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THE CORPORATE OBJECTIVE DEBATE IN NEW ZEALAND: (RE)ASSERTING THE NORMATIVE DESIREABILITY AND DESCRIPTIVE ACCURACY OF ENTITY PRIMACY IN THE CONTEXT OF CORPORATE ENVIRONMENTAL SUSTAINABILITY

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Abstract

The question of corporate purpose has been the focus of sustained and heated debate in corporate governance literature. However, in the context of environmental degradation and anthropomorphic climate change, the historic debate has taken on new significance and urgency. In the context of encouraging greater corporate environmental responsibility, this paper contends that entity primacy is the normatively desirable and descriptively accurate answer to the corporate objective question in New Zealand. In particular, entity primacy highlights the instrumental overlap between the company's "best interests", such as reputation, and environmental sustainability. However, the resonance of entity primacy's case for environmental sustainability is hampered by the operation of short-termism and the 'social norm' of shareholder primacy. Not only is this bad for environmental sustainability, but it also runs counter to the company's "best interests" which are arguably long term in nature. Therefore, should law-makers want to unlock an entity vision of corporate purpose, they must reassert entity primacy's accuracy as a legal and social norm in New Zealand corporate law.

Word Length

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Subjects and Topics

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I Introduction

In 2019, Rob Everett, Chief Executive Officer (CEO) of the Financial Markets Authority (FMA), suggested that the primacy of shareholders in corporate governance may not longer be appropriate in New Zealand corporate law.[1] As Everett rebuked, shareholder primacy "is not broken, because it was never a valid or sustainable model in the first place". Instead, he contended, company directors should consider how their company could serve a "broader set of stakeholders than just shareholders". In his opinion, this could include company employees, suppliers, creditors, the community in which the company operated, and even the environment.

A focus upon stakeholders, especially the environment, is significant and fits within a broader international trend of big hitters, such as the Business Roundtable, Larry Fink of Blackrock Inc., and the World Economic Forum, who have sought to encourage greater corporate environmental and social responsibility through stakeholderism.[2] The significance of recognising the environment as a stakeholder is underscored by concern for environmental degradation and the urgency of climate change, both of which have changed societal expectations of what constitutes acceptable corporate practice. However, is stakeholderism an appropriate method of encouraging greater corporate environmental responsibility? Should we be so quick to abandon shareholder primacy? And, what other approaches are there?

Placed in its broader context, stakeholder theory represents one of three dominant theories of corporate purpose or 'corporate objective'. In turn, the debate of the corporate objective represents a foundational philosophical and legal quandary in corporate governance. On its surface it asks: 'To whom are directors' fiduciary duties owed?'. However, at its most essential, it asks: 'Of what can society expect of its companies?'. The potential answers to these questions are varied. For example, whereas stakeholder theory contemplates a broad interpretation of corporate purpose under which directors' fiduciary duties are owed to company stakeholders, shareholder primacy asserts that they are owed only to the company's capital investors, and entity primacy holds that they are owed to the company entity.

This paper seeks to contribute to the corporate objective debate in New Zealand by critically analysing the three dominant theories of the corporate objective in light of their capacity to encourage greater corporate environmental responsibility. Of the theories, this paper prefers entity primacy because it is both normatively desirable, and arguably descriptively accurate in New Zealand. Descriptive accuracy is found in the theory's consistency with the historical evolution of the modern Anglo-American company, and specifically in New Zealand, the approach of the Law Commission whose draft legislation ultimately became the Companies Act 1993. In turn, entity primacy's normative appeal lies in its capacity to highlight the

[1] Rob Everrett, CEO FMA "Thinking beyond shareholders" (Speech to the New Zealand Capital Markets Forum, 21 March 2019).
[2] Discussed below, infra n 9.

instrumental overlap between the company's "best interests", such as reputation and brand improvement, and environmental sustainability ('instrumental claim').

By contrast, the theories of shareholder primacy and stakeholder theory are normatively inadequate. For example, although it is desirable for directors to consider environmental sustainability in their decision-making *ex ante*, this should not be achieved through stakeholderism. The environment is not an appropriate stakeholder; the environment's interests are tapu or non-substitutable and therefore it is inappropriate to balance its interests against the interests of other stakeholders. Similarly, shareholder primacy rests upon flawed logic and, echoing Everett's criticisms, has the potential to precipitate unsustainable decision-making in business. This reflects that a singular focus upon shareholder profits may come at the expense of other imperatives, such as the company's long-run value or environmental sustainability.

However, entity primacy and its instrumental claim have failed to resonate with New Zealand company directors in practice. This paper suggests that resonance, in particular, and directors' capacity to pursue environmental sustainability initiatives, more generally, is hampered by short-termism and the operation of the 'social norm' of shareholder primacy. Not only is short-termism bad for environmental sustainability, but it also runs counter to the company's best interests which are arguably inherently long-run in nature. As this paper contends, a focus on long-run profit generation is implicitly mandated by the company characteristic of legal perpetuity, which represents the company's capacity to exist forever.

Therefore, in the context of seeking to encourage greater corporate environmental sustainability, "the company" for the purposes of directors' fiduciary duties ought to be conceptualised as a distinct legal entity and its best interests as being long-run in nature. Should law-makers and regulators concur, they must (re)assert entity primacy. Due to the popular perception that New Zealand is a shareholder primacy jurisdiction and the operation of the social norm of shareholder primacy, this will require (re)asserting the accuracy of entity primacy as both a social *and* legal norm in New Zealand corporate law.

Part II begins by challenging the traditional corporate governance assumption that environmental protection and corporate law do not mix. Part III introduces the corporate objective debate. Part IV introduces and critiques stakeholder theory. Part V introduces and critiques shareholder primacy. Part VI outlines the case for entity primacy's descriptive accuracy. Part VII explores the relationship between entity maximisation and environmental sustainability. Part VIII discusses resonance issues and the phenomena of short-termism and the social norm of shareholder primacy. Part IX introduces the concept of legal perpetuity and explains why the company's "best interests" are inherently long-run in nature. Part X explores the role of shareholders and board accountability under entity primacy, and potential next steps for law-makers.

II Environmental sustainability: an issue for external regulation or corporate law?

Before embarking on any discussion of the relationship between companies and the environment, it is firstly important to address a key assumption of traditional Anglo-American corporate law scholarship.[3] According to traditional theory, the appropriate place for environmental protections is in separate, external regulation.[4] This assumption reflects an understanding that the only appropriate focus of corporate law is upon "agency problems", such as those which exist between company directors and shareholders.[5] Consequently, the theory holds that, "any externalities that the corporation generates are best addressed by regulatory constraints from other areas of the law."[6] However, there are three factors which suggest that environmental concerns should not be quarantined to external regulation and should instead be considered within corporate decision-making *ex ante*.

The first factor refers to the importance of what Mike Carney, former Governor of the Bank of England, describes as aligning corporate and environmental "horizons".[7] By extending upon the economic dilemma of the Tragedy of the Commons, Carney emphasises the cost that failing to integrate climate change concerns into present-day financial cycles will have on future generations.[8] Like a shared resource pillaged because of a lack of property rights, the viable environment for future generations may be polluted beyond use because financial and business markets failed to integrate rules to prevent it.[9] This creates what Carney calls a "Tragedy of the Horizon"[10] and suggests that environmental sustainability concerns should be integrated into boardroom decision-making to align corporate and environmental horizons.

Connected to the theme of intergenerational environmental harm, the second issue concerns the moral hazard of applying a present-day price to the future cost of climate change. The issue identified is that certain kinds of external regulation, such as carbon pricing regulation, commit the moral hazard of suggesting that there is a present-day price which is (a) capable

[3] See generally Andrew Johnston "Reforming English Company Law to Promote Sustainable Companies" (2014) 11(2) Journal of European Company Law 63 at 65 who states: "Debunking this argument [external versus internal regulation argument]is an *essential first step* on the road to a broader system of company law which takes account of sustainability issues and social costs more generally" (emphasis added).
[4] At 23.
[5] See generally John Armour, Henry Hansmann and Reinier Kraakman "Agency Problems and Legal Strategies" in Kraakman and Hansmann (eds) *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd ed, 2017, Oxford Scholarship Online) 29; other "agency problems" exist between minority and majority shareholders; and shareholders and parties with whom the company contracts, such as creditors, employees and customers.
[6] At 23.
[7] Mike Carney, Governor of the Bank of England and Chairman of the Financial Stability Board "Breaking the Tragedy of the Horizon – Climate Change and financial stability" (Llyod's of London, 29 September 2015).
[8] At 3.
[9] At 12.
[10] At 12.

of compensating the harm, and (b) acceptable to society.[11] In fact, the environment is tapu[12] or non-substitutable and therefore future generations will not be adequately compensated for environmental harm by any monetary payment.[13] Therefore, no present-day price for carbon emissions can be acceptable to society. The lesson is that external regulation may be insufficient and therefore environmental sustainability concerns should be internalised in company decision-making to lower or even prevent emissions *ex ante*.

The third argument is one of simple urgency. Even if it was appropriate under 'business as usual' to silo environmental regulation under an assumption of sufficiency (that is, an assumption that external regulation is sufficient to address the problem), this is not business as usual. As declared by many local councils in New Zealand, and Parliaments internationally, we are in a climate emergency.[14] This status would imply a disruption of 'business as usual' and may permit environmental sustainability considerations within directors' duties and corporate governance.[15] Indeed, as identified by Richard J Lazarus, "time is not costless".[16] The longer we delay on taking action on climate change, the more difficult and disruptive the task will become.[17]

Therefore, having established that it is permissible to integrate environmental sustainability concerns into corporate decision-making, the next section considers how theories of the "corporate objective" suggest that it be done.

III The Debate of the 'Corporate Objective'

It is trite to say that the debate of the corporate object is not new. Engaging famous academics including Adolph Berle (1931),[18] Merrick Dodd (1932),[19] Milton Friedman

[11] Cass R Sunstein "On the Expressive Function of Law" (1996) 144 U Pa L Rev 2021 at 2046 cited by Gail Elizabeth Henderson "A Duty to Minimize the Corporations Environmental Impacts: Corporate Governance and Sustainable Development." (PHD Thesis, University of Toronto, Faculty of Law, 2014) at 62.
[12] For example, see Linda Te Aho "Corporate Governance: Balancing Tikanga Māori with Commercial Objectives" (2005) 8(2) Yearbook of New Zealand Jurisprudence 300 at 303-304.
[13] Henderson, above n 11, at 60-62.
[14] Felix Desmarais, Matthew Tso and Nicholas Boyack "Councils Declare Climate Emergencies, but Will it Result in Real Change?" *The Dominion Post* (Online ed, Auckland, 28 June 2019); Jennifer Rankin "'Our house is on Fire': EU Parliament Declares Climate Emergency" *The Guardian* (Online ed, London, 28 November 2019).
[15] This view is arguably consistent with the opinion of lawyers Chapman Tripp who indicated that s 137 of the CA 1993 requires directors to take account of climate change-related financial risk to companies: Chapman Tripp "Climate change Risk – Implications for New Zealand Company Directors and Managed Investment Scheme Providers" (Memorandum of Opinion, October 2019).
[16] Richard Lazarus "Super Wicked Problems and Climate Change: Restraining the Present to Liberate the Future" (2009) 94 Cornell L Rev 1153 at 1160.
[17] At 1160
[18] Adolf A Berle, "Corporate Powers as Powers in Trust" (1931) 44 Harvard Law Review 1049.
[19] E Merrick Dodd "For Whom Are Corporate Managers Trustees?" (1932) 45 Harvard Law Review 1148.

(1970),[20] Edward Freeman (2010),[21] and most recently Lynn Stout (2012),[22] the question of 'the purpose of the company' has plagued academics for decades.

The normative starting point for the debate in New Zealand should properly be section 131 of the Companies Act 1993 (CA 1993) which provides that a director, when exercising or performing duties, must act in good faith and in what he/she/they believes to be the best interests of the company (the 'best interests rule'). This statutory duty reflects a duty at equity to act bona fide in the company's best interest.[23] Implicit in either statement of the duty are two questions: who is "the company" and how does one determine their "best interests"?

