, Long Title.

[323] Bainbridge, above n 18, at 556.

[324] Justice Paul Heath "Directors Direct; Managers Manage" (NZLS Seminar, June 2012).

[325] Bainbridge, above n 18, at 556.

[326] At 571.

[327] Brett McDonnell "Professor Bainbridge and the Arrowian Moment: A Review of the New Corporate Governance in Theory and Practice" 34 Del JCorp.L 139 (2009) at 188-189.

[328] Wayne Hanewicz "Director Primacy, Omnicare, And The Function Of Corporate Law" (2004) 71 Tenn LRev 511 at 570.

[329] Companies Act 1993, s 129.

[330] Section 128(3).

[331] Bainbridge, above n 18, at 573.

[332] Bruner, above n 160, at 220.

IX Implementing Entity Primacy in New Zealand

While entity primacy is a normatively desirable model for NZ, implementing it is another matter. This section begins by proposing regulatory intervention by amending s 131 of the Companies Act. It then turns to reporting requirements and incorporation of strategic reports based on the UK model which encourages ex-ante compliance with the new amendment, before looking at incorporating a 'social licence' in soft law corporate governance codes. The section concludes by considering ex-post enforcement mechanisms through an expansion of the category of 'complainants' who can pursue a derivative action.

A Amending s 131

1 Why Legislation?

Legislative amendment of s 131 of the Companies Act make sense. Supporters for similar reforms in Canada point out this can "send a uniform, nation-wide message" to directors.[333] In a jurisdiction where shareholder primacy has prevailed, a legislative change can signal a shift in community expectations of the company.[334] The unsatisfactory alternative is to wait for judicial reform, which is both time consuming and any findings of law will inevitably be constrained by the facts of the case.[335]

While s 131 as it is worded does allow directors to take into account stakeholder interests, this is normally only done if it benefits the shareholders.[336] Some have argued legislative intervention is unnecessary, as providing a "smorgasbord of options" will not necessarily lead to "socially desirable" decisions.[337] This argument is not persuasive, as it is unlikely self-regulation by directors to take into account stakeholder interests will lead to anything more than a reaffirmation of shareholder primacy.[338]

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[333] Paramonova, above n 249, at 46.

[334] du Plessis, above n 286, at 39.

[335] Posyniak, above n 239, at 121.

[336] Vasudev, above n 35, at 126-127 and 130.

[337] Jason Harris "Shareholder Primacy, in Changing Times" (Speech to Supreme Court of New South Wales Commercial & Corporate Law Conference, Sydney, 20 November 2018).

[338] Andrew Lumsden and Saul Fridman "Corporate social responsibility: The case for a self-regulatory model" (2007) 25 C&SLJ 147 at 178. See also: Amir Licht "Stakeholder Impartiality: A New Classic Approach for the Objectives of the Corporation" (European Corporate Governance Institute paper, 2019) at 25-26.

There is a sense of urgency to clarify the issue. The management of companies is fast becoming a public policy problem, given the devastating impacts companies and directors' decisions can have on stakeholders, whether after Pike River mine or the 2008 financial crisis.[339] Social norms entrenching shareholder primacy have also been denounced as one of the greatest impediments to sustainability.[340] According to Beate Sjåfjell, this should not be underestimated. Social norms can easily turn into "legal myths", which makes it even more important for the law to be clarified.[341]

2 *Proposed approach*

The best model is to adopt a provision similar to s 122(1.1) of the CBCA, but amended to suit NZ conditions. The proposed approach is:

> When acting with a view to the best interests of the company under subsection (1), the directors of a company may consider, but are not limited to, the following factors:
> the interests of:
> - shareholders,
> - employees,
> - creditors,
> - consumers,
> - the government,
> - the community; and
> - the environment;
>
> health and safety risks; and
> the long-term interests of the company.