In most cases, the answer to these questions will depend upon how one defines the objective of the company.[24] As explained by Chief Justice Helen Winkelmann in a speech delivered alongside Justices Susan Glazebrook and Ellen France to the Asia Pacific Judicial Colloquium 2019, "the scope of the duty to act in the 'best interest' of the company depends on the model of corporate governance preferred."[25] As explained by Michael Jenson, how we answer this question is of fundamental importance because, at its most fundamental, it is asking 'of what can society expect of its companies?'[26]

The potential answers to this 'corporate objective' question are contained in three prominent theories which fall along a continuum.[27] At the narrowest end of the spectrum is 'shareholder primacy'. This theory holds that the corporate objective is to maximise the value of the company for the benefit of shareholders.[28] It is narrow because the only beneficiary of directors' fiduciary duties are the company's equity investors (ie shareholders). In what I regard as the middle of the spectrum is 'entity primacy' in which the company itself is viewed as a legal person or 'entity' to whom directors' fiduciary duties are owed.[29] Under this theory, directors are only required to consider the interests of other constituencies, shareholder or stakeholder, to the extent that it benefits the entity. Lastly, and at the far end of the spectrum, is stakeholder theory which holds that a company should be "managed for the

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[20] Milton Friedman, "The Social Responsibility of Business is to Increase Its Profits" *New York Times Magazine* (Online ed, New York, 13 September 1970).
[21] Edward R Freeman *Strategic management: A stakeholder Approach* (Cambridge University Press, Cambridge, 2010).
[22] Lynn A Stout and Margaret M Blair "A Team Production Theory of Corporate Law" (1999) 85(2) Virginia Law Review 247.
[23] Susan Watson "What More Can a Poor Board Do? Entity primacy in the 21st Century" (2017) 23 NZBLQ 142 at 144.
[24] Andrew Keay "Ascertaining The Corporate Objective: An Entity Maximisation and Sustainability Model" (2008) Modern Law Review 71(5) 633 at 644.
[25] 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 [12].
[26] Michael C Jensen "Value Maximisation, Stakeholder Theory, and the Corporate Objective Function" (2010) 22(1) Journal of Applied Corporate Finance 32 at 32.
[27] Jonathan Barrett and Ronán Feehily "Corporate Governance in New Zealand" in *Understanding Corporate Law* (online looseleaf ed, Lexis Nexis) at [16.1].
[28] Ljiljana Erakovi; Susan Watson, Monique Cikaliuk, Brad Jackson, Chris Noonan "Board of Directors and Stakeholders: Building Bridges of Understanding" (2017) 23 NZBLQ 202 at 205.
[29] At 205.

benefit of, and accountable to, all stakeholders."[30] This is the broadest definition of the corporate objective because, although definitions vary, 'stakeholders' can include employees, suppliers, creditors, the community in which the business operates, and even the environment.

Next, Part IV introduces stakeholder theory. In particular, subpart *A* explores the case for stakeholderism as represented by the theory's normative claim (the moral reasons we ought to recognise stakeholders) and instrumental claim (why recognising stakeholders is 'good for business').

IV Stakeholder Theory

A The Case for Stakeholderism

In recent years, popular discussion on corporate governance has been characterised by a greater emphasis upon stakeholders.[31] In 2019 and 2020, in particular, calls to recognise stakeholder interests in corporate decision-making penetrated popular corporate governance discourse both locally and internationally. As subpart *A* will explain, these appeals can be understood as encapsulating the normative and instrumental aspects of stakeholder theory.

1 Normative Claim

In August 2019, the Business Roundtable (BRT), an influential conglomerate of CEOs from United States' biggest companies, released a revised 'Statement on the Purpose of the Corporation'.[32] The statement was signed by 181 CEOs who committed to "lead their companies for the benefit of all stakeholders." Appearing to reverse BRT's decades-old commitment to the primacy of shareholders, the statement was heralded by some in the media as a "Damascus moment".[33] In December 2019, the World Economic Forum (WEF) also

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[30] Andrew Keay "Stakeholder Theory in Corporate Law: Has it Got What it Takes?" (2010) 9(3) Richmond Journal of Global & Business 249 at 256.
[31] For example, Jason Karaian declared "stakeholders" to be the buzzword at the 2020 World Economic Forum: Jason Karaian "And the winner of 2020 World Economic Forum is… stakeholders" *Quartz Magazine* (online ed, 25 January 2020).
[32] 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>.
[33] Nikki Mandow "Business Roundtable has a Damascus Moment" *Newsroom* (online ed, 29 August 2019); For example, BRT's 1997 Statement stated: "In The Business Roundtable's view, the *paramount duty of management and of boards of directors is to the corporation's stockholders*; the interests of other stakeholders are relevant as a derivative of the duty to stockholders. The notion that the board must somehow balance the interests of stockholders against the interests of other stakeholders fundamentally misconstrues the role of directors. It is, moreover, an unworkable notion because it would leave the board with no criterion for resolving conflicts between interests of stockholders and of other stakeholders or among different groups of stakeholders." BRT "Statement on Corporate Governance" (White Paper, September 1997) at 3 (emphasis added).

published the 'Davos Manifesto 2020' which declared that "[t]he purpose of the company is to engage all of its stakeholders in shared and sustained value creation."[34]

Inherent in the BRT and WEF statements is the normative aspect of stakeholder theory. That is, the idea that parties who contribute firm-specific contributions, and upon whom the firm is reliant to operate, deserve recognition from the company.[35] This could include, for example, the interests of employees who contribute their time (labour) and undertake non-transferrable firm-specific training.[36] It could also include the interests of suppliers who invest in particularised equipment to fulfil unique firm-specific orders.[37] According to stakeholder theory, recognising stakeholder interests reflects the deontological imperative of treating company stakeholders as "ends" in and of themselves as opposed to just "means" by which the company is enriched.[38]

2 Instrumental Claim

A second example is a public letter to CEOs from Larry Fink, founder and CEO of the world's largest asset manager, Blackrock Inc. Published in January 2020, the public letter urges CEOs to heed the significance of climate change and, in doing so, commit to:[39]

> …embracing purpose and serving all stakeholders – your shareholders, customers, employees, and the communities where you operate. In doing so, your company will enjoy greater long-term prosperity, as will investors, workers, and society as a whole.

Fink's letter elicits the instrumental aspects of stakeholder theory which holds that recognising stakeholder interests is 'good for business'.[40] This view recognises the strategic value which consulting stakeholder interests can have for companies.[41] The theory is that if stakeholders trust that their interests will be considered, they will more readily commit to and support the company, thereby improving business performance.[42]

In summary, subpart *A* introduced the case for stakeholderism and showed that the popular statements from BRT, WEF, and Fink may be understood as representative of the normative

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[34] Klaus Schwab "Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution" (2 December 2019) World Economic Forum <https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/>.
[35] Erakovi et al., above n 28, at 207.
[36] Keay "Stakeholder Theory in Corporate Law: Has It Got What it Takes?", above n 30, at 266.
[37] At 266.
[38] At 257.
[39] Larry Fink "A Fundamental Reshaping of Finance" (16 January 2020) Harvard Law School Forum on Corporate Governance <https://corpgov.law.harvard.edu/2020/01/16/a-fundamental-reshaping-of-finance/>.
[40] Erakovi et al., above n 28, at 208: "Corporate decision-makers take various tactics, from consulting the key stakeholders on various business matters (for example, employee satisfactory surveys) to co-decision making. By employing these tactics, the board and management consider stakeholders' interests and concerns in order to reduce potential conflicts (and costs) and gain efficiencies, which can lead to competitive advantage."
[41] At 208.
[42] As noted by Andrew Keay, "Stakeholding is the instrument through which efficiency, profitability, competition, and economic success can be promoted on the basis that if one removed cohesion among stakeholders I would not be possible or corporations to be competitive": Keay "Stakeholder Theory in Corporate Law: Has It Got What it Takes?", above n 30, at 265.

and instrumental aspects of stakeholder theory.[43] Next, subpart *B* explores how stakeholder theory suggests that directors, through the best interest rule, are to give recognition to stakeholder interests.

B Accountability and Enforcement

In stakeholder literature, there are three prominent examples of how to recognise stakeholders' interests through the best interest rule.[44] These include the United Kingdom's (UK) enlightened shareholder value (ESV), the Canadian 'stakeholder remedy' model, and the pluralist model.

1 Enlightened Shareholder Value

Section 172(1) of the Companies Act 2006 (UK) provides an explicit list of stakeholders to whom directors must consider as part of their duty to "promote the success of the company for the benefit of all members [shareholders]". The non-exhaustive list of factors for directors' consideration includes the interests of the company's employees,[45] the need to foster the company's business relationship with suppliers and customers,[46] and the impact of the company's operations on the community and the environment.[47] ESV is 'enlightened' as it appears to broaden the scope of directors' fiduciary duty to include other stakeholders.[48]

ESV has been heralded by some as having "information and educational value".[49] Elevating stakeholder interests to statute, it is argued, has the potential to change perceptions of what constitutes good corporate management. In particular, s 172(1) has the potential to send a strong legislative signal to directors who "systematically unappreciated the significance of stakeholder effects for long-term value", to expand their horizons.[50] It also gives legislative

[43] In discussing whether the BRT statement represented a commitment to stakeholder or pluralist stakeholderism, Bebchuk and Tollarita concluded that: "if the BRT statement were to be read as a significant move away from the earlier version, then it would be difficult to interpret it as requiring merely instrumental stakeholderism": Lucian A Bebchuk and Roberto Tallarita "The Illusory Promise of Stakeholder Governance" (2020) Cornell Law Review (Forthcoming) at 23.
[44] NB: This list excludes the German co-determination method as it mandates stakeholder representation and does not rely on the best-interest rule alone.
[45] Companies Act 2006 (UK), s 172(1)(b).
[46] Section 172(1)(c).
[47] Section 172(1)(d).
[48] Andrew Keay "Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach'" (2007) 29(4) Sydney Law Review 577 at 592.
[49] Bebchuk and Tollarita, above n 43, at 14.
[50] Keay "Tackling the Issue of the Corporate Objective", above n 48, at 599

reassurance to directors that they may “look at interests other than short-term shareholder value” without fear of being sued.[51]

However, as noted by Lucian Bebchuk and Roberto Tallarita, in substance ESV is conceptually indistinguishable from shareholder primacy.[52] This recognises that the “success of the company for the benefit of” shareholders remains the overriding objective for directors’ exercise of discretion.[53] Therefore, contrary to the normative aspect of stakeholder theory, stakeholder interests under ESV may only be considered to the extent that there is a ‘business case’ for doing so (ie as ‘means’ and not ‘ends’).[54]

Furthermore, breaches of s 172 are only enforceable by the company or by shareholders via derivative action on behalf of the company.[55] Therefore, enforcement action that benefits stakeholders is only likely to occur in cases where a failure to consider a stakeholder also resulted in a provable loss to the company.[56] Ultimately, therefore, the ‘enlightened’ benefit of ESV for stakeholders may be illusory as it fails to give stakeholders an enforceable interest.

2 Stakeholder Remedy Model

In contrast to ESV, Canada has adopted a ‘stakeholder remedy model’ under which the right to bring derivative action is extended to non-shareholder groups.[57] For example, s 238 of the Canada Business Corporations Act (CBCA) defines ‘complainant’ as including security holders (covering both shareholders and creditors), directors and officers, and “any other person who, in the discretion of a court, is a proper person to make an application under this Part.” This broad definition appears to permit stakeholders, in addition to shareholders, to bring derivative action.[58]

However, as noted by Palladam M Vasudev, it remains an “open question” whether “the stakeholder remedy provided in the *CBCA* has been effective.”[59] For example, in *Air Canada*

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[51] Keay “Tackling the Issue of the Corporate Objective”, above n 48, at 599; NB: to the extent that it is consistent with shareholder value.
[52] Bebchuk and Tollarita, above n 43, at 11; Similarly, Johnston “Reforming English Company Law to Promote Sustainable Companies”, above n 3, at 63 states that the s 172 reforms “did not make major substantive changes to the previous common law position, which equated the ‘interests of the company’ with the shareholder interest, albeit that it was down to the directors to determine the time frame for, and riskiness of, shareholder returns.”
[53] Palladam M Vasudev “Corporate Stakeholders in New Zealand – the Present, and Possibilities for the Future” in P M Vasudev and Susan Watson (eds) *Corporate Governance after the Financial Crisis* (2012, Elgar Online) 120 at 135.
[54] Paul Redmond described this as requiring “…stakeholder interests must pass through the eye of the needle of shareholder value”: Paul Redmond “Directors’ Duties and Corporate Social Responsiveness” (2012) 35(1) UNSW Law Journal 317 at 328.
[55] Company Act 2006 (UK), ss 178 and 260-264
[56] Keay “Tackling the Issue of the Corporate Objective” above n 48, at 59.
[57] Vasudev, above n 53, at 135.
[58] At 136.
[59] At 137.

Pilots Association v Ace, the Ontario Supreme Court declined to recognise the pilot association as a 'proper person' to bring an action,[60] and in *BCE Inc v 1976 Debenture Holders*, the Supreme Court of Canada refused to recognise the creditor's 'interests' as distinct from their legal rights.[61] This is despite the Supreme Court in *BCE* recognising at [42] that:

> We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate… for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.

In June 2019, the Canadian legislature moved to enumerate a list of stakeholders that directors *may consider* under the best interest rule. Similar to ESV, new sub-section 122(1.1) now provides that the interests directors "may consider, but are not limited to":[62]

(a) the interests of
   (i) Shareholders,
   (ii) Employees,
   (iii) Retirees and pensioners,
   (iv) Creditors,
   (v) Consumers, and
   (vi) Governments;
(a) the environment; and
(b) the long-term interests of the corporation.

At first glance, the amendment appears to strengthen the position of stakeholders by elevating their interests to statute. In addition, the section lists the environment as a discrete stakeholder, suggesting that it ought to be considered as a unique end separate from other stakeholders. However, the (un)enforceability of stakeholders interests is left unaltered as the reforms do not address the asymmetry between stakeholders' access to remedies as compared to shareholders.