The lessons from the UK are instructive and the proposed approach avoids prioritizing shareholders' interests, like in the CBCA. In the UK, directors are required to "promote the success of the company for the benefit of its *members*" [emphasis added]. While the duty in the UK may have had some soft impact on directors' behaviour in fulfilling an educational value,[342] directors are able to prioritise the shareholders' interests even if it is

[339] Michael Webb "The Changing Landscape of Corporate Law – Developments in Directors' Liability" in Susan Watson (ed) *The Changing Landscape of Corporate Law* (Centre for Commercial & Corporate Law Inc, Christchurch, 2017) 221 at 223.
[340] Beate Sjåfjell "Dismantling the Legal Myth of Shareholder Primacy: The Corporation as a Sustainable Market Actor." in Nina Boeger and Charlotte Villiers (ed) *Shaping the Corporate Landscape: Towards Corporate Reform and Enterprise Diversity* (Hart Publishing, Oxford, 2018) at 78.
[341] At 80.
[342] Moore, above n 195, at 146.

contrary, and detrimental, to the company.[343] For example, directors may be inclined to distribute any company surplus as dividends to shareholders rather than grow the company by investing the surplus back into the company.[344] This would go even further than the status quo in NZ and entrenches the position shareholders have over the company.[345] In practical terms, the UK approach is unlikely going to lead to any change.[346]

There are notable differences between the proposed approach and the CBCA. For a start, it refers to "health and safety risks". This implements one of the recommendations of the Royal Commission into Pike River Mine, which identified an anomalous result where directors are not obliged by statute to consider health and safety risks, but managers and employers are.[347] Moreover, it adds "the community", which is present in the UK statute but not in the CBCA. While the meaning of "the community" can be unclear, it generally refers to places where the company operates.[348] Under entity primacy, the community plays a major role in dictating the fortunes of the company's fund, especially from a reputational standpoint.[349] The proposed approach deletes "retirees and pensioners" which featured in the CBCA. This was because workplace pensions in Canada were at risk of collapsing if the employer becomes insolvent, which is less of an issue in NZ due to KiwiSaver.[350]

It makes sense to keep the list non-exhaustive through the words "but not limited to" as it appeared in the CBCA, with similar wording also in the Companies Act (UK). This is because there will be other factors which occur in the life of a NZ company which might be relevant. For instance, the increasing use of the company as a vehicle by Māori iwi and hapu in post-settlement negotiations with the Crown may necessitate consideration of tikanga Māori or Te Tiriti o Waitangi 1840 by the directors.[351]

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[343] Lista, above n 202, at 85.

[344] Daniel Attenborough "Misreading the directors' fiduciary duty of good faith" (2020) 20 JCL 73 at 93.

[345] Bruner, above n 160, at 29.

[346] Keay and Iqbal, above n 184, at 321.

[347] Panckhurst, Bell and Henry, above n 114, at 33.

[348] Keay, above n 187, at [6.119].

[349] Watson, above n 86, at 160.

[350] Department of Finance Canada, above n 226, at 67.

[351] See: Elizabeth Macpherson "Iwi Companies" in Susan Watson and Lynne Taylor (ed) *Corporate Law in New Zealand* (Thomson Reuters, Wellington, 2019) 111 and Linda Te Aho "Corporate governance: balancing Tikanga Maori with commercial objectives" (2005) 8(2) YBNZ Juris 300.

The proposed approach also gives directors a degree of discretion by using "may consider". The wording mirrors an increasing convergence across common law jurisdictions, where the law is more deferential to directors' decision-making. The statutory source of directors' powers in NZ is leading to a "board-centric" model similar to Delaware.[352] Moreover, the statutory changes in both the UK and Canada have led to directors more leeway to justify their decisions.[353] Greater discretion is consistent with recent NZ Supreme Court pronouncements that the courts are not well-positioned to "second-guess" business decisions, even with expert evidence.[354] The reaffirmation of a common law 'business judgment rule' further solidifies a natural progression towards entity primacy. This is because directors are not compelled to act for the interests of either shareholders or any particular stakeholders.