3 Pluralist Stakeholder Model

A third method of recognising stakeholders' interests is the pluralist model,[63] which suggests that the best interest rule should be interpreted as requiring directors to protect and promote the welfare of all stakeholders in decision-making.[64] According to this model, stakeholder welfare is to be treated as an end in itself, irrespective of any positive benefit to the

[60] *Air Canada Pilots Association v ACE* [2007] OJ No 89 (QL), 2007 CanLII 337 (Ont Sup Ct) cited by Vasudev, above n 53, at 138.
[61] *BCE Inc v 1976 Debenture holders*, 2008 SCC 69, [2008] 3 SCR 560 cited by Vasudev, above n 53, at 138. See also *Peoples Department Stores Inc (Trustees of) v Wise* (2004) 3 SCR 461.
[62] Canada Business Corporations Act 1985 (CBCA), s 121(1.1) as introduced by Budget Implementation Act 2019 (No 1), s 141.
[63] There has not been full enactment of the pluralist model although there is arguably a partial enactment in the USA constituency statutes: Bebchuk and Tollarita, above n 43, at 15.
[64] Keay "Stakeholder Theory in Corporate Law: Has it Got What it Takes?", above n 30, at 256

company.[65] Heavily reliant on director discretion, Stout suggests that the role of the board under a pluralist model is that of "mediating hierarchs".[66] This requires *inter alia* that directors identify stakeholders, balance their interests, and determine how to "maximize the joint welfare of the team as a whole".[67]

The task assigned to directors under this model has been described by some as "herculean"[68] and by others as "impossible."[69] These critiques have been well-canvased and will only mentioned briefly. Firstly, there is a lack of clarity about who constitutes a 'stakeholder' and how directors have to identify their interests. This is a task complicated by conflicting 'stakeholder' definitions within the literature, and the fact that interests *within* stakeholder groups are not homogenous.[70] Secondly, there is no guidance as to how directors have to balance the interests of stakeholders or reconcile conflicts of interests.[71] As per Bebchuk and Tallarita, "the potential trade-offs between shareholders and stakeholders are ubiquitous."[72] Connected to the issue of trade-offs, and the focus of this critique, is the question of whether it is appropriate to use a stakeholder model to promote environmental sustainability by classifying the environment as a 'stakeholder'.

The most prominent criticism of including the environment as a stakeholder is articulated by Eric Orts and Alan Strudler. They argue that, as an inanimate object, there is no way to ascertain the environment's "interests" and therefore it is impossible to include the environment in any balancing exercise:[73]

> A car may run better with high-octane gas, but that does not show that the car itself has an interest in gas…Similarly, a piece of prairie may be more beautiful and may more successfully sustain indigenous plants and animals if cleansed of toxic wastes, but that does not demonstrate that nature itself has an interest in being cleansed.

However, Orts and Strudlers' is a western view of the environment. In Tikanga Māori, for example, the natural environment has a clear and instinct interest, or mauri.[74] Mauri may be translated as the "life force" which all things possess.[75] As explained by Gareth Harmsworth and Shaun Awatere, "[d]amage or contamination to the environment is… damage to or loss

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[65] Bebchuk and Tollarita, above n 43, at 15; contra instrumental aspect.
[66] Stout and Blair, above n 22, at 281.
[67] At 271, 281 and 291.
[68] Bebchuk and Tollarita, above n 43, at 15.
[69] Keay "Stakeholder Theory in Corporate Law: Has it Got What it Takes?", above n 30, at 277.
[70] At 276.
[71] At 274.
[72] Bebchuk and Tollarita, above n 43, at 20.
[73] Eric W Orts and Alan Strudler "The Ethical and Environmental Limits of Stakeholder Theory" (2002) 12(2) Business Ethics Quarterly 215 at 223.
[74] Te Aho, above n 12, at 303; A case is also currently before the Environment Court where Te Runānga o Ngāti Awa is challenging a consent to extract water by a water bottling plant on the basis of its impact upon the mauri of the water: Te Aniwa Hurihanganui "Creswell defends bid to take from aquifer: 'there is no loss of mauri'" *RNZ* (New Zealand, 28 July 2020) https://www.rnz.co.nz/news/te-manu-korihi/422220/creswell-defends-bid-to-take-from-aquifer-there-is-no-loss-of-mauri
[75] Māori Dictionary "Mauri" (n.d) <https://Māoridictionary.co.nz/search?&keywords=mauri>

of mauri."[76] Therefore, the classification of the environment as a stakeholder cannot be discounted simply by a belief that it has no interest.[77]

What Orts and Strudler have correct, however, is that it is not appropriate to *balance* the interests of the environment against the interests of other stakeholders.[78] This reflects two considerations previously discussed in Part II. Firstly, respect for the incomparable value or tapu nature of the environment; and secondly, the moral hazard of applying a present-day price to the future-costs of climate change. As noted by Andrew Johnston, "the cost of ecosystem collapse are of a different order and so are not comparable with the benefits of shareholders, employees and consumers of business as usual."[79] Ultimately, as Orts and Strudler themselves conclude, any attempt to confine concerns for the environment to the concept of 'stakeholder' "as a substitute for serious consideration about how best to include these kinds of concerns in the processes of business decision-making – is unpersuasive."[80]

D Conclusion

Subpart *B* showed that, although it may be appropriate to internalise sustainability considerations in corporate decision-making, this cannot be achieved through stakeholder models. The environment is not an appropriate stakeholder and, even if it were, ESV and the stakeholder remedy models fail to give stakeholders an enforceable interest.

Moving away from stakeholder theory, the next section explores the second theory on the corporate objective continuum; shareholder primacy. Part V tests the logic behind the primacy of shareholders and explores whether the theory accurately describes New Zealand as a corporate law jurisdiction.

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[76] Gareth R Harmsworth (Te Arawa, Ngati Tuwharetoa, Ngati Raukawa) and Shaun Awatere (Ngati Porou) Indigenous Māori Knowledge and Perspectives of Ecosystems" in JR Dymond *Ecosystem Services in New Zealand – Conditions and Trends* (Manaaki Whenua Press, Lincoln, New Zealand, 2013) 274 at 276; In relation to Māori corporate governance lead by tikanga Māori, Linda Te Aho stated that "… it would be abhorrent for a Māori director to consider any course of action that might harm or degrade the mauri of the river for a commercial outcome": Te Aho, above n 12, at 304.

[77] In fact, Kao et al., argue that the problem in the relationship between company and the environment is that business has diminished the environment by treating it as a "silent" stakeholder: "Throughout human history, we have been continuously taking from nature, and asking nature 'Give me that which I want.' The silent nature remains (as always) silent, and we take it as 'silent consent.' We have rarely asked nature: what can we give you which you want?": Raymond W Y Kao, Kenneth R Kao, Rowland R Kao *Entrepreneurism: A Philosophy and a Sensible Alternative for the Market Economy* (River Edge, NJ: Imperial College Press, 2002) at 130. However, in relation to the interdependence of environment and community, Spiller et al., notes in tikanga Māori that "Nature is not a silent stakeholder, but an extension of the human person, just as the human person is an extension of nature: it is a kin relationship": Chellie Spiller, Edwina Pio, Lijijana Erakovic, and Manuka Henare "Wise Up: Creating Organizational Wisdom Through an Ethic of Kaitiakitanga" (2011) 104 J Bu Ethics 223 at 228

[78] Orts and Strudler, above n 73, at 222.

[79] Johnston "Reforming English Company Law to Promote Sustainable Companies", above n 3, at 66.

[80] Orts and Strudler, above n 73, at 222.

V Shareholder Primacy

In 2001, corporate law behemoths, Henry Hansmann and Reinier Kraakman declared that a "broad normative consensus"[81] had developed "among the academic, business, and government elites in leading jurisdictions"[82] that "shareholders alone are the parties to whom corporate managers should be accountable."[83] The authors' article, entitled *The End of History for Corporate Law* suggested that the logic of shareholder primacy had won out, marking the end of the corporate objective debate as corporate law had known it.

However, as the statements from Rob Everett of the FMA, BRT, WEF, and Fink exemplify, the corporate objective debate is alive and kicking, and the jostling between corporate objective theories continues. Furthermore, as subpart *A* will explain, the logic which supports the primacy of shareholders in corporate law is contested. There are three broad arguments for the primacy of shareholders in corporate law: shareholders as "owners"; shareholders as "principals"; and shareholder as "residual claimants".[84] Each will be considered in turn.

A The Logic behind the Primacy of Shareholders in Corporate Law

1 Shareholders as "Owners"

Firstly, the privileged status of shareholders in corporate law is commonly justified on the basis that the company "belongs" to shareholders.[85] For example, the FMA *Corporate Governance Handbook* succinctly states that "[s]hareholders are the ultimate *owners* of companies."[86] As "owners", it is argued, shareholders are entitled to have the company managed in their best interests. After all, if shareholders "did not provide the 'share capital', which was essential for the commercial endeavours of the company, there would be no company."[87]

However, to describe shareholders as owners of corporate entities is incorrect in law. As a separate legal person, the company "owns" itself; "just as human beings own themselves."[88] After all, the effect of separate legal personality is to entitle the company to own property and rights, contract, and sue and be sued in its own name. Instead, shareholders' rights are more limited. Indeed, as Lynn Stout highlights, they are self-defining; "shareholders own shares in

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[81] Henry Hansmann and Reinier Kraakman "The End of History for Corporate Law" (2001) 89(2) Georgetown Law Journal 439 at 441
[82] At 440-441
[83] At 441.
[84] Additional arguments for shareholder including efficiency and certainty equally apply to entity primacy, explored below infra at p 22.
[85] See, for example, Friedman, above n 20; and Berle, above n 18.
[86] FMA *Corporate Governance Handbook* (2018) at 27 (emphasis added).
[87] Jean Jacques du Plessis "Corporate Governance, Corporate Responsibility and Law: Shareholder Primacy and Other Stakeholder Interests" (2016) 43 C&SLJ 238 at 238.
[88] Lynn Stout "How Shareholder Primacy Gets Corporate Economics Wrong in Lynn Stout" in *The Shareholder Value Myth* (Berrett-Koehler Publishers, San Francisco, 2012) (online ed).

stock".[89] Furthermore, as the discussion of the normative and instrumental aspects of stakeholder theory highlighted, shareholders' capital investment is not the only investment required for company survival.[90] Other necessary inputs include the firm-specific investments of stakeholders, such as the human capital (labour) of employees.

2 Shareholders as "Principals"

A second argument for the primacy of shareholders holds that shareholder primacy is justified on the basis that it reduces "agency costs".[91] According to this theory, directors (agents) are hired to run the company to promote the welfare of shareholders (their principals). However, information asymmetry, especially in widely held companies, may create an incentive for directors to act opportunistically.[92] The costs incurred in attempting to prevent self-interested behaviour, such as self-dealing and shirking, are called "agency costs".[93] In this context, the theory holds that shareholders (as principals) are entitled to directors' (as their agents) fiduciary duties and other control rights so as to motivate directors to act in shareholders' best interests and to reduce agency costs.[94]

However, the relationship between shareholders and directors is not strictly one of legal agency. Firstly, as Andrew Keay points out, directors "are employed by the corporation and not shareholders."[95] It is on behalf of the company (and not shareholders) that directors enter contracts and make decisions. Therefore, it is more logical to say that directors are the agents of the company and that, "at best the responsibilities owed to shareholders are only indirect".[96] Secondly, as per Stout, the law of agency provides that principals are entitled to control the actions of their agents.[97] This would suggest that shareholders (as principals) would have complete oversight of the running of the company, but this is not the case. In New Zealand, the CA 1993 instead confers authority for running the company on the board of directors.[98] This fact, that directors' authority is conferred by statute, also undermines a correlated argument for shareholder primacy which holds that shareholders are the *source* of directors' powers.[99]

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[89] Lynn A Stout "Bad and Not-so-Bad Arguments for Shareholder Primacy" (2002) 75 Southern California Law Review 1989 at 1991.
[90] Jacques du Plessis, above n 87, at 238.
[91] Armour et al., "Agency Problems and Legal Strategies", above n 5, at 29.
[92] At 29.
[93] At 29; Andrew Keay "Shareholder Primacy in Corporate Law: Can it Survive – Should it Survive?" (2010) 7 ECFR 369 at 381.
[94] Armour et al., "Agency Problems and Legal Strategies", above n 5, at 29.
[95] Keay "Shareholder Primacy in Corporate Law", above n 93, at 382.
[96] At 382.
[97] Stout, "How Shareholder Primacy Gets Corporate Economics Wrong" in *The Shareholder Value Myth*, above n 88.
[98] Stephen Bainbridge "Director Versus Shareholder Primacy in New Zealand Company Law as Compared to U.S.A Corporate Law" (2014) NZLR 551 att 563; NB: unless the constitution provides otherwise.
[99] At 565; Winkelmann et al., above n 25, at [112].

C Shareholders as "Residual Claimants"

A third, more sophisticated argument, for shareholder primacy holds that shareholders' privileged position in the company is explained by their status as the company's "residual claimants".[100] This theory comes from the "contractarian" or nexus of contracts theory of the firm created by law and economics scholar, Daniel Fischel. According to Fischel, the company "is nothing more than a legal fiction that serves as a nexus for a mass of contracts which various individuals have voluntarily entered into for mutual benefit."[101] Within this nexus, the most important contract is with shareholders as investors of capital. However, shareholders are also uniquely vulnerable as compared to the company's other contracting constituencies because they are the company's "residual claimants". This means that shareholders are entitled to the company's surplus, or everything left over once the company's fixed costs and liabilities have been satisfied. As 'last in the queue' for payment, the theory holds that shareholders have the largest incentive to monitor the performance of the company and to maximise its value. After all, shareholders' fortunes rise and fall with the fortunes of the company.[102] Therefore, contractarians argue, the best way to maximise aggregate welfare (including the well-being of company stakeholders and wider society), is to increase shareholder value.[103]

As Stout writes, the idea of 'shareholders-as-the-company's-residual-claimants' takes its inspiration from bankruptcy law.[104] In the context of company liquidation, it is shareholders who are theoretically entitled to the insolvent company's remaining assets once its contractual and legal costs are settled.[105] However, as Stout explains, once de-contextualised and transposed to the context of *solvent* companies, describing shareholders as the company's sole residual claimants loses coherence.[106] Firstly, as previously discussed, shareholders have no general entitlement to company profits because company assets are owned by the company.[107] Secondly, conceptualising shareholders as the sole residual claimant is problematic as other parties, such as the employees, creditors and suppliers, are also harmed by company insolvency.[108]

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[100] For example, Peter Watts *Directors' Powers and Duties* (2nd ed, LexisNexis Limited, Wellington, 2015) at 128.
[101] Daniel R Fischel "The Corporate Governance Movement" (1982) 35 Vanderbilt Law Review 1259 at 1273.
[102] Keay "Tackling the Issue of the Corporate Objective", above n 48, at 582.
[103] John Armour, Henry Hansmann, Reinier Kraakman, and Mariana Pargendler "What is Corporate Law?" in *Hansmann* and Kraakman (eds) *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd ed, 2017, Oxford Scholarship Online) 1 at 23.
[104] Stout, "How Shareholder Primacy Gets Corporate Economics Wrong" in *The Shareholder Value Myth*, above n 88.
[105] Stout, "How Shareholder Primacy Gets Corporate Economics Wrong" in *The Shareholder Value Myth*, above n 88.
[106] Lynn Stout "The Toxic Side Effects of Shareholder Primacy" (2004) 161 University of Pennsylvania Law Review 2003 at 2013; Stout, "How Shareholder Primacy Gets Corporate Economics Wrong" in *The Shareholder Value Myth*, above n 88.
[107] Stout, "How Shareholder Primacy Gets Corporate Economics Wrong" in *The Shareholder Value Myth*, above n 89.
[108] Keay "Shareholder Primacy in Corporate Law", above n 93, at 378.

Lastly, the claim that focusing on increasing shareholder value will maximise aggregate welfare is also not borne out in practice. Indeed, shareholder primacy has commonly been criticised as an impoverished, narrow view of corporate purpose.[109] In particular, critics argue that shareholder primacy's singular focus upon shareholder value – generally understood to mean profits – too often comes at the expense of other stakeholders and the long-run value of the company.[110]

For example, Stout argues that a singular focus upon shareholder value can precipitate myopic decision making in the company.[111] Directors, Stout argues, incentivised to maximise the present-day share price, may underspend on research and development (R&D), cut back on "customer relations and support in ways that eventually erode consumer trust and loyalty", or engage in a large labour-force restructure which impacts employee satisfaction.[112] This practice will inflate share price of the company in the short-term, but ultimately harm the company's long-term prospects which depend upon long-term investment, innovation, and the company's reputation.[113]

Myopic decision making or 'short-termism' can also lead to unsustainable environmental practice.[114] Examples may include under-investing in sustainable transition strategies and carbon abatement, or simply 'externalising' the cost of the company's environmental pollution.[115] As discussed in Part II, traditional corporate governance theory cited in support of shareholder primacy holds that the focus of corporate governance should be upon "agency problems" and views environmental pollution and contamination as "externalities" and the prerogative of external, separate regulation.[116] This approach is unsustainable and brings society no closer to reducing the impact of human beings on the environment as is required to address climate change and achieve a just transition to net zero carbon emissions by 2050.[117] As Rob Everett described, the model of shareholder primacy is "not broken, because it was never a valid or sustainable model in the first place."[118]

[109] See generally Beate Sjåfjell and Christopher M Brunder (eds) *The Cambridge Handbook of Corporate Law* (Cambridge University Press, UK, 2019).
[110] Keay "Ascertaining The Corporate Objective", above n 24, at 672.
[111] Stout "How shareholder Primacy Gets the Empirical Evidence Wrong" in *The Shareholder Value Myth*, above n 89.
[112] Stout "Short-term Speculators Versus Long-Term Investors" in *The Shareholder Value Myth*, above n 88.
[113] Similar points are made by Alex Edmans, see generally: Alex Edmans *Grow the Pie* (Cambridge University Press, Cambridge, 2020.
[114] See generally, Beate Sjåfjell "Beyond Climate Risk: Integrating Sustainability into the Duties of the Corporate Board" (2018) Deakin Law Review 41; The 'social norm' of shareholder primacy is discussed further infra n 30.
[115] The Australian Panel of Experts on Environmental Law *The Private Sector, Business Law and Environmental Performance* (Technical Paper 7, April 2017) at 8.
[116] See supra at 6.
[117] Climate Change Response Act 2002, s 5Q.
[118] Everett, above n 1.

3 Conclusion

In conclusion, subpart *A* has shown that shareholder primacy is normatively undesirable as a theory of the corporate objective. The theory has contested logic and, importantly, does not encourage environmental sustainability in corporate practice. Nevertheless, although subpart *A* surveyed the *logic* behind the supremacy of shareholders in corporate governance and noted multiple critiques, there still exists a strong argument that shareholder primacy *defines* New Zealand as a corporate law jurisdiction. This is explored in subpart *B*.

B Shareholder Primacy in New Zealand Corporate Law

Following Rob Everett's speech to the New Zealand Capital Markets Forum in 2019 entitled *Thinking Beyond Shareholders*, which questioned the desirability of shareholder primacy in New Zealand, corporate law scholar and practitioner, Peter Watts QC prepared an article in response.[119] The article, which was highly critical of the dangers of stakeholderism,[120] defended primacy of shareholders and argued that "[d]irectors owe their duties to those who entrust their hard-earned capital to the company" (shareholders).[121] Indeed, in another article written in response to Lynn Stout in 2012, Watts declared that shareholder primacy was "alive and well" in New Zealand corporate law.[122] The basis for this view, Watts argues, is to be found in "the fabric of New Zealand company law" itself.[123]

New Zealand company law, Watts argues, reflects shareholder primacy because it prioritises the interests of shareholders through strong control rights under the CA 1993.[124] This includes, shareholders' rights to appoint (and remove) directors;[125] the requirement for shareholder approval before major transactions are undertaken by the company;[126] the right of shareholders to design the objects of the company by adopting a constitution;[127] and shareholders' right to modify the board's powers to manage the company via the constitution.[128]

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[119] Peter Watts "To Whom Should Directors Owe Legal Duties in Exercising their Discretion – A Response to Mr Rob Everett" (May, 2019) Companies and Securities Law Bulletin 49.
[120] An interesting criticism includes the risk that amending the law to reflect stakeholder primacy would create a "political football" for debate over corporate law: Watts, above n 119, at 50.
[121] Watts, above n 119, at 49.
[122] Peter Watts "Shareholder Primacy in Corporate Law – A Response to Professor Stout" in P M Vasudev and Susan Watson (eds) *Corporate Governance after the Financial Crisis* (Edward Elgar Publishing Limited, Gloucestershire, 2012) 42 at 42
[123] Peter Watts "Shareholder Supremacy in Classical Company Law — With Particular Reference to the Making of Business Decisions by Shareholders on Behalf of Their Company" in Susan Watson (ed) *The Changing Landscape of Corporate Law* (Centre for Commercial and Corporate Law, University of Canterbury, 2017). Available at SSRN: https://ssrn.com/abstract=2882300
[124] Watts "To Whom Should Directors Owe Legal Duties in Exercising their Discretion – A Response to Mr Rob Everett", above n 118, at 51.
[125] CA 1993, s 153(2), 155, 156.
[126] Section 129.
[127] Watts *Directors' Powers and Duties*, above n 100, at 132.
[128] CA 1993, Section 128(3).

To illustrate the extent of shareholders' potential influence, Watts suggests that there is also nothing in the CA 1993, common law, or the New Zealand Exchange (NZX) *Listing Rules* that prevents: "All shareholders voting to appoint themselves directors"; "[s]hareholders giving themselves the right to select the company's CEO"; or "[s]hareholders otherwise removing from directorial control the majority, if not all parts, of business decision making".[129] For Keay, it is "beside the point" whether shareholders *would* use such powers or *could* logistically coordinate to achieve such things.[130] Instead, the "critical question is *can* in law the shareholders do these things?" and the answer is "[y]es".[131]

Overall, the fact that the CA 1993 confers upon shareholders powerful control rights is *prima facie* consistent with shareholder primacy. This represents a strong argument for shareholder primacy in New Zealand corporate law. However, shareholder control rights are not inconsistent with other theories of the corporate objective *per se*. For example, under Keay's model of Entity Maximisation and Sustainability, a model premised upon entity primacy, the role of shareholders as supervisors is still justified on the basis of their having invested in the company.[132] As per Susan Watson, as owners of shares (but not owners of the company entity), shareholders still have a vested interest in holding the board to account.[133] The role of shareholders under entity primacy is further discussed in Part X.[134]

C Conclusion

Part V has considered the second second theory on the corporate objective continuum, shareholder primacy. In surveying the logic behind the supremacy of shareholders, subpart *A* noted multiple critiques and concluded that shareholder primacy was normative undesirable as a theory of corporate governance. In so concluding, it noted in particular the potential unsustainability inherent in shareholder primacy's exclusive focus on shareholder profits; profits which may often come at the expense of other imperatives, such as environmental sustainability.

However, subpart *B* acknowledged that indicators of shareholder primacy are evident in the "fabric of New Zealand company law".[135] In particular, shareholders' strong rights of control under CA 1993 are *prima facie* consistent with a shareholder-centric model. However, shareholder control rights, in particular, and the supervision of shareholders, more generally, are not inconsistent with entity primacy *per se*. Indeed, speaking extra-judicially in 2019, Chief Justice Winkelmann suggesting that entity primacy is "arguably mandated" under the CA 1993.[136]

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[129] Watts "Shareholder Primacy in Corporate Law – A Response to Professor Stout", above n 122, at 44.
[130] At 45.
[131] At 45.
[132] Andrew Keay "Investors" in *The Corporate Objective* (Edward Elgar, Cheltenham, 2011) 276 at 277.
[133] Watson "What More Can a Poor Board Do? Entity primacy in the 21st Century", above n 23, at 150.
[134] See infra at 38.
[135] Watts "Shareholder Supremacy in Classical Company Law", above n 123.
[136] Winkelmann et al., above n 25, at [114].

Next, Part VI explores the final theory on the corporate objective continuum, entity primacy. Part VI contends that, as a matter of descriptive-accuracy, New Zealand company law reflects entity primacy which holds that directors' fiduciary duties are owed to the company as a distinct legal entity. This being consistent with both the evolution of the modern Anglo-American company, and, specifically in New Zealand, the approach of the New Zealand Law Commission whose draft legislation ultimately became the CA 1993.

VI Entity Primacy

A The Development of the Modern Anglo-American Company

Traditional corporate law scholarship has often regarded a company's separate legal personality as an artificial or empty "fiction". For example, as was discussed in Part VI, Fischel regards the company as a mere 'convenience' to facilitate the nexus of contracts.[137] Alternatively, persons wary of reifying the inanimate corporate entity, may compare companies as "fictions" to the metaphysical 'realness" of the human person.[138]

By contrast, the corporate objective theory of entity primacy views a company's separate legal personality as conclusive. Indeed, the theory highlights that a company's legal personality is very much as real in law as you and I.[139] Pursuant to s 15 of the CA 1993, for example, the company can hold rights, contract and own property, and sue and be sued in its own name. Indeed, as discussed in Part V, to say that the law reflects shareholder primacy on the basis that shareholders "own" the company is to forget that the company owns itself.[140]

According to entity primacy, directors' fiduciary duties are owed to the company a distinct legal person (or "entity") separate from its shareholders and stakeholders.[141] Under entity primacy, the role of the board of directors is conceptualised as one of guardianship and stewardship.[142] In turn, the 'economic entity' or fund is understood to comprise a set of tangible and intangible assets.[143] This includes, for example, human capital or "inputs that are the outcome of human activity by those who contract with the entity", and intangibles such as brand, reputation and goodwill.[144]

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[137] For example, Fischel, above n 101, at 1273 regards the company as a mere fiction or convenience to facilitate the nexus of contracts.
[138]Eric W Orts "Foundations of the Firm I: Business Entities and Legal Persons" in *Business Persons: A Legal Theory of the Firm* (Oxford Scholarship Online, September 2013) 9 at 16.
[139] For critique of nexus theory, see generally: Margaret M Blair "The Neglected Benefits of the Corporate Form: Entity Status and the Separation of Asset Ownership from Control" in Anna Grandori (eds) *Corporate Governance and Firm Organisation* (Oxford Scholarship Online, 2007) 46.
[140] Lynn Stout "How Shareholder Primacy Gets Corporate Law Wrong" in *the Shareholder Value Myth*, above n 88.
[141] For example, as Sarah Worthington describes, real entity theory "recognises the legal realities associated with the company's position". Sarah Worthington "'Shares and Shareholders: Property, Power and Entitlement (Part 2)" (2001) 22 The Company Lawyer 307 at 309.
[142] Watson "What More Can a Poor Board Do? Entity primacy in the 21st Century", above n 23, at 150.
[143] At 154
[144] At 154.