On the other hand, the proposed approach suffers from a lack of guidance on how directors should balance the different interests. This was a significant criticism leveraged against ESV in the UK.[355] As Keay concedes, it is impossible to create a single test which can cover every situation confronting the multitude of companies in existence. Instead, the more realistic approach is to rely on broader principles, which entity primacy does by focussing directors' minds on maximising the value of the company and maintaining solvency.[356] While not an entirely satisfactory answer, this was the approach taken by the Supreme Court of Canada which observed there are "no absolute rules" in how directors act in the "best interests of the [company]".[357] What will be in the "best interests of the company" will change according to the company's lifecycle.[358] For instance, directors need to prioritise creditors' interests when the company is near or in insolvency, which is consistent with existing case law.[359]

B Introducing New Mandatory Disclosure

Legislative reform by itself is unlikely going to be effective. Disclosure under the Companies Act in NZ is currently directed towards financial or accounting metrics in annual reports.[360] While important for any company, annual reports do not incorporate

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[352] Section 128 and Compare with Delaware General Corporation Law, § 141.

[353] Lista, above n 343, at 84. Puri, above n 243, at 432.

[354] *Madsen*-Ries, above n 52, at 112.

[355] Keay, above n 186, at 131.

[356] Keay, above n 187, at 295.

[357] *BCE*, above n 209, at [67].

[358] See: Palmer, above n 49.

[359] See, for example: *Madsen-Ries*, above n 52, at [177].

[360] Section 208.

the variety of factors which directors may encounter when making a decision under entity primacy. Annual reports are also directed explicitly to the shareholders, rather than the interests which may affect the corporate fund or the company itself.[361] Moreover, reporting under both the NZX and FMA is voluntary and inconsistent.[362] Consequently, there is an accountability deficit which will need to be remedied if directors were to take the proposed approach seriously.[363]

Reporting requirements are a feature which accompanied the statutory reforms in both the UK[364] and Canada.[365] In the UK, strategic reports are prepared specifically for shareholders to ensure directors have complied with their duties to promote the success of the company.[366] These reports are advantageous for two reasons. First, as the UK Government identified, it compels directors to "think more carefully" about the way they make decisions affecting stakeholders.[367] It is also another means for governments to pressure companies to achieve socially desirable ends.[368] This is important, as these decisions can have an impact on the corporate fund, such as how the company is perceived and its reputation. Second, it deals with information asymmetry and ensures stakeholders are aware of board decisions which may have a detrimental impact on the company.[369] Under entity primacy, reporting is one way of mitigating the broad discretion allocated to directors and ensuring they are making decisions which ultimately benefit the company.

Drawing on the UK, NZ should insert a section within the Companies Act imposing a duty on directors to prepare a strategic report which should be prepared yearly. These reports should discuss how the directors have balanced the interests mentioned under the proposed approach from employees to the environment, which mirrors the s 172(1) statement large UK companies have to prepare.[370] Moreover, NZ could also consider

[361] Section 211.
[362] Watson, above n 70, at 181.
[363] At 182.
[364] See: Companies Act 2006 (UK), s 414A.
[365] Department of Finance Canada, above n 226, at 67.
[366] Financial Reporting Council "Guidance on the Strategic Report" (2018) at 4 and Davies and Worthington, above n 159, at [21.24].
[367] Department for Business, Energy & Industrial Strategy "Corporate Governance Reform: The Government response to the green paper consultation" (August 2017) at [2.35].
[368] Davies, above n 12, at 315 and 317.
[369] Keay, above n 87, at 242.
[370] Compare with s 414CZA.

imposing additional reporting requirements on listed companies, such as the effectiveness of company policies on social, human rights and anti-corruption issues in relation to measurable key performance indicators.[371] The lack of specificity is intentional, as these reporting requirements will need to apply across companies of different types and sizes.