According to Professor Susan Watson of the University of Auckland, entity primacy is the answer to the corporate objective question because it is descriptively accurate (ie not only should entity primacy be the law, but it *is* the law). This argument relies upon two threads from the evolution of the modern Anglo-American company. Firstly, separate legal personality and secondly, the separation of the company fund from company shareholders as developed from an *ex poste* interpretation of the the joint stock company.

1 Separate Legal Personality

The first foundational idea finds its genesis in the Italian theory of *persona ficta*, under which Pope Innocent IV (c 1243 - 1254) conceptualised the *universitas* as a "'person' at law" rather than a body of persons granted legal status as a collective.[145] In turn, this idea was transplanted into the Common Law in *Sutton's Case* in which Coke CJ held that a company's legal personhood was not parasitic upon natural persons or the existence of real property.[146] Instead, the corporation came into being by virtue of concession from the state (ie incorporation) and could exist in the abstract; "invisible, immortal, and rest[ing] only in intendment and consideration of the law."[147]

2 Separation of Company Fund from Shareholders

The second necessary thread comes from the concept of the Joint Stock Company, under which the practice of Double Entry Bookkeeping[148] facilitated the separation of Joint Stock from Stockholders for accounting (but not legal) purposes.[149] Later, legal and accounting separation was achieved through the use of deed of settlement 'companies' under which the assets of the company were held separately in a legal trust.[150] However, this business form lacked utility because legal separation was only recognised by the Chancery Courts and the trust lacked legal personhood.[151] It was then not until the passage of the general incorporation statutes in the 19th Century that limited liability (ie complete legal separation between the fund and shareholders) and legal personhood would be achieved in the company's legal form.[152]

As Watson recounts, the consequence of limited liability meant that the company at law became a distinct "legal person endowed by the state containing a fund that comprises

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145 Susan Watson "The Corporate Legal Entity as a Fund" (2018) 6 Journal of Business Law 467 at 469.
146 *Sutton's Hospital Case* (1611) 77 ER 960; Watson "The Corporate Legal Entity as a Fund", above n 85, at 470.
147 *Sutton's Hospital Case*, above n 146, at 973 per Coke LJ.
148 For those unfamiliar, Double Entry Bookkeeping as a method of accounting requires that every account entry have a corresponding and opposite entry (e.g. assets/liability or credit/debit) as opposed to merely recording company transactions
149 Watson "What More can a Poor Board Do? Entity primacy in the 21st Century", above n 23, at 151.
150 At 151; As Watson details, deed of settlement companies were primarily used as vehicle to circumvent the requirements of the Bubble Act 1720, enacted to prevent the use of the joint stock company.
151 At 152; Watson "The Corporate Legal Entity as a Fund", above n 145, at 473.
152 Watson "The Corporate Legal Entity as a Fund", above n 145, at 474.

rights".[153] In 1897, this status was judicially recognised in the classic case of *Salomon v Salomon & Co Ltd*.[154] In this case, the House of Lords overturned the Court of Appeal's ruling that the 'one-man' company, Salomon & Co Ltd, was the trustee of Mr Salomon. As Lord Macnaghten clearly stated:[155]

> The company is at law a different person altogether from the subscribers to the memorandum; and, although it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them.

Separate legal corporate personality as recognised in *Salomon* now finds statutory expression in s 15 of the CA 1993 which provides that "[a] company is a legal entity in its own right separate from its shareholders and continues in existence until it is removed from the New Zealand register."

B The Approach of the Law Commission

In their 2019 speech to the Asia Pacific Judicial Colloquium, previously mentioned, Chief Justice Winkelmann alongside Justices Glazebrook and France stated that entity primacy was "arguably mandated" in New Zealand under the CA 1993.[156] Why entity primacy is arguably mandated in New Zealand reflects that such an approach is consistent with that of the Law Commission whose *Company Law: Reform and Restatement* Report informed the CA 1993. As Watson describes:[157]

> …the Companies Act 1993 (CA93) and the New Zealand Law Commission Report that led to the CA93 were enlightened for their time by conceiving the company as an enterprise, marking a shift away from the focus on shareholders and their interest.

For example, the Law Commission's Report highlighted that the corporate objective question suffered "from confusion as to whether 'the best interest of the company'… requires assessment of 'the company' as the collective shareholders or the enterprise itself."[158] Earlier in its Report the Law Commission had suggested that the former interpretation – ie, "the line of authority which identifies the company with the collective shareholders" – was "outmoded or misapplied" because it predated the House of Lords decision in *Salomon*.[159] As recounted, *Salomon* recognised the company as a separate legal entity, distinct from its shareholders.

Furthermore, citing the case of *Greenhalgh v Ardern Cinemas Ltd*, in which the House of Lords recognised that collective shareholders could include "future shareholders", the Law

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[153] Watson "The Corporate Legal Entity as a Fund", above n 145, at 467 and 475.
[154] At 482; The Rt. Hon. Lord Cooke of Thorndon, K.B.E "A Real Thing: Salomon v A: Salomon & Co Ltd" in *The Hamlyn Lectures – Turning Points of the Common Law* (1997, Sweet & Maxwell, London) 1.
[155] *Salomon v Salomon and Co Ltd* [1897] AC 22 (HL) at 51.
[156] Winkelmann et al., above n 25, at [114].
[157] Susan Watson "Moving beyond Virtue Signaling: Corporate Sustainability for New Zealand" in Beate Sjåfjell and Christopher M Bruner *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge University Press, Cambridge, 2019) at 176 at 177.
[158] Law Commission *Company Law: Reform and Restatement* (NZLC DP9, 1998) at [118].
[159] Law Commission, above n 98, at [127].

Commission expressed the opinion that "identification of the company with the enterprise may have largely been achieved in law."[160] According to Watson, this commentary suggests that the Law Commission was willing to recognise "that the concept of future shareholders was loose enough to permit an approach that identified the company with the enterprise."[161]

Indeed, although left unmentioned by Watson, the distinction between the company and its shareholders is also made explicit in the CA 1993's personal action provisions. Specifically, s 169(3) provides that whereas directors' duties contained in ss 90 (*duty to supervise share register*), 140 (*disclosure of interest*) and 148 (*disclosure of share dealing by directors*) are "owed to shareholders", ss 131 (*best interest rule*), 133 (*powers to be exercised for a proper purpose*), 135 (*reckless trading*), 136 (*duty in relation to obligations*), 137 (*director's duty to exercise care, diligence and skill*) and 145 (*use of information*) are "owed to the company and not shareholders".[162] This delineation reflects the Law Commission's reluctance, in the context of determining the distinction between the company as enterprise or collective shareholders, not to be "dogmatic about questions of theory" and instead "to regard the issue as principally directed at the right of remedy."[163]

The delineation is deliberate, and specifies the recipient of each sets of duties. Whereas administrative and transparency-related duties (namely, ss 90, 140 and 148) are owed to shareholders, substantial fiduciary duties, including s 131, are "owed to the company". This means, that although shareholders (current and former) may take personal action in respect of s 169(3)(a)-(c) duties, they can only bring action in respect of s 169(3)(d)-(i) duties via derivative action.[164] Unlike personal action claims, which are taken for shareholder's personal benefit, derivative action is taken *on behalf*, and *for the benefit*, of the company. In the context of the corporate objective debate, shareholders' capacity to take derivative action on behalf of the company is consistent with entity primacy. In particular, it suggests that the beneficiary of s 131, and therefore the victim of any breach, is the company entity.[165]

One last element may also inform our reading of the Law Commission's Report and their view of the company as a separate legal entity. In its draft legislation, the Law Commission proposed to place directors' duties in a hierarchy to emphasis their respective importance *inter se* and to help reconcile conflicts of interest between duties.[166] Within this hierarchy, s 131 was to be paramount.[167] Although the Companies Act was ultimately enacted without

[160] Law Commission, above n 158, at [189].
[161] Watson "Moving beyond Virtue Signalling: Corporate Sustainability for New Zealand", above n 157, at 185.
[162] See, for example, *Tyron Holdings Ltd v Infrastructure NZ Ltd* [2018] NZHC 1899.
[163] Law Commission, above n 158, at [190].
[164] CA 1993, ss 171 and 169(1)(a)-(c); There is an argument that, because the CA 1993 is not a code, shareholders could still claim for breach of s 169(3)(d)-(i) through their common law equivalents. However, it begs the question of why an explicit distinction would be drawn by the Law Commission: See Watts *Directors' Powers and Duties*, above n 100, at 30.
[165] Stout and Blair, above n 22, at 293.
[166] Law Commission, above n 158, at [194].
[167] At [194].

the hierarchy,[168] it is notable that the Law Commission's stated intent was that the hierarchy would make "explicit the equation of 'the company' with the enterprise itself."[169]

C Conclusion

In summary, Part IV, V and VI have responded to the first element of the corporate objective question (ie what is "the company" for the purposes of the best interest rule). Part IV and V rejected stakeholder and shareholder theories as normatively inadequate, and Part VI asserted that, as a matter of descriptive accuracy, the company is best understood as a separate legal entity. Such an interpretation is consistent with both the historical evolution of the modern Anglo-American company and the approach adopted by the Law Commission whose draft legislation ultimately became the CA 1993. Part VII will consider the second element of the corporate objective question (ie 'how does one determine the company's "best interests"?)

VII Entity Maximisation and Sustainability

In entity literature, the most prominent articulation of the role of the board of directors is provided by Andrew Keay's Entity Maximisation and Sustainability model (EMS).[170] According to the model, the role of directors is to be understood as one of guardianship and representation.[171] Furthermore, the function of directors (and the ends to which directors' exercise of discretion ought to be directed) is to maximise and sustain the entity.[172] In this context, *entity maximisation* requires that directors grow the entity's "total wealth creating potential"[173] and endeavour "to increase the overall long-run market value of the company as a whole".[174] In turn, *entity sustainability* requires that directors "sustain the company as a going concern" or, put simply, ensure the company's "survival".[175]

In contrast to shareholder primacy, directors under entity primacy are not limited to maximising the value of the company in terms of profits alone.[176] Instead, in determining the best interests of the entity under EMS, directors may have regard to the company's wider estate or asset base.[177] It was mentioned in Part VI that the company entity's assets or 'economic entity' comprises a fund which contains rights to tangible and intangible property. This includes the entity's reputation, brand and goodwill. Therefore, the company's "best

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[168] Law Commission *Company Law Reform: Transition and Revision* (NZLC 1990, R16) at 14.
[169] Law Commission, above n 158, at [194].
[170] See generally, Andrew Keay "The Enforcement of the Entity Maximisation and Sustainability Model" in *The Corporate Objective* 131, above n 132.
[171] Watson "What More can a Poor Board Do? Entity primacy in the 21st Century", above n 23, at 159.
[172] Andrew Keay "Board Accountability and the Entity Maximisation and Sustainability Approach" in Barnali Choudhury and Martin Petrin (eds) *Understanding the Company: Corporate Governance and theory* (Online ed, Cambridge University Press, 2017) 271 at 272.
[173] Keay "An Entity Maximisation and Sustainability Model" in *The Corporate Objective* 173, above n 132, at 174.
[174] At 198.
[175] At 175.
[176] At 199.
[177] Watson "What More can a Poor Board Do?", above n 23, at 159-160.

interests" under entity primacy could conceivably include strategies which grow the company's financial profits and therefore shareholders' profits (dividends), as well as strategies which augment the company's intangibles, such as initiatives which improve the company's brand.[178]

Returning to the Part II conclusion that it is desirable e to internalise sustainability considerations within directors' decision-making *ex ante*, subpart A considers how this can be done under an entity paradigm.

A Reputation – Watson's Instrumental Claim

In terms of the company's relationship with the environment, Susan Watson argues that there is an *instrumental* overlap between the company's "best interests" and environmental sustainability.[179] For example, similar to stakeholder theory's instrumental claim, Watson argues that pursuing environmental sustainability can be 'good for business' because, "by enhancing and protecting the reputation and brand of the company, it is good for the entity".[180] Consider, for example, the successful actions of sustainable footwear company, AllBirds which raised US$77.5 million in its latest funding round.[181] The company, which makes sneakers from sustainable products like eucalyptus and wool has been described as having "tapped into specifically millennial' desire[s]… to change the value they place on products based on how much they align to their own personal values."[182]

In summary, therefore, Watson's analysis suggests that directors ought to pursue environmental sustainability to the extent that it positively augments the company's intangible assets, such as reputation.[183] To further illustrate the argument, consider the converse of a reputational net gain associated with (un)sustainability (ie reputational damage). Consider, for example, the lingering reputational harm suffered by British Petroleum (BP) following the Deepwater Horizon oil rig catastrophe in 2010.[184] Ten years after the explosion, which caused 130 million gallons of crude oil to leak into the Gulf of Mexico and incalculable damage to local biodiversity, the event still represents a black stain against BP's international reputation.[185] Furthermore, in the ten years following the

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178 Keay "An Entity Maximisation and Sustainability Model" in *The Corporate Objective* 173, above n 132, at 199 and 201.
179 Watson "What More can a Poor Board Do?", above n 23, at 159.
180At 154.
181 Biz Carson "Sneaker Startup Allbirds Taks Flight with $50 Million in Funding" *Forbes* (Online ed, New York, 11 Octoer 2018); Allbirds "Our Materials" (n.d) https://www.allbirds.co.nz/pages/our-materials-wool
182 Cara Salpini "For the Birds: This DTC Brans is Flying High on Sustainable Wings" *Retail Dive* (22 April 2019). https://www.retaildive.com/news/for-the-birds-this-dtc-brand-is-flying-high-on-sustainable-wings/552698/
183 Keay "Ascertaining The Corporate Objective", above n 24, at 685.
184Joan Meiners "Ten years late, BP oil spill continues to harm wildlife –especially dolphins" *National Geographic* (Online ed, Washington, 17 April 2020).
185 Robert G Eccles and George Sarafeim "The Performance Frontier: Innovating for a Sustainable Strategy" (2013) Harvard Business 51 at 52.

catastrophe – in an ever more interconnected and social media-driven world – the significance of reputation has only grown

This feedback loop between a company's actions on environmental (un)sustainability and the augmentation of its reputation, brand and goodwill is often referred to as 'civil regulation'. Civil regulation represents those non-legal influences of consumers, employees, investors and (ie civil society at large) which can pressure a company to pursue ethical and environmentally sustainable strategies.[186]

In extreme cases where a company's activities (e.g. negative environmental externalities) are egregious, civil regulation can lead to the phenomenon of 'stigmatisation'. According to Ansar et al., stigmatisation represents a "tipping point" in consumer behaviour which represents a *permanent* change of the view of the company as acceptable or unacceptable due to their impact on society or the environment.[187] In the context of climate change, one may ask whether the stigmatisation which now generally applies to once prosperous tobacco companies, such as Phillip Morris, may soon apply to fossil fuel companies, such as BP.[188] Indeed, in the case of fossil fuel divestment in the context of ethical investing, we are already witnessing such corporate 'social distancing'.[189]

B Social Licence

Another dimension to the instrumental overlap between environmental sustainability and the company's intangible assets is a company's local 'social licence' to operate.[190] Although the term escapes clear definition, a company's 'social license' can generally be understood as meaning that companies are "constrained to meet the expectations of society and to avoid activities that societies (or influential elements of them) deem unacceptable."[191]

For example, a 2002 study entitled *Social Licence and Environmental Protection: Why Business Go Beyond Compliance*, Neil Gunningham et al., found that "social licence, by punishing or rewarding firms in terms of reputation capital, can induce firms to take 'beyond

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[186] John Parkinson "Disclosure and Corporate Social and Environmental Performance: Competitiveness and Enterprise in a Broader Social Frame" (2003) 3(1) Journal of Corporate Law Studies 3 at 4.
[187] Atif Ansar, Ben Caldecott and James Tilbury *Stranded Assets and the Fossil Fuel Divestment Campaign: What does Divestment Mean for the Valuation of Fossil Fuel Assets?* (Stranded Assets Programme, Smith School of Enterprise and the *Environment*, University of Oxford, October 2013) at 12 and 30.
[188] Andrew Johnston "Climate-Related Financial Disclosures: What Next for Environmental Sustainability?" (University of Oslo Research Paper Series No 2018-02) at 26.
[189] See, for example, Anusha Bradley "Super Fund to Ditch Fossil Fuel Investments" *RNZ* (Online, Hawke's Bay, 19 October 2016); Andar et al., above n 187, at 17.
[190] Keay "Ascertaining The Corporate Objective", above n 24, at 687
[191] Neil Gunningham, Robert A Kagan and Dorothy Thornton *Social Licence and Environmental Protection: why Businesses go beyond compliance* (Centre for Analysis of Risk and Regulation at the London School of Economics and Political Science, Discussion Paper, October 2002) at 1; The McGuinness Institute defines "social licence" as the "ethical or moral obligations imposed on an entity by stakeholders that are not derived from a legal contract": McGuinness Institute *The Climate Reporting Emergency: A New Zealand Case Study* (Discussion Paper 2019/01, October 2019) at 4.

compliance' measures of the 'good citizenship' variety."[192] This included reducing pollutants below required levels and proactively consulting with the community.[193] According to Keay, a company's concerns to maintain their local social licence to operate might also cause directors to "decline to take on a project that despite being potentially profitable in the short term, might alienate the local or wider community and lead to the entity being derided and see its reputation diminish."[194]

To apply this theory to an empirical example, consider the recent Government announcement to fast-track the resource consent process under the Resource Management Act 1991 as part of the post Covid-19 stimulus.[195] The Covid-19 Recovery (Fast-track Consenting) Act 2020 abridges the previous consultation procedures and introduces an alternative consenting pathway via expert panel. As reported by Radio New Zealand, the effect of the legislation is to "take away the ability of the public and council to have input in whether projects proceed."[196]

In this example, the objective of the alternative consent pathway is to stimulate the economy by making it quicker for companies to commence projects, employ workers, and access revenues. Nevertheless, the importance of social licence suggests that it may still be in a company's best interests to proactively engage with their local community notwithstanding any additional delays.[197] As the FMA's *Handbook on Corporate Governance* provides: "managing stakeholder interests should be viewed as good for business and can have positive long-term impacts on society and the environment. It ensures entities maintain their social licence to operate".[198]

C Conclusion

Underpinning Watson's instrumental claim and Keay's social licence appeal is the idea that directors, protected by the business judgment rule (which gives directors discretion to act in what they *believe* to be the best interests of the company), should use their discretion to pursue environmental sustainability. Both claims are attractive. The claims are attractive because they suggest that companies, acting in their own rational self-interest, will proactively reduce their impact upon the environment.

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[192] Gunningham et al., above n 191, at 7.
[193] At 14.
[194] Keay "An Entity Maximisation and Sustainability Model" in *The Corporate Objective* 173, above n 132, at 201.
[195] New Zealand Government "Fast-track Consenting to Get Shovel-ready Projects Moving" (press release, 3 May 2020).
[196] RNZ "Cabinet approves fast tracking of shovel ready projects" *RNZ* (New Zealand, 3 May 2020) https://www.rnz.co.nz/news/national/415689/cabinet-approves-fast-tracking-of-shovel-ready-projects
[197] Erakovi, above n 28, at 213; Similarly, OECD Corporate Governance Principals provide the long-term benefit to companies from cooperation with stakeholders: OECD "620/OECD Principles of Corporate Governance" (2015, Paris) at 34
[198] FMA, above n 86, at 28.

However, the approaches may be criticised for representing 'weak sustainability'.[199] As per Poonan Puri, weak sustainability "narrows sustainability and the protection of human [and environmental] welfare to the calculations about the net positive impact on the corporations' long-term financial performance."[200] Under Watson's analysis, for example, the protection of the environment is 'narrowed' to a calculation about the net benefit to the company entity.

However, Watson's instrumental claim in fact goes further than other models. In comparison to shareholder primacy, for example, Watson's claim extends beyond merely considering the impact of a given decision on the company's financial performance or profits. Instead, under entity primacy and EMS, directors have a broader remit to pursue environmental sustainability to the extent that it augments the company's intangible and tangible assets. This includes a positive benefit to the company's reputation, brand, and goodwill.

Overall, Part VII has suggested that, not only is it permissible to internalise sustainability considerations within company decision-making *ex ante* (the conclusion of Part II), but according to Watson's instrumental claim and the importance of maintaining a company's local social licence to operate, it is also in the company's best interests to do so. However, notwithstanding the compelling nature of Watson and Keay's appeals, companies – as a critical mass – are not taking sufficient action to mitigate the negative impact of their activities on the environment. As discussed in Part III, "business-as-usual currently undermines sustainability goals" and must change.[201] This tension, between focusing on short run imperatives, such as profit targets, and long-run environmental sustainability is the focus of Part XIII.

XIII Short-termism and the Social Norm of Shareholder Primacy

It is often said that a company's capacity to act sustainably is hamstrung by short-termism. That is, that although directors have sufficient discretion to pursue a long-term strategy and adopt environmental sustainability policies (to the extent that it is consistent with the company's best interests), directors' capacity to do so in practice is constrained by short-term

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[199] Beate Sjåfjell and Christopher M Bruner "Corporations and Sustainability" in Beate Sjåfjell and Christopher M Brunder (eds) *The Cambridge Handbook of Corporate Law: Corporate Governance and Sustainability* (Cambridge University Press, UK, 2019) 4.

[200] Poonam Puri "Green but Not Green Enough: Sustainability in Canadian Corporate Governance" in Beate Sjåfjell and Christopher M Brunder (eds) *The Cambridge Handbook of Corporate Law: Corporate Governance and Sustainability* (Cambridge University Press, UK, 2019) 146 at 146.

[201] Beate Sjåfjell, Jukka Mähönen, Mark Taylor, Eléonore Maitre-Ekern, Maja van der Velden, Tonia Novitz, Clair Gammage, Jay Cullen, Marta Andhov, Roberto Caranta *SMART Deliverable 2.7 Supporting the Transition to Sustainability: SMART Reform Proposals* (University of Oslo, 1 November 2019) at 8.

pressures and incentives.[202] As the European Union's *Action Plan: Financing Sustainable Growth* describes:[203]

> Undue short-term market pressures may make it difficult to lengthen the time horizon in corporate decision-making. Corporate managers may become overly focused on short-term financial performance and disregard opportunities and risks stemming from environmental and social considerations.

For example, the phenomenon of short-termism was identified as a dominant contributing factor for the 2008 Great Financial Crisis (GFC). In this context, pressures from shareholders to increase the short-term share price, and the formulation of executive compensation packages had caused directors to focus on short-term performance at the expense of the company's long-run sustainability.[204] Indeed, Mark Carney's device of the Tragedy of the Horizon (mentioned in Part II) captures the idea that society's capacity to respond to the intergenerational problem of climate change is hampered by society's fidelity to short-run cycles. Consider, for example, the three-year election cycle; quarterly financial reports; or daily profit targets.

In her prominent works on the relationship between companies and planet, Beate Sjåfjell identifies short-termism as the by-product of the "social norm of shareholder primacy". Here, the term 'social norm' of shareholder primacy distinguishes Sjåfjell's critique from the legal norm and theory of shareholder primacy discussed in Part V. The pertinent distinction being between a requirement to prioritise shareholders' interests, and a requirement to maximise short-run shareholder profits at all costs. As Sjåfjell argues, although there is no legal requirement to maximise shareholder value (as understood to mean short run profits), directors may nevertheless do so because of a pervasive *perception* that they are so bound.

For example, under the latitude conferred under the business judgement rule, directors could reasonably consider other interests or focus on long-run profits (to the extent that directors reasonably believe that it will be in the company's best interests).[205] Nevertheless, the misconception that directors' cannot do so is compounded by "remuneration incentives and other drivers" which tie director performance to short-term targets.[206] According to Sjåfjell et al., the social norm of shareholder primacy represents a "systematically entrenched barrier to corporate sustainability."[207]

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[202] Beate Sjåfjell, Andrew Johnston, Linn Anker-Sørensen, and David Millon "Shareholder Primacy: The Main Barrier to Sustainable Companies" Beate Sjåfjell and Bejamin J Richardson (eds) *Company Law and Sustainability* (Cambridge University Press, Cambridge, 2015) 79 at 88.

[203] European Union *Action Plan: Financing Sustainable Growth* (COM (2018) 87, Brussels, 2018) at 11.

[204] Andrew Johnston and Beate Sjåfjell "Can Disclosure Overcome the Failings of Shareholder Primacy?" in M Peeters and M Eliantonio (eds) *Research Handbook on EU Environmental Law* (Edward Elgar, Gloucestershire, 2020) 396 at 401.

[205] Watts "Shareholder Primacy in Corporate Law – A Response to Professor Stout", above n 122, at 42.

[206] Beate Sjåfjell and Jukka Mähönen "Upgrading the Nordic Corporate Governance Model for Sustainable Companies" (2014) 11(2) European company law journal 58 at 58; Beate Sjåfjell "Realising the Potential of the Board for Corporate Sustainability" in (696) in Beate Sjåfjell and Christopher M Brunder (eds) *The Cambridge Handbook of Corporate Law* (Cambridge University Press, UK, 2019) 696 at 697.