The purpose of strategic reports should be stated upfront. While the audience of a strategic report was directed at shareholders in the UK, an entity primacy approach dictates a different audience should be the subject of reporting in NZ.[372] The statute should expressly stipulate reports are aimed at the company and any interests which can affect the corporate fund, which would include the stakeholders mentioned under the proposed amendment from employees to the environment. This is a much broader audience compared to the UK.

The reporting requirements in the UK discriminates between smaller, medium-sized and larger companies. Smaller companies are exempt from such requirements, while medium-sized companies have less onerous requirements.[373] This is because of the burden reporting can have on businesses.[374] The distinction is based on the annual turnover, balance sheet and number of employees a company has, which can be adjusted for NZ conditions.[375] The strategic reporting requirements should apply to companies which are currently obliged to prepare an annual report.[376] This would include, for instance: listed companies, public entities and large companies, which are defined as NZ companies with total assets worth over NZD 60 million or total revenue exceeding NZD 30 million.[377]

Strategic reports in NZ should also exempt directors from reporting on “impending developments” or negotiations which may “be seriously prejudicial to the interests of the company”.[378] Such an exemption recognises commercial realities and is significantly narrower than the exemption afforded to NZ directors when preparing annua; reports, who can choose to exclude any information which may be “harmful to the business of the company”.[379] The latter standard for annual reports would be inappropriate for a strategic

[371] See: ss 414C and 414CA
[372] Financial Reporting Council, above n 366, at 4.
[373] See ss 414B and 414C(6).
[374] Department for Business, Energy & Industrial Strategy, above n 367, at [2.37] and [2.38].
[375] See Companies Act (NZ), s 382.
[376] Section 208.
[377] Financial Reporting Act 2013, s 45.
[378] Companies Act (UK), s 414C(14).
[379] Compare with Companies Act (NZ), s 211(1)(a).

report. This is because it can undermine the broader decision-making and accountability which strategic reports are trying to incentivise, despite the entity primacy approach mandating directors to maximise the value of the company.

There are drawbacks to strategic reports. A balance will need to be achieved between prescription and discretion. The former may result in "boiler-plating" while the latter could lead to underreporting.[380] Reports might also be unhelpful and not provide much insight into director decision-making, especially given the commercial sensitivity of some business decisions. This is compounded by similar issues experienced in the UK, where directors were concerned by competition and the threat of legal liability.[381] For instance, an empirical study into the strategic reports of eight listed retail companies in the UK suggested there was little difference to how companies reported, despite the onset of a statutory duty to do so.[382] These risks will need to be mitigated.

One step is to require directors to explain why they may have not considered a particular interest under the proposed approach, similar to a comply or explain model. It goes beyond the UK approach, which only requires directors to state they have not considered a particular interest without the need to provide any reason for doing so.[383]

In addition, a regulation-making power should be granted to an executive body such as the FMA. This ensures compliance with reporting requirements is monitored and can be updated to suit changing circumstance. Such a body should have the ability to make binding and non-binding rules on how strategic reports are prepared. In contrast, the UK's Financial Reporting Council is only empowered to issue guidance with "persuasive rather than mandatory force".[384] Consequently, companies do not necessarily have to ensure their strategic reports are in line with both best practice and changing circumstances, resulting in an accountability deficit despite a statutory obligation to prepare a strategic report.[385] Greater powers for the regulator can address this deficit.

[380] Keay, above n 186, at 149.

[381] At 162.

[382] Keay and Iqbal, above n 184, at 321.

[383] Section 414C(7).

[384] Financial Reporting Council, above n 366, at 3.

[385] Keay, above n 186, at 171-172.

C Reforming Soft law

As indicated earlier, soft law codes in NZ are effectively "water[ed] down" affirmations of shareholder primacy.[386] In Australia, however, there was a shift to embrace a "social licence to operate' in the ASX corporate governance guidelines. Strenuous opposition meant the wording was later replaced by "reputation" and "standing in the community".[387] Regardless, the idea remains a good one and should be implemented in NZ as a complementary measure following the proposed legislative shift towards entity primacy.