[207] Sjåfjell "Beyond Climate Risk", above 114, at 42.

In New Zealand, short-termism and the social norm of shareholder primacy arguably prevents Watson's instrumental claim and the importance from social licence from resonating and gaining traction with business leaders. For example, despite the descriptive accuracy of entity primacy and the the clear approach of the New Zealand Law Commission, visiting professor Stephen Bainbridge observed that shareholder primacy thinking remains dominant in New Zealand.[208]

In particular, the social norm of shareholder primacy may be operating to short-circuit directors' capacity to pursue environmental sustainability, even where there is an instrumental overlap with the company's best interests. Indeed, as per John Parkinson, in order for civil regulation to operate (and therefore to incentivise corporate environmental responsibility), companies must care about their reputation.[209] However:[210]

> … under pressure from stock market to improve profitability, or rely on managerial incentive pay schemes that reward near-term financial performance, there is a danger that reputation management will be afforded low priority."

Therefore, Part XIII suggests that, in order for environmental sustainability to be internalised in corporate decision-making *ex ante*, directors must abandon short-term decision-making for a long-run, entity-centric approach. However, what gives positive legal (and not just normative) credence to the idea that the company's long-term sustainability should take precedence over short-term performance? Ie, what explains directors' obligation to focus on the long-run future of the company? As Part IX proposes, the answer arguably lies is the legal characteristic of corporate perpetual life.

IX Legal Perpetuity

In the *Anatomy of the Corporate Law*, Henry Hansmann and Reinier Kraakman describe the company as a legal entity by reference to a set of core legal characteristics. These include separate legal personality, limited liability, transferable shares, and delegated management under a board structure.[211] However, this list could also include another attribute which is unique to the company entity and distinguishes it from other business forms; the legal characteristic of perpetual life.[212]

In simple terms, perpetuity represents the company's capacity to exist forever. It means that, although the company's directors and stakeholders may change, the company itself remains the same: "just as the river Thames is still the same river, although the parts which compose

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[208] Bainbridge, above n 98, at 573.
[209] Parkinson, above n 186, at 3.
[210] At 27.
[211] They also include "investor ownership". However, as established supra at 13, entity primacy does not view shareholders as 'owners' as the company owns itself.
[212] See, for example, Lynn A Stout "On the Nature of Corporations" (2005) 1 University of Illinois Law Review 253 who at 267 lists "limited liability, perpetual life, centralized management, and freely transferable shares."

it are changing every instant."[213] Of course, this does not mean that the law *guarantees* the company's continued existence (indeed, bankruptcy and dissolution would soon tell us otherwise). Instead, legal perpetuity means that, unlike other business forms (such as partnerships), the company does not come to an end when those who originally formed it die or exit.[214] For example, under s 15 of the CA 1993, the company as a legal entity is recognised as "continu[ing] in existence" until or "unless it is removed from the New Zealand register". As Blackstone's Commentaries describe, the perpetual company is a "person that never dies."[215]

A Perpetuity and Corporate Purpose

According to Lynn Stout, the qualities of legal perpetuity and separate legal personality lie at the heart of unlocking what the company entity was originally intended to achieve.[216] That is, in her view, to promote "intergenerational equity and intergenerational efficiency"[217] by allowing "present generations to preserve and invest resources to benefit future generations."[218] Historically, as Stout describes, "preserving resources and pursuing long-term projects for future generations were exactly what some of the earliest corporations – among them townships, universities, and monasteries – were created to do."[219]

For example, consider the Veneranda Fabbrica del Duomo di Milano which was established in 1387 and has been continuously developed and maintained the Cathedral of Milan for other 630 years.[220] In such a case, the completion of the joint project would not have been possible for mortal human beings without the "legal technology" of the company entity.[221] This includes, for example, the company's capacity to aggregate the capital of many individuals within the corporate form, to protect the collective interest in the project through asset lock-in, and to pursue the project across multiple mortal lifetimes.[222] As Chief Justice Marshall observed in the United States case of *Trustees of Dartmouth College v Woodward*, the true brilliance of the company as a form of enterprise lies in its capacity to permit "a perpetual succession of individuals" to act "for the promotion of a particular object, like one immortal being."[223]

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[213] William Blackstone *Blackstone Commentaries* (Oceana Publications Inc, 1967) at 468 cited by Andrew A Schwartz "The Perpetual Corporation" (2012) 80(3) The George Washing Law Review 764 at 774.
[214] Lynn Stout "The Corporation as Time Machine: Intergenerational Equity, Intergenerational Efficiency, and the Corporate Form" (2015) 38 Seattle University Law Review 685 at 691.
[215] Blackstone, above n 213, at 773.
[216] Stout "The Corporation as Time Machine, above n 214
[217] At 686.
[218] At 698.
[219] At 696.
[220] Lynn Stout *Corporate Entities: Their Ownership, Control, and Purpose* (Cornell Legal Studies Research Paper No 16-38, September 2016) available at https://ssrn.com/abstract=2841875; Duomo Di Milano "Who we (n.d.) https://www.duomomilano.it/en/infopage/who-we-are/46/.
[221] Stout "The Corporation as Time Machine, above n 214, at 686.
[222] At 687-688.
[223] Schwartz, above n 213, at 773 citing *Trustees of Dartmouth College v Woodward* 17 U.S. (4 Wheat.) 518, 636 (1819).

Stout's commentary is pertinent to the debate of the corporate objective because, fundamentally, it informs how one may answer the question 'of what can society expect of its companies?'. As Sjåfjell et al., cogently articulate, at its root, the debate of the corporate objective is really about "the purpose of the company as a societal institution".[224] That is, "the purpose for which society through the law recognises the existence of companies as separate legal entities."[225] According to Stout's vision, the company's capacity – facilitated by the legal characteristic of perpetuity – to preserve resources and pursue long-term projects, sheds light on the purpose of the company entity to promote intergenerational equity and efficiency.

However, some authors, such as Frank Easterbrook and Daniel Fischel, are agnostic about the centrality of perpetuity to company purpose. Instead, the authors argue, legal perpetuity does not achieve the status of a legal characteristic and means only that the company "lasts until dissolved" or, in the words of the CA 1993, is "removed from the Companies register."[226] However, although Easterbrook and Fischels' observation holds technical accuracy in the narrowest sense, the company's capacity to survive its incorporators still distinguishes the company from other business forms, such as partnerships. Furthermore, although one may find Easterbrook and Fischels' reduction compelling, Andrew A Schwartz argues for a broader normative interpretation of legal perpetuity.[227] In particular, Schwartz argues that legal perpetuity provides positive law credence to the idea that the company's 'best interests' are inherently long-term in nature.

B Perpetuity and the Company's Best Interests

In *Perpetual Corporation,* Schwartz identifies the legal characteristic of perpetuity as providing positive law credence to the notion that company directors are legally bound to pursue a long-run investment horizon.[228] In Schwartz's view, any assertion (whether it be in case law or commentary) that the ultimate goal of the company was to "generate value and wealth over the long-term" could not "simply be plucked from thin air".[229] After all, companies are creatures of statute and there is "no natural law of corporations".[230]

In Schwartz's view, the requisite foundation in positive law is found in the company's capacity for perpetual life. Specifically, perpetual life defines the nature of the company's best interests and colours how directors ought to give effect to their duties.[231] As Schwartz describes, the "perpetual nature of the corporation means that it *must* plan for an infinite

[224] Sjåfjell et al., "Shareholder Primacy: The Main Barrier to Sustainable Companies", above n 202, at 89.
[225] At 89.
[226] Frank H Easterbrook and Daniel R Fischel *The Economic Structure of Corporate Law* (Cambridge, Massachusetts, Harvard University Press, 1991) at 11.
[227] See generally, Schwartz, above n 213.
[228] Schwartz, above n 213.
[229] At 766.
[230] At 766.
[231] At 782; 807; 808.

future and therefore long-term." [232] In other words, the company (*ergo* directors) must invest "with an eye to perpetuity". [233]

To understand Schwartz's thesis, it is useful to refer to a hypothetical. Compare, for example, the hypothetical interests of a mortal person with a human timescale and a person with the potential to live forever. According to Schwartz, the immortal's best interests will rationally differ from the mortals in two distinct ways: the length of their investment horizons and their inherent discount rate on investment. [234]

Firstly, a moral's *investment horizon* (the total duration of time in which an investor is willing to place their investment at risk) is determined by how long they expect to live. [235] Here, whereas the mortal may plan in the longest term for retirement, the immortal must enhance their value over the ultra-long-term and ought therefore to adopt an ultra-long horizon.[236]

Secondly, a person's *inherent discount rate* (a device used to convert future value into comparable present value) is also dependent upon one's lifetime or "expected likelihood of surviving to receive the future award. [237] As it is known that the immortal company will be around long into the future, it follows that an immortal investor "can and should employ a lower discount rate than a moral would use." [238] In summary, the capacity for immortality (perpetuity) therefore informs the nature of the company's best interests as being inherently long-term in nature.

Schwartz's conclusion that companies ought to adopt a long-run investment rate as well as a low discount rate on investment is significant for two reasons. Firstly, adopting a long investment horizon will logically mean that the company will have a higher risk appetite than mortal investors. [239] This, according to Schwartz, will enable companies to "invest in less liquid and more volatile investments than a natural person, both of which are correlated with relatively high returns over time."[240] Secondly, the adoption of a low discount rate means that the company will place a higher value on future investment[241] as it "gains no advantage from consuming its resources within a relatively brief time frame". [242] In other words, "[i]t can afford to be patient." [243]

[232] Schwartz, above n 213, at 766 (emphasis added).
[233] At 807.
[234] Schwartz, above n 213, at 784.
[235] At 785.
[236] At 784.
[237] At 783.
[238] At 783.
[239] At 784.
[240] At 784.
[241] At 784.
[242] Stout "The Corporation as Time Machine", above n 214, at 686.
[243] At 686; Jack B Jacobs coins this approach to investment "Patient Capital". See: Jack B Jacobs "'Patient Capital': Can Delaware Corporate Law Help Revive It?" (2011) 68 Wash and Lee Law Review 1645.

C Legal Perpetuity and the Promotion of Long-terminism

Stout and Schwartzs' analysis suggests that the legal characteristic of perpetuity – the company's capacity to exist forever - carries "implications about the nature and objectives" of the entity and its best interests.[244] In particular, it suggests that the company's best interests are, by their very nature, long-run interests. Good company management and strategy should therefore be guided by the imperatives of perpetuity as found in the adoption of long-run sustainable strategies. Directors should make decisions *as if* the company will continue to have a long-term legacy, and pursue long-term projects even if the benefits will not be realised in the short-term. Three comments may be made about this conclusion.

Firstly, although not all companies (such as very small companies or companies in financial distress), will be in a position to adopt an (ultra) long investment horizon or a low (or zero) discount rate on investment, a long-run focus remains pertinent to all companies' best interests. For example, the importance of long-run thinking was underlined during the 2020 Covid-19 pandemic. In particular, the impact of the lock-down laid bare how many New Zealand companies operated on a week-to-week or month-to-month basis. As Adrian Orr, Governor of the Bank of New Zealand described, "Covid-19 shows us that we need to move from a 'just in time' approach to one of 'just in case'."[245] The relevance of New Zealand's experience of Covid-19 to corporate environmental sustainability was captured by the Economist observed that "[f]ollowing the pandemic is like watching the climate crisis with your finger jammed on the fast-forward button."[246]

Secondly, the conclusion that companies (*ergo* directors) ought to adopt a long-run focus is significant for corporate environmental sustainability. Not only is a long-term focus (long-termism) a foil to short-termism, but a long-run focus also promotes sustainable decision-making. As the European Union's *Action Plan: Financing Sustainable Growth* describes: "[s]ustainability and long-termism go hand in hand. Long-termism describes the practice of making decisions that have long-term objectives or consequences."[247]

Lastly, the conclusion that legal perpetuity creates an "implicit mandate" for directors to focus on the long-run is also consistent with the EMS model which requires that directors aim to maximise and sustain the company for the *long-term*. According to Keay, a long-term focus may require "making less profit one year compared with a previous one", but still growing and sustaining the company overall.[248] In Keay's view, a long-term focus is beneficial for two reasons. Firstly, it engenders trust in the company's stakeholders that the company is "not involved in a 'smash and grab' but seeking to develop ties with investors

[244] Stout "The Corporation as Time Machine", above n 214, at 685.
[245] McGuiness Institute "Near Horizon – Seizing the opportunities and managing the risks in the transition to net zero: the importance of climate-related financial disclosures" (28 May 2020).
[246] The Economist "Countries Should Seize the Moment to Flatten the Climate Curve" (Online ed, London, 21 May 2020)
[247] European Union *Action Plan: Financing Sustainable Growth*, above n 203, at 3
[248] Keay "An Entity Maximisation and Sustainability Model" in *The Corporate Objective* 173, above n 132, at 200.

over a significant period".[249] Secondly, it permits directors to focus on innovation projects, such as R&D, which are crucial to the "preservation and expansion of human, natural and social capital – assets without which business cannot operate".[250]

D Conclusion

In summary, Parts VI, VII, and IX cumulatively contend that the correct answer to the corporate objective question in New Zealand is that "the company" for the purposes of s 131 means the company as a distinct legal entity' and the entity's "best interests" are to be understood as inherently long-run in nature. In terms of environmental sustainability, this suggests that there is instrumental benefit to the company in internalising environmental sustainability considerations in directors' decision-making *ex ante*, and that the pursuit of environmental sustainability should not be hamstrung by an unwarranted focus on the short run.

In Part X, the final section, we discuss board accountability under entity primacy and possible next steps for law-makers and regulators interested in (re)asserting entity primacy as a social and legal norm in New Zealand corporate governance.

X Board Accountability Under Entity Primacy

To respond to the Tragedy of the Horizons (ie corporate fidelity to short-termism) and promote greater corporate environmental sustainability, corporate law requires reform. In particular, "[c]ompany law must take back the power to define the purpose of the company" by replacing the social norm of shareholder primacy with the social and legal norm of entity primacy.[251] This Part X is split into two sections: Firstly, considerations and avenues for (re)asserting entity primacy as a social and legal norm in New Zealand; and secondly, board accountability and the role of shareholders under entity primacy.

A (Re)asserting Entity Primacy in New Zealand Corporate Law

As discussed in Part V, there is a strong argument that shareholder primacy underpins New Zealand's corporate law model and is perceived to define New Zealand as a corporate law jurisdiction. Support for this conclusion is found in the numerous control rights available to shareholders of New Zealand companies under the CA 1993. However, the development of New Zealand's corporate law also tells another history, one which holds that s 131 of the CA 1993 is properly to be constructed as a duty owed to the "company" as a distinct legal entity.

Although both theories may reasonably be described as 'descriptively accurate' of the law in New Zealand, the capacity for entity primacy to resonate with New Zealand directors has

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[249] Keay "An Entity Maximisation and Sustainability Model" in *The Corporate Objective* 173, above n 132, at 219.
[250] At 200.
[251] Sjåfjell et al., *Supporting the Transition to Sustainability: SMART Reform Proposals*, above n 201, at 11.

arguably been ham-strung by short-termism and the operation of the social norm of shareholder primacy. Indeed, it is arguable that the social norm of shareholder primacy has co-opted the interpretation of s 131 and obscured the entity primacy interpretation intended by the Law Commission who drafted the provision.

Therefore, should law-makers and regulators seek to encourage the resonance of Watson's instrumental claim in New Zealand and assert the descriptive accuracy of entity primacy, they must displace the social norm of shareholder primacy for the social *and* legal norm of entity primacy. According to Sjåfjell, removing the social norm of shareholder primacy requires that law-makers "take back the power to redefine the purpose of the company".[252] Such a task requiring the clarification and redefinition of the purpose of the company and the role and duties of the board.[253] Although this paper makes no final recommendations as to the exact measures required to (re)define the purpose of the company and (re)assert entity primacy, several comments may be made.

Firstly, one could argue that, if entity primacy is descriptively accurate (ie *is* the law) in New Zealand, as was posited in Part VI, then (re)asserting entity primacy does not require law reform *per se*. After all, "the company" in s 131 is perfectly capable of carrying the meaning of, or interpretation as, the company as a distinct legal entity. This would be a literal interpretation of the word "company", informed by the approach adopted by the Law Commission whose draft legislation ultimately became the CA 1993.

However, as discussed in Part VIII, the operation of the social norm of shareholder primacy has obscured the descriptive accuracy of entity primacy in New Zealand and shareholder-centric interpretation of directors' fiduciary duties has taken root. Therefore, some explicit communication that "the company" for s 131 means the company entity and its "best interests" are long-run in nature will be required, whether it be through amendment of s 131 or through "soft law" instruments, such as the FMA Handbook.

Should law-makers choose to clarify and redefine the purpose of the company by explicit legislative amendment, their approach could be informed by the actions taken in comparable jurisdictions like the UK and Canada. As mentioned in Part IV, amending the s 131 (the best interest rule) to enumerate a range of relevant stakeholders can have communicative and educative benefit and expand directors' horizons. For Parliament to proceed with an amendment would also send a clear legislative message that the societal purpose of the company is not limited, and in fact, transcends benefit to a singular corporate constituency (ie shareholders).

However, a word of caution to law-makers who may be tempted to follow the Canadian and UK approaches. Although, in wanting to encourage greater corporate environmental

[252] Sjåfjell et al., *SMART Deliverable 2.7 Supporting the Transition to Sustainability: SMART Reform Proposals*, above n 291, at 11.
[253] At 12.

responsibility, it may be tempting to follow jurisdictions like Canada and the UK by writing-into s 131 a requirement to consider the environment as part of directors' fiduciary obligations, such actions can have illusory benefit. As discussed in Part IV, it would ultimately be undesirable if an explicit requirement to consider the environment gave citizens false comfort that the government was taking sufficient action on climate change. As Bebchuk and Tollarita capture: [254]

> The presence of illusory hopes that corporate leaders would on their own choose to reduce carbon emissions over the coming years might lead… public officials to view legal, regulatory, and policy interventions as not critical or at least give them a good excuse for avoiding such interventions or delaying them to first give stakeholderism time to perform its magic.

Overall, subsection *A* has argued that, for entity primacy to operate in New Zealand, it must be (re)asserted as a social and legal norm in New Zealand corporate law. Although this paper does not definitively opine on the measures required to (re)assert entity primacy or the form that such measures should take, explicit communication will be required. Next, subpart *B* explores board accountability and the role of shareholders under entity primacy.

B The Role of Shareholders, and Board Accountability under Entity Primacy

The OECD *Principles of Corporate Governance* state that a jurisdiction's "corporate governance framework should ensure the strategic guidance of the company, the effective monitoring and management by the board, and the board's accountability to the company and the shareholders."[255] As discussed in Part VI, under entity primacy, EMS stipulates that the role of the board of directors' is one of guardianship and stewardship. In turn, the function of the board of directors as corporate managers is to maximise and sustain the company. Therefore, should entity primacy be (re)asserted in New Zealand, directors must understand themselves to be acting for the best interests of the entity; "in making any decision the director must ask: what will benefit the company?"[256] However, how is the board under entity primacy to be held accountable?

By divorcing corporate directors from their fidelity to the shareholders, traditional corporate theorists might reasonably argue that entity primacy will exacerbate so-called "agency problems".[257] The particular concern is that directors will become less accountable for their decisions and therefore slack or act in their own self-interest. However, Keay's EMS model

[254] Bebchuk and Tollarita, above n 43, at 65
[255] OECD "620/OECD Principles of Corporate Governance" (2015, Paris) at 56.
[256] Keay *The Corporate Objective*, above n 132, at 174–175.
[257] See generally, Hansmann and Kraakman "Agency Problems and Legal Strategies", above n 5.

envisages that directors will still held be accountable to shareholders in their capacity as owners of shares (but not owners of the company). As Keay provides: [258]

> There must be accountability to some person or body that is independent of the board, as an accountee (the one accounted to) in the accountability process must be independent of the accountor (the one who does the accounting).

Specifically, directors are to be accountable to shareholders as a function of the General Meeting. [259] This is similar to how directors are presently held accountable. However, the focus and role of the accountees (directors and shareholders) is distinct. As Keay explains:[260]

> The general meeting is entitled in this capacity to define the will of the company. In no way does the board or the general meeting express the will of shareholders, nor do they act for the shareholders; they act for the company itself.

Therefore, as alluded to in Part V, shareholders under entity primacy still play an important supervisory role as they do under shareholder primacy. However, the understanding of the company as a separate legal entity in its own right with interests distinct and independent of its stakeholders (including shareholders), frames the orientation of the General Meeting and delimits the function and focus of shareholders' supervision. [261]

A risk identified by Keay, however, is that shareholders under EMS may still have an incentive to still act in a self-serving manner.[262] There might, for example, be instances where shareholders' "own interests individually, or as a group of shareholders" might be inconsistent with those of the company or inconsistent with "some of the wider interests that contribute to the enhancement of the company's wealth." [263] In such circumstances, shareholders may have a tendency to prioritise concern for their own interests and act against the interests of the company entity.

To address the risk, Keay recommends that law-makers enact a statutory shareholder duty to act in the best interests of the company entity. [264] According to Keay, this would not be a free-standing, generally applicable duty but one which operates solely in the General Meeting.[265] Therefore, should New Zealand law-makers wish to (re)assert entity primacy in

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258 Keay "Board Accountability and the Entity Maximisation and Sustainability Approach", above n 172, (online ed).
259 Susan Watson "What More can a Poor Board Do? Entity primacy in the 21st Century", above n 23, at 149.
260 Keay "Board Accountability and the Entity Maximisation and Sustainability Approach", above n 172, (online ed).
261 Keay "Board Accountability and the Entity Maximisation and Sustainability Approach", above n 172, (online ed).
262 Keay "Board Accountability and the Entity Maximisation and Sustainability Approach", above n 172, (online ed).
263 Keay "Board Accountability and the Entity Maximisation and Sustainability Approach", above n 172, (online ed).
264 Keay "Board Accountability and the Entity Maximisation and Sustainability Approach", above n 172, (online ed).
265 Keay "Board Accountability and the Entity Maximisation and Sustainability Approach", above n 172, (online ed).

New Zealand, the recognition of a shareholder duty to act in the best interests of the company may also be required.[266]

Although New Zealand does not presently recognise a fiduciary duty owed by shareholders to the company in either case law or the CA 1993, the concept is not alien to corporate law. Comparative law, such as USA case law, provide examples of how a shareholder duty can operate in practice and could be cited to support the recognition of a similar duty in the New Zealand courts.[267] For example, the California courts of appeal have long recognised that:[268]

> … majority shareholders, either acting singly or in concert to accomplish a joint purpose, have a fiduciary duty to the minority and the corporation to use their ability to control the corporation in a fair, just, and equitable manner. Majority shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business.

However, a legislated duty is preferable to a court recognised duty for several reasons. As mentioned above, entity primacy does not yet stand alone as a social and legal norm in New Zealand. It is therefore preferable that law-makers expressly communicate the new entity focus for corporate governance. A statutory duty would send a clear legislative signal of what is required of shareholders acting in the General Meeting, and the specific and narrow focus of the duty as only operating in the General Meeting. An statutory duty can more clearly enumerate who is entitled to bring derivative action against shareholders on behalf of the company.[269]

In conclusion, subpart *B* has outlined the role of shareholders and board accountability under entity primacy. In particular, it suggested that, as party of a wider (re)assertion of entity primacy in New Zealand, law-makers may be required to enact a shareholder duty to the company specific to their function as supervisors in General Meeting.

XI Conclusion

In conclusion, this paper has sought to contribute to the corporate objective debate in New Zealand by analysing the three theories of corporate purpose in light of their capacity to

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266 Watson "What More Can a Poor Board Do? Entity primacy in the 21st Century", above n 23, at 150; Watson also supports the recommendation stating that there are "strong normative arguments" which support shareholders holding such a duty.
267 See, *inter alia*, for example: [California] Jones *v HF Ahmanson & Co* 1 Cal 3d 93 (1969); *Brown v Halbert* 271 Cal App 2d 252 (1969); *Burt v Irvine Co* 237 Cal App 2 d 828 (1965); *Efron v Kalmanovitz* 226 Cal App 2d 546 (1964); *Remillard Brick Co v Remillard-Dandini Co* 109 Cal App 2d 405 (1952); [USA 2nd Circuit Court of Appeal] case *Perlman v Feldman* (1955) 219 F 2d 173; and [Delaware] *Kahn v Lynch Communication Systems* 669 A 2d 79 (1995).
268 *Jones v HF Ahmanson & Co* 1 Cal 3d 93 (1969) at [108].
269 In California, for example, minority shareholders have been the typical claimants against shareholders.

encourage greater environmental corporate responsibility. Of the theories, it is entity primacy which is both normatively desirable and arguably descriptively accurate in New Zealand. Descriptive accuracy is found in the theory's consistency with the historical evolution of the modern Anglo-American company, and specifically in New Zealand, the approach of the New Zealand Law Commission whose draft legislation ultimately became the CA 1993. In turn, entity primacy's normative appeal lies in its capacity to highlight the instrumental overlap between the company's "best interests", such as reputation and brand improvement, and environmental sustainability.

However, in practice, entity primacy and its instrumental claim have failed to resonate with New Zealand corporate leaders. It is suggested that resonance, in particular, and directors' capacity to pursue environmentally sustainability strategies, more generally, has been hamstrung by short-termism and the operation of the 'social norm' of shareholder primacy. Both phenomena precipitate a focus on short-run profits at the expense of longer term sustainable imperatives, such as long-term value creation and environmental sustainability. Not only is short-termism bad for environmental sustainability, but it also runs counter to the company's "best interests" which are arguably inherently long-run in nature.

Overall, should law-makers seek to encourage the resonance of Watson's instrumental claim and assert the descriptive accuracy of entity primacy in New Zealand, law-makers and regulators must displace the social norm of shareholder primacy for the social and legal norm of entity primacy. (Re)asserting entity primacy requires explicit communication and may require introducing a statutory shareholders' duty to the company.

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