The ASX describes a social licence as something which companies can lose if they act unlawfully, unethically or socially irresponsibly.[388] Hence, directors need to take into account the "views and interests of a broader range of stakeholders" ranging from consumers to suppliers.[389] In other words, it is the extent stakeholders are willing to accept the company's activities.[390] While the term has been criticised for its lack of precision,[391] there is an educational value to such a statement and it can legitimise corporate activity.[392] It is consistent with entity primacy as it confirms directors can take into account stakeholder interests to the extent it benefits the company.[393] This recognises while companies are run for private reasons, there is a public dimension requiring companies to be responsible for its actions.[394]

Moreover, there is a precedent for soft law norms taking on more onerous obligations than hard law. For example, the UK Corporate Governance Code also requires directors to have "engagement mechanisms" aimed at understanding stakeholders' interests, which goes beyond the requirements of the statute.[395] The attempt in Australia marks an

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386 Watson, above n 70, at 185.

387 Elizabeth Johnstone, Chair of the ASX Corporate Governance Council "Launch Of The 4th Edition Of The Corporate Governance Principles & Recommendations" (27 February 2019).

388 ASX Corporate Governance Council, above n 270, at 25.

389 At 25.

390 Pamela Hanrahan "Corporate governance in these 'exciting times'" (2017) 32 Aust Jnl of Corp Law 142

391 John Colvin and Nicholas Saady "Guiding in which direction? An analysis of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations — Part Two, Some issues" (2019) 2 Australian Banking and Finance Law Bulletin 8 at 10.

392 John Kay "The concept of the corporation" (2019) 61 Business History 1129 at 1139.

393 See generally: Rosemary Langford "Social Licence to Operate and Directors' Duties: Is There a Need for Change?" (2019) 37 C&SLJ 200 at 208-209.

394 Marc Moore and Matrin Petrin *Corporate Governance: Law, Regulation and Theory* (Palgrave, United Kingdom, 2017) at 28-29.

395 Financial Reporting Council, above n 182, at 5.

increasing convergence in soft law norms which envisage a broader conception of the company's purpose.[396]

A less controversial, but similar concept which has been incorporated into the UK Corporate Governance Code is "long-term sustainable success".[397] As Rosemary Langford points out, sustainability is equally ambiguous as a social licence to operate, but both require directors to consult with stakeholders.[398] While most companies can be sustainable, a social licence is difficult for companies in certain industries to comply with, such as coal, gambling or tobacco.[399] The risk of soft law reforms which are unfriendly to businesses is that companies can refuse to follow them.[400] Regardless, the debate stimulated by the very notion of a 'social licence' in Australia makes an endeavour to incorporate it in NZ worthwhile.

D A Right with a Remedy

This part discusses ex-post means of enforcing the proposed amendment to s 131. The risk of the proposed amendment is that it may give directors a "sword" and "shield" to make decisions without fear of being challenged, a concern which was directed at stakeholderism.[401] As discussed earlier, both the UK and Canadian experiences indicate there are difficult hurdles for stakeholders when seeking to challenge directors' decisions. In the former, there are simply no avenues for most non-shareholder stakeholders to challenge directors' decisions,[402] while in the latter the courts have been reluctant to do so.[403] These barriers have led some to condemn those two jurisdictions as essentially giving effect to the legal adage that 'a right without a remedy is not a right at all'.[404] Drawing on these lessons, NZ should consider using derivative actions as a means of ensuring directors are acting in the best interests of the company by giving stakeholders and affected interests a pathway to hold directors to account.

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[396] Jennifer Hill "Shifting Contours of Directors' Fiduciary Duties and Norms in Comparative Corporate Governance" (European Corporate Governance Institute Working Paper, 2020) at 178.
[397] Langford, above n 393, at 211-212.
[398] See: UK Corporate Governance Code 2018
[399] Langford, above n 393, at 212.
[400] Tsagas, above n 196, at 142.
[401] Gatti and Ondersma, above n 40.
[402] Keay, above n 74, at 87.
[403] Vasudev, above n 35, at 138.
[404] Loughrey, Keay and Cerioni, above n 199, at 96 and VanDuzer, above n 206, at 635.

1 Derivative actions

Derivative actions are brought in the company's name for a harm suffered by the company.[405] These actions are designed to address situations where the directors or majority shareholders do not want the company to mount a legal action, as the harm may have been caused by them or they want to avoid the negative impacts litigation may have on the company's finances and reputation.[406] Unlike personal actions under the unfair prejudice remedy, derivative actions are pursued for the benefit of the company, taking on a collective character.[407] This makes derivative actions a useful focal point for enforcing directors' duties under entity primacy.

Expanding the category of complainants who can bring forward a derivative action is not a novel idea. Andrew Keay has mooted stakeholders should be allowed to bring forward such actions, in addition to shareholders or directors. While it makes sense under shareholder primacy to limit standing for pursuing a derivative action to only shareholders, entity primacy mandates a broader range of interests should be considered if it benefits the company.[408] Hence, the status quo would become redundant if the proposed statutory amendments to s 131 is adopted.

Keay's suggestion in the UK context was to allow "anyone who appears to the court to be interested in the company" to pursue derivative actions.[409] The formulation is similar to the CBCA, where a "complainant" includes "any other person who, in the discretion of a court, is a proper person".[410] Broadening the statutory language, however, is insufficient. As the Canadian experience has indicated, merely giving the courts a possible discretion to grant leave for non-shareholder stakeholders to take derivative actions does not mean the courts will actually use that discretion.[411] An equilibrium is needed between allowing interests which can legitimately affect the company's best interests enforce their rights while ensuring the boards have the discretion to make decisions.[412]

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[405] *Alexander Ward & Co Ltd v Samyang Navigation Co Ltd* [1975] 1 WLR 673, [1975] 2 ALL ER 424 (HL) as cited in Lynne Taylor "Derivative Action" Susan Watson and Lynne Taylor (ed) *Corporate Law in New Zealand* (Thomson Reuters, Wellington, 2019) 751 at 751.

[406] At 752.

[407] Keay, above n 87, at 266.

[408] At 254.

[409] At 275.

[410] Canada Business Corporation Act, s 238.

[411] VanDuzer, above n 209, at 634.

[412] Daniel Attenborough "Enforcement of Corporate Conduct under the Equitable Maximisation and Viability Principle" (2013) 33 LS 650 at 658.

The best approach is to introduce a two-step definition which broadens the scope of possible complainants while ensuring the courts turn their minds to the goals of entity primacy. First, a "complainant" should be allowed to bring a derivative claim, in addition to shareholders and directors, by amending ss 165-168 of the Companies Act. The change can also be added to provisions for an injunction under the Act,[413] without displacing other remedies available to shareholders.[414] Second, the meaning of a "complainant" should be defined in the interpretation section of the Companies Act, and it should differ from the Canadian definition. One approach is:

> A "complainant" means:
> any person or interest which can *materially* affect how a director of a company exercises powers or performs duties according to s 131.

Materiality achieves several important objectives. By framing it from the directors' point of view, this remains consistent with a subjective reading of s 131. As directors are acting in the best interests of the company, it would exclude competitors from potentially misusing a derivative action to damage the company. The definition also avoids allowing every possible stakeholder from pursuing a derivative claim. Hence, a lone disgruntled consumer with a personal vendetta against the company will not be able to use the action to further their own interests. These hurdles will also minimise the risks of companies having to bear the cost of a successful application for leave in the courts.[415] Moreover, the specific reference to s 131 will compel the courts to turn towards how the factors listed under the proposed amendment link back to the company when deciding whether to grant leave for a derivative action. This recognises interests such as employees to the environment may have a material stake in how the company is run.

As Keay posits, the existing barriers to a successful derivative action should remain in place.[416] Practical constraints such as the legal hurdles complainants will need to satisfy and the benefits of any action only accrue to the company will likely forestall a flurry of litigation.[417] Consequently, only the most determined stakeholders or interests would take action. In practice it will be difficult for them to succeed, given the proposed

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[413] Section 164.
[414] See, ss 170, 172 and 174.
[415] Section 167.
[416] Keay, above n 87, at 261.
[417] At 264. See also: Frank Easterbrook and Daniel Fischel *The Economic Structure of Corporate Law* (Harvard University Press, Cambridge, Massachusetts, 1991) at 101.

amendment retains a subjective character to the section.[418] Consequently, concerns that this may deter individuals from seeking directorships, impose high transaction costs or induce risk adverse decisions are likely overstated if directors comply with the proposed amendment.[419] The intention behind providing a remedy lies in discouraging directorial wrongdoing and improving board decision-making.[420]

Returning to an example discussed in Section III, the employees and possibly the surrounding community of Cadbury's Dunedin factory would have at least standing to bring forward a derivative action against the directors. The mere fact this is possible will cause the directors to consider employee and other stakeholder interests, rather than just the shareholders, when making a decision to close the factory. Whether such an action could succeed, however, is a different story. The directors could show through both their strategic reports and in their decision-making processes under the amended 131 that it was, on balance, in the best interests of the company for the factory to close down despite the harm to employees and community. If that were the case, then the directors have nothing to be concerned about.

2 Unfair prejudice?

One mooted alternative to derivative actions is an expansion of the unfair prejudice remedy. As mentioned earlier, the remedy was designed to protect minority shareholders.[421] In NZ, one suggestion has been to expand the existing definition of "entitled persons" in the interpretation section of the Companies Act to "include people or groups who are affected by the actions of the company" and have a "significant stake" in the company.[422] While a seemingly attractive option, as Keay points out, it is inappropriate as a means of enforcing entity primacy.[423] This is because it is a personal remedy, meaning the benefits of a successful action accrue to the claimant and not the company.[424] Given entity primacy is about maximising the value of the company, it is difficult to reconcile the theory with an expansion of the unfair prejudice remedy unless stakeholderism is adopted.

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[418] See generally: Davies, above n 12, at 49.

[419] Attenborough, above n 412, at 666.

[420] Taylor, above n 405, at 752.

[421] Matthew Berkahn, Susan Watson and Lynne Taylor "The Unfair Prejudice Remedy" Susan Watson and Lynne Taylor (ed) *Corporate Law in New Zealand* (Thomson Reuters, Wellington, 2019) 785 at 786.

[422] Annandale, above n 154, at 305 and Vasudev, above n 35, at 128.

[423] Keay, above n 87, at 253.

[424] See: Companies Act, s 174.

X Conclusion

Times are changing and it is important for directors' duties to keep up. The debate between shareholder primacy and stakeholderism has neglected a third contender which offers a compromise between the two: entity primacy. Entity primacy is normatively desirable as it enables directors to consider stakeholder interests without losing sight of the principal end of corporate governance, which is to maximise the corporate fund. Judicial acknowledgement of entity primacy by the Supreme Court marks a step away from a two-theory dichotomy. Recent statutory changes to the best interest duty in Canada are likely to foreshadow the direction of where the law in NZ is heading.

Therefore, NZ should follow suit and take four steps to implement entity primacy. First, s 131 of the Companies Act should be amended to include a list of interests which directors can consider when they make decisions. Second, strategic reports monitored by an executive body, such as the FMA, should be introduced to ensure directors are maximising the value of the company so affected stakeholders and interests can hold directors to account. Third, corresponding changes to soft law should be embraced, with the incorporation of a 'social licence' a novel way of changing how directors exercise their discretion. Fourth, an expanded set of complainants should be able to pursue derivative actions. Altogether, these four steps shift directors' incentives away from a shareholder primacy paradigm towards an entity primacy conception of company law.

